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Section 6: Business Law

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

VI. BUSINESS

In This Section:

IBP, Inc. v. Alvarez, et al.

(03-1238)

Ruling Below: (*Alvarez v. IBP, Inc*, 339 F.3d 894 (9^{th} Cir. Wash., 2003), *cert granted* 125 S. Ct. 1292; 161 L. Ed. 2d 104; 73 USLW 3494 (2005).

Employees at IBP, Inc. sued to recover lost pay for time they spent donning and doffing specialized protective clothing before and after work and their lunch breaks. The Ninth Circuit Court of Appeals affirmed the key conclusions of a federal district judge in Washington, holding that walking time should be compensated under the Fair Labor Standards Act. The court stated that the work day begins with the first act of compensable work. Because wearing protective clothing is a part of the principal work activity, required by law, any and all time between donning and doffing that equipment should be compensated.

Questions Presented: Whether time spent by employees walking between clothes-changing stations and their actual work stations constitutes non-compensable activity within the meaning of the Fair Labor Standards Act and Portal-to-Portal Act.

Gabriel ALVAREZ, et al., Plaintiffs-Appellants,
v.
IBP, Inc., a Delaware corporation, Defendant-Appellee.

United States Court of Appeals
for the Ninth Circuit

Decided August 5, 2003

[Excerpt: some footnotes and citations omitted]

THOMAS, Circuit Judge:

Perhaps the packing plant employees in Pasco, Washington, should have heeded Henry David Thoreau's warning to "beware of all enterprises that require new clothes."

The central dispute in this class action lawsuit is whether IBP, Inc. ("IBP") should be required to compensate its employees for the time it takes to change into required specialized protective clothing and safety gear. Under the circumstances presented by this case, we conclude that it must. . . .

I.

* * *

IBP, Inc. is the world's largest producer of fresh beef, pork, and related products. . . .

Among IBP's many meat processing facilities is a "kill and processing plant" in Pasco, Washington ("the Pasco plant"). As the moniker suggests, the Pasco plant includes slaughter and processing work sections, both of which play a direct role in the carcass "disassembly process. . . ."

. . . Pasco plant production line employees . . . are required to be at their work stations and prepared to work as the first piece of meat comes across the production line. However, before they are able to assume their work stations all Pasco plant employees must complete a number of preliminary tasks, and before employees may leave the Pasco plant at the end of a shift, most of these preliminary tasks must be completed in inverse form. Each Pasco plant job classification has specific tool, supply, walk-time, and gear requirements. . . . [F]or all Pasco plant production line employees, a general pattern obtains: At the start of a shift, Pasco plant employees must gather their assigned equipment, don that equipment in one of the Pasco plant's four locker rooms, and prepare work-related tools before venturing to the slaughter or processing floors. At the end of every shift, employees must clean, restore, and replace their tools and equipment, storing all of it at the Pasco plant itself.

Until July of 1998, the Pasco plant's shifts ran eight hours. . . . In July of 1998, IBP restructured its shift time to include four minutes of so-called "clothes" time, thereby reducing the overall work time to seven hours and fifty-six minutes. In the fall of 1999, the Pasco plant reduced its shift time to seven hours and fifty-one minutes. Long-running litigation between IBP and the United States Department of Labor (hereinafter "USDOL") in the 1990s spurred much of IBP's shift-time reduction. In the course of that litigation, damage and wage issues comparable to those raised in this case were decided. . . . *See Reich v. IBP, Inc., 38 F.3d 1123, 1127 (10th Cir. 1994)* (holding IBP liable for unpaid pre-shift and post-shift donning, doffing, and cleaning of special packinghouse industry safety equipment and for time spent between waiting to pick up and return knives). Once a shift begins, the Pasco plant employees' time is strictly regulated and monitored. As a rule, employee rest- or meal-break time begins as soon as the last piece of meat passes on the production line, and, as a rule, employees must be completely prepared to resume work as soon as the break period ends. When departing the processing and slaughter floors—whether to go to the cafeteria or to the restroom—employees are permitted to leave only hats, hairnets, goggles, earplugs, and boots in place; outer garments, protective gear, gloves, scabbards, and chains must be removed. For many Pasco plant employees, the operation of IBP's mandatory donning and doffing rules necessarily impinges—if not more—their unpaid thirty-minute meal break time.

To help monitor employee arrival and departure times, IBP instituted a mandatory, computerized "swipe card" system at the Pasco plant. IBP does not use the data its swipe card system gathers in calculating employee pay. Instead, IBP pays its Pasco plant employees according to a "gang time pay" model, which bases employee remuneration entirely on the times during which employees are actually cutting and bagging meat. Under this "gang time" framework, the period in which IBP considers its employees to be performing compensable work commences with the processing of the first piece of meat and ends with the processing of the last, notably excluding any time spent abiding the Pasco plant's required pre- or post-shift routines.

In 1999, believing parts of IBP's compensation practices to be unlawful, the Pasco plant's slaughter and processing employees brought this class action suit under § 16(b) of the Fair Labor Standards Act ("FLSA"), *see 29 U.S.C. § 216(b) (1999)* . . . in United States District Court for the Eastern District of Washington. Three aspects of their work-day animated plaintiffs' claim: (1) the pre-shift donning of protective gear and the preparation of work-related tools, including the attendant waiting and walking; (2) the requisite donning and doffing of protective gear during the thirty-minute unpaid meal-break; and (3) the post-shift doffing, cleaning, and storing of protective gear and tools.

* * *

[A twenty-day bench trial followed.]

. . . [O]n September 14, 2001, the district court issued thorough findings of fact and conclusions of law. . . . [It found] that FLSA required compensation for all of plaintiffs' work time—e.g., donning, doffing, and cleaning of "integral and indispensable" protective gear; waiting and some walking time during the workday—both during pre-shift and post-shift times and during the thirty-minute meal-break.

* * *

The district court also rejected IBP's . . . FLSA-based defenses. . . . [T]he district court found that *29 U.S.C. § 203(o) (1999)*, which excludes "clothes changing" and "washing" time from compensable time when these activities are the subject of collective bargaining, offered IBP no relief because *§ 203(o)*'s "changing clothes" and "washing" exclusions did not reach donning, doffing, and cleaning of specifically protective, non-clothing-like gear; that IBP lacked "good faith"; and that the *Portal-to-Portal Act* did not operate to plaintiffs' disadvantage because the donning, doffing, and cleaning of protective gear was "integral and indispensable" to their jobs, fulfilling mutual obligations of employer and employee. Walking and waiting time, the district court continued, occurred during the principal workday and was thus compensable.

For IBP's FLSA . . . violations, the district court awarded plaintiffs liquidated damages . . . and prejudgment interest. . . .

II.

It is axiomatic, under the FLSA, that employers must pay employees for all "hours worked." *See 29 U.S.C. § § 206, 207 (1999)*; *Turner v. City of Philadelphia, 262 F.3d 222, 224 (3d Cir. 2001).* The threshold question in this case is whether the activities cited by the plaintiffs—donning and doffing, waiting and walking—constitute "work" under the FLSA. We agree with the district court that, under the facts presented by this case, they do.

"Work," the Supreme Court has long noted, is "physical or mental exertion (whether burdensome or not) controlled or required by the employer and pursued necessarily and primarily for the benefit of the employer." *See Tenn. Coal, Iron & R. Co. v. Muscoda Local No. 123, 321 U.S. 590, 598, 88 L. Ed. 949, 64 S. Ct. 698 (1944).* Definitionally incorporative, *Muscoda's* "work" term includes even non-exertional acts. *See Armour & Co. v. Wantock, 323 U.S. 126, 133, 89 L. Ed. 118, 65 S. Ct. 165 (1944)* (noting that even "exertion" is not the *sine qua non* of "work" because "an employer . . . may hire a man to do nothing, or to do nothing but wait for something to happen").

Plaintiffs' donning and doffing, as well as the attendant retrieval and waiting, constitute "work" under *Muscoda* and *Armour*'s catholic definition: "pursued necessarily and primarily for the benefit of the employer," *Muscoda, 321 U.S. at 598,* these tasks are activity, burdensome or not, performed pursuant to IBP's mandate for IBP's benefit as an employer. *323 U.S. at*

133; *321 U.S. at 598.* The activities, therefore, constitute "work."

That such activity is "work" as a threshold matter does not mean without more that the activity is necessarily compensable. The Portal-to-Portal Act of 1947 relieves an employer of responsibility for compensating employees for "activities which are preliminary or postliminary to [the] principal activity or activities" of a given job. *29 U.S.C. § 254(a) (1999).* Not all "preliminary or postliminary" activities can go uncompensated, however. "Activities performed either before or after the regular work shift," the Supreme Court has noted, are compensable "if those activities are an integral and indispensable part of the principal activities." *Steiner v. Mitchell, 350 U.S. 247, 256 (1956).*

The Supreme Court's approach to this "principal," "integral and indispensable" duty question is context-specific. To be "integral and indispensable," an activity must be necessary to the principal work performed and done for the benefit of the employer. Plaintiffs' donning and doffing of job-related protective gear satisfies *Steiner*'s bipartite "integral and indispensable" test.

First, because the donning and doffing of this gear on the Pasco plant's "premises is required by law, by rules of [IBP], [and] by the nature of the work," *see 29 C.F.R. § 790.8(c) n.65 (1999)*, this donning and doffing is "necessary" to the "principal" work performed. From sanitary aprons to metal-mesh gear, IBP "by rule," *id.*, mandates the donning and doffing of clothes and gear at various intervals throughout the workday, requiring employees to wait for and to retrieve that gear in particular areas at particular times on the Pasco plant's premises. *See Steiner, 350 U.S. at 256.* United States Department of Agriculture sanitation standards and Occupational Safety and Health Administration (hereinafter "OSHA") industry standards bolster this "by rule" conclusion, demanding maintenance of sanitary conditions, *9 C.F.R. § 308.3*, and the provision of protective equipment at the Pasco plant "wherever necessary by reason of hazards or processes of [work] environment." *29 C.F.R. § 1910.132(a) (1999).*

Second . . . the donning, doffing, washing, and retrieving of protective gear is, at both broad and basic levels, done for the benefit of IBP. These plaintiff-performed activities allow IBP to satisfy its [legal] requirements . . . [and] prevent unnecessary workplace injury and contamination, both of which would inevitably impede IBP's "disassembly" process. Under *Steiner*, plaintiffs' donning, doffing, and cleaning activities are "integral and indispensable" to Pasco's "principal" activity.

This "integral and indispensable" conclusion extends to donning, doffing, and cleaning of non-unique gear (e.g., hard-hats) and unique gear (e.g., Kevlar gloves) alike. Little time may be required to don safety glasses and the use of safety goggles is undoubtedly pervasive in industrial work. But ease of donning and ubiquity of use do not make the donning of such equipment any less "integral and indispensable" as that term is defined in *Steiner*. Safety goggles are, like metal-mesh leggings, required by IBP, and they are, like metal-mesh leggings, necessary to the performance of the principal work. Both are "integral and indispensable" under *Steiner*'s exception to the Portal-to-Portal Act's bar to compensation of preliminary or postliminary activity.

However, we agree with the district court's alternative conclusion as to why the time spent donning and doffing non-unique protective gear such as hardhats and safety goggles is not compensable: The time it takes to perform these tasks vis-a-vis non-unique protective gear is *de minimis* as a matter of law. . . .

* * *

In sum . . . "donning and doffing" and "waiting and walking" constitute compensable work activities except for the *de minimis* time associated with the donning and doffing of non-unique protective gear.

III.

The FLSA contains an exception for "any time spent in changing clothes." *29 U.S.C. § 203(o) (1999)* (hereinafter " § 3(o)"). IBP argues that, even if compensable in a general sense, the time employees spend donning and doffing protective gear is non-compensable under the "changing clothes or washing" exclusion.

* * *

Distilled to its essence, this case requires us to decide whether putting on and taking off protective gear constitutes "changing clothes" as that phrase is used in the statute. Neither *§ 3(o)* nor its legislative history defines the phrase, and no case law assesses the precise question we address here. In light of this doctrinal, statutory, and legislative lacunae, we give the relevant language its "ordinary, contemporary, common meaning." *Perrin v. United States, 444 U.S. 37, 42 (1979).*

* * *

. . . FLSA exemptions, the Supreme Court has long counseled, "are to be narrowly construed against the employers seeking to assert them." *Arnold v. Ben Kanowsky, Inc.*, 361 U.S. 388, 392 (1960). Following the Supreme Court's lead, we have also read FLSA exemptions—such as *§ 3(o)*—tightly, refusing to apply FLSA exemptions "except [in contexts] *plainly and unmistakably* within the [given exemption's] terms and spirit." *Klem v. County of Santa Clara, 208 F.3d 1085, 1089 (9th Cir. 2000).* The protective gear at issue does not "plainly and unmistakably" fit within *§ 3(o)*'s "clothing" term. Absent such a plain and clear *§ 3(o)* fit, *Arnold* requires that we construe *§ 3(o)*'s against the employer seeking to assert it. *361 U.S. at 392.* Thus, the exemption must be construed against IBP.

Second, and perhaps more importantly, specialized protective gear is different in kind from typical clothing. The admonition to wear warm clothing, for example, does not usually conjure up images of donning a bullet-proof vest or an environmental spacesuit. Rather, personal protective equipment generally refers to materials worn by an individual to provide a barrier against exposure to workplace hazards. OSHA has recognized the difference in its regulations defining "personal protective equipment[.]"

. . ."General work clothes (e.g. uniforms, pants, shirts or blouses) not intended to function as protection against a hazard are not considered to be personal protective equipment." *29 C.F.R . § 1910.1030 (1999).*

Of course, this OSHA definition was promulgated in a different context. Nonetheless, it provides a useful analytic distinction. It also underscores the fact that, from both a regulatory and common sense perspective, "changing clothes" means something different from "donning required specialized personal protective equipment." In short, the district court correctly interpreted the "changing clothes" exception in *§ 3(o)* as not including the time spent putting on personal protective equipment.

IV.

IBP also disputes the district court's view of the compensable work day. It claims that the district court erred in determining that the compensable work day began with the first act of compensable work. Specifically, IBP argues that workers should not be paid for the time spent walking to and from the Pasco plant stations after donning personal protective equipment. Under *§ 4 of the Portal-to-Portal Act*, employees receive compensation only for "hours worked," i.e., for work occurring during the "workday." Under *§ 4*, employees have no right to receive overtime compensation for activities that are "preliminary to or postliminary to [a job's] principal activity or activities," *29 U.S.C. § 254(a) (1999)*, unless those preliminary or postliminary activities are "integral and indispensable [to] the principal activities for which [the employees] are employed." *Steiner, 350 U.S. at 256*; *29 U.S.C. § 254(a) (1999)*.

The district court properly reasoned that the workday commenced with the performance of a preliminary activity that was "integral and indispensable" to the work, and the district court also properly determined that any activity occurring thereafter in the scope and course of employment was compensable. Thus, the district court included "the reasonable walking time from the locker to work station and back . . . for employees required to don and doff compensable personal protective equipment" in its "compensable" time measure.

* * *

. . . The district court correctly held that Pasco plant work time was continuous, not the sum of discrete periods.

V.

IBP contends that it is shielded from liability by FLSA's good faith defense provisions. *See 29 U.S.C. § § 259, 260 (1999)*. . . .

* * *

The good faith provisions of *§ 259* do not embrace IBP's conduct. To come within the exception's reach, an employer's acts "must have been taken in reliance on [an] administrative ruling or interpretation." *Home Ins. Co., 672 F.2d at 264*. . . . As the district court rightly noted, [prior] litigation provided IBP "nothing upon which to rely other than its assumptions about what clothes changing and washing were including under *3(o)*."

* * *

VI.

[The district court appropriately applied 29 U.S.C. *§ 255*'s three-year statute of limitations to IBP's willful conduct.]

* * *

VII.

[The district court did not err in awarding liquidated damages under the FLSA.]

* * *

VIII.

[The district court properly rejected IBP's contention that it was exempt from the State of Washington's overtime wage provisions.]

* * *

IX.

[The Washington Minimum Wage Act, like the FLSA, requires employers to compensate employees at, at least, a minimum-wage rate. Some courts have held that, under the FLSA, an employee's right to recover minimum wage accrues each workweek, not by individual hour. The district court concluded that Washington courts were "likely" to adopt the per-hour standard for hourly employees. We agree.]

* * *

X.

[Under Washington Administrative Code, plaintiffs are owed compensation for the full thirty-minute period where IBP has intruded upon or infringed the mandatory thirty-minute term to any extent.]

* * *

XI.

[The district court did not abuse its discretion in its compensation calculation.]

* * *

CONCLUSION

For the foregoing reasons, we affirm in part and reverse in part the judgment of the district court. We remand for recalculation of damages. . . .

Tum v. Barber Foods

(04-0066)

Rulings Below: (*Tum v. Barber Foods,* 360 F.3d 274 (1st Cir. Me., 2004), *cert granted* 125 S. Ct. 1295, 161 L. Ed. 2d 104, 73 USLW 3494).

Employees of Barber Foods sued their employer for alleged violations of the Fair Labor Standards Act ("FLSA"), seeking to recover wages for time they spent donning and doffing specialized protective clothing before and after work. The First Circuit Court of Appeals affirmed the decision of a Maine federal district court, holding that only time spent actually donning and doffing legally required gear was compensable. Neither waiting in line for required equipment nor walking between stations was compensable, under the Portal-to-Portal Act's exceptions to the FLSA.

Questions Presented: Whether time employees spend walking to and from stations where required safety equipment is distributed is compensable under the Fair Labor Standards Act and Portal-to-Portal Act, and whether employees have a right to compensation for time spent waiting at the required safety equipment stations.

Abdela TUM, et al., Plaintiffs, Appellants,
v.
BARBER FOODS, Inc., Defendant, Appellee.

United States Court of Appeals
for the First Circuit

Decided March 10, 2004

[Excerpt: some footnotes and citations omitted]

TORRUELLA, Circuit Judge:

Plaintiffs-appellants are a group of hourly wage employees ("Employees") who brought suit against their employer, Barber Foods, for alleged violations of the Fair Labor Standards Act of 1938 ("FLSA"), *29 U.S.C. § 216(b).* Employees sought compensation for alleged unrecorded and uncompensated work performed by them for Barber Foods.

The district court granted partial summary judgment for the defendant. A trial was held on the issue of whether the time spent donning and doffing required clothing constituted "work" and whether such time was *de minimis.* The jury found for the defendant. Employees appeal from the grant of summary judgment and from the district court's decision and they challenge two of the district court's jury instructions. Barber Foods cross-appeals, arguing that the district court erred in ruling that the donning and doffing of required clothing and equipment is an integral part of the Employees' work for Barber Foods and is not excluded from compensation under the *Portal-to-Portal Act* as preliminary or postliminary activity.

After initial review by the panel, we affirmed. *Tum v. Barber Foods, Inc., 331 F.3d 1 (1st Cir. 2003).* Plaintiffs filed a petition for rehearing, after which we received an amicus brief from the Secretary of Labor ("the Secretary"). Having considered the arguments, we now grant rehearing but affirm.

I. Background

Located in Portland, Maine, Barber Foods is a secondary processor of poultry-based products. . . . Barber Foods has two shifts, each with six production lines, consisting of three "specialty" lines and three "pack-out" lines. . . .

The production lines are staffed primarily by rotating associates, employees who generally rotate to different positions on the lines every two hours. . . .

All associates are expected to be on the production floor ready to work when their shift begins. They are paid from the time they actually punch in to a computerized time-keeping system from time clocks located at the entrances to the production floor.

A. Equipment

Rotating associates are required to wear lab coats, hairnets, earplugs, and safety glasses. The lab coats, hairnets, and earplugs must be on before they can punch in and until they punch out. Safety glasses and any items that they choose but are not required to wear, such as gloves, aprons, and sleeve covers, can be donned after punching in and doffed before punching out.

* * *

Shipping and receiving associates are required to wear steel-toed boots, hard hats, and back belts. They generally don these items before punching in and doff them after punching out. Their time clock is located on the production floor, so they must also don and doff lab coats, hairnets, and earplugs in order to enter the production floor to punch in and out.

* * *

Employees may have to wait to obtain and dispense with clothing and equipment. At busier times, there may be lines at the coat racks, glove liner bins, and cage window. There may also be lines at the time clocks.

B. Time Keeping

Barber Foods uses a computerized time-keeping system. The system downloads clock punches into the payroll software. Time clocks are located at the entrances and exits to the production floor and at various other locations in the facility. . . .

Employees get paid from the moment they punch in. In an attempt to stagger check-in times, Barber Foods allows Employees twelve minutes of "swing time," meaning that Employees can punch in up to six minutes early and get paid for that additional time or punch in up to six minutes late and not be charged with an attendance violation.

C. History of Dispute

Seven current employees and thirty-seven former employees brought suit in district court claiming that Barber Foods violated the FLSA by forcing its hourly employees to work "off the clock" by not paying Employees for the time it takes to obtain, don, and doff their gear. . . . [T]he district court . . . found that the donning and doffing of clothing and equipment required by Barber Foods or by government regulation is an integral part of Plaintiffs' employment. This finding removed the donning and doffing of required gear from the Portal-to-Portal Act and its exclusion of compensability for preliminary or postliminary activity. *29 C.F.R. § 790.8.* A trial was held on the issue of whether the time spent donning and doffing required clothing was *de minimis* and thus did not constitute work under the FLSA.

. . . The jury found that each of [the] donning and doffing times [was] *de minimis*, making the donning and doffing time non-compensable. Employees do not challenge the jury's findings.

Employees appeal the following findings: . . . (1) that the time employees must necessarily spend walking and waiting in connection with obtaining, donning, doffing, and disposing of the sanitary and protective gear required by Barber Foods and/or federal regulation is not compensable; (2) that the time spent donning and doffing clothing, equipment, and gear which is not expressly required by Barber Foods is non-compensable. In addition, Employees challenge two district court jury instructions.

* * *

III. Discussion

The FLSA requires an employer to record, credit, and compensate employees for all of the time which the employer requires or permits employees to work, *29 U.S.C. § 201, et seq.*, commonly defined as "physical or mental exertion (whether burdensome or not) controlled or required by the employer and pursued necessarily and primarily for the benefit of the employer and his business." *Tenn. Coal, Iron & R.R. Co. v. Muscoda Local No. 123, 321 U.S. 590, 598 (1944).*

However, even when an activity is properly classified as "work," the Portal-to-Portal Act, *29 U.S.C. § 254*, exempts from compensation activities which are preliminary or postliminary to an employee's principal activity or activities unless they are an "integral and indispensable part of the principal activities for which covered workers are employed and not specifically excluded by section 4(a)(1) [of the Portal-to-Portal Act]." *Lindow v. United States, 738 F.2d 1057, 1060 (9th Cir. 1984).* In addition, some activities that may qualify as "work" and fall outside of the Portal-to-Portal Act nevertheless do not require compensation because the activities require such little time that they are adjudged *de minimis. Dunlop v. City Elec. Inc. 527 F.2d 394 (5th Cir. 1976).*

A. Donning and Doffing of Gear

The district court found that the donning and doffing of required gear is an integral and indispensable part of Employees' principal activities. See generally *Steiner v. Mitchell, 350 U.S. 247 (1956)* (holding that activities should be considered integral and indispensable when they are part of the principal activities for the particular job tasks). We agree with the district court's conclusion as to the required gear. In the context of this case, Employees are required by Barber Foods and or government regulation to wear the gear. Therefore, these tasks are integral to the principal activity and therefore compensable. See *Alvarez v. IBP, Inc., 339 F.3d 894, 903 (9th Cir. 2003).*

As relates to the non-required gear, Employees contend that any activity which promotes safety and sanitary conditions necessarily benefits the employer. We think this takes the argument too far. The donning and doffing of non-required gear is not compensable under these facts. Not everything an employee does in her workplace is compensable under the FLSA. These optional items are required neither by the employer nor by the regulations and are worn by Employees at their own discretion.

B. Walking Time

Employees argue that the district court improperly excluded from compensable time the periods Employees walk from one area where they obtain an initial piece of clothing or equipment (required by Barber Foods and/or USDA regulations) to another area where they obtain additional items, the period they spend walking from getting their garb to the time clocks, and the period they spend walking to the area where they dispose of clothing and equipment after they punch out.

The Portal-to-Portal Act specifically addresses walking time, generally exempting from compensation "walking, riding, or traveling to and from the actual place of performance of the principal activity or activities which such employee is employed to perform." The Act also generally exempts from compensation activities which are preliminary or postliminary to an employee's principal activity or activities. On their face, these provisions would appear to exempt from compensation the walking at issue here.

Employees argue that the Portal-to-Portal Act excludes only that walking time which occurs before an employee commences her principal activity or activities. The Code of Federal Regulations ("Code") states that Congress intended the term "principal activities" to be broad. *29 C.F.R. § 790.8(a) (2002).* However, the Code regulations state that just because the changing of clothes may in "certain situations be so directly related to the specific work the employee is employed to perform that it would be regarded as an integral part of the employee's 'principal activity[,]' this does not necessarily mean, however, that travel between the washroom or clothes-changing place and the actual place of performance of the specific work the employee is employed to perform, would be excluded from the type of travel to which section 4(a) [Portal-to-Portal Act] refers."

Compensability issues are determined under the FLSA and its accompanying regulations. Both parties agree that the Portal-to-Portal Act does not apply to questions of compensability during the "workday." The Secretary urges an expansion of the ordinary "workday" rule in favor of a broader, automatic rule that any activity that satisfies the "integral and indispensable" test itself starts the workday, regardless of context. . . .

[N]othing in *Steiner* requires the result that the Secretary urges, and the Secretary's rule threatens to undermine Congress's purpose in the Portal-to-Portal Act, which (with rare exceptions) sought to exclude preliminary and postliminary waiting and walking time from compensability.

. . . We affirm the determination that the employees' walking time is not compensable.

C. Waiting Time

Employees claim that Barber Foods must compensate them for all the time they spend waiting in line to receive the required clothing or equipment and to punch in at the time clocks.

Whether waiting time is compensable under the FLSA depends on whether an employee is "waiting to be engaged" or "engaged to wait." See generally *Skidmore, 323 U.S. at 136-37*. Idle time may be considered work under the FLSA where it is controlled by the employer and the time spent is dominated by the need to serve the employer's needs. See *Armour & Co. v. Wantock, 323 U.S. 126, 133-34 (1944)*. The regulations elaborate on this principle by stating that an employee is engaged to wait, i.e., working, when "the employee is unable to use the time effectively for his own purposes. It belongs to and is controlled by the employer. . . ."

. . . Employees argue that they should be compensated for time spent waiting to punch in at the time clocks. Waiting in line to punch in at the time clock is explicitly excluded from compensable activity by *29 C.F.R. § 790.8(c)*. There is no indication that any of the time spent waiting is controlled by the employer. Employees have adduced no evidence to counter that conclusion.

Second, we turn to the waiting time associated with donning and doffing of clothes. Even if we were to find that the employees were engaged to wait under the FLSA and its accompanying regulations, the waiting time would qualify as preliminary or postliminary activity under the Portal-to-Portal Act. . . . When we look at *29 C.F.R. § 790.8*, we find that while the Code does not explicitly address the type of waiting time at issue, the Code indicates that a reasonable amount of waiting time is intended to be preliminary or postliminary. . . . [B]y excluding walking with ordinary equipment and carrying light equipment, the Code indicates that a line must be drawn, otherwise an almost endless number of activities that precipitate the employees' essential tasks would be compensable. We find that a short amount of time spent waiting in line for gear is the type of activity that the Portal-to-Portal Act excludes from compensation as preliminary.

* * *

E. Jury Instructions

[Employees challenged two jury instructions referring to the definition and scope of "donning" and "doffing." Both instructions were accurate, and neither was prejudicial, so the challenges are without foundation.]

* * *

IV. Conclusion

For the reasons stated above, we affirm the district court judgment.

AFFIRMED.

CONCURRING:

BOUDIN, Chief Judge:

The central issue in this case is whether walking and waiting time, incident to the donning and doffing of required clothes and equipment, are compensable where (according to findings in the district court) the time spent in donning and doffing is minimal but the combined walking and waiting time may be extensive. There may be no "right" answer short of the Supreme Court's reading of its own precedents, but the problem can at least be understood if the history and underlying tensions are candidly arrayed.

The original Fair Labor Standards Act made compensable time spent in "work," but it defined the concept only in the most general terms. . . .

* * *

. . . [The Supreme Court's interpretations] contradicted actual pay practice within the industries and created large overhanging liabilities for employers. To the extent that workers received more than the minimum wage, the decisions also upset underlying bargains. A flood of lawsuits followed. Congress responded with the Portal-to-Portal Act to cut off these claims for the past and to provide in the future (with exceptions not here relevant) that compensation was not required for [preliminary or postliminary activities].

A decade later, this new legislative balance was reset (and perhaps upset) in a small way by a new Supreme Court decision. In *Steiner,* the Justices held that the Portal-to-Portal Act did not cover the time spent donning and doffing of special clothing and time spent showering, in facilities required by state law, to protect workers dealing with dangerously caustic and toxic materials. . . .

Steiner was an understandable reaction—after all, the dangers were extreme and unique to the job . . . ; but the tension with the Portal-to-Portal Act's underlying policy has been less easy to escape as *Steiner* has been extended.

* * *

However, the more serious problem for employers arises in cases such as this one by attempts to extend *Steiner* further to walking and waiting incident to such donning and doffing. . . .

. . . [T]hus extended, the tension with the Portal-to-Portal Act becomes acute: after all, why is this complex of donning, doffing, waiting and travel within the Barber plant very different from the preliminary activities which were involved in the *Mt. Clemens* case—one of the targets of the Portal-to-Portal Act. . . .

* * *

. . . [T]wo positions are juxtaposed. One is the . . . mechanical combination of *Steiner* with a rigid "everything after is work" principle. The other is to treat required donning and doffing as compensable where more than *de minimis* but, where it is not, leaving both it and any associated walking and waiting time as non-compensable. Neither outcome is impossible analytically and neither is clearly dictated by Supreme Court precedent or underlying policy.

So where does the balance of advantage lie? . . .

On Barber's side, as already noted, the history and language of the Portal-to-Portal Act tend to favor Barber, as do two of the three circuit decisions; the question is how far *Steiner* has qualified the statute. . . .

Finally, it appears that wages at the Barber plant were set against a background practice of treating as non-compensable the donning, doffing, walking and waiting involved in this case. Unless those wages are the federal minimum, a decision that now such time is compensable will likely be offset by wage adjustments in the future, leaving only a one-time windfall for employees. It is hard to begrudge this to workers doing difficult and disagreeable work, but the situation does bear an uncanny resemblance to that which prompted the Portal-to-Portal Act. It may be time for the Supreme Court to have another look at the problem.

"Local Attorneys Gearing up for Supreme Court"

GSA Business (S.C.)
March 23, 2005
Francis B. Allgood

Sometime this fall, the U.S. Supreme Court will deliver a decision that may dictate whether a manufacturer must pay employees for the time it takes to put on protective clothing and walk to their workstations.

David R. Wylie and Christopher Lauderdale, attorneys with Jackson Lewis LLP in Greenville, are representing the National Chicken Council, American Meat Institute and the National Association of Manufacturers. They petitioned the Supreme Court, claiming there are inconsistent interpretations of the Fair Labor Standards Act. "It's a battle of language of the statute enacted by Congress 60 years ago and the way the Labor Department wants to interpret it," Lauderdale says.

Interest by the Supreme Court was sparked by two separate rulings: *Abdela Tum v. Barber Foods Inc.* in Portland, Maine, and *IBP Inc. v. Gabriel Alvarez* in Pasco, Wash.

For IBP—now known as Tyson Fresh Meats Inc.—the company was ordered to pay $3.1 million to 815 employees for the time it takes to put on protective clothing and walk to their workstations. Barber Foods, on the other hand, won its case, following a rehearing decision that provided some conflicting opinions.

The argument before the court is that there is contradicting language among decisions made by the high courts and Congress for what's compensable.

In 1946, the definition of "work" under the FLSA was extended to include time spent by employees walking to their workstations and other activities, such as changing clothes. In response, Congress passed the Portal-to-Portal Act in an attempt to stop such claims from being compensable, asserting it would create "unexpected liabilities" for the employer.

But in 1956, in *Steiner v. Mitchell,* the Supreme Court found exception to the Portal-to-Portal Act. Employees exposed to toxic chemicals while working in a battery plant were required to change clothes prior to their shift and shower immediately after their shift. The court ruled that because the workers were in hazardous conditions, showering and changing clothes was compensable. "Steiner almost swallowed the rule of the Portal-to-Portal Act," Lauderdale says.

Kevin Russell, an attorney with Goldstein & Howe PC in Washington, D.C., represents the employees in ***Tum v. Barber Foods.*** He says employees must wait in line to get their lab coats, ear plugs, safety glasses and other gear from a distribution cage, then change clothes and walk to their work area before they clock in. "The employer has no incentive to making that line move quicker," Russell says. "It's not a huge amount of money for the employer, but it is significant to the low-paid worker."

In the original ***Tum v. Barber Foods*** case, the court ruled the time it takes to change into uniform was compensable, but ruled against the time it takes to wait in line to get the equipment and the time it takes to walk from the changing room to the workstation.

If the worker is paid for changing clothes, but is not compensable for leaving the changing room for her workstation, inevitably there's a conflict.

"It's a scheme that doesn't make a whole lot of sense," Russell admits. Lauderdale says in the beef industry, where heavy equipment is donned by workers, changing clothes has been compensable and is not being challenged. Lightweight protective gear, such as a bump cap and clean outerwear garments worn in poultry processing plants, don't warrant the same standard. "It's not just limited to the poultry issue," Lauderdale says.

As recently as a week ago, a similar case was settled in Timmonsville.

Honda of South Carolina Manufacturing Inc. will pay a $2 million settlement for the time it took employees to prepare for work. The suit, filed in U.S. District Court in Florence, asks Honda to pay overtime for the 7.3 minutes it took each time to change into and out of uniforms from July 1, 2001, to July 31, 2003.

On Aug. 1, 2003, Honda changed its policy to allow workers to prepare for work at home. The agreement states that Honda denies the allegations, but Honda and other automotive manufacturers have seen similar lawsuits before.

In January 2003, Honda agreed to pay $1.2 million in back pay at a plant in Lincoln, Alabama.

In April 2003, Mercedes-Benz U.S. International paid $687,588 in back wages to workers in Vance, Alabama.

David George, president of Data Driven Manufacturing Inc., which offers Six Sigma consulting and data analysis services, says the manufacturers he works for have always ruled compensation begins at the employee's workstation.

"I've never seen it come into play," George says. "If you are scheduled to be at your workstation, that includes being dressed appropriately. Whether you are having to wear proper shoes or eye protection, you come ready to work or you change at work."

According to George, most employees at General Electric Gas Turbines in Greenville wear their uniforms to work. The only equipment donned at GE are special boots for some workers. At Associated Fuel Pump Systems Corp. in Anderson, the company pays for a portion of up to 11 sets of uniforms per employee, and offers to do a week's worth of work laundry.

But human resource manager Donna Baker says uniforms are optional, not required. Basic equipment, such as protective eyewear, takes only seconds to put on, she says. "In my mind, this has more to do with companies that have clean rooms where (employees) have to dress," says Baker, who has kept abreast of the recent court rulings.

Lauderdale says the concern is how the Supreme Court's ruling may impact not only meat processors, but other manufacturers, and state and local governments.

Cases involving law enforcement and fire officials have also revealed conflicting arguments.

"Everybody's got to dress. Whether its a tuxedo, a waitress uniform or just a coat and tie," says Clay Johnston, owner of Wright-Johnston Uniforms in Columbia. Specializing in public safety uniforms with a small industrial business, Johnston admits he's never heard of such cases.

Wright-Johnston is a supplier for the Greenville Police Department.

"Putting on a belt holster may take 30 seconds, not much more than that," Johnston says.

"Tyson Asks Court to Resolve Pay Dispute"

Legal Times
April 26, 2004
Tony Mauro

Tyson Foods, the world's largest supplier of meats, is trying to enlist the Supreme Court in its dispute with slaughterhouse workers over their claim that they should be paid for the time it takes to change into protective clothing and walk to and from their work stations.

In a petition filed by Carter Phillips of Sidley Austin Brown & Wood, the company is hoping to reverse a ruling that awarded workers at its Pasco, Wash., plant more than $3 million in damages for its failure to pay workers for the time at issue. The case is called ***IBP Inc. v. Alvarez,*** No. 03-1238. IBP was taken over by Tyson in 2001, after the suit was filed.

Citing conflicting rulings in circuits across the country, a brief filed by the National Chicken Council and other industry groups also urges the high court to grant review. "The issue raised by this case regarding the compensability of walking time is extremely important" to the meat industry, says David Wylie of Haynsworth Baldwin Johnson & Greaves in Greenville, S.C., author of the industry brief.

The case is one of dozens that the Court will discuss at its private conference April 30. The Court could announce on May 3 whether it will review the case.

The original lawsuit was brought in the U.S. District Court for the Eastern District of Washington on behalf of 815 beef slaughter and processing workers, citing violations of federal and state labor laws. They sought compensation for the time they spend donning and doffing protective clothing they are required to wear for health and safety reasons, and for the time then needed to walk between locker rooms where they change and their work stations at the beginning and end of their shifts. U.S. District Judge Robert Whaley sided with the workers.

IBP appealed, citing sections of federal law that allow employers not to pay workers for time spent "changing clothes" or walking to and from work areas. The Labor Department also weighed in, with then-Labor Solicitor Eugene Scalia filing a brief agreeing that the walking time should be compensated. On the clothing issue, the department reversed a Clinton-era interpretation and sided with the company, finding that companies did not have to compensate workers for the time spent putting on and taking off the garments and protective gear.

The San Francisco-based U.S. Court of Appeals for the 9th Circuit affirmed the District Court, rejecting IBP's arguments. The statute, wrote Judge Sidney Thomas, could not be read to "lead to the conclusion that a workday may be commenced, then stopped while the employee is walking to his station, then recommenced when the walking is done." On the clothing issue, the panel agreed that the specialized gear required by the employer was "different in kind from typical clothing," and therefore the workers' time should be compensated.

Thomas also noted that since the publication of Upton Sinclair's *The Jungle* in 1906, the meatpacking industry has been heavily regulated, yet still remains "one of the most dangerous jobs in America."

On a lighter note, Thomas also said, "Perhaps the packing plant employees in Pasco, Wash. should have heeded Henry David Thoreau's warning to 'beware of all enterprises that require new clothes.' "

Thomas was joined by circuit Judge Dorothy Nelson and Judge Susan Illston of the Northern District of California, sitting by designation.

Phillips, in his brief for IBP, notes that the Boston-based 1st Circuit "squarely rejected" the 9th Circuit's reasoning in a decision last year, and a decision by the Denver-based 10th Circuit also ruled differently in a case involving IBP.

The brief for the workers in the case argues that there is no significant circuit conflict on the issue and that the 9th Circuit ruling is correct and should not be disturbed. "The few opinions to date are intensely fact-bound," writes William Rutzick of Schroeter Goldmark & Bender in Seattle. "They involve only a few industries and small amounts of time."

"Workers Sue for Back Pay at Barber"

Portland Press Herald (Maine)
December 28, 2000
Peter Pochna

Several employees at Barber Foods have filed a lawsuit against the poultry-packing plant, claiming that the company has violated federal labor law by requiring workers to perform tasks for which they are not paid.

The claim strikes at the company's reputation as a generous employer that strives to take care of its many foreign-born workers. Barber has 750 full-time employees, 44 percent of whom are foreign-born.

Four employees are named as plaintiffs in the collective-action case that eventually could include hundreds more workers. At stake are millions in wages dating back three years.

The lawsuit filed Dec. 12 in U.S. District Court claims that the company does not pay its hourly employees for the time they spend at the St. John Street plant gathering and putting on safety equipment before shifts, and storing the equipment at the end of the day. For some of the workers, that amounts to nearly an hour of overtime pay each day that they aren't getting, the lawsuit states.

Worker advocates say the company is taking advantage of employees who don't speak English well and don't understand their rights.

"I think people are fed up with how they are being treated," said Kathy Poulos, a Portland advocate for refugee and immigrant rights. "We want these procedures to be revised and to come into compliance with the law. We want people paid for the hours they work."

Vicki Mann, a spokeswoman for Barber, said the company tries to treat its employees fairly. She cited the numerous services the company offers its workers, such as the four on-site classrooms where English, math, science and computer skills are taught.

"It's very unfair" to accuse the company of mistreating its workers, Mann said. "We pride ourselves on treating all our employees fairly."

She said Barber officials are investigating the allegations made in the lawsuit.

"Obviously, we are taking this very seriously," Mann said. "It has always been our intention to comply with the law."

Barber Foods is a locally owned company founded in 1955 by Gus Barber and still owned by the Barber family. It offers a wide variety of products, including frozen chicken entrees. It distributes to grocery stores, restaurants and other businesses throughout the United States and Canada as well as some other foreign markets.

Many of the jobs at the plant involve work on "specialty lines," where employees perform tasks such as wrapping chicken parts and packing them in trays. Workers typically earn between $ 9 and $ 13 an hour.

The 21-page lawsuit states that "Barber foods has willfully engaged in a pattern and practice of unlawful conduct by declining to record and pay for all of the time it requires or permits its employees to work, in violation of the" Fair Labor Standards Act.

The case only covers three years because the statute of limitations blocks any claims for previous years.

Tadeusz Olszynski, one of the plaintiffs, is a machine operator who has worked for Barber since 1991. He immigrated to Portland from Poland 12 years ago.

Before punching the clock each day, he must put on extensive safety equipment, such as gloves, earplugs, safety glasses, a hairnet, a hat, steel-toed boots and a safety belt. He claims he should earn about an hour more of overtime wages per day. He believes the company owes him at least $ 10,000.

"They don't pay for what they are supposed to pay for," Olszynski said. "People have been scared to bring this up. But I think now many others will join this lawsuit."

The other plaintiffs are Abdela Tum, who has worked at Barber since 1990, Celso Florendo, an employee since 1994, and Najib Sayed, who worked there from 1994 to February of this year.

The law firm of Gordon, Silberman, Wiggins and Childs, based in Washington, D.C., is representing the workers. The firm specializes in employment litigation.

Poulos, who helped organize the legal action, is in the process of informing all the workers at the plant about the suit. This involves distributing forms in numerous different languages. Olszynski estimates that about 1,000 current and former workers will join the suit.

In order for the case to be considered a class-action lawsuit, the plaintiffs' lawyers must convince the court that there is a substantial group of people who may have been harmed by the defendant's actions.

"Court Rules Tyson Fresh Meats Must Pay $3.1 Million to Wallula, Wash. Workers"

Tri-City Herald (Washington)
August 9, 2003
Jeff St. John

Tyson Fresh Meats Inc. must pay more than $ 3.1 million to workers at its Wallula beef plant for time they spent putting on and taking off mandatory safety gear on the job, a federal appeals court has ruled.

Workers at the plant and their union representatives, who have sought the back pay for four years, said Friday that the ruling was a victory for themselves and meatpacking workers across the nation.

"This band of workers here have really been setting the bar for workers in the meatpacking industry," said Lorene Scheer, organizing director for Teamsters union Local 556 in Walla Walla, which represents workers at the Wallula plant.

The ruling by the 9th U.S. Circuit Court of Appeals, filed Tuesday, upholds a 2001 U.S. District Court order to pay more than 800 workers up to $ 10,000 apiece for the time they spent donning and doffing their gear.

The class-action lawsuit, ***Alvarez v. IBP Inc.,*** began in 1999, before IBP was purchased by Tyson Foods Inc. and changed its name to Tyson Fresh Meats earlier this year. The suit claimed IBP violated the federal Fair Labor Standards Act and related state laws by not paying workers adequately for the time it takes to dress in safety gear and clean and store tools.

Workers who use knives can spend up to 30 minutes a day putting on and taking off the specialized equipment, which includes safety boots and metal mesh vests, aprons, leggings, sleeves and gloves, said Melquiadez Pererya, Local 556 president.

Tyson Fresh Meats said in a news release that it will seek a rehearing of the case and, if necessary, appeal the ruling to the U.S. Supreme Court.

The court's decision "is in direct conflict with other recent federal court decisions, regulations and policies of the U.S. Department of Labor, and over 50 years of industry precedent," Tyson spokesman Gary Mickelson said in the statement.

The 9th Circuit Court also has asked U.S. District Court Judge Robert H. Whaley to calculate into any final award the pay owed to workers who were forced to cut short the 30-minute unpaid lunch break they were given each day, said Kathy Goater, a Seattle attorney representing the workers.

Because workers weren't allowed to eat lunch with their protective gear on, but weren't given any extra time to remove and put on the gear either, they should be compensated for free time lost during the lunch breaks, she said.

Workers sought payment for the lost lunch time in the lawsuit, and adding that compensation to any final award could increase the amount owed to workers to about $ 7.4 million, she said.

"It's a huge victory for these workers," she said. "They truly deserve this award, and we're thrilled for them."

The ruling may also lend weight to a second class-action lawsuit filed by Wallula plant workers who weren't included in the 1998 lawsuit, she said. This second lawsuit, *Chavez v. IBP Inc.,* is scheduled to be heard by Judge Whaley in September 2004, she said.

Tyson Fresh Meats workers who gathered outside the Wallula plant Friday said that they were less concerned about getting a check in the mail than about setting an example for other meatpacking workers.

"We finally got justice," Maria Chavez, one of the workers in the lawsuit, said in Spanish. "This is a little compensation for what we've suffered."

The 59-year-old Pasco woman has worked at the Wallula plant since 1983, and said she'll use whatever money comes to her for her retirement.

Worker Arturo Aguilar of Kennewick said the ruling was "an example for other workers" and a matter of pride for union employees at the Wallula plant. "This is something you can't touch," he said, "something priceless."

Texaco, Inc. v. Dagher

(04-805)

Ruling Below: *Dagher v. Saudi Refining, Inc.*, 369 F.3d 1108 (9th Cir. 2004), *cert. granted* 125 S. Ct. 1372, (U.S. June 1, 2005). The Solicitor General was invited to file a brief expressing the views of the United States, 125 S. Ct. 1372 (2005).

Plaintiffs, a class of 23,000 Shell and Texaco service station owners represented by Fouad Dagher and others, sued three oil companies alleging that these companies had conspired to fix the nationwide prices for the Shell and Texaco brands of gasoline through the creation of a national alliance consisting of 2 joint ventures. The district court granted the oil companies summary judgment for lack of standing and because the owners failed to raise a triable issue of fact as to whether the Sherman Act's *per se* prohibition against price fixing was applicable to the economic arrangements between the companies. The Ninth Circuit Court of Appeals reversed as to the owners' failure to create a triable issue of fact. The Ninth Circuit found that the absence of persuasive evidence showing a pro-competitive justification for initiating the price-fixing scheme, when viewed along with the owners' evidence showing anti-competitive effects, was a convincing showing as to the applicability of the *per se* rule.

Question Presented: Whether it is *per se* illegal concerted action under § 1 of the Sherman Act for an economically integrated joint venture to set the selling price of its own products.

Fouad N. DAGHER, Plaintiff-Appellant
v.
SAUDI REFINING, INC., Defendant-Appellee

United States Court of Appeals
for the Ninth Circuit

Decided June 1, 2004

[Excerpt: Some footnotes and citations omitted]

OPINION: REINHARDT, Circuit Judge:

Plaintiffs Fouad N. Dagher, et al., appeal from the district court's award of summary judgment to the defendants, Texaco, Inc., Shell Oil Co., and Saudi Refining, Inc. (SRI), et al. The plaintiffs represent a class of 23,000 Texaco and Shell service station owners who allege that the defendants conspired to fix the nationwide prices for the Shell and Texaco brands of gasoline through the creation of a national alliance consisting of two joint ventures. The district court granted two summary judgment motions: one to dismiss defendant SRI because the plaintiffs lacked antitrust standing; the other to dismiss the complaint against the remaining defendants because the plaintiffs failed to raise a triable issue of fact as to whether the *Sherman Antitrust Act*'s *per se* prohibition against price fixing is applicable to the economic arrangements between the defendants. We affirm the district court's ruling as to the plaintiffs' standing to sue SRI, but reverse the district court's decision that the plaintiffs failed to create a triable issue of fact under the Sherman Act.

* * *

There is a voluminous record documenting the economic justifications for creating the joint ventures. After analysis by teams made up of representatives of all three companies, the defendants concluded that numerous synergies and cost efficiencies would result. The defendants concluded that nation-wide there would be up to $800 million in cost savings annually. The Federal Trade Commission and several State Attorneys General approved the formation of the joint ventures, subject to modifications demanded by both the federal agency and the various Attorneys General.

The creation of the alliance ended competition between Shell and Texaco throughout the nation in the areas of downstream refining and marketing of gasoline. Texaco and Shell signed non-competition agreements which prohibited them from competing with either Equilon or Motiva and committed them "not to engage in the manufacturing and marketing of certain products in the [relevant] geographic areas, including fuel, synthetic gasoline, and electricity." The two joint ventures established fixed ratios for profit sharing and for bearing the risk of losses. . . .

* * *

The various agreements between the oil companies allowed Texaco and Shell to consolidate and unify the pricing of the Texaco and Shell gasoline brands within the Equilon and Motiva joint ventures. Before creating the two joint ventures, Shell, Texaco, and Star all independently set prices for their wholesale and retail sales, generally through decisions made by their corporate pricing units. Testimony in the record reveals that, either immediately before the formation of the joint ventures or sometime shortly thereafter, "a decision was made that the Shell and Texaco brands would have the same price in the same market areas.". . .

The alliance consolidated pricing of the Texaco and Shell brands such that a single individual at each joint venture was responsible for setting a coordinated price for the two brands. . . .

The price optimization program may have allowed Equilon and Motiva to raise gasoline prices at a time when the price of crude oil was low and stable. During a time when crude oil prices reached near-historic lows—the price of crude oil decreased from $ 10 to $ 12 per barrel between September 1998 and February 1999—Equilon raised its prices $ .40 per gallon in Los Angeles and $ .30 per gallon in both Seattle and Portland.

* * *

II. Standard of Review

We review a district court's grant of summary judgment *de novo*. *United States v. City of Tacoma, 332 F.3d 574, 578 (9th Cir. 2003).* Taking the evidence in the light most favorable to the nonmovant, we must consider whether there are any genuine issues of material fact and whether the district court properly applied the pertinent substantive law.

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IV. Liability Under the Sherman Antitrust Act

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The Sherman Antitrust Act makes illegal "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations[.]" *15 U.S.C. § 1*. . . .

* * *

Price fixing is the quintessential example of a *per se* violation of *§ 1*. . . .

Notwithstanding the above, it is plain that *§ 1*'s blanket prohibition on price fixing, like the Act itself, cannot be read literally. *Cf. Prof'l Engineers, 435 U.S. at 687 (§ 1 of the Sherman Act* "cannot mean what it says"). There are *some* price fixing arrangements that violate the letter of the Sherman Act but are legal nonetheless. For instance, when two competing companies agree to merge and to combine their product lines, or to eliminate the old product lines and create an entirely new one, they generally agree to adopt a uniform pricing scheme. The Supreme Court has permitted such arrangements. . . .

It is not the case, however, that the mere existence of a bona fide joint venture means that participating companies may use the enterprises to do anything they please with full immunity from *per se* analysis under *§ 1*, including price fixing. . . . For instance, if in reliance on the existence of a valid joint venture between Coca Cola and Pepsi designed to research new types of soda flavors, the two companies imposed a price floor on all soda sold nationwide, the price fixing would constitute an illegal "naked restraint on trade." Along these lines, the Supreme Court has recognized that even joint ventures that are lawful in their general operations may violate the Sherman Act when they engage in specific anticompetitive conduct. . . .

The defendants' argument to the contrary—that joint ventures such as Equilon and Motiva are incapable of violating the Sherman Act—ignores the lesson of *Citizen Publishing Co. v. United States, 394 U.S. 131*. . . . In *Citizen Publishing* . . . two daily newspapers in Tucson, Arizona . . . entered into a joint venture agreement, which "provided that each paper should retain its own news and editorial departments, as well as its corporate identity." *394 U.S. at 133*. The joint venture established a new company, Tucson Newspapers, Inc., "which was to manage all departments of their business except the news and editorial units. . . .

The Supreme Court held that the confluence of these anti-competitive restraints, in the context of a joint venture between two formerly vigorous competitors in the market area targeted by the venture, constituted a *per se* violation of the Sherman Act. . . .

The district court distinguished *Citizen Publishing* in three ways. Each is unsatisfactory. First, the court found that the Tucson newspapers in *Citizen Publishing* effectively eliminated "all competition," whereas Equilon and Motiva "continue to compete with several major oil companies in their relevant markets." This distinction runs contrary to Supreme Court precedent.

Second, the district court found that the *Citizen Publishing* newspapers "combined for the specific purpose of restricting competition and fixing prices," in contrast to a complete lack of evidence establishing such intent for the alliance ventures. That distinction, if true, would speak only to the validity of Equilon and Motiva as a whole—it would not justify the defendants' adoption of a price fixing scheme. . . .

Third, the district court believed that the only reason the non-competition agreement in *Citizen Publishing* was unlawful was because the agreement joined the only two competitors in the market. The Western oil market, by contrast, is a diverse market with "several competitors," while the Equilon joint venture has a much narrower non-competion agreement. This distinction returns to an analysis of market power, an analysis which the Supreme Court has held is inappropriate in this type of case. . . .

* * *

The Supreme Court has upheld joint ventures and other corporate combinations involving fixed prices, but generally has done so only when it appeared plain to the Court that the restraints undertaken by the joint ventures were "necessary" to the legitimate aims of the joint venture. *See BMI, 441 U.S. at 23* (approving an otherwise invalid price restraint only because "the agreement on price is necessary to market the product at all"); *NCAA, 468 U.S. at 117* ("Our decision not to apply a per se rule to this case rests in large part on our recognition that a certain degree of cooperation is necessary if the type of competition that petitioner and its member institutions seek to market is to be preserved."). . . .

In considering the relationship of the enterprise's pricing actions to the venture's legitimate objectives, we find it significant that the defendants here did not simply consolidate the pricing decisions within the joint ventures—they *unified* the pricing of the two brands from the time the alliance was formed by designating one individual in each joint venture to set a single price for both brands. Normally, a business determines the prices it will charge for its various products by considering numerous factors, just a few of which include the costs of production and marketing and the contours of the relevant product markets. In this case, the defendants have stressed that, in addition to the differences in the product themselves, the gasolines marketed under the Texaco and Shell labels have different reputations and consumer bases. It thus seems likely that independent price analyses would result, at least in some circumstances, in the rational decision to sell the different brands at different prices. Instead, the defendants chose to fix those prices uniformly.

The defendants have thus far failed to offer any explanation of how their unified pricing of the distinct Texaco and Shell brands of gasoline served to further the ventures' legitimate efforts to produce better products or capitalize on efficiencies. . . . The absence of persuasive evidence showing a procompetitive justification for initiating the price-fixing scheme, when viewed along with the plaintiffs' evidence showing anti-competitive effects, convinces us that the plaintiffs have made a sufficient showing as to the applicability of the *per se* rule.

The defendants offer only two justifications for the unitary pricing scheme. First, the defendants argue—as does our dissenting colleague—that, as a general rule, any bona fide joint venture must be able to set prices for its products at whatever level it chooses: "without the ability to price its products, neither venture would have had the authority to make fundamental decisions affecting its financial performance." Appellees' Brief, at 16. Second, the defendants argue that Equilon and Motiva fixed uniform Texaco and Shell prices in order to "prevent issues of price discrimination from arising under the *Robinson-Patman Act*[.]" *Id.* We address the latter justification first.

A cursory examination of the Robinson-Patman Act, *15 U.S.C. § 13*, which was designed to prevent sellers from engaging in price discrimination, reveals its inapplicability here. . . . As another Circuit has explained,

> . . . "[I]t is fairness, as Congress perceives it, that Robinson-Patman is all about." The Act's goal is to abolish unwarranted favoritism among all functional competitors, big or small. Its objective is to assure "that businessmen at the same functional level start on equal competitive footing so far as price is concerned"; "to assure that all sellers regardless of size, competing directly for the same customers . . . receive evenhanded treatment from their suppliers." . . .

Alan's of Atlanta, Inc. v. Minolta Corp., 903 F.2d 1414, 1422 (11th Cir. 1990).

The quoted passage makes it clear that the defendants' Robinson-Patman argument is wholly without merit. The Act would unquestionably be inapplicable to a decision by the defendants to sell the distinct Texaco and Shell brands of gasoline at different prices. Any such decision would necessarily be predicated on the differences between the two brands, not upon the identity of the buyers. . . .

The first of the defendants' two arguments—that a joint venture must be able to set whatever price it chooses for its products—proves too much. If that were true, any number of companies could create joint ventures as fronts for price-fixing. The simple answer is that the Supreme Court has declined to immunize joint ventures from *per se* antitrust scrutiny. . . .

Finally, the defendants claim—as does our dissenting colleague—that an application of the *per se* rule here would mean that joint ventures could not set prices for their products. We reject this argument. We of course recognize that joint ventures may price their products; that is not the question. The question is whether two former (and potentially future) competitors may create a joint venture in which they unify the pricing, and thereby *fix* the prices, of two of their distinct product brands. We have held that the Sherman Act's *per se* rule applies when the defendant fails to demonstrate a sufficient relationship between the price fixing scheme and furthering the legitimate aims of the joint venture—a relationship that justifies the otherwise prohibited price restraints. Thus far in this litigation, the defendants have failed to produce sufficient evidence demonstrating that their price fixing scheme was ancillary rather than naked and, thus, that they are entitled to summary judgment.

* * *

DISSENT: FERNANDEZ, Circuit Judge, Concurring and Dissenting:

I agree that the plaintiffs lacked standing as to SRI and, therefore, concur in the result of part III of the majority opinion. However, I dissent from part IV.

While this case does involve a very complicated set of transactions, it presents a rather straightforward antitrust law question. That is, where former competitors create a bona fide joint venture to which all of their assets and operations in segments of their businesses are contributed, will there be a *per se* violation of the antitrust laws, if the joint venture entity sets the prices of the goods it sells? I think the answer is no. . . .

* * *

It is plain enough that the mere creation of a joint venture is not a *per se* antitrust violation. No doubt, like mergers, joint ventures are combinations of business assets but "such combinations are judged under a rule of reason" analysis. *Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 768, 104 S. Ct. 2731, 2740, 81 L. Ed. 2d 628 (1984).* Especially should that be true of the LLC type of venture, which is not only a separate entity, but which also functions as a separate economic unit for all practical purposes. In fact, to slightly paraphrase the Supreme Court statement in *Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 356, 102 S. Ct. 2466, 2479, 73 L. Ed. 2d 48 (1982)*:

> [Equilon is] . . . analogous to partnerships or other joint arrangements in which persons who would otherwise be competitors pool their capital and share the risks of loss as well as the opportunities for profit. In such joint ventures, the partnership is regarded as a single firm competing with other sellers in the market.

Nor does the mere fact that Equilon sets prices for the products it manufactures and sells suffice to demonstrate that its actions were price fixing for antitrust purposes. *See Broad. Music, Inc., v. Columbia Broad. Sys., Inc., 441 U.S. 1, 8-9, 99 S. Ct. 1551, 1556-57, 60 L. Ed. 2d 1 (1979).* Rather, "literalness is overly simplistic and often overbroad. When two partners set the price of their goods or services they are literally 'price fixing,' but they are not *per se* in violation of the Sherman Act." *Id. at 9, 99 S. Ct. at 1557.* So just what could make the operation of Equilon a *per se* violation of the antitrust laws? Surely it is not a claim that the venture is a sham.

* * *

. . . Independent Operators argue, in this case the fixing of prices by the venture is neither essential nor "reasonably ancillary to the legitimate cooperative aspects of the venture." *Freeman v. San Diego Ass'n of Realtors, 322 F.3d 1133, 1151 (9th Cir. 2003).* The majority agrees; I cannot understand why. The situation here is far from the kind of situation we faced in *Freeman*. There, the reason for the venture was the unifying of disparate multiple listing databases. *Id. at 1140-41.* That done, there was a new database entity, and the corporations that formed it for that purpose went on operating their own businesses. But they all also agreed to fix a price for support services. That was essentially unrelated to the database itself, and was unnecessary, and unjustified. *Id. at 1151.* It was the latter "price fix" that ran afoul of antitrust principles. Here we have nothing of the kind.

In this case, nothing more radical is afoot than the fact that an entity, which now owns all of the production, transportation, research, storage, sales and distribution facilities for engaging in the gasoline business, also prices its own products. It decided to price them the same, as any other entity could. What could be more integral to the running of a business than setting a price for its goods and services? I am at a loss for an answer to that question, and nothing written about this case to date imparts additional wisdom or better information.

"Oil Giants Take on Gas Station Owners; Supreme Court to Determine Fate of Antitrust Ruling"

Houston Chronicle
July 06, 2005
Alexis Grant

WASHINGTON—The Supreme Court will hear a price-fixing case that has pitted big oil companies against the owners of gas stations and could have an effect on some of the biggest names in American business.

The issue is whether a joint venture created by Texaco and Shell Oil Co. can sell gasoline at the same price to all distributors under laws designed to preserve competition.

Antitrust experts say the case, which was accepted at the end of the court's recent term, is likely to be one of the more significant business issues it considers when it goes back to work in October.

The case comes from the San Franscisco-based 9th U.S. Circuit Court of Appeals, which ruled in favor of the gas station owners. Big names on the side of the oil companies include the U.S. government, Visa USA, Coca-Cola Co. and Microsoft Corp.

"Beyond the implications for these very major industry players, the 9th Circuit's decision has far-reaching implications for all kinds of joint ventures," said David Price, an attorney with the Washington Legal Foundation, who filed a brief in favor of the oil companies. "It would create potential for antitrust liability when a joint venture makes routine decisions, like pricing."

Two brands, one price

The class action lawsuit filed on behalf of 23,000 service station owners argued that the joint venture violated antitrust laws making it illegal to limit competition by setting a common price for a product made by competing companies.

The creation of two refining and marketing joint ventures in 1998 allowed Texaco and Shell to continue to sell their brands separately but save an estimated $ 800 million each year by sharing refining capacity and the cost of selling the fuels. At the pump, consumers saw Texaco and Shell as two different brands of gas, but the gas was sold at the same wholesale price by the joint venture.

The joint venture at the heart of the lawsuit, Equilon, operated in the western United States. Texaco and Shell were partners with Saudi Refining in a similar joint venture called Motiva that operated in the eastern U.S.

The oil companies argue that setting a price for gas produced under Equilon was a necessary part of doing business, even if it was sold under two brand names.

Price spikes

According to the 9th Circuit Court, the companies that joined to create Equilon sharply increased the price of their gasoline in some West Coast cities, including Los Angeles, at a time when oil prices were at near-historic lows of $ 10 to $ 12 per barrel. Additional costs were passed by distributors to consumers.

Texaco's stake in the joint venture was sold to Shell Oil Co. after Texaco was taken over by ChevronTexaco Corp.

Daniel Shulman, an attorney for the plaintiffs, called the move price-fixing and said it falls under the "per se" rule of antitrust law, which makes it illegal regardless of the circumstances.

"The Supreme Court has said for 50 years that joint ventures are not entitled to any type of special protection," Shulman said.

But those backing the oil company argue the situation should be judged according to the "rule of reason," which allows joint ventures to set prices if they are efficient. The idea is that such combinations may produce new products, made less expensively or more plentiful for consumers.

Error made?

In a brief, the U.S. government urged the high court to overturn what it saw as an error by the appeals court and treat Equilon as a separate company created to refine and sell fuel more efficiently, which it said should exempt it from price-fixing rules.

The appeals court's decision poses a threat to the proper enforcement, both private and public, of the antitrust laws, wrote Paul Clement, acting solicitor general.

Shulman countered that Equilon should not qualify as efficient because it did not create a product that was different from what Texaco and Shell produced independently.

The American Antitrust Institute, a nonprofit group that aims to increase competition among businesses, has not yet taken a stance on the issue. But its president, Bert Foer, said a reversal by the high court has the potential to set a precedent that could hurt consumers.

The two cases, which will be combined for argument before the court, are *Texaco v. Dagher* and *Shell Oil Co. v. Dagher.*

"FTC, DOJ Pitch Joint Venture Ruling"

Daily Deal
June 1, 2005
Cecile Kohrs Lindell

The nation's two antitrust enforcement bodies, the Federal Trade Commission and the Department of Justice's Antitrust Division, jointly asked the Supreme Court on Tuesday, May 31, to overturn a California appeals court ruling that a joint venture may not set the same price for separate brands made by its parent companies.

The case of ***Texaco Inc. v. Dagher et al.*** centers on Equilon, one of two joint ventures formed by Texaco Inc. and Shell Oil Co. to market and distribute gasoline made by the two companies. Fouad N. Dagher, representing individual owners of Shell or Texaco gasoline retailers, argues that Equilon's sale of Shell and Texaco products at the same price amounts to price-fixing, which is illegal.

Central District of California Judge George H. King ruled for the oil companies, only for Judge Stephen Reinhardt of the 9th Circuit Court of Appeals in San Francisco to overturn him last June.

The appellate ruling, which asserts that a joint venture approved by the FTC and four states may not set its own price for the products it sells, has caused a stir in the antitrust bar. "The implications for all kinds of extremely common business practices for joint ventures is huge," said Roy Englert, a partner at Robbins, Russell, Englert, Orseck & Untereiner LLP who specializes in appellate work.

The FTC-DOJ brief notes that "under the terms of the consummated joint venture, petitions granted Equilon an exclusive license to sell gasoline under their brand names [Shell and Texaco] in the Western United States, and they agreed to split Equilon's profits (or losses) in a fixed ratio based on the assets each contributed to the joint venture."

Englert noted that the joint brief, sought by the Supreme Court, is unusually direct in urging the top court to hear, and then reverse, the lower-court ruling. "The agencies tend to be institutionally conservative in their briefs," he said, explaining that most briefs take a "on-the-one-hand, on-the-other-hand" look at the reasons for or against hearing a case.

But the clarity of the joint recommendation makes it more likely that the Supreme Court will hear the case, probably next year. "The chances are very, very high that the Supreme Court will grant cert," Englert said.

If the Supreme Court lets the appellate decision stand, it would "[interfere] with common business activity, and a lot of common business practices would have to be reconsidered," Englert said.

"Gasoline Price-Fixing Suit Reinstated"

Ventura County Star
June 2, 2004
David Kravets

A federal appeals court on Tuesday reinstated a lawsuit accusing ChevronTexaco Corp. and Shell Oil Co. of operating a price-fixing conspiracy.

The suit accuses the companies' joint ventures—Motiva Enterprises and Equilon Enterprises—as being part of a plan by the oil giants to inflate fuel prices beginning in 1998 and ending as early as 2001, when Texaco sold its stake to win approval of its purchase of Chevron.

Judge Stephen Reinhardt, while noting that Texaco and Shell charged the same for gasoline after the formation of the joint ventures, ruled that "the very purpose of the alliance was to eliminate competition in order to realize efficiency gains and gain market share."

Reinhardt, in a 2-1 ruling, said it was up to a jury to decide whether two competitors that agreed to charge the same for gasoline created the alliance "to restrict competition."

Between September 1998 and February 1999, when crude oil was at historic lows of $10 to $12 per barrel, Equilon increased the Shell and Texaco brands 40 cents per gallon in Los Angeles and 30 cents in Seattle and Portland, Reinhardt said.

U.S. District Judge George King dismissed the case in 2002, which was brought by 23,000 gasoline vendors. King ruled that a jury could not find that the companies "formed Equilon and Motiva merely to achieve an ulterior anticompetitive purpose or that the ventures are patently anticompetitive."

In a sharp dissent Tuesday, Judge Ferdinand Fernandez agreed.

A lawyer for the vendors, Daniel Shulman, said the companies fixed prices in violation of federal law.

"They're not allowed to do that," he said.

The distributors, he said, paid $1 billion or more in excessive charges, which they will seek to recoup. "They are either going to pay or we're going to litigate it," he added.

While the distributors passed the alleged excess costs to consumers, antitrust law allows them to recover the illegal fees, Shulman said.

If the vendors prevail, consumers are not eligible for refunds, said Joseph Alioto, another attorney for the vendors.

Jeff Moore, a spokesman for San Ramon-based ChevronTexaco, said the oil concern is "confident, when this matter is finally resolved, it will be determined that the joint venture formed by Texaco and Shell, which received regulatory approval by the Federal Trade Commission after extensive review, and was also approved by several state attorneys general, never violated any antitrust laws."

Cameron Smyth, a spokesman for Houston-based Shell—the U.S. branch of the Dutch/Shell Group, said the company was reviewing the decision and had no comment.

The case is *Dagher v. Motiva Enterprises*, 02-56509.

"Gas Pains; L.A. Lawyer Tom Bleau Takes Service Station Woes to the Court"

New Times Los Angeles
November 30, 2000
Bob Burtman

Tom Bleau takes his work personally. The Los Angeles lawyer represents service-station dealers in California, and he has difficulty suppressing his outrage at their plight. "When they're on the brink," Bleau says, the companies "push up their prices."Bleau filed two federal lawsuits against the Shell-Texaco joint venture, and he recently won a crucial injunction in one of them after dealers were presented with new leases that essentially guaranteed their demise. The injunction prevents the company from terminating dealers who refuse to sign until the court case is resolved. "No dealer in his right mind wants to sign these leases," he says.

It's not easy to sue a major oil company, no matter how obvious the transgression. With a seemingly unlimited legal budget, a Shell or an Exxon can throw banks of lawyers and other resources at a case that the cash-strapped dealers can't possibly afford to match. Even when the dealers' attorney works on contingency, the company can delay and obfuscate for years with relative impunity. In a still unresolved 1991 federal class-action case filed in Miami against Exxon, for example, the list of motions alone ran more than 100 pages.

Invariably the companies request that documents and testimony produced in a dealer case be sealed, claiming that the release of proprietary information could damage their business. In the event the cases settle, the seal becomes permanent. Alabama attorney Jim Gunther would love to share documents from his cases against BP, but he can't. "I've got smoking-gun kind of evidence," Gunther says, "but they put that "confidential' stamp on everything."

Smoking guns rarely escape the files, but more are emerging, including a damaging deposition by a former Shell marketing executive in a Miami case. The testimony indicates that while the dealers thought they were getting a break on rent if they sold more gallons under the rent rebate program, the company was making it back by charging them more for gas. The hidden rent component in their wholesale gas price has been the basis for one of many fraud charges against Shell.

That deposition has now made its way to other states. A judge in an Indiana case became so incensed by Shell's consistent refusal to obey the rules and produce documents as ordered that he allowed a legal team from Texas to travel to Indianapolis and copy whatever it wanted from the case file (though the material is still officially sealed).

Lawyers for the dealers generally have taken the shotgun approach in suits, tossing as many charges as possible into every case and seeing if anything sticks. Results to date have been decidedly mixed. Some of the Shell suits seem to be gaining momentum, and the dealers have won a few scattered victories, but a recent verdict in a San Diego Chevron case may have a chilling effect on future litigation. A group of 22 California dealers won $3.4 million from Chevron in 1995 after a jury found the company illegally manipulated prices to pressure the dealers financially. But a three-judge panel overturned the verdict, and a judge recently awarded Chevron its attorney's fees, which total $6.8 million. Most of the dealers, bled dry after the eight-year battle, will have to declare bankruptcy.

Another remedy for dealers can be found in Congress. The federal Petroleum Marketing Practices Act was designed to protect dealers from predatory practices, but the law has proved easy to dodge. Antitrust laws provide some protection, and the disparity in West Coast gas prices has spurred a Federal Trade Commission investigation. Democratic U.S. Senator Barbara Boxer of California has been especially active in calling for federal intervention. "Some big oil companies appear to have embarked on an all-out campaign to drive their own franchisees out of business in an effort to tighten their stranglehold over California's gasoline industry," Boxer wrote in a letter to FTC chairman Robert Pitofsky.

As the oil companies like to point out, however, investigations usually die on the vine. Millions in campaign contributions and hordes of lobbyists flooding legislative hallways probably help. In California, for example, the major oil companies and their trade groups have spent more than $4.7 million on lobbying alone since the beginning of 1999. As Chevron spokesman Jack Coffey hinted recently, the money is spent "to be sure our business opportunities can continue in the way we want them to continue."

The state and local levels seem to provide more opportunities for dealer relief. Six states and Washington, D.C., have divorcement laws on the books, which generally prohibit refiners from running their own retail outlets. San Francisco and San Diego came close to passing divorcement ordinances the last couple of years, though furious lobbying beat them back at the eleventh hour—the San Diego County Board of Supervisors approved a divorcement bill in 1998 but withdrew it after an industry trade group sued the board for $50 million.

Statewide initiatives have met similar resistance. Democratic state Senator Steve Peace of San Diego sponsored an "open supply" bill in 1999 that would have allowed dealers to buy gas from any wholesaler selling the same brand (currently, they must buy directly from the company at whatever price the company sets). The bill passed the Senate but died in the Assembly Utilities and Commerce Committee—thanks to South Central L.A. Democrat Roderick Wright, the committee's chairman, who refused to bring it to a vote. Last May a state task force on California's high gas prices recommended both divorcement and open supply as remedies, but no such legislation has yet appeared on the horizon.

Given the cool climate for reform, the courts remain the likeliest avenue for the dealers in their fight for survival. They recognize the long odds of going to war with Goliath, though most say all they really want is to be bought out at a fair price or compensated for their years of service. "I'm just trying to minimize my losses as much as I can," says L.A. Shell dealer Fred Dagher, a plaintiff in both Bleau lawsuits.

But unless they're brought to their knees in court, the companies aren't likely to pay up voluntarily. As a Shell motion in a Texas case clearly states, "Shell does not owe a duty of good faith and fair dealing to plaintiffs."

Illinois Tool Works Inc. v. Independent Ink, Inc.

(04-1329)

Case Below: (*Independent Ink, Inc. v. Illinois Tool Works, Inc.*, 396 F.3d 1342 (Fed. Cir. 2005), *cert. granted*, 125 S. Ct. 2937, 73 U.S.L.W. 3733 (U.S. June 20, 2005)(No. 04-1329)).

Illinois Tool was sued by a competing ink manufacturer claiming a violation of the Sherman Act. Illinois Tool requires users of its patented printheads to purchase non-patented ink from them as well. The U.S. District Court for the Central District of California granted summary judgment for the defendant because plaintiff had not shown that defendant had market power over the tying product. The Federal Circuit reversed, saying there is a rebuttable presumption of market power in patent tying cases.

Question Presented: Whether, in an action under Section 1 of the Sherman Act, 15 U.S.C. § 1, alleging that the defendant engaged in unlawful tying by conditioning a patent license on the licensee's purchase of a non-patented good, the plaintiff must prove as part of its affirmative case that the defendant possessed market power in the relevant market for the tying product, or market power instead is presumed based solely on the existence of the patent on the tying product.

INDEPENDENT INK, INC., Plaintiff-Appellant,
v.
ILLINOIS TOOL WORKS, INC. and TRIDENT, INC.,
Defendants-Appellees.

United States Court of Appeals
for the Federal Circuit

Decided January 25, 2005

[Excerpt: Some citations and footnotes omitted]

OPINION: DYK, Circuit Judge.

Independent Ink, Inc. ("Independent") appeals from the judgment of the United States District Court for the Central District of California in this patent tying antitrust action. The district court granted summary judgment on plaintiff Independent's *Sherman Act section 1* claim because Independent had failed to produce any evidence of market power over the tying product. *Indep. Ink, Inc. v. Trident, Inc., 210 F. Supp. 2d 1155 (C. D. Cal. 2002).* We hold that a rebuttable presumption of market power arises from the possession of a patent over a tying product. Because no rebuttal evidence was submitted by the patent holder, we reverse the grant of summary judgment on the *Sherman Act section 1* claim and remand for further proceedings. As to Independent's *Sherman Act section 2* claim, we affirm the district court's grant of summary judgment.

BACKGROUND

Defendant Trident, Inc. ("Trident") is a wholly-owned subsidiary of defendant Illinois Tool Works, Inc. ("ITW"). Trident is a manufacturer of printheads and holds a patent over its printhead technology. See U.S. Patent No. *5,343*, 226 ("the '226 patent"). Printer manufacturers (the "OEMs") use Trident's printhead technology to manufacture printers. The end users of the printers are usually product manufacturers, who use the printers to place bar codes on cartons.

As disclosed by the '226 patent, ink jet devices for printing bar codes consume a large quantity of ink. The small cartridges typical in other ink jet devices are impractical for such applications. But the use of a large supply of ink poses problems for transferring the ink from the container to the printhead. . . . The '226 patent discloses an ink jet device and supply system using a hand actuated peristaltic pump. The use of hand pumping overcomes the usual complexity and expense of such devices.

Trident also manufactures ink for use with its patented printheads. Trident's standard form licensing agreement allowing the OEMs to use its patented product requires "OEMs to purchase their ink for Trident-based systems exclusively from Trident." (Br. of Appellees at 8.) Specifically, the licensing agreement grants the right to "manufacture, use and sell ink jet printing devices supplied by Trident" only "when used in combination with ink and ink supply systems supplied by Trident." (J. A. at 275.) There is now no claim that the ink is protected by any of Trident's patents. We thus have an explicit tying agreement conditioning the sale of a patented product (the printhead covered by the '226 patent [and possibly other patents as well]) on the sale of an unpatented one (the ink).

Independent is a competing manufacturer of ink. It manufactures ink usable in Trident's printheads. Independent filed suit in the United States District Court for the Central District of California on August 14, 1998, initially seeking a declaratory judgment of non-infringement and invalidity against Trident's patents. Independent subsequently amended its complaint to allege that Trident was engaged in illegal tying and monopolization in violation of *sections 1 and 2 of the Sherman Act, 15 U.S.C. § 1 et seq.* Both parties moved for summary judgment as to the *section 1* claim, and Trident moved for summary judgment as to the *section 2* claim. The district court granted summary judgment in favor of Trident on both claims.

The district court held that for patent tying to constitute a violation of the antitrust laws, the plaintiff must affirmatively prove market power. *Indep. Ink, 210 F. Supp. 2d at 1162.* The district court, in a footnote, dismissed several Supreme Court cases holding to the contrary as "vintage." *Id. at 1165 n. 10.* Addressing the Supreme Court's more recent decision in *Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2, 16, 80 L. Ed. 2d 2,· 104 S. Ct. 1551 (1984)*, it declined to follow the rule announced by the majority in that case that "the sale or lease of a patented item on condition that the buyer make all his purchases of a separate tied product from the patentee is unlawful." Instead, relying on the concurring opinion in Jefferson Parish, the dissent from a denial of certiorari by two members of the Jefferson Parish majority, and academic criticisms of the presumption of market power, the district court dismissed the majority opinion of Jefferson Parish as dictum that should not be followed. *Indep. Ink, 210 F. Supp. 2d at 1164-65.* The district court found that Independent submitted no affirmative evidence defining the relevant market nor proving Trident's power within it, and therefore could not prevail in either antitrust claim. *Id. at 1173-77.*

The parties settled all their remaining claims, which were accordingly dismissed with prejudice, and final judgment was entered. This appeal followed. Because the complaint originally contained a claim for declaratory judgment of invalidity and non-infringement of the '226 patent, we have jurisdiction pursuant to *28 U.S.C. § 1295(a)(1).*

DISCUSSION

I

The first issue before us is whether Federal Circuit or Ninth Circuit law governs the legality of patent tying under the *Sherman Act*, an issue which may arise both in the context of affirmative claims (as here) and in the context of a patent misuse defense. We have previously held that where an affirmative antitrust claim or antitrust misuse defense is based on "procuring or enforcing a patent," the central antitrust question is a matter governed by Federal Circuit law. *Nobelpharma AB v. Implant Innovations, Inc., 141 F.3d 1059, 1067-68 (Fed. Cir. 1998)* (en banc in relevant part). We conclude that the antitrust consequences of patent tying likewise is a question governed by our law. However, as stated in Nobelpharma, "we will continue to apply the law of the appropriate regional circuit to issues involving other elements of antitrust law," such as defining the relevant market and determining as a factual matter whether power exists within that market. *Id. at 1068.*

II

We now address the *Sherman Act section 1* claim. This case first requires us to determine whether patent tying is illegal per se (or presumptively illegal) under the *Sherman Act*, or whether the plaintiff is obliged to prove as part of its affirmative case that the patent confers market power in the relevant market for the tying product.

This case comes to us with a long history of Supreme Court consideration of the legality of tying arrangements. Earlier Supreme Court cases dealing with tying agreements were extremely hostile to them, whether the case involved intellectual property or other tying products. The first case that found tying to violate *section 1 of the Sherman Act* was a patent tying case. *Int'l Salt Co. v United States, 332 U.S. 392, 92 L. Ed. 20, 68 S. Ct. 12 (1947).* n5 In *Standard Oil Co. v. United States, 337 U.S. 293, 305, 93 L. Ed. 1371, 69 S. Ct. 1051 (1949)*, the Court commented that "tying agreements serve hardly any purpose beyond the suppression of competition."...

Later Supreme Court cases reflected divergent treatment, depending on whether statutory intellectual property was involved. Those cases not involving patents or copyrights refined the test, holding that tying was only unlawful if the defendant had "market power" in the market for the tying product. As articulated in *United States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610, 620, 51 L. Ed. 2d 80, 97 S. Ct. 861 (1977)* ("Fortner II"), this requirement of "market power" necessitated an inquiry into "whether the seller has the power, within the market for the tying product, to raise prices or to require purchasers to accept burdensome terms that could not be exacted in a completely competitive market." The requirement of demonstrating sufficient market power to raise prices was notably more onerous than the Northern Pacific requirement that there be some power to "appreciably restrain free competition."

The Supreme Court further explained the requirement for market power in the 1984 Jefferson Parish decision, which involved an agreement requiring patients of a hospital to use a particular anesthesiology firm. The Court stated that "certain tying arrangements pose an unacceptable risk of stifling competition." *466 U.S. at 9.* But the "unacceptable risk of stifling competition" arises, and consequent liability attaches, only if there is anticompetitive "forcing." As explained by the Court:

> The essential characteristic of an invalid tying arrangement lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms. When such "forcing" is present, competition on the merits in the market for the tied item is restrained and the *Sherman Act* is violated.

Id. at 12. The requirement of proving "forcing" or "market power" in cases not involving intellectual property necessitates a definition of the market in which such power is alleged to exist and showing an "actual adverse effect on competition." *Id. at 29-31.* The Supreme Court reaffirmed the requirement of market power in such cases in *Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451, 462, 119 L. Ed. 2d 265, 112 S. Ct. 2072 (1992)*, where it held that tying "violates *§ 1 of the Sherman Act* if the seller has 'appreciable economic power' in the tying product market and if the arrangement affects a substantial volume of commerce in the tied market."

The Court's treatment of tying cases when the tying product is patented or copyrighted, however, has been more consistent. In the 1947 *International Salt* case, the defendant held patents over "machines for utilization of salt products." *332 U.S. at 394.* It leased these machines on the condition that the lessee purchase from the defendant "all unpatented salt and salt tablets consumed in the leased machines." Id. The Supreme Court held that this arrangement violated the *Sherman Act*, holding that "the patents confer no right to restrain use of, or trade in, unpatented salt." *Id. at 395-96.* The Court found that by tying the lease of machines to the purchase of salt, and "contracting to close this market for salt against competition, [the defendant] engaged in a restraint of trade for which its patents afford no immunity from the antitrust laws." *Id. at 396.* The Court made no inquiry of the defendant's market power, finding that "the admitted facts left no genuine issue. . . . The tendency of the [patent tying] arrangement to accomplishment of monopoly seems obvious." Id.

In *United States v. Loew's, Inc., 371 U.S. 38, 9 L. Ed. 2d 11, 83 S. Ct. 97 (1962)*, relying on *International Salt*, the Court made clear that, where the tying product is patented or copyrighted, market power may be presumed rather than proven. *Loew's* involved the tying of less popular films to popular copyrighted films by movie distributors in their licenses to television stations. The Court stated that in tying cases not involving intellectual property the "standard of illegality is that the seller must have sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product." *Id. at 45.* However, "the requisite economic power is presumed when the tying product is patented or copyrighted." Id. The *Loew's* Court confirmed that patent tying is a distinct doctrine when it noted defendants' argument "that their behavior is not to be judged by the principle of the patent cases . . . but by the general principles which govern the validity of tying arrangements of nonpatented products." *Id. at 48.* The *Loew's* Court also stated that it needed not inquire into whether the distributors had market power. "The mere presence of competing substitutes for the tying product . . . is insufficient to destroy the legal, and indeed the economic, distinctiveness of the copyrighted product." *Id. at 49.*

The subsequent Supreme Court cases that have required proof of market power in tying cases not involving intellectual property have consistently reaffirmed the holdings of *International Salt* and *Loew's* that no proof of market power is necessary in patent or copyright tying cases. The Fortner II Court in 1977 expressly restated the presumption of market power in cases of patent tying, stating that "the statutory grant of a patent monopoly in [*International Salt*] . . . represented tying products . . . sufficiently unique to give rise to a presumption of economic power. *429 U.S. at 619.* Likewise, the Jefferson Parish Court in 1984 stated that "if the Government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power." *466 U.S. at 16.*

In sum, the Supreme Court cases in this area squarely establish that patent and copyright tying, unlike other tying cases, do not require an affirmative demonstration of market power. Rather, *International Salt* and *Loew's* make clear that the necessary market power to establish a *section 1* violation is presumed. The continued validity of *International Salt* and *Loew's* as binding authority, and the distinction between patent tying and other tying cases that was articulated in *Loew's*, have been consistently reaffirmed by the Court ever since.

* * *

IV

The defendants argue . . . that *International Salt* and *Loew's* are no longer good law. They offer three theories in support of this contention. First, they point to Walker Process, where the Court stated in a patent antitrust case that it was "reluctant to extend [per se illegality] on the bare pleadings and absent examination of market effect and economic consequences." *382 U.S. at 178.* But *Walker Process* was a *section 2* case asserting claims of monopolization, not a *section 1* claim for tying. Moreover, the gravamen of *Walker Process* was the inappropriate obtaining of the patent, *id. at 174*, not the extension of that patent beyond its terms to an unpatented article through a tying arrangement, see *Int'l Salt, 332 U.S. at 395-96.* We conclude that *Walker Process* does not articulate a rule applicable to patent tying cases.

The defendants next point to Justice O'Connor's concurrence in *Jefferson Parish,* which was joined by Chief Justice Burger, Justice Powell and then-Justice (now Chief Justice) Rehnquist, stating that it is a "common misconception . . . that a patent or copyright . . . suffices to demonstrate market power." *466 U.S. at 37 n. 7* (O'Connor, J., concurring). Defendants argue that the 1984

Jefferson Parish concurrence, coupled with a dissent in the following year joined by two members of the *Jefferson Parish* majority, imply that a then-majority of the Court indicated that *International Salt* and *Loew's* were no longer good law. The district court relied on this reasoning. *Indep. Ink, 210 F. Supp. 2d at 1164-65*. It is not persuasive. Justice White's opinion in *Data General,* joined by Justice Blackmun, did not expressly contradict *International Salt, Loew's, Jefferson Parish,* or opine that a showing of market power was required in patent and copyright tying cases. Justice White noted that the court of appeals "viewed [a] copyright . . . as creating a presumption of market power, and seemingly concluded that forcing power is sufficiently established to demonstrate per se antitrust liability if some buyers find the tying product unique and desirable." *Data Gen., 473 U.S. at 909*. The only conclusion Justice White drew was that the case raised "several substantial questions of antitrust law and policy, including . . . what effect should be given to the existence of a copyright or other legal monopoly in determining market power." Id. This hardly amounts to a repudiation of the presumption of market power. More importantly, the district court's practice of "nose-counting," as one sister circuit has called it, *Felton v. Sec'y, United States Dep't of Educ., 739 F.2d 48, 72 25* n. (2d Cir. 1984), is "a pastime in which we do not commonly engage." *United States v. Curcio, 712 F.2d 1532, 1542 (2d Cir. 1983)*.

The defendants finally point to the numerous academic articles criticizing the Supreme Court cases relying on a presumption of market power in patent and copyright cases. We recognize that the Supreme Court precedent in this area has been subject to heavy criticism. . . .

The fundamental error in all of defendants' arguments is that they ignore the fact that it is the duty of a court of appeals to follow the precedents of the Supreme Court until the Court itself chooses to expressly overrule them. This message has been conveyed repeatedly by the Court. The Court's "decisions remain binding precedent until [it] sees fit to reconsider them, regardless of whether subsequent cases have raised doubts about their continuing vitality." *Hohn v. United States, 524 U.S. 236, 252-53, 141 L. Ed. 2d 242, 118 S. Ct. 1969 (1998)*. "If a precedent of the Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to the Court the prerogative of overruling its own decisions." *Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 484, 104 L. Ed. 2d 526, 109 S. Ct. 1917 (1989)*. Even where a Supreme Court precedent contains many "infirmities" and rests upon "wobbly, moth-eaten foundations," it remains the "Court's prerogative alone to overrule one of its precedents." *State Oil Co. v. Khan, 522 U.S. 3, 20, 139 L. Ed. 2d 199, 118 S. Ct. 275 (1997)*. None of the authorities that defendants present, whether it be the language of *Walker Process,* the concurrence in *Jefferson Parish,* or the dissent from denial of certiorari in *Data General,* constituted an express overruling of *International Salt* or *Loew's*. We conclude that the Supreme Court has held that there is a presumption of market power in patent tying cases, and we are obliged to follow the Supreme Court's direction in this respect. The time may have come to abandon the doctrine, but it is up to the Congress or the Supreme Court to make this judgment.

V

We must therefore address the scope of the rule announced by the Supreme Court's patent and copyright tying cases. Independent submits that under *International Salt* and its progeny, patent tying is per se illegal in every case and market power is irrebuttably presumed. In this area, unfortunately, there is no Supreme Court case directly addressing the issue, and we are required to ascertain the rule from dictum. *Loew's* expressly stated that "there may be rare circumstances in which the doctrine we have enunciated under *§ 1 of the Sherman Act* prohibiting tying arrangements involving patented or copyrighted tying products is inapplicable." *371 U.S. at 49-50. Jefferson Parish* confirmed that *International Salt* created only a presumption of market power: "If the Government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power." *466 U.S. at 16* (emphasis added). It would stretch the language of "fair to presume" beyond the breaking point to say that such a presumption is irrebuttable. We are obliged to follow such clearly articulated Supreme Court dicta.

Other circuits have similarly interpreted the Supreme Court's patent and copyright tying cases to create a rebuttable presumption of market power. See, e.g., *Digidyne Corp. v. Data Gen. Corp., 734 F.2d 1336, 1344 (9th Cir. 1984)* (Copyright "created a presumption of economic power sufficient to render the tying arrangement illegal per se.) The burden to rebut the presumption shifted to defendant.

Thus, a patent presumptively defines the relevant market as the nationwide market for the patented product itself, and creates a presumption of power within this market. Once the plaintiff establishes a patent tying agreement, it is the defendant's burden to rebut the presumption of market power and consequent illegality that arises from patent tying.

VI

The district court found that, even if there was a presumption of market power in patent tying cases, any presumption of mark et power was rebutted in this case because

> it is undisputed that consumers could place bar-coded labels on their products before other competitors manufactured bar-coding printers, and Plaintiff does not establish that the various labeling systems are not proper substitutes for Defendants' printhead system or dispute Defendants' arguments that they are. Moreover . . . at least two other competitors . . . have designed printheads that can print bar codes on kraft paper. The fact that [two competitors] have done so indicates that any barriers to entry, such as R & D and manufacturing costs, are not so great as to prevent competitors from entering the market.

Indep. Ink., 210 F Supp. 2d at 1167. The defendants argue that the district court was correct because there is testimony here by the president of an OEM that consumers use labels as substitutes for Trident's printhead technology, (J. A. at 983), and it is undisputed that two competitors offer competing printheads.

However, "the mere presence of competing substitutes for the tying product . . . is insufficient to destroy the legal, and indeed the economic, distinctiveness of the [patented] product." *Digidyne, 734 F.2d at 1345* (quoting *Loew's, 371 U.S. at 49*). Rather, the definition of a market requires careful consideration of both the product and geographic markets. *Bhan v. NME Hosp., Inc., 929 F.2d 1404, 1413 (9th Cir. 1991).* The presumption can only be rebutted by expert testimony or other credible economic evidence of the cross-elasticity of demand, the area of effective competition, or other evidence of lack of market power. On the present record there is not sufficient evidence to rebut the presumption of market power resulting from the patent itself, or to create a genuine issue of material fact on the issue.

Accordingly, we reverse the district court's grant of summary judgment on the *Sherman Act section 1* claim. Because plaintiff's summary judgment motion appeared to rest entirely on a theory that the presumption of market power is irrebuttable, we remand to the district court to permit defendants an opportunity to supplement the summary judgment record with evidence that may rebut the presumption. Should the defendants on remand fail to present sufficient relevant evidence to create a genuine issue of material fact as to whether the presumption has been rebutted, partial summary judgment on liability under *section 1 of the Sherman Act* should be granted.

* * *

"High Court to Re-Evaluate Precedent Affecting Antitrust Law"

The Recorder
June 21, 2005
Tony Mauro

The U.S. Supreme Court on Monday agreed to consider overturning a 43-year-old precedent that has been interpreted to make it easy for competitors to sue patent holders for antitrust violations.

In agreeing to hear the case of ***Illinois Tool Works v. Independent Ink*** in the fall, the court was responding to pleas by major patent holders as well as the American Intellectual Property Law Association and the American Bar Association on behalf of its 9,000 antitrust lawyer members and its 19,000 intellectual property members.

The Bush administration has not weighed in yet, but in a recent speech, Assistant Attorney General for Antitrust R. Hewitt Pate said the case provided a "good opportunity" to resolve an important antitrust issue. Andrew Pincus of Mayer, Brown, Rowe & Maw, lawyer for Illinois Tool, informed the court of Pate's June 3 speech.

"This is an important case at the intersection of patent and antitrust law," Pincus said on Monday. "It is increasingly significant as our economy is driven more and more by intellectual property."

Under the 1962 ruling *United States v. Loew's Inc.*, the fact that a defendant holds a patent on a product creates a presumption that it exerts enough power over the marketplace to be guilty of illegal "tying" under the Sherman Act.

Illegal tying occurs when a company requires customers who want one of its products to buy another one. The presumption makes it easier to make tying claims and get them to trial when the target of the claim is a patent holder.

In the case before the court, Illinois Tool Works is accused of requiring customers to buy its ink when they buy its patented "printheads," which are used to apply bar codes onto packaging. Independent Ink, which markets compatible inks, made a Sherman Act tying claim against Illinois Tool, invoking the *Loew's* precedent. A judge in the U.S. District Court for the Central District of California sided with Illinois Tool, but the Federal Circuit U.S. Court of Appeals reversed.

In the circuit ruling, Judge Timothy Dyk said that even if the *Loew's* decision rested on "wobbly, moth-eaten foundations" that have been overtaken by market realities, his court is still bound by the Supreme Court precedent that created the presumption. Dyk added that it is up to the Supreme Court, not lower courts, to overturn one of its precedents, and up to Congress to change the law if it wants to.

In his brief for the American Intellectual Property Law Association, Patrick . . . says the Federal Circuit ruling conflicts with decisions by the Sixth and Seventh Circuits, a conflict that reflects growing disagreement over the basis of the presumption.

"The mere issuance of a patent does not convey market power in a relevant market, except in very rare cases," Coyne wrote.

"Asserting Old Standard in Patent-Tying Case"

National Law Journal
February 28, 2005
Pamela A. MacLean

After a decade of reluctant flirting between the antitrust and patent bars, the U.S. Court of Appeals for the Federal Circuit acted as matchmaker recently to the arranged marriage of lawyers in both specialties.

And the progeny may be something only a plaintiffs' lawyer would love.

The Federal Circuit put a stop to the slow drift of legal commentators and a smattering of federal courts away from the Supreme Court notion that patents confer market power in tying cases. The court forcefully reasserted a long-standing Supreme Court precedent that the burden of proof falls to the defendant patent holder to show lack of market power in an antitrust suit alleging illegal product tying of a patented product.

Traditional antitrust cases not involving intellectual property obligate the plaintiff to show that a defendant company possesses the market power to affect prices and limit the ability to compete. In this case, the Federal Circuit made clear that it is the defendant's duty to rebut a presumption of market power based on the ownership of a patent. Wrote Judge Timothy Dyk: "Once a plaintiff established a patent tying agreement, it was the defendant's burden to rebut the presumption of market power and consequent illegality that arose from patent tying," *Independent Ink Inc. v. Illinois Tool Works*, No. 04-1196.

The decision of Jan. 25 rebuffs a host of legal commentators and smattering of judges around the country who have suggested in recent years that the Supreme Court's 20-year-old precedents on market power are hopelessly out of date and have been all but abandoned.

That all changed with the ***Independent Ink*** decision.

"I expect that the presumption of market power has been the dirty linen of circuit folklore," said Herbert Hovenkamp, a professor at the University of Iowa College of Law. "Courts have bent over backwards to distinguish [the presumption] away.

"There have been very few cases in the last 10 years that based a presumption-of-market-power conclusion solely on the fact that a product was patented. I expect there will be more now. The Federal Circuit has breathed new life into this," said Hovenkamp, who has written extensively on the need for the Supreme Court to update its thinking on patent tying and market power.

"This is not a rational presumption," he added. "It grew out of a time when the Supreme Court was hostile to patents. The court assumed that if you had a patent you had a monopoly," he said.

The *Jefferson Parish* precedent

If the ruling is appealed, it could open the way for the Supreme Court to confront for the first time the meaning of a rebuttable presumption of market power in a patent-tying case and to potentially re-examine its 1984 decision on market power. *Jefferson*

Parish v. Hyde, 466 U.S. 2 (1984).

In that case, Justice Sandra Day O'Connor stated in a footnote in a concurring opinion signed by three other justices that it is a "common misconception . . . that a patent or copyright . . . suffices to demonstrate market power."

Jefferson Parish and a subsequent decision by the court one year later with similar language has been the slender reed used for much of the commentary and some court rulings pushing away from the presumption that patent holders enjoy market power.

Among those who have suggested that the power of the patent is overrated has been Judge Richard A. Posner of the 7th Circuit. He wrote in a 2001 article, "Most patents confer too little monopoly power to be a proper object of antitrust concern. Some patents confer no monopoly power at all."

Hovenkamp wrote last year, "Most patents confer absolutely no market power on their owners. . . . The economic case for presuming sufficient market power . . . simply because the tying product is patented . . . is very weak."

Not so fast, came the response in ***Independent Ink.***

"The time may have come to abandon the doctrine, but it is up to the Congress or the Supreme Court to make this judgment," Dyk wrote.

Patents and antitrust law make for a legal odd couple. Antitrust law is intended to protect and foster competition, while patents create a temporary monopoly for the owner.

Patent specialist Dennis Crouch of McDonnell Boehnen Hulbert & Berghoff in Chicago said the majority of patent cases now also involve an antitrust claim. "When someone is sued for infringement, the defendant shoots back a counterclaim that the plaintiff improperly used the patent and violated antitrust law."

This has prompted closer ties between antitrust and patent practitioners, both inside companies and in private practice, Crouch said.

In this case, Illinois Tool Works Inc. and its subsidiary, Trident Inc., license a patented device that prints bar codes on corrugated boxes. Illinois Tool required users of its patented printhead to use it in combination with the company's ink and ink supply systems.

Independent Ink sought a declaratory judgment in 1998 that it did not infringe the Illinois Tool patents. That was followed by Trident's filing of a patent infringement suit. Independent Ink responded with a claim that Trident orchestrated an illegal tying arrangement, restraining trade, in violation of § 1 of the Sherman Antitrust Act.

Companies create tying arrangements when a seller ties the purchase of one product with the obligation to buy a second product; in this case the purchase of a patented printhead was tied to buying ink made by the same firm.

U.S. District Judge Nora Manella of Los Angeles dismissed Independent Ink's claims in a summary judgment in 2002. The Federal Circuit overturned her decision and reinstated Independent Ink's § 1 Sherman Antitrust Act claim over tying the purchase of printheads and ink. The panel gave instructions to allow Illinois Tool to rebut the market power presumption, if it could.

Precedent was never revoked

Edward O'Connor, attorney for Independent Ink, insisted that the Federal Circuit simply reaffirmed a doctrine that is well established. "The commentators are saying the doctrine is dead or doesn't exist and have extrapolated from the Patent Misuse Reform Act. But the precedent was never revoked by the Supreme Court."

Patent and copyright holders can be justifiably nervous because the potential costs can be enormous. Violations of antitrust law carry treble damages.

O'Connor pointed out that his case involves gross sales of the tied product, the ink, for 10 years. "When you start adding it up you're talking about hundreds of millions of dollars," he said.

"[The defendants] will probably try to take it to the Supreme Court, but if the court reversed, it would have to reverse three Supreme Court decisions," said O'Connor of O'Connor, Christensen & McLaughlin in Irvine, Calif.

Illinois Tool's attorney, Jordan Sigale, a partner in the Chicago office of Sonnenschein Nath & Rosenthal, declined to comment on a potential Supreme Court appeal.

He did say, "Nobody believes, long term, this is a viable rule. The trend since the 1970s has been to whittle back on per se rules." He said the Department of Justice and many people felt that the "Supreme Court had moved away" from its 1984 *Jefferson Parish* opinion.

"One way or another this is a short-term blip, a glitch," Sigale said. "In the short term, businesses will be wary but in the long term it will be corrected."

The ***Independent Ink*** decision set off red lights in the intellectual property bar.

Edward Filardi, who heads the antitrust committee of the American Bar Association's Section of Intellectual Property Law, said, "We are in the midst of looking at this. My view is we will end up supporting reversal of the [market power] presumption.

"It places too much burden on patent holders," said Filardi of Skadden, Arps, Slate, Meagher & Flom in New York.

"I think the policy and the writing of many third parties and nonjudicial types has created a dynamic where people think the practices are OK," said Alexander Hadjis, a patent specialist in the Washington office of New York-based Weil, Gotshal & Manges. "There has been less focus on precedent than the rationale by the parties."

"No matter how you look at this case, the Federal Circuit got it right. They had to do what they did," he said.

Whether the Supreme Court would even consider the case brought bets from both sides.

Hal S. Shaftel of Proskauer Rose in New York, an antitrust litigator who handles patent issues, said the appellate court "is speaking at the intersection of several cutting-edge issues on the role of patents in antitrust and the standards we are going to assess in tying practices."

Shaftel said that not long ago the Supreme Court opted to defer a question of how tying practices may violate antitrust law. The issue of rebuttable presumption may attract the court, he said.

"But I think the likelihood is the court will allow, at the district court level, further percolation of these issues. They may see how courts start to scrutinize how a patent holder can rebut the presumption and how exacting a test is applied," Shaftel said.

Randal Picker, a University of Chicago Law School professor, said, "What you're seeing is an increasingly strong intersection of patent and antitrust." A number of years ago, the antitrust bar became very concerned about the Federal Circuit. "The Federal Circuit was patent friendly and antitrust unfriendly, and that gave you a broad shield from antitrust actions," he said.

He suggested that the Supreme Court probably should take the opportunity to review the case and see if its precedent is outdated.

Deborah A. Coleman, a litigation partner with Hahn Loeser + Parks in Cleveland who has written about antitrust and infringement said, "The Federal Circuit has provided an important service to those like me who are trying to counsel IP rights owners in regard to restrictive terms in licensing contracts, since the inconsistency between the Federal Circuit decision and decisions of regional circuits may compel the Supreme Court to finally weigh in to provide clarity."

Shaftel said that on a day-to-day basis practitioners will deal with the ruling by developing the proof to rebut the assumption of market power. "That's where the reactions to the decision are going to become apparent," he said.

"What Antitrust Law May Tell Us about Abortion"

SCOTUSblog
July 3, 2005
Tom Goldstein

In previous posts, we identified as the "most important" cases of the Term several that present hot-button social issues such as abortion. In light of Justice O'Connor's retirement, the most overlooked case of the term is a little-noticed antitrust case, ***Illinois Tool Works v. Independent Ink***. The case presents a somewhat esoteric issue—whether the tying of the sale of a patented product to a non-patented product gives rise to a presumption that the seller has market power.

Despite the narrowness of the issue involved, ***Illinois Tool Works*** may prove quite noteworthy because the answer to that question is already very well settled. In *International Salt Company v. United States* (1947) and *United States v. Loew's* (1962) the Supreme Court held that the answer is "yes," courts should presume market power when a patented product is tied with a non-patented product.

The *actual* question presented by ***Illinois Tool Works*** is thus whether the Supreme Court should overrule *International Salt* and *Loew's*. The case will accordingly provide the Court with its most direct explicit opportunity in the near term to address the circumstances in which one of its prior precedents should be overruled or instead adhered to as a matter of *stare decisis*.

To be sure, ***Illinois Tool Works*** is a statutory case, and the standards for *stare decisis* in the statutory context traditionally differ from those in constitutional cases. The Supreme Court traditionally has been more willing to overrule constitutional precedents, which in contrast to statutory decisions cannot be formally overruled by Congress.

Nonetheless, ***Illinois Tool Works*** remains very significant. As Marty Lederman's earlier post discussed, many significant statutory precedents are potentially open to overruling in light of Justice O'Connor's retirement. For example, federal civil rights and habeas corpus standards are almost all creatures of statute rather than the Constitution. Moreover, the gap between the Court's standards for overruling statutory and constitutional precedents is not as great as is sometimes thought, for the basic principle that the law should retain its continuity applies equally in both contexts. It was on that basis, for example, that the Court in *Planned Parenthood v. Casey* voted to sustain *Roe v. Wade* and that the Court in the *Dickerson* case voted to sustain *Miranda*.

So, the Court's willingness to overrule its prior precedents in ***Illinois Tool Works*** could serve as a bellwether for its openness to revisiting a broad swath of law decided over the past decade by narrow majorities that included Justice O'Connor.

Volvo Trucks North America v. Reeder-Simco GMC

(04-905)

Case Below: *Reeder-Simco GMC, Inc., v. Volvo GM Heavy Truck Corp.,* 374 F.3d 701 (8th Cir. 2004), *cert. granted* 125 S.Ct. 1596, 161 L.Ed.2d 276, 73 U.S.L.W. 3529 (U.S. March 7, 2005) (No. 04-905).

Reeder-Simco GMC, a dealer in large trucks, sued Volvo under the Robinson-Patman Act (RPA), claiming that Volvo had engaged in price discrimination by providing larger price concessions to Reeder's competitors. Dealers request price concessions from manufacturers when bidding on sales to third parties. The difference between concessions to separate dealers will affect the final price of the trucks. The Eighth Circuit affirmed the United States District Court for the Western District of Arkansas in ruling for Reeder. Volvo appeals, arguing primarily that Reeder is not a "purchaser" for purposes of the RPA.

Question Presented: The Robinson-Patman Act prohibits specified forms of price discrimination "between different purchasers" where the effect of "such discrimination" may be harm to competition "with any person who knowingly receives the benefit of such discrimination." The question presented is: Whether an unaccepted offer that does not lead to a purchase—so that there is not "discriminat[ion] between different purchasers" as the statutory language contemplates—may be the basis for liability under the Act.

Reeder-Simco GMC, Inc., Appellee,

v.

Volvo GM Heavy Truck Corporation, now known as Volvo Trucks North America, Inc., Appellant.

United States Court of Appeals
for the Eighth Circuit

Decided July 12, 2004

[Excerpt: Some footnotes and citations omitted]

OPINION: BYE, Circuit Judge.

Volvo Trucks North America, Inc. (Volvo) appeals from a judgment entered in the district court in favor of Reeder-Simco GMC, Inc. (Reeder) on claims alleging unfair price discrimination under the Robinson-Patman Act (RPA), *15 U.S.C. § 13*, and a failure to deal in good faith and in a commercially reasonable manner under the Arkansas Franchise Practices Act (AFPA), *Ark. Code Ann. § § 4-72-201 through 4-72-209.* We affirm.

I

This is an appeal from the denial of a motion for judgment as a matter of law (JAML) following a jury verdict; consequently we recite the evidence in the light most favorable to the verdict holder, Reeder. See *Jones v. Swanson, 341 F.3d 723, 731 (8th Cir. 2003).*

Reeder sells new and used trucks, including heavy-duty trucks, out of a dealership located in Fort Smith, Arkansas. Volvo manufactures a broad line of heavy-duty trucks for both over-the-road and vocational use (dump trucks, mixer trucks, etc.). In 1995, Reeder signed a franchise agreement with Volvo to become an authorized Volvo truck dealer for a five-year term expiring March 31, 2000. The agreement provided for automatic one-year extensions of the franchise if Reeder met certain sales objectives established unilaterally by Volvo.

The majority of heavy-duty trucks sold by dealers are manufactured only after a retail customer has solicited and accepted bids from several dealers. During this competitive bidding process, dealers seek concessions from Volvo for a price below the initial wholesale price (80% of the published retail price) which then allows the dealers to offer lower prices to their customers. This is an industry-wide practice. To remain competitive with other truck manufacturers, Volvo does not reveal its method of calculating concessions. The crux of this case is Reeder's claim that Volvo gave other dealers more favorable price concessions than Volvo granted Reeder, which concomitantly reduced Reeder's profits on successful bids and increased the number of Reeder's unsuccessful bids.

Reeder filed this action in February 2000 alleging Volvo violated the RPA and AFPA and tortiously interfered with Reeder's contracts. . . .

Reeder presented the following evidence at trial. In December 1997, Volvo announced the "Volvo Vision" in an email distributed to its dealers, including Reeder. The email had a list of Volvo's challenges, which included "too many dealers" and "under performing dealers." App. 576. The Volvo Vision called for "fewer dealers, larger markets." Id. The email further indicated Volvo wanted to more than double the average market size of its dealers and decrease the number of dealer owners from 146 to 75.

In March 1998, Volvo held its annual North American Dealer Conference in Marco Island, Florida. Marc Gustavson, a Volvo executive, was the conference's keynote speaker. He elaborated on the Volvo Vision by indicating 50% of current Volvo truck dealers would not be in business in the next few years. Unlike Volvo's past annual dealer conferences, where Volvo featured motivational speakers who got dealers "revved up" to sell more trucks, id. at 1119, the featured guest speaker of the 1998 conference was Jon Krakauer, author of *Into Thin Air: A Personal Account of the Mt. Everest Disaster.* Krakauer spoke of falling short of his goal to reach the summit of Mt. Everest and told the dealers sometimes they had to learn to give up without achieving their goals.

Prior to and during this same time frame (1996-1998), Reeder noticed an increase in the sales objectives Volvo expected of it, coupled with a decrease in the pricing concessions it obtained from Volvo. After learning of the Volvo Vision and its stated goal of reducing the number of authorized Volvo dealers, as well as mistakenly receiving faxes from Volvo intended for other dealers which listed larger concessions than Reeder was getting, Reeder came to suspect it was one of the dealers Volvo sought to eliminate.

A. Head-to-Head Competition with Another Dealer for the Same Customer.

Reeder presented evidence that in the summer of 1999, it bid on the sale of twelve trucks to Hiland Dairy Company located in Springfield, Missouri. Reeder requested a 12% concession, but Volvo authorized only 7.5%. Another Volvo authorized dealer, Southwest Missouri Truck Center in Springfield, successfully obtained the Hiland Dairy contract when Volvo granted it an 8.5% concession. As a result of the difference in price concessions, Southwest could offer the Missouri customer a price of $ 62,890 per truck, while Reeder's price per truck was $ 63,632.69. Had Reeder obtained the account, it would have realized a gross profit of $ 30,000 on the sale.

B. Contemporaneous Sales of Like Grade and Quality Trucks in Which Favored Volvo Dealers Received Greater Price Concessions than Reeder.

In March 1998, Reeder successfully bid on the sale of thirty trucks to Lane Freight located in Tulsa, Oklahoma, involving a mixture of over-the-road day-cab and sleeper-cab trucks. Reeder initially requested a 12.51% concession on this sale. When Volvo denied the request, Reeder asked for a 10% concession on the day-cab trucks and 8.4% on the sleepers. Volvo ultimately granted a 9% concession on both truck types. Two months earlier, Volvo had granted a dealer located in Tyler, Texas, a 12.3% concession on the sale of twelve trucks of like grade and quality to Brookshire Grocery located in Tyler. As a result of the difference in concessions, the price Reeder's customer paid for each truck was $ 2,606 higher than the price the Texas dealer provided to its customer. Had Volvo offered Reeder the 12.3% concession the Texas dealer received, Reeder would have realized $ 52,120 in additional profits. [The court noted other examples.]

* * *

C. Unsuccessful Sales Following Volvo's Refusal to Grant Requested Price Concessions.

In a third category of evidence Reeder presented to prove price discrimination, Reeder recounted numerous situations in which it unsuccessfully requested particular concessions from Volvo to close sales, while during the same time frame Volvo granted higher concessions to other Volvo dealers who were able to close sales. For example, in . . . May 1998, Reeder sought a price concession of 21% on a sale of five trucks. Volvo approved only 2%. Reeder did not get its contract. During the same time, Volvo gave another dealer a 10.6% concession on a sale of three trucks of like grade and quality. The other dealer got its contract.

The jury returned a verdict in favor of Reeder on both claims and awarded damages of $ 1,358,000 on the RPA claim and $ 513,750 on the AFPA claim. The trial court trebled the RPA damages pursuant to *15 U.S.C. § 15a* and awarded Reeder attorney fees. Volvo brought a motion for JAML following trial. The district court denied the motion, and Volvo filed a timely appeal with this court.

II

"We review the denial of a motion for JAML de novo." *Naucke v. City of Park Hills, 284 F.3d 923, 929 (8th Cir. 2002).* Although our review is de novo, a party seeking posttrial JAML based on the sufficiency of the evidence "faces an onerous burden [because we must] view the evidence in a light most favorable to the jury's verdict [and reverse only] when there is a complete absence of probative facts to support the conclusion reached." *Inacom Corp. v. Sears, Roebuck & Co., 254 F.3d 683, 689 (8th Cir. 2001).*

A. The RPA Claim

The RPA provides, in pertinent part:

> It shall be unlawful for any person engaged in commerce . . . to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, . . . and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.

15 U.S.C. § 13(a).

There are three types of violations under the RPA. Primary-line violations occur when a seller's price discrimination adversely impacts competition with its own competitors. Secondary-line violations occur when a seller's price discrimination injures competition among its customers. Tertiary-line violations occur when a discriminating seller's purchasers do not compete directly, but their customers compete within a unified market region. *Godfrey v. Pulitzer Publ'g Co., 161 F.3d 1137, 1140 (8th Cir. 1998)* (Godfrey I). In the instant case, Reeder avers a secondary line violation, claiming Volvo's price discrimination injured competition among Volvo's customers, i.e., Reeder and other Volvo dealers.

To prove its claim, Reeder had to show 1) Volvo discriminated in price between Reeder and the favored dealers, 2) this price discrimination substantially affected competition between Reeder and the favored dealers, 3) the truck sales occurred in interstate commerce, and 4) the trucks sold by Reeder and the other dealers were of like grade and quality. *Godfrey v. Pulitzer Publ'g, Inc., 276 F.3d 405, 408 (8th Cir. 2002)* (Godfrey II). In addition, because the RPA prohibits price discrimination "between different purchasers," *15 U.S.C. § 13(a)*, Reeder had to show there were actual sales at two different prices to two different Volvo dealers, i.e., a sale to itself and a sale to another Volvo dealer. *Fusco v. Xerox Corp., 676 F.2d 332, 335 (8th Cir. 1982).* In other words, as a threshold matter Reeder had to show it was a "purchaser" within the meaning of the RPA. *Id. at 334.*

1. Two-Purchase Requirement

Volvo contends competitive bidding situations do not implicate the RPA because an unsuccessful bidder is not a purchaser. Volvo emphasizes that much of Reeder's proof involved situations where Reeder did not purchase trucks from Volvo. . . .

We agree an unsuccessful bidder is not a purchaser within the meaning of the RPA. In Fusco, we said a purchaser is one who actually makes a purchase, not "one who [merely] seeks to purchase, a person who goes into the market-place for the purpose of purchasing." *676 F.2d at 335* (quoting *Shaw's, Inc. v. Wilson-Jones Co., 105 F.2d 331, 333 (3d Cir. 1939)).* "Thus, a sale at one price plus either an offer to sell at a higher price or a refusal to sell at any price is generally thought not to violate the

[RPA]." *Id.* (citing *M.C. Mfg. Co. v. Texas Foundries, Inc., 517 F.2d 1059, 1065 n.11 (5th Cir. 1975)).* When Reeder unsuccessfully bid on contracts because Volvo's price concessions were not favorable enough to obtain the contracts, Reeder did not actually purchase trucks from Volvo. Thus, Reeder was not a purchaser in those instances, but merely went into the market-place for the purpose of purchasing. Volvo may have offered to sell trucks to Reeder at a higher price than it offered to other dealers, but mere offers to sell do not violate the RPA.

This conclusion is consistent with the conclusion of many courts that hold price discrimination in the competitive bidding process does not violate the RPA because only one of the two competitors actually makes a purchase.

In this case, however, Volvo concedes Reeder was more than an unsuccessful bidder. Reeder gave four examples where it actually purchased Volvo trucks following successful bids on contracts. Reeder compared those successful sales to actual sales made by other dealers during the same time period (Reeder purchased fifty-five trucks and compared those purchases to other dealers' purchases of twenty-two trucks). Although Volvo challenges the sufficiency of these actual purchase-to-purchase comparisons on other grounds (addressed below), these successful bids clearly gave Reeder "purchaser" status. As a result, it follows Reeder was entitled to pursue a claim for price discrimination under the RPA.

2. Actual Competition

Volvo argues Reeder failed to show it was in actual competition with the favored dealers. The standard for showing actual competition is whether, "as of the time the price differential was imposed, the favored and disfavored purchasers competed at the same functional level, i.e., all wholesalers or all retailers, and within the same geographic market." *Best Brands Beverage, Inc. v. Falstaff Brewing Corp., 842 F.2d 578, 585 (2d Cir. 1987).* Here there is no dispute the dealers all competed at the same functional level, but Volvo contends Reeder did not compete within the same geographic market as the favored dealers. We disagree.

Although Reeder had an assigned geographic area (ten counties in western Arkansas and two counties in eastern Oklahoma), it was free to sell outside that area, and did so. Reeder introduced evidence that it looked to the entire continental United States in making its sales, and had sold or delivered trucks in Arkansas, Oklahoma, Missouri, Texas, Iowa, Illinois, Minnesota, Ohio, Pennsylvania, North Carolina, Georgia, Colorado, and Oregon. Reeder also established that end-buyers of the trucks are very mobile and price-shop nationwide.

Reeder's evidence focused upon sales and bids made in the southwest region of the United States. Reeder presented evidence of sales or bids it made in three states in the southwest region (Arkansas, Missouri, and Oklahoma) and compared the sales or bids to those made by other dealers in four states in the southwest region (Arkansas, Missouri, Texas, and Tennessee). Reeder presented at least two instances where it competed directly with a favored dealer—the head-to-head competition with Southwest Missouri Truck Center in Springfield, Missouri, for a twelve-truck deal to Hiland Dairy, and a concession request from Reeder for a five-truck deal to Tommy Davidson which also involved a bid made by a Volvo dealer in Springdale, Arkansas. . . . From this evidence a jury could reasonably decide Reeder was in actual competition with favored dealers.

3. Like Grade and Quality; Reasonably Contemporaneous in Time

To establish an RPA violation, Reeder had to show the comparative sales involved trucks of like grade and quality. *Id. at 408.* Products are not of like grade and quality "if there are substantial physical differences in products affecting consumer use, preference or marketability." *Checker Motors Corp. v. Chrysler Corp., 283 F. Supp. 876, 889 (S.D. N.Y. 1968)*, aff'd, *405 F.2d 319 (2d Cir. 1969).* Volvo argues the sales-to-sales comparisons made by Reeder involved trucks with different major components that affected consumer preference and marketability. In support of its position Volvo points to trial testimony which showed differences in truck components influence consumers' decisions to buy—particularly engine types and gear ratios.

Reeder offered testimony, however, showing that any differences in components were inconsequential—in all cases the trucks were the same model and same year, with comparable engines and largely similar components. Also, Reeder provided evidence that the differences in components were taken into account in the calculation of the price quotes and concessions, so the jury could reasonably conclude that when the comparisons involved trucks with somewhat different components, the differences did not substantially affect the concessions Volvo offered.

We note the RPA says the commodities involved must be of *like* grade and quality, not *identical* grade and quality. We have previously indicated the concept "was designed to serve as one of the necessary *rough guides* for separating out those commercial transactions insufficiently comparable for price regulation by the statute." *Moog Indus. v. Fed.Trade Comm'n, 238 F.2d 43, 50 (8th Cir. 1956)*[.] Here, the jury was instructed on the concept of like grade and quality, and Volvo does not argue the district court erred in its instructions. The jury found by special interrogatory the comparisons involved trucks of like grade and quality. We acknowledge there was conflicting evidence on the substantiality of the differences in components, but there was ample evidence supporting the jury's determination the differences were immaterial. . . .

Reeder also had to show the comparative sales were reasonably contemporaneous in time, but "there is no requirement that the two sales be made at precisely the same time or place." *DeLong Equip., 990 F.2d at 1202 (11th Cir. 1993).* The four sales-to-sales comparisons offered by Reeder were between one and four months apart, with one exception . . . Volvo argues the sales were not contemporaneous because as little as a single-month gap could make a substantial difference in the price concession it offered due to changes in model-year availability or backlog or both. . . . Volvo never presented evidence, however, to show the gaps between the sales comparisons involved in this case *did* make a difference in the price concessions it offered. Again, the jury was instructed on the issue whether the comparative sales occurred at about the same time, found by special interrogatory that they did, and Volvo does not challenge the district court's instructions. Under the standard we must apply in reviewing a motion for JAML, we find no basis for disturbing the jury's verdict.

4. Injury/Damages

a. Competitive Injury

The RPA prohibits price discrimination "where the effect of such discrimination may be substantially to lessen competition . . . or to injure, destroy, or prevent competition." *15 U.S.C. § 13(a)*. The RPA "guards against injury to competition, not injury to individual competitors." *Rose Confections, Inc. v. Ambrosia Chocolate Co., 816 F.2d 381, 387 n.3 (8th Cir. 1987).* The RPA does not, however, "require that the discriminations must in fact have harmed competition, but only that there is a reasonable possibility that they 'may' have such an effect." *Corn Prods. Ref. Co. v. Fed. Trade Comm'n, 324 U.S. 726, 742, 89 L. Ed. 1320, 65 S. Ct. 961, 40 F.T.C. 892 (1945).*

A plaintiff may demonstrate a reasonable possibility of competitive injury in two ways. "First, plaintiff may introduce direct evidence that disfavored competitors lost sales or profits as a result of the discrimination." *Rose Confections, 816 F.2d at 385* (citing *Falls City Indus., Inc. v. Vanco Beverage, Inc., 460 U.S. 428, 437-38, 75 L. Ed. 2d 174, 103 S. Ct. 1282 (1983)).* In other words, while the RPA does not guard against injury to individual competitors, proving injury to individual competitors is one way to demonstrate a discriminatory practice likely injured competition. "Second, [a plaintiff] can show that the favored competitor received a substantial price reduction over a substantial period of time, which gives rise to a permissible inference of competitive injury." *Id.* (citing *Fed. Trade Comm'n v. Morton Salt Co., 334 U.S. 37, 50-51, 92 L. Ed. 1196, 68 S. Ct. 822, 44 F.T.C. 1499(1948)).* Volvo argues Reeder failed to demonstrate a reasonable possibility of competitive injury because Reeder did not prove the lower concessions Volvo granted to other dealers drew sales away from Reeder. We disagree.

The evidence presented by Reeder was sufficient for the jury to conclude Volvo's discriminatory concessions resulted in lost profits and sales to Reeder and other dealers, and that favored competitors received substantial price reductions over a substantial period of time. As stated above, Volvo acknowledged in December 1997 that it wanted to cut the number of its dealers in half as part of its "Volvo Vision." At trial, Volvo acknowledged it had, in fact, succeeded in reducing the numbers of its dealers. . . . From this evidence, the jury could properly infer Volvo's intent to reduce the number of its dealers manifested itself in the discriminatory concession practices.

Reeder also presented evidence that it lost profits and sales as a result of Volvo's price concession practices. . . .

Reeder showed its sales of Volvo trucks had been solid prior to the period of Volvo's price discrimination (1996-2000). During the period of discrimination, Reeder's sales decreased substantially and its profit margins were lower despite increased sales efforts. In all, Reeder's gross profits fell from \$ 165,499 in 1996 to \$ 26,327 in 2000. At the same time, favored dealers' sales and overall market sales stayed strong. Based on this evidence, the jury could reasonably conclude Reeder's average gross profit was lower than the average of favored Volvo dealers because Volvo discriminated against Reeder in its price concessions.

Reeder also presented evidence that Volvo's practice extended over a substantial period of time (1996-2000). In addition, the evidence established that dealer profit margins were narrow during that time. Thus, the jury could reasonably conclude even small differences in price concessions had a substantial impact on competition.

b. Actual Injury

Although Reeder only needed to prove competitive injury *may* result to establish a violation of *15 U.S.C. § 13(a)*, it had to make some showing of actual injury to itself to recover treble damages under *15 U.S.C. § 15(a)*. Volvo argues Reeder did not show actual injury because Reeder offered too few examples of Volvo's discriminatory practices, there was no evidence the favored dealers sold the trucks to end-users at lower retail prices, and no evidence the end users selected the favored dealers' bids because of the lower prices. We believe Volvo construes too narrowly the requirements for proving actual injury.

In addressing whether Reeder proved it was actually injured by Volvo's price discrimination, Volvo would have us limit our analysis to the one instance of direct head-to-head competition with Southwest Missouri Truck Center for the Hiland Dairy contract and the four sales-to-sales comparisons Reeder offered to prove its purchaser status, while disregarding all the other evidence offered to prove actual injury. We believe such an approach is inconsistent with the Supreme Court's teachings, both with respect to the role circumstantial evidence plays in RPA claims and the scope of injury to be remedied by the RPA.

Reeder presented other substantial evidence to prove competitive and actual injury. Reeder presented numerous instances of its unsuccessful sales due to Volvo's failure to grant requested price concessions, and evidence of Volvo's admitted intentions to reduce the number of its dealers. Indeed, Reeder showed Volvo successfully reduced the number of its dealers and placed many more on probation during a "record" sales period. Reeder presented evidence that its own sales and profits were substantially reduced during this boom in the heavy truck industry, despite an increase in its own sales efforts. From this evidence the jury could reasonably infer Volvo's discriminatory practice and Reeder's injuries extended beyond the five specific head-to-head and sales-to-sales comparisons.

* * *

[T]here was sufficient evidence from which the jury could infer favored dealers received lower prices from Volvo than did Reeder, and this price advantage allowed other dealers to undercut Reeder's prices, hurting Reeder's sales and profits. There was also evidence Volvo was aware this discriminatory practice could destroy Reeder's business; indeed, the elimination of some dealers like Reeder appeared to be Volvo's intent. This is precisely the type of injury the antitrust laws were meant to prevent. See *Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 125, 23 L. Ed. 2d 129, 89 S. Ct. 1562 (1969)* (permitting causality to be inferred from circumstantial evidence where the injury involved was "precisely the type of loss that the claimed violations of the antitrust laws would be likely to cause."). Moreover, Reeder was not required to prove Volvo's price discrimination was the only reason for its injuries, or the only reason for heavy truck customers' purchasing decisions—it was enough that Reeder showed the price discrimination was a "material" cause of its injuries. *Id. at 114 n.9*

* * *

III

We affirm the judgment entered in the district court in all respects.

DISSENT: HANSEN, Circuit Judge, concurring in part and dissenting in part.

Although I do not disagree with the court's resolution of the state law issue, I write separately to express my view that Reeder has failed to make out a claim under the *Robinson-Patman Act.* Even viewing all of the evidence in the light most favorable to the verdict, I conclude that Reeder cannot prove the necessary elements to recover treble damages in this case. Specifically, Reeder has not proven a violation of *§ 13(a)* because the facts fail to show injury or likelihood of injury to actual competition between Reeder and the "favored" Volvo dealers. Furthermore, even if we assume that Volvo violated *§ 13(a)*, there is absolutely no indication that any such violation was the cause of Reeder's injury, for the purpose of recovering damages under *§ 15(a).* I therefore respectfully dissent from Section II(A) of the court's opinion.

There is little doubt that the facts of this case fail to fit neatly into the framework that courts have established in analyzing Robinson-Patman Act secondary-line claims. Much of my disagreement in this case stems from what I perceive as the court's attempt to fit a square peg into a round hole. Traditional RPA cases involve sellers and purchasers that carry inventory or deal in fungible goods. By contrast, the parties in this case operate in a unique marketplace where special order products are sold to individual, pre-identified customers only after competitive bidding. By its very nature, this process will never produce the kind of competition the RPA was designed to protect because it will never result in the type of two purchase transaction that itself creates a market for the goods that are sold. Indeed, where, at the time of the end purchase, only one possible seller and one possible buyer exist, competition is totally absent. It is the nature of competitive bidding, not price discrimination, that makes it so.

The court properly recognizes that a competitive bidding situation will never involve two "purchasers," and thus always will fall outside of the purview of the RPA. Despite this determination, however, the court goes on to conclude that Reeder's purchases with respect to four transactions give it "purchaser status" as to separate instances in which it did not make a purchase, and therefore was not in fact a purchaser. I disagree with this proposition. Reeder cannot piggyback nonpurchaser transactions onto purchaser transactions for purposes of recovering under the RPA. My concern does not stem from a strict adherence to the two purchase requirement, but rather from my belief that "purchaser status" is inextricably intertwined with the existence of actual competition and the possible threat thereto. Because my primary objection to the court's opinion is that it overlooked this important aspect of actual competition, I turn next to that issue.

Despite the fact that Reeder operates at the same functional level as the "favored" Volvo dealers and that they may do business in the same or overlapping geographic areas, I nevertheless conclude that Reeder has failed to prove that it was in actual competition with the "favored" Volvo dealers. There certainly may exist a national market in which heavy-truck dealers compete to receive the opportunity to bid on potential sales to customers. The Volvo dealers in this case very well may have competed against each other in this market on a regular basis. However, any difference in price that Volvo eventually may quote to a dealer who actually bids on a potential sale has no effect on this market. The evidence shows that an end user's decision to request a bid from a particular dealer or to allow a particular dealer to bid is controlled by such factors as an existing relationship, geography, reputation, and cold calling or other marketing strategies initiated by individual dealers. Once bidding begins, however, the relevant market becomes limited to the needs and demands of a particular end user, with only a handful of dealers competing for the ultimate sale. Thus, although Reeder and other "favored" dealers may have competed generally with each other in the larger market for obtaining bids, there is evidence of only two occasions where Reeder competed with a "favored" Volvo dealer for an actual sale. . . .

* * *

It is my view that an injury to competition can be proven only where the factors necessary to state an RPA claim all are present in the same relevant transaction. To the extent that the court looks for the existence of one factor in one transaction and the existence of another factor in a second transaction, I conclude that the proof in this case is too tenuous and requires too many inferences piled atop inferences to reach the court's result.

Nevertheless, even if we assume that Volvo violated *§ 13(a) of the RPA*, I would reverse Reeder's RPA damage award because Reeder has failed to prove that it was actually injured by Volvo's price discrimination as required by *§ 15(a)*. See *J. Truett Payne, 451 U.S. at 562* ("To recover treble damages, then, a plaintiff must make some showing of actual injury attributable to something the antitrust laws were designed to prevent."). Although Reeder may have established that it lost sales and profits to other non-Volvo competitors, there can be no inference of actual injury for the purpose of the RPA without some evidence (and there is none in this record) that the discriminatory pricing caused those sales and profits to be diverted from Reeder to another Volvo dealer who received more favorable terms from Volvo.

* * *

Although it is possible that Reeder lost sales or profits to non-Volvo dealers because it did not receive a sufficiently high concession from Volvo in the first three scenarios, the difference in concessions offered to Reeder and the "favored" Volvo dealers did not cause the lost sales or profits on those deals. In order to prove that the *§ 13(a)* violation caused its injuries, Reeder essentially must show that absent a price difference, it would not have lost those sales or profits. However, even if Volvo had not offered the "favored" dealers greater concessions, i.e., not discriminated, there still is no proof that Reeder would have made the sales. Furthermore, as to the sales that Reeder did make, it would be improper to calculate lost profits based on what Reeder otherwise characterizes as illegal price discrimination.

The fact that the sales and profits were not diverted from Reeder to "favored" Volvo dealers demonstrates not only a lack of causation of actual injury under *§ 15(a)*, but also seriously undermines our court's conclusion that there is any likelihood of injury to competition between Reeder and the "favored" Volvo dealers. . . .

"High Court Takes Volvo Appeal on Discounts to Truck Dealers"

Transport Topics
March 14, 2005
Roger Gilroy

The Supreme Court said it would hear an appeal by Volvo Trucks North America of a federal appeals court decision that found the truck manufacturer had illegally offered one of its dealers smaller discounts than it offered other dealers.

Two lower courts had backed the contention of an Arkansas Volvo dealer, Reeder-Simco GMC Inc., which said price concessions it received from Volvo violated the federal Robinson-Patman Act, which regulates discounting practices in commercial transactions.

"Volvo is pleased the Supreme Court agreed to hear our case. This involves an issue that is important to us and we did not take this step lightly. We hope that the court will find our arguments compelling and will act to overturn the lower court's ruling," VTNA spokesman Jim McNamara told *Transport Topics* March 9.

Volvo's said the case is about whether it violated the law by offering different prices to two different dealers "when either those dealers are not competing with each other, or they are competing, but only one of the two actually makes a purchase," said Roy Englert Jr., VTNA's outside counsel with Robbins, Russell, Englert, Orseck & Untereiner LLP in Washington, D.C.

Joe Byars Jr., a lawyer with Christian & Byars in Fort Smith, Ark., representing Reecler-Simco, told *Transport Topics* the main question was whether the federal law would "prevent a manufacturer from discriminating in price between dealers in similar, reasonably contemporaneous transactions, where the effect may bc to injure competition."

The Supreme Court agreed March 7 to hear Volvo s appeal of the case sometime during the nine-month term that would begin in October, Bloomberg News reported.

Englert told *Transport Topics* the initial briefs both sides filed in February with the Supreme Court simply argued why the court "should or shouldn't hear the case."

Volvo attorney Englert argued the appeals court's interpretation of the law "cannot be reconciled with the text of the statute or prior interpretations of it by other courts of appeals." He said VTNA would file another brief outlining the merits of its position.

Byars argued for the dealer that the appeals court "did not create 'new law,' but applied the law, as announced in long-standing precedent, to the specific facts in this case."

David Price, an attorney with the Washington Legal Foundation, who filed arguments supporting VTNA, said the case came up now because the Supreme Court "typically waits until there is a conflict among the lower courts before it steps in to resolve an issue."

In July, the Court of Appeals for the Eighth District affirmed Reeder-Simco's claim of price discrimination.

The court said there was "sufficient evidence" that allowed a jury to "infer favored dealers received lower prices from

Volvo than did Reeder, and the price advantage allowed other dealers to undercut Reader's prices, hurting Reeder's sales and profits."

The court said Volvo was aware this discriminatory practice "could destroy Reeder's business; indeed, the elimination of some dealers like Reeder appeared to be Volvo's intent. This is precisely the type of injury the antitrust laws were meant to prevent."

A dissenting appeals court judge said, "The parties in this case operate in a unique marketplace where special-order products are sold to individual, pre-identified customers only after competitive bidding. By its very nature, this process will never produce the kind of competition the RPA was designed to protect."

Earlier, the U.S. District Court for the Western District of Arkansas awarded Reeder-Simco $1.4 million in damages plus attorney fees, which were tripled as required by law to about $4 million.

"U.S. Supreme Court Grants Certiorari in Significant Robinson-Patman Act Case"

Mondaq
May 12, 2005
William Hohengarten

The Supreme Court recently granted certiorari in a case under the Robinson-Patman Act that is of substantial interest to the business community. The Robinson-Patman Act makes it unlawful "to discriminate in price between different purchasers of goods of like grade and quality, . . . where the effect of such discrimination may be substantially to lessen competition, . . . or to injure, destroy, or prevent competition with any person who . . . knowingly receives the benefit of such discrimination." 15 U.S.C. § 15(a).

In ***Reeder-Simco GMC, Inc. v. Volvo GM Heavy Truck Corp.***, 374 F.3d 701 (8th Cir. 2004), a divided panel of the Eighth Circuit Court of Appeals upheld a multimillion dollar treble damages award, plus attorneys' fees, in a Robinson-Patman suit brought by the respondent heavy truck dealer, Reeder, against the petitioner manufacturer, Volvo. The damages award rested on the "industry-wide practice" whereby heavy truck manufacturers grant discretionary discounts to dealers that are bidding on orders from specific customers. Reeder showed that Volvo offered different discretionary discounts to different dealers on different potential retail sales. However, other federal courts of appeals have held that Robinson-Patman liability does not arise in this type of competitive bidding market. Those courts have reasoned that when a dealer who does not obtain the most favorable discount is unsuccessful in making a sale, there is no "purchase" by the dealer, as required for liability under the Act.

In departing from the rule adopted by other circuits and upholding liability under these circumstances, the decision of the Eighth Circuit potentially expands Robinson-Patman liability. The Eighth Circuit allowed Reeder to compare discounts on its purchases from Volvo for sales to specific retail customers with the deeper discounts obtained from Volvo by other dealers for sales to different customers, even though Volvo claimed there was no head-to-head competition between Reeder and the other dealers on those sales. In addition, the Eighth Circuit allowed Reeder to obtain damages for sales lost to dealers for other manufacturers, even though Reeder was not a "purchaser" on those sales.

The Supreme Court's decision in this case will likely have major significance for any industry in which manufacturers offer discretionary discounts to dealers bidding against other manufacturers' dealers for the business of specific retail customers—a practice that promotes interbrand competition. In addition, as this is the first Robinson-Patman case the Supreme Court has taken in more than a decade, the Court's reasoning on the liability and damages issues could have a substantial impact on all cases arising under the Act.

Briefs for petitioner Volvo and amici curiae supporting Volvo and urging reversal are due May 20. Briefs for respondent Reeder and amici supporting respondent will be due June 24. The case is No. 04-905, ***Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc.***

Lockhart v. United States

(04-881)

Ruling Below: (*Lockhart v. United States*, 376 F.3d 1027 (9th Cir. 2004), *cert. granted*, 125 S. Ct. 1928, 161 L. Ed. 2d 772, 73 U.S.L.W. 3630 (U.S. Apr. 25, 2005) (No. 04-881)).

James Lockhart is 67 years old and has roughly $80,000 in unpaid student loans. He defaulted on his loans in 1991 when he became unemployed due to disability. The federal government began withholding money from his Social Security disability benefit in 2002 in order to repay those loans. That amount increased when Lockhart began receiving an old-age benefit. Lockhart claims that the Government cannot reclaim the amount due on the loans because it has been more than ten years since the loans became outstanding. Two federal laws appear to be in conflict. One provides for aggressive collection of loans and removes the statute of limitations, while the other prohibits the offset of Social Security benefits to pay debts that are more than ten years old. The U.S. District Court for the Western District of Washington dismissed the case for lack of subject matter jurisdiction and failure to state a claim for relief. On appeal, the Ninth Circuit held that, despite the confusion, Congress intended to repeal the ten year limit on Social Security offsets, and therefore affirmed the judgment.

Question Presented: Do the Social Security Act and the Debt Collection Improvement Act bar the United States from withholding social security benefits to collect student loan debt that has been outstanding for more than ten years, as the Eighth Circuit has held, or does the Higher Education Act eliminate any such bar, as the Ninth Circuit held below?

NOTE: In a conflicting case, the Eighth Circuit held last year in *Lee v. Paige*, 376 F.3d 1179 (8th Cir. 2004), *cert. filed, 73 USLW 3531 (Feb 25, 2005)(NO. 04-1139)* that the statute of limitations still applies. That case follows on pages 373-374.

James LOCKHART, Plaintiff-Appellant
v.
UNITED STATES OF AMERICA, ET AL., Defendants

United States Court of Appeals
for the Ninth Circuit

Decided July 23, 2004

[Excerpt: Some citations and footnotes omitted.

OPINION: Noonan, Circuit Judge:

* * *

PROCEEDINGS

On March 20, 2002, Lockhart filed a complaint against the United States, the Attorney General and the Secretaries of Education and the Treasury alleging that he had received notice from the United States Department of Education that it intended to offset a portion of his monthly Social Security benefits to secure repayment of his government educational loans. Lockhart asserted that, because "more than 10 years have passed since [his] education loans became outstanding," the attempt to collect them by offset was "time barred under *31 U.S.C. § 3716(e)(1)*."

This claim was buried in a barrage of other contentions which the district court understandably found confusing and which Lockhart failed to clarify when ordered to show cause why his case should not be dismissed for failure to show a basis for jurisdiction and to state a claim for which relief could be granted. On June 4, 2002, the complaint was dismissed in its entirety, and judgment was entered for the defendants.

Lockhart appeals.

JURISDICTION and STANDARD OF REVIEW

We have jurisdiction over the final judgment of the district court pursuant to *28 U.S.C. § 1291*. We review de novo both a dismissal for want of subject matter jurisdiction and a dismissal for failure to state a claim.

ANALYSIS

Construction of Lockhart's Complaint. In compliance with precedent, we bend over backwards to pluck a viable claim from Lockhart's wide-ranging complaint. The contention that the government's offset is barred by statute is such a claim. By implication, the claim also alleges federal question jurisdiction.

The Statutes At Issue. Four statutes must be considered. The Debt Collection Act of 1982 provided for administrative offset as a way of collecting debts of the United States, at the same time stating:

> (e) This section does not apply—
>
> (1) to a claim under this subchapter that has been outstanding for more than 10 years; or
>
> (2) when a statute explicitly prohibits using administrative offset to collect the claim or type of claim involved.

Pub. L. No. 97-365, 96 Stat. 1754 (1982) (codified as amended in *31 U.S.C. § 3716(e)*).

Social Security benefits once appeared to fall squarely within the Act's exception. *§ 3716(e)(2)*. The Social Security Act, *42 U.S.C. § 407* was amended in 1983 to read:

> (a) The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this sub-chapter shall be subject to execution, levy, attachment, garnishment, or other legal

> process, or to the operation of any bankruptcy or insolvency law.
>
> (b) No other provision of law, enacted before, on, or after April 20, 1983, may be construed to limit, supersede, or otherwise modify the provisions of this section except to the extent that it does so by express reference to this section.

Id. Notably, this amendment did not mention offset by the government. Arguably, offset is included under "other legal process." Offset, however, is a form of self-help that may not fall within the term. Congress, having so recently amended the Debt Collection Act to provide for administrative offset, may not have intended to deny this remedy to the government. To decide this case we need not resolve the question.

In 1991, the *Higher Education Assistance Act* was amended to read as follows:

> (1) It is the purpose of this subsection to ensure that obligations to repay loans and grant overpayments are enforced without regard to any Federal or State statutory, regulatory, or administrative limitation on the period within which debts may be enforced.
>
> (2) Notwithstanding any other provision of statute, regulation, or administrative limitation, no limitation shall terminate the period within which suit may be filed, a judgment may be enforced, or an offset, garnishment, or other action initiated or taken by—. . . .
>
> (D) the Secretary, the Attorney General, the administrative head of another Federal agency . . . for the repayment of [a student loan] . . . that has been assigned to the Secretary. . . .

20 U.S.C. § § 1091a(a)(1)-(2). As of 1991, therefore, the statute of limitations contained in the Debt Collection Act no longer prevented the collection of student loans, and the only restriction the government arguably faced in collecting delinquent student loans was that it could not use administrative offset to reach social security benefits. *See 42 U.S.C. § 407.*

However, in 1996, Congress amended the Debt Collection Act by adding:

> (c)(3)(A)(i) Notwithstanding any other provision of law (including sections 207 and 1631(d)(1) of the Social Security Act (*42 U.S.C. 407* and *1383(d)(1)*) . . . all payments due to an individual under the Social Security Act . . . shall be subject to offset under this section.
>
> (ii) An amount of $ 9,000 which a debtor may receive under Federal benefit programs cited under clause (i) within a 12-month period shall be exempt from offset under this subsection.

31 U.S.C. § § 3716(c)(3)(A)(i)-(ii). This statute explicitly removes any protection under *section 407* that Social Security benefits may have had from offset, and thus allows the government to reach Lockhart's benefit in order to collect on his debt.

This amendment was inserted in the Debt Collection Act without removing the language already quoted about the non-applicability of "this section" to claims outstanding for more than 10 years or to statutes explicitly prohibiting administrative offset. *See 31 U.S.C. § § 3716(e)(1)-(2).*

A puzzle has been created by the codifiers. But it seems clear that in 1996, Congress explicitly authorized the offset of Social Security benefits, and that in the Higher Education Act of 1991, Congress had overridden the 10-year statute of limitations as applied to student loans. That the codifiers failed to note the impact of the 1991 repeal on *section 3716(e)* does not abrogate the repeal. Because the Debt Collection Act's statute of limitation is inapplicable here, the government's offset is not time-barred.

Accordingly, we affirm the judgment entered against Lockhart.

Dee Ella LEE, Appellee,
v.
Roderick PAIGE, Secretary of the Department of Education, Appellant.

United States Court of Appeals
for the Eighth Circuit

Decided July 23, 2004

Note: The following Eighth Circuit Court decision conflicts with the Ninth Circuit Court's decision in *Lockhart v. United States*. Petition for cert. was filed February 25, 2005.

[Excerpt: Some citations and footnotes omitted]

OPINION: PER CURIAM.

Roderick Paige, Secretary of the United States Department of Education, appeals from a grant of summary judgment entered in favor of Dee Ella Lee, contending that the district court incorrectly barred the department from garnishing Ms. Lee's social security benefits on account of her outstanding student loans. We affirm.

Ms. Lee defaulted on two student loans in 1984. The Department of Education took assignment of the loans in the late 1980's and has sought repayment ever since. In October, 2001, the government began withholding a portion of Ms. Lee's social security benefits, applying the amount to Ms. Lee's outstanding loan balance. She filed suit to stop the government from garnishing her benefits.

The dispute between Ms. Lee and Secretary Paige requires the synthesis of three separate acts: the *Social Security Act*, the *Debt Collection Act* (as amended by the *Debt Collection Improvement Act*), and the *Higher Education Act*.

The *Higher Education Act*, passed in 1991, eliminated statutes of limitations on the government's right to seek repayment on defaulted federal student loans. . . . At the time that the *Higher Education Act* became law, the *Debt Collection Act* authorized the government to offset unpaid debt balances from some federal payments but not from social security benefits. Congress later passed the *Debt Collection Improvement Act*, which authorizes federal agencies to recover money owed on delinquent student loans (as well as some other debts) by offsetting a debtor's social security benefits. *The Debt Collection Improvement Act* left unchanged, however, the original *Debt Collection Act*'s limitation on the right of offset, under which government agencies are not allowed to use the remedy of administrative offset on claims that have been outstanding in excess of ten years.

Though he concedes that the claims against Ms. Lee had been outstanding for more than ten years, Secretary Paige nonetheless argues that the ten-year limitation in the *Debt Collection Act* did not prohibit the administrative offset of Ms. Lee's benefits because that would be contrary to *§ 1091a(a)(2)* which had eliminated statutes of limitations. Instead, he maintains that the ten-year disabling provision in *§ 3716(e)(1)* should control all claims except those like the collection of student loans, where Congress eliminated all statutes of limitation. Ms. Lee argues that the disabling provision of *§ 3716(e)(1)* was intentionally left in the statute and that it controls this case.

The district court agreed with Ms. Lee. The court reasoned that when "Congress removed all statute of limitations obstacles in *§ 1091a*, it could not have contemplated that its actions would have any effect on Social Security payments, because such payments were not yet subject to offset," *id. at 984*, and subsequent Congressional approval of offsetting social security benefits did not import *§ 1091a* into the social security context, because Congress expressly left the ten-year disabling provision intact. Had Congress intended to limit the disabling provision to allow the government unlimited offset opportunities for the collection of delinquent student loans, the district court reasoned, it would have done so explicitly. In the absence of Congressional language authorizing application of *§ 1091a* to social security offsets, the district court concluded that the specific limitations in *§ 3716(e)(1)* prevail.

We review *de novo* a district court's interpretation of a statute. *Loehrer v. McDonnell Douglas Corp., 98 F.3d 1056, 1061 (8th Cir. 1996).* We affirm the judgment for the reasons given in the district court's well-reasoned opinion. The Department of Education remains free to pursue payment on the defaulted loans from Ms. Lee; it simply cannot take money from her monthly social security check to reduce the debt.

"Justices to Decide if Social Security Can Be Seized"

Los Angeles Times
April 26, 2005
David Savage

In the latest installment of the baby boomers-reach-retirement-age saga, the Supreme Court said Monday that it would decide whether the government could seize Social Security benefits from individuals who failed to repay decades-old student loans.

At issue is $3.6 billion in student loans that have gone unpaid for more than 10 years.

One federal law says Education Department officials should aggressively try to collect money from those who defaulted on their government-backed loans by garnishing their wages or seeking other sources of money.

But a second law says the government should not take Social Security benefits to repay debts that are more than 10 years old.

Not surprisingly, lower courts are split on which law to follow.

To resolve the dispute,.the justices voted to hear the case of James Lockhart, a Washington state man who went to four colleges in the 1980s with the help of federally guaranteed student loans. He became disabled as a result of diabetes and heart disease, and was unemployed in 1991 when he defaulted on nine student loans.

In 2002, Lockhart was living on his Social Security disability benefit of $874 a month. At the same time, he had $80,000 in unpaid student loans.

To repay his debt, the government took $93 a month from his disability benefit. A year later, Lockhart reached age 65 and began receiving an old-age benefit instead of a disability benefit. Now, the government is taking $143 a month.

Under the law, the government can seize 15% of a recipient's monthly benefit to repay the loans.

The Education Department said the seizures had proved to be an effective means of recovering unpaid students loans. In 2003, the collection effort brought in $400 million from reclaimed Social Security benefits.

Lockhart sued three years ago to block the seizure, but he lost before a federal judge in Seattle and the U.S. 9th Circuit Court of Appeals in San Francisco. Its judges pointed to the education law that encouraged the government to collect on the unpaid loans.

In a different case, the U.S. 8th Circuit Court of Appeals in St. Louis came to the opposite conclusion by pointing to the Debt Collection Act, which bars the government from seizing Social Security benefits to pay debts that are more than 10 years old.

The Public Citizen Litigation Group, a public interest law firm, appealed on Lockhart's behalf. Its lawyers argued that many people, like Lockhart, had no income other than Social Security, and that Congress did not want agencies to seize the benefits of such individuals.

The high court said it would hear the case of *Lockhart vs. U.S.* in the fall. . . .

"Government Can't Offset Student Loans with Social Security"

Consumer Financial Services Law Report
August 25, 2004

A senior citizen prevailed over the government's attempt to collect on her outstanding student loans by seizing part of her Social Security payments. The 8th U.S. Circuit Court of Appeals upheld the District Court's decision that the government had no right to offset because the loans were more than 10 years old. (*Lee v. Paige,* No. 03-3819 (8th Cir. 08/04/04).)

In making this determination, the 8th Circuit analyzed the Social Security Act, the Debt Collection Act and the Higher Education Act. Congress passed the HEA in 1991. The court pointed out that the HEA, *20 USC 1091a*(a)(2), eliminated the statutes of limitations on the government's right to seek repayment on defaulted federal student loans. At that time, the DCA, *31 USC 3716,* authorized the government to offset unpaid debt balances from some federal payments but not from Social Security benefits, the court noted.

Congress then amended the DCA, authorizing federal agencies to recover money owed on delinquent student loans by offsetting a debtor's Social Security benefits. However, the DCA had a limitation on the right of offset, which was not affected by the amendments. Under *31 USC 3716*(e)(1), the government cannot offset claims that have been outstanding for more than 10 years.

In this case, Dee Ella Lee defaulted on her student loans in 1984, and the government began garnishing her benefits in 2001.

Contrary to HEA

The government argued that the 10-year limitation should not apply because it was contrary to the HEA, which eliminated statutes of limitations for collecting student loans. The 10-year provision should control all claims except student loans, the government argued.

The District Court pointed out that when the statute of limitations obstacles were removed, student loans were not subject to offset from Social Security payments. When Congress amended the law to allow offsetting, it could have removed the 10-year limitation, but didn't.

"While the Department of Education remains free to pursue payment on the defaulted loans from Ms. Lee, it simply cannot take money from her Social Security check to reduce the debt," the 8th Circuit said.

The court affirmed the District Court's opinion.

United States v. Philip Morris

(No. 05-92)

Case Below: (*U.S. v. Philip Morris USA Inc., Et al.*, 396 F3d 1190 (D.C. Cir. 2005), *petition for cert. filed*, (U.S. Jul. 18, 2005)(No. 05-92)).

As part of ongoing litigation against the tobacco industry for concealing the danger posed by smoking and for marketing to minors, the United States sought disgorgement of past profits under the Racketeer Influenced and Corrupt Organizations Act (RICO). The government estimates those profits to total $280 billion. The United States District Court for the District of Columbia denied the manufacturers' motion for partial summary judgment on this issue. The D.C. Circuit reversed, saying disgorgement is not within the express terms of the statute, nor could the court include disgorgement as an expansion on those remedies already enumerated, because the statute is directed toward future conduct.

Question Presented: Whether the district court's equitable jurisdiction to issue "appropriate orders" to "prevent and restrain" violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. 1964(a), encompasses the remedial authority to order disgorgement of illegally-obtained proceeds.

UNITED STATES OF AMERICA, APPELLEE
v.
PHILIP MORRIS USA INC., ET AL., APPELLEES

United States Court of Appeals
for the District of Columbia Circuit

Decided February 4, 2005

[Excerpt: some citations and footnotes omitted]

OPINION:

SENTELLE, *Circuit Judge*: A group of cigarette manufacturers and related entities ("Appellants") appeal from a decision of the District Court denying summary judgment as to the Government's claim for disgorgement under the Racketeer Influenced and Corrupt Organizations Act ("RICO" or "the Act"), *18 U.S.C. § § 1961-68*. The relevant section of RICO, *18 U.S.C. § 1964(a)*, provides the District Courts jurisdiction only for forward-looking remedies that prevent and restrain violations of the Act. Because disgorgement, a remedy aimed at past violations, does not so prevent or restrain, we reverse the decision below and grant partial summary judgment for the Appellants.

I. Background

In 1999 the United States brought this claim against appellant cigarette manufacturers and research organizations, claiming that they engaged in a fraudulent pattern of covering up the dangers of tobacco use and marketing to minors. The Government sought damages under the Medical Care Recovery Act ("MCRA"), *42 U.S.C. § § 2651 -53,* and the Medicare Secondary Payer ("MSP") provisions of the Social Security Act, *42 U.S.C. § 1395y* to recover health-care related costs Appellants allegedly caused. The United States also claimed that Appellants engaged in a criminal enterprise to effect this cover-up, and sought equitable relief under RICO, including injunctive relief and disgorgement of proceeds from Appellants' allegedly unlawful activities. The Government sought this relief under *18 U.S.C. § 1964(a)*, which gives the District Court jurisdiction

> to prevent and restrain violations of [RICO] by issuing appropriate orders, including, but not limited to: ordering any person to divest himself of any interest, direct or indirect, in any enterprise; imposing reasonable restrictions on the future activities or investments of any person, including, but not limited to, prohibiting any person from engaging in the same type of endeavor as the enterprise engaged in, the activities of which affect interstate or foreign commerce; or ordering dissolution or reorganization of any enterprise. . . .

18 U.S.C. § 1964(a).

Appellants moved to dismiss the complaint in 2000. The District Court did dismiss the MCRA and MSP claims, but allowed the RICO claim to stand. *United States v. Philip Morris, Inc., 116 F. Supp. 2d 131, 134 (D.D.C. 2000).*

Section 1964(a) conferred jurisdiction on the District Court only to enter orders "to prevent and restrain violations of the statute." In considering wither disgorgement came within this jurisdictional grant, the court relied on a decision of the Second Circuit, the only circuit then to have considered "whether . . . disgorgements . . . are designed to 'prevent and restrain' *future* conduct rather than to punish *past* conduct." *United States v. Carson, 52 F.3d 1173, 1182 (2d Cir. 1995)* (emphasis in original). . . . The District Court accepted the Second Circuit's suggested holding that the appropriateness of disgorgement depends on whether the proceeds are available for the continuing of the criminal enterprise, but ruled that the question was premature, and denied the motion for dismissal on the RICO-disgorgement claim. *Philip Morris, 116 F. Supp. 2d at 151-52.* Neither party sought leave to file an interlocutory appeal of that ruling.

The case proceeded, and the Government sought disgorgement of $ 280 billion that it traced to proceeds from Appellants' cigarette sales to the "youth addicted population" between 1971 and 2001. This population includes all smokers who became addicted before the age of 21, as measured by those who were smoking at least 5 cigarettes a day at that age.

After discovery, Appellants moved for summary judgment on the disgorgement claim arguing that (1) disgorgement is not an available remedy under *§ 1964(a)*, (2) even if disgorgement were available, the Government's model fails the *Carson* test for permissible disgorgement that will "prevent and restrain" future violations, and (3) even if disgorgement were available, the

Government's proposed model is impermissible because it includes both legally and illegally obtained profits in violation of *SEC v. First City Financial Corp., 281 U.S. App. D.C. 410, 890 F.2d 1215 (D.C. Cir. 1989)*. The District Court denied this motion in a memorandum order designated " # 550." On motion of the defendants, the District Court certified Order # 550 for interlocutory appeal pursuant to *28 U.S.C. § 1292(b)*. . . .

II. Analysis

A. Scope of Review

* * *

We review an order denying summary judgment *de novo*. Obedient to *Yamaha*, we will review Order # 550 denying summary judgment applying anew the standards of *Rule 56*, and will not simply review that part of the District Court's thinking directed to the applicability of the *Carson* standard or the consistency of the Government's proffers with that standard. Therefore, we must address the issue, logically prior to the *Carson* question, of whether disgorgement is available at all. We hold that the language of *§ 1964(a)* and the comprehensive remedial scheme of RICO preclude disgorgement as a possible remedy in this case.

B. The Availability of Disgorgement

The Government argues that *§ 1964* contains a grant of equitable jurisdiction that must be read broadly to permit disgorgement in light of *Porter v. Warner Holding Co., 328 U.S. 395, 90 L. Ed. 1332, 66 S. Ct. 1086 (1946)*, and its progeny. The *Porter* Court considered reimbursement awards under the Emergency Price Control Act of 1942 ("EPCA") and concluded that where a statute grants general equitable jurisdiction to a court, "all the inherent equitable powers . . . are available for the proper and complete exercise of that jurisdiction." *Porter, 328 U.S. at 398*. This grant is only to be limited when "a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction." *Id.* In this case the text and structure of the statute provide just such a restriction.

As the Supreme Court has repeatedly observed: "Federal courts are courts of limited jurisdiction. They possess only that power authorized by Constitution and statute, which is not to be expanded by judicial decree." *Kokkonen v. Guardian Life Ins. Co. of America, 511 U.S. 375, 377, 128 L. Ed. 2d 391, 114 S. Ct. 1673 (1994)* (citations omitted). Reading *Porter* in light of this limited jurisdiction we must not take it as a license to arrogate to ourselves unlimited equitable power. We will not expand upon our equitable jurisdiction if, as here, we are restricted by the statutory language, but may only assume broad equitable powers when the statutory or Constitutional grant of power is equally broad.

As our dissenting colleague correctly notes, the Court in *Porter* was considering whether a district court acting under the authority granted in the EPCA had the authority to order restitution for overcharges. . . .

The Supreme Court did not have to make much of a stretch to determine that the phrase "enforcing compliance with such provision," and expressly referring to "a permanent or temporary injunction, restraining order, or other order," would include restitution for amounts collected exceeding the ceilings determined under the statute. The Government in the present case asks us to work a far greater expansion of the statutory grant enabling the District Court in a civil RICO action brought by the Government under *§ 1964(a)*. We further note that the Court in *Porter* was ordering restitution, under a statute designed to combat inflation. Restitution of overcharge works a direct remedy of past inflation, directly effecting the goal of the statute. The Court in *Porter* set forth two theories under which "an order for the recovery and restitution of illegal rents may be considered a proper 'other order'" under the applicable statute. *328 U.S. at 399*. First, the recovery of the illegal payment by the victim tenant "may be considered as an equitable adjunct to the injunction decree," as it effects "the recovery of that which has been illegally acquired and which has given rise to the necessity for injunctive relief." *Id.* The equitable jurisdiction of the Court having been properly invoked, the Court then had the power "to decide all relevant matters in dispute and to award complete relief. . . ." *Id.* Also, and more to the point, the Court was authorized "in its discretion, to decree restitution of excessive charges in order to give effect of the policy of Congress." *Id. at 400*. The policy of Congress under the EPCA was to prevent overcharges with inflationary effect. The goal of the RICO section under which the government seeks disgorgement here is to prevent or restrain future violations. We therefore must consider the forward-looking nature of the remedy in a way not applicable to a different remedy in *Porter* for the accomplishment of a different goal under a different statute.

Section 1964(a) provides jurisdiction to issue a variety of orders "to prevent and restrain" RICO violations. This language indicates that the jurisdiction is limited to forward-looking remedies that are aimed at future violations. The examples given in the text bear this out. Divestment, injunctions against persons' future involvement in the activities in which the RICO enterprise had been engaged, and dissolution of the enterprise are all aimed at separating the RICO criminal from the enterprise so that he cannot commit violations *in the future*. Disgorgement, on the other hand, is a quintessentially backward-looking remedy focused on remedying the effects of past conduct to restore the status quo. It is measured by the amount of prior unlawful gains and is awarded without respect to whether the defendant will act unlawfully in the future. Thus it is both aimed at and measured by *past* conduct.

The Government would have us interpret *§ 1964(a)* instead to be a plenary grant of equitable jurisdiction, effectively ignoring the words "to prevent and restrain" altogether. This not only nullifies the plain meaning of the terms and violates our canon of statutory construction that we should strive to give meaning to every word, but also neglects Supreme Court precedent. In *Meghrig v. KFC Western, Inc., 516 U.S. 479, 488, 134 L. Ed. 2d 121, 116 S. Ct. 1251 (1996)*, the Court held that compensation for past environmental cleanup was ruled out by the plain language of the *Resource Conservation and Recovery Act* which authorized actions "to restrain" persons who were improperly disposing of hazardous waste. If "restrain" is only aimed at future actions, "prevent" is even more so.

* * *

The order of disgorgement is not within the terms of that statutory grant, nor any necessary implication of the language of the statute.

* * *

In RICO . . . Congress has laid out elaborate enforcement proceedings. One of those proceedings is a government action brought under *§ 1964(a)*. That one does not provide for disgorgement. That one provides only for orders which "prevent or restrain" future violations. Disgorgement does not do that.

It is true, as the Government points out, that disgorgement may act to "prevent and restrain" future violations by general deterrence insofar as it makes RICO violations unprofitable. However, as the Second Circuit also observed, this argument goes too far. "If this were adequate justification, the phrase 'prevent and restrain' would read 'prevent, restrain, and discourage,' and would allow any remedy that inflicts pain." *Carson, 52 F.3d at 1182.*

The remedies available under *§ 1964(a)* are also limited by those explicitly included in the statute. The words "including, but not limited to" introduce a non-exhaustive list that sets out specific examples of a general principle. Applying the canons of *noscitur a sociis* and *ejusdem generis*, we will expand on the remedies explicitly included in the statute only with remedies similar in nature to those enumerated. The remedies explicitly granted in *§ 1964(a)* are all directed toward future conduct and separating the criminal from the RICO enterprise to prevent future violations. Disgorgement is a very different type of remedy aimed at separating the criminal from his prior ill-gotten gains and thus may not be properly inferred from *§ 1964(a)*.

The structure of RICO similarly limits courts' ability to fashion equitable remedies. Where a statute has a "comprehensive and reticulated" remedial scheme, we are reluctant to authorize additional remedies; Congress' care in formulating such a "carefully crafted and detailed enforcement scheme provides strong evidence that Congress did *not* intend to authorize other remedies that it simply forgot to incorporate expressly." . . . In a criminal RICO action the defendant must forfeit his interest in the RICO enterprise and unlawfully acquired proceeds, and may be punished with fines, imprisonment for up to twenty years, or both. *18 U.S.C. § 1963(a)*. In a civil case the Government may request limited equitable relief under *§ 1964(a)*. Individual plaintiffs are made whole and defendants punished through treble damages under *18 U.S.C. § 1964(c)*. This "comprehensive and reticulated" scheme, along with the plain meaning of the words themselves, serves to raise a "necessary and inescapable inference," sufficient under *Porter, 328 U.S. at 398*, that Congress intended to limit relief under *§ 1964(a)* to forward-looking orders, ruling out disgorgement.

Congress' intent when it drafted RICO's remedies would be circumvented by the Government's broad reading of its *§ 1964(a)* remedies. The disgorgement requested here is similar in effect to the relief mandated under the criminal forfeiture provision, *§ 1963(a)*, without requiring the inconvenience of meeting the additional procedural safeguards that attend criminal charges, including a five-year statute of limitations, *18 U.S.C. § 3282*, notice requirements, *18 U.S.C. § 1963(l)*, and general criminal procedural protections including proof beyond a reasonable doubt. Further, on the Government's view it can collect sums paralleling-perhaps exactly-the damages available to individual victims under *§ 1964(c)*. Not only would the resulting overlap allow the Government to escape a statute of limitations that would restrict private parties seeking essentially identical remedies, but it raises issues of duplicative recovery of exactly the sort that the Supreme Court said in *Holmes v. Securities Investor Protection Corp., 503 U.S. 258, 269, 117 L. Ed. 2d 532, 112 S. Ct.*

1311 (1992), constituted a basis for refusing to infer a cause of action not specified by the statute. Permitting disgorgement under *§ 1964(a)* would therefore thwart Congress' intent in creating RICO's elaborate remedial scheme.

A note appended to the statute stating that RICO "shall be liberally construed to effectuate its remedial purposes" does not effect this structural inference. Organized Crime Control Act of 1970, Pub. L. No. 91-452, § 904(a), 84 Stat. 947 (codified in a note following *18 U.S.C. § 1961*). This clause may warn us against taking an overly narrow view of the statute, but "it is not an invitation to apply RICO to new purposes that Congress never intended." *Reves v. Ernst & Young, 507 U.S. 170, 183, 122 L. Ed. 2d 525, 113 S. Ct. 1163 (1993).* The text and structure of RICO indicate that those remedial purposes do not extend to disgorgement in civil cases.

The Second Circuit in *Carson* has interpreted "prevent and restrain" not to eliminate the possibility of disgorgement altogether, but to limit it to cases where there is a finding "that the gains are being used to fund or promote the illegal conduct, or constitute capital available for that purpose." *Carson, 52 F.3d at 1182.* The Fifth Circuit adopted this interpretation in a case holding that disgorgement after the defendant had ceased production of an allegedly defective product would be inappropriately punitive rather than directed toward future violations. While we avoid creating circuit splits when possible, in this case we can find no justification for considering any order of disgorgement to be forward-looking as required by *§ 1964(a)*. The language of the statute explicitly provides three alternative ways to deprive RICO defendants of control over the enterprise and protect against future violations: divestment, injunction, and dissolution. We need not twist the language to create a new remedy not contemplated by the statute.

* * *

III. Conclusion

Because we hold that the District Court erred when it found that disgorgement was an available remedy under *18 U.S.C. § 1964(a)*, we reverse the District Court and grant summary judgment in favor of Appellants as to the Government's disgorgement claim.

* * *

DISSENT:

TATEL, *Circuit Judge*, dissenting:

* * *

. . . Philip Morris asks us—and the court now agrees—to decide an issue (1) not briefed in the motion leading up to the certified order, (2) not decided in the district court's opinion accompanying the certified order, (3) not raised by Philip Morris in its request for certification, (4) not discussed in the order granting certification, (5) not raised by Philip Morris in its *section 1292(b)* petition before this court, and (6) decided in an entirely different order which Philip Morris could at any time have asked the district court to certify. This presents serious questions on two separate fronts: our jurisdiction over this appeal under *section 1292(b)*, and our general policy of declining to consider arguments not made to the district court in the motion leading to the order under appeal. Unlike the court, I cannot brush these concerns aside.

* * *

I would therefore dismiss the interlocutory appeal. . . .

But the court disagrees with my position. The appeal stands before us, so in the following sections I exercise a dissenter's prerogative to address the merits.

II.

Like my colleagues, I begin with the structure and language of RICO's remedial provisions. RICO authorizes criminal penalties and civil remedies against those engaging in patterns of racketeering behavior. *18 U.S.C. § 1963* sets out the criminal penalties: guilty persons shall "be fined under this title or imprisoned . . . or both, and shall forfeit to the United States" any illegally acquired interest. *Section 1964* provides for the civil remedies. At issue in this case is subsection *(a)*, [supra].

Another subsection, *§ 1964(c)*, authorizes injured persons to sue RICO violators for treble damages and to recover attorneys' fees. Finally, Congress directed that RICO "shall be liberally construed to effectuate its remedial purposes[.]"

The government argues that district courts have authority to order any remedy, including disgorgement, within their inherent equitable powers. More narrowly, the government argues that assuming the district courts may only impose equitable remedies for the purpose of keeping defendants from committing RICO violations, disgorgement—by reducing the incentives for the tobacco companies to violate RICO in the future—will accomplish that purpose in this case. These two distinct arguments present very different consequences for district courts: under the first theory, courts may order disgorgement any time they find the remedy necessary to ensure complete relief, while under the second theory courts may order disgorgement only to prevent ongoing or future violations. In this case, the district court accepted only the second argument. *See 321 F. Supp. 2d at 74-80.* The court today rejects both.

A.

In dismissing the argument that district courts may impose any equitable remedy for RICO violations, the court distinguishes—unconvincingly, in my view—the two Supreme Court cases relied on by the government, *Porter v. Warner Holding Co., 328 U.S. 395, 90 L. Ed. 1332, 66 S. Ct. 1086 (1946)*, and *Mitchell v. Robert DeMario Jewelry, Inc., 361 U.S. 288, 4 L. Ed. 2d 323, 80 S. Ct. 332 (1960).* I believe these two cases control this case and compel the conclusion that district courts may impose any equitable remedy for RICO violations.

In *Porter*, the Supreme Court considered whether a district court had authority to order restitution in a suit brought by the Price Control Administrator against a landlord who had violated the Emergency Price Control Act (EPCA) by charging too much rent. The act contained no specific provision for restitution or disgorgement, but—like RICO—authorized a broad array of other remedies, both criminal and civil. . . .

* * *

. . . [T]he Court concluded—and I quote at length since the language is so critical to the disposition of this case—that

> such a jurisdiction is an equitable one. Unless otherwise provided by statute, all the inherent equitable powers of the District Court are available for the proper and complete exercise of that jurisdiction. And since the public interest is involved in a proceeding of this nature, those equitable powers assume an even broader and more flexible character than when only a private controversy is at stake. . . . The court may go beyond the matters immediately underlying its equitable jurisdiction and decide whatever other issues and give whatever other relief may be necessary under the circumstances. Only in that way can equity do complete rather than truncated justice.
>
> Moreover, the comprehensiveness of this equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command. Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied.

Id. at 398 (citations omitted). The Court concluded that because the EPCA, despite the very detailed and specific nature of the authorized remedies, did not rule out restitution by a "necessary and inescapable inference," the district court could order restitution even if not expressly authorized by the statute. *See id. at 398-400*; *see also Mitchell, 361 U.S. at 291* (discussing *Porter*).

* * *

The court's opinion today sounds a lot like the *Porter* dissent. The court observes that the language of *section 1964(a)*—a court has "jurisdiction to prevent and restrain violations"—does not explicitly open the door to all of equity, but neither did EPCA section 205(a) (a court may issue orders "enjoining" violations or "enforcing compliance"). The court asserts that reading full equitable jurisdiction into RICO will render *section 1964(a)*'s language largely meaningless, but *Porter* rejected just this concern with regard to EPCA section 205(a). The court emphasizes that RICO "already provides for a comprehensive set of remedies," majority op. at 18, but the EPCA had at least as comprehensive a remedial structure. The court further points out that should restitution be available, the government could obtain duplicative recovery (given RICO's criminal forfeiture provisions) and also escape the applicable statutes of limitations, but the *Porter* majority dismissed similar concerns, *328 U.S. at 401-02*; *see also id. at 406-08* (Rutledge, J., dissenting). Finally, the court attempts to distinguish *Porter* on the grounds that the EPCA had a different policy goal than RICO (preventing inflation rather than seeking to eradicate organized crime), but this has no effect on *Porter*'s essential holding that "the court may go beyond the matters immediately underlying its equitable jurisdiction . . . and give whatever other relief may be necessary under the circumstances," *see id. at 398*. In sum, the court offers no basis for concluding that RICO's structure and language get the statute past *Porter*'s high bar for finding by a "necessary and inescapable inference" that

Congress intended to empower district courts to order only limited equitable relief.

Nor does Philip Morris point to anything in RICO's legislative history that creates such a "necessary and inescapable inference."...

Mitchell, the second Supreme Court decision the government relies on, considered whether district courts could order restitution of wages lost from unlawful discharge in suits brought by the Secretary of Labor under section 17 of the Fair Labor Standards Act (FLSA), *29 U.S.C. § 217 (1960)*. Relying on *Porter*, the Court concluded that where the statute provided that "the district courts are given jurisdiction . . . for cause shown, to restrain violations" of the act, *29 U.S.C. § 217*, district courts had full equitable powers, *361 U.S. at 291-95*; *see also id. at 289*. . . .

Mitchell reinforces the proposition that district courts may order any equitable relief in civil RICO suits brought by the government. My colleagues suggest that in "the RICO Act, Congress provided a statute granting jurisdiction defined with the sort of limitations not present in the FLSA." Majority op. at 16. The only jurisdictional hook in the FLSA's text, however, was its language: "the district courts are given jurisdiction . . . for cause shown, to restrain violations" of the act, *29 U.S.C. § 217*. If this language opens the door to all equitable relief, then RICO's language—"the district courts . . . shall have jurisdiction to prevent and restrain violations"—certainly does the same. And if the possibility of duplicative recovery did not circumscribe the district court's equitable authority under the FLSA, then neither should that possibility under RICO do so.

* * *

Instead of following *Porter* and *Mitchell*, the court relies on a later Supreme Court decision, *Meghrig v. KFC Western, Inc., 516 U.S. 479, 134 L. Ed. 2d 121, 116 S. Ct. 1251 (1996)*. In *Meghrig*, the Supreme Court considered whether private citizens could seek restitution under the Resource Conservation and Recovery Act (RCRA) for the cost of having cleaned up a prior landowner's toxic waste. The statute provided that the "district court shall have jurisdiction . . . to restrain any person who has contributed or who is contributing" to waste problems, "to order such person to take such other action as may be necessary, or both." *Id. at 482* n.* (quoting *42 U.S.C. § 6972(a)*). The Court held that it was "apparent from the two remedies described . . . that RCRA's citizen suit provision is not directed at providing compensation for past cleanup efforts." *Id. at 484*. While not explicitly defining the limits of the two remedies described, the court suggested that these remedies should be equated with prohibitory and mandatory injunctions. *Id.* Moreover, relying in part on the fact that an analogous statute expressly authorized damages, the Court concluded that "neither remedy . . . contemplates the award of past cleanup costs, whether these are denominated 'damages' or 'equitable restitution.'" *Id. at 484-85*. According to the Court, it "'is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it.'"

The *Meghrig* Court noted that in arguing that the district court had inherent authority to award equitable remedies, the plaintiffs relied on *Porter* and its progeny. *Id. at 487*. Without expressly distinguishing those cases, the Court explained that "the limited remedies described in [RCRA], along with the stark differences between the language of that section and the cost recovery provisions [of the analogous statute], amply demonstrate that Congress did not intend for a private citizen to be able to undertake a cleanup and then proceed to recover its costs under RCRA." *Id. at 487.* Notably for our purposes, *Meghrig* did not overrule *Porter.* Indeed, even after *Meghrig,* the Supreme Court has cited *Porter* for the proposition that "we should not construe a statute to displace courts' traditional equitable authority absent . . . an 'inescapable inference' to the contrary." *Miller v. French, 530 U.S. 327, 340, 147 L. Ed. 2d 326, 120 S. Ct. 2246 (2000).*

At one level, reconciling *Meghrig* with *Porter* and *Mitchell* is difficult. . . . These tensions cannot be dealt with simply by dismissing *Porter* and *Mitchell.* . . .

In my view, *Porter* and *Mitchell,* not *Meghrig,* "directly control" this case. Several reasons support this conclusion, and nothing points the other way. First, RICO's statutory scheme resembles the EPCA more than the RCRA. Both RICO and the EPCA stand alone in grappling with a broad social issue, whereas the RCRA had a closely related statute on which the Court in *Meghrig* relied heavily. Second, as in both *Porter* and *Mitchell,* the government brought the suit rather than a private party like the *Meghrig* plaintiff, and *Porter* makes clear that district courts may have "even broader and more flexible" equitable powers where the public interest is involved, *328 U.S. at 398.* This point has particular traction if the government is the only party that may seek equitable relief under RICO. Finally, *Meghrig*'s suggestion that "restrain" in the RCRA refers only to prohibitory injunctions cannot apply to *section 1964(a),* since that section explicitly authorizes other remedies—e.g., divestment—to "prevent and restrain" RICO violations. For these reasons, in determining whether the phrase "prevent and restrain" limits the district court's equitable powers, I think it makes more sense to look to *Porter* and *Mitchell,* not *Meghrig.*

* * *

Finally, while Congress modeled *section 1964(a)* on the antitrust laws. I disagree with Philip Morris that the Supreme Court's antitrust decisions provide useful guidance as to whether the phrase "prevent and restrain" limits the equitable remedies available to district courts. On the one hand, the Court once ignored, though did not explicitly reject, an invitation by Justice Douglas to apply *Porter* to antitrust actions. On the other hand, some antitrust cases suggest that courts may impose equitable remedies beyond those intended merely to stop future violations from occurring. As these cases illustrate, antitrust precedent offers little reason to doubt the applicability of *Porter* and *Mitchell* to the case at hand.

To sum up, *Porter* and *Mitchell* rather than *Meghrig* control this case, and no "necessary and inescapable inference" limits the district court's jurisdiction in equity. If the district court concludes that the government has shown that the tobacco companies have committed RICO violations by advertising to youth despite assertions to the contrary and by falsely disputing smoking's addictive, unhealthy effects, then it may order whatever equitable relief it deems appropriate. Of course, the court must work within the bounds of equitable doctrines, recognizing defenses like laches and unclean hands, paying due regard for the rights of the innocent, and generally exercising its discretion. With these principles in mind, the district court can "do complete rather than truncated justice," *Porter, 328 U.S. at 398.*

B.

In addition to rejecting the government's argument that district courts may impose any equitable remedy on RICO violators, the court rejects the government's alternative, narrower argument—that even if district courts may order only remedies that "prevent and restrain" RICO violations, disgorgement can appropriately accomplish that purpose. Because the court's analysis of this argument is as flawed as its analysis of the government's broader argument, I add this discussion of the issue. In my view, the court transforms what should be a question of fact—what remedies appropriately prevent and restrain future violations—into a question of statutory interpretation in a way that disregards *section 1964(a)*'s plain language and ignores Supreme Court precedent recognizing the equitable flexibility of district courts.

* * *

The government offers expert testimony to the effect that a disgorgement order will deter the tobacco companies from violating RICO in the future--in the dictionary's language, it will deprive them of the hope of succeeding in benefiting from future RICO violations and hold them back from committing such violations. In essence, the government claims that the tobacco companies, having engaged in a persistent pattern of deceptive representations over decades, will be less likely to continue this illegal behavior if they must surrender their past ill-gotten profits. Treating the government's expert testimony as correct, as we must at this stage of the litigation, *see Anderson, 477 U.S. at 255*, I think it enough to forestall summary judgment in Philip Morris's favor. Indeed, the Supreme Court has accepted just this theory of deterrence, stating in *Porter* that restitution "could be considered as an order appropriate and necessary to enforce compliance with the Act" since "future compliance may be more definitely assured if one is compelled to restore one's illegal gains." *328 U.S. at 400*. If restitution helps enforce compliance, then we should have little doubt that disgorgement helps prevent and restrain violations.

This court does not conclude that disgorgement can never have a restraining effect on future conduct of the defendants—the only conclusion that could justify a holding that district courts can never order disgorgement under *section 1964(a)*. Instead, the court offers several unpersuasive reasons for its conclusion that as a matter of statutory interpretation disgorgement is not a permissible remedy under *section 1964(a)*.

First, the court states that disgorgement "is a quintessentially backward-looking remedy." Majority op. at 15. Although I agree that a court sitting in equity cannot order disgorgement that exceeds a defendant's past ill-gotten profits, this does not mean disgorgement is always backward-looking and can never have a forward-looking effect on the defendants. . . .

Second, the court concludes that district courts are limited not merely by the words "prevent and restrain," but also "by those [three remedies] explicitly included in the statute" by application of the canons *noscitur a sociis* and *ejusdem generis*. Even assuming we should apply these canons, however, they spell out nothing more than what everyone agrees on: that the only "appropriate" orders under this section are equitable ones.

More important, I doubt the canons apply here at all. While the canons can prove useful where there is otherwise "no general principle in sight," here the statute provides the general principle of preventing and restraining violations. Indeed, the Supreme Court declined to use these canons altogether in interpreting a statute which gave the EEOC the power of enforcement "through appropriate remedies, including reinstatement or hiring of employees with or without back pay," *42 U.S.C. § 2000e-16(b)*. *See West, 527 U.S. at 218*[.] I see no reason why we should do otherwise here, especially since *section 1964(a)* uses the even more expansive language: "including, but not limited to." Finally, *noscitur a sociis* and *ejusdem generis* should not be used to limit the types of equitable relief available to district courts given Congress's instruction that RICO "shall be liberally construed to effectuate its remedial purposes," *see supra* at 14, one of which is preventing and restraining future violations—an aim that, far from being a "new purpose[ ] that Congress never intended," expressly appears in the statute's text. If an equitable remedy achieves this goal, then the statute authorizes it.

Third, the court suggests that disgorgement should be unavailable because it allows the government to achieve relief "similar in effect" to criminal forfeiture, raising concerns that the government can achieve duplicative recovery and evade the procedural safeguards girding the forfeiture provision. *See* majority op. at 19. To be sure, such concerns are relevant in considering whether to infer additional causes of action. As discussed earlier, *supra* at 18, however, given the Supreme Court's explicit rejection of similar concerns in *Porter* and *Mitchell*, they cannot carry the day. . . .

Of course, that disgorgement may sometimes serve to prevent and restrain defendants from committing RICO violations does not mean that it will always accomplish that purpose. As the district court here recognized, a court must first find that the defendants are likely to commit future RICO violations. *321 F. Supp. 2d at 75-76*. This is not a foregone conclusion. . . . Assuming district courts are limited to remedies that prevent and restrain, *but see supra* Part II.A, I also share the Second Circuit's apparent conclusion that disgorgement may be ordered only to prevent and restrain *a defendant* from future RICO violations[.] Because any remedy imposed for a solely exemplary purpose (i.e., to dissuade others from committing RICO violations) would amount to punishment, it goes beyond what Congress intended, *see* S. Rep. No. 91-617, at 81, as well as pushing the boundaries of what equity permits, *cf. Tull, 481 U.S. at 422*. In this case, however, the government offers evidence that the defendant companies themselves are likely to commit future RICO violations by misleading the public about the health consequences of smoking and the addictive effects of nicotine, as well as by persisting in marketing to young people.

* * *

[A]s noted earlier, record evidence in this case suggests that disgorgement will in fact "prevent and restrain" defendants from committing future RICO violations. As one of the government's experts stated, "Requiring defendants to pay proceeds will affect their expectations . . . about the returns from future misconduct." Appellee's App. at 813. The expert added that, even if coupled with an injunction laden with contempt penalties, disgorgement will "provide additional economic incentives to deter future misconduct" by "strengthening the credibility of existing laws" which the defendants have allegedly violated in the past. *Id.* at 814. . . . At this stage of the litigation, then, we must assume that the government expert is correct and that disgorgement will "prevent and restrain" future RICO violations. Should Philip Morris offer expert testimony along the lines suggested by the concurrence, then it will be up to the district court to evaluate the competing evidence and make appropriate findings of fact. Should either party appeal, this court, unrestrained by the inferences required at summary judgment, would then review that factual determination pursuant to *Rule 52*'s clear error standard.

C.

In sum, were this case properly before us, I would hold, in accordance with *Porter* and *Mitchell*, that district courts have authority to order any remedy, including disgorgement, necessary to ensure complete relief. As the concurrence points out, sep. op. at 9 (Williams, J., concurring), my approach would create a circuit split, since *Carson* did not apply *Porter* and *Mitchell* to RICO (and, indeed, the parties do not appear to have brought these cases to the Second Circuit's attention). Even if, as *Carson* holds, district courts may only impose equitable remedies for the purpose of keeping defendants from committing RICO violations, I would still affirm the denial of summary judgment, leaving it to the district court to determine, on the basis of a fully developed record, whether disgorgement will help accomplish this purpose. I disagree with my colleagues' conclusions not because they have created a circuit split of their own by rejecting *Carson*'s holding that disgorgement may prevent and restrain RICO violations, but because they have done so by accepting an interlocutory appeal that we should not hear and by disregarding both Supreme Court precedent and *section 1964(a)*'s plain language.

* * *

"U.S. Seeks Higher Damages in Tobacco Industry Suit"

New York Times
July 19, 2005
Eric Lichtblau

The Justice Department on Monday asked the Supreme Court for the legal authority once again to seek $280 billion in damages from the tobacco industry in a lawsuit that has become a growing political liability for the Bush administration.

Even though the trial judge in the case has not yet issued a final ruling, the Justice Department asked the Supreme Court to intervene by overturning an appellate ruling in February that limited the damages it could seek.

The department said that the February decision, if allowed to stand, would hurt the government's ability to bring similar racketeering cases against businesses and industries and that it would have "enormous consequences for the American public."

The decision to appeal was another shift for the government in the six-year-old case. At the close of a nine-month trial, Justice Department lawyers stunned a federal courtroom last month by cutting the amount of damages they were seeking to $10 billion from $130 billion.

Senior Justice Department officials said they had little choice but to reduce their demands, in light of the adverse decision in February by the circuit court for the District of Columbia.

But internal Justice Department documents showed that the decision drew fierce objections from the career lawyers on the tobacco team, who said it was legally groundless, would be seen as politically driven and would undermine the department's position in possible settlement discussions with the tobacco industry. Several members of the trial team threatened to quit over the decision, officials said.

Health advocates and Democrats in Congress also objected to the decision to reduce the requested damages, prompting the Justice Department to open an ethics inquiry, still under way, into charges of political interference.

While the Justice Department said its decision was driven solely by legal considerations, Democrats pointed to the tobacco industry's frequent political contributions to the Bush administration and its ties to some senior Justice Department officials as evidence of possible political motivations.

Justice Department officials declined to discuss their thinking in their decision to ask the Supreme Court to overturn the damage limit. Some tobacco industry lawyers and others involved in the case speculated that the public reaction last month might have played a role.

"Nothing in this case surprises me anymore," said William B. Schultz, a former Justice Department lawyer who led the tobacco team at the outset of the lawsuit. "I think the government has been schizophrenic in how they've litigated this case, but maybe now they've resolved to treat it as an advocate would."

The Justice Department maintains that the nation's tobacco companies have engaged in a half-century pattern of fraud and deceit in marketing cigarettes and have been running what amounts to a criminal enterprise. But in February the appellate court ruled that the government could not seek $280 billion in damages against the industry. It said federal racketeering laws did not allow the government to recover illegally generated profits as a way of preventing future violations.

In its request for Supreme Court review, the Justice Department said the ruling would have "potentially far-reaching implications" for the government's ability to collect financial damages in racketeering cases. The decision, government lawyers said, was "a mistaken precedent that will continue to misdirect other courts."

Tobacco opponents said they were pleased by the Justice Department's move.

The ruling "had really tied the hands of the Justice Department in pursuing the most serious racketeering cases," said Matthew L. Myers, who is president of the Campaign for Tobacco-Free Kids and testified for the government in the case. "The concept that someone could engage in a massive criminal enterprise without any risk of giving up their ill-gotten gains turned the racketeering statute into a paper tiger."

The tobacco industry has 30 days to respond to the request for a Supreme Court review. An industry lawyer, speaking on condition of anonymity because he did not want to give away legal strategy for a case still in litigation, said the cigarette makers would probably argue that the appeal was "ill-timed," because the judge in the case, Gladys Kessler, has not yet ruled on damages.

"Government Appeals on Tobacco Remedy"

SCOTUSblog
July 18, 2005
Lyle Denniston

The Justice Department on Monday afternoon asked the Supreme Court to rule that the tobacco industry may be ordered to give up corporate revenues obtained from an alleged four-decade campaign of deception about the health hazards of smoking. (An earlier post, below, examines some of the reasons for and against Supreme Court review of the case.)

The industry has not yet been found by a U.S. District Court to have violated the federal anti-racketeering law, popularly known as "RICO." The surrender of gains would be a remedy only if the Supreme Court allowed it, and only if liability were first found at the trial that is ongoing. The government has said the industry should be required to surrender $280 billion in "ill-gotten gains."

Ending uncertainty about whether it would take the long-running case on to the highest court, the Department filed a petition for review (*U.S. v. Philip Morris USA, Inc.*, et al., docket 05-92). It poses a single question:

"Whether the District Court's equitable jurisdiction to issue 'appropriate orders' to 'prevent and restrain' violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 USC 1964-a, encompasses the remedial authority to order disgorgement of illegally-obtained proceeds."

Solicitor General Paul D. Clement is not taking part in the appeal. The petition said, without explanation, that he "is disqualified in this case." The lead attorney on the case is one of his deputies, Acting Solicitor General Edwin S. Kneedler.

The appeal, calling the case "extraordinarily important," challenges a February 4 ruling by the D.C. Circuit. Dividing 2-1, a panel of the Circuit Court ruled that RICO does not give federal judges power to require a violator to disgorge its gains from past illegal activity, as a remedy for a civil violation of the Act. The civil remedies allowed by RICO, the panel found, must be limited to "forward-looking remedies that are aimed at future violations."

That ruling, the Justice Department appeal contended, "is inconsistent with this Court's decisions, squarely conflicts with the decisions of other courts of appeals, wrongly decides an important issue and, if left uncorrected, will impede, rather than advance, the ultimate resolution of the proceedings in this extraordinarily important case."

"The court of appeals," the government contends in the petition, "has disabled the government from employing a critically important remedial tool—equitable disgorgement—for achieving Congress's objectives. That court has done so in a case of vital interest to the American public."

The government did not ask the Court to expedite its handling of the new appeal, so it will come up in regular order in the Court Term that starts Oct. 3. The industry has 30 days to file its opposition. The government's appeal is from a Circuit Court so it is not mandatory that the Court hear and decide it; that is a matter left to its discretion.

In arguing for review, the petition not only laments the denial of a disgorgement remedy, but also complains that the Circuit Court ruling threatens the scope of any other remedy that could emerge if a RICO violation is found. The petition noted that the industry is now arguing in District Court that the February ruling prohibits any remedy that would cure the ill effects of past unlawful conduct, including a stop-smoking campaign aimed at those who previously had become addicted to nicotine-laced cigarettes.

The government noted that U.S. District Judge Gladys Kessler had not yet issued a final ruling on remedies, but that she had commented that the Circuit Court ruling "simply does not permit non-disgorgement remedies to prevent and restrain the effects of past violations."

As a result, it noted, the government has curtailed its proposal for remedies, cutting a cessation and education program down to $14 billion lasting no longer than ten years. (It had previously sought a $130 billion plan, to run for 25 years.)

Even though the case is not yet over in District Court, the new appeal argues that the Supreme Court should step in now to resolve the availability of a disgorgement remedy. "If the Court postpones correction of the court of appeals' mistaken guidance until after the district court issues an artificially constrained final judgment and this complex case traces a new route through the court of appeals, then the district court will be precluded from correctly resolving this litigation until remand proceedings can be convened at a far distant date."

The petition suggested that the case might not get back to the Supreme Court until the summer of 2007, putting off a final decision until 2008. If the Court takes the case in its next Term, and resolves it by the summer of 2005, the District Court could issue a final ruling by the summer of 2006, it said.

The case has already run on in the lower courts for nearly six years.

"Huge Tobacco Case Seems Court-Bound"

SCOTUSblog
April 20, 2005
Lyle Denniston

A 3-3 split in the D.C. Circuit on Wednesday, denying rehearing *en banc* on a key remedies issue in the government's massive and long-running lawsuit against the tobacco industry, probably will be the signal for the Bush Administration to move on to the Supreme Court. Indeed, it would be astonishing if the government were now to abandon its attempt to recoup $280 billion of profits made by six tobacco companies—a goal it has pursued relentlessly for nearly six years.

The tobacco case, now rivaling the fabled *Jarndyce v. Jarndyce* in Charles Dickens' *Bleak House,* has just gone through its 95th trial day this week. District Judge Gladys Kessler in Washington has issued 927 orders, and there have been 5,261 docket entries. No entry in that case was more controversial than Kessler's Order No. 550, issued on April 24 last year, refusing to throw out the government's plea that the companies "disgorge" corporate earnings made on sales of nicotine-containing tobacco products. That claim has been a part of the case since it was first filed, on September 22, 1999, under the anti-racketeering RICO Act of 1970.

That order was overturned by the D.C. Circuit, in a 2-1 ruling on February 4 this year (*Philip Morris USA, et al., v. U.S.*, docket 04-5252). Judge Kessler has since described the decision as "a body blow to the government's case." The Justice Department sought rehearing *en banc*, arguing that the panel ruling threatened to cripple the "remedial force" of RICO. That was the request turned down on Wednesday. Three judges on the D.C. Circuit did not take part, without saying why, and the remaining six divided evenly; under Circuit rules, five votes were necessary to grant *en banc* review. Kessler has said she expected the government to take the case on to the Supreme Court if it lost in the Circuit Court. Nothing in the government's actions up to this point suggests it would surrender now.

Here is the way Kessler, in her Order 550 a year ago, described the issue: "The government seeks . . . disgorgement of $280 billion dollars of ill-gotten gains for what it alleges to be defendants' unlawful conspiracy to deceive the American public. The government's amended complaint describes a four-decade long conspiracy, dating from at least 1953, to intentionally and willfully deceive and mislead the American public about . . . the harmful nature of tobacco products, the addictive nature of nicotine, and the possibility of manufacturing safer and less addictive tobacco products." The disgorgement was sought under RICO. Kessler ruled that RICO did not bar a disgorgement remedy even if it was aimed, at least in part, at punishing the companies for past conduct, as a deterrent to prevent future violations. She thus refused to grant the industry summary judgment on the point.

The six companies took the issue on to the D.C. Circuit, and the divided panel ruled that RICO only allowed "forward-looking" remedies. The Act, the majority said, gives federal courts authority to issue orders "to prevent and restrain" RICO violations. "This language indicates that the jurisdiction is limited to forward-looking remedies that are aimed at future violations. . . . Permitting disgorgement . . . would . . . thwart Congress' intent in creating RICO's elaborate remedial scheme."

The appeal was interlocutory, and the trial continues before Kessler, with heavy new controversy already developed over what other remedies the government may still seek if Kessler, in the bench trial, rules that the companies did violate RICO. The latest tussle there was over a government request to call a Harvard Business School professor, Max Bazerman, as a witness to discuss possible removal of senior executives of the tobacco companies, as one possible remedy. The industry denounced that as "a draconian new remedy to replace its now-dismissed $280 billion disgorgement claim."

Judge Kessler on April 9 refused to strike Bazerman as a witness or to take any "corporate restructuring remedy" off the table. The government has not yet begun its case-in-chief on the remedies issue, so the "corporate restructuring" dispute is likely to recur. The judge and the Justice Department contend that the entire remedies case has shifted as a result of the D.C. Circuit ruling on the disgorgement question. That, no doubt, will be a key facet of any appeal the government takes to the Supreme Court.

"Political Leanings Were Always Factor in Tobacco Suit"

New York Times
June 19, 2005
Eric Lichtblau

The case started as a bombshell: deep into his State of the Union address in 1999, President Bill Clinton surprised even the most ardent antismoking advocates by announcing that he was unleashing the considerable resources of his Justice Department to prepare a lawsuit against Big Tobacco.

Nine months later, a team of lawyers working in the bowels of the Justice Department made good on the president's promise by filing what amounted to one of the biggest federal lawsuits in history, accusing cigarette makers of a half-century of fraud, deceptive advertising and dangerous marketing practices.

The career lawyers working the case saw themselves on the cutting edge of a novel if controversial piece of litigation, several recalled in interviews. But exuberance turned to trepidation for some of the lawyers 15 months later when the Bush administration inherited the case. Some senior officials in the new administration saw the case as an albatross that prompted clear ambivalence, if not outright hostility.

John Ashcroft, who had opposed the lawsuit while a senator, pronounced it weak after taking over as attorney general, and tried to cut the money for it. And President Bush himself, asked about the lawsuit in an interview in early 2001 on Fox News, said, "I worry about a litigious society." Noting that many states had already sued the tobacco industry and forced settlements, Mr. Bush said, "At some point, you know, enough is enough."

Nearly six years after the lawsuit was brought, that point may finally have come.

At the close of a nine-month trial, the Justice Department has now reduced the penalties it was seeking from the tobacco industry to $10 billion from $130 billion. Senior political appointees at the department made the move despite strong objections from leaders of the trial team running the case, who argued that the decision was not based on the facts of the case, would appear politically motivated and would undermine the government's position in a possible settlement, according to a May 30 memorandum disclosed last week in the *New York Times*. With speculation swirling about a possible settlement, the government filed a sealed motion in the case late on Thursday. The judge, who must now decide what penalties, if any, to impose against the tobacco industry, scheduled a last-minute hearing for Monday, which will apparently be closed to the public. Officials would not discuss the nature of the government's motion or the topic of the hearing.

The case has created a political tempest for the Bush administration, as health advocates and Democrats in Congress have protested the decision as politically calculated, and it has prompted an internal ethics investigation by the Justice Department.

"There is no clearer example of this administration's view that government and the courts should protect big corporations first and real people last," Senator Edward M. Kennedy, Democrat of Massachusetts, said in a speech on the Senate floor. "They made a political decision to back Big Tobacco."

Janet Reno, the attorney general under Mr. Clinton, who brought the case in 1999, said the Bush administration needed to do a better job of explaining why it changed course so abruptly at the 11th hour in the case.

"I've never heard of a party changing its position in a manner so inconsistent with its past positions," Ms. Reno said in a telephone interview. "To have this case pulled out from under the career lawyers like this deserves an explanation, and if there was no political interference, we can dispel that notion."

The district court judge hearing the case in Washington, Gladys Kessler, said in court of the Justice Department's abrupt shift, "Perhaps it suggests that additional influences have been brought to bear on what the government's case is."

But the Justice Department has resolutely defended its position, saying that its decisions have been based not on political considerations but on legal ones, particularly in light of a February appellate court decision that limited the types of penalties the government could seek.

The tobacco case has always been politically tinged, whether a Democrat or a Republican was in the White House. Mr. Clinton's critics accused him of demonstrating excessive exuberance and an overly litigious nature in ordering up the lawsuit, while Mr. Bush's critics see his administration's ambivalence toward the lawsuit as evidence of its close ties to big business in general and the tobacco industry in particular.

Past and present members of the tobacco trial team say that during the Clinton and the Bush administrations, the political leanings of whichever administration was in charge were always a factor in a case involving so much money and so many powerful players.

"I don't know that what the Bush administration has done is any more politically based than what Clinton did in bringing the case in the first place," said Paul Honigberg, a lawyer who worked on the Justice Department's case from its inception and left as deputy director of the trial team in September 2001. "A high-profile case like this represents a place where policy and the law inevitably cross, and you have to figure senior officials in the Justice Department have a right to make decisions based on their view of policy and the law," he said.

At the center of the shifting political dynamics are the several dozen career Justice Department lawyers on the trial team, who have reviewed millions of pages of documents and interviewed hundreds of witnesses over the last six years. Lawyers traveled to far-flung spots from Minnesota to England and Australia in search of evidence to corroborate their theories of fraudulent conduct by the tobacco industry. The cost of prosecuting the case topped $135 million as of the latest official tally from the Justice Department last October.

At the outset of the case, recalled Thomas J. Perelli, a Justice Department official in the Clinton administration who oversaw the lawsuit's inception, skeptics among the lawyers doubted whether a huge civil case could be brought. The lawyers threw out some theories altogether, like an antirust claim.

"But the more people started getting into the facts of the case and saw the pattern of fraud by the industry, the more people started to really believe in the case," Mr. Perelli said.

The Justice Department has had its share of legal setbacks in court. Early on in the case, Judge Kessler threw out one of the government's central claims—that the tobacco industry should reimburse the government for the Medicare costs for people made sick by smoking in past decades.

And an appellate decision in February denied the government the chance to seize any ill-gotten profits from the tobacco industry's past practices and imposed a "forward-looking" model on any penalties. That decision, Judge Kessler acknowledged in a February order, "struck a body blow to the government's case," and it forced the government to rely on what some lawyers called a Plan B, seeking damages from the tobacco industry to pay for a program to help nicotine addicts stop smoking. Months after the appellate court ruled, the Justice Department put on a health expert who said the smoking cessation plan would cost $130 billion over the next 25 years, and it filed a motion just a month ago, signed by senior officials, backing that plan.

The Justice Department said the appellate decision left it with little choice but to limit the damages it sought from the tobacco industry. In the view of the tobacco industry, that department's decision to scale back reflected years of over-reaching by the career lawyers in the case.

"The government lawyers running this case were creative and tenacious and were basically pounding a square peg in a round hole," said William S. Ohlemeyer, a vice president with the Altria Group, which owns Philip Morris USA, one of the tobacco defendants. "But sooner or later, the law catches up with a case like this."

Health advocates and Democrats maintain that it was not the law, but politics, that drove the recent turn of events. Democrats have circulated a long list of financial ties that they say run deep between the Bush administration and the tobacco industry. Those ties include $2.7 million in industry contributions to Republicans in 2004, the past work of several senior Justice Department officials at law firms that have represented tobacco companies, and political consulting work that Karl Rove, a senior Bush advisor, did for Phillip Morris in the 1990's.

The Justice Department's decision to cut its proposed penalties "was a decision that looks like it was made for other than legal reasons," said Matthew L. Myers, who is president of the Campaign for Tobacco-Free Kids and testified for the government in the case. "All too often, the Republican leadership has been perceived as doing the bidding of the American tobacco industry, and I'm afraid that's what we may be seeing here."

Bank of China v. NBM, LLC

(03-1559)

Ruling Below: *Bank of China v. NBM, LLC,* 359 F.3d 171 (2nd Cir. 2004), *cert. granted* 125 S. Ct. 2956 (U.S. June 27, 2005).

Bank of China sued defendants, individuals and companies, allege a civil RICO claim based on bank fraud. A jury trial returned verdict in favor of the bank, finding that the defendants breached contracts with the Bank of China. The district court entered judgment for the bank in an amount in excess of $106 million. The Second Circuit Court of Appeals vacated the judgment and remanded, holding that the district court erred in instructing the jury that the bank could be defrauded regardless of whether its officers and employees were aware of or participated in the fraud. The district court also erred in not requiring the bank to prove "reasonable reliance." The Second Circuit held that this was not harmless error because it failed to inform the jury of an essential element of a civil RICO action predicated on fraud.

Question Presented: Did the Court of Appeals for the Second Circuit err when it held that civil RICO plaintiffs alleging mail and wire fraud as predicate acts must establish "reasonable reliance" under 18 U.S.C. § 1964(c)?

"Second Circuit Reverses $106 Million Fraud Award Due to Erroneous Jury Instruction on Reliance"

Commercial Lending Litigation News
March 5, 2004

In a case that proves the devil is in the details, a lender lost a 106 million award for bank fraud because a District Court misstated the applicable law when it gave a jury instruction. The 2d U.S. Circuit Court of Appeals ruled that the instruction, which did not require the lender to show that it reasonably relied on borrowers' fraudulent misrepresentations, relieved the lender of its burden of proof and warranted a reversal of the verdict. (*Bank of China v. NBM LLC, et al.*, No. 02-9267 (2d Cir. 02/17/04).)

The Bank of China sued several corporations and individuals, including a former employee, claiming they defrauded it of 34 million over a 10-year period through a series of loan transactions. A jury awarded the lender 35.4 million in compensatory damages, and the U.S. District Court, Southern District of New York trebled the award as permitted under the Racketeer Influenced and Corrupt Organizations Act (see Oct. 3, 2002 issue, p. 2). The debtors appealed.

To prevail on a civil RICO claim, a plaintiff must show that the defendant's fraudulent acts were the proximate cause of its injury. For certain types of fraud, including mail, wire or securities fraud, a plaintiff can establish proximate causation by proving that it reasonably relied on the defendants' representations. The debtors argued that the District Court's jury instruction, stating that the bank could be defrauded even if its employees knew the true nature of the loan transactions, was erroneous because it did not require the bank to prove reasonable reliance.

U.S. District Judge Shira A. Scheindlin, sitting with the 2d Circuit by designation, noted that no Circuit or District Courts had explicitly addressed whether a plaintiff must prove reasonable reliance when it bases a RICO claim on bank fraud. However, the judge pointed out that civil RICO plaintiffs must satisfy the proximate cause requirement, regardless of whether the defendant committed bank fraud or some other prohibited action. Determining that recovery is not warranted unless a plaintiff can show that the defendants caused its losses, the court concluded that the Bank of China needed to prove it reasonably relied on the debtors' misrepresentations.

Although the District Court instructed the jury that the lender needed to prove reasonable reliance to establish common law fraud, it also stated that the lender could be a victim of bank fraud even if its officers and employees participated in the debtors' fraudulent activities. If the lender's employees knew the true nature of the loan transactions, the lender could not have relied on the debtors' misrepresentations when it approved the loans.

"These two instructions are at best confusing, at and worst irreconcilable," the judge wrote.

Because the cumulative jury instructions failed to inform the jury about an essential element of the lender's bank fraud claim, Judge Scheindlin explained, the lender did not have to sustain its burden of proof and the debtors were not able to present their best defense. The jury could have inferred from the evidence that the lender's employees knew about the debtors' fraudulent misrepresentations and that the lender did not rely on the statements. Concluding the error was not harmless, the 2d Circuit reversed the lender's 106 million award and remanded the case for a new trial.

Wachovia Bank, National Association v. Daniel G. Schmidt III, et. al

(04-1186)

Ruling Below: (*Wachovia Bank, National Association* v. Daniel G. Schmidt, 388 F.3d 414 (4th Cir. 2004), *cert. granted*, 125 S.Ct. 2904, 73 U.S.L.W. 3540, 73 U.S.L.W. 3713, 73 U.S.L.W. 3718 (U.S. June 13, 2005) (No. 04-1186)).

Wachovia is a national banking association with a principal place of business in Charlotte, North Carolina. Wachovia has branch offices in several other states, including South Carolina. Daniel G. Schmidt is a citizen of South Carolina. Schmidt accused Wachovia of fraud, and filed suit against Wachovia in South Carolina state court. Wachovia removed the case to federal district court, claiming that the federal district court had diversity subject matter jurisdiction. The district court ruled against Wachovia on the merits of the claim, and Wachovia appealed to the Fourth Circuit Court of Appeals. At the court of appeals, Schmidt argued that there was no diversity of citizenship between Wachovia and Schmidt. He claimed that according to 28 U.S.C.S. § 1348 Wachovia was "located" in South Carolina for purposes of determining citizenship because Wachovia had branch offices within the state. The court of appeals agreed with Schmidt, concluding that a national bank is the citizen of any state in which it operates branch offices. This ruling contradicts with decisions in the Fifth and Seventh Circuit Court of Appeals.

Questions Presented: Whether, for purposes of federal diversity jurisdiction, a national banking association is "located" in, and thus deemed to be a citizen of, every state in which the association maintains a branch, as held by the court below, or instead has a more limited citizenship, as held by three other courts of appeals; and (ii) whether the word "located," as used in, 28 U.S.C.S. § 1348 is ambiguous?

"National Bank's Branches Destroy Diversity Jurisdiction, 4th Circuit Holds"

Daily Record (Baltimore, MD)
November 8, 2004
Barbara Grzinci

National banks with branches in Maryland cannot use the federal courts to litigate state-law claims by or against Maryland citizens, the 4th U.S. Circuit Court of Appeals has held.

The court broke ranks with two other federal appeals courts that recently decided the same issue, setting the stage for a possible Supreme Court battle—a fact that left the 2-1 majority unconcerned.

"Questions of statutory interpretation are not decided by majority vote of the courts of appeals"," Judge J. Michael Luttig wrote for the majority. "That our sister circuits may disagree with us in any given case is significant only insofar as their reasoning is persuasive. Here, that reasoning is simply unconvincing."

The disagreement arose over the proper boundaries of a federal court's diversity jurisdiction, that is, its authorization to hear disputes between citizens of different states.

Federal law provides that, for purposes of diversity jurisdiction, national banks are deemed to be "citizens of the States in which they are respectively located."

Under the plain meaning of the statute, "a national banking association is 'located' wherever it operates branch offices," Luttig wrote.

That decision echoes a comment made last year by the 2nd U.S. Circuit Court of Appeals interpreting the same federal law, *28 U.S.C. §1348,* Luttig noted.

However, the 5th and 7th Circuits reached the opposite conclusion in opinions this year and last; so, too, did the 9th Circuit in 1943, interpreting a 19th-century version of the law.

The majority last week found those interpretations "utterly implausible."

Writing in dissent, Judge Robert B. King said national banks should have the same access to federal courts as state banks and corporations, for which a branch office in one state does not automatically destroy diversity jurisdiction.

"The Comptroller of the Currency has also endorsed this view," King noted. "[O]ur creation of a circuit split on this issue is unwarranted," he wrote. "Because the majority has unjustifiably circumscribed federal court jurisdiction of disputes involving national banks, I respectfully dissent."

Last week's decision sends a dispute between North Carolina-based Wachovia Bank N.A. and a South Carolina investor, Daniel G. Schmidt III, back to the South Carolina state court where it was filed.

Schmidt and other plaintiffs claimed Wachovia fraudulently induced them to engage in a risky, tax-motivated investment scheme.

Wachovia removed the action to federal

court and appealed to the 4th Circuit after the federal judge refused to compel arbitration.

On appeal, Schmidt argued for the first time that the federal court lacked diversity jurisdiction because Wachovia had branches in South Carolina. The majority agreed and vacated the ruling, ordering the case remanded to state court.

The 4th Circuit's decision is binding on federal courts in Maryland, North Carolina, South Carolina, Virginia and West Virginia.