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V. Business

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Customers brought an antitrust class action against Comcast alleging that it harmed a class of people consisting of cable subscribers in the Philadelphia region by improperly eliminating competition, raising entry barriers to potential competition, and increasing prices at unreasonable levels, while depriving subscribers of lower prices that would have come from effective competition, in violation of federal anti-trust laws. Plaintiffs asserted that Comcast caused these injuries by certain acquisitions and swaps of customers with other providers in the Philadelphia region in exchange for customers in other regions. The United States District Court for the Eastern District Pennsylvania certified class. Comcast appealed.

Question Presented: Whether a district court may certify a class action without resolving whether the plaintiff class has introduced admissible evidence, including expert testimony, to show that the case is susceptible to awarding damages on a class-wide basis.

For the reasons that follow, we hold that the Court did not exceed its permissible discretion in determining that Plaintiffs established by a preponderance of evidence that they would be able to prove through common evidence (1) class-wide antitrust impact (higher cost on non-basic cable programming), and (2) a common methodology to quantify damages on a class-wide basis. Accordingly, we will affirm.
arrangements or devices,” and section 2 of the Sherman Act, 15 U.S.C. § 2, on theories of monopolization and attempted monopolization. The Complaint alleged anticompetitive conduct in the Philadelphia area and the Chicago area. As only the alleged conduct in Philadelphia is before us, we focus on the nature of the class and the allegations in Philadelphia.

The Complaint alleged that Comcast had perpetrated an anticompetitive “clustering scheme.” According to the Complaint, Comcast eliminated competition by (1) acquiring competitors in the Philadelphia market and (2) swapping with competitors cable systems and subscribers outside of the Philadelphia market for cable systems and subscribers within the Philadelphia market. The Complaint also alleged that Comcast engaged in conduct intended to exclude competition from overbuilder RCN Telecom Services, Inc. (“RCN”), by denying it access to “Comcast Sportsnet,” requiring contractors to enter non-compete agreements, and inducing potential customers to sign up for long contracts with special discounts and penalty provisions in the areas where RCN intended to overbuild.

As a result of its clustering, Comcast allegedly harmed the class by eliminating competition, raising entry barriers to potential competition, maintaining increased prices for cable services at supra-competitive levels, and depriving subscribers of the lower prices that would result from effective competition.

II.

... Reviewing a district court’s certification of a class, we examine the elements of the class’s claims “through the prism” of Rule 23. The elements of the claims before us are (1) a violation of the antitrust laws (here, sections 1 and 2 of the Sherman Act), (2) individual injury resulting from that violation, and (3) measurable damages. Individual injury, also known as antitrust impact, “is critically important for the purpose of evaluating Rule 23(b)(3)’s predominance requirement because it is an element of the claim that may call for individual, as opposed to common, proof.” At the class certification stage, Plaintiffs’ burden is “to demonstrate that the element of antitrust impact is capable of proof at trial through evidence that is common to the class rather than individual to its members.”

III.

Comcast devotes much of its energy to contending that the District Court exceeded its discretion in holding that Plaintiffs had established common evidence of antitrust impact.

A.

We will affirm the District Court’s conclusion that the Philadelphia Designate Market Rea (DMA) is a relevant geographic market “susceptible to proof at trial through available evidence common to the class.” 264 F.R.D. at 160.

The relevant geographic market is a component of substantive antitrust law. For antitrust claims analyzed through the rule of reason, plaintiffs must demonstrate that the defendant possessed market power in the relevant geographic market. For per se claims, plaintiffs need not establish a geographic market. Additionally, “direct proof of monopoly power does not require a definition of the relevant market.”

Defining the relevant geographic market, however, is an issue of the merits. At the class certification stage, a court need only be
satisfied that issues—including the definition of a geographic market—will be capable of proof through evidence common to the class. If the plaintiffs allege per se claims, they may still need to persuade the district court that, in the event defining the relevant geographic market becomes necessary, it is capable of common proof.

B.

First, we perceive no legal error in the District Court’s reasoning. Procedurally, it conducted the required “rigorous analysis” by examining in depth the expert opinions on both sides and setting forth its conclusions. Substantively, the Court determined that “the record evidence shows that consumers throughout the DMA can face similar competitive choices and suffer the same alleged antitrust impact resulting from Comcast’s clustering conduct in the Philadelphia DMA.” 264 F.R.D. at 160. Comcast contends that the Court failed to apply the consumer demand substitutability test, which defines the relevant geographic market as “that area in which a potential buyer may rationally look for the goods or services he seeks.” We determine otherwise: the Court’s analysis of the relevant geographic market for purposes of class certification comported with our precedent.

“[I]dentification of the relevant geographic market is a matter of analyzing competition.” Defining it “is a question of fact to be determined in the context of each case in acknowledgment of the commercial realities of the industry being considered.” In these decisions of our Court, one of which has commanded our attention for almost thirty years, we relied on two Supreme Court cases to develop this standard: United States v. Grinnell Corp., 384 U.S. 563, 576 (1966), which held that the relevant geographic market under the Sherman Act was “not the several local areas which the individual stations serve, but the broader national market that reflects the reality of the way in which they built and conduct their business,” and Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320, 327, 332 (1961), which defined the relevant geographic area for § 3 of the Clayton Act, 15 U.S.C. § 3, as “the market area in which the seller operates, and to which the purchaser can practicably turn for supplies” or as the area in which suppliers “effectively compete.”

C.

The District Court’s determination—that consumers “face similar competitive choices” in the Philadelphia DMA as a result of Comcast’s alleged clustering conduct—is consistent with the above standards because it considers both where a buyer may rationally look for goods and the commercial reality of the industry. Comcast’s insistence that the geographic market must be the individual household (as the only place where a consumer can “comparison shop”) ignores that the geographic market must be “economically significant,” and may be premised on “the commercial realities of the industry being considered,” the area where suppliers “effectively compete” or the broader market reflecting the reality of conducting business. We therefore discern no legal error in the District Court’s analysis. . . .

E.

Second, we recognize ample evidence in the record supporting the District Court’s factual findings underpinning its market determination, which precludes us from reversing those findings as clearly erroneous.
Simply put, the District Court determined by a preponderance of the evidence that, when addressed on the merits, the class may be able to prove through common evidence that the relevant geographic market is the Philadelphia DMA.

IV.

Comcast hinges its next line of arguments on the District Court’s final certification: “Proof of antitrust impact relative to such claims shall be limited to the theory that Comcast engaged in anticompetitive clustering conduct, the effect of which was to deter the entry of overbuilders in the Philadelphia DMA.” According to Comcast, the District Court made clearly erroneous findings of fact by relying on Plaintiffs’ expert, Dr. Williams, in support of the certified theory of antitrust impact.

A.

On appeal, Comcast constructs a four-tiered argument to support its objections. First, it contends that Plaintiffs cannot show class-wide antitrust impact based on potential overbuilding by any of the “Transaction parties.” According to Comcast, the evidence demonstrated there was no actual competition between the Transaction parties; Plaintiffs therefore must show that the challenged conduct eliminated potential competition. In Comcast’s view, the record evidence reflects that no Transaction parties had taken any affirmative steps to overbuild and, consequently, there was no potential competition to eliminate. Second, Comcast contends that Plaintiffs identified only RCN Telecom Services, Inc., as attempting to overbuild in the Philadelphia DMA. The evidence establishes, according to Comcast, that RCN was not going to overbuild as a result of its own financial woes, not as a result of any alleged activity on the part of Comcast. Third, as the argument goes, because there was no record evidence demonstrating actual or potential competition, the theoretical opinions indicating otherwise rendered by Plaintiffs’ expert, Dr. Williams, were clearly erroneous. Comcast disputes at many levels Dr. Williams’s methodology and results in his “market structure” and “market performance” opinions. Fourth, Comcast adds that any evidence of anticompetitive conduct specific to Delaware County could not serve as evidence of class-wide impact for the Philadelphia cluster.

B.

Plaintiffs respond to each level of Comcast’s position. First, citing many portions of the record, they assert that there is “overwhelming” record evidence that Comcast’s clustering of the Philadelphia DMA deterred and reduced overbuilding competition, resulting in antitrust impact (higher cable prices) for all class members. According to the class, the record demonstrates: clustering deters overbuilding, the swaps and acquisitions eliminated competition, Multi-System Operators (“MSOs”) actually do overbuild one another, Comcast and other MSOs look to one another’s prices to set their own, and the MSOs chose affirmatively not to compete. Second, Plaintiffs contend that Comcast raises a merits issue by asking the Court to examine whether Comcast’s conduct in fact prevented RCN from overbuilding in more areas than it did. In any event, they state that the record evidence demonstrates RCN had the intent and capital to overbuild the Philadelphia market. Third, Plaintiffs state that Dr. Williams’s theoretical model plainly shows common evidence of class-wide impact; Comcast’s contention that Dr. Williams’s opinions do not prove antitrust impact is one for the jury to decide on the
merits. Fourth, the evidence related to Delaware County “adds to and illustrates” the common evidence of Comcast’s anticompetitive clustering conduct.

V.

We begin the analysis of these contentions by focusing on the precise inquiry:

Plaintiffs’ burden at the class certification stage is not to prove the element of antitrust impact, although in order to prevail on the merits each class member must do so. Instead, the task for plaintiffs at class certification is to demonstrate that the element of antitrust impact is capable of proof at trial through evidence that is common to the class rather than individual to its members.

_Hydrogen Peroxide_, 552 F.3d at 311–312. Many of Comcast’s contentions ask us to reach into the record and determine whether Plaintiffs actually have proven antitrust impact. This we will not do. Instead, we inquire whether the District Court exceeded its discretion by finding that Plaintiffs had demonstrated by a preponderance of the evidence that they could prove antitrust impact through common evidence at trial.

Comcast has not carried its burden. Plaintiffs provided evidence at the certification hearing that tended to show that Comcast’s clustering (through swaps and acquisitions) reduced competition, deterred the entry of overbuilders, and resulted in higher cable prices for the entire class. This evidence displays “some hue of credibility” and bears a rational relationship to the Court’s finding.

All of this evidence demonstrates that Comcast’s alleged clustering conduct indeed could have reduced competition, raised barriers to market entry by an overbuilder, and resulted in higher cable prices to all of its subscribers in the Philadelphia Designated Market Area. Based on this evidence, we determine that the antitrust impact Plaintiffs allege is “plausible in theory” and “susceptible to proof at trial through available evidence common to the class.”

VI.

Comcast’s other contentions are equally unpersuasive. There is conflicting evidence as to the role Comcast played in RCN Telecom Services, Inc.’s decision to not overbuild further in the Philadelphia DMA. Plaintiffs highlight record evidence that RCN had the intent and capital necessary to overbuild the Philadelphia market. Comcast contends instead that RCN faced financial woes, as a result of which it abandoned its plans to overbuild. The District Court credited Plaintiffs’ explanation: “What Dr. Teece considers ‘unlikely,’ Dr. Singer considers to be the common evidence of antitrust impact, namely that RCN was stymied in its efforts by Comcast’s predatory behavior.” Again, we are satisfied that the District Court’s finding was not clearly erroneous. “Where there are two permissible views of the evidence, the factfinder’s choice between them cannot be clearly erroneous.”

Similarly, Comcast contends that Dr. Williams’s analysis and methodology was flawed for various reasons, including the allegation that it was unsupported by any actual evidence. We disagree. As detailed above, there was ample evidence that clustering conduct can deter entry of overbuilders and result in higher cable prices.
Comcast also asserts that every individual had one or two options from which to choose cable and that consequently only the name of the provider changed, not the number of options. This assertion completely overlooks the nature of the claims of the class: by clustering, Comcast was able to deter the entry of overbuilders, which resulted in higher prices for all non-basic Comcast subscribers. And Plaintiffs provided evidence that clustering can have this effect.

As to Comcast’s remaining contention that the District Court erred by crediting as evidence of class-wide impact the alleged conduct targeted at RCN Telecom Services, Inc., in Delaware County, we agree with the class that the alleged conduct is relevant to establishing class-wide impact. We have explained that “courts must look to the monopolist’s conduct taken as a whole rather than considering each aspect in isolation.”). Alleged specific conduct aimed at preventing the entry of an overbuilder anywhere in the Philadelphia DMA supports Plaintiffs’ allegations of Comcast’s ability to maintain supra-competitive prices for the entire market.

VII.

At bottom, Comcast misconstrues our role at this stage of the litigation. Comcast would have us decide on the merits whether there was actual or potential competition among the Transaction parties, the reason RCN Telecom Services, Inc., abandoned the Philadelphia market, and whether Plaintiffs’ experts proved antitrust impact. We are not the jury. Although in Hydrogen Peroxide we heightened the inquiry a district court must perform on the issue of class certification, nothing in that opinion indicated that class certification hearings were to become actual trials in which factual disputes are to be resolved.

In sum, we hold that the District Court’s determination—that Plaintiffs have demonstrated by a preponderance of the evidence that they can establish class-wide antitrust impact through common evidence—did not exceed its discretion.

VIII.

To satisfy another portion of the predominance requirement, Plaintiffs must establish that the alleged damages are capable of measurement on a class-wide basis using common proof.

A.

The District Court examined the methodology, conclusions, and criticisms of the experts on both sides, before providing its conclusions. Because on appeal Comcast renews the arguments it made to the District Court, we set forth each side’s position in the District Court and the Court’s response. Plaintiffs’ damages expert, Dr. McClave, concluded that the prices in the Philadelphia market were consistently and substantially higher than the prices in areas of effective competition. His econometric analysis demonstrated that the alleged antitrust impact was class-wide, because the prices were elevated above competitive levels across all class members and for the entire time period. For his methods, Dr. McClave constructed “but-for” prices against which to compare the prices Comcast charged in the Philadelphia DMA. “But-for” prices are those that would have existed absent the alleged anticompetitive conduct. To construct the “but-for” prices, he first selected comparable “benchmark” counties around the country by applying two “screens” to determine whether the counties represented a level of competition similar to
what Comcast would have faced in the Philadelphia market absent its alleged anticompetitive conduct. It is important to understand these two screens. The first screen—the “market share screen” or “40% screen”—required that the county have a Comcast subscriber penetration rate of less than 40%. Dr. McClave chose 40% because it represented the approximate midpoint of Comcast’s penetration rate in the Philadelphia DMA (between approximately 20% in 1998 and 60% from 2003 through 2008). He chose this number also because it allowed for growth during the class period but focused on markets where Comcast was likely to have less market power than it does in the Philadelphia market. The second screen—the “Direct Broadcast Satellite screen”, or “DBS screen”—required that the county be in a Designated Market Area where the penetration level for Alternative Delivery Systems (which essentially includes DBS, but also master antenna systems and multipoint distribution systems) was at or higher than the national average of Alternative Delivery Systems penetration rates in Comcast markets. Using data from the counties that fit the two screens, Dr. McClave performed a multiple regression analysis to compare actual prices in the Philadelphia DMA to the estimated “but-for” prices. He then applied the overcharge percentage to the relevant revenue obtained by Comcast for expanded basic service in the Philadelphia market during the class period to reach a final conservative estimated overcharge value: $875,576,662.

Comcast’s experts, Dr. Teece and Dr. Tasneem Chipty, contested several parts of Dr. McClave’s methodology, and questioned his results. First, they challenged both benchmark screens used by Dr. McClave. Regarding the “DBS screen,” Dr. Teece asserted that Dr. McClave erroneously chose the higher national Direct Broadcast Satellite penetration rate, instead of the lower regional rate predicted by Plaintiffs’ experts Dr. Singer and Dr. Williams. The District Court rejected the critique, stating that Dr. McClave “used his national average DBS penetration screen as a descriptor of typical competitive market conditions,” and was not attempting to predict the Direct Broadcast Satellite penetration rate of the Philadelphia DMA Regarding the “market share screen,” Dr. Chipty contended that because Comcast was present in only a few counties in 1999, its actual market share was much higher in the counties where it was and 0% where it was not; as a result, the less-than-40% penetration rate provided an inappropriate screen. The District Court rejected the criticism as unsupported by the record, stating that Dr. Chipty should have presented evidentiary data to show that 40% was an incorrect midpoint estimate or average rate. The Court also noted that the 40% screen was supported by the evidence as Comcast’s approximate share of the Philadelphia DMA at the midpoint of the class period.

Second, Dr. Chipty faulted Dr. McClave’s model for failing to consider properly demographic variables among the counties: specifically, for omitting the variables of population density and the number and type of households. The District Court credited as well-supported Dr. McClave’s response as to why he omitted population density: it is correlated with medium household income (which he included) and using it as well as household income would create confounding and unreliable results.

Third, Dr. Chipty criticized Dr. McClave’s model for comparing list prices for expanded basic cable in the Philadelphia DMA against the benchmark counties. She opined that Dr. McClave’s model did not take into account the significant number of
promotions and discounts offered to Comcast customers. The Court rejected Dr. Chipty’s models as “suffer[ing] significant flaws.” It stated that Dr. McClave’s model accounted for discount prices in the formula (not model) when he multiplied anticompetitive overcharge by Comcast’s relevant revenues. Accordingly, by adding discount prices to the model as well, Dr. Chipty’s model doubly counted the discount.

Fourth, the District Court rejected Dr. Chipty’s attempt to impeach Dr. McClave’s model by using it to calculate damages for basic cable prices, instead of expanded basic cable. The Court explained that Dr. McClave’s model aimed to analyze only expanded basic cable, because Comcast alters its prices at the expanded level, so “any application of the McClave model to [basic cable prices] explains nothing.” Comcast does not contest that ruling.

Fifth and finally, the Court asked the parties after the hearing how to interpret Dr. McClave’s damages model if it credited at least one, but not all, of Dr. Williams’s four theories of antitrust impact. It determined that Dr. McClave’s damages model was still viable, even if it rejected some theories of antitrust impact, explaining that Dr. McClave selected benchmarks to isolate the effect of anticompetitive conduct, and that his use of the DBS screen was “entirely unrelated” to Dr. Williams’s DBS foreclosure theory. The Court concluded that Dr. Williams’s theories of antitrust impact were not relevant to Dr. McClave’s methods of choosing benchmarks because “[a]ny anticompetitive conduct is reflected in the Philadelphia DMA price, not in the selection of the comparison counties.”

B.

Comcast contends that the District Court exceeded its discretion in accepting Plaintiffs’ proposed damages calculation methodology. Its arguments are recast versions of those rejected by the District Court.

Plaintiffs remind us that the District Court already thoroughly considered and rebutted each of the points that Comcast now raises.

IX.

We pause to identify the forest for the trees. If allowed to proceed to trial, the class must establish that the injury it suffered from the violation of the antitrust laws is measurable. The usual measure in an overcharge case “is the difference between the illegal price that was actually charged and the price that would have been charged ‘but for’ the violation multiplied by the number of units purchased.” Given the inherent difficulty of identifying a “but-for world,” we do not require that damages be measured with certainty, but rather that they be demonstrated as “a matter of just and reasonable inference.”

The inquiry for a district court at the class certification stage is whether the plaintiffs have demonstrated by a preponderance of the evidence that they will be able to measure damages on a class-wide basis using common proof. Some variation of damages among class members does not defeat certification. Complex and individual questions of damages, however, weigh against finding predominance.

On appeal, the inquiry narrows. Because the District Court held that Plaintiffs had established they could measure damages through common proof, we examine whether that determination was beyond the Court’s discretion. Having identified the forest of law, we proceed to scrutinize the
timber that Comcast faults as rotted.

A.

Comcast contends that Dr. McClave’s model cannot isolate damages for individual theories of harm, and that it therefore cannot distinguish between lawful and unlawful competition.

We are not persuaded by Comcast’s argument. To measure damages, Dr. McClave used screens to select and average benchmark counties against which to compare the actual Philadelphia market. The screens themselves were not intended to calculate damages, but instead to construct an estimated competitive “but-for” Philadelphia market (a market absent the alleged anticompetitive conduct).

As a result, if the class proves at trial that Comcast engaged in anticompetitive behavior, it can use the constructed “but-for” market to measure the anticompetitive impact on the class members. At the class certification stage we do not require that Plaintiffs tie each theory of antitrust impact to an exact calculation of damages, but instead that they assure us that if they can prove antitrust impact, the resulting damages are capable of measurement and will not require labyrinthine individual calculations. We are satisfied that Plaintiffs’ damages model meets this burden.

B.

Comcast’s remaining arguments contest specific parts of Dr. McClave’s damages methodology. These contentions are a renewal of those it made to the District Court, each of which the Court rejected. For those determinations to be beyond the Court’s discretion, Comcast must convince us that the Court’s acceptance of the pieces of Dr. McClave’s methodology was clearly erroneous.

At the outset, we agree with the class that the heart of Comcast’s arguments are attacks on the merits of the methodology that have no place in the class certification inquiry. Even if we were to overrule as clearly erroneous the District Court’s findings on all four contested pieces of Dr. McClave’s methodology—i.e., modify both of Dr. McClave’s screens, add population density as a variable, and incorporate Dr. Chipty’s proposed method for calculating discounts—only the final amount of estimated damages would change. Comcast’s assertions do not impeach the District Court’s ultimate holding that damages are capable of common proof on a class-wide basis.

X.

The District Court certified the class for resolution of four claims. Comcast contends that the District Court erred by certifying the following claim:

Whether Defendants conspired with competitors, and whether Defendants entered into and implemented agreements with competitors, to allocate markets, territories, and customers for cable television services; and whether such conduct is a per se violation, or whether it constitutes a restraint of trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

According to Comcast, the District Court lacked any legal authority to certify a per se claim based on the class’s allegations.

This is a merits issue beyond the scope of our Rule 23(f) jurisdiction. Comcast misconstrues the District Court’s certification order. The Court certified the class and stated that one of the questions to
be litigated is whether there has been a per se violation. It did not declare that a per se violation had occurred. Appeals taken pursuant to Rule 23(f) do not furnish the proper vehicle to address the merits of Plaintiffs’ antitrust claims. Comcast’s request to have us declare on the merits that Plaintiffs cannot establish a per se antitrust violation is beyond the scope of the certification decision from which Comcast appeals pursuant to Rule 23(f). Accordingly, we do not reach this contention.

***

We have considered carefully all the contentions presented by the parties. Plaintiffs have demonstrated that this case can proceed as a class action. Comcast has not carried its burden to convince us otherwise. Accordingly, we will AFFIRM in all respects the District Court’s Order certifying the class.

JORDAN, Circuit Judge, concurring in the judgment part and dissenting in part.

I agree with the Majority’s conclusion, though not its reasoning, with respect to the question of antitrust impact, and I therefore join in holding that the District Court did not abuse its discretion when it determined that Plaintiffs could establish antitrust impact through evidence common to a class comprising Comcast cable television customers in the Philadelphia DMA. But because I conclude that damages cannot be proven using evidence common to that entire class, I would vacate the certification order to the extent it provides for a single class as to proof of damages, and I would remand the case to the District Court to consider whether the class can be divided into subclasses for the purpose of proving damages. I therefore respectfully dissent in part.

Much confusion has been caused in this case by the conflation of two distinct concepts: the antitrust concept of “relevant geographic market,” which has traditionally been defined as the smallest area within which a monopolist can exercise market power, and the class action concept of a “class definition,” which gives the parameters of a set of plaintiffs as to whom the elements of a claim can be proven using common evidence. Because, in this case, the class definition includes a geographic component, the term “relevant geographic market” has been used equivocally by the parties, the District Court, and the Majority to describe both the area affected by antitrust impact and the area within which potential class members reside—the latter area being what I will call, for lack of a better term, the “class region.” The problem with that equivocal usage is that the relevant geographic market and the class region are not necessarily coterminous. Even if we assume that, within the Philadelphia DMA, there are many distinct geographic markets that are relevant for antitrust purposes, as Comcast argues, that does not mean that Plaintiffs cannot prove, by common evidence, that Comcast’s acts caused antitrust impact within all of them. As a theoretical matter, class proof can cover multiple relevant geographic markets, and, indeed, other Courts of Appeals have so held.

The Majority is correct that defining the relevant geographic market is not a task we need to undertake at this stage, but that is not because the task takes us into the merits. It is rather because, regardless of whether there are one or many relevant geographic markets associated with the Philadelphia DMA, the question before us at this juncture is whether there is some class, in this case defined geographically, that can be shown, through common evidence, to have experienced elevated prices as a result of
reduced overbuilding because of Comcast’s clustering.

II. Whether Damages Can Be Proven Using Evidence Common to the Class

I part ways with the Majority entirely when it comes to class-wide proof of damages. The only evidence supporting Plaintiff’s claim that damages can be proven using evidence common to the class is the expert opinion of Dr. McClave. But, as detailed hereafter, Dr. McClave’s testimony is incapable of identifying any damages caused by reduced overbuilding in the Philadelphia DMA. Consequently, his testimony is irrelevant and should be inadmissible at trial, pursuant to Federal Rule of Evidence 702 and Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993), as lacking fit. Thus, it cannot constitute common evidence of damages.

Our precedent explains that Rule 702 and Daubert impose three requirements for admission of expert testimony: the expert must be qualified, the expert’s methodology must be reliable, and the expert’s proffered testimony must fit the particular case. Like any relevancy determination, the question of fit is reviewed for abuse of discretion. Here, Dr. McClave’s opinion fails the requirement of “fit” because it is disconnected from Plaintiff’s only viable theory of antitrust impact, i.e., reduced overbuilding, and, thus, the proffered expert testimony cannot help the jury determine whether reduced overbuilding caused damages. It was, consequently, an abuse of discretion for the District Court to consider Dr. McClave’s opinion as demonstrating that damages could be proven using evidence common to the class.

A. Dr. McClave’s Benchmark Counties Do Not Reflect “But For” Conditions in the Philadelphia DMA

To identify his benchmark counties, Dr. McClave used three “screens.” While those screens might, if properly employed, have helped identify relevant benchmark counties in a case involving antitrust impacts beyond limited overbuilding, they fail to identify the “but for” conditions that are relevant to what is now the only impact of Comcast’s allegedly anticompetitive conduct, namely the deterrence of overbuilding. They, therefore, cannot help identify damages caused by that impact.

B. Damages Are Not Capable of Being Proven By Evidence Common to the Entire Class

Central to Dr. McClave’s damages model is the conclusion that the price of cable television service in any given franchise area is affected by the relative market shares of at least three entities: overbuilders, DBS providers, and incumbent cable providers. All else being equal, for example, areas that are overbuilt will have lower prices than areas that are not overbuilt, and areas with high DBS penetration will have lower prices than areas with low DBS penetration. For that reason, Dr. McClave’s model identifies benchmark counties by screening for the relative market shares of those three entities. While I do not accept the manner in which Dr. McClave has measured the relative shares of those entities in the “but for” Philadelphia DMA, I accept the premise that the relative shares have significant influence on the price of cable television service.

If price does vary with the changes in relative share within a franchise area, however, it is hard to see how those 650 franchise areas can simply be treated as average for purposes of proving damages. The record indicates that, on the contrary,
the “but for” market shares of overbuilders, DBS providers, and incumbent providers would vary, sometimes significantly, from franchise area to franchise area.

This primary flaw in Dr. McClave’s methodology—using a single set of assumptions for the entire Philadelphia DMA—cannot be fixed merely by altering his model. It seems to me that no model can calculate class-wide damages because any damages—such as they may be—are not distributed on anything like a similar basis throughout the DMA. Rather, where some class members might reside in a franchise area that would have been 50 percent overbuilt for the entire class period and other class members might reside in a franchise area that would have been only 5 percent overbuilt and only for a single year, or not overbuilt at all, it strains credulity to believe that the damages suffered by those individuals would all be the same as a result of reduced overbuilding. Yet Dr. McClave’s model treats them as though they are the same, as would any model attempting to calculate damages on an average class-wide basis.

III. Conclusion

For the foregoing reasons, I would vacate the District Court’s certification order to the extent it provides for a single class as to proof of damages and remand the case for the District Court to address whether Dr. McClave’s model could, in fairness, be revised to accurately reflect the conditions that would have existed in the Philadelphia DMA in the absence of any reduction in overbuilding caused by clustering. I would further ask the District Court to consider whether the class certified for proving antitrust impact can be divided into appropriate subclasses for purposes of proving damages.
In the closing days of its term, the Supreme Court announced that it had granted certiorari in *Comcast Corporation v. Behrend*, setting up what is certain to be a major battle over expert testimony and class certification hearings.

*Behrend* arises from what appears to be the largest certified class in history—more than two million former and current subscribers to Comcast’s cable services in the Philadelphia metropolitan area. According to the complaint, Comcast violated Sections 1 and 2 of the Sherman Act by pursuing a strategy of anticompetitive clustering—deliberately buying up cable systems in geographic areas where Comcast already has a significant foothold while selling or trading away cable systems where the carrier’s holdings were less concentrated. According to the plaintiffs, Comcast’s clustering deterred entry by “overbuilders”—companies who deliberately enter a market where another cable provider is already established.

Comcast’s cert petition in *Behrend* set the case up as a straightforward application of the Court’s landmark 2011 decision in *Wal-Mart Stores, Inc. v. Dukes*, where the Court announced that class certification is proper only if the trial court is satisfied, “after a rigorous analysis,” that the requirements for class certification have been proven—even if plaintiffs will be required to prove the same propositions again in order to prevail on the merits at trial. *Dukes* was handed down against a background of earlier lower court holdings applying a lesser standard, often certifying classes based only on a determination that class representatives would likely be able to establish the prerequisites for class certification later, at trial. These cases took their cue from the Supreme Court’s apparent bar in *Eisen v. Carlisle & Jacquelin* against inquiring into the merits at the class certification stage. But the *Dukes* court dispatched *Eisen* in a footnote, dismissing the relevant language as “purest dictum.” Comcast asked for summary reversal in *Behrend*, arguing that the Third Circuit had ignored *Dukes* and resurrected *Eisen*, disregarding Comcast’s various merits arguments on a variety of Rule 23 issues.

The Court seems to have been deadlocked about what to do with *Behrend* for several weeks, relisting the case from conference to conference no less than seven times. Ultimately, the justices reached a compromise, granting cert on a single question: whether a district court could certify a class without deciding whether the plaintiffs had introduced admissible evidence, including expert testimony, to show that awarding damages on a class-wide basis is practical. In other words, when an expert’s testimony is crucial to the plaintiffs’ Rule 23 arguments—which it will generally be in antitrust, if not in most class actions—must the parties and the court have a full-blown *Daubert* proceeding before a class can be certified?

“We are really expecting this to be the big one,” Ankur Kapoor of Constantine Cannon told the Philadelphia Inquirer after cert was
granted. "The legal journals will be writing about it for years." Lawyers at Mayer Brown LLP agreed, writing that the issue is of "extraordinary importance to businesses defending themselves against class actions of all stripes." Seyfarth Shaw’s Workplace Class Action blog agreed, writing that the opinion in Behrend "could have wide-ranging impact on class actions, including those in the workplace arena." Cozen O’Connor’s Class Action Defense Review, on the other hand, predicted that Behrend would not have the profound impact of Dukes and the Court’s other class action landmark of 2011, AT&T Mobility v. Concepcion.

There’s no question a Circuit split has developed in the years immediately before and after Dukes on the question of how to handle expert testimony. As the petitioners in Behrend pointed out, the Seventh Circuit has held at least twice that district courts must make a definitive ruling on the Daubert inquiry at the class certification stage if the plaintiff’s compliance with Rule 23 depends on the admissibility of the expert’s testimony—most recently in Messner v. Northshore University Healthsystem, and earlier in American Honda Motor Co. v. Allen. The Ninth Circuit endorsed a full-blown Daubert analysis in Ellis v. Costco Wholesale Corp. The Eleventh Circuit agreed in Sher v. Raytheon Co., following Allen in an unpublished opinion.

But on the other hand, there is the Eighth Circuit’s opinion in In re Zurn Pex Plumbing Products Liability Litigation, filed only two weeks after Dukes. The Eighth Circuit failed to take up the Supreme Court’s heavy hint in Dukes that Daubert was fully applicable to class certification hearings, affirming a district court’s "tailored" determination that expert testimony was sufficiently reliable “in light of the existing state of the evidence” to justify certifying a class. After all, the Eighth Circuit pointed out, class certification was “inherently tentative,” and a full Daubert inquiry could not be justified at such an early stage.

Given the Supreme Court’s dicta in Dukes and the apparent compromise at the cert stage, it seems likely that the Court will reject the Eighth Circuit’s approach in Zurn Pex, as it should. Class certification is a crucial stage in class action litigation, particularly in antitrust cases. Designing an econometric model which reliably predicts damages on a classwide basis is an enormous challenge and, as the cert petition in Behrend observes, “most cases will be on the fast track to settlement shortly after class certification.” Although plaintiffs may press for more discovery pre-certification if courts are required to conduct full-blown Daubert inquiries before certification, this seems like a reasonable price to pay in order to defeat meritless class actions early. Although some have worried that courts which approve expert testimony at the certification hearing will decline to reconsider at the close of discovery, this seems unlikely, given the discovery and factual development likely to occur in the interim. All in all, Behrend is likely to be an important battle at the Supreme Court, and a worthy sequel to the Court’s opinion in Dukes.
Our immediately prior posting addressed the issue of how a single case in a multiparty, multidistrict litigation raising industry-wide antitrust claims was plucked out and sent to arbitration. How a plaintiff manages around that result is a question not just of international litigation practice but for the corporate or transactional lawyer/draftsman to avoid as well.

How are antitrust claims faring these days in overcoming another major procedural hurdle, that of class certification? Behrend, et al. v. Comcast Corp., et al., No. 10-2865 (3d Cir. Aug. 2011), addresses the issue extensively. And despite the Supreme Court's decision in Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011), which we discussed here, the Third Circuit affirmed the District Court's certification decision of antitrust claims.

The claims arise out of alleged series of transactions that increased Comcast's share of the multichannel video programming distribution services offered in the Philadelphia area through alleged anticompetitive "clustering". After the Third Circuit initially denied interlocutory appeal (permissible under Fed. R. Civ. P. 23 in certain cases) [enhanced version], the District Court held a four-day evidentiary hearing from both fact and expert witnesses, and examined deposition excerpts and documents. The challenges on appeal centered around whether there was sufficient evidence of class-wide antitrust impact, whether the damages methodology was acceptable, and whether the District Court's certification of what the defendants' characterized as a per se antitrust claim was clear error. The Third Circuit rejected all challenges.

Among other things, the Circuit rejected the invitation to decide the merits of the litigation, without discussing whether what the District Court did was tantamount to that trial nonetheless. Admittedly, recent class-action jurisprudence "heightened the inquiry a district court must perform on the issue of class certification," nothing in the controlling cases requires "actual trials in which factual disputes are to be resolved." The Court of Appeals differentiated requiring plaintiffs to establish the elements of certification by a preponderance of the evidence from requiring plaintiffs to "prove their case at the class certification stage." The Court also noted "recent scholarship," which "uniformly has expressed concern over the trend towards converting certification decisions into mini trials." The Court did however quote Oliver Wendell Holmes's classic comment from The Path of the Law, 10 Harv. L. Rev. 457 (1897): "For the rational study of the law the black-letter man may be the man of the present, but the man of the future is the man of statistics and the master of economics".

The Circuit also rejected the suggestion that Wal-Mart supported the claim that the damages model proffered by plaintiffs' expert could be "safely disregarded". The Court of Appeals, without more discussion, found that Wal-Mart "involved a massive discrimination class action and . . . neither guides nor governs the dispute before us".
A federal judge has once again certified a class action antitrust suit against cable television giant Comcast Corp., declaring that the plaintiffs have succeeded in satisfying a new, stricter class action test imposed last year by the 3rd U.S. Circuit Court of Appeals.

The suit, Behrend v. Comcast Corp., alleges the company set out to establish a monopoly in the Philadelphia market in order to increase prices once it had eliminated all the competition.

Comcast and its would-be competitors, the suit alleges, struck a series of deals in which they “swapped” assets and customers so that each company would have “clusters” of markets.

In May 2007, U.S. District Judge John R. Padova handed down a decision that certified a class of Comcast subscribers in the 16-county Philadelphia metropolitan area, including six Pennsylvania counties, two Delaware counties and eight New Jersey counties.

But the legal landscape changed significantly in 2008 when the 3rd Circuit handed down its ruling in In re Hydrogen Peroxide Antitrust Litigation, and a team of lawyers for Comcast, led by Darryl May of Ballard Spahr, responded by urging Padova to vacate his May 2007 ruling.

Padova agreed and later held a four-day hearing that was designed to meet the new, more rigorous test for class certification required by Hydrogen Peroxide, including, in some cases, an inquiry into the expert witnesses offered by both sides to determine whether the plaintiffs are truly able to meet the requirements of Rule 23.

Now, in an 86-page opinion, Padova has certified the case again, but the opinion shows that the judge has significantly pruned the plaintiffs’ theories.

“Having rigorously analyzed the expert reports, as well as the testimony presented by the parties during a four-day evidentiary hearing, we conclude that the class has met its burden to demonstrate that the element of antitrust impact is capable of proof at trial through evidence that is common to the class rather than individual to its members, and that there is a common methodology available to measure and quantify damages on a class-wide basis,” Padova wrote.

Padova once again appointed two firms—Heins Mills & Olson in Minneapolis and Susman Godfrey in Dallas—to serve as co-lead counsel for the class.

Comcast is likely to take an immediate appeal—a move that could stall the suit, which was filed in 2003, for a year or more. Under Rule 23(f) of the Federal Rules of Civil Procedure, decisions on class certification motions are immediately subject to discretionary appellate review.

In his order, Padova defined the class to include “all cable television customers who subscribe or subscribed at any time from December 1, 1999 to the present to video programming services (other than solely to..."
basic cable services) from Comcast, or any of its subsidiaries or affiliates in Comcast’s Philadelphia cluster.”

The Philadelphia “cluster” is defined in the order to include: Berks, Bucks, Chester, Delaware, Montgomery and Philadelphia counties in Pennsylvania; Kent and New Castle counties in Delaware; and Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer and Salem counties in New Jersey.

Padova also specifically certified four issues to be litigated:

• Whether Comcast conspired with competitors and entered into agreements with competitors “to allocate markets, territories, and customers for cable television services,” and whether such conduct “is a per se violation, or whether it constitutes a restraint of trade in violation of Section 1 of the Sherman Act.”

• Whether Comcast “unlawfully attempted to monopolize, or unlawfully possess and willfully acquired or maintained monopoly power in, the Philadelphia area cable market with respect to cable television services in violation of Section 2 of the Sherman Act.”

• Whether the actions alleged to violate Sections 1 and 2 of the Sherman Act “caused prices for cable television services in the relevant markets to be artificially high and not competitive.”

• Whether the plaintiffs and members of the class were injured by the alleged conduct. But, significantly, Padova rejected the plaintiffs’ theory that Comcast’s clustering strategy made it profitable for Comcast to deny access to its regional sports programming content, Comcast SportsNet (CSN) Philadelphia, to DirecTV and EchoStar, its direct broadcast satellite competitors, resulting in decreased penetration by the satellite providers in the Philadelphia market, which, in turn, led to increased expanded basic cable prices to all class members.

In the battle of the experts on that point, Padova said, Comcast was the clear winner and demonstrated that the plaintiffs’ theory was invalid.

Padova said the plaintiffs’ expert “fails to recognize that Comcast has maintained its policy of distributing CSN Philadelphia only to wireline providers of video services since launching CSN Philadelphia in 1997, well before formation of the Philadelphia cluster.”

And the decision not to license the satellite providers, Padova noted, “occurred before the class period.”

Lead plaintiffs attorney David R. Woodward of Heins Mills & Olson did not return calls seeking comment. Comcast’s lawyer, Darryl May of Ballard Spahr, declined to comment.
“Squeezing Class Actions”

SCOTUSblog
August 30, 2011
Scott Dodson

In their prominent Civil Procedure casebook, Rick Marcus, Marty Redish, Ed Sherman, and Jim Pfander describe the 1966 amendments to Rule 23 of the Federal Rules of Civil Procedure as “bring[ing] about great changes in class action practice.” Those amendments were designed with two related ideas in mind. First, litigating in bulk could save costs for both plaintiffs and defendants, and it could be more efficient for courts. Second, the cost savings to plaintiffs, coupled with expanding the scope of a grievance to many different class members, could encourage private litigation to enforce public ends. The class action, in other words, was designed to be a public benefit, saving litigant and judicial resources while encouraging salutary litigation.

One wouldn’t guess that from reading recent Supreme Court decisions. Today, the class action is decidedly persona non grata. The Supreme Court’s 2010 Term in particular evinces both skepticism of and hostility to class actions. Justice Antonin Scalia was the main frontman, writing two major opinions restricting class actions and issuing a stay by himself in another.

What intrigues me is that the assault on class actions is coming so forcefully from all sides. In Wal-Mart Stores Inc. v. Dukes, the Court narrowed the availability of Rule 23(b)(2), with the effect of shuttling many discrimination and civil-rights classes into the more-difficult-to-sustain mechanism of Rule 23(b)(3). Dukes also enhanced the requirement of commonality under Rule 23(a)(2), which applies to all class actions in federal court, by holding that a class must demonstrate that each class member’s claim must depend upon a common contention capable of class-wide resolution. Dukes thus confronts the federal class-action mechanism directly.

Other cases, however, come at class actions from a different angle. In Philip Morris USA Inc. v. Scott, Justice Scalia stayed a state-court class action against several tobacco companies on behalf of all Louisiana smokers alleging that the companies defrauded the plaintiffs by distorting public knowledge about the addictive effects of nicotine. The Louisiana courts had credited the plaintiffs’ theory, certified the class under state law, and entered a judgment of almost $250 million against the defendants. Justice Scalia nevertheless stayed the judgment until the defendants could seek certiorari in the Supreme Court because, in his view, the Louisiana courts had used the class-action device to eliminate the defendants’ opportunity to contest the element of reliance on an individualized basis. Justice Scalia reasoned that such an effect implicated constitutional due-process concerns. Scott, then, reflects one Justice’s invocation of the federal Due Process Clause to constrain state class-action relief.

In AT&T Mobility LLC v. Concepcion, the Court held that the Federal Arbitration Act prohibits states from conditioning the enforceability of certain arbitration agreements on the availability of class-wide arbitration procedures. By lifting state regulation, the decision enables private parties to restrict class procedures under the aegis of the FAA. In effect, Concepcion
permits “even encourages” defendants, through private arbitration agreements, to eliminate the class mechanism altogether.

Class actions have been under attack for some time, but usually on their own terms, and with some apologies by the Supreme Court, as in the famous class-action cases of General Telephone Co. v. Falcon, Amchem Products, Inc. v. Windsor, and Ortiz v. Fibreboard Corp. But this Term’s assault comes from all sides: directly narrowing Rule 23, imposing federal constraints on state class-action mechanisms, and encouraging the privatization of procedure. And the pervading tenor of the Court’s opinions suggests that class actions ought to be disfavored and used only in rare cases. These features of the Court’s agenda lead me to make three observations.

First, and most obviously, the Court’s decisions probably will reduce the numbers and scope of class actions in both state and federal court. As analogous support, consider the effect of the Supreme Court’s Amchem and Ortiz decisions from 1997 and 1999, respectively. These decisions narrowed the scope of Rule 23(b)(3) and overturned class settlements of asbestos-related claims. One might reasonably expect the numbers of mass-tort class-action cases to fall in the wake of Amchem and Ortiz. That seems to have happened; a recent study by Brian Fitzpatrick found that of the 688 federal class settlements in 2006 and 2007, almost none was a mass tort case. If Amchem and Ortiz had such an impact on mass-tort classes, consider what kind of an impact last Term’s Wal-Mart decision will have on all federal class actions.

To compound the effect, state courts and class-arbitration agreements are no longer safe havens for plaintiffs who fear a new restrictiveness in federal courts. The Class Action Fairness Act of 2005 reduces the number of potential classes that can dodge removal to federal court. For those classes that properly remain in state court, Scott presages greater federal oversight of state procedures. And for those classes that the law undeniably allows, Concepcion permits defendants broad leeway to contract around those laws through arbitration agreements. Ultimately, the effect on class actions is an empirical question, but even in the absence of data, it is not a stretch to wonder if we are hearing the death knell of the class action.

Second, the Court’s recent class-action decisions coincide with a shift in procedure theory from liberality to restrictiveness. Bob Bone once called for more procedure theory, and perhaps the Supreme Court is responding to that call. If so, the class-action decisions, with their anti-class sentiments, support what Ben Spencer has observed as a new “restrictive ethos” of civil procedure that elevates efficiency over court access.

Third, the Supreme Court is charting this course on its own. Although it routinely entertains proposals and conducts studies, the Rules Advisory Committee has not seriously tinkered with Rule 23, and its basic structure remains identical to its original 1966 form. Congress rarely intervenes in federal procedure, and although it did pass the Class Action Fairness Act to expand the removability of state class actions, it did not purport to change the standards for class certification in state or federal court or otherwise constrict the availability of the class mechanism overall. Others, such as Steve Burbank, Kevin Clermont, Arthur Miller, and Steve Yeazell, have criticized the Court for failing to defer to the rulemakers and to Congress in other areas of civil practice. Whether their criticisms apply to the Court’s recent class-action decisions I leave to others to pursue; I mean here to
point out that the Court’s class-action
decisions may be part of a broader mistrust
in the rulemaking and legislative processes
to solve perceived problems with civil
litigation.

Whatever one thinks of the Court’s agenda
from a normative perspective, we ought to
be aware of how its decisions affect the
direction of procedure. In a narrow sense,
decisions like *Wal-Mart* and *Concepcion*
can be seen as part of a recent trend cabining
the use of class mechanisms. But in a
broader doctrinal context, they may signify a
macro shift in procedural theory toward
efficiency, with system-wide doctrinal
implications. And in a structural context,
they may reveal a new role for the Supreme
Court in civil-procedure development as
leader, rather than as follower.
Next term's big class-action case before the Supreme Court is Comcast Corp. v. Behrend, set for argument on Nov. 5, one day before Election Day.

The justices are expected to decide whether a district court can certify a class without delving into the merits and determining whether there is enough admissible evidence to show that class-wide damages could be awarded.

Whether the case will still be on the docket in November is an open question and depends on the status of a possible settlement in the underlying antitrust dispute between Comcast and 2 million of its Philadelphia-area subscribers.

Twelve days before the Supreme Court granted review in the case, parties for both sides informed a district court judge in Philadelphia on June 13 that they "have reached a tentative agreement to resolve."

According to a recent story in The Legal Intelligencer, a sibling publication to The National Law Journal and Daily Report, plaintiffs attorneys say the Supreme Court case could be moot, though the settlement has not been approved by the judge. Plaintiffs also told the district court that Comcast lawyers should have informed the Supreme Court about the settlement.

Miguel Estrada, lead counsel for Comcast before the Supreme Court, said in a statement, "the case is not moot."

The Gibson, Dunn & Crutcher partner added, "I have no reason to believe that the case will, or should, be dismissed before or after argument."

Estrada also insisted, "nothing has occurred that would warrant any filing with the Supreme Court, before certiorari was granted or since.” He added, "Plaintiffs have filed a motion in district court trying to head off Supreme Court review, but we have opposed that motion.” Barry Barnett of Susman Godfrey in Dallas, the counsel of record for the plaintiffs before the Supreme Court, declined comment.

Alleged anti-competitive transactions by Comcast to increase its hold on multichannel video programming in the Philadelphia area are at the center of the class action.

The complaint, brought by a group of Comcast subscribers, alleged the company engaged in an unlawful "clustering scheme" through business deals to eliminate competition and deprive customers of lower prices.

The U.S. Court of Appeals for the Third Circuit last summer upheld class certification after declining to consider the merits at the certification stage. The court certified a plaintiffs’ class of all cable television customers who subscribe or subscribed to Comcast, beginning in December 1999, other than solely basic cable services.

Invoking last year’s Supreme Court ruling in Wal-Mart v. Dukes as well as Rule 23 of the Federal Rules of Civil Procedure governing class actions, Judge Ruggero Aldisert wrote, "the factual and legal underpinnings of Wal-
Mart—which involved a massive discrimination class action and different sections of Rule 23—are clearly distinct from those of this case. Wal-Mart, therefore, neither guides nor governs the dispute before us.”

In his petition to the high court, Estrada, who is co-chair of the firm’s appellate and constitutional law practice group, said the case presents the high court the chance to resolve “an issue of great significance” in class-action litigation.

“[I]t would further allow the Court to continue its long-standing practice of ensuring that lower courts apply procedural rules, including Rule 23, with appropriate rigor,” Estrada wrote.

Helgi Walker, who has represented Comcast in other high-profile cases but is not involved in the Supreme Court litigation, said the dispute tests whether the high court’s decision in Wal-Mart will stick. Walker is co-chair of the appellate practice at Wiley Rein.

“In Wal-Mart, Justice [Antonin] Scalia said evaluation of class certification requires a rigorous analysis that may often overlap with the merits of the case,” Walker said this week. “But in the Comcast matter, the Third Circuit said, ‘We can’t engage in an inquiry under Rule 23 that goes to the merits.’”

Walker said she thinks Wal-Mart will control how Comcast is resolved in the high court and that the Third Circuit will be reversed. “I think the American business interest community would be supportive of Comcast’s position,” she said.
Amgen v. Connecticut Retirement Plans and Trust Funds

11-1085


On behalf of purchasers of Amgen stock, Connecticut Retirement Plans & Trust Funds brought a securities fraud class action regarding Amgen’s misrepresentations from 2004 to 2007 about the safety of anemia drugs Aranesp and Epogen, which inflated the price of Amgen’s stock. Under Section 10(b) of the Securities and Exchange Act, 15 U.S.C. § 78j(b), a plaintiff must show that reliance on the alleged misrepresentation is common to the class to obtain class certification in a misrepresentation action. The district court granted class-certification in this action and held that Connecticut Retirement Plans & Trust Funds could invoke the fraud-on-the-market theory, with rebuttal of that presumption being held for trial. The Court of Appeals for the Ninth Circuit affirmed, holding that at the time of class-certification, the plaintiff in a securities fraud class action invoking the fraud-on-the-market presumption “need only allege materiality with sufficient plausibility to withstand a 12(b)(6) motion.”

Question Presented: (1) Whether, in a misrepresentation case under Securities and Exchange Commission Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory; and (2) whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory. (Breyer, J., recused)

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS, Plaintiff–Appellee,
v.
AMGEN INC.; Kevin W. Sharer; Richard D. Nanula; Roger M. Perlmutter; George W. Morrow, Defendants–Appellants.

United States Court of Appeals for the Ninth Circuit

Decided November 8, 2011

[Excerpt; some footnotes and citations omitted.]

SILVERMAN, Circuit Judge

To obtain class certification in a 10b-5 securities fraud case, the plaintiff, as required by Federal Rule of Civil Procedure 23(b)(3), must convince the district court that the element of reliance is common to the class. The Supreme Court has held that this can be done in an appropriate case by invoking the “fraud-on-the-market” presumption—the principle that the market price of a security traded in an efficient market reflects all public information and therefore that a buyer of the security is presumed to have relied on the truthfulness of that information in purchasing the
security. Were it not for the fraud-on-the-market presumption, a plaintiff seeking class certification would be required to show the impossible—reliance by each individual prospective class member who bought the stock.

What must a plaintiff do to invoke the fraud-on-the-market presumption in aid of class certification? Today we join the Third and Seventh Circuits in holding that the plaintiff must (1) show that the security in question was traded in an efficient market (a fact conceded here), and (2) show that the alleged misrepresentations were public (a fact not contested here). As for the element of materiality, the plaintiff must plausibly allege—but need not prove at this juncture—that the claimed misrepresentations were material. Proof of materiality, like all other elements of a 10b-5 claim, is a merits issue that abides the trial or motion for summary judgment. Likewise, rebuttal of the fraud-on-the-market presumption, at least by showing that the alleged misrepresentations were not material, is a matter for trial or summary judgment, not a matter to be taken up in a class certification motion.

In this case, the plaintiff plausibly alleged that several of the defendants’ public statements about Amgen’s pharmaceutical products were false and material. Coupled with the concession that Amgen’s stock traded in an efficient market, this was sufficient to invoke the fraud-on-the-market presumption of reliance. The district court did not abuse its discretion in certifying the class.

I. Background

Connecticut Retirement Plans and Trust Funds brought this securities fraud action against biotechnology company Amgen Inc. and several of its officers, alleging that, by misstating and failing to disclose safety information about two Amgen products used to treat anemia (a red blood cell deficiency), they violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78t(a), and Rule 10b-5, 17 C.F.R. § 240.10b-5.

The complaint alleges four actionable misstatements. First, Amgen supposedly downplayed the FDA’s safety concerns about its products in advance of an FDA meeting with a group of oncologists. Second, Amgen allegedly concealed details about a clinical trial that was canceled over concerns that Amgen’s product exacerbated tumor growth in a small number of patients. Third, Amgen purportedly exaggerated the on-label (that is, for FDA-approved uses) safety of its products. And fourth, Amgen allegedly misrepresented its marketing practices, claiming that it promoted its products solely for on-label uses when it in fact promoted significant off-label usage, in violation of federal drug branding statutes.

Those alleged misstatements and omissions, according to the complaint, inflated the price of Amgen’s stock when Connecticut Retirement purchased it. Later, corrective disclosures allegedly caused Amgen’s stock price to fall, injuring Connecticut Retirement.

II. The District Court’s Class Certification Order

Connecticut Retirement moved in the district court to certify the action as a class action under Federal Rule of Civil Procedure 23(b)(3) on behalf of all purchasers of Amgen stock between the date of the alleged misstatements and omissions and the date of the corrective disclosures. Rule 23(b)(3) permits a party to maintain a class action if
the Rule 23(a) prerequisites are satisfied and "the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed.R.Civ.P. 23(b)(3).

The district court found that the Rule 23(a) prerequisites were satisfied and that common questions predominated. Of the elements of a claim under Section 10(b) and Rule 10b-5, the district court found that the following questions were common to the class: whether Amgen made false statements, whether those statements were material, whether those statements were connected with the sale of securities, whether those statements were intentionally false, and whether those statements caused the class members' losses. The district court further found that although the class members' losses differed depending on when and how much they bought, the losses would be simple to calculate.

The district court also ruled that the remaining element—reliance—was common to the class because the class could avail itself of the fraud-on-the-market presumption of reliance. That doctrine, first approved by the Supreme Court in Basic Inc. v. Levinson, 485 U.S. 224 (1988), rests on the efficient capital market hypothesis: The price of a stock traded in an efficient market fully reflects all publicly available information about the company and its business. See 485 U.S. at 241-42, 244-45, 246-47. If the stock price did not reflect a piece of publicly available information, the logic goes, then investors would have a strong incentive to buy the stock (if the information were positive) or sell it (if negative); in an efficient market, that activity would drive the stock price up or down until it fully reflected the information. Anyone who buys stock at the prevailing market price is presumed to have relied on that price—and, by extension, each piece of publicly available information it reflects—as a measure of the stock's value, even if the investor never saw that information. See id. at 247. Thus, the fraud-on-the-market presumption is a way to prove reliance—a causal link from the defendant's misrepresentation, reflected in the prevailing market price, to each class member's decision to buy the stock. The presumption, however, is rebuttable—for example, by showing that the market was already aware of the truth behind the defendant's supposed falsehoods and thus that those falsehoods did not affect the market price (the so-called "truth-on-the-market" defense), or by showing that a particular plaintiff would have bought the stock without relying on the integrity of the market price. See Basic, 485 U.S. at 248-49.

The district court ruled that Connecticut Retirement successfully invoked the fraud-on-the-market presumption by showing that Amgen's stock traded in an efficient market (which Amgen conceded) and that the alleged misstatements were public (which Amgen did not contest). The district court further held that at the class certification stage, Connecticut Retirement did not need to prove—but rather could merely allege—that Amgen's supposed falsehoods were material to invoke the fraud-on-the-market presumption. Materiality would, of course, have to be proven at trial.

Moreover, the district court declined to afford Amgen an opportunity to rebut the presumption of reliance at the class certification stage, holding again that rebuttal of the presumption was a trial issue. Amgen's proposed rebuttal consisted of evidence purportedly showing that the truth
behind each of the supposed misstatements had already entered the market by the time the misstatements were made. Amgen argued that the misstatements therefore could not have affected Amgen’s stock price, or, by extension, anyone relying on the integrity of that stock price.

Having found that the Rule 23(a) prerequisites were satisfied and that common questions predominated, the district court certified the action as a class action under Rule 23(b)(3).

III. Amgen’s Interlocutory Appeal

We granted Amgen’s Rule 23(f) request for permission to appeal the district court’s class certification order. See Chamberlan v. Ford Motor Co., 402 F.3d 952, 959 (9th Cir. 2005). We have jurisdiction under 28 U.S.C. § 1292(e).

IV. Analysis

A. Connecticut Retirement’s Motion to Vacate Grant of Permission to Appeal

At the outset, Connecticut Retirement moves to vacate our grant of permission to appeal the certification order, arguing that the central issue in this appeal has been settled by three cases decided since the district court certified the class: United Steel, Paper & Forestry, Rubber, Manufacturing Energy, Allied Industrial & Service Workers International Union v. ConocoPhillips Co., 593 F.3d 802 (9th Cir. 2010), Dukes v. Wal-Mart Stores, Inc., 603 F.3d 571 (9th Cir. 2010) (en banc), rev’d, ___ U.S. ___, 131 S.Ct. 2541, 180 L.Ed.2d 374 (2011), and Miller v. Thane International, Inc., 615 F.3d 1095 (9th Cir. 2010). But neither United Steel Workers nor Dukes was a securities fraud case, and thus neither had occasion to decide whether a securities fraud plaintiff must prove materiality to avail herself of the fraud-on-the-market presumption of reliance. See United Steel, 593 F.3d at 804 (state law wage and hour claim); Dukes, 131 S.Ct. at 2547 (sex discrimination claim). And Miller had no occasion to decide the question either, because that case was brought under a securities fraud statute that—unlike Section 10(b) here—does not require the plaintiff to show reliance. See Miller, 615 F.3d at 1102 n. 2. Accordingly, because the question remains unsettled, we deny Connecticut Retirement’s motion.

B. Elements That Must Be Proved at the Class Certification Stage to Invoke the Fraud-on-the-Market Presumption of Reliance

We review a district court’s class certification order for abuse of discretion, and any error of law on which a certification order rests is deemed a per se abuse of discretion. See United Steel, 593 F.3d at 807; Yokoyama v. Midland Nat’l Life Ins. Co., 594 F.3d 1087, 1090-91 (9th Cir. 2010).

As the party seeking class certification, Connecticut Retirement “bears the burden of demonstrating that the requirements of Rules 23(a) and (b) are met.” See United Steel, 593 F.3d at 807. And the district court facing a class certification motion is required to conduct “a rigorous analysis” to ensure that the Rule 23 requirements are satisfied. Gen. Tel. Co. of Sw. v. Falcon, 457 U.S. 147, 161 (1982).

Amgen argues that Connecticut Retirement failed to carry that burden because it did not prove that Amgen’s supposedly false statements were material. If those misrepresentations were immaterial, Amgen contends, they by definition would not affect Amgen’s stock price in an efficient market,
and thus no buyer could claim to have been misled by an artificially inflated stock price. Thus, Amgen concludes, each individual plaintiff would be left to prove reliance at trial individually—making a class proceeding unwieldy.

The problem with that argument is that, because materiality is an element of the merits of their securities fraud claim, the plaintiffs cannot both fail to prove materiality yet still have a viable claim for which they would need to prove reliance individually. See Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341 (2005). If the misrepresentations turn out to be material, then the fraud-on-the-market presumption makes the reliance issue common to the class, and class treatment is appropriate. But if the misrepresentations turn out to be immaterial, then every plaintiff's claim fails on the merits (materiality being a standalone merits element), and there would be no need for a trial on each plaintiff's individual reliance. Either way, the plaintiffs' claims stand or fall together—the critical question in the Rule 23 inquiry. As the Supreme Court said in Dukes,

"[w]hat matters to class certification... is not the raising of common 'questions'—even in droves — but, rather the capacity of a classwide proceeding to generate common answers apt to drive the resolution of the litigation. Dissimilarities within the proposed class are what have the potential to impede the generation of common answers."

131 S.Ct. at 2551 (quoting Richard A. Nagareda, Class Certification in the Age of Aggregate Proof, 84 N.Y.U. L. Rev. 97, 132 (2009)).

By contrast, the elements of the fraud-on-the-market presumption—whether the securities market was efficient and whether the defendant's purported falsehoods were public—are not elements of the merits of a securities fraud claim. See Dura Pharm., 544 U.S. at 341-42. Thus, if the plaintiffs failed to prove those elements, they could not use the fraud-on-the-market presumption, but their claims would not be dead on arrival; they could seek to prove reliance individually. That scenario, however, would be inappropriate for a class proceeding. Accordingly, the district court was correct to require Connecticut Retirement to prove at the class certification stage that the market for Amgen's stock was efficient and that Amgen's supposed misstatements were public. (Because those elements were uncontested, we need not decide the applicable standard of proof for proving those elements at the class certification stage.)

The Seventh Circuit, recently faced with this same issue, held that proving materiality is not a precondition to invoking the fraud-on-the-market presumption at the class certification stage:

Defendants say that, before certifying a class, a court must determine whether false statements materially affected the price. But whether statements were false, or whether the effects were large enough to be called material, are questions on the merits. Although we concluded in [a prior case] that a court may take a peek at the merits before certifying a class, [we] insisted that this peek be limited to those aspects of the merits that affect the decisions essential under Rule 23. If something about "the merits" also shows that individual questions predominate over common ones,
then certification may be inappropriate. Falsehood and materiality affect investors alike, however. It is possible to certify a class under Rule 23(b)(3) even though all statements turn out to have only trivial effects on stock prices. Certification is appropriate, but the class will lose on the merits. 

*Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir. 2010). The Third Circuit agrees. See *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 631 (3d Cir. 2011) (“To invoke the fraud-on-the-market presumption of reliance, plaintiffs must show they traded shares in an efficient market, and the misrepresentation at issue became public”) (citations omitted).

The three circuits that require a plaintiff to prove materiality at the class certification stage do so on the apparent rationale that a footnote in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), compels it. See id. at 248 n. 27, 108 S.Ct. 978 (“The Court of Appeals held that in order to invoke the presumption, a plaintiff must allege and prove . . . that the misrepresentations were material. . . .”); see also *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 481 (2d Cir. 2008) (“The *Basic* Court thereby set forth a test of general applicability that where a defendant has (1) publicly made (2) a material misrepresentation (3) about stock traded on an impersonal, well-developed (i.e., efficient) market, investors’ reliance on those misrepresentations may be presumed.”) (citing *Basic*, 485 U.S. at 248 n. 27); *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 264 (5th Cir. 2007) (“The Supreme Court in *Basic* adopted this presumption of reliance. . . . Reliance is presumed if the plaintiffs can show that ‘(1) the defendant made public material misrepresentations, . . .’”) (citation omitted), *abrogated on other grounds by Erica P. John Fund*, 131 S.Ct. at 2183, 2186; *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 8 n. 11 (1st Cir. 2005) (noting in a dictum that to invoke fraud-on-the-market presumption at class certification stage, plaintiff must prove materiality) (quoting *Basic*, 485 U.S. at 248 n. 27, 108 S.Ct. 978).

But as the Seventh Circuit pointed out, those circuits misread the *Basic* footnote: “All note 27 [in *Basic* does . . . is state that the court of appeals deemed materiality essential; the Justices did not adopt it as a precondition to class certification.” See *Schleicher*, 618 F.3d at 687; see also *Basic*, 485 U.S. at 248 n. 27. That reading of *Basic* also enjoys support from the Supreme Court’s more recent formulations of the presumption in *Erica P. John Fund* and *Dukes*, which require the plaintiff to show that the stock was traded in an efficient market but do not mention materiality as a requirement. See *Erica P. John Fund v. Halliburton*, 131 S.Ct. 2179, 2185 (2011); *Dukes*, 131 S.Ct. at 2552 n. 6.

Moreover, two Ninth Circuit cases have mentioned materiality as an element of the presumption, but neither squarely held that a plaintiff must prove materiality at the class certification stage. See *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999) (noting that “the presumption of reliance is available only when a plaintiff alleges that a defendant made material misrepresentations or omissions concerning a security that is actively traded in an ‘efficient market,’” but holding that presumption did not apply because market was not efficient); *Blackie v. Barrack*, 524 F.2d 891, 900-01 & n. 17, 905-08 (9th Cir. 1975) (holding, in pre-*Basic* case, that complaint’s allegation of materiality sufficed to trigger presumption).

In sum, because proof of materiality is not necessary to ensure that the question of
reliance is common among all prospective class members’ securities fraud claims, we hold that plaintiffs need not prove materiality to avail themselves of the fraud-on-the-market presumption of reliance at the class certification stage. They need only allege materiality with sufficient plausibility to withstand a 12(b)(6) motion. See Ashcroft v. Iqbal, 556 U.S. 662 (2009).

C. Opportunity to Rebut the Presumption at the Class Certification Stage

Amgen also argues that the district court erred by not affording it an opportunity to rebut the fraud-on-the-market presumption at the class certification stage. Specifically, Amgen sought to introduce evidence that FDA announcements and analyst reports about Amgen’s business publicized the truth about the safety issues looming over Amgen’s drugs, and thus that Amgen’s alleged misrepresentations could not have affected the stock price—the so-called “truth-on-the-market” defense. See, e.g., Basic, 485 U.S. at 248-49 (“[I]f, despite [defendants’] allegedly fraudulent attempt to manipulate market price, [the truth] credibly entered the market and dissipated the effects of the misstatements, those who traded . . . after the corrective statements would have no direct or indirect connection with the fraud.”).

But as the Supreme Court and Ninth Circuit have explained, the truth-on-the-market defense is a method of refuting an alleged misrepresentation’s materiality. See, e.g., Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1097-98 (1991); Provenz v. Miller, 102 F.3d 1478, 1492 (9th Cir. 1996). As explained above, a plaintiff need not prove materiality at the class certification stage to invoke the presumption; materiality is a merits issue to be reached at trial or by summary judgment motion if the facts are uncontested. The only elements a plaintiff must prove at the class certification stage are whether the market for the stock was efficient and whether the alleged misrepresentations were public—issues that Amgen does not contest here.

Thus, the district court correctly refused to consider Amgen’s truth-on-the-market defense at the class certification stage.

AFFIRMED.
The U.S. Supreme Court said Monday it will consider Amgen Inc.'s challenge to a securities lawsuit alleging the biotech company played down safety concerns about two drugs used to treat anemia.

The suit, brought by Connecticut pension funds on behalf of purchasers of Amgen stock, alleged the Thousand Oaks, Calif., company repeatedly reassured investors about the safety of anti-anemia drugs Aranesp and Epogen even as clinical trial data raised concerns that the drugs could harm cancer patients who were taking them. Amgen's statements led to inflated share prices, the suit alleged.

The lawsuit alleged the misrepresentations took place from April 2004 through May 10, 2007, a day when Amgen's shares dropped more than 9% after a Food and Drug Administration panel expressed concerns about the drugs and recommended new limits on patient use.

Amgen is seeking to overturn a lower-court ruling that certified the lawsuit to proceed as a class action. The company said the plaintiffs couldn't show that the alleged misrepresentations had a material effect on the price of Amgen shares. The market had readily available access to the safety information that Amgen allegedly played down, the company said.

At issue before the Supreme Court is whether securities plaintiffs, before being allowed to proceed with a class-action lawsuit, have to demonstrate that a company's alleged misrepresentations materially affected share prices.

Amgen argued that companies need to be able to defeat weak lawsuits at early stages of the proceedings. Otherwise, companies will feel financial pressures to settle cases even when they think they have a strong defense, Amgen said.

The case is *Amgen v. Connecticut Retirement Plans and Trust Funds*, 11-1085. The Supreme Court is expected to hear oral arguments in the fall.
Stockholders can move ahead with a class action alleging that the biotechnology company Amgen inflated its stock price by misstating and withholding safety information about its anemia drugs, the 9th Circuit ruled Tuesday.

While Amgen promoted its products, the U.S. Food and Drug Administration had concerns, according to the consolidated securities-fraud action filed by Connecticut Retirement Plans and Trust Funds and other investors. Amgen allegedly hid the true nature of these concerns and “concealed details about a clinical trial that was canceled over concerns that Amgen’s product exacerbated tumor growth in a small number of patients,” according to the court’s description of the case.

Investors also claim that Amgen misrepresented the on-label safety of the drugs and “promoted significant off-label usage, in violation of federal drug branding statutes.”

The investors moved for federal class status in Los Angeles, arguing that Amgen’s alleged misstatements and omissions had inflated the company’s stock price and cost them money.

U.S. District Judge Philip Gutierrez found the allegations sufficient, and the plaintiffs sufficiently linked, to certify the class. Specifically, he found that the plaintiffs had reliance in common based on the “fraud-on-the-market” presumption: “the principle that the market price of a security traded in an efficient market reflects all public information and therefore that a buyer of the security is presumed to have relied on the truthfulness of that information in purchasing the security,” according to the ruling.

The 9th Circuit agreed in an interlocutory appeal, affirming the lower court and rejecting Amgen’s call for proof of materiality rather than mere plausible allegations among the class.

“Plaintiffs need not prove materiality to avail themselves of the fraud-on-the-market presumption of reliance at the class certification stage,” Judge Barry Silverman wrote for the unanimous, three-judge panel in Pasadena. “They need only allege materiality with sufficient plausibility.”

Silverman added that the proposed class had “plausibly alleged that several of the defendants’ public statements about Amgen’s pharmaceutical products were false and material.”

“Coupled with the concession that Amgen’s stock traded in an efficient market,” he wrote, “this was sufficient to invoke the fraud-on-the-market presumption of reliance.”
The U.S. Supreme Court will decide whether investors must prove that misinformation from Amgen (AMGN) Inc. propped up its stock price before they can pursue a class-action stock-fraud suit against the world's largest biotechnology company.

The justices today agreed to review an appeal by Amgen in a case alleging the company and its executives misled investors for more than three years about safety questions involving its Aranesp and Epogen anemia drugs.

Amgen says a federal appeals court ruling makes it too easy to mount class-action lawsuits representing thousands of people, pressuring companies to pay settlements for even frivolous allegations rather than risk huge damages in a trial. Amgen's appeal is backed by the U.S. Chamber of Commerce and the pharmaceutical industry's trade group.

"Securities class actions are almost always settled once a class is certified, because the risks to a defendant of going to trial are so substantial," a group of law professors and former Securities and Exchange Commission members said in a brief supporting Amgen's bid for a Supreme Court hearing.

All sides agree that the investors alleging securities fraud must, at some point, show that misrepresentations by Amgen had an effect on its share price.

The company says judges should resolve disputes about the relevance of misleading information before letting multiple investors band together in a class-action suit. The San Francisco-based 9th U.S. Circuit Court of Appeals disagreed, saying that, if a case meets other requirements for class-action status, evidence about the effect on share price must wait for the trial itself.

"Enormous Sums"

Because the potential cost of class-action lawsuits is so large, Amgen said companies will "frequently be forced, by practical realities, to settle cases for enormous sums" before trial. They may never get a chance to prove that allegedly misleading statements were irrelevant, the Thousand Oaks, California-based company said.

The 9th Circuit's ruling acknowledged that other federal appeals courts have conflicting views.

A New York-based federal court has said investors must show that misleading information affected stock prices before a judge can allow a class-action suit. An appeals court in Philadelphia doesn't require investors to show the effect on share price at that point, although it has said a company can defeat a request for class-action status by proving that alleged wrongdoing had no impact on trading.

Class-Action Rules

In a case last year about the standards for granting class-action status, the Supreme
Court sided with investors, ruling unanimously that they could sue Halliburton Co. (HAL) as a group without first showing that they lost money because of alleged fraud.

Investors, led by Connecticut’s public employee pension plans, allege that Amgen executives withheld or played down safety concerns, including questions about whether its anemia drugs contributed to growth of cancerous tumors. Amgen says it didn’t mislead investors, and that information about drug-safety questions was widely known and was reflected in Amgen’s share price.

The justices will hear arguments in the case during the term that begins in October.

The case is Amgen v. Connecticut Retirement Plans and Trust Funds, 11-1085.
Must a plaintiff in a securities fraud class action prove that the alleged misrepresentations or omissions are material in order to obtain class certification? That is the issue the U.S. Supreme Court agreed to consider when it granted certiorari in Connecticut Retirement Plans and Trust Funds v. Amgen, 660 F.3d 1170 (9th Cir. 2011), cert. granted, ___ U.S. ___, (June 11, 2012).

In Amgen, the Ninth Circuit held that materiality is not an issue at the class certification stage—a plaintiff can rely on the fraud-on-the-market presumption to demonstrate that reliance is a common issue simply by proving that there is an efficient market for the security at issue and the misrepresentation was public. The court observed that materiality is a merits issue to be addressed in a motion for summary judgment or at trial, not at the class certification stage. Amgen, 660 F.3d at 1177.

In light of this holding, the court also rejected Amgen’s argument that it should be permitted an opportunity to rebut the fraud-on-the-market presumption to defeat class certification by pointing to evidence that the truth already was published to the market so the alleged misrepresentations could not have affected the stock price because this so called “truth-on-the-market” defense is a method of refuting an alleged misrepresentation’s materiality. Id.

With this holding, the Ninth Circuit joined the Seventh Circuit (Schleicher v. Wendt, 618 F.3d 679, 685 (7th Cir. 2010)) and the Third Circuit (In re DVI, Inc. Sec. Lit., 639 F.3d 623, 631 (3d Cir. 2011)). Three circuits disagree: the Second Circuit (In re SalomonAnalyst Metromedia Litig., 544 F.3d 474, 481 (2d Cir. 2008)), the Fifth Circuit (OscarPrivate Equity Invs. v. Allegiance Telecom Inc., 487 F.3d 261, 264 (5th Cir. 2007)), and the First Circuit (In re PolyMedica Corp. Sec. Litig., 432 F.3d 1, 8 n. 11 (1st Cir. 2005).

The Ninth Circuit noted that its conclusion (and that of the Seventh Circuit) “enjoys support from the Supreme Court’s more recent formulations of the presumption in Erica P. John Fund and Dukes, which require the plaintiff to show that the stock was traded in an efficient market but do not mention materiality as a requirement.” Amgen at 1176.

However, Erica P. John Fund Inc. v. Halliburton, 563 U.S. ___, 131 S. Ct. 1179 (2011), does not support the Ninth Circuit’s conclusion and, in fact, suggests a contrary conclusion. In Halliburton, the Supreme Court held that a plaintiff need not prove loss causation to obtain class certification in a securities fraud class action. It noted that reliance is a common element if the plaintiff can rely on the fraud-on-the-market presumption and the presumption does not require a showing of loss causation. “Loss causation addresses a matter different from whether an investor relied on a misrepresentation presumptively or otherwise, when buying or selling a stock.” Id. at 2186.
However, the court reiterated that the fraud-on-the-market theory applies only with regard to "material misrepresentations." Quoting from its opinion in Basic v. Levinson, 485 U.S. 224, the Supreme Court stated in Halliburton: "According to [the fraud-on-the-market theory], "the market price of shares reflects all publicly available information, and, hence, any material misrepresentations." Id. at 2185.

The court described as "Basic's fundamental premise" "that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction." Id. at 2186. As Basic made clear, the market price reflects all material representations. Thus, for the fraud-on-the-market presumption to apply, a plaintiff should be required to prove that the alleged misrepresentation is material.

In Halliburton, the defendant argued that while the Fifth Circuit in Amgen held that plaintiff was required to prove loss causation to obtain class certification, what the Fifth Circuit really meant was that plaintiff was required to prove that the alleged misrepresentation affected the market price, i.e., that the misrepresentation was material.

The Supreme Court elected not to address the issue: "While the opinion below may include some language consistent with a 'price impact' approach . . . , we simply cannot ignore the Court of Appeals' repeated and explicit references to 'loss causation,' [citations omitted]. Whatever Halliburton thinks the Court of Appeals meant to say, what it said was loss causation. . . . We take the Court of Appeals at its word. Based on those words, the decision cannot stand." Id. at 2187.

Thus, while the Supreme Court in Halliburton agreed with the Second Circuit's holding in Salomon Analyst Metromedia that the plaintiff is not required to prove loss causation at the class certification stage, it did not address the Second Circuit's holding that the plaintiff has the burden to establish that the alleged misrepresentations were material in order to invoke the fraud-on-the-market presumption.

In Salomon Analyst Metromedia, the Second Circuit held that the plaintiff seeking class certification could satisfy its burden to prove materiality without showing a market price reaction by demonstrating under the test first enunciated in TSC Indus. Inc. v. Northway Inc., 426 U.S. 438, 449 (1976), "a substantial likelihood that the alleged misrepresentations and omissions would have been viewed by a reasonable investor as having significantly altered the 'total mix' of information available."

The Second Circuit held this was sufficient to make a threshold showing that the misrepresentations were material, but that defendants would have to be afforded an opportunity before class certification to demonstrate that the misrepresentations were not material, which the defendants could do by showing that "the allegedly false or misleading material statements did not measurably impact the market price of the security." Id. at 486 n.9.

In Oscar v. Allegiance, 487 F.3d 262, 264 (5th Cir. 2007), the Fifth Circuit went further, holding that plaintiff has the burden to prove that the alleged misrepresentation "actually moved the market." However, the Oscar court's holding was based on its requirement that the plaintiff must prove loss causation to invoke the fraud-on-the-market presumption. Id. at 265. As discussed above, that rationale was
undermined by the Supreme Court’s rejection of the loss causation requirement in Halliburton.

Conclusion

The fraud-on-the-market presumption applies where the defendant publicly makes a material misrepresentation about a stock traded in an efficient market. Therefore, to take advantage of the fraud-on-the-market presumption to obtain class certification, a plaintiff should be required to prove that the alleged misrepresentation is material.

Moreover, although not required to prove loss causation, a plaintiff should be required to show that the alleged misrepresentation actually impacted the stock price. Requiring a plaintiff to demonstrate an impact on the stock price would provide a much needed bright line test as to whether the alleged misrepresentation is in fact material, and therefore whether the case should proceed as a class action.
Nike, Inc. v. Already, LLC

11-982


In July 2009, Nike, the producer of Air Force 1 sneakers, sued Already, the producer of YUMS shoes, alleging trademark infringement, false designation of origin, unfair competition, and trademark dilution. Already denied infringement and filed a counterclaim challenging validity of Nike’s mark registration. In March 2010, Nike delivered a “Covenant Not to Sue” (the “Covenant”) to Already and moved to dismiss its complaint with prejudice and then dismiss Already’s counterclaim for lack of subject matter jurisdiction. The U.S. District Court for the Southern District of New York proceeded to dismiss Nike’s claim with prejudice and dismiss Already’s counterclaims without prejudice, finding that the court no longer had jurisdiction over the counterclaim. The Court of Appeals for the Second Circuit affirmed the district court’s order, finding that after Nike’s Covenant Not to Sue, there was no longer a live controversy upon which the court could find jurisdiction.

Question Presented: Whether a federal district court is divested of Article III jurisdiction over a party’s challenge to the validity of a federally registered trademark if the registrant promises not to assert its mark against the party’s then-existing commercial activities.

NIKE, INC., Plaintiff–Counter–Defendant–Appellee,
v.
ALREADY, LLC d/b/a Yums, Defendant–Counter–Claimant–Appellant.

United States Court of Appeals for the Second Circuit

Decided December 10, 2011

[Excerpt; some footnotes and citations omitted.]

LOHIER, Circuit Judge

This appeal requires us to decide whether a trademark registrant’s delivery of a covenant not to sue, and voluntary dismissal of its trademark claims, divests a federal court of subject matter jurisdiction over a defendant’s counterclaims for a declaratory judgment and cancellation of the trademark’s registration. After considering the breadth of the plaintiffs covenant not to sue and the improbability of future infringement, the United States District Court for the Southern District of New York (Richard J. Sullivan, J.) dismissed the defendant’s counterclaims because no case or controversy existed under Article III of the United States Constitution. We affirm.

BACKGROUND

1. The Complaint and Counterclaims

In July 2009, plaintiff Nike, Inc. filed a
complaint against defendant Already, LLC d/b/a Yums ("Yums"), alleging trademark infringement, false designation of origin, unfair competition, and trademark dilution in violation of 15 U.S.C. §§ 1114(1), 1125(a), and 1125(c), and related claims under New York common law and New York General Business Law § 360. According to the complaint, in 1982, Nike designed a shoe called the Air Force 1, which it has since produced in more than 1,700 color combinations, selling millions of pairs each year. The complaint alleged that the Air Force 1 shoe has a distinctive appearance for which Nike owns several federal trademark registrations, including U.S. Trademark Registration Number 3,451,905, registered with the United States Patent and Trademark Office on June 24, 2008 (hereinafter the "'905 Registration"), for "the design of the stitching on the exterior of the shoe, the design of the material panels that form the exterior body of the shoe, the design of the wavy panel on the top of the shoe that encompasses the eyelets for the shoe laces, the design of the vertical ridge pattern on the sides of the sole of the shoe, and the relative position of these elements to each other." Compl. ¶ 11 (quoting the '905 Registration). It further alleged that Yums was selling "footwear bearing a confusingly similar imitation" of the Air Force 1 shoe, including shoes known as Sugar and Soulja Boy. Id. at ¶¶ 14-15.

In November 2009, Yums filed counterclaims for a declaratory judgment that the '905 Registration was not in fact a "trademark" under 15 U.S.C. § 1127 or New York law, and for cancellation of the '905 Registration pursuant to the cancellation provisions of the Lanham Act, 15 U.S.C. § 1119. Yums also alleged that an "actual controversy" existed regarding whether Yums had infringed any rights Nike had in the purported trademark.

2. The Covenant Not To Sue

In March 2010, Nike delivered a "Covenant Not to Sue" (the "Covenant") to Yums. The Covenant's preamble stated as follows:

NIKE has recently learned that [Yums]'s actions complained of in the Complaint no longer infringe or dilute the NIKE Mark at a level sufficient to warrant the substantial time and expense of continued litigation and NIKE wishes to conserve resources relating to its enforcement of the NIKE Mark.

The Covenant obligated Nike as follows:

to refrain from making any claim(s) or demand(s), or from commencing, causing, or permitting to be prosecuted any action in law or equity, against [Yums] or any of its [successors or related entities and their customers], on account of any possible cause of action based on or involving trademark infringement, unfair competition, or dilution, under state or federal law in the United States [sic] relating to the NIKE Mark based on the appearance of any of [Yums]'s current and/or previous footwear product designs, and any colorable imitations thereof, regardless of whether that foot-wear is produced, distributed, offered for sale, advertised, sold, or otherwise used in commerce before or after the Effective Date of this Covenant.

3. The District Court Proceedings and Decision

In April 2010, a month after Nike delivered the Covenant, the District Court held a hearing to determine whether the Covenant
divested it of subject matter jurisdiction over Yums’s counterclaims. Although Nike conceded during the hearing that it would be bound by the Covenant even if Yums became a competitive threat, Yums argued that a case or controversy persisted because Nike’s litigation—and the ’905 Registration itself—constituted a “continuing libel” against Yums by making it appear that Yums had infringed and continued to infringe Nike’s trademark. In the course of its argument, Yums acknowledged that it had not previously sought to cancel the ’905 Registration, which had been filed nearly two years earlier.

After the hearing, Nike moved pursuant to Rule 12(b)(1) of the Federal Rules of Civil Procedure to dismiss Yums’s counter-claims without prejudice on the ground that the District Court lacked subject matter jurisdiction. Nike also moved to dismiss its own claims voluntarily and with prejudice, pursuant to Rule 41(a)(2).

In response, Yums argued that Nike’s claims should be dismissed with prejudice by summary judgment under Rule 56(b) rather than Rule 41(a)(2) to allow the action, insofar as it included Yums’s counter-claims, to proceed. Yums argued that its counterclaims were not subject to dismissal along with Nike’s claims because, under the Declaratory Judgment Act, they created an independent controversy over whether Nike had violated Yums’s rights by improperly obtaining a trademark registration.

To demonstrate the existence of an actual controversy notwithstanding the Covenant’s broad language, Yums filed affidavits from prospective investors who suggested that Nike’s lawsuit had deterred them from investing in Yums or had prompted them to withdraw prior investments. A former investor in Yums, for example, stated that he resold his stock to Yums at a loss after learning of Nike’s lawsuit, which he feared would tarnish Yums’s reputation and deter other investors from investing in the company. The investor explained that the Covenant provided inadequate assurance that Nike could not “assert its trademarks against” Yums in the future over the sales of shoes similar to Air Force 1.

On January 20, 2011, the District Court dismissed Nike’s claims with prejudice and Yums’s counterclaims without prejudice. See Nike, Inc. v. Already, LLC, d/b/a Yums, No.09 Civ. 6366(RJS), 2011 WL 310321, at *1, *8 (S.D.N.Y. Jan. 20, 2011). In dismissing Nike’s claims “on consent,” the District Court explained that Yums had “consent[ed] to” dismissal of these claims but did not specify which rule, if any, it was invoking. Id. at *2.

Turning to Yums’s counterclaims and relying on MedImmune, Inc. v. Genentech, Inc., 549 U.S. 118 (2007), the District Court first concluded that Yums’s declaratory judgment action failed to create a justiciable “case or controversy,” since a declaratory judgment claimant “must, ‘under all the circumstances,’ demonstrate ‘a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.”’ Nike, Inc., 2011 WL 310321, at *4 (quoting MedImmune, 549 U.S. at 127). The District Court held that Yums’s counterclaims did not meet this standard in light of the Covenant. In reaching this conclusion, the District Court considered the Covenant’s language and broad scope, id., Yums’s failure to show that it had taken meaningful steps to create new shoes not covered by the Covenant, id. (quoting Diamonds.net LLC v. IdenyOnline, Ltd., 590 F.Supp.2d 593, 600 (S.D.N.Y. 2008)), and the absence of prior litigation
between Nike and Yums. *Id.* at *5 (citing ICOS Vision Sys. Corp., N.V. v. Scanner Techs. Corp., 699 F.Supp.2d 664, 670-71 (S.D.N.Y. 2010) (Chin, J.)). The District Court then ruled that Yums’s counterclaim for cancellation of the ‘905 Registration under 15 U.S.C. § 1119 failed to confer subject matter jurisdiction because such a claim can arise only as part of a separate, independently supportable action. *Id.* at *6-7. Lastly, without holding an evidentiary hearing, the District Court rejected Yums’s application for attorneys’ fees under the Lanham Act, 15 U.S.C. § 1117(a), because the case was not “exceptional” as required by the Act. *Id.* at *8.

Yums timely appealed, challenging both the District Court’s dismissal of its claims and the court’s denial of Yums’s motion for attorneys’ fees without an evidentiary hearing.

**DISCUSSION**

We determine the existence of subject matter jurisdiction before addressing other threshold issues. Where a district court dismisses an action “for lack of subject matter jurisdiction, we review factual findings for clear error and legal conclusions *de novo.*” *Maloney v. Soc. Sec. Admin.*, 517 F.3d 70, 74 (2d Cir. 2008). A “case is properly dismissed for lack of subject matter jurisdiction under Rule 12(b)(1) when the district court lacks the statutory or constitutional power to adjudicate it.” *Makarova v. United States*, 201 F.3d 110, 113 (2d Cir. 2000).

1. **Rule 41(a)(2)**

Because the District Court’s conclusion that it lacked jurisdiction followed its dismissal of Nike’s claims under Rule 41(a)(2), Yums urges us to review in the first instance whether the District Court complied with that rule, which provides, in relevant part:

> Except as provided in Rule 41(a)(1), an action may be dismissed at the plaintiffs request only by court order, on terms that the court considers proper. If a defendant has pleaded a counterclaim before being served with the plaintiffs motion to dismiss, the action may be dismissed over the defendant’s objection only if the counterclaim can remain pending for independent adjudication.

Fed.R.Civ.P. 41(a)(2). Yums claims that it did not consent to dismissal of its counterclaims, and that the District Court’s dismissal of the entire action in fact occurred “over the defendant’s objection” in violation of the second sentence of the rule.

When a plaintiff seeks to withdraw its claims pursuant to Rule 41(a)(2), but another event independently deprives the district court of an Article III case or controversy involving the defendant’s counterclaims, Rule 41(a)(2) is irrelevant. See *Super Sack Mfg. Corp. v. Chase Packaging Corp.*, 57 F.3d 1054, 1057 n. 2 (Fed. Cir. 1995) (finding it unnecessary to consider whether dismissal pursuant to Rule 41(a)(2) was proper where dismissal was clearly proper because of the absence of an Article III case or controversy), abrogated on other grounds by *MedImmune*, 549 U.S. 118; see also *Intellectual Prop. Dev., Inc. v. TCI Cablevision of Cal., Inc.*, 248 F.3d 1333, 1340 & n. 6 (Fed. Cir. 2001) (affirming a dismissal of a counterclaim based on a lack of Article III case or controversy even though the district court had not indicated any reliance on Rule 41(a)(2) or a statement of non-liability, and the record failed to show whether the defendant consented to Rule 41(a)(2) relief).
Accordingly, we need not further address Rule 41(a)(2) because we conclude, as a matter of law, that Nike’s delivery of the Covenant to Yums divested the District Court of subject matter jurisdiction, and we affirm on that basis.

2. The Covenant Not To Sue

In order to qualify as a justiciable “case or controversy” under Article III, “[t]he controversy must be definite and concrete, touching the legal relations of parties having adverse legal interests.” *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240-41 (1937). The “case or controversy” requirement is not satisfied by a “difference or dispute of a hypothetical or abstract character.” *Id.* at 240. In trade-mark cases seeking relief under either the Declaratory Judgment Act, 28 U.S.C. § 2201(a), or Section 37 of the Lanham Act, 15 U.S.C. § 1119, a valid covenant not to sue may strip district courts of jurisdiction. We review the jurisdictional effect of such a covenant under both Acts in turn.

a. Declaratory Judgment Act

We turn first to the effect of such a covenant in trademark cases involving the Declaratory Judgment Act, which provides in relevant part:

> In a case of actual controversy within its jurisdiction . . . any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought.

28 U.S.C. § 2201(a). The Declaratory Judgment Act does not expand the subject matter jurisdiction of the federal courts. *See PDK Labs, Inc. v. Friedlander*, 103 F.3d 1105, 1110 (2d Cir. 1997). In *Aetna*, the Supreme Court “explained that the phrase ‘case of actual controversy’ in the Act refers to the type of ‘Cases’ and ‘Controversies’ that are justiciable under Article III.” *MedImmune*, 549 U.S. at 127 (citing *Aetna*, 300 U.S. at 240). Its pronouncement in *Aetna* was refined four years later in *Maryland Casualty Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270, 273 (1941), in which the Supreme Court endorsed a totality of the circumstances test for determining whether a party seeking relief under the Act has demonstrated that a justiciable “controversy” exists. The Court in *Maryland Casualty* explained that “[b]asically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.” *Id.* In adopting this test, the Supreme Court recognized that “[t]he difference between an abstract question and a ‘controversy’ contemplated by the Declaratory Judgment Act is necessarily one of degree, and it would be difficult, if it would be possible, to fashion a precise test for determining in every case whether there is such a controversy.” *Id.*

We did not apply the *Maryland Casualty* test in a trademark case until *Starter Corp. v. Converse, Inc.*, 84 F.3d 592, 595 (2d Cir. 1996) (per curiam). In that case, we employed a two-pronged test for determining whether subject matter jurisdiction exists:

> [i]n a declaratory judgment action involving trademarks, the test for an “actual case or controversy” has two prongs, both of which must be satisfied in order to establish
declaratory judgment jurisdiction: (1) has the defendant’s conduct created a real and reasonable apprehension of liability on the part of the plaintiff, and (2) has the plaintiff engaged in a course of conduct which has brought it into adversarial conflict with the defendant.

Id. at 595.

After our decision in Starter, the Supreme Court decided MedImmune, which confirmed that Maryland Casualty's totality of the circumstances test for declaratory judgment actions applied in intellectual property cases, see 549 U.S. at 126-27, but which rejected Starter's reasonable apprehension requirement, id. at 122, 132 (quoting Gen-Probe Inc. v. Vysis, Inc., 359 F.3d 1376, 1381 (Fed. Cir. 2004)). MedImmune requires that we consider only whether the adversity of legal interests that exists between the parties is "real and substantial" and "admits of specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts." Id. at 127 (quoting Aetna Liabilities, Co., 300 U.S. at 241). The Court also suggested that the threat of future litigation remains relevant in determining whether an actual controversy exists. As in MedImmune, for example, simply holding litigation in abeyance, where a party could forestall litigation indefinitely by paying licensing fees, does not eliminate the case or controversy. Id. at 128 ("[T]he declaratory judgment plaintiff's own acts . . . eliminate the imminent threat of harm [and]t[he] question before us is whether this causes the dispute no longer to be a case or controversy within the meaning of Article III.").

Until now, we have not applied MedImmune in an intellectual property case. However, a few of our sister circuits have done so in the context of declaratory judgment actions involving patents, which we have described as sufficiently "analogous" to those involving trademarks that "principles applicable to declaratory judgment actions involving patents are generally applicable with respect to trademarks." Starter Corp., 84 F.3d at 596; see also Revolution Eyewear, Inc. v. Aspex Eyewear, Inc., 556 F.3d 1294, 1298-99 (Fed. Cir. 2009) (applying MedImmune to declaratory judgment action involving patents).

In determining whether a covenant not to sue eliminates a justiciable case or controversy in a declaratory judgment action involving a trademark, district courts applying the MedImmune totality of the circumstances test should especially consider, in addition to other factors: (1) the language of the covenant, (2) whether the covenant covers future, as well as past, activity and products, and (3) evidence of intention or lack of intention, on the part of the party asserting jurisdiction, to engage in new activity or to develop new potentially infringing products that arguably are not covered by the covenant.

Applying these factors here, we agree with the District Court that it had no actual case or controversy before it. The language of the Covenant is broad, covering both present and future products: Nike "unconditionally" and permanently renounced its right to claim, demand or "commenc[e], caus[e] or permit[] to be prosecuted any action in law or in equity" with respect to any shoe currently made by Yums, including the Sugar and Soulja Boy shoes, and all colorable imitations thereof: Nike, Inc., 2011 WL 310321, at *1-2. The breadth of the Covenant renders the threat of litigation remote or non-existent even if Yums
continues to market and sell these shoes or significantly increases their production. Given the similarity of Yums’s designs to the ‘905 mark and the breadth of the Covenant, it is hard to imagine a scenario that would potentially infringe the ‘905 mark and yet not fall under the Covenant. Yums has not asserted any intention to market any such shoe. Nike, Inc., 2011 WL 310321, at *4.

In Revolution Eyewear, 556 F.3d at 1296, the Federal Circuit concluded that a controversy persisted when the plaintiff delivered a covenant that promised not to sue only as to prior sales of the allegedly infringing product. The crucial difference between Revolution Eyewear and this case is the scope of the two covenants. In Revolution Eyewear, it was undisputed that the covenant did not protect the defendant from suit for any future marketing. Id. Here, the Covenant is far broader. It covers both past sales and future sales of both existing products and colorable imitations. Given the breadth of the Covenant, no controversy exists.

Yums nevertheless urges that a justiciable controversy persists because Nike’s litigation continues to have an injurious effect. Pointing to the affidavits of various investors, Yums alleges harm from the potential loss of investments by investors who fear infringement lawsuits in the future and for that reason have refrained from further investing or have withdrawn their investments. In this case, potential investor concerns about infringement law-suits against the company, despite Nike’s broad Covenant, fail to establish the sort of genuinely adverse legal interests between Nike and Yums that MedImmune requires. In addition, Yums contends that the Covenant is a “continuing libel” against it because the Covenant asserts Yums’s ongoing de minimis infringement of Nike’s trademark. Yums did not file a counterclaim alleging libel, however, and in any event we reject the contention that the mere existence of a document asserting infringement—where the registrant cannot assert a claim relating to that infringement—creates a case or controversy.

Relying on Cardinal Chemical Co. v. Morton International, Inc., 508 U.S. 83, 96, 99-103 (1993), Yums also argues that a finding of non-infringement does not deprive a court of jurisdiction to rule on the validity of a trademark or patent. Cardinal Chemical is inapposite, however, as it “concern[s] the jurisdiction of an intermediate appellate court, not a trial court.” Giese v. Pierce Chem. Co., 43 F.Supp.2d 98, 112 n. 14 (D.Mass. 1999); see also Lamb-Weston, Inc. v. McCain Foods, Ltd., 78 F.3d 540, 546 (Fed. Cir. 1996) (“The Supreme Court’s decision in Cardinal Chemical is limited to the specific facts of that case[;] [s]pecifically, [that] an affirmance by th[e] court [of appeals] of a finding of noninfringement is not, by itself, enough to vacate a declaratory judgment holding the patent invalid.”). Moreover, unlike the trial court in Cardinal Chemical, the District Court here made no “finding[s]” on the merits of Yums’s declaratory judgment action. See Cardinal Chemical, 508 U.S. at 86, 95 (emphasizing that the only issue before the Court was the circuit court’s jurisdiction, and that “[i]n the trial court, of course, a party seeking a declaratory judgment has the burden of establishing the existence of an actual case or controversy”).

Yums also makes much of the District Court’s exercise of subject matter jurisdiction over Nike’s claims, which Yums contends was inconsistent with the District Court’s determination that a case or
controversy no longer existed. We have already acknowledged that the District Court could have dismissed Nike's claims either for lack of subject matter jurisdiction or "on consent." See supra at 92-94. But Yums has not appealed the District Court's exercise of jurisdiction over Nike's claims, which resulted in a ruling favorable to Yums, and in the part of the District Court order that is before us there is no error.

b. The Lanham Act


Section 1119 therefore creates a remedy for trademark infringement rather than an independent basis for federal jurisdiction. Both the Third Circuit and the Federal Circuit have held that, by its plain terms, this provision requires that "a controversy as to the validity of or interference with a registered mark . . . exist before a district court has jurisdiction to grant the cancellation remedy." Ditri v. Coldwell Banker Residential Affiliates, Inc., 954 F.2d 869, 873 (3d Cir. 1992); see id. (noting that a petition to the Patent and Trademark Office is the "primary means of securing a cancellation," and that § 1119 provides no independent basis for jurisdiction) (citing Universal Sewing Mach Co., 185 F.Supp. at 260); Windsurfing Int'l Inc. v. AMF Inc., 828 F.2d 755, 758-59 (Fed. Cir. 1987); see also McCarthy on Trademarks and Unfair Competition § 30:110 (4th ed. 2010) ("[Section 1119] alone does not create grounds for federal jurisdiction."). We agree with their analysis, and hold that a claim for trademark cancellation under § 1119 is insufficient to support federal jurisdiction where a covenant not to sue has resolved the underlying infringement action.

Yums cites only one case, Bancroft & Masters, Inc. v. Augusta National Inc., 223 F.3d 1082 (9th Cir. 2000), in support of its argument that a court may retain jurisdiction over a § 1119 claim notwithstanding the end of a case or controversy with respect to the rest of the action. The Ninth Circuit in Bancroft & Masters, however, concluded that the promise not to sue in that case failed to end the case or controversy. Id. at 1085. Its pronouncement that even an unqualified promise "would not have mooted [the] separate request for [§ 1119] cancellation of [the] trademarks" is therefore dictum. Id. In addition, the Ninth Circuit in Bancroft failed to consider the language in § 1119 that renders that section remedial, not jurisdictional. Accordingly, we find its opinion unpersuasive.

Yums next characterizes Nike's original lawsuit as a "properly instituted and otherwise jurisdictionally supportable action" and contends that this fact alone provided a basis for the District Court to retain jurisdiction over Yums's § 1119 cancellation counterclaim notwithstanding the Covenant. Yums's argument ignores the settled rule that the "case-or-controversy requirement . . . subsists through all stages of federal judicial proceedings." White River
Amusement Pub, Inc. v. Town of Hartford, 481 F.3d 163, 167 (2d Cir. 2007) (internal quotation marks omitted) (citing Spencer v. Kemna, 523 U.S. 1, 7 (1998)). Although Nike’s action was “properly instituted,” it was no longer “jurisdictionally supportable” after the Covenant was delivered.

3. Attorneys’ Fees

We review an order denying attorneys’ fees under the Lanham Act for abuse of discretion. See Gordon & Breach Science Publishers S.A. v. Am. Inst. of Physics, 166 F.3d 438, 439 (2d Cir. 1999) (per curiam). Such fees are available only in “exceptional cases,” which generally means that fees will be awarded to the defendant only if the plaintiff filed the action in bad faith. See Banff, Ltd. v. Colberts, Inc., 996 F.2d 33, 36 (2d Cir. 1993). Here, Nike filed its action pursuant to its own registered trademark and withdrew the action quickly. On the record before us, we cannot say that the District Court abused its discretion when it found that Nike had not acted in bad faith, and Yums fails to identify what additional information the District Court needed to make an informed decision about attorneys’ fees. Accordingly, we find no abuse of discretion in its decision to deny fees without a hearing.

CONCLUSION

We affirm the judgment of the District Court.
Is a trademark owner’s promise not to sue for infringement a good enough reason for a challenger to the mark to be forced to walk away from litigation? On Monday the U.S. Supreme Court gave intellectual property practitioners a good reason to look forward to next term, granting certiorari to a shoe company called Already in a trademark dispute with Nike. The case has a through-the-looking-glass quality because the issue is whether Already can proceed with counterclaims against Nike even though Nike dropped its infringement case against Already.

Here’s the backstory. In 2009 Nike sued Already, which is the producer of YUMS shoes, in federal court in Manhattan, claiming that one of Already’s designs infringed a Nike trademark. Already denied the infringement but also filed a counterclaim challenging the validity of Nike’s mark. According to Already’s petition for writ of certiorari—filed by James Dabney of Fried, Frank, Harris, Shriver & Jacobson—Nike “abruptly” changed course in March 2010 and delivered a “Covenant Not to Sue” to Already, promising not to sue over any of the company’s current or previous shoe designs. Nike moved to dismiss its own complaint with prejudice and asked U.S. District Judge Richard Sullivan to dismiss Already’s counterclaim for lack of subject matter jurisdiction.

Already certainly had no problem with Nike dropping the infringement suit but urged the court to keep its invalidity counterclaim alive. In January 2011 Sullivan sided with Nike, finding that Already was no longer exposed to potential litigation based on the trademark, so the court did not have jurisdiction over the counterclaim. In November 2011 a three-judge panel of the 2nd Circuit Court of Appeals affirmed Sullivan’s order, saying the “breadth of (Nike’s) covenant not to sue and the improbability of future infringement” meant that there was no live controversy that would give the district court jurisdiction. (The opinion was written by Circuit Judge Raymond Lohier for a panel that also included judges Debra Ann Livingston and Pierre Leval.)

Already’s cert petition argued that the 2nd Circuit’s decision created a circuit split with a 2000 ruling by the 9th Circuit. That ruling, in a case called Bancroft & Masters v. Augusta National, held that a promise not to assert a registered trademark did not divest the lower court of jurisdiction to hear challenges to the mark at issue.

Should the Supreme Court side with Already, the balance of power during litigation and settlement negotiations would shift noticeably from the mark holder to the accused infringer, said Jason Rantanen, an associate professor of law at the University of Iowa who blogs at PatentlyO. As things stand, when rights holders sue to protect their marks, they risk invalidity challenges. If the 2nd Circuit ruling for Nike stands, Rantanen said, a trademark or patent holder who’s worried about such a challenge could just pull the relevant mark from the
litigation and promise not to enforce it against the alleged infringer. A finding for Already, on the other hand, would likely force patent and trademark owners to think a little more carefully about which marks they want to risk enforcing. “Once you place your irons in the fire, it (would be) much harder to pull them out,” Rantanen said.

Wilmer Cutler Hale Pickering and Dorr IP Chair Donald Steinberg, who is not involved in the case, said that the issue is the breadth of protection a mark holder should receive from a promise not to sue. Because that is a fact-specific question (i.e., what does the no-suit covenant say?), Steinberg said, it’s possible the court will focus more on general guidance than a strict rule.

Specific facts aside, the reach of intellectual property has been of interest to the high court lately. In recent decisions, including March’s Mayo Collaborative Services v. Prometheus Laboratories, which invalidated a process patent for correlations between blood test results and patient health, the Supreme Court has taken an interest in the broader policy question of how far rights holders’ powers should extend, Steinberg said.

Thomas Goldstein of Goldstein & Russell and attorneys from Banner & Witeoff handled Nike’s brief opposing cert. Attorneys from Dickstein Shapiro also represented Nike at the 2nd Circuit. Goldstein’s office directed me to a Nike spokesperson, who declined to comment.

(Reporting by Erin Geiger Smith)
Nike sued YUMS back in 2009 alleging trademark infringement, unfair competition, and dilution under both federal and NY state law. The complaint included the image below comparing YUMS brand shoes with Nike’s federal trademark registration number 3,451,905. The design is related to Nike’s Air Force 1 shoe that was first released in 1982. The Yums intentionally retro look is apparently fashionable for skaters and freestyle BMX riders. (The image does not show the shoes’ creative soles.)

![Comparison of YUMS shoes with Nike Air Force 1](image)

After being sued, YUMS counterclaimed—seeking to cancel the registration. However, before the court could reach a decision on the merits, Nike’s attorneys at Banner & Witcoff provided YUMS with a covenant-not-to-sue on the AF1 design rights. In the document, Nike wrote that YUMS brand “no longer infringe or dilute the Nike Mark at a level sufficient to warrant the substantial time and expense of continued litigation.”

The covenant was limited to YUMS current shoes as well as ‘colorable imitations’ of current lines. In particular, Nike promised to:

refrain from making any claim(s) or demand(s), or from commencing, causing, or permitting to be prosecuted any action in law or equity, against [Yums] or any of its [successors or customers], on account of any possible cause of action based on or involving trademark infringement, unfair competition, or dilution, under state or federal law in the United States relating to the [Nike eAir Force 1 Mark] based on the appearance of any of [Yums]’s current and/or previous footwear product designs, and any colorable imitations thereof, regardless of whether that footwear is produced, distributed, offered for sale, advertised, sold, or otherwise used in commerce before or after the Effective Date of this Covenant.

YUMS was apparently happy with the document, but not fully satiated. Rather, YUMS maintained its declaratory judgment lawsuit—arguing that the Nike Mark continued to improperly chill its innovative marketing efforts. However, the district court dismissed the case—finding that it lacked subject matter jurisdiction because there was no ongoing case or controversy. Important for its ruling, YUMS had not taken any “meaningful steps” toward developing a new potentially infringing product not covered by the covenant-not-to-sue.

On appeal, the Second Circuit affirmed, holding specifically that the cancelation power under 15 U.S.C. § 1119 does not provide federal courts with an independent basis for jurisdiction absent an actual case-or-controversy between the parties.
Supreme Court: Now, YUMS has appealed to the US Supreme Court—relying upon the expertise of Jim Dabney and Prof John Duffy (of KSR fame) to bring their case. They raise the simple question: “Whether a federal district court is divested of Article III jurisdiction over a party’s challenge to the validity of a federally registered trademark if the registrant promises not to assert its mark against the party’s then-existing commercial activities.” The complaint raises a circuit split between the Second Circuit here and the Ninth Circuit, which is much more friendly to DJ trademark actions in this type of situation. In addition, the petition highlights Supreme Court precedent that suggest broad jurisdiction should be available to challenge the validity of suspect intellectual property rights. See Lear, Inc. v. Adkins, 395 U.S. 653 (1969), MedImmune, Inc. v. Genentech, Inc., 549 U.S. 118 (2007), Cardinal Chem. Co. v. Morton Int’l, Inc., 508 U.S. 83 (1993), and Scott Paper Co. v. Marcalus Mfg. Co., 326 U.S. 249 (1945).

The Supreme Court has now asked Nike to respond to the petition—due May 4. This move greatly increases the odds that the petition will eventually be granted.

Of interest, a key element of the Myriad gene patent case is whether the ACLU and AMP have standing to sue. This case may shed further light on that outcome.
I’ve written before on the sad state of patent quality in our country. Today I’m writing about a beacon of hope. Earlier this week, the Supreme Court agreed to hear a case that could greatly expand the right of the public to defend itself from bogus patents.

Remember, the granting of a patent is an intrusive act of government telling you, me and every other American we cannot do something. Jefferson called them “embarrassments,” and he was right, they are, especially when they are completely undeserved, as a great many of the 4,500 patents issued every week are.

Unfortunately, as unbelievable as it may sound, there is absolutely nothing you, me or any other American can do to stop the government from taking our freedom away willy nilly by granting meritless patents in the first place. In fact, the government makes a lot of money doing so (it makes ten times as much money when it grants a patent as when it denies one; which would you prefer if you were a fat cat bureaucrat?). This is why it is so important to have ways to take our freedom back after the government has stolen it from us. As of now, that’s very hard to do, because the government knows it has to make it as hard as possible for us Americans to take back our freedom in order to “protect the value of IP” (that’s how the Director of the Patent Office spins the situation), else the Patent Office won’t make as much money giving our freedom away.

In the Supreme Court case accepted this week, Nike (yes, that Nike, the famous sportswear company) sued a much smaller shoe company called Already, which does business under the name YUMS, for allegedly infringing one of its trademarks relating to the design of a shoe. Already looked at the trademark and quite quickly realized that it was completely invalid. (If you want to know how it’s possible for our government to give out invalid trademarks and patents, see my talk on the Patent Pollution Problem. The same government agency, the United States Patent and Trademark Office, grants both.)

Knowing it was going to lose, Nike decided to quit and walk off the field before time expired. In legal terms, what that means is Nike promised never to sue Already again for infringing that trademark “for similar shoes.” After making the “promise” and giving up on its dead loser of a case, Nike asked the court to dismiss Already’s request that the trademark be declared invalid. In other words, Nike picked a fight with a much smaller competitor, realized it was going to get its butt kicked once the little guy decided to defend itself, became a total chicken, and tried to run the other way, all the while retaining its trademark to assert against the same little guy again in the future (because surely Nike will argue new shoes by Already are not “similar” and therefore fall outside the “promise” they made).

Nike is not alone in using this hit-and-run tactic. There are numerous examples of overly aggressive patent owners doing exactly the same thing, threatening innocent
people with completely false claims of infringement, suing them in court hoping the burden of defense alone will make them crumble, but then seeking to drop the entire case by making a meaningless promise not to sue once they realize the jig is up because their patent is completely bogus and the defendant is seeking to have it invalidated by the court. These patent bullies want to concede the case in order to avoid permanently losing the right to threaten and sue again in the future for infringing the same worthless patent. It's absolutely disgusting and the people who do this should be ashamed of themselves. If you want to start a fight, that's your prerogative, but you better be ready for the other guy to finish it. You can't just call time out when you're on the brink of losing so you can start over later on when you've got your chutzpah back. No sir, that's not how we roll here in America.

Not surprisingly, innocently accused parties are as outraged as I am at this ploy. They don't want to get sued at all, much less for infringing invalid trademarks and patents that would get shredded if they ever truly had their day in court. Already fought Nike in both the district court and the court of appeals for its right to have Nike's trademark declared invalid, but both courts let Nike off the hook. So, Already appealed to the Supreme Court, which, as I say above, on Monday decided to hear the case. Thank heavens. At least someone in our judicial system has some sense and backbone.

There are at least two huge reasons to celebrate the fact that the Supreme Court may direct lower courts to permit challenges to trademarks and patents being used to hit-and-run the American people.

First, as previously mentioned, American patent quality is poor, so poor, the Patent Office should be even more “embarrassed” than Jefferson was back when he was in charge of deciding what applications should be granted or denied. The American people desperately need ways to challenge and eliminate worthless patents that take away their freedom. Allowing accused infringers to maintain challenges against patent holders who sue for infringement will not only help fix the patent pollution problem, it will also make patent holders think twice about the true strength of their patents before even asserting them against others. It will thus greatly reduce anti-competitive over-litigious and just plain cowardly behavior.

Second, allowing validity challenges is consistent with general American principles relating to protecting freedom from improper government restraint. Like criminal statutes, patents are government-issued ways of taking away rights of the American people to do something, and the Supreme Court has repeatedly allowed parties to challenge criminal statutes even when there was no threat of those statutes ever being enforced, much less when they had been used to hit-and-run. And in the last Supreme Court case on the right of parties to challenge patents, the Supreme Court relied on those other cases challenging criminal statutes to find that the patent challenge could proceed even though the potential infringers were not even likely to be sued by the patent holder. It’s only logical that a party that has been previously accused of infringing a patent should be able to challenge it. Further still, the right to bring a challenge should stem from the fact that the existence of the bogus patent is a threat to freedom in and of itself, especially when the patent holder has been brandishing it in an aggressive and threatening way.

We'll now have to wait several months before we get a decision from the Supreme
Court in the case, but it would be strange indeed for them to have taken it merely to uphold the lower courts’ decisions to dismiss the challenges. Hopefully, the *Alfred v Nike* case will open up new doors for the American people to take back their freedom by challenging invalid patents. I’m going to go buy some YUMS products right now to show my support. One of my favorite little cousins is heading to college this fall and could use some new kicks.
**Kirtsaeng v. John Wiley & Sons, Inc.**

11-697


As an international student, Supap Kirtsaeng came from Thailand for his undergraduate and doctoral education. Kirtsaeng had family in Thailand purchase textbooks and ship them to him. After using them, Kirtsaeng sold these textbooks on eBay to repay the original purchasers, and kept the remaining profit to himself. Eight of the textbooks he sold were printed by John Wiley & Sons in Asia. John Wiley & Sons brought suit under the Copyright Act § 602(a)(1), under which it is impermissible to import a work without the copyright owner’s consent. In defense, Kirtsaeng cited § 109(a) which allows the owner of a lawfully made copy to sell without the copyright owner’s permission. The district court found for John Wiley & Sons, holding that the first sale doctrine does not extend to goods manufactured abroad and imported into the United States. On appeal to the Court of Appeals for the Second Circuit in 2011, the majority upheld the district court’s decision for the plaintiff. Kirtsaeng’s request for a rehearing was denied.

**Question Presented:** How do Section 602(a)(1) of the Copyright Act, which prohibits the importation of a work without the authority of the copyright’s owner, and Section 109(a) of the Copyright Act, which allows the owner of a copy “lawfully made under this title” to sell or otherwise dispose of the copy without the copyright owner’s permission, apply to a copy that was made and legally acquired abroad and then imported into the United States?

**JOHN WILEY & SONS, INC., Plaintiff–Appellee,**

v.

**Supap KIRTSANG, doing business as Bluechristine99, Defendant–Appellant.**

United States Court of Appeals for the Second Circuit

Decided August 15, 2011

[Excerpt; some footnotes and citations omitted.]

**CABRANES, Circuit Judge**

The “first sale doctrine” in copyright law permits the owner of a lawfully purchased copy of a copyrighted work to resell it without limitations imposed by the copyright holder. The existence of the doctrine dates to 1908, when the Supreme Court held that the owner of a copyright could not impose price controls on sales of copies of a copyrighted work beyond the initial sale. Congress codified the doctrine in successive Copyright Acts, beginning with the Copyright Act of 1909.

The principal question presented in this appeal is whether the first sale doctrine, 17 U.S.C. § 109(a), applies to copies of copyrighted works produced outside of the United States but imported and resold in the
United States. Under another basic copyright statute, it is ordinarily the case that “[i]mportation into the United States, without the authority of the owner of copyright under [the Copyright Act], of copies . . . of a work that have been acquired outside the United States is an infringement of the [owner’s] exclusive right to distribute copies . . . .”

Defendant contends, however, that individuals may import and resell books manufactured abroad pursuant to 17 U.S.C. § 109(a), which provides that “the owner of a particular copy . . . lawfully made under [the Copyright Act], or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy.”

Defendant’s claim is an issue of first impression in our Court.

BACKGROUND

A. The Parties

Plaintiff-appellee John Wiley & Sons, Inc. (“plaintiff or “Wiley”) is the publisher of academic, scientific, and educational journals and books, including textbooks, for sale in domestic and international markets. Wiley relies upon a wholly-owned subsidiary, John Wiley & Sons (Asia) Pte Ltd. (“Wiley Asia”), to manufacture books for sale in foreign countries. While the written content of books for the domestic and international markets is often similar or identical, books intended for international markets can differ from the domestic version in design, supplemental content (such as accompanying CD-ROMS), and the type and quality of materials used for printing, including “thinner paper and different bindings, different cover and jacket designs, fewer internal ink colors, if any, [and] lower quality photographs and graphics.” Joint App’x at 18. The foreign editions, moreover, are marked with a legend to designate that they are to be sold only in a particular country or geographic region. One example of such a designation reads as follows:

Authorized for sale in Europe, Asia, Africa and the Middle East Only.

This book is authorized for sale in Europe, Asia, Africa and the Middle East only [and] may not be exported. Exportation from or importation of this book to another region without the Publisher’s authorization is illegal and is a violation of the Publisher’s rights. The Publisher may take legal action to enforce its rights. The Publisher may recover damages and costs, including but not limited to lost profits and attorney’s fees, in the event legal action is required.

Defendant Supap Kirtsaeng (“defendant” or “Kirtsaeng”) moved to the United States from Thailand in 1997 to pursue an undergraduate degree in mathematics at Cornell University. According to Kirtsaeng, he later moved to California to pursue a doctoral degree.

B. The Instant Action

To help subsidize the cost of his education, Kirtsaeng allegedly participated in the following scheme: Between 2007 and September 8, 2008, Kirtsaeng’s friends and family shipped him foreign edition textbooks printed abroad by Wiley Asia. In turn, Kirtsaeng sold these textbooks on commercial websites such as Bay.com. Using the revenues generated from the sales,
Kirtsaeng would reimburse his family and friends for the costs that they incurred during the process of acquiring and shipping the books and then keep any remaining profits for himself. Kirtsaeng claims that, before selling the textbooks, he sought advice from friends in Thailand and consulted "Google Answers," a website which allows web users to seek research help from other web users, to ensure that he could legally resell the foreign editions in the United States.


C. Relevant Pre-Trial Proceedings

In anticipation of trial, Kirtsaeng submitted proposed jury instructions charging that the first sale doctrine was a defense to copyright infringement. By Order dated October 9, 2009, the District Court prohibited Kirtsaeng from raising this defense and rejected the applicability of the first sale doctrine to foreign editions of text-books, holding that "[t]here is no indication that the imported books at issue here were manufactured pursuant to the U.S. Copyright Act. . . . [and,] [t]o the contrary, the textbooks introduced as evidence purport, on their face, to have been published outside of the United States."

On October 23, 2009 and November 3, 2009, Kirtsaeng filed motions in limine to preclude the introduction at trial of (1) his online "PayPal" sales records, and specifically, evidence of his gross revenues from the sales of the foreign editions of Wiley's books, and (2) the profits he earned on unrelated sales activities. From the bench during a pre-trial conference on November 3, 2009, the District Court granted the motions in part and denied them in part. The Court explained that Wiley could not introduce evidence of profits earned by Kirtsaeng from the sales of textbooks produced by other publishers, but "in . . . anticipation that the net worth testimony [would indicate] that [Kirtsaeng did not have] significant net worth . . . [Wiley’s counsel had the] right to inquire about additional revenue s and the profits there from and where they went in order to make sure that we had an accurate record about [Kirtsaeng’s] net worth.” The Court further stated that Wiley’s counsel “must be careful not to refer to these [unrelated] sales in any way as infringing sales, because that would be entirely improper.”

D. Events at Trial

At trial, during direct examination, Wiley’s counsel asked Kirtsaeng, “Now sir, if we were to go back and look at January 1st of 2008, what were your financial assets at that point in time?”

The District Court sustained an objection by Kirtsaeng’s counsel and a sidebar discussion followed.

After the sidebar conference and a recess, the first question by Wiley’s counsel to Kirtsaeng was: “Mr. Kirtsaeng, before the break we were talking about your net worth during the period of 1999, correct? Excuse me. 200.9.” Kirtsaeng answered “yes.” Wiley’s counsel proceeded to ask Kirtsaeng
a series of questions about his “net worth” in an attempt to impeach his previous statements. Specifically, he attempted to enter into evidence a record of Kirtsaeng’s PayPal revenues, showing $1.2 million in revenues, in contrast to Kirtsaeng’s previous testimony that he had earned only $900,000 in revenues.

At a second sidebar conference, during which the jury was excused from the courtroom, the District Court excluded the record of the PayPal evidence as “confusing and unfairly prejudicial.”

When the jury reentered the courtroom, Wiley’s counsel continued to ask Kirtsaeng about his revenues from eBay sales. Although Kirtsaeng’s counsel immediately objected to the line of questioning on the basis that it had already been “asked and answered”—an objection the District Court initially sustained—the Court subsequently allowed the questioning, explaining that it was uncertain whether the same questions had in fact been asked of the witness earlier in the examination.

At the end of the trial, the District Court charged the jury to determine whether Kirtsaeng had infringed the copy-rights of each of eight works and whether any such infringements had been willful. The District Court explained that, under the statutory damages scheme found at 17 U.S.C. § 504(c), if the jury found that Kirtsaeng had infringed Wiley’s copyright, it could award no less than $750 and no more than $30,000 in damages for each infringed work.

The District Court identified two exceptions to this rule. First, the District Court instructed the jury that, if it found that Wiley had proved by a preponderance of the evidence that the infringement was willful, under the statutory scheme the jury had the option of awarding up to $150,000 in damages per infringed work. Second, if the jury found that Kirtsaeng had proved by a preponderance of the evidence “that he was not aware and had no reason to believe that his acts constituted an infringement of copyright,” the jury could choose to impose an award of statutory damages as low as $200 per infringed work. The jury ultimately found Kirtsaeng liable for willful copyright infringement of all eight works and imposed damages of $75,000 for each of the eight works.

Kirtsaeng filed a timely notice of appeal. He claims that (1) the District Court erred in holding that the first sale doctrine was not an available defense in the circumstances presented; (2) the District Court should have advised the jury of the first sale doctrine as a defense to the claim of willful infringement; and (3) with respect to the jury’s assessment of statutory damages, the admission into evidence of testimony regarding the amount of Kirtsaeng’s gross receipts was unduly prejudicial.

DISCUSSION

A. The first sale doctrine does not apply to goods produced outside of the United States.

1. Standard of review

The threshold question is whether, pursuant to § 109(a) of the Copyright Act, see note 1, ante, the District Court correctly determined that the phrase “lawfully made under this title” does not include copyrighted goods manufactured abroad.

Where the decision of a district court “presents only a legal issue of statutory
interpretation . . . [w]e reVIew whether the district court correctly interpreted the statute.”

2. Interpreting the First-Sale Doctrine

In the Copyright Act of 1976, Congress enacted what is now 17 U.S.C. § 602(a)(1). That section provides:

Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies or phonorecords under section 106, actionable under section 501.

Even if the conduct at issue in this case is otherwise covered by this statutory language, Kirtsaeng contends that he is shielded from any liability under the Copyright Act by § 109(a), see note 1, ante. Again, in relevant part, that section provides: “Notwithstanding the provisions of section 106(3) [of the Copyright Act], the owner of a particular copy . . . lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy.” Section 109(a) is a codification of the longstanding “first sale doctrine.”

There is at least some tension between § 602(a)(1), which seemingly seeks to give copyright holders broad control over the circumstances in which their copyrighted material may be imported (directly or indirectly) into the United States, and § 109(a), which limits the extent to which the copyright holder may limit distribution following an initial sale. The Supreme Court first had occasion to address the interplay between § 602(a)(1) and § 109(a) in Quality King Distributors, Inc. v. L’anza Research International, Inc.

*Quality King* involved the sales practices of L’anza Research International, a California corporation engaged in the business of manufacturing and selling shampoos, conditioners, and other hair care products. L’anza sold its products domestically and internationally, but its prices to foreign distributors were 35% to 40% lower than the prices charged to its domestic distributors. L’anza brought suit against Quality King Distributors, Inc., which had purchased shipments of L’anza’s products from one of L’anza’s foreign distributors and then reimported the products into the United States for resale. L’anza alleged that Quality King’s actions violated its “exclusive rights under 17 U.S.C. §§ 106, 501 and 602 to reproduce and distribute the copyrighted material in the United States.” The Supreme Court heard the case in order to decide the question of “whether the ‘first sale’ doctrine endorsed in § 109(a) is applicable to imported copies.”

In a unanimous opinion, the Supreme Court held that § 109(a), operating in combination with § 106(3), does in fact limit the scope of § 602(a). However, there was a key factual difference at work in *Quality King* that is of critical importance to our disposition of the instant appeal. In *Quality King*, the copyrighted items in question had all been manufactured in the United States. Indeed, this important fact provided the basis for Justice Ginsburg’s brief concurring opinion, in which she explained: “This case involves a ‘round trip’ journey, travel of the copies in question from the United States to places abroad, then back again. I join the Court’s opinion recognizing that we do not today resolve cases in which the allegedly
infringing imports were manufactured abroad."

Although the majority opinion did not directly address the question of whether § 109(a) can apply to items manufactured abroad, the opinion contains instructive *dicta* that guides our disposition of the issue. In particular, the Court took pains to explain ways in which § 109(a) and § 602(a) do, and do not, overlap. As the Court stated: "Although both the first sale doctrine embodied in § 109(a) and the exceptions in § 602(a) may be applicable in some situations, the former does not subsume the latter; those provisions retain significant independent meaning." For instance, § 602(a) "encompasses copies that are not subject to the first sale doctrine—e.g., copies that are lawfully made under the law of another country[.]" The Court even pondered the following hypothetical:

If the author of [a] work gave the exclusive United States distribution rights—enforceable under the Act—to the publisher of the United States edition and the exclusive British distribution rights to the publisher of the British edition, . . . presumably only those made by the publisher of the U.S. edition would be ‘lawfully made under this title’ within the meaning of § 109(a). The first sale doctrine would not provide the publisher of the British edition who decided to sell in the American market with a defense to an action under § 602(a) (or, for that matter, to an action under § 106(3), if there was a distribution of the copies).

In these passages, the Court suggests that copyrighted material manufactured abroad cannot be subject to the first sale doctrine contained in § 109(a).

The Supreme Court recently seemed poised to transform this dicta into holding when it granted a writ of *certiorari* to review the Ninth Circuit’s decision in *Omega S.A. v. Costco Wholesale Corp.* That case involved the importation into the United States of Omega-brand watches by unidentified third parties without the permission of Omega; the watches were ultimately purchased and resold by Costco Wholesale Corporation. The Ninth Circuit maintained its well-settled position that § 109(a) does not apply to items manufactured outside of the United States unless they were previously imported and sold in the United States with the copyright holder’s permission. After hearing oral argument, an equally divided Supreme Court (with Justice Kagan recused) was obliged to affirm the judgment rendered by the Ninth Circuit.

Without further guidance from the Supreme Court, we now consider the extent to which the protections set forth in § 109(a) may apply to items manufactured abroad. In doing so, we rely on the text of § 109(a), the structure of the Copyright Act, and the Supreme Court’s opinion in *Quality King*.

3. Textual Analysis

We start, of course, by turning to the statutory language enacted by Congress. "Statutory interpretation always begins with the plain language of the statute, assuming the statute is unambiguous." In the instant case, we are principally called upon to give meaning to the phrase “lawfully made under this title” contained in § 109(a).

In arriving at a satisfactory textual interpretation of the statutory language at issue, we focus primarily on the words “made” and “under,” but this task is complicated by two factors: (1) the word “made” is not a term of art in the Copyright
Act, and (2) "[t]he word 'under' is [a] chameleon" and courts "must draw its meaning from its context." Wiley contends that we must interpret "lawfully made under this title" to mean "lawfully made in the United States." This view of the law—which was also adopted by the United States in its amicus brief before the Supreme Court in Costco—is certainly consistent with the text of § 109(a). It is also the logical consequence, Wiley submits, of the general presumption against the extraterritorial application of statutes, a presumption which we have specifically applied to the copyright laws. Wiley argues that Title 17 only applies in the United States, and thus, copyrighted items can only be "made" under that title if they were physically made in this country.

But the extraterritorial application of Title 17 is more complicated than Wiley allows, since certain provisions in Title 17 explicitly take account of activity occurring abroad. Most notably, § 104(b)(2) provides that "[t]he works specified by sections 102 and 103, when published, are subject to protection under this title if the work is first published in the United States or in a foreign nation that, on the date of first publication, is a treaty party." Indeed, because § 104(b)(2) provides that copyright protection can apply to works published in foreign nations, it is possible to interpret § 109(a)’s "lawfully made under this title" language to mean, in effect, "any work that is subject to protection under this title."

There are other reasons why a textual analysis alone is not sufficient to support Wiley’s preferred reading of § 109(a). Most obviously, if Congress had intended the first sale doctrine—at least as codified by § 109(a)—to apply only to copies of works made in the United States, it could have easily written the statute to say precisely that. Moreover, "lawfully made under this title" appears in other provisions of Title 17 where it is at least arguable that Congress intended this language to apply to copies of works manufactured outside of the United States. For instance, § 106(a)(1) of the Audio Home Recording Act provides for applicable royalty payments to be made to "any interested copyright party whose musical work or sound recording has been embodied in a digital musical recording or an analog musical recording lawfully made under this title that has been distributed. . . ." It is the view of the U.S. Copyright Office that distribution of royalty payments under this Act is not limited to those recordings manufactured in the United States.

But while a textual reading of § 109(a) does not compel the result favored by Wiley, it does not foreclose it either. The relevant text is simply unclear. "[L]awfully made under this title" could plausibly be interpreted to mean any number of things, including: (1) "manufactured in the United States," (2) "any work made that is subject to protection under this title," or (3) "lawfully made under this title had this title been applicable."

4. Section 602(a)(1) and Quality King

Confronted with an utterly ambiguous text, we think it best to adopt an interpretation of § 109(a) that best comports with both § 602(a)(1) and the Supreme Court’s opinion in Quality King.

Section 602(a)(1) prohibits the importation into the United States of copies of copyrighted works acquired abroad without the authorization of the copyright holder. This provision is obviously intended to allow copyright holders some flexibility to divide or treat differently the international and domestic markets for the particular copyrighted work. If the first sale doctrine codified in § 109(a) only applies to
copyrighted copies manufactured domestically, copyright holders would still have a free hand—subject, of course, to other relevant exceptions enumerated in Title 17, such as those in §§ 107, 108, and 602(a)(3)—to control the circumstances in which copies manufactured abroad could be legally imported into the United States. On the other hand, the mandate of § 602(a)(1)—that “[i]mportation into the United States, without the authority of the owner of copyright under [the Copyright Act], of copies ... of a work that have been acquired outside the United States is an infringement of the [owner’s] exclusive right to distribute copies”—would have no force in the vast majority of cases if the first sale doctrine was interpreted to apply to every copy manufactured abroad that was either made “subject to protection under Title 17,” or “consistent with the requirements of Title 17 had Title 17 been applicable.” This reading of the Copyright Act militates in favor of finding that § 109(a) only applies to domestically manufactured works. While the Ninth Circuit in Omega held that § 109(a) also applies to foreign-produced copies of works sold in the United States with the permission of the copyright holder, that holding relied on Ninth Circuit precedents not adopted by other courts of appeals. Accordingly, while perhaps a close call, we think that, in light of its necessary interplay with § 602(a)(1), § 109(a) is best interpreted as applying only to copies manufactured domestically.

In adopting this view, we are comforted by the fact that our interpretation of § 109(a) is one that the Justices appear to have had in mind when deciding Quality King. There, the Court reasoned, admittedly in dicta, that § 602(a)(1) had a broader scope than § 109(a) because, at least in part, § 602(a)(1) “applies to a category of copies that are neither piratical nor ‘lawfully made under this title.’ That category encompasses copies that were ‘lawfully made’ not under the United States Copyright Act, but instead, under the law of some other country.” This last sentence indicates that, in the Court’s view, copies “lawfully made” under the laws of a foreign country—that perhaps not produced in violation of any United States laws—are not necessarily “lawfully made” insofar as that phrase is used in § 109(a) of our Copyright Act.

Applying these principles to the facts of this case, we conclude that the District Court correctly decided that Kirtsaeng could not avail himself of the first sale doctrine codified by § 109(a) since all the books in question were manufactured outside of the United States. In sum, we hold that the phrase “lawfully made under this Title” in § 109(a) refers specifically and exclusively to copies that are made in territories in which the Copyright Act is law, and not to foreign-manufactured works.

We freely acknowledge that this is a particularly difficult question of statutory construction in light of the ambiguous language of § 109(a), but our holding is supported by the structure of Title 17 as well as the Supreme Court’s opinion in Quality King. If we have misunderstood Congressional purpose in enacting the first sale doctrine, or if our decision leads to policy consequences that were not foreseen by Congress or which Congress now finds unpalatable, Congress is of course able to correct our judgment.

B. The District Court did not err in its instructions to the jury.

“We review jury instructions de novo, and reverse only when the charge, viewed as a
whole, constitutes prejudicial error.” Kirtsaeng claims that the District Court erred by rejecting proposed jury instructions that acknowledged that the applicability of the first sale doctrine to foreign-produced goods was an unresolved question in the federal courts. Specifically, Kirtsaeng argues that he was prejudiced by the Court’s failure to charge that the first sale doctrine was an unsettled area of law because the charge was essential to his argument that he had performed presak internet research regarding the legality of his sales and therefore had not “willfully” infringed the copyrights.

It is undisputed that Kirtsaeng’s counsel did not object to the final jury instructions during trial. “[F]ailure to object to a jury instruction . . . prior to the jury retiring results in a waiver of that objection.” Nonetheless, under Federal Rule of Civil Procedure 51(d)(2), we “may consider a plain error in the instruction that has not been preserved as required [under Rule 51] if the error affects substantial rights.”

“To constitute plain error, a court’s action must contravene an established rule of law.” Kirtsaeng does not meet his burden under this stringent standard. Although the District Court was free to permit the jury to consider the unsettled state of the law in determining whether Kirtsaeng’s conduct was willful, we can find no binding authority for the proposition that it was required to do so. Furthermore, Kirtsaeng was provided ample opportunity to introduce evidence at trial and to argue to the jury that his internet research had led him to believe that his conduct was not unlawful. Accordingly, we cannot conclude that the District Court plainly erred in declining to give Kirtsaeng’s proposed instruction.

C. The District Court did not err in allowing into evidence the amount of defendant’s gross revenues.

Kirtsaeng argues that admission of evidence regarding his gross revenues prejudiced him by confusing the jury as to the amount of damages that should have been awarded to Wiley. He suggests that the majority of his revenues came from the sale of other publishers’ used volumes, many of which were produced in the United States, and claims that because of the evidence of revenues that the judge permitted to be presented to the jury, he was inappropriately forced to pay high statutory damages.

To determine whether evidence of the amount of defendant’s gross revenues was properly admitted, ordinarily we first determine the appropriate standard of review. As stated above, where a party does not contemporaneously object to an evidentiary ruling, that party must demonstrate that the District Court committed “plain error.” However, even if a proper objection was asserted in a timely fashion, we accord “considerable deference to a district court’s decision to admit . . . evidence” pursuant to Federal Rule of Evidence 403(b) and will reverse a district court’s evidentiary ruling only if it constitutes an abuse of discretion. When we review a district court’s “judgment regarding the admissibility of a particular piece of evidence under [Federal Rule of Evidence] 403, we generally maximize its probative value and minimize its prejudicial effect.” Here, however, we need not reach the question of whether Kirtsaeng’s counsel properly objected to the admission of evidence regarding his gross revenues because we hold that admission of the
evidence by the District Court was not error or an abuse of discretion, and certainly not plain error.

At trial, the jury awarded $75,000 in statutory damages per copyrighted work for Kirtsaeng’s willful infringement of eight works. Under the relevant statutory provision, 17 U.S.C. § 504(c), see note 10, ante, the jury could have awarded damages of up to $150,000 per copyrighted work. Because abundant evidence was available to support the jury’s finding of willfulness, the admission of information about Kirtsaeng’s revenues was not prejudicial—that is, the jury could have imposed the same amount of damages without knowledge of Kirtsaeng’s revenues. For example, the books in question clearly stated the following:

This book is authorized for sale [in a foreign region] only and may not be exported out of this region. Exportation from or importation of this book to another region without the Publisher’s authorization, is illegal and is a violation of the Publisher’s rights. The Publisher may take legal action to enforce its rights. The Publisher may recover damages and costs, including but not limited to lost profits and attorney’s fees, in the event legal action is required.

In these circumstances, it does not seem anomalous or extraordinary that the jury made the findings it did, and we see no reason to conclude that the District Court’s decision was improper under Rule 403(b).

CONCLUSION

To summarize, we hold that (1) the first sale doctrine does not apply to copies manufactured outside of the United States; (2) the District Court did not err in declining to instruct the jury regarding the unsettled state of the first sale doctrine; and (3) the District Court did not err in admitting evidence of Kirtsaeng’s gross revenues.

Accordingly, the judgment of the District Court is AFFIRMED.

J. GARVAN MURTHA, District Judge, dissenting:

As noted by the majority, the application of the first sale doctrine when a copy is manufactured outside the United States is an issue of first impression in this Circuit. The Supreme Court has recently considered the issue but unfortunately provided no specific guidance. Unlike the majority, I conclude the first sale defense should apply to a copy of a work that enjoys United States copyright protection wherever manufactured. Accordingly, I respectfully dissent.

The Copyright Act sections that are pertinent to this appeal—17 U.S.C. §§ 106(3), 109(a), and 602(a)(1)—are set out in the opinion of the majority. The distribution right of § 106(3) primarily protects a copyright owner’s ability to control the terms on which her work enters the market. The first sale doctrine of § 109(a) limits the scope of this distribution right. Finally, § 602(a)(1) addresses the extent to which the distribution right allows a copyright owner to also control importation of copies of her work.

The Supreme Court has held a copyright owner’s § 602(a) right to control the importation of copies of her work is derivative of § 106(3)’s distribution right, which is subject to the first sale doctrine. Quality King Distrib. v. L’anza Research Int’l Inc., 523 U.S. 135. The Court noted
"the text of § 602(a) itself unambiguously states that the prohibited importation is an infringement of the exclusive distribution right ‘under section 106, actionable under section 501.’" Because the rights granted in § 106(3) are “subject to sections 107 through 122,” the copyright owner’s power to limit importation is qualified by the first sale doctrine of § 109(a).

The issue is whether this holding can be extended to copies manufactured outside the United States. The Quality King Court held the first sale doctrine applies to imported copies that were made in the United States. Here, the district court held—and the majority affirms—the doctrine does not apply to imported copies that were made abroad because § 109(a) applies only to copies that are “lawfully made under this title,” and that means physically manufactured in the United States. The court’s decision is based on the following dicta in Quality King:

Even in the absence of a market allocation agreement between, for example, a publisher of the United States edition and a publisher of the British edition of the same work, each such publisher could make lawful copies. If the author of the work gave the exclusive United States distribution rights-enforceable under the Act-to the publisher of the United States edition and the exclusive British distribution rights to the publisher of the British edition, however, presumably only those made by the publisher of the United States edition would be ‘lawfully made under this title’ within the meaning of § 109(a). The first sale doctrine would not provide the publisher of the British edition who decided to sell in the American market with a defense to an action under § 602(a) . . .

I respectfully disagree with the court’s analysis. To apply, § 109(a) requires (1) the person claiming protection be the owner of the copy, and (2) the copy was “lawfully made under this title.” 17 U.S.C. § 109(a). Courts have split over the meaning of “lawfully made under this title;” with some holding it means “legally manufactured . . . within the United States,” and others “confess[ing] some uneasiness with this construction” and suggesting “lawfully made under this title” refers not to the place a copy is manufactured but to the lawfulness of its manufacture as a function of U.S. copyright law.

The statutory text does not refer to a place of manufacture: It focuses on whether a particular copy was manufactured lawfully under title 17 of the United States Code. 17 U.S.C. § 109(a). The United States law of copyrights is contained in title 17. Accordingly, the lawfulness of the manufacture of a particular copy should be judged by U.S. copyright law. A U.S. copyright owner may make her own copies or authorize another to do so. 17 U.S.C. § 106(1). Thus, regardless of place of manufacture, a copy authorized by the U.S. rightsholder is lawful under U.S. copyright law. Here, Wiley, the U.S. copyright holder, authorized its subsidiary to manufacture the copies abroad, which were purchased and then imported into the United States.

This interpretation of “lawfully made” is supported by the language of the Copyright Act as a whole. For example, Congress used the phrase “under this title” in multiple sections of the Act to describe the scope of rights created by the Act. However, “[w]hen Congress considered the place of manufacture to be important . . . the
statutory language clearly expresses that concern.” *Sebastian*, 847 F.2d at 1098 n. 1. For example, § 601(a), the “manufacturing requirement,” provides:

Prior to July 1, 1986, and except as provided by subsection (b), the importation into or public distribution in the United States of copies of a work consisting preponderantly of nondramatic literary material that is in the English language and is *protected under this title* is prohibited unless the portions consisting of such material have been *manufactured in the United States* or Canada.

17 U.S.C. § 601(a)(1) (emphasis added). Also, as the majority points out, § 104(b)(2) provides “[t]he works specified by sections 102 and 103, when published, are subject to protection under this title if the work is first published *in the United States or in a foreign nation . . . .” 17 U.S.C. § 104(b)(2) (emphasis added). If Congress intended § 109(a) to apply only to copies manufactured in the United States, it could have stated “lawfully manufactured in the United States under this title.” As Congress did not include “manufactured in the United States” in § 109(a), though it was clearly capable of doing so as demonstrated by § 601(a), the omission supports the conclusion that Congress did not intend the language “lawfully manufactured under this title” to limit application of § 109(a) to only copies manufactured in the United States.

As noted in the majority opinion, supra note 14, the first sale doctrine originated in *Bobbs-Merrill Co. v. Straus*. There the Supreme Court held defendant retailer’s sales of a copyrighted book for less than the price noted on the copyright page was not a copyright violation. “The purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it.” Once the copyright holder has controlled the terms on which the work enters the market, i.e., the purpose of the distribution right, “the policy favoring a copyright monopoly for authors gives way to the policy opposing restraints of trade and restraints on alienation.” Accordingly, the *Bobbs-Merrill* Court held the copyright owner did not have the right to control the terms of subsequent sales.

The common law policy against restraints on trade and alienation is not limited by the place of manufacture. Under the 1909 (codifying the *Bobbs-Merrill* holding) and 1947 Copyright Acts, the first sale doctrine applied to “any copy of a copyrighted work *the possession of which has been lawfully obtained*.” The Supreme Court noted “[t]here is no reason to assume Congress intended either § 109(a) or the earlier codifications of the doctrine to limit its broad scope.” The changed wording in the current version of § 109(a)—“lawfully made under this title”—from the prior versions—“possession of which has been lawfully obtained”—should likewise not be presumed to do so.

Economic justifications also support applicability of the first sale doctrine to foreign made copies. Granting a copyright holder unlimited power to control all commercial activities involving copies of her work would create high transaction costs and lead to uncertainty in the secondary market. An owner first would have to determine the origin of the copy—either domestic or foreign—before she could sell it. If it were foreign made and the first sale doctrine does not apply to such copies, she would need to receive permission from the copyright holder. Such a result would
provide greater copyright protection to copies manufactured abroad than those manufactured domestically: Once a domestic copy has been sold, no matter where the sale occurred, the copyright holder’s right to control its distribution is exhausted. I do not believe Congress intended to provide an incentive for U.S. copyright holders to manufacture copies of their work abroad.

The Ninth Circuit has attempted to circumvent this perpetual right when a copy is made abroad by holding the first sale doctrine can apply to copies made outside the United States but only after there has been one authorized sale here. This precedent carried over into the reasoning in Omega S.A. The Supreme Court, however, provided no guidance as to its views on the Ninth Circuit’s imperfect solution, which is judicially created. This interpretation finds no support in the statutory text and is in direct conflict with the portion of the Supreme Court’s Quality King decision which noted that where a sale occurs is irrelevant for first sale purposes.

Supporters of limiting the application of the first sale doctrine to domestically manufactured copies rely on the argument that applying the doctrine to foreign made copies would render § 602(a) “virtually meaningless.” (Appellee’s Br. at 15-17.) However, § 602(a) will always apply to copies of a work that have not been sold or are piratical copies. It also applies to copies of a work not lawfully manufactured under title 17 but lawfully manufactured under some other source of law, as in the Quality King dicta, and to copies not in the possession of the “owner,” e.g., a bailee, licensee, consignee or one whose possession of the copy was unlawful. Further, § 602(a) itself states unauthorized importation is an infringement of the exclusive distribution right of § 106, which as noted above is subject to the first sale doctrine of § 109(a).

Nothing in § 109(a) or the history, purposes, and policies of the first sale doctrine limits it to copies of a work manufactured in the United States. That leaves the question whether the Quality King dicta “sp[eks] directly to whether the first sale doctrine applies to copies manufactured abroad.” That dicta, however, makes no reference to the place of manufacture, Quality King, and therefore does not speak directly to the issue of applicability of the doctrine to foreign made copies. Further, the dicta states the first sale doctrine would not provide a defense to the publisher who sold copies in the American market. Of course, because in that situation there has been no first sale unlike here, where the issue is whether the first sale doctrine is available as a defense to the subsequent purchaser.

In Quality King, Justice Ginsburg, in a concurrence joined by no other justice, noted: “I join the Court’s opinion recognizing that we do not today resolve cases in which the allegedly infringing imports were manufactured abroad.” That issue, however, was squarely before the Supreme Court in Omega and four justices presumably did not agree the Quality King dicta directly addresses it or constitutes the Court’s current view. In light of the above analysis, I agree with the majority that it is a “close call,” supra p. 221, and I would conclude the first sale doctrine applies to foreign manufactured copies.

For the foregoing reasons, I respectfully dissent.
The Supreme Court agreed Monday to decide a copyright case with important implications for the large and growing markets in discount and Internet sales.

The justices said they will hear an appeal from a Thai student doing graduate work in the United States who tried to make ends meet by re-selling textbooks that family and friends first purchased abroad. A jury awarded textbook publisher John Wiley & Sons $600,000 after deciding that math graduate student Supap Kirtsaeng infringed on the company’s copyrights.

The issue at the Supreme Court is whether U.S. copyright protection applies to items that are made abroad, purchased abroad and then resold in the U.S. without the permission of the manufacturer. The high court split 4-4 when it tried to answer that question in a case in 2010 involving Costco and Swiss watch maker Omega.

Justice Elena Kagan sat out the Costco case, but will join the other justices in hearing the new dispute.

Discount sellers like Costco and Target and Internet giants eBay and Amazon help form an estimated $63 billion annual market for goods that are purchased abroad, then imported and resold without the permission of the manufacturer. The U.S.-based sellers, and consumers, benefit from the common practice of manufacturers to price items more cheaply abroad than in the United States. This phenomenon is sometimes called a parallel market or gray market.

The high court already has ruled that copyright protections do not apply when the goods are made in the U.S., sold abroad and reimported. This case concerns only foreign-made items.

Federal judges have come to different conclusions about whether copyright law applies in Kirtsaeng’s and other cases.

Kirtsaeng returned to Thailand in 2010 after doing graduate work at the University of Southern California, said his lawyer, Joshua Rosenkranz. Earlier, he received his undergraduate degree from Cornell University in Ithaca, N.Y.

While at USC, Kirtsaeng arranged for family and friends living abroad to purchase textbooks and ship them to him. He resold the copies on eBay. Eight textbooks sold by Kirtsaeng were published by Wiley’s Asian subsidiary. The company sued the student in federal court in New York.

eBay was among the outside parties urging the court to hear the case and decide it in Kirtsaeng’s favor.

The case will be argued in the fall.
The cloud lingering over the gray market industry since the Supreme Court split 4-4 in Costco just got a lot darker. Gray market goods are those made by the copyright holder abroad and then imported into this country without the permission of the copyright holder. Just last week it seemed the 2d Circuit would never decide John Wiley v. Kirtsaeng argued in May of 2010. Today in 2-1 decision the 2d Circuit (2-1) affirmed the result below.

The 2d Circuit held that §602(a)(1) of the Copyright Act trumps the first sale doctrine in §109(a) of that Act with respect to goods made abroad and then imported into this country. But the tension between §602(a)(1) and §109(a) is far from over. Kirtsaeng admitted the case raised “a particularly difficult question of statutory construction” and the result was therefore a “close call” And Judge Murtha’s well-reasoned dissent in Kirtsaeng adds to the uncertainty.

Sections 109 and 602 are in tension because they lead to opposing results. Section 109, the first sale doctrine, provides that a copyright holder loses control over the distribution of goods once the holder has made a first sale. But Section 602(a)(1) provides that a copyright holder may retain control over the distribution of copyrighted goods made abroad if they were then imported into the US without the permission of the copyright holder. Control is maintained because §602(a)(1) states that unauthorized importation of goods into the U.S. infringes copyright holder’s “exclusive right to distribute... under section 106.” This tension between these sections was at play in Kirtsaeng. Mr. Kirtsaeng was engaged in what some refer to as textbook arbitrage. He bought text books Wiley made abroad and intended for distribution abroad and without Wiley’s consent imported and sold them in this country at prices below what Wiley charged for the same texts it manufactured here.

Kirtsaeng sought refuge under the first sale doctrine. He argued that, once Wiley had sold these texts abroad, Wiley had exhausted its first sale rights and therefore he was free to resell them in the U.S. Kirtsaeng relied on the “subject to” language of section106 (3). That language gives the copyright holder the exclusive right to distribute “subject to” a number of sections of the Copyright Act, including section 109. Thus, Kirtsaeng asserted that, once Wiley exercised its first sale rights abroad, Wiley lost its exclusive right to control distribution of the goods under §§602(a)(1) and 106(3). In other words, Kirtsaeng stated that Wiley should not complain that he, as lawful owner of the goods, resold them here because Wiley had already received a fair return for those goods abroad.

The problem for Mr. Kirtsaeng was some vague and ill-chosen language in the first sale doctrine. It only applies to copyrighted goods “lawfully made under this title.” But no one really knows what “lawfully made under this title” means. As the 2d Circuit aptly noted in Kirtsaeng, “made is not a term of art in the Copyright Act,” and the word “under” is a “chameleon and courts must draw its meaning from its context.”
Kirtsaeng offered three interpretations of “lawfully made under this title.” This phrase may refer to (1) goods manufactured in this country; (2) goods made anywhere that are “subject to protection under this title”; or (3) goods “lawfully made under this title had this title been applicable.”

The majority in Kirtsaeng opted for the first interpretation with considerable skepticism, recognizing that “lawfully made under this title” “is simply unclear.” The lack of clarity hobbles the opinion.

Kirtsaeng stated that restricting the first sale doctrine to domestically made goods might be the “logical consequence” of the presumption against extraterritorial application of the Copyright Act. Id. at 14. But the court also acknowledged that “certain provisions of Title 17 take account of activity occurring abroad.” For instance, the court stated that “§ 104(b)(2) provides that copyright protection can apply to works published in foreign nations.”

Moreover, Kirtsaeng indicated that “‘lawfully made under this title’ appears in other provisions of Title 17 where it is at least arguable that Congress intended this language to apply to works manufactured outside of the United States.” The court pointed to § 106(a)(1) of the Audio Home Recording Act, which provides for royalties to the copyright owner whose work is embodied in a digital recording. The court noted the Copyright Office’s view that royalties under this section are “not limited to those recordings manufactured in the United States.”

So, in view of this “particularly difficult question” of first impression, what prompted the Second Circuit to restrict the first sale doctrine to only those goods made in the U.S.?

The Second Circuit stated that this result “best comports” with § 602 (a)(1) and the Supreme Court’s opinion in Quality King. The court reasoned that, applying the first sale doctrine to works made abroad, would give “no force” to § 602 “in the vast majority of cases.” But, as the dissent pointed out, § 602 will still apply: “to copies of a work that have not been sold [abroad] or are piratical copies;” “to copies of a work not lawfully manufactured under title 17 but lawfully manufactured under some other source of law,” and “to copies not in the possession of the ‘owner,’ e.g., a bailee, licensee, consignee or one whose possession of the copy was unlawful.”

The court also indicated that dicta in the Supreme Court’s earlier opinion in Quality King v. L’Anza seemed to suggest that § 602 “had a broader scope than § 109(a)” because § 602 applied to goods made “under the laws of some other country.” But the concepts of being lawfully made under the laws of another country and lawfully made under this title are not mutually exclusive. If a U.S. copyright holder makes goods in Brazil, then the copies are made in accordance with the Copyright Act (which gives the holder the right to make copies) and therefore those goods are lawfully made under this title as well as presumably under Brazilian law.

The defendant had appropriately warned that a finding for Wiley may induce manufacturers to shift operations overseas to take advantage of the expanded protections of § 602. Although the majority touched on this concern, the court passed the ball to Congress, inviting it to “correct our judgment” “if our decision leads to policy consequences that were not foreseen by Congress.”

Kirtsaeng raises some troubling questions
that are the subject of Mr. Kirtsaeng's petition for *en banc* review. If the first sale doctrine no longer applies to any goods made abroad (as others have warned) even though imported with the permission of the copyright holder, has the Second Circuit given foreign manufacturers the right to destroy longstanding and enormously important secondary and rental markets in this country? In other words, does a Japanese car manufacturer who imports and sells a car in this country now have the section 106(3) right to direct the buyer not to resell it?

Further, the Second Circuit has yet to decide *Pearson v. Arora*, argued on January 19, 2011 and *Pearson v. Kumar*, argued March 21, 2011 both of which raise identical issues.

But *Kirtsaeng* is now binding Second Circuit precedent that *Arora* and *Kumar* must follow. Only an intervening change in the law or *en banc* review will allow the Second Circuit to deviate from its holding in *Kirtsaeng*. Nevertheless, with the 4-4 split in *Costco* and Judge Murtha’s dissent in *Kirtsaeng*, there may be more to come.
"Made in the USA: Does the ‘First Sale’ Doctrine Require It?"

Forbes
May 2, 2012
Richard Busch

Are used books and CDs legal? The answer may depend on where the book or CD was manufactured. People who trade in used books and CDs should closely watch a case pending before the Supreme Court that will determine if the Copyright Act’s “first sale” doctrine applies to “gray market” copyrighted goods, i.e. those manufactured abroad but imported to the United States for resale.

The first sale doctrine provides that after a copyrighted good, like a CD or a book, has been sold once, that copy of the work can be resold without the authorization of the copyright owner. That means you can legally buy and sell books and CDs. This keeps local Nashville favorites like Grimey’s New & Preloved Music and McKay Books open for business. It is also a huge source of revenue for behemoths like Amazon.com. According to the language of the Copyright Act, the first sale doctrine applies as long as the copyrighted good was “lawfully made under [the Copyright Act].”

The question that follows is what does “lawfully made under [the Copyright Act]” really mean? Does it refer to any work that is protected under the Copyright Act, regardless of where it was manufactured? Or does it mean “manufactured in the United States,” so that only copyrighted goods manufactured in the United States are subject to the first sale doctrine? The Supreme Court first planned to address this issue a couple of years ago in the case Omega S.A. v. Costco Wholesale Corporation, but Justice Kagan had to recuse herself from participating, and the remaining justices split 4-4 over the issue. As a result, the Supreme Court did not deliver a written opinion or set any precedent.

The case now before the Supreme Court, John Wiley & Sons, Inc. v. Kirtsaeng, involves the resale of textbooks manufactured in both the United States and in Thailand. The publisher, John Wiley & Sons, Inc., sells its textbooks in both domestic and international markets, including Thailand. The domestic and international versions have mostly the same content, but the textbooks manufactured in Thailand differ in design and are made from lower quality materials. Accordingly, the textbooks manufactured in Thailand sell at a much lower price than the United States versions.

The defendant in the case, Supap Kirtsaeng, a native of Thailand, moved to the United States to pursue his education. While a doctoral candidate at the University of Southern California, Kirtsaeng helped
subsidize the cost of his education by having friends and family purchase Wiley textbooks manufactured in Thailand and ship them to him for resale on websites like eBay.com. Wiley learned about Kirtsaeng’s business and sued him for copyright infringement in the United States District Court for the Southern District of New York.

The trial court refused to allow Kirtsaeng to assert a first sale defense and the jury found him liable for copyright infringement, awarding Wiley $600,000 in damages. On appeal, the Second Circuit agreed that the first sale doctrine does not apply to copyrighted goods manufactured outside of the United States.

Based on the 4-4 split in the Costco case, it’s not clear what the Supreme Court will think about the Second Circuit’s interpretation of “lawfully made under [the Copyright Act].” It is clear, however, that Justice Kagan’s view on the matter likely will be the deciding factor.

The Court’s decision could have a big impact on the gray market for copyrighted goods, including CDs and possibly even mp3s (the Southern District of New York ruled earlier this year that it may be possible to resell an mp3). This might not affect your local used book store, but it would likely have a big impact on sites like Amazon.com and eBay.com. It also might be good for content producers like publishers and record labels. As I discussed in a previous post on how eliminating CDs and lowering the price of mp3 albums could encourage more new sales, websites like Amazon.com often sell used CDs for less than their mp3 counterparts, with no additional royalties to the record label, artist, and songwriter because of the first sale doctrine.

If the Supreme Court agrees with the Second Circuit and decides that the first sale doctrine does not apply to albums manufactured abroad, this will prohibit people from purchasing foreign gray market albums and reselling them on Amazon.com and other similar sites. The result could mean less used CDs available for sale, an increase in sales of new CDs or mp3 albums, and more control for content owners over the distribution of their copyrighted works.
The Supreme Court has decided to take a second crack at reconciling two apparently contradictory provisions in the Copyright Act: one that permits buyers to resell goods without worrying about permission from U.S. copyright holders, and another that controls the importation of copyrighted material into the United States.

It may sound arcane, but this is a hugely consequential issue. The case in which the Supreme Court granted certiorari or judicial review involves a Thai graduate student reselling used foreign-manufactured books on eBay, but the court's ultimate ruling will profoundly affect the approximately $63 billion "gray market" business.

On Monday, the Supreme Court agreed to hear *Kirtsaeng v. John Wiley & Sons*, which stems from one man’s enterprise to help pay his tuition fees. Supap Kirtsaeng, a University of Southern California graduate student from Thailand, had family and friends buy textbooks manufactured internationally and ship them to him in California. He then resold the books on eBay and pocketed the proceeds. (Kirtsaeng’s attorney for the earlier portions of this case, solo practitioner Sam Israel, was joined in Supreme Court briefing by counsel from Orrick, Herrington & Sutcliffe. Orrick partner E. Joshua Rosenkranz said the firm had been watching the case and approached Israel about teaming up.)

According to his petition for certiorari Kirtsaeng was a notably well-informed eBay dealer. He researched the first-sale doctrine of U.S. copyright law, which entitles the owner of lawfully-produced work to resell the work without the authority of the copyright owner. John Wiley & Sons, whose Asian subsidiary produced some of the books Kirtsaeng resold, disagreed with the graduate student’s interpretation of the law. The publisher filed an infringement suit in Manhattan federal district court in 2008. A jury eventually found Kirtsaeng liable for infringing eight works and imposed statutory damages of $600,000.

But Kirtsaeng is just a small player in the vast gray market, which includes not only individuals re-selling items, but also huge discount businesses like Costco selling foreign-made goods. By the time his case reached the 2nd Circuit Court of Appeals the Supreme Court had already taken its first crack at regulating the market. In December 2010, in a 4-to-4 split ruling in which Justice Elena Kagan did not take part, the high court affirmed, without written opinion, a ruling by the 9th Circuit Court of Appeals, holding in *Costco Wholesale Corp. v. Omega* that the first-sale doctrine applies only to U.S.-made works.

The 2nd Circuit applied the Costco case when it decided Kirtsaeng’s case in August 2011, but acknowledged tension in the copyright law. In a 2-to-1 decision, Judges Jose Cabranes and Robert Katzmann (with a dissent from U.S. District Court Judge J. Garvan Murtha of Vermont, sitting by designation) upheld the verdict against the graduate student, ruling that the first-sale doctrine applies only to goods made in the
United States. But the appeals court also noted a “particularly difficult question of statutory construction,” because another section of the Copyright Act holds that importation of copyrighted goods without the authority of the copyright owner infringes the holder’s right to distribute copies.

The decision has had the strange impact of giving foreign manufactures the right “to control how goods are resold in the American marketplace,” said Andrew Berger of Tannenbaum Helpern Syracuse & Hirschtritt, who authors the blog IP In Brief.

He explained the implications via an extreme hypothetical: He might right afoul of the 2nd Circuit’s Kirstaeng opinion if he tried to resell his foreign-made Nissan Altima despite any Nissan claims that dashboard elements are copyrighted. (That hypothetical might not even be so crazy—the issue in the Costco case was a watch whose copyrighted component was a logo on the back.) “The Second Circuit seemed to say that this that is the kind of control Congress intended,” Berger said.

It’ll now be up to the Supreme Court to decide Congress’s intent and reconcile the gap in rights between U.S. and foreign manufacturers when it comes to resale. (Kagan, who will participate this time around, would seem to be the key vote, given the high court’s previous 4-to-4 split in Costco.) Orrick’s Rosenkranz, who will likely argue on behalf of Kirstaeng, said that the 100-year-old first-sale doctrine should also apply to foreign-made goods. “This notion that we would give foreign made goods greater protection than local goods makes no sense at all to me,” he said.

Theodore Olson of Gibson, Dunn & Crutcher, who represents John Wiley, did not return a call for comment. A Wiley spokesperson sent this statement: “The 2nd Circuit correctly concluded that those seeking to profit from the creative works of others cannot evade our intellectual property laws by importing copies from overseas. We look forward to defending that decision in the Supreme Court.”
Symczyk v. Genesis HealthCare Corp.

10-3178


From April 2007 through December 2007, Symczyk was employed by defendants as a Registered Nurse at Pennypack Center in Philadelphia, Pennsylvania. On December 4, 2009, Symczyk initiated a collective action under 29 U.S.C. § 216(b) on behalf of herself and all similarly situated individuals, alleging defendants violated the FLSA when they implemented a policy subjecting the pay of certain employees to an automatic meal break deduction whether or not they performed compensable work during their breaks. On February 18, 2010, defendants filed an answer to Symczyk’s complaint and served her with an offer of judgment under Fed.R.Civ.P. 68 in the amount of “$7,500.00 in alleged unpaid wages, plus attorneys’ fees, costs and expenses as determined by the Court.” Symczyk did not dispute the adequacy of defendants’ offer but nevertheless declined to respond. U.S. District Judge Michael M. Baylson ordered that the plaintiff would have 90 days to conduct initial discovery before filing her motion to have the case certified as a collective action. On March 23, 2010, defendants filed a motion to dismiss for lack of subject matter jurisdiction under Fed.R.Civ.P. 12(b)(l), contending that, because Symczyk had effectively rejected their Rule 68 offer of judgment. On May 19, 2010, the District Court “tentatively concluded” that defendants’ Rule 68 offer mooted the collective action and that the action should be dismissed for lack of subject matter jurisdiction. Symczyk appealed.

Question Presented: Whether a case becomes moot, and thus beyond the judicial power of Article III, when the lone plaintiff receives an offer from the defendants to satisfy all of the plaintiff’s claims.

Laura SYM CZY K, an individual, on behalf of herself and others similarly situated, 
Appellant
v.
GENESIS HEALTHCARE CORPORATION; ElderCare Resources Corporation d/b/a
Genesis ElderCare.

United States Court of Appeals for the Third Circuit

Filed August 31, 2011

[Excerpt: Some footnote and citations omitted.]

SCIRICA, Circuit Judge

Laura Symczyk sought relief under the Fair Labor Standards Act (FLSA), 29U.S.C. §§ 207 and 216(b), on behalf of herself and all others similarly situated. The District Court for the Eastern District of Pennsylvania dismissed Symczyk’s complaint for lack of subject matter jurisdiction after defendants Genesis HealthCare Corporation and

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ElderCare Resources Corporation extended an offer of judgment under Fed.R.Civ.P. 68 in full satisfaction of her alleged damages, fees, and costs. At issue in this case is whether a collective action brought under § 216(b) of the FLSA becomes moot when, prior to moving for “conditional certification” and prior to any other plaintiff opting in to the suit, the putative representative receives a Rule 68 offer. We will reverse and remand.

I.

From April 2007 through December 2007, Symczyk was employed by defendants as a Registered Nurse at Pennypack Center in Philadelphia, Pennsylvania. On December 4, 2009, Symczyk initiated a collective action under 29 U.S.C. § 216(b) on behalf of herself and all similarly situated individuals, alleging defendants violated the FLSA when they implemented a policy subjecting the pay of certain employees to an automatic meal break deduction whether or not they performed compensable work during their breaks. On February 18, 2010, defendants filed an answer to Symczyk’s complaint and served her with an offer of judgment under Fed.R.Civ.P. 68 in the amount of “$7,500.00 in alleged unpaid wages, plus attorneys’ fees, costs and expenses as determined by the Court.” Symczyk did not dispute the adequacy of defendants’ offer but nevertheless declined to respond.

The District Court—unaware of the offer of judgment—held a Fed.R.Civ.P. 16 scheduling conference on March 8, 2010. Two days later, the court entered a scheduling order providing for “an initial ninety (90) day discovery period, at the close of which [Symczyk] will move for conditional certification under § 216(b) of the FLSA.” Following the court’s ruling on certification, the parties were to have “an additional six (6) month discovery period, to commence at the close of any Court-ordered opt-in window.”

On March 23, 2010, defendants filed a motion to dismiss for lack of subject matter jurisdiction under Fed.R.Civ.P. 12(b)(1), contending that, because Symczyk had effectively rejected their Rule 68 offer of judgment, see Fed.R.Civ.P. 68(a) (providing a plaintiff with 14 days to accept an offer), she “no longer ha[d] a personal stake or legally cognizable interest in the outcome of this action, a prerequisite to this Court’s subject matter jurisdiction under Article III of the United States Constitution.” Symczyk objected, citing defendants’ strategic attempt to “pick off” the named plaintiff before the court could consider her “certification” motion.

On May 19, 2010, the District Court “tentatively concluded” that defendants’ Rule 68 offer mooted the collective action and that the action should be dismissed for lack of subject matter jurisdiction. In its memorandum, the court explained:

Symczyk does not contend that other individuals have joined her collective action. Thus, this case, like each of the district court cases cited by Defendants, which concluded that a Rule 68 offer of judgment mooted the underlying FLSA collective action, involves a single named plaintiff. In addition, Symczyk does not contest Defendants’ assertion that the 68 offer of judgment fully satisfied her claims.

The court instructed Symczyk to file a brief in support of continued federal jurisdiction on her state-law claims and her motion for class certification under Fed.R.Civ.P. 23 by June 10, 2010. Symczyk did so but
conceded she did not believe the court possessed an independent basis for jurisdiction over her state-law claims in the event her FLSA claim was dismissed. The District Court declined to exercise supplemental jurisdiction over Symczyk’s state-law claims in accordance with 28 U.S.C. § 1367(c) and dismissed those claims without prejudice. The court also dismissed Symczyk’s FLSA claim with prejudice in accordance with its earlier memorandum. Symczyk timely appealed.

II.

A.

Enacted in 1938, the FLSA, 29 U.S.C. § 201 et seq., was designed “to aid the unprotected, unorganized and lowest paid of the nation’s working population; that is, those employees who lacked sufficient bargaining power to secure for themselves a minimum subsistence wage.” *Brooklyn Sav. Bank v. O’Neil*, 324 U.S. 697, 707 n. 18 (1945). Under the “collective action” mechanism set forth in 29 U.S.C. § 216(b), an employee alleging an FLSA violation may bring an action on “behalf of himself . . . and other employees similarly situated,” subject to the requirement that “[n]o employee shall be a party plaintiff to any such action unless he gives his consent in writing to become such a party and such consent is filed in the court in which such action is brought.”

Prior to 1947, the FLSA permitted an aggrieved employee to “designate an agent or representative to maintain such action for and in behalf of all employees similarly situated.” *Martino v. Mich. Window Cleaning Co.*, 327 U.S. 173, 175 n. 1 (1946). But in response to “excessive litigation spawned by plaintiffs lacking a personal interest in the outcome,” Congress amended the Act to eliminate “representative action by plaintiffs not themselves possessing claims.” *Hoffmann-La Roche, Inc. v. Sperling*, 493 U.S. 165, 173 (1989). Further altering the collective action procedure in § 216(b), Congress inserted a requirement that similarly situated employees must affirmatively “opt in” to an ongoing FLSA suit by filing express, written consents in order to become party plaintiffs.

In deciding whether a suit brought under § 216(b) may move forward as a collective action, courts typically employ a two-tiered analysis. During the initial phase, the court makes a preliminary determination whether the employees enumerated in the complaint can be provisionally categorized as similarly situated to the named plaintiff. If the plaintiff carries her burden at this threshold stage, the court will “conditionally certify” the collective action for the purposes of notice and pretrial discovery. In the absence of statutory guidance or appellate precedent on the proper definition of “similarly situated,” a divergence of authority has emerged on the level of proof required at this stage. Some trial courts within our circuit have allowed a plaintiff to satisfy her burden simply by making a “substantial allegation” in her pleadings that she and the prospective party plaintiffs suffered from a single decision, plan or policy, but the majority of our circuit’s trial courts have required the plaintiff to make a “modest factual showing” that the proposed recipients of opt-in notices are similarly situated.

Under the “modest factual showing” standard, a plaintiff must produce some evidence, “beyond pure speculation,” of a factual nexus between the manner in which the employer’s alleged policy affected her and the manner in which it affected other employees. We believe the “modest factual
showing" standard—which works in harmony with the opt-in requirement to cabin the potentially massive size of collective actions—best comports with congressional intent and with the Supreme Court's directive that a court "ascertain[ ] the contours of [a collective] action at the outset."

After discovery, and with the benefit of "a much thicker record than it had at the notice stage," a court following this approach then makes a conclusive determination as to whether each plaintiff who has opted in to the collective action is in fact similarly situated to the named plaintiff. Morgan v. Family Dollar Stores, Inc., 551 F.3d 1233, 1261 (11th Cir.2008). "This second stage is less lenient, and the plaintiff bears a heavier burden." Should the plaintiff satisfy her burden at this stage, the case may proceed to trial as a collective action.

Absent from the text of the FLSA is the concept of "class certification." As the Eighth Circuit has noted, however, "[m]any courts and commentators . . . have used the vernacular of the Rule 23 class action for simplification and ease of understanding when discussing representative cases brought pursuant to § 16(b) of the FLSA." Kelley v. Alamo, 964 F.2d 747, 748 n. 1 (8th Cir.1992). As a result, courts commonly refer to a plaintiff's satisfaction of her burden at the notice stage as resulting in "conditional certification," see, e.g., Ruehl v. Viacom, Inc., 500 F.3d 375, 389 n. 17 (3d Cir.2007), or "provisional certification," see, e.g., Nash v. CVS Caremark Corp., 683 F.Supp.2d 195, 199 (D.R.I.2010). Similarly, the court's second-step analysis is traditionally triggered by a defendant's motion to "decertify the class" on the ground that its proposed members are not similarly situated. And, in the same fashion, a named plaintiff becomes a "class representative," see, e.g., id. at 966, his attorney becomes "class counsel," see, e.g., Harkins v. Riverboat Servs., Inc., 385 F.3d 1099, 1101 (7th Cir.2004), and similarly situated employees become "potential class members," see, e.g., In re Family Dollar FLSA Litig., 637 F.3d 508, 518 (4th Cir.2011).

Despite this judicial gloss on § 216(b), "the 'certification' we refer to here is only the district court's exercise of [its] discretionary power, upheld in Hoffmann-La Roche, to facilitate the sending of notice to potential class members," and "is neither necessary nor sufficient for the existence of a representative action under FLSA." Myers v. Hertz Corp., 624 F.3d 537, 555 n. 10 (2d Cir.2010); see also Morgan, 551 F.3d at 1261 n. 40. Defendants here rely heavily on the superficiality of the similarities between the "certification" processes inherent in Rule 23 class actions and § 216(b) collective actions in arguing Symczyk could not purport to "represent" the interests of similarly situated employees before anyone had opted in to the action. And, as noted, expedient adoption of Rule 23 terminology with no mooring in the statutory text of § 216(b) may have injected a measure of confusion into the wider body of FLSA jurisprudence. Although "conditional certification" may not vest a § 216(b) "class" with the independent legal status that certification provides a Rule 23 class, see Trotter v. Klinicar, 748 F.2d 1177, 1183 (7th Cir.1984), this realization does not control our mootness analysis in the manner suggested by defendants. Provision of notice does not transform an FLSA suit into a "representative action," but, as we will explain, its central place within the litigation scheme approved of by the Supreme Court in Hoffmann-La Roche necessarily shapes our approach to squaring Rule 68 and § 216(b).
B.

Article III of the United States Constitution limits the jurisdiction of the federal courts to “actual ‘Cases’ and ‘Controversies.’” *Sprint Commc'ns Co. v. APCC Servs., Inc.*, 554 U.S. 269, 298 (2008) (Roberts, C.J., dissenting). “When the issues presented in a case are no longer ‘live’ or the parties lack a legally cognizable interest in the outcome, the case becomes moot and the court no longer has subject matter jurisdiction.” *Weiss v. Regal Collections*, 385 F.3d 337, 340 (3d Cir. 2004). “An offer of complete relief will generally moot the plaintiff’s claim, as at that point the plaintiff retains no personal interest in the outcome of the litigation.” Thus, whether or not the plaintiff accepts the offer, no justiciable controversy remains when a defendant tenders an offer of judgment under Rule 68 encompassing all the relief a plaintiff could potentially recover at trial. We have recognized, however, that conventional mootness principles do not fit neatly within the representative action paradigm.

Rule 68 was designed “to encourage settlement and avoid litigation.” *Marek v. Chesny*, 473 U.S. 1, 5, 105 S.Ct. 3012, 87 L.Ed.2d 1 (1985). In the representative action arena, however, Rule 68 can be manipulated to frustrate rather than to serve these salutary ends. Exploring this deviation from Rule 68’s purposes, the Supreme Court has noted:

Requiring multiple plaintiffs to bring separate actions, which effectively could be ‘picked off’ by a defendant’s tender of judgment before an affirmative ruling on class certification could be obtained, obviously would frustrate the objectives of class actions; moreover it would invite waste of judicial resources by stimulating successive suits brought by others claiming aggrievement.


We addressed the tension between Rules 23 and 68 in *Weiss*. There, the named plaintiff filed a federal class action complaint alleging violations of the Fair Debt Collection Practices Act, 15 U.S.C. § 1692, and, prior to moving for class certification, received a Rule 68 offer of judgment in full satisfaction of the individual relief sought. The plaintiff rejected the offer, and the court granted the defendants’ 12(b)(1) motion to dismiss the complaint on mootness grounds. On appeal, we explored the applicability of the “relation back” doctrine to a scenario in which the defendants’ “tactic of picking off” lead plaintiffs with a Rule 68 offer . . . may deprive a representative plaintiff the opportunity to timely bring a class certification motion, and also may deny the court a reasonable opportunity to rule on the motion.” 385 F.3d at 347. Finding application of the doctrine necessary to vindicate the policy aims inherent in Rule 23, we held that, “[a]bsent undue delay in filing a motion for class certification . . . where a defendant makes a Rule 68 offer to an individual claim that has the effect of mooting possible class relief asserted in the complaint, the appropriate course is to relate the certification motion back to the filing of the class complaint.” As there had been no undue delay, we reversed and directed the district court to allow the plaintiff to file a class certification motion that would “relate back” to the filing of the complaint.

In essence, the relation back doctrine allows a district court to retain jurisdiction over a matter that would appear susceptible to dismissal on mootness grounds by virtue of
the expiration of a named plaintiff's individual claims. In Sosna v. Iowa, 419 U.S. 393, 401 (1975), the Supreme Court found federal court jurisdiction to adjudicate a live controversy between members of a certified Rule 23 class and a named defendant was not extinguished by the named plaintiff's claim becoming moot before the district court reached the merits of the case. Addressing the possibility that resolution of the controversy as to the named plaintiffs may occur "before the district court can reasonably be expected to rule on a certification motion," the Court explained such certification "can be said to 'relate back' to the filing of the complaint" when the issue might otherwise evade review.

This equitable principle has evolved to account for calculated attempts by some defendants to short-circuit the class action process and to prevent a putative representative from reaching the certification stage. Certification vests a named plaintiff with a procedural right to act on behalf of the collective interests of the class that exists independent of his substantive claims. Although traditional mootness rules would ordinarily apply absent an affirmative ruling on class certification, "in certain circumstances, to give effect to the purposes of Rule 23, it is necessary to conceive of the named plaintiff as a part of an indivisible class and not merely a single adverse party even before the class certification question has been decided." Weiss, 385 F.3d at 347. The rationale underpinning the relation back doctrine serves to shield from dismissal on mootness grounds those claims vulnerable to being "picked off" by defendants attempting to forestall class formation. As the Seventh Circuit has explained:

"Normally, ... a class action must be certified as such in order for it to escape dismissal once the claims of the named plaintiff become moot. But the courts have recognized that an absolute requirement would prevent some otherwise justiciable claims from ever being subject to judicial review.... Just as necessity required the development of the relation back doctrine in cases where the underlying factual situation naturally changes so rapidly that the courts cannot keep up, so necessity compels a similar result here. If the class action device is to work, the courts must have a reasonable opportunity to consider and decide a motion for certification. If a tender made to the individual plaintiff while the motion for certification is pending could prevent the courts from ever reaching the class action issues, that opportunity is at the mercy of a defendant, even in cases where a class action would be most clearly appropriate."

Susman v. Lincoln Am. Corp., 587 F.2d 866, 870 (7th Cir.1978).

When a defendant's Rule 68 offer threatens to preempt the certification process, reconciling the conflicting imperatives of Rules 23 and 68 requires allocating sufficient time for the process to "play out," Weiss, 385 F.3d at 348. By invoking the relation back doctrine, a court preserves its authority to rule on a named plaintiff's attempt to represent a class by treating a Rule 23 motion as though it had been filed contemporaneously with the filing of the class complaint. Consequently, "the relation back' principle ensures that plaintiffs can reach the certification stage." Sandoz v. Cingular Wireless LLC, 553 F.3d 913, 919 (5th Cir.2008).
III.

A.

The issue we must resolve on this appeal, then, is whether an FLSA collective action becomes moot when (1) the putative representative receives a Rule 68 offer in full satisfaction of her individual claim prior to moving for “conditional certification,” and (2) no other potential plaintiff has opted in to the suit. Animating our decision in *Weiss* was the ability of defendants to use Rule 68 “to thwart the putative class action before the certification question could be decided.” 385 F.3d at 349. Symczyk cites similar arguments in the § 216(b) context and discerns no material distinction between the two procedures insofar as this consideration is concerned. By contrast, defendants contend *Weiss* does not apply in the FLSA context because a putative § 216(b) named plaintiff allegedly lacks the “representative” status that accords a Rule 23 named plaintiff a personal stake in the matter sufficient to confer continued Article III jurisdiction once his individual claim has been mooted. We believe the considerations warranting application of the relation back doctrine to Rule 23 class actions also apply to § 216(b) collective actions.

In support of their effort to confine *Weiss* to the class action setting, defendants rely principally on the dissimilar roles played by Rule 23 and § 216(b) named plaintiffs. As noted, the statutory form of aggregation provided for in the FLSA requires each party plaintiff affirmatively to opt in to a collective action by filing a consent form “in the court in which such action is brought.” 29 U.S.C. § 216(b). Whereas a member of a certified class in a Rule 23(b)(3) proceeding will be bound by judgment unless he has intentionally opted out of the suit, resolution of a § 216(b) collective action will not bind any similarly situated employee absent his express, written consent. Defendants argue a § 216(b) named plaintiff whose individual claim has been mooted by a Rule 68 offer before anyone has opted in to the action cannot purport to possess a personal stake in representing the interests of others.

Although defendants’ logic has some surface appeal, reliance on the watershed event of an opt-in to trigger application of the special mootness rules that prevail in the representative action context incentivizes the undesirable strategic use of Rule 68 that prompted our holding in *Weiss*. As the Supreme Court explained in *Hoffmann-La Roche*, actualization of § 216(b)’s purposes often necessitates a district court’s engagement at the notice phase of the proceeding. 493 U.S. at 170-71, 110 S.Ct. 482. When a defendant’s Rule 68 offer arrives before the court has had an opportunity to determine whether a named plaintiff has satisfied his burden at this threshold stage, and the court has therefore refrained from overseeing the provision of notice to potential party plaintiffs, it is not surprising to find the offer has also preceded the arrival of any consent forms from prospective opt-ins. If our mootness inquiry in the § 216(b) context were predicated inflexibly on whether any employee has opted in to an action at the moment a named plaintiff receives a Rule 68 offer, employers would have little difficulty preventing FLSA plaintiffs from attaining the “representative” status necessary to render an action justiciable notwithstanding the morting of their individual claims.

In *Sandoz*, the only court of appeals’ decision to address the applicability of the relation back doctrine in the FLSA context, the Fifth Circuit concluded Congress did not intend, through the enactment of § 216(b), to create an “anomaly” by allowing employers
“to use Rule 68 as a sword, ‘picking off’ representative plaintiffs and avoiding ever having to face a collective action.” 553 F.3d at 919. The court elaborated:

[T]he differences between class actions and FLSA § 216(b) collective actions do not compel a different result regarding whether a certification motion can “relate back” to the filing of the complaint. The status of a case as being an “opt in” or “opt out” class action has no bearing on whether a defendant can unilaterally moot a plaintiff’s case through a Rule 68 offer of judgment. Although the differences between Rule 23 class actions and FLSA § 216(b) collective actions alter the conceptual mootness inquiry, each type of action would be rendered a nullity if defendants could simply moot the claims as soon as the representative plaintiff files suit. Thus, the policies behind applying the “relation back” principle for Rule 23 class actions apply with equal force to FLSA § 216(b) collective actions.

There, the defendant tendered its offer of judgment approximately one month after Sandoz had commenced her FLSA action, and Sandoz waited thirteen months after filing her complaint to move for “conditional certification.” Borrowing language from Weiss and holding that “relation back is warranted only when the plaintiff files for certification without undue delay,” the Fifth Circuit remanded for the district court to consider whether Sandoz had “timely sought certification of her collective action.” . . .

B.

Although the opt-in mechanism transforms the manner in which a named plaintiff acquires a personal stake in representing the interests of others, it does not present a compelling justification for limiting the relation back doctrine to the Rule 23 setting. The considerations that caution against allowing a defendant’s use of Rule 68 to impede the advancement of a representative action are equally weighty in either context. Rule 23 permits plaintiffs “to pool claims which would be uneconomical to litigate individually.” Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 809, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985). Similarly, § 216(b) affords plaintiffs “the advantage of lower individual costs to vindicate rights by the pooling of resources.” Hoffmann–LaRoche, 493 U.S. at 170. Rule 23 promotes “efficiency and economy of litigation.” Crown, Cork & Seal Co. v. Parker, 462 U.S. 345, 349 (1983). Similarly, “Congress’ purpose in authorizing § 216(b) class actions was to avoid multiple lawsuits where numerous employees have allegedly been harmed by a claimed violation or violations of the FLSA by a particular employer.” Prickett v. DeKalb Cnty., 349 F.3d 1294, 1297 (11th Cir.2003).

When Rule 68 morphs into a tool for the strategic curtailment of representative actions, it facilitates an outcome antithetical to the purposes behind § 216(b). Symczyk’s claim—like that of the plaintiff in Weiss—was “acutely susceptible to mootness” while the action was in its early stages and the court had yet to determine whether to facilitate notice to prospective plaintiffs. When the certification process has yet to unfold, application of the relation back doctrine prevents defendants from using Rule 68 to “undercut the viability” of either type of representative action.

C.

Additionally, the relation back doctrine
helps safeguard against the erosion of FLSA claims by operation of the Act’s statute of limitations. To qualify for relief under the FLSA, a party plaintiff must “commence” his cause of action before the statute of limitations applying to his individual claim has lapsed. Sperling v. Hoffmann–La Roche, Inc., 24 F.3d 463, 469 (3d Cir.1994). For a named plaintiff, the action commences on the date the complaint is filed. 29 U.S.C. § 256(a). For an opt-in plaintiff, however, the action commences only upon filing of a written consent. Id. § 256(b). This represents a departure from Rule 23, in which the filing of a complaint tolls the statute of limitations “as to all asserted members of the class” even if the putative class member is not cognizant of the suit’s existence. Protracted disputes over the propriety of dismissal in light of Rule 68 offers may deprive potential opt-ins whose claims are in jeopardy of expiring of the opportunity to toll the limitations period—and preserve their entitlements to recovery—by filing consents within the prescribed window.

D.

In sum, we believe the relation back doctrine helps ensure the use of Rule 68 does not prevent a collective action from playing out according to the directives of § 216(b) and the procedures authorized by the Supreme Court in Hoffmann–La Roche and further refined by courts applying this statute. Depriving the parties and the court of a reasonable opportunity to deliberate on the merits of collective action “conditional certification” frustrates the objectives served by § 216(b). Absent undue delay, when an FLSA plaintiff moves for “certification” of a collective action, the appropriate course—particularly when a defendant makes a Rule 68 offer to the plaintiff that would have the possible effect of mooting the claim for collective relief asserted under § 216(b)—is for the district court to relate the motion back to the filing of the initial complaint.

Upon remand, should Symczyk move for “conditional certification,” the court shall consider whether such motion was made without undue delay, and, if it so finds, shall relate the motion back to December 4, 2009—the date on which Symczyk filed her initial complaint. If (1) Symczyk may yet timely seek “conditional certification” of her collective action, (2) the court permits the case to move forward as a collective action (by virtue of Symczyk’s satisfaction of the “modest factual showing” standard), and (3) at least one other similarly situated employee opts in, then defendants’ Rule 68 offer of judgment would no longer fully satisfy the claims of everyone in the collective action, and the proffered rationale behind dismissing the complaint on jurisdictional grounds would no longer be applicable. If, however, the court finds Symczyk’s motion to certify would be untimely, or otherwise denies the motion on its merits, then defendants’ Rule 68 offer to Symczyk—in full satisfaction of her individual claim—would moot the action.

IV.

For the foregoing reasons, we will reverse the judgment of the District Court and remand for proceedings consistent with this opinion.
The U.S. Supreme Court will decide whether an employer’s offer of judgment to satisfy all claims of a lone named plaintiff in a putative collective action wage suit renders the case moot—and thus beyond the power of Article III courts. On June 25, the High Court agreed to review *Genesis Health Care Corp v Symczyk* (Docket No 11-1059), a Third Circuit decision that revived a putative FLSA collective action that was dismissed below after the named plaintiff rejected the employer’s offer of judgment satisfying her claim in full.

In the underlying case, a registered nurse filed an FLSA suit claiming the employer had an unlawful policy of automatically deducting pay for meal breaks without regard to whether employees had actually taken their breaks. She sought to represent similarly situated employees who were also subjected to the auto-deduct policy but she had not yet moved to conditionally certify a class. In response to the complaint, the employer made an offer of judgment to satisfy the plaintiff’s claims in full, as well as attorneys’ fees and costs, but she rejected the settlement. The district court therefore dismissed the action as moot.

Reversing, the Third Circuit ruled that a Rule 68 offer of judgment did not prevent an FLSA collective action from moving forward. The objectives of Sec. 216(b) of the Act would be frustrated if the parties and the court were deprived of a reasonable opportunity to deliberate on the merits of the collective action prior to conditional certification, the appeals court reasoned. The circuit court was concerned that defendants could wield Rule 68 as a sword to avoid further proceedings in collective actions. “When Rule 68 morphs into a tool for the strategic curtailment of representative actions, it facilitates an outcome antithetical to the purposes behind Sec. 216(b),” according to the appeals court. In petitioning the Supreme Court, however, the employer argued that “the willingness of lower courts to elevate ungrounded policy concerns over Article III principles warrants this Court’s immediate attention.” . . .
“Employers Cannot ‘Pick Off’ Plaintiff to End Case Early”

Pittsburg Post Gazette
September 2, 2011
Shannon P. Duffy

When an employer is hit with a proposed collective action under the Fair Labor Standards Act, it cannot “pick off” the lead plaintiff by making an offer of judgment that moots the claim before any other workers have the chance to “opt in” to the case, a judicial panel has ruled.

In Symczyk v. Genesis HealthCare Corp., three judges from the 3rd U.S. Circuit Court of Appeals unanimously held that defendants in collective actions cannot strategically use an offer of judgment under Rule 68 to end such a case at the outset.

U.S. Circuit Court Judge Anthony J. Scirica found that Rule 68 was designed to “encourage settlement and avoid litigation,” but that “in the representative action arena, however, Rule 68 can be manipulated to frustrate rather than to serve these salutary ends.”

In the suit, lead plaintiff Laura Symczyk, a registered nurse in Philadelphia, claimed that Genesis HealthCare violated the FLSA when it implemented a policy that imposed an automatic meal break deduction regardless of whether workers had performed compensable work during their breaks.

U.S. District Judge Michael M. Baylson ordered that the plaintiff would have 90 days to conduct initial discovery before filing her motion to have the case certified as a collective action.

But defense lawyers moved quickly by filing an answer to the complaint and serving the plaintiff with a Rule 68 offer of judgment for $7,500—the full amount of Ms. Symczyk’s alleged unpaid wages—plus attorney fees and costs to be “determined by the court.”

Ms. Symczyk objected, claiming the defense was making a strategic attempt to “pick off” the named plaintiff before the court could consider her certification motion.

But Judge Baylson sided with the defense, saying that since no other workers had yet opted in, the Rule 68 offer had effectively mooted the case.

Now the 3rd Circuit has ruled that Judge Baylson should have employed the “relation back” doctrine to allow the plaintiff to file a motion for certification of the collective action as if it had been filed at the time the suit began.

“When Rule 68 morphs into a tool for the strategic curtailment of representative actions, it facilitates an outcome antithetical to the purposes behind” the FLSA, Judge Scirica wrote in an opinion joined by Judges Thomas L. Ambro and Thomas I. Vanaskie.

The relation back doctrine, Judge Scirica said, “allows a district court to retain jurisdiction over a matter that would appear susceptible to dismissal on mootness grounds by virtue of the expiration of a named plaintiff’s individual claims.”

As an “equitable principle,” Scirica said, the
doctrine “has evolved to account for calculated attempts by some defendants to short-circuit the class action process and to prevent a putative representative from reaching the certification stage.”

The 3rd Circuit first applied the relation back doctrine in its 2004 decision in Weiss v. Regal Collections, holding that a Rule 68 offer could not be used to end a class action.

Now the 3rd Circuit has extended the holding in Weiss to encompass collective actions.

Genesis HealthCare’s lawyer, James N. Boudreau of Greenberg Traurig, argued that Weiss should be confined to the class action setting because there are key differences between class actions and collective actions.

Unlike a member of a class, Mr. Boudreau argued, a named plaintiff in a collective action whose individual claim has been mooted by a Rule 68 offer before anyone else has opted in cannot purport to possess a personal stake in representing the interests of others.

Judge Scirica disagreed, saying “reliance on the watershed event of an opt-in to trigger application of the special mootness rules that prevail in the representative action context incentivizes the undesirable strategic use of Rule 68 that prompted our holding in Weiss.”

If courts employed an inflexible approach that required others to opt in to avoid the mootness that results from a Rule 68 offer, Judge Scirica said, “employers would have little difficulty preventing FLSA plaintiffs from attaining the ‘representative’ status necessary to render an action justiciable notwithstanding the mooting of their individual claims.”

Mr. Boudreau declined to comment on the ruling.

Plaintiffs attorney Gary F. Lynch of Carlson Lynch in New Castle, Pa., could not be reached for comment.