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Samsung Electronics Co. v. Apple, Inc.

15-777

Ruling Below: *Apple Inc. v. Samsung Elecs. Co.*, 786 F.3d 983 (Fed. Cir. 2015)

Plaintiff Apple sued Defendant Samsung alleging that the South Korean tech company infringed on Apple's patented iPhone designs. The United States District Court for the Northern District of California, San Jose Division, entered judgement against Samsung.

The U.S. Federal Circuit Court of Appeals affirmed the district court's judgment awarding Apple the "total profits" of the Samsung smartphone devices named in the lawsuit. However, the court vacated the district court's judgment that the competitors committed trade dress infringement and remanded the case.

Question Presented: Whether, where a design patent is applied to only a component of a product, an award of infringer's profits should be limited to those profits attributable to the component.

APPLE INC., a California corporation
v.
SAMSUNG ELECTRONICS CO., LTD.,
A Korean corporation,
SAMSUNG ELECTRONICS AMERICA, INC.,
A New York corporation,
SAMSUNG TELECOMMUNICATIONS AMERICA, LLC
A Delaware limited liability company

The United States Court of Appeals for the Federal Circuit

Decided on May 18, 2015

[Excerpt; some citations and footnotes omitted]

PROST, Chief Judge.

Background

Apple sued Samsung in April 2011. On August 24, 2012, the first jury reached a verdict that numerous Samsung smartphones infringed and diluted Apple's patents and trade dresses in various combinations and awarded over $1 billion in damages.

The infringed design patents are U.S. Design Patent Nos. D618,677 ("D'677 patent"), D593,087 ("D'087"), and D604,305 ("D'305"), which claim certain design elements embodied in Apple's iPhone. The infringed utility patents are U.S. Patent Nos. 7,469,381 ("'381 patent"), 7,844,915 ("915 patent"), and 7,864,163 ("163 patent), which claim certain features in the iPhone's user interface. The diluted trade dresses are Trademark Registration No. 3,470,983 ("'983 trade dress") and an unregistered trade dress defined in terms of certain elements in the configuration of the iPhone.

Following the first jury trial, the district court upheld the jury's infringement, dilution, and validity findings over Samsung's post-trial motion. The district court also upheld $639,403,248 in damages, but ordered a partial retrial on the remainder of the damages because they had been awarded for a period when Samsung lacked notice of some of the asserted patents. The jury in the partial retrial on damages awarded Apple $290,456,793, which the district court upheld over Samsung's second post-trial motion. On March 6, 2014, the district court entered a final judgment in favor of Apple, and Samsung filed a notice of appeal. We have jurisdiction under 28 U.S.C. § 1295(a)(1).

Discussion

We review the denial of Samsung's post-trial motions under the Ninth Circuit's procedural standards. The Ninth Circuit reviews de novo a denial of a motion for judgment as a matter of law. "The test is whether the evidence, construed in the light most favorable to the nonmoving party, permits only one reasonable conclusion, and that conclusion is contrary to that of the jury."

The Ninth Circuit reviews a denial of a motion for a new trial for an abuse of discretion. "In evaluating jury instructions, prejudicial error results when, looking to the instructions as a whole, the substance of the applicable law was [not] fairly and correctly covered." The Ninth Circuit orders a new trial based on jury instruction error only if the error was prejudicial. A motion for a new trial based on insufficiency of evidence may be granted "only if the verdict is against the great weight of the evidence, or it is quite clear that the jury has reached a seriously erroneous result."

Samsung appeals numerous legal and evidentiary bases for the liability findings and damages awards in the three categories of intellectual property asserted by Apple: trade dresses, design patents, and utility patents. We address each category in turn.

I. Trade Dresses

The jury found Samsung liable for the likely dilution of Apple's iPhone trade dresses under the Lanham Act. When reviewing Lanham Act claims, we look to the law of the regional circuit where the district court sits. We therefore apply Ninth Circuit law.

The Ninth Circuit has explained that "[t]rade dress is the totality of elements in which a product or service is packaged or presented." The essential purpose of a trade dress is the same as that of a trademarked word: to identify the source of the product. In this respect, "protection for trade dress exists to promote competition."

The protection for source identification, however, must be balanced against "a fundamental right to compete through imitation of a competitor's product . . . ." This "right can only be temporarily denied by the patent or copyright laws." In contrast, trademark law allows for a perpetual monopoly and its use in the protection of "physical details and design of a product" must be limited to those that are "nonfunctional." Thus, it is necessary for us to determine first whether Apple's asserted trade dresses, claiming elements from its iPhone product, are nonfunctional and therefore protectable.

"In general terms, a product feature is functional if it is essential to the use or purpose of the article or if it affects the cost or quality of the article." "A product feature need only have some utilitarian advantage to be considered functional." A trade dress, taken as a whole, is functional if it is "in its particular shape because it works better in this shape."

"[C]ourts have noted that it is, and should be, more difficult to claim product configuration trade dress than other forms of trade dress." Accordingly, the Supreme Court and the Ninth Circuit have repeatedly found product configuration trade dresses functional and therefore non-protectable.

Moreover, federal trademark registrations have been found insufficient to save product configuration trade dresses from conclusions of functionality. The Ninth Circuit has even reversed a jury verdict of non-functionality of a product configuration trade dress. Apple conceded during oral argument that it had not cited a single Ninth Circuit case that found a product configuration trade dress to be non-functional.

The Ninth Circuit's high bar for non-functionality frames our review of the two iPhone trade dresses on appeal. While the parties argue without distinguishing the two trade dresses, the unregistered trade dress and the registered '983 trade dress claim different details and are afforded different evidentiary presumptions under the Lanham Act. We analyze the two trade dresses separately below.

A. Unregistered Trade Dress

Apple claims elements from its iPhone 3G and 3GS products to define the asserted unregistered trade dress:

- a rectangular product with four evenly rounded corners;
- a flat, clear surface covering the front of the product;
- a display screen under the clear surface;
- substantial black borders above and below the display screen and narrower black borders on either side of the screen; and
- when the device is on, a row of small dots on the display screen, a matrix of colorful square icons with evenly rounded corners within the display screen, and an unchanging bottom dock of colorful square icons with evenly rounded corners set off from the display's other icons.

As this trade dress is not registered on the principal federal trademark register, Apple "has the burden of proving that the claimed trade dress, taken as a whole, is not functional . . . ."

Apple argues that the unregistered trade dress is nonfunctional under each of the *Disc Golf* factors that the Ninth Circuit uses to analyze functionality: "(1) whether the design yields a utilitarian advantage, (2) whether alternative designs are available, (3) whether advertising touts the utilitarian advantages of the design, and (4) whether the particular design results from a comparatively simple or inexpensive method of manufacture." However, the Supreme Court has more recently held that "a feature is also functional . . . when it affects the cost or quality of the device." The Supreme Court's holding was recognized by the Ninth Circuit as "short circuiting some of the *Disc Golf* factors." Nevertheless, we explore Apple's contentions on each of the *Disc Golf* factors and conclude that there was insufficient evidence to support a jury finding in favor of nonfunctionality on any factor.

1. Utilitarian Advantage

Apple argues that "the iPhone's physical design did not 'contribute unusually . . . to the usability' of the device." Apple further contends that the unregistered trade dress was "developed . . . not for 'superior performance.'" Neither "unusual usability" nor "superior performance," however, is the standard used by the Ninth Circuit to determine whether there is any utilitarian advantage. The Ninth Circuit "has never held, as [plaintiff] suggests, that the product feature must provide superior utilitarian advantages. To the contrary, [the Ninth Circuit] has suggested that in order to establish nonfunctionality the party with the burden must demonstrate that the product feature serves no purpose other than identification."

The requirement that the unregistered trade dress "serves no purpose other than identification" cannot be reasonably inferred from the evidence. Apple emphasizes a single aspect of its design, beauty, to imply the lack of other advantages. But the evidence showed that the iPhone's design pursued more than just beauty. Specifically, Apple's executive testified that the theme for the design of the iPhone was:

> “to create a new breakthrough design for a phone that was beautiful and simple and easy to use and created a beautiful, smooth surface that had a touchscreen and went right to the rim with the bezel around it and looking for a look that we found was beautiful and easy to use and appealing.”

Moreover, Samsung cites extensive evidence in the record that showed the usability function of every single element in the unregistered trade dress. For example, rounded corners improve "pocketability" and "durability" and rectangular shape maximizes the display that can be accommodated. A flat clear surface on the front of the phone facilitates touch operation by fingers over a large display. The bezel protects the glass from impact when the phone is dropped. The borders around the display are sized to accommodate other components while minimizing the overall product dimensions. The row of dots in the user interface indicates multiple pages of application screens that are available. The icons allow users to differentiate the applications available to the users and the bottom dock of unchanging icons allows for quick access to the most commonly used applications. Apple rebuts none of this evidence.

Apple conceded during oral argument that its trade dress "improved the quality [of the iPhone] in some respects." It is thus clear that the unregistered trade dress has a utilitarian advantage.

2. Alternative Designs

The next factor requires that purported alternative designs "offer exactly the same features" as the asserted trade dress in order to show non-functionality. A manufacturer "does not have rights under trade dress law to compel its competitors to resort to alternative designs which have a different set of advantages and disadvantages."

Apple, while asserting that there were "numerous alternative designs," fails to show that any of these alternatives offered exactly the same features as the asserted trade dress. Apple simply catalogs the mere existence of other design possibilities embodied in rejected iPhone prototypes and other manufacturers' smartphones. The "mere existence" of other designs, however, does not prove that the unregistered trade dress is non-functional.

3. Advertising of Utilitarian Advantages

"If a seller advertises the utilitarian advantages of a particular feature, this constitutes strong evidence of functionality." An "inference" of a product feature's utility in the plaintiff's advertisement is enough to weigh in favor of functionality of a trade dress encompassing that feature.

Apple argues that its advertising was "[f]ar from touting any utilitarian advantage of the iPhone design . . . ." Apple relies on its executive's testimony that an iPhone advertisement, portraying "the distinctive design very clearly," was based on Apple's "product as hero" approach. The "product as hero" approach refers to Apple's stylistic choice of making "the product the biggest, clearest, most obvious thing in [its] advertisements, often at the expense of anything else around it, to remove all the other elements of communication so [the viewer] see[s] the product most predominantly in the marketing."

Apple's arguments focusing on its stylistic choice, however, fail to address the substance of its advertisements. The substance of the iPhone advertisement relied upon by Apple gave viewers "the ability to see a bit about how it might work," for example, "how flicking and scrolling and tapping and all these multitouch ideas simply [sic]." Another advertisement cited by Apple similarly displayed the message, "[t]ouching is believing," under a picture showing a user's hand interacting with the graphical user interface of an iPhone. Apple fails to show that, on the substance, these demonstrations of the user interface on iPhone's touch screen involved the elements claimed in Apple's unregistered trade dress and why they were not touting the utilitarian advantage of the unregistered trade dress.

4. Method of Manufacture

The fourth factor considers whether a functional benefit in the asserted trade dress arises from "economies in manufacture or use," such as being "relatively simple or inexpensive to manufacture."

Apple contends that "[t]he iPhone design did not result from a 'comparatively simple or inexpensive method of manufacture'" because Apple experienced manufacturing challenges. Apple's manufacturing challenges, however, resulted from the durability considerations for the iPhone and not from the design of the unregistered trade dress. According to Apple's witnesses, difficulties resulted from its choices of materials in using "hardened steel"; "very high, high grade of steel"; and, "glass that was not breakable enough, scratch resistant enough." These materials were chosen, for example, for the iPhone to survive a drop:

> If you drop this, you don't have to worry about the ground hitting the glass. You have to worry about the band of steel surrounding the glass hitting the glass. . . . In order to, to make it work, we had to use very high, high grade of steel because we couldn't have it sort of deflecting into the glass.

The durability advantages that resulted from the manufacturing challenges, however, are outside the scope of what Apple defines as its unregistered trade dress. For the design elements that comprise Apple's unregistered trade dress, Apple points to no evidence in the record to show they were not relatively simple or inexpensive to manufacture.

In sum, Apple has failed to show that there was substantial evidence in the record to support a jury finding in favor of non-functionality for the unregistered trade dress on any of the *Disc Golf* factors. Apple fails to rebut the evidence that the elements in the unregistered trade dress serve the functional purpose of improving usability. Rather, Apple focuses on the "beauty" of its design, even though Apple pursued both "beauty" and functionality in the design of the iPhone. We therefore reverse the district court's denial of Samsung's motion for judgment as a matter of law that the unregistered trade dress is functional and therefore not protectable.

B. The Registered '983 Trade Dress

In contrast to the unregistered trade dress, the '983 trade dress is a federally registered trademark. The federal trademark registration provides "prima facie evidence" of non-functionality. Once this presumption is overcome, the registration loses its legal significance on the issue of functionality.

The '983 trade dress claims the design details in each of the sixteen icons on the iPhone's home screen framed by the iPhone's rounded-rectangular shape with silver edges and a black background:

> The first icon depicts the letters "SMS" in green inside a white speech bubble on a green background;
>
> . . .
>
> the seventh icon depicts a map with yellow and orange roads, a pin with a red head, and a redand-blue road sign with the numeral "280" in white;
>
> . . .
>
> the sixteenth icon depicts the distinctive configuration of applicant's media player device in white over an orange background.

'983 trade dress (omitting thirteen other icon design details for brevity).

It is clear that individual elements claimed by the '983 trade dress are functional. For example, there is no dispute that the claimed details such as "the seventh icon depicts a map with yellow and orange roads, a pin with a red head, and a red-and-blue road sign with the numeral '280' in white" are functional. Apple's user interface expert testified on how icon designs promote usability. This expert agreed that "the whole point of an icon on a smartphone is to communicate to the consumer using that product, that if they hit that icon, certain functionality will occur on the phone." The expert further explained that icons are "[v]isual shorthand for something" and that "rectangular containers" for icons provide "more real estate" to accommodate the icon design. Apple rebuts none of this evidence.

Apple contends instead that Samsung improperly disaggregates the '983 trade dress into individual elements to argue functionality. But Apple fails to explain how the total combination of the sixteen icon designs in the context of iPhone's screen-dominated rounded-rectangular shape—all part of the iPhone's "easy to use" design theme—somehow negates the undisputed usability function of the individual elements. Apple's own brief even relies on its expert's testimony about the "instant recognizability due to highly intuitive icon usage" on "the home screen of the iPhone." Apple's expert was discussing an analysis of the iPhone's overall combination of icon designs that allowed a user to recognize quickly particular applications to use.

The iPhone's usability advantage from the combination of its icon designs shows that the '983 trade dress viewed as a whole "is nothing other than the assemblage of functional parts . . . ." The undisputed facts thus demonstrate the functionality of the '983 trade dress. "In the face of sufficient and undisputed facts demonstrating functionality, as in our case, the registration loses its evidentiary significance."

The burden thus shifts back to Apple. But Apple offers no analysis of the icon designs claimed by the '983 trade dress. Rather, Apple argues generically for its two trade dresses without distinction under the *Disc Golf* factors. Among Apple's lengthy citations to the record, we can find only two pieces of information that involve icon designs. One is Apple's user interface expert discussing other possible icon designs. The other is a citation to a print iPhone advertisement that included the icon designs claimed in the '983 trade dress. These two citations, viewed in the most favorable light to Apple, would be relevant to only two of the *Disc Golf* factors: "alternative design" and "advertising." But the cited evidence suffers from the same defects as discussed in subsections I.A.2 and I.A.3. Specifically, the expert's discussion of other icon design possibilities does not show that the other design possibilities "offer[ed] exactly the same features" as the '983 trade dress. The print iPhone advertisement also fails to establish that, on the substance, it was not touting the utilitarian advantage of the '983 trade dress. The evidence cited by Apple therefore does not show the non-functionality of the '983 trade dress.

In sum, the undisputed evidence shows the functionality of the registered '983 trade dress and shifts the burden of proving non-functionality back to Apple. Apple, however, has failed to show that there was substantial evidence in the record to support a jury finding in favor of non-functionality for the '983 trade dress on any of the *Disc Golf* factors. We therefore reverse the district court's denial of Samsung's motion for judgment as a matter of law that the '983 trade dress is functional and therefore not protectable.

Because we conclude that the jury's findings of nonfunctionality of the asserted trade dresses were not supported by substantial evidence, we do not reach Samsung's arguments on the fame and likely dilution of the asserted trade dresses, the Patent Clause of the Constitution, or the dilution damages.

II. Design Patents

The design patents on appeal claim certain design elements embodied in the iPhone. The focuses on design elements on the front face of the iPhone.

Samsung contends that it should not have been found liable for infringement of the asserted design patents because any similarity was limited to the basic or functional elements in the design patents. Moreover, according to Samsung, there was no evidence of actual deception of consumers and that the differences between the accused smartphones and the asserted design patents should have been clear if prior art designs were properly considered. Samsung raises these three issues—functionality, actual deception, and comparison to prior art—in the context of the jury instructions and the sufficiency of evidence to support the infringement verdict. Finally, Samsung argues that the district court legally erred in allowing the jury to award as damages Samsung's entire profits on its infringing smartphones. We do not find any of these challenges persuasive as discussed below.

A. Infringement

1. Jury Instructions

<u>a. Functional Aspects in the Asserted Design Patents</u>

"Where a design contains both functional and nonfunctional elements, the scope of the claim must be construed in order to identify the non-functional aspects of the design as shown in the patent." Samsung contends that the district court erred in failing to exclude the functional aspects of the design patents either in the claim construction or elsewhere in the infringement jury instructions. Specifically, Samsung contends that the district court should have excluded elements that are "'dictated by their functional purpose,' or cover the 'structural . . . aspects of the article.'" Such elements, according to Samsung, should be "ignored" in their entirety from the design patent claim scope. For example, Samsung contends that rectangular form and rounded corners are among such elements that should be ignored in the infringement analysis.

Our case law does not support Samsung's position. In *Richardson*, the design patent at issue depicted a multifunction tool with numerous components that were "dictated by their functional purpose." But the claim construction in *Richardson* did not exclude those components in their entirety. Rather, the claim construction included the ornamental aspects of those components: "the standard shape of the hammer-head, the diamond-shaped flare of the crow-bar and the top of the jaw, the rounded neck, the orientation of the crow-bar relative to the head of the tool, and the plain, undecorated handle." That construction was affirmed on appeal. As such, the language "dictated by their functional purpose" in *Richardson* was only a description of the facts there; it did not establish a rule to eliminate entire elements from the claim scope as Samsung argues.

Our case law likewise does not support Samsung's proposed rule of eliminating any "structural" aspect from the claim scope. Samsung arrives at its proposed rule by selecting a few words from the following statement in *Lee*: "[d]esign patents do not and cannot include claims to the structural or functional aspects of the article . . . ." But that statement addressed design patent validity. It did not specify a rule, as Samsung represents, to eliminate elements from the claim scope of a valid patent in analyzing infringement.

More directly applicable to the claim scope issue at hand, Lee stated elsewhere that "it is the non-functional, design aspects that are pertinent to determinations of infringement." That principle was properly reflected in this case in the district court's construction of the design patents as claiming only "the ornamental design" as shown in the patent figures. Samsung has not persuasively shown how the district court's claim constructions were legally erroneous under *Lee* or *Richardson.*

Samsung asserted alternatively during oral argument that the jury should have been instructed to compare the accused Samsung smartphones to the "overall ornamental appearance" of a patented design, instead of simply "the overall appearance" as the district court provided. According to Samsung, "crucially, what's missing there is the word 'ornamental.'" But jury instructions are reviewed "as a whole" to determine whether "the substance of the applicable law was [not] fairly and correctly covered" such that the alleged error was prejudicial. The jury instructions, as a whole, already limited the scope of the asserted design patents to the "ornamental" elements through the claim constructions as discussed earlier: the design patents were each construed as claiming "the ornamental design" as shown in the patent figures. As such, Samsung has failed to show prejudicial error in the jury instructions as a whole that would warrant a new trial.

<u>b. Actual Deception and Role of Prior Art</u>

Samsung further contends that the infringement instruction was erroneous for stating that actual deception was not required, and for providing guidelines in considering prior art. A design patent is infringed if an ordinary observer would have been deceived: "if, in the eye of an ordinary observer, giving such attention as a purchaser usually gives, two designs are substantially the same, if the resemblance is such as to deceive such an observer, inducing him to purchase one supposing it to be the other, the first one patented is infringed by the other." Moreover, an infringement analysis must include a comparison of the asserted design against the prior art: "[i]f the accused design has copied a particular feature of the claimed design that departs conspicuously from the prior art, the accused design is naturally more likely to be regarded as deceptively similar to the claimed design, and thus infringing."

These holdings from *Gorham* and *Egyptian Goddess* were reflected in the infringement instruction here, and Samsung does not contend otherwise. Samsung argues instead that the portions in the infringement instruction highlighted below made the jury consider a lack of actual deception irrelevant and led the jury to disregard the prior art:

> "Two designs are substantially the same if, in the eye of an ordinary observer, giving such attention as a purchaser usually gives, the resemblance between the two designs is such as to deceive such an observer, inducing him to purchase one supposing it to be the other. You do not need, however, to find that any purchasers actually were deceived or confused by the appearance of the accused Samsung products. . . .
>
> This determination of whether two designs are substantially the same will benefit from comparing the two designs with prior art. You must familiarize yourself with the prior art admitted at trial in making your determination of whether there has been direct infringement.
>
> You may find the following guidelines helpful to your analysis . . . ."

We conclude instead that the jury instruction simply clarified that actual deception was not required, which is an accurate reflection of the analysis in *Gorham*.

We also conclude that the jury instruction expressly required that each juror "must" consider the prior art admitted at trial. The jury instruction's guidelines did not reduce the entire prior art analysis to a mere option as Samsung contends.

Samsung again has failed to show that "when, looking to the instructions as a whole, the substance of the applicable law was [not] fairly and correctly covered."

2. Supporting Evidence

Samsung contends that the infringement verdict was not supported by substantial evidence. Samsung's contentions, however, are premised on the same issues—functionality, actual deception, and comparison to prior art—it raises in the context of the jury instructions.

Having rejected the jury instruction challenges, we likewise find Samsung's parallel substantial evidence complaints unpersuasive. Apple's witnesses provided sufficient testimonies to allow the jury to account for any functional aspects in the asserted design patents. Additionally, the witnesses testified on the similar overall visual impressions of the accused products to the asserted design patents such that an ordinary observer would likely be deceived. Apple's experts also testified about the differences between the asserted patents and both the prior art and other competing designs. The jury could have reasonably relied on the evidence in the record to reach its infringement verdict.

3. Preclusion of Evidence

Samsung also appeals the district court's preclusion of testimony on Samsung's independent development of its F700 phone that pre-dated the iPhone to rebut an allegation of copying. The evidence on the F700 was previously excluded as a prior art reference under a Rule 37 sanction due to Samsung's failure to timely disclose the evidence during discovery, which Samsung does not challenge.

The district court found that Samsung's witness did not design any of the accused devices and was unaware that any of the accused devices was based on the F700. The district court thus determined that the proffered testimony of Samsung's witness would have limited probative value on the question of whether Samsung copied any of Apple's design patents because she lacked first-hand knowledge relevant to the underlying issue. As a result, the district court concluded that the limited probative value of the testimony was outweighed by the likelihood that it would be considered by the jury for the prohibited purpose under the earlier Rule 37 sanction. We find that the district court acted within its discretion in precluding Samsung's proffered testimony to rebut an allegation of copying.

We conclude that there was no prejudicial legal error in the infringement jury instructions on the three issues that Samsung raises: functionality, actual deception, and comparison to prior art. We further conclude that the district court did not abuse its discretion in excluding Samsung's evidence of independent development and that there was substantial evidence to support the jury's infringement findings. We therefore affirm the district court's denial of Samsung's motion for judgment as a matter of law on design patent infringement and Samsung's alternative motion for a new trial.

B. Damages

Finally, with regard to the design patents, Samsung argues that the district court legally erred in allowing the jury to award Samsung's entire profits on its infringing smartphones as damages. The damages, according to Samsung, should have been limited to the profit attributable to the infringement because of "basic causation principles . . . ." Samsung contends that "Apple failed to establish that infringement of its limited design patents . . . caused any Samsung sales or profits." Samsung further contends that consumers chose Samsung based on a host of other factors.

These "causation" arguments, however, advocate the same "apportionment" requirement that Congress rejected. The provisions in the Act of 1887 on design patent infringement damages were subsequently codified in Section 289 of Title 35.

Section 289 now provides:

> “Whoever during the term of a patent for a design, without license of the owner, (1) applies the patented design, or any colorable imitation thereof, to any article of manufacture for the purpose of sale, or (2) sells or exposes for sale any article of manufacture to which such design or colorable imitation has been applied shall be liable to the owner to the extent of his total profit, but not less than $250, recoverable in any United States district court having jurisdiction of the parties.
>
> Nothing in this section shall prevent, lessen, or impeach any other remedy which an owner of an infringed patent has under the provisions of this title, but he shall not twice recover the profit made from the infringement.”

35 U.S.C. § 289. In reciting that an infringer "shall be liable to the owner to the extent of [the infringer's] total profit," Section 289 explicitly authorizes the award of total profit from the article of manufacture bearing the

patented [1002] design.1Link to the text of the note Several other courts also concluded that Section 289 authorizes such award of total profit. The clear statutory language prevents us from adopting a "causation" rule as Samsung urges.

Samsung continues its quest for apportionment by arguing, alternatively, that the profits awarded should have been limited to the infringing "article of manufacture," not the entire infringing product. Samsung argues for limiting the profits awarded to "the portion of the product as sold that incorporates or embodies the subject matter of the patent." Samsung contends that the Second Circuit had "allowed an award of infringer's profits from the patented design of a piano case but not from the sale of the entire piano . . . ." These Second Circuit opinions, however, addressed a factual situation where "[a] purchaser desiring a piano of a particular manufacturer may have the piano placed in any one of several cases dealt in by the maker." That factual situation occurred in the context of the commercial practice in 1915 in which ordinary purchasers regarded a piano and a piano case as distinct articles of manufacture. The facts at hand are different. The innards of Samsung's smartphones were not sold separately from their shells as distinct articles of manufacture to ordinary purchasers. We thus do not agree with Samsung that these Second Circuit cases required the district court to limit the damages for design patent infringement in this case.

We agree with the district court that there was no legal error in the jury instruction on the design patent damages. Samsung does not argue a lack of substantial evidence to support the damages awards under the district court's jury instruction. We therefore affirm the damages awarded for design patent infringements.

III. Utility Patents

Finally, Samsung challenges the validity of claim 50 of the ‘163 patent and claim 8 of the ‘915 patent. Samsung also challenges the damages awarded for utility patent infringement.

A. Validity

1. Indefiniteness of Claim 50 of the ‘163 patent

Claim 50 of the ‘163 patent relates to a user interface feature in which a user's double tapping on a portion of an electronic document causes the portion to be enlarged and "substantially centered" on the display. ‘163 patent, claim 50. Samsung contends that claim 50 is indefinite because the ‘163 patent provides "no objective standard to measure the scope of the term 'substantially centered.'"

Samsung's complaint about a lack of an "objective standard [of] measure" is seeking a level of precision that exceeds the definiteness required of valid patents. "The definiteness requirement . . . mandates clarity, while recognizing that absolute precision is unattainable." Given this recognition, "a patent is invalid for indefiniteness if its claims, read in light of the specification delineating the patent, and the prosecution history, fail to inform, with reasonable certainty, those skilled in the art about the scope of the invention."

Samsung, however, points to no evidence showing that skilled artisans would find the element "substantially centered" as lacking reasonable certainty in its scope. In contrast, Apple's expert explained that the "padding" allowed in the '163 patent provides skilled artisans with enough information to understand what "substantially centered" means in the patent. Apple's expert cites a discussion in the specification of an embodiment referring to the figure reproduced below where the enlarged portion of the document is essentially centered except for "a predefined amount of padding along the sides of the display."

Apple thus presented evidence to show that skilled artisans would interpret "substantially centered" in the '163 patent to mean essentially centered except for a marginal spacing to accommodate ancillary graphical user interface elements. We are not persuaded by Samsung's attempt to discredit this expert testimony. We therefore agree with the district court that Samsung failed to carry its burden in challenging the validity of claim 50 of the '163 patent for indefiniteness.

2. Anticipation of Claim 8 of the '915 Patent

Claim 8 of the '915 patent describes a computer-based method for distinguishing between scrolling and gesture (such as zooming) operations on a touch screen.

The dispute centers on whether a prior art reference, the Nomura patent application, taught the "event object" element in claim 8. The claim recites "event object" in the context such as: "creating an event object in response to the user input; determining whether the event object invokes a scroll or gesture operation . . . ." Samsung contends that the "movement history" in Nomura inherently disclosed the "event object" in claim 8 based on the opinion of its expert.

Apple, however, rebuts with its own expert testimony. Apple's expert explained that "event objects" in claim 8 refers to a particular "programming construct[]" and that there were many potential programming alternatives that Nomura could have used to implement the "movement history" it disclosed. According to the explanation by Apple's expert, Nomura did not inherently disclose the claimed "event object." We find that a reasonable jury could have credited the testimony of Apple's expert over Samsung's expert. Thus, we agree with the district court that there was substantial evidence to support the jury's finding that claim 8 of the '915 patent was not anticipated.

B. Damages

Apple advanced at trial both lost profits and reasonable royalty damages theories. The jury determined that for certain Samsung phones found to infringe the '915 patent, no reasonable non-infringing alternative was available, and thus lost profits was an appropriate measure of damages. For the other Samsung phones found to infringe Apple's utility patents-in-suit, the jury determined that an award of lost profits was not supported, and thus awarded Apple a reasonable royalty for Samsung's infringement.

1. Lost Profits for Infringement of the '915 Patent

"To recover lost profits, the patent owner must show causation in fact, establishing that but for the infringement, he would have made additional profits." The patentee must "take[] into account any alternatives available to the infringer." "[M]arket sales of an acceptable noninfringing substitute often suffice alone to defeat a case for lost profits."

Samsung argues that lost profits should not have been awarded because the evidence showed the existence of non-infringing substitutes. Specifically, Samsung contends that two Samsung phones, found to have not infringed the ‘915 patent, should have been considered by the jury as non-infringing substitutes. Samsung further asserts that Apple failed to prove consumer preference of the '915 patent's technology over a purportedly comparable feature available in the two non-infringing Samsung phones.

However, "the '[m]ere existence of a competing device does not make that device an acceptable substitute.'" The mere existence of noninfringing phones is all Samsung is relying on to attack the jury's verdict. For example, Samsung points to no evidence to support its assertion that the two noninfringing phones included a feature comparable to the one claimed in the '915 patent.

In contrast, there was substantial evidence to support the jury's refusal to consider the two phones asserted by Samsung as non-infringing substitutes. Of these two phones, one had significantly different features, such as a slide-out physical keyboard in combination with a small, low-resolution screen. And the other phone was never sold by a U.S. carrier. The jury could have reasonably found that these two Samsung phones were not acceptable alternatives. Samsung's unsupported assertion to the contrary fails to show a lack of substantial evidence supporting the awards of lost profits.

2. Reasonable Royalty

Samsung argues that Apple's expert in the damages retrial, Ms. Davis, offered only a cursory explanation of how she arrived at the royalty rates she calculated based on the *Georgia-Pacific* factors. Samsung complains specifically about Ms. Davis's testimony that the evidence of demand from her lost profits analysis was "also relevant to the determination of the amount of reasonable royalties."

Samsung does not dispute that Ms. Davis sufficiently explained her analysis of demand in the lost profit context. Samsung is only challenging that she did not repeat the same information with all of the details in testifying about her reasonable royalty calculation. However, Ms. Davis expressly testified that the demand factor for lost profits was also relevant to the determination of a reasonable royalty. A reasonable jury could refer to Ms. Davis's testimony from an earlier context and appropriately weigh the evidence in considering Ms. Davis's calculation on the royalty rates. Moreover, Ms. Davis's testimony included additional substance on the *Georgia-Pacific* factors. For example, Ms. Davis expressly considered the cost to Samsung of being out of the market long enough to design around the patents, the profits attributable to Samsung's use of the patented technology, and the commercial relationship between the parties. Taken as a whole, Ms. Davis's testimony provided sufficient evidence to support the jury's reasonable royalty awards in the damages retrial.

Finally, Samsung complained that Apple's expert in the first damages trial, Mr. Musika, failed to explain his *Georgia-Pacific* analysis and identified no evidence supporting his royalty rates. Upon Apple's response, Samsung acknowledges that Mr. Musika did in fact identify and discuss specific *Georgia-Pacific* factors and that Mr. Musika referred to an exhibit during his testimony. Samsung now contends that the analysis was not meaningful and the cited exhibit did not discuss the *Georgia-Pacific*'s factors at all. Samsung's fault-finding is meritless.

We therefore affirm the district court's denial of Samsung's motion for judgment as a matter of law on the invalidity of claim 50 of the ‘163 patent and claim 8 of the ‘915 patent, as well as the damages awarded for utility patent infringement. We also affirm the district court's denial of Samsung's motions for a new trial on these same issues. We remand for immediate entry of final judgment on all damages awards not predicated on Apple's trade dress claims and for any further proceedings necessitated by our decision to vacate the jury's verdicts on the unregistered and registered trade dress claims.

AFFIRMED-IN-PART, REVERSED-IN-PART, VACATED-IN-PART and REMANDED.

“Supreme Court to Hear Samsung Appeal on Apple Patent Award”

The New York Times

Adam Liptak

March 21, 2016

The Supreme Court on Monday agreed to hear an appeal from Samsung on what it must pay Apple for infringing on part of the design of the iPhone. In a brief supporting Samsung, companies including Google and Facebook said the legal framework governing the design patents at issue was “out of step with modern technology.”

Samsung, the Korean electronics company, argued that design patents, which address what products look like, are poorly suited to complex devices with many features, adding that they can give rise to disproportionate penalties.

Design patents once covered household items like spoons and fireplace grates — whose design was central to the product — and a finding of infringement required the defendant to turn over all of its profits. Samsung argued that this “total profit rule” did not make sense in the digital era and would “reward design patents far beyond the value of any inventive contribution.”

“In other words,” the company’s brief said, “even if the patented features contributed 1 percent of the value of Samsung’s phones, Apple gets 100 percent of Samsung’s profits.”

Design patents are far less common than utility patents, which cover how products work. The Supreme Court has not heard a design patent case in over a century.

In December, Samsung agreed to pay Apple $548 million in damages in the case, but it reserved the right to appeal to the Supreme Court. The company now stands to recover as much as $399 million of that, representing its total profits from various models of phones that Apple said, in a lawsuit filed in 2011, infringed on its design patents.

A Samsung spokeswoman, Danielle Meister Cohen, said in a statement that the court’s review “could lead to a fair interpretation of patent law that will support creativity and reward innovation.” Apple declined to comment.

The three design elements at issue in the case, *Samsung Electronics Co. v. Apple Inc*., No. 15-777, are, in Samsung’s description, “a particular black rectangular round-cornered front face”; “a substantially similar rectangular round-cornered front face plus the surrounding rim”; and “a particular colorful grid of sixteen icons.”

In urging the Supreme Court not to hear the case, Apple said the justices should not reward a copycat.

“The iPhone’s explosive success was due in no small part to its innovative design, which included a distinctive front face and a colorful graphical user interface — features protected by U.S. design patents,” the company’s brief said. “The innovation and beauty of Apple’s designs were not only hailed by consumers and the press, but envied by Apple’s fiercest competitor, Samsung, which by its executive's own admission in related litigation is a 'fast follower' rather than an innovator."

The justices agreed to decide only one of the questions on which Samsung had sought review: "Where a design patent is applied to only a component of a product, should an award of infringer's profits be limited to those profits attributable to the component?"

Last year, the United States Court of Appeals for the Federal Circuit, a specialized court that handles patent appeals, ruled that the governing statute "explicitly authorizes the award of total profit from the article of manufacture bearing the patented design."

The court appeared to acknowledge the possibility that "an award of a defendant's entire profits for design patent infringement makes no sense in the modern world." But it added that "those are policy arguments that should be directed to Congress."

"We are bound by what the statute says, irrespective of policy arguments that may be made against it," the court said.

David Opderbeck, a law professor at Seton Hall University, said the justices had focused on an important issue.

"The key question is whether damages relating to a design patent should be apportioned in relation to the value added by the patented design or can cover the infringer's entire profit on the infringing product," he said.

"The Federal Circuit read the design patent law very literally and held that the entire profits can be recovered," he added. "In my opinion, this is a far too literal reading of the statute, particularly because a product's ornamental design very often is not the primary driver of consumer demand and of the manufacturer's profits. In some ways, the Federal Circuit's ruling could allow design patent law to swallow utility patent law, making the ornamental design more important than the underlying technology."

"Apple Case against Samsung Should Go Back to the Lower Court: Justice Department"

Reuters

Dan Levine

June 9, 2016

The U.S. Department of Justice asked the Supreme Court to overturn an appeals court ruling that had favored Apple Inc over Samsung Electronics Co Ltd in smartphone patent litigation, and asked that it return the case to the trial court for more litigation.

Samsung had appealed a federal appeals court ruling to the Supreme Court, which agreed to hear the case. The Justice Department submitted its view in an amicus brief on Wednesday.

An Apple spokeswoman declined to comment, while Samsung told Reuters in a statement it welcomes "overwhelming support" for overturning the appeals court ruling in favour of Apple from various parties including the U.S. government.

"If left uncorrected, the appeals court's ruling could lead to diminished innovation, pave the way for design troll patent litigation and negatively impact the economy and consumers," the South Korean firm said.

The world's top smartphone rivals have been feuding over patents since 2011, when Apple sued Samsung in Northern California alleging infringement of the iPhone's patents, designs and trademarked appearance.

Following a 2012 jury trial, Samsung was ordered to pay Apple $930 million. Samsung has been trying to reduce that figure ever since.

Its efforts were partially rewarded in May 2015, when the U.S. Court of Appeals for the Federal Circuit reversed the trademark liability, bringing Samsung's exposure down to $548 million.

The appeals court, however, upheld Samsung's infringement of the iPhone's patents, including those related to the designs of the iPhone's rounded-corner front face, bezel and colorful grid of icons.

Samsung then asked the Supreme Court to review the design patent portion of the decision, calling the damages awarded excessive. In March, the justices agreed to look into whether courts should award in damages the total profits from a product that infringes a design patent, if the patent applies only to a component of the product.

In its amicus brief on Wednesday, the Justice Department said it was unclear whether Samsung had produced enough evidence to support its argument that phone components, not the entire phone, should be what matters when calculating damages.

The Supreme Court should send the case back for the trial court to determine whether a new trial is warranted on that issue, the Justice Department said.

The case is Samsung Electronics Co Ltd et al vs. Apple Inc, in the Supreme Court of the United States, No. 15-777.

“Supreme Court Takes Up *Apple v. Samsung*, First Design Patent Case in a Centurty”

Ars Technica

Joe Mullin

March 21, 2016

If Apple was finally feeling like it had a solid win after getting paid $548 million in patent damages by Samsung—well, now it shouldn't be so sure.

The Supreme Court said today that it will consider what kind of damages should be warranted when a design patent is found to be infringed as the court takes up the blockbuster *Apple v. Samsung* case.

After a 13-day trial in 2012, a jury held that Samsung's phones infringed Apple utility and design patents. Apple was originally granted $1.05 billion, but that number was slashed down on appeal. Samsung paid $548 million late last year, but the company didn't give up its right to one last appeal. A Supreme Court win could result in Samsung getting much of that money back.

In its petition, Samsung says that the massive damage awarded based on three design patents is a "ridiculous" result. In Samsung's view, the company was ordered to pay 100 percent of its profits for several phones even though there's no doubt that the patented designs only made a small contribution.

"The decision below is thus an open invitation to litigation abuse and has already prompted grave concern across a range of US companies about a new flood of extortionate patent litigation, especially in the field of high technology," write Samsung lawyers.

Apple sued over design patents on a black rectangular front face with round corners, a similar face with a surrounding rim or "bezel," and its colorful grid of sixteen icons.

The patents at issue are D618,677 (shown below, a black rectangle with rounded corners), D593,087 (with bezel on surrounding rim), and D604,305 (colorful grid of 16 icons.)

Samsung's petition was supported by several tech companies looking to lessen patent damages as well as a brief from Public Knowledge and the Electronic Frontier Foundation.

In the tech companies' amicus brief, they argue that Section 289 of the Patent Act, which dates to the 19th century, only envisages awards of an infringer's total profits on "relatively simple products."

"So far as the consumers are concerned, the effect of design patent laws that are respected is to give them more beautiful carpets and wall-papers and oil-cloths," reads the House Report on the bill that became Section 289.

The brief is signed by eight tech giants that have found themselves mostly on the defensive in patent cases dealing with both "patent trolls" and competitors for years: Dell, eBay, Facebook, Google, H-P, Newegg, Pegasystems, and Vizio.

Apple's brief in opposition reviews the history of the case below, arguing that Samsung is simply dead wrong on the law. The company quotes the appeals court that found Section 289 "explicitly authorizes the award of total profit." It also blasts Samsung again as being an egregious copycat and patent infringer.

Samsung's petition "depends on a made-up narrative in which Samsung, not Apple, is the innovator, despite the overwhelming evidence that Samsung copied the iPhone’s innovative design," Apple says.

"Unlike the buttons, knobs, and ugly protrusions of prior phones, Apple’s iPhone was smooth and elegant and earned immediate acclaim," write Apple lawyers. "Although Samsung now tries to portray itself as an innovator, Samsung acknowledged at the time that the iPhone’s design was miles ahead of its own."

Little attention was paid to design patents until the blockbuster 2012 trial. *The New York Times* reports that the Supreme Court hasn't heard a design patent case in more than a century.

This case doesn't relate to the second *Apple v. Samsung* patent trial, which covered a newer generation of Samsung phones. That trial led to a $120 million jury verdict in Apple's favor, but Apple's win was thrown out entirely last month when an appeals court invalidated Apple's "slide to unlock" patent and two others.

"We welcome the Court’s decision to hear our case," a Samsung spokesperson said in a statement earlier today. "The Court’s review of this case can lead to a fair interpretation of patent law that will support creativity and reward innovation."

“Court will reduce Apple's $930 million win in Samsung patent case”

The Verge

Adi Robertson

May 18, 2015

Apple and Samsung's patent infringement battle isn't over, and in the latest ruling, neither side has gotten exactly what it wanted. In a filing posted today, the US Court of Appeals for the Federal Circuit reaffirmed that Samsung had copied specific design patents in Apple's iPhone. But the court decided that Samsung wasn't infringing on Apple's overall trade dress — the look and feel of its phones. This means that while the damages Apple was granted for patent infringement will stand, the company's overall $930 million award will be downsized.

The court's analysis hinged on the idea that trade dress had to be based on aesthetic decisions meant to make something visually distinctive, and that rules protecting it have to be balanced with "a fundamental right to compete through imitation of a competitor’s product." While Apple argued that the iPhone's rounded rectangle shape and rows of square apps were designed to give it a particular look that fit Apple's brand, the court cited Apple's previous claims that the shape was also easier to use. The same went for its app icons, which were attractive but also meant to make the iPhone more intuitive.

The current legal fight between Samsung and Apple has been going on since 2011, when Apple alleged that several Samsung phones infringed on design and utility patents for its iPhone. In 2012, a court found that Samsung had indeed infringed on Apple's patents for "bounce-back" scrolling, multitouch gestures, and tap-to-zoom options on iOS. It also found that Samsung's phones had infringed on both officially registered and unregistered iPhone trade dress. Apple had requested $2.5 billion in damages, and it ended up getting slightly over $1 billion.

Since then, Samsung and Apple have both been trying to tilt the ruling and the damages in their favor. Apple tried and failed to get a sales ban on the infringing phones and tablets (all of which have now been obsolete for several years), and it requested an additional $707 million from Samsung. It got neither of these; in fact, its original damages were recalculated and slightly cut back. Now that the earlier decision has been struck down, lower courts will have to calculate a new damages number. Samsung, however, has also had its share of disappointment. It lost a second patent battle to Apple in 2014, for the smaller amount of around $120 million. And this latest ruling reaffirms that it infringed on Apple's patents, so it's still going to be paying out in this case — just not as much as originally expected.

Apple, for its part, is optimistic about the decision. "We are pleased the Federal Circuit Court of Appeal confirmed Samsung blatantly copied Apple products," said a spokesperson on the news. "This is a victory for design and those who respect it. Even though Samsung must pay for its widespread infringement of our patents, this case has always been about more than money. It’s about innovation and the hard work that goes into inventing products that people love, which is hard to put a price on."

And, of course, so is Samsung. "We welcome the US Court of Appeals' ruling overturning Apple's infringement and damage claims against Samsung over trade dress," its spokesperson said. "Today's decision shows that Apple's claims over trade dress and damages lack merit and are grossly exaggerated. We remain confident that our products do not infringe on Apple’s design patents and other intellectual property, and we will continue to take all appropriate measures to protect our products."

Salman v. US

15-8049

Ruling Below: *United States v. Salman*, 792 F.3d 1087 (9th Cir. 2015)

Salman was accused of insider trading, having been tipped off by his brother-in-law (Maher Kara) via his brother-in-law's brother (Michael Kara). While no traditional gifts or transactions of a pecuniary or similarly valuable nature were made, the Government showed evidence that the tippee (Michael) and tipper (Maher) had a mutually beneficial and fulfilling familial relationship, which Salman was aware of, and claimed that this was sufficient to meet the standard set in *Dirks v. S.E.C.*

Salman was found guilty of four counts of securities fraud and one count of conspiracy to commit securities fraud. Salman subsequently appealed, claiming that a new standard set by *United States v. Newman* from the Second Circuit should be applied. On appeal, the Ninth Circuit affirmed the District Court's decision on the grounds that the familial relationship presented sufficient evidence.

Question Presented: Whether the insider trading rule in *Dirks v. SEC* requires proof of "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature," as in *United States v. Newman*, or whether a close family relationship between the tipper and tippee is sufficient.

UNITED STATES of America, Plaintiff–Appellee,
v.
Bassam Yacoub SALMAN, aka Bessam Jacob Salman, Defendant–Appellant.

United States Court of Appeals, Ninth Circuit

Decided on July 6, 2015

[Excerpt; some citations and footnotes omitted]

Defendant–Appellant Bassam Yacoub Salman appeals his conviction, following jury trial, for conspiracy and insider trading. He argues that the evidence was insufficient to sustain his conviction under the standard announced by the United States Court of Appeals for the Second Circuit in *United States v. Newman*, which he urges us to adopt. We find that the evidence was sufficient, and we affirm.

BACKGROUND

This case arises from an insider-trading scheme involving members of Salman's extended family. On September 1, 2011, Salman was indicted for one count of conspiracy to commit securities fraud in violation of 18 U.S.C. § 371 and four counts of securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff, 17 C.F.R. §§ 240.10b–5, 240.10b5–1 and 240.10b5–2, and 18 U.S.C. § 2. At trial, the Government presented evidence of the following:

In 2002, Salman's future brother-in-law Maher Kara joined Citigroup's healthcare investment banking group. Over the next few years, Maher began to discuss aspects of his job with his older brother, Mounir ("Michael") Kara. At first, Maher sought help from Michael, who held an undergraduate degree in chemistry, in understanding scientific concepts relevant to his work in the healthcare and biotechnology sectors. In 2004, when their father was dying of cancer, the focus of the brothers' discussions shifted to companies that were active in the areas of oncology and pain management. Maher began to suspect that Michael was trading on the information they discussed, although Michael initially denied it. As time wore on, Michael became more brazen and more persistent in his requests for inside information, and Maher knowingly obliged. From late 2004 through early 2007, Maher regularly disclosed to Michael information about upcoming mergers and acquisitions of and by Citigroup clients.

Meanwhile, in 2003, Maher Kara became engaged to Salman's sister, Saswan ("Suzie") Salman. Over the course of the engagement, the Kara family and the Salman family grew close. In particular, Salman and Michael Kara became fast friends. In the fall of 2004, Michael began to share with Salman the inside information that he had learned from Maher, encouraging Salman to "mirror-imag [e]" his trading activity. Rather than trade through his own brokerage account, however, Salman arranged to deposit money, via a series of transfers through other accounts, into a brokerage account held jointly in the name of his wife's sister and her husband, Karim Bayyouk. Salman then shared the inside information with Bayyouk and the two split the profits from Bayyouk's trading. The brokerage records introduced at trial revealed that, on numerous occasions from 2004 to 2007, Bayyouk and Michael Kara executed nearly identical trades in securities issued by Citigroup clients shortly before the announcement of major transactions. As a result of these trades, Salman and Bayyouk's account grew from $396,000 to approximately $2.1 million.

Of particular relevance here, the Government presented evidence that Salman knew full well that Maher Kara was the source of the information. Michael Kara (who pled guilty and testified for the Government) testified that, early in the scheme, Salman asked where the information was coming from, and Michael told him, directly, that it came from Maher. Michael further testified about an incident that occurred around the time of Maher and Suzie's wedding in 2005. According to Michael Kara, on that visit, Michael noticed that there were many papers relating to their stock trading strewn about Salman's office. Michael became angry and admonished Salman that he had to be careful with the information because it was coming from Maher. Michael testified that Salman agreed that they had to "protect" Maher and promised to shred all of the papers.

The Government further presented evidence that Maher and Michael Kara enjoyed a close and mutually beneficial relationship. Specifically, the jury heard testimony that Michael helped pay for Maher's college, that he stood in for their deceased father at Maher's wedding, and, as discussed above, that Michael coached Maher in basic science to help him succeed at his job. Maher, for his part, testified that he "love[d] [his] brother very much" and that he gave Michael the inside information in order to "benefit him" and to "fulfill [ ] whatever needs he had." For example, Maher testified that on one occasion, he received a call from Michael asking for a "favor," requesting "information," and explaining that he "owe[d] somebody." After Michael turned down Maher's offer of money, Maher gave him a tip about an upcoming acquisition instead.

Finally, the Government presented evidence that Salman was aware of the Kara brothers' close fraternal relationship. The Salmans and the Karas were tightly knit families, and Salman would have had ample opportunity to observe Michael and Maher's interactions at their regular family gatherings. For example, Michael gave a toast at Maher's wedding, which Salman attended, in which Michael described how he spoke to his younger brother nearly every day and described Maher as his "mentor," his "private counsel," and "one of the most generous human beings he knows." Maher, overcome with emotion, began to weep.

The jury found Salman guilty on all five counts. Salman then moved for a new trial pursuant to Rule 33 of the Federal Rules of Criminal Procedure, on the ground, inter alia, that there was no evidence that he knew that the tipper disclosed confidential information in exchange for a personal benefit. The district court denied his motion in full.
Salman timely appealed, but did not raise a challenge to the sufficiency of the evidence in his opening brief. After he filed his reply brief, the United States Court of Appeals for the Second Circuit, in *United States v. Newman*, vacated the insider-trading convictions of two individuals on the ground that the Government failed to present sufficient evidence that they knew the information they received had been disclosed in breach of a fiduciary duty. After the Second Circuit denied the Government's petition for panel rehearing and rehearing en banc, Salman promptly moved for leave to file a supplemental brief arguing that the Government's evidence in the instant case was insufficient under the standard announced in *Newman*, which he urged this Court to adopt. We granted Salman's motion and gave the Government an opportunity to respond.

DISCUSSION

A.

The threshold question is whether Salman waived the present argument by failing to raise it in his opening brief on this appeal, even though he had raised it below and, after Newman was decided, promptly raised it in a supplemental brief that the Government responded to before oral argument. Ordinarily, we will not consider " 'matters on appeal that are not specifically and distinctly argued in appellant's opening brief.' "

However, we make an exception to this general rule (1) for "good cause shown" or "if a failure to do so would result in manifest injustice," (2) "when it is raised in the appellee's brief," or (3) "if the failure to raise the issue properly did not prejudice the defense of the opposing party."

The third exception applies here. As both parties have had a full opportunity to brief this issue and to address it at oral argument, the Government cannot complain of prejudice. Accordingly, we address Salman's claim on the merits.

B.

In reviewing a challenge to the sufficiency of the evidence, we must determine whether, when viewed in the light most favorable to the Government, the evidence was " 'adequate to allow any rational trier of fact to find the essential elements of the crime beyond a reasonable doubt.' " Salman urges us to adopt *Newman* as the law of this Circuit, and contends that, under *Newman*, the evidence was insufficient to find either that Maher Kara disclosed the information to Michael Kara in exchange for a personal benefit, or, if he did, that Salman knew of such benefit.

The "personal benefit" requirement for tippee liability derives from the Supreme Court's opinion in *Dirks v. S.E.C.* Dirks presented an unusual fact pattern. Ronald Secrist, a whistleblower at a company called Equity Funding, had contacted Raymond Dirks, a well-known securities analyst, after Secrist's prior disclosures to the Securities and Exchange Commission ("SEC") had gone for naught. Secrist, for no other purpose than exposing the Equity Funding fraud, disclosed inside information about the company to Dirks, who in turn launched his own investigation that eventually led to public exposure of a massive fraud. However, in the process of his investigation, Dirks openly discussed the information provided by Secrist with various clients and investors, some of whom then sold their Equity Funding stock on the basis of that information. Upon learning this, the SEC charged Dirks with securities fraud, and this position was upheld by an SEC Administrative Law Judge and affirmed by the District of Columbia Circuit, after which certiorari was granted.

When the case came to the Supreme Court, Justice Powell, writing for the Court, began by noting that, whistleblowing quite aside, corporate insiders, in the many conversations they typically have with stock analysts, often accidentally or mistakenly disclose material information that is not immediately available to the public. Thus, "[i]mposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market." At the same time, the Court continued, "[t]he need for a ban on some tippee trading is clear. Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain."

"Thus, the test is whether the insider personally will benefit, directly or indirectly, from his disclosure," for in that case the insider is breaching his fiduciary duty to the company's shareholders not to exploit company information for his personal benefit. And a tippee is equally liable if "the tippee knows or should know that there has been [such] a breach," i.e., knows of the personal benefit.

Of particular importance here, the Court then went on to define what constitutes the "personal benefit" that constitutes the breach of fiduciary duty. It would include, for example, "a pecuniary gain or a reputational benefit that will translate into future earnings." However, "[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend."

The last-quoted holding of *Dirks* governs this case. Maher's disclosure of confidential information to Michael, knowing that he intended to trade on it, was precisely the "gift of confidential information to a trading relative" that *Dirks* envisioned. Indeed, Maher himself testified that, by providing Michael with inside information, he intended to "benefit" his brother and to "fulfill[ ] whatever needs he had." As to Salman's knowledge, Michael Kara, whose testimony we must credit on a challenge to the sufficiency of the evidence, testified that he directly told Salman that it was Michael's brother Maher who was, repeatedly, leaking the inside information that Michael then conveyed to Salman, and that Salman later agreed that they had to "protect" Maher from exposure. Given the Kara brothers' close relationship, Salman could readily have inferred Maher's intent to benefit Michael. Thus, there can be no question that, under *Dirks*, the evidence was sufficient for the jury to find that Maher disclosed the information in breach of his fiduciary duties and that Salman knew as much.

Salman, however, argues that the Second Circuit in *Newman* interpreted Dirks to require more than this. Of course, *Newman* is not binding on us, and our own reading of *Dirks* is guided by the clearly applicable language italicized above. But we would not lightly ignore the most recent ruling of our sister circuit in an area of law that it has frequently encountered.

The defendants in *Newman*, Todd Newman and Anthony Chiasson, both portfolio managers, were charged with trading on material non-public information regarding two companies, Dell and NVIDIA, obtained by a group of analysts at various hedge funds and investment firms. The information came to them via two distinct tipping chains. The Dell tipping chain originated with Rob Ray, a member of Dell's investor relations department. Ray tipped information regarding Dell's earnings numbers to Sandy Goyal, an analyst. Goyal, in turn, relayed the information to Jesse Tortora, another analyst, who relayed it to his manager, Newman, as well as to other analysts including Spyridon Adondakis, who passed it to Chiasson. The NVIDIA tipping chain began with Chris Choi, of NVIDIA's finance unit, who tipped inside information to his acquaintance Hyung Lim, who passed it to Danny Kuo, an analyst, who circulated it to his analyst friends, including Tortora and Adondakis, who in turn gave it to Newman and Chiasson.

Having received this information, Newman and Chiasson executed trades in both Dell and NVIDIA stock, generating lavish profits for their respective funds.

The Government presented the following evidence regarding the relationships between the Dell and NVIDIA insiders and their respective tippees. The Dell tipper and tippee, Ray and Goyal, attended business school together and had been colleagues at Dell, but were not "close." Goyal provided career advice and assistance to Ray, for example, discussing the qualifying examination required to become an analyst and editing his résumé. This advice began before Ray started to give Goyal information, and Goyal testified that he would have given it as a routine professional courtesy without receiving anything in return. As to the NVIDIA tips, the insider, Choi, and his tippee, Lim, were "family friends" who met through church and occasionally socialized with one another. Lim testified that he did not provide anything of value to Choi in return for the tips, and that Choi did not know that he was trading in NVIDIA stock.

The Second Circuit held that this evidence was insufficient to establish that either Ray or Choi received a personal benefit in exchange for the tip. It noted that, although the "personal benefit" standard is "permissive," it "does not suggest that the Government may prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature." Instead, to the extent that "a personal benefit may be inferred from a personal relationship between the tipper and tippee, ... such an inference is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."

Applying these standards, the court concluded that the "circumstantial evidence ... was simply too thin to warrant the inference that the corporate insiders received any personal benefit in exchange for their tips," and furthermore, that "the Government presented absolutely no testimony or any other evidence that Newman and Chiasson knew they were trading on information obtained from insiders, or that those insiders received any benefit in exchange for such disclosures."

Salman reads *Newman* to hold that evidence of a friendship or familial relationship between tipper and tippee, standing alone, is insufficient to demonstrate that the tipper received a benefit. In particular, he focuses on the language indicating that the exchange of information must include "at least a potential gain of a pecuniary or similarly valuable nature," which he reads as referring to the benefit received by the tipper. Salman argues that because there is no evidence that Maher received any such tangible benefit in exchange for the inside information, or that Salman knew of any such benefit, the Government failed to carry its burden.

To the extent *Newman* can be read to go so far, we decline to follow it. Doing so would require us to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an "insider makes a gift of confidential information to a trading relative or friend." Indeed, *Newman* itself recognized that the " 'personal benefit is broadly defined to include not only pecuniary gain, but also, inter alia, ... the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend.' "

In our case, the Government presented direct evidence that the disclosure was intended as a gift of market-sensitive information. Specifically, Maher Kara testified that he disclosed the material nonpublic information for the purpose of benefitting and providing for his brother Michael. Thus, the evidence that Maher Kara breached his fiduciary duties could not have been more clear, and the fact that the disclosed information was market-sensitive—and therefore within the reach of the securities laws, was obvious on its face. If Salman's theory were accepted and this evidence found to be insufficient, then a corporate insider or other person in possession of confidential and proprietary information would be free to disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return. Proof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend is sufficient to establish the breach of fiduciary duty element of insider trading.

In Salman's case, the jury had more than enough facts, as described above, to infer that when Maher Kara gave inside information to Michael Kara, he knew that there was a potential (indeed, a virtual certainty) that Michael would trade on it. And while Salman may not have been aware of all the details of the Kara brothers' relationship, the jury could easily have found that, as a close friend and member (through marriage) of the close-knit Kara clan, Salman must have known that, when Maher gave confidential information to

Michael, he did so with the "intention to benefit" a close relative.

Accordingly, we find that the evidence was more than sufficient for a rational jury to find both that the inside information was disclosed in breach of a fiduciary duty, and that Salman knew of that breach at the time he traded on it.

AFFIRMED.

“An Insider Trading Case Heads to the Supreme Court”

The New York Times

Peter J. Henning

January 20, 2016

The Justice Department got its wish on Tuesday, at least in a backhanded way, when the Supreme Court unexpectedly granted review of an insider trading conviction.

After rejecting the government’s request to review the decision of the United States Court of Appeals for the Second Circuit in *United States v. Newman* in October, which overturned two convictions for insider trading, the Supreme Court decided to review a decision by the United States Court of Appeals for the Ninth Circuit in *United States v. Salman* that upheld a conviction for trading on inside information.

Even though Justice Department lost a number of convictions as a result of the decision in the *Newman* case, the *Salman* case may be a better vehicle for the department to argue that the justices should take a broad view of the circumstances that will support finding that providing inside information was illegal.

To prove an act of tipping is illegal, the Supreme Court stated in 1983 in *Dirks v. S.E.C.*, “the test is whether the insider personally will benefit, directly or indirectly, from his disclosure.” That benefit can be tangible, like money or services, or “when an insider makes a gift of confidential information to a trading relative or friend.”

In the *Newman* case, the United States Court of Appeals for the Second Circuit overturned the convictions of two hedge fund managers, Todd Newman and Anthony Chiasson, who received corporate earnings information through a chain of analysts, never dealing directly with the insiders who made the disclosures. The appeals court found that the jury instructions failed to require a finding that the defendants knew a benefit was passed between the recipients, called the tippees, and their tippers.

In reaching that result, the appeals court also explained that when the violation is based on friendship between tipper and tippee, then the government must show “a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”

That language drew the ire of the Justice Department, which asked the Supreme Court to review the decision. A brief filed by Donald B. Verrilli Jr., the solicitor general, argued that the *Newman* decision effectively rewrote the requirements in the *Dirks* case for proving tipping.

If the case was not overturned, he wrote, it would “hurt market participants, disadvantage scrupulous market analysts, and impair the government's ability to protect the fairness and integrity of the securities markets."

The Supreme Court rejected the government's petition, leaving the appeals court's decision undisturbed.

It is unclear whether the concerns expressed about the potential impact of the *Newman* case were well founded. Just last week, the United States Court of Appeals for the Second Circuit affirmed the conspiracy and securities fraud convictions of David Riley, the former chief information officer at Foundry Networks, for giving information to Matthew G. Teeple, an adviser to a hedge fund, about the impending acquisition of the company by Brocade Communications.

Their relationship was based on friendship, much like in the *Newman* case, but the government's evidence went further than just casual social interactions between them. Mr. Teeple gave Mr. Riley investment advice, assisted in his search for a job and advised an angel investment group Mr. Riley had put together with other former Foundry executives. The appeals court found this sufficient to establish the passing of an "immediately pecuniary tangible benefit" between them, meeting the requirement of the decisions in the *Newman* and *Dirks* cases for a violation.

The Justice Department and the Securities and Exchange Commission may well have made their peace with the *Newman* case, and the result in Mr. Riley's case gave some comfort that the law would not take a strong turn against the government. But just days later came the Supreme Court's announcement that it would review the *Salman* case to consider what the *Dirks* case requires for proving insider trading, calling into question whether the justices might raise the bar for proving liability for tipping.

In that case, Maher F. Kara, a former investment banker at Citigroup, disclosed information about health care deals to his older brother, Michael. The brothers were part of a close family and spoke with each other nearly every day. Maher Kara testified that he gave his brother the information to "benefit him" and "fulfill whatever needs he had."

Bassam Yacoub Salman, in turn, started receiving inside information through Michael, whom Mr. Salman knew because his sister had become Maher Kara's fiancée. Mr. Salman was convicted of trading on the confidential information that Maher Kara took from Citigroup, making a profit of about $1.7 million. No money ever changed hands in exchange for the information, and the benefits were of the type usually seen in that situation: love and affection.

In an interesting twist, the opinion of the Court of Appeals for the Ninth Circuit was written by Judge Jed S. Rakoff of the Federal District Court for the Southern District in Manhattan, who has presided over a number of insider trading cases and was sitting on the appeals court by designation. Although he would normally be bound by the decision in the *Newman* case in a matter in his own courtroom, he was not required to follow it when a different appeals court reviewed a conviction.

The appeals court rejected Mr. Salman's argument that the *Newman* case required showing a tangible benefit beyond the close familial relationship. "To the extent *Newman* can be read to go so far, we decline to follow it," Judge Rakoff wrote. Instead, the opinion concluded there was sufficient evidence that the information "was intended as a gift" to meet the requirements of the Supreme Court's analysis in the *Dirks* case.

The Court of Appeals for the Ninth Circuit did not specifically disagree with the Court of Appeals for the Second Circuit, but it took a more forgiving approach to what is necessary to show a benefit in a tipping case.

Does that mean there is a conflict between the appellate courts that the Supreme Court needs to resolve?

The Justice Department pointed to the conflicting approaches as a reason for the Supreme Court to review the *Newman* case, asking the justices "to restore a uniform interpretation of *Dirks*." But in opposing Mr. Salman's petition for review, the government argued that "review is less warranted here than in *Newman* because the decision that petitioner urges this court to review is correct and wholly consistent with *Dirks*."

In other words, the Justice Department essentially claimed that after refusing to review the *Newman* case, the Supreme Court should just let sleeping dogs lie. That did not persuade the justices, however, especially as the *Salman* case squarely presents the question about how much evidence is needed to prove a benefit when it is based on friendship or family, not something tangible.

Although the Justice Department might have preferred to have the *Newman* case reviewed, the facts underlying Mr. Salman's conviction may give the government a better opportunity to ask the Supreme Court to uphold the conviction. As an initial matter, the jury has already found the evidence sufficient to show a benefit, so the justices may not want to substitute their judgment for that of the jurors.

Mr. Newman and Mr. Chiasson were far removed from the original sources of the inside information, who were never charged for their disclosure. That made it difficult to fathom how a tippee could be liable when the tipper did not rate being accused of violating the law. Thus, it was not difficult to see why the appeals court found that the government's evidence "was simply too thin to warrant the inference that the corporate insiders received any personal benefit in exchange for their tips."

In Mr. Salman's case, on the other hand, there was a close-knit family along with testimony from Maher Kara, the tipper, that he intended to benefit his brother Michael by dispensing highly sensitive deal information. Although earnings projections are passed around with regularity among analysts, information about deals is highly valuable and clearly confidential, so showing that a tippee knew about a benefit when it comes through family ties might be closer to what the Supreme Court has already said is a violation in the *Dirks* case.

Judge Rakoff pointed out that if the evidence of the benefit in Mr. Salman's case was insufficient, "then a corporate insider or other person in possession of confidential and proprietary information would be free to disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return."

Don't be surprised to see the Justice Department quote this line as the primary basis for asking the Supreme Court to uphold the conviction and not impose more onerous requirements for proving that tipping confidential information is a violation. So although the government did not get what it wanted in the *Newman* case, it may get the result it desires – a broad reading of liability for tipping inside information – in the *Salman* case.

“Supreme Court Decides To Weigh In On Insider Trading”

Forbes

Michael Bobelian

January 20, 2016

Months after turning down the Department of Justice’s request to review an appeal of an insider trading case, the Supreme Court yesterday agreed to hear a different insider trading case that has split the nation’s appellate courts.

The case in question, *Salman v. United States*, comes from a Ninth Circuit Court of Appeals case from last year that applied a less stringent legal standard than the one employed by the Second Circuit Court of Appeals in 2014.

It is typical for the Supreme Court to weigh in on circuit splits where federal appellate courts from across the country apply or interpret laws differently. What’s at stake in this case is whether the justices will approve the Ninth Circuit’s methodology, and thereby make it easier for prosecutors to pursue certain types of insider trading claims.

In *U.S. v. Salman*, the Ninth Circuit had to determine whether the defendant’s actions met the standards set out by the Supreme Court in *Dirks v. S.E.C.*, a seminal opinion issued in 1983.

Insider trading is largely a product of judicial decisions rather than federal statutes. As a result, the nation’s federal appellate courts have used *Dirks* as their guide over the years.

The appeal arose over *Dirks‘s* requirement that an original tipper – the first person to share confidential information – gain either “directly or indirectly” from an insider trading transaction.

Under *Dirks*, tippees – the people who receive and trade on confidential information – can only be found guilty of insider trading if they know that the tippers received some “personal benefit” for passing on the illicit information. This standard applies to tippees even if they are two or more steps removed from the original tipper.

In *Salman*, the defendant, Bassam Yacoub Salman, received confidential information about potential health care deals from Michael Kara, who had received it from his brother Maher Kara, designating Maher as a downstream tippee in insider trading parlance.

Salman traded on the information for a profit of little more than $1.7 million but never paid Maher for the information.

The question for the Ninth Circuit was whether Maher saw some direct or indirect gain from the information he had divulged to his brother and whether Salman knew of this personal benefit.

The court found that Maher had indeed received an intangible benefit by helping his brother, with whom he was very close, financially through the exchange of confidential information and that Salman, who became Maher's brother-in-law, knew of the benefits Maher derived from these exchanges.

The Ninth Circuit's ruling sharply differed from the Second Circuit Court of Appeals, which oversees the largest number of insider trading cases because of its location in New York.

In late 2014, the Second Circuit overturned the convictions of Todd Newman and Anthony Chiasson, two hedge fund portfolio managers who were found guilty of trading on confidential information they had received through second-hand sources rather than original tippers. In *U.S. v. Newman*, the Second Circuit had to determine whether the links between Newman and Chiasson and the original tippers were too inconsequential and whether the defendants knew of any tangible benefits accorded to these tippers for their transmission of insider information.

"First, the Government's evidence of any personal benefit received by the alleged insiders was insufficient to establish the tipper liability from which defendants' purported tippee liability would derive," Judge Barrington Parker wrote for the appellate panel. "Second,… the Government presented no evidence that Newman and Chiasson knew that they were trading on information obtained from insiders in violation of those insiders' fiduciary duties."

Newman made it much more difficult to pursue downstream tippees by requiring more direct connections between the original tippers and those that ultimately profited from the confidential information. It also declared that mere friendships or other close relationships are not enough to constitute the personal benefit requirement posed in *Dirks*.

Weeks after the Supreme Court declined to hear the government's appeal in the *Newman* case last October, Preet Bharara, the U.S. Attorney for the Southern District of New York, dropped insider trading charges against seven defendants. "These prosecutions were all undertaken in good faith reliance on what this Office and others, including able defense counsel for all those who pled guilty, understood to be the well-settled law before *Newman*," Bharara said when announcing the move.

When the government filed an appeal to the Supreme Court, it warned that if *Newman* was "allowed to stand, the court of appeals' novel… standard will restrict enforcement of… insider trading."

In *Salman*, the Ninth Circuit sided with the Department of Justice. Following the Second Circuit's approach, the Ninth Circuit declared would "require us to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an 'insider makes a gift of confidential information to a trading relative or friend.'"

The facts in the two cases were not identical, leaving the Supreme Court with an opportunity to borrow from both circuit rulings in arriving at its decision. The justices are set to hear the case later in this term.

“Judge Rakoff Ruling on Tips May Help Prosecution on Insider Trading Cases”

The New York Times

Peter J. Henning

July 7, 2015

Insider trading cases based on the passing of tips seemed endangered after a decision by the federal appeals court in Manhattan in December.

The case, *United States v. Newman*, decided at the end of 2014, reversed the convictions of two hedge fund managers for insider trading. The ruling also troubled prosecutors and the Securities and Exchange Commission, by making it more difficult to prove a violation by requiring proof that a tipper received a tangible benefit in exchange for providing inside information.

It seemed as if all prominent defendants convicted of insider trading, like Raj Rajaratnam and Mathew Martoma, were asking to have their convictions overturned because of the *Newman* opinion.

But a decision from the United States Court of Appeals for the Ninth Circuit in California has taken some of the bite out of the *Newman* decision. That ruling adopts a more favorable standard for proving a violation when inside information is passed among family members.

And in a fascinating twist, the author of the opinion is Jed S. Rakoff, a United States District Court judge in Manhattan, who had earlier expressed concern with the *Newman* decision.

The *Newman* case involved two hedge fund managers — Todd Newman and Anthony R. Chiasson — who were tried together. They were at the end of a chain of analysts who were passing along information about impending corporate earnings announcements, and earning handsome profits by trading ahead of the disclosures.

The United States Court of Appeals for the Second Circuit reversed their convictions, saying that the trial judge had not instructed the jury that it had to find that the defendants knew the original source of the information had received a benefit from tipping off others.

The real problem for the government came in a short discussion about what evidence was needed to establish that the tipper had received an impermissible benefit. The *Newman* opinion asserted that it must involve something more than a casual friendship between the tipper and tippee.

As the court wrote, there must be proof of a "meaningfully close personal relationship" in which there was "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."

The appeals court didn't explain exactly what that meant, leaving an opening for defendants like Mr. Rajaratnam and Mr. Martoma to argue that the government's proof was insufficient.

The Justice Department asked the appeals court to reconsider, a request rejected in April. Prosecutors are considering whether to seek Supreme Court review.

United States v. Salman, which was heard before the United States Court of Appeals for the Ninth Circuit, took a more favorable view of what the government has to prove in a tipping case.

In that case, Maher F. Kara, a former investment banker at Citigroup, provided information about health care deals to his older brother, Michael, who traded on it. The brothers were part of a very close family, speaking with each other nearly every day. Maher Kara testified that he gave his brother the information to "benefit him" and "fulfill whatever needs he had."

Bassam Yacoub Salman, in turn, started receiving the inside information through Michael (Mr. Salman knew the family because his sister had become Maher Kara's fiancée). Mr. Salman was convicted of trading on the confidential information that Maher Kara took from Citigroup. No money ever changed hands, and the benefits Mr. Kara received from Michael were of the type usually exchanged between family members: love and affection.

The *Newman* opinion came out while Mr. Salman's case was before the Ninth Circuit. Mr. Salman argued that the Second Circuit's decision should be applied to his case, asserting that the government did not introduce sufficient evidence that a tangible benefit had been received by Maher Kara.

Judge Rakoff was assigned to the three-judge panel hearing Mr. Salman's appeal under a statute that authorizes federal district judges to sit on an appeals court "whenever the business of that court so requires." Judges are assigned randomly to cases, so it was the luck of the draw that put him on yet another closely watched insider trading case.

This is not the first time Judge Rakoff has considered the scope of the Newman decision. In *S.E.C. v. Payton*, decided in April, he rejected the argument of two defendants who were friends and had sought to dismiss insider trading charges because the S.E.C. had not identified a sufficient benefit being given in exchange for the information.

Judge Rakoff expressed some unease with the *Newman* opinion when he wrote that the appeals court's conclusion about what constitutes a benefit "may not be obvious." He added that the opinion's interpretation of the law did not make it "easy for a lower court" to conform with the Supreme Court decision in *Dirks v. S.E.C.* that established the benefits test.

In *Dirks*, decided in 1983, the Supreme Court said that the benefit to the tipper may be tangible, but can "also exist when an insider makes a gift of confidential information to a trading relative or friend."

Judge Rakoff found that the S.E.C. complaint included enough detail about potential benefits exchanged between the defendants, so the insider case could move forward.

A federal district court must follow the dictates of the appellate court under which it sits, so Judge Rakoff has to follow the precedents of the Second Circuit, including the *Newman* decision. But once he was designated to sit on the Ninth Circuit, he had a freer hand to consider the proper analysis of what type of benefit to a tipper was sufficient for insider trading liability.

In the *Salman* opinion, Judge Rakoff pointed out that the Second Circuit's decision is not binding on the Ninth Circuit, but noted that "we would not lightly ignore the most recent ruling of our sister circuit in an area of law that it has frequently encountered." He wrote that if the *Newman* case meant that every benefit provided to a tipper had to be tangible, then "we decline to follow it" because it would "depart from the clear holding of *Dirks*" that recognized gifts as an acceptable benefit.

Without saying he disagreed with the *Newman* approach, he pointed out that it could go too far in protecting tipping in certain situations. "A corporate insider or other person in possession of confidential and proprietary information would be free to disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return," he wrote.

In finding that passing along information among close family members was sufficient even without proof of a tangible benefit, Judge Rakoff emphasized what a narrower reading of the law might entail.

Judge Rakoff's opinion for the Ninth Circuit did not directly reject the *Newman* decision, which would have set up the type of disagreement among the appeals courts that the Supreme Court might step in to resolve.

Instead, the decision views tipping information among family members as very different from the *Newman* case, in which the participants in the trading were casual social acquaintances with little continuing connection among them. Thus, in Judge Rakoff's view, close family members like those in the *Salman* case do not need anything more than love and affection to establish that there was a benefit received for insider information.

The *Newman* and *Salman* cases set very different limits for the benefit element of tipping. If the defendants are just friends, and perhaps not very good ones, then the benefit to the tipper must have a tangible value. When information passes between close family members, then the benefit is essentially presumed, and additional evidence beyond their relationship is unnecessary.

As more tipping cases work through the system, the courts will have to figure out how they fit under the decisions of both the Second and Ninth Circuits. cases involving more distant relatives, or those who do not interact on a regular basis, may be murkier. Still, an especially close friendship might be enough to establish that giving the information was a gift sufficient to show the benefit.

For prosecutors and the S.E.C., the *Salman* opinion gives them something to point to on what constitutes the requisite benefit in exchange for insider information that avoids the tougher test in the *Newman* decision.

The *Newman* and *Salman* decisions are not taking opposite positions, but are not harmonious, either. Judge Rakoff's opinion limits the effect of the Second Circuit's decision on insider trading law by simply ignoring its benefit analysis for family members passing along inside information. It will be interesting to see whether other courts follow Judge Rakoff's reasoning about the *Newman* decision.

Visa, Inc. v. Stoumbos & *Visa, Inc. v. Osborn*

15-962 & 15-961

Ruling Below: *Osborn v. Visa Inc.*, 797 F.3d 1057 (D.C. Cir. 2015)

A group brought action against a collective of banks and bankcard association, claiming that said collective was in violation of the Sherman Act by engaging in anticompetitive activities. The motion was dismissed, and the motion to amend the complaint was denied. The plaintiffs appealed.

The Court of Appeals held that the plaintiffs had standing to sue, that they had sufficiently alleged their claim of horizontal conspiracy, and that member banks failed to establish withdrawal from conspiracy.

Question Presented: Whether allegations that members of a business association agreed to adhere to the association's rules and possess governance rights in the association, without more, are sufficient to plead the element of conspiracy in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, as the Court of Appeals held below, or are insufficient, as the Third, Fourth, and Ninth Circuits have held.

Sam OSBORN, et al., Appellants
v.
VISA INC., et al., Appellees.

United States Court of Appeals, District of Columbia Circuit

Decided on August 4, 2015

[Excerpt; some citations and footnotes omitted]

Opinion for the Court filed by Circuit Judge WILKINS.

WILKINS, Circuit Judge:

Users and operators of independent (non-bank) automated teller machines (ATMs) brought these related actions against Visa, MasterCard, and certain affiliated banks, alleging anticompetitive schemes for pricing ATM access fees. The crux of the Plaintiffs' complaints is that when someone uses a non-bank ATM, the cardholder pays a greater fee and the ATM operator earns a lower return on each transaction because of certain Visa and MasterCard network rules. These rules prohibit differential pricing based on the cost of the network that links the ATM to the cardholder's bank. In other words, the Plaintiffs allege anticompetitive harm because Visa and MasterCard prevent an independent operator from charging less, and potentially earning more, when an ATM transaction is processed through a network unaffiliated with Visa and MasterCard.

The District Court concluded that the Plaintiffs had failed to allege essential components of standing, and also that they had failed to allege an agreement in restraint of trade cognizable under the Sherman Antitrust Act. We disagree, and so we vacate and remand these cases for further proceedings based on the proposed amended complaint.

I.

ATMs "have been a part of the American landscape since the 1970s—beacons of self-service and convenience, they revolutionized banking in ways we take for granted today." One view is that "[t]hey live to serve; we only really notice them when we can't seem to locate one." But Plaintiffs tell us they do take notice of ATMs—specifically, of the fee structure that attaches to their use and what they gain or lose from it. We credit for purposes of this appeal all facts alleged in the proposed amended complaints.

Some background history: Until the mid–1990s, consumers who wished to withdraw cash from their bank accounts generally could do so only by visiting a bank branch or a bank-operated ATM. But states began to abolish various laws that had prohibited ATM operators from charging access fees directly to cardholders. This created a financial incentive for nonbanks to enter the ATM market, and independent ATMs took root accordingly. These independent ATMs connect to a cardholder's bank through an ATM network. The most popular networks are operated by Visa (the Plus, Interlink, and VisaNet networks) and MasterCard (the Cirrus and Maestro networks).

Today, a cardholder can use any independent ATM to access her bank account, so long as her bank card and the ATM are linked by at least one common network. Most bank cards indicate the networks to which they are linked with logos printed on the back of the card, referred to colloquially as "bugs."

Independent ATM operators rely on two streams of revenue to sustain their businesses. The first is the "net interchange" fee: the gross interchange fee paid by the cardholder's bank to the ATM operator, which runs between $0.00 and $0.60 per transaction, less any network services fee charged by the ATM network. MasterCard and Visa generally charge high network services fees, which means that ATM operators receive low net interchange fees—running between $0.06 and $0.29 for domestic transactions, and even less for international transactions—for transactions on these networks. Several competing networks charge comparatively low network services fees, thus enabling an ATM operator to collect a higher net interchange fee (up to $0.50 per transaction) when using the lower-fee networks.

The second source of revenue comes from the ATM access fees paid by the cardholder. The average access fee in 2012 was $2.10.

Visa and MasterCard each impose, as a condition for ATM operators to access their networks, a sort of nondiscrimination or most favored customer clause called the "Access Fee Rules." These rules provide that no ATM operator may charge customers whose transactions are processed on Visa or MasterCard networks a greater access fee than that charged to any customer whose transaction is processed on an alternative ATM network. Thus, under the Access Fee Rules, operators cannot say to cardholders: "We will charge you $2.00 for a MasterCard or Visa transaction, but if your card has a Star or Credit Union 24 bug on it, we will charge you only $1.75."

Both Visa and MasterCard were owned and operated as joint ventures by a large group of retail banks at the time that the Access Fee Rules were adopted. Although these member banks later relinquished direct control over the bankcard associations through public offerings, the IPOs did not alter the substance of the Access Fee Rules, which remain intact to this day.

Plaintiffs assert that these rules illegally restrain the efficient pricing of ATM services. They characterize the Access Fee Rules as constituting an "anti-steering" regime that prevents independent ATM operators from incentivizing cardholders to choose and use cards "that are more efficient and less costly than either Visa or MasterCard's."

This consolidated appeal arises from decisions in three separate but related civil actions. The first action, *Stoumbos v. Visa*, was filed by a debit cardholder, Mary Stoumbos, who paid access fees in connection with ATM transactions at various independent ATMs. The second action, *Mackmin v. Visa* (referred to here as the Osborn case), was filed by four consumers of independent and bank-run ATM services. The third action, National ATM Council v. Visa, was brought by a leading association of independent ATM operators and several individual ATM operators. The Plaintiffs allege violations of Section 1 of the Sherman Act as well as various state laws, and they name Visa and MasterCard entities as defendants. In addition, the Osborn plaintiffs name certain member banks as co-defendants.

On February 12, 2013, the District Court concluded that the Plaintiffs' respective complaints had failed to allege facts sufficient to establish standing and, in the alternative, lacked adequate facts to establish concerted activity under Section 1 of the Sherman Act. It dismissed not just the complaints, but the cases without prejudice.

In an attempt to toll the statute of limitations, Plaintiffs timely moved the District Court to modify its judgment from dismissal of the cases without prejudice to dismissal of the complaints with leave to replead. Plaintiffs simultaneously submitted proposed amended complaints. On December 19, 2013, the District Court denied Plaintiffs' motions after concluding that their proposed amended complaints still lacked sufficient facts to establish standing or a conspiracy. The Plaintiffs appeal.

II.

Procedural quirks notwithstanding, we review de novo the District Court's determination that the filing of the amended complaints would be futile due to the perceived deficiencies of those complaints under Rules 12(b)(1) and 12(b)(6). To reach that bottom line, we must do some procedural untangling.

The District Court's February 12 order dismissed the cases without prejudice. The principle guiding a dismissal without prejudice is that absent futility or special circumstances (such as undue delay, bad faith, or dilatory motive), a plaintiff should have the opportunity to replead so that claims will be decided on merits rather than technicalities. Where, as it appears was the case here, a plaintiff has not notified the district court that a statute of limitations issue might bar the plaintiff "from correcting the complaint's defects and filing a new lawsuit," a dismissal of the case without prejudice is not an abuse of discretion.

Plaintiffs followed an appropriate course against this background, asking the District Court to modify its judgment pursuant to Rule 59—so that merely the complaint, and not the case, would have been dismissed—and simultaneously filing a proposed amended complaint. In its December 19 opinion on those motions, the District Court asked and answered the essential question—whether leave to amend was futile—but the accompanying order purported to deny on the merits Plaintiffs' motion for leave to amend their complaints, and to deny as moot their motion to modify the February 12 judgment. As a technical matter, the District Court lacked authority to rule on the merits of the Rule 15(a) motion because it did not modify its final judgment dismissing those cases.

Because the District Court's denial of the Plaintiffs' Rule 59(e) motion as moot was based on its conclusion that amendment of the complaints would be futile, see NAC II, 7 F.Supp.3d at 54, we review the decision below as a denial on the merits of the motion to modify the judgment. On this question, we look for abuse of discretion. An abuse of discretion necessarily occurs when a district court misapprehends the underlying substantive law, and we examine the underlying substantive law de novo. In other words, the District Court's futility conclusion turned on a legal determination—here, the sufficiency of the proposed amended complaints under Rule 12(b)(1) or Rule 12(b)(6)—and we review those legal determinations independently of the District Court.

That brings us to the substantive questions we must decide. We look first, as always, at the question of whether the Plaintiffs have standing and second, whether the Plaintiffs' proposed amended complaints adequately stated a claim.

A.

The District Court determined that the Plaintiffs lacked Article III standing because their allegations showed neither injury nor redressability. To establish standing, a plaintiff must show that (i) it has "suffered a concrete and particularized injury in fact, (ii) that was caused by or is fairly traceable to the actions of the defendant, and (iii) is capable of resolution and likely to be redressed by judicial decision."

Plaintiffs contend that "in the absence of the access fee rules, ATM operators would offer consumers differentiated access fees at the point of transaction, consumers would then demand multi-bug PIN cards from their banks, their banks would provide these cards, and the market for network services would become more competitive, all resulting in more choice of networks and lower access fees for consumers." The District Court held that this was an "attenuated, speculative chain of events[ ] that relies on numerous independent actors, including the PIN card issuing banks." We disagree, and we think the District Court was demanding proof of an economic theory that was not required in a complaint.

A plaintiff's burden to demonstrate standing grows heavier at each stage of the litigation. Thus, "[a]t the pleading stage, general factual allegations of injury resulting from the defendant's conduct may suffice, for on a motion to dismiss we presum [e] that general allegations embrace those specific facts that are necessary to support the claim."

Two distinct theories of injury are relevant in this appeal. First is the ATM operators' theory of harm. The operators allege that

MasterCard and Visa, working in concert with the member banks, have maximized their own returns on each transaction, thereby minimizing the independent ATM operators' cut. According to the operators, in a competitive market, the imbalance between low- and high-cost networks “would be corrected by a price differential for the final service, and consumers would respond to lower prices for a fungible service by switching.” But while ATM operators can respond by routing transactions on multi-bugged cards over the lowest priced networks, they are prevented from using differential pricing to incentivize customers to use such cards. As the operator plaintiffs put it, “ATM operators are prohibited from setting the price differential needed to encourage consumers to switch.” Visa and MasterCard are thereby insulated from competition with other networks and can charge supra-competitive network services fees with impunity.

The consumers' theory of harm complements that of the operators. The consumers allege that they pay inflated access fees when they visit ATMs. They believe that the Access Fee Rules inhibit competition in both the network services market and the market for ATM access fees. But for the Rules, some ATM operators would offer discounted access fees for cards linked to lower-cost ATM networks, and this discounting would create downward pressure on access fees generally.

Economic harm, such as that alleged here, “is a classic form of injury-in-fact.” But the Defendants painted Plaintiffs' allegations as speculative and conclusory, and the District Court agreed. The District Court reasoned that the “protracted chain of causation” alleged by Plaintiffs “fails both because of the uncertainty of several individual links and because of the number of speculative links that must hold for the chain to connect the challenged acts to the asserted particularized injury.” This was error.

At the pleadings stage, a court “must accept as true all material allegations of the complaint,” an obligation that we have recognized “might appear to be in tension with the Court's further admonition that an allegation of injury or of redressability that is too speculative will not suffice to invoke the federal judicial power.” But “this ostensible tension is reconciled by distinguishing allegations of facts, either historical or otherwise demonstrable, from allegations that are really predictions.” Thus, “[w]hen considering any chain of allegations for standing purposes, we may reject as overly speculative ... those types of allegations that are not normally susceptible of labelling as ‘true’ or ‘false.’ ”

Plaintiffs' theories here are susceptible to proof at trial. The Plaintiffs allege a system in which Visa and MasterCard insulate their networks from price competition from other networks. This insulation yields higher profits for Visa and MasterCard (and higher returns for their shareholders), at the cost of consumers and independent ATM operators. The economic injury alleged is present and ongoing.

Moreover, the complaints contain factual details, including details about the Plaintiffs' own conduct, that support the alleged causal link between the Access Fee Rules and the economic harm. According to the Plaintiffs, Visa and MasterCard currently capture over half of all ATM transactions, despite charging higher fees than rival networks. Plaintiffs further allege that independent ATM operators (such as the operator plaintiffs) have the desire and technical capacity to offer discounts on cards linked to low-cost networks. They contend that consumers, such as Stoumbos and the Osborn plaintiffs, are “sensitive to differences in ATM Access Fees and where possible will seek out ATMs with the lowest Access Fees.” To be certain, Plaintiffs also rely on certain economic assumptions about supply and demand: that other consumers besides the Plaintiffs are price conscious; that bank operators will respond to consumer demand for cards tied to low-cost networks; and that in the face of competitive pressure, ATM networks will reduce their network fees. But these sorts of assumptions are provable at trial. Indeed, allegations of economic harm “based on standard principles of ‘supply and demand’ ” are “routinely credited by courts in a variety of contexts.”

In deciding that the Plaintiffs had failed to establish injury and redressability, the District Court relied on cases that had been decided at summary judgment. On a motion for summary judgment by a defendant, the question is not whether the plaintiff has asserted a plausible theory of harm, but rather whether the plaintiff has offered sufficient evidence for a reasonable jury to conclude that its theory is correct. A Rule 12(b)(1) motion, however, is not the occasion for evaluating the empirical accuracy of an economic theory. Because the economic facts alleged by the Plaintiffs are specific, plausible, and susceptible to proof at trial, they pass muster for standing purposes at the pleadings stage.

B.

We next turn to the District Court's alternative holding that the Plaintiffs failed to plead adequate facts to establish the existence of concerted activity. Under the familiar Twombly–Iqbal standard, “[t]o survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face.' ”

Section 1 of the Sherman Act prohibits any “contract, combination ... or conspiracy, in restraint of trade or commerce.” Thus, to make out a claim under this section, the Plaintiffs must allege that “the challenged anticompetitive conduct stems from ... an agreement, tacit or express.” If such an agreement is among competitors, we refer to it as a horizontal restraint. The complaints are sufficient if they contain “enough factual matter (taken as true) to suggest that an agreement was made.” We conclude that the Plaintiffs have alleged a horizontal agreement to restrain trade that suffices at the pleadings stage.

According to the Plaintiffs, the member banks developed and adopted the Access Fee Rules when the banks controlled Visa and MasterCard. The rules served several purposes. First and foremost, the rules protected Visa and MasterCard from competition with lower-cost ATM networks, thereby permitting Visa and MasterCard to charge supra-competitive fees. The rules also benefited the banks, who were equity shareholders of the associations (and therefore financial beneficiaries of the deal). And the rules protected banks from competition with each other over the types of bugs offered on bank cards.

That the rules were adopted by Visa and MasterCard as single entities does not preclude a finding of concerted action. The Supreme Court has “long held that concerted action under [Section] 1 does not turn simply on whether the parties involved are legally distinct entities,” but rather depends upon “a functional consideration of how the parties involved in the alleged anticompetitive conduct actually operate.” Thus, “a legally single entity violate[s] [Section] 1 when the entity [i]s controlled by a group of competitors and serve[s], in essence, as a vehicle for ongoing concerted activity.”

The allegations here—that a group of retail banks fixed an element of access fee pricing through bankcard association rules—describe the sort of concerted action necessary to make out a Section 1 claim. Indeed, in 2003 the Second Circuit upheld a trial court's finding that rules adopted by Visa and MasterCard that prohibited member banks from issuing American Express or Discover cards violated Section 1 of the Act.

The Defendants correctly observe that "[m]ere membership in associations is not enough to establish participation in a conspiracy with other members of those associations." But the Plaintiffs here have done much more than allege "mere membership." They have alleged that the member banks used the bankcard associations to adopt and enforce a supracompetitive pricing regime for ATM access fees. That is enough to satisfy the plausibility standard.

Defendants next seek refuge in the fact that the banks reorganized MasterCard and Visa as publicly held corporations in 2006 and 2008, respectively. The Defendants contend that even if there had been agreements or conspiracies, the public offerings terminated them. In their view, the offering constituted a withdrawal by the member banks—and with that withdrawal, the cessation of any concerted action. The Rules that remained intact no longer represented an agreement by the member banks, but rather unilateral impositions by the bankcard associations themselves, over which the banks no longer had control.

To establish withdrawal, a defendant may show that it has taken "[a]ffirmative acts inconsistent with the object of the conspiracy and communicated in a manner reasonably calculated to reach co-conspirators." Even where a member of the conspiracy appears to sever ties with other co-conspirators, there is no withdrawal if that member continues to support or benefit from the agreement. Whether there was an effective withdrawal is typically a question of fact for the jury.

According to the complaints, each member bank "knew and understood that it and each and every other member of the applicable network would agree or continue to agree to be bound" by the rules both before and after the public offerings. To support that allegation, the plaintiffs point out that the banks have continued to issue Visa- and MasterCard-branded cards and to comply with the Access Fee Rules at their own ATMs. Furthermore, even though the banks no longer directly control Visa and MasterCard, the plaintiffs observe, the banks work with those associations to route more transactions over their networks. For example, at least some member banks offer single-bug cards so that independent ATM operators have no choice but to run those transactions over a high-cost network run by Visa or MasterCard. Based on these allegations, a jury could no doubt conclude that, in so doing, the banks continue to protect Visa and MasterCard from price competition. Plaintiffs also allege that several member banks continue to benefit indirectly from the Access Fee Rules. Because the major banks still own shares in Visa and MasterCard, it can be inferred that the banks reap some ongoing financial benefit from increased profits at Visa and MasterCard. And by removing any incentive for customers to demand multi-bugged debit cards, the banks are able to avoid competition with each other on network offerings attached to their cards.

We therefore reject the Defendants' assertion that the public offerings dispelled any hint of conspiracy. The Plaintiffs have adequately alleged an agreement that originated when the member banks owned and operated Visa and MasterCard and which continued even after the public offerings of those associations.

In a final attempt to defeat the proposed complaints, the Defendants contend that even if the Plaintiffs have adequately pleaded standing and agreement, they have failed to state a claim because their allegations do not establish antitrust injury. The Defendants do not provide a meaningful argument as to why antitrust standing is not present here, where the Plaintiffs have alleged that the Access Fee Rules chill competition among network service providers, leading to artificially high access fees for consumers and artificially low margins for the ATM operators. We therefore decline Defendants' invitation to affirm on that basis.

III.

For the foregoing reasons, we hold that the District Court erred in concluding that the Plaintiffs had failed to plead adequate facts to establish standing or the existence of a horizontal conspiracy to restrain trade. We therefore vacate the District Court's December 19 order denying the Plaintiffs' motion to amend the judgment, and we remand for further proceedings consistent with this opinion.

SO ORDERED.

“Supreme Court agrees to review ATM fee antitrust lawsuit”

Reuters

Lawrence Hurley

June 28, 2016

The U.S. Supreme Court on Tuesday agreed to hear appeals by Visa Inc, Mastercard Inc and several U.S. banks seeking to throw out lawsuits claiming they conspired to inflate the prices of ATM access fees in violation of antitrust law.

The high court will hear the companies' bid to overturn an August 2015 ruling by the U.S. Court of Appeals for the District of Columbia Circuit that revived three related class action lawsuits.

The appeals court said a district court erred when it concluded that consumers had no standing to sue and had not adequately alleged antitrust violations. It remanded the three consolidated lawsuits to the district court for further proceedings.

The decision revived two class action suits brought by consumers and another one brought by independent ATM operators.

Their lawsuits accused Visa and MasterCard of adopting rules protecting themselves from competition with a lower-cost ATM network. The rules blocked ATM operators from charging less when ATM transactions were processed by networks competing with Visa and Mastercard, the lawsuits said.

The rules also benefited major banks, which were equity shareholders of Visa and Mastercard, the lawsuits said.

The lawsuits seek damages for consumers and ATM operators for violations of antitrust law.

The lawsuits said that the banks controlled Visa and MasterCard and set higher ATM charges before the credit card companies went public in 2008 and 2006, respectively.

The Supreme Court will hear oral arguments and issue a ruling in its next term, which starts in October and ends in June 2017.

“Supreme Court Will Hear Antitrust Case Over ATM Fees”

The National Law Journal

Zoe Tillman

June 28, 2016

The U.S. Supreme Court on Tuesday agreed to hear an antitrust case that accuses Visa Inc., MasterCard Inc. and three major banks—Bank of America, Chase and Wells Fargo—of conspiring to inflate ATM access fees.

Operators and users of independent ATM machines claim Visa and MasterCard, which run ATM networks, and the banks illegally control how much the ATM operators charge consumers for access. The plaintiffs say that the defendants conspired to adopt and enforce rules that prevent operators from charging consumers lower fees for getting cash via competitor ATM networks.

The case was dismissed in 2013 but was revived last year by the U.S. Court of Appeals for the D.C. Circuit. The appeals court found that the plaintiffs met the standard for pleading antitrust claims over the banks' and networks' roles in setting ATM fee rules.

The banks and networks argued in their petition to the Supreme Court in January that the D.C. Circuit's decision would make participation in a business membership association — in this case, the bankcard associations that banks joined to be part of Visa and MasterCard's ATM networks — a violation of federal antitrust law.

"If firms that participate in business associations must incur the burden of defending costly antitrust litigation and discovery on mere allegations like these, the antitrust laws will become a substantial deterrent to the use of this procompetitive form of business organization," the financial institutions wrote.

The case concerns independent ATM machines that aren't affiliated with a particular bank. Visa and MasterCard operate the most popular networks that connect independent ATMs to cardholders' bank accounts so that they can withdraw cash. At issue is how much the operators charge consumers to get cash via Visa and MasterCard networks, as compared to rival networks.

The ATM operators and users claimed that Visa, MasterCard and the banks conspired to keep their fees high by barring operators from charging lower service fees for consumers' access to less expensive networks. The operators said those rules deprived them of the opportunity to attract consumers who use the cheaper rival networks.

Three lawsuits filed by operators and users were consolidated before U.S. District Judge Amy Berman Jackson of the District of Columbia. She dismissed the cases in 2013, finding that the claims of economic injury were too speculative and that the plaintiffs failed to show how membership in the bankcard associations amounted to collusion under federal antitrust law.

The D.C. Circuit reversed Jackson in August. Judge Robert Wilkins, writing for a three-judge panel, said that Jackson demanded a "proof of economic theory" that wasn't required at that stage of the litigation. On the antitrust claims, Wilkins wrote that the plaintiffs did more than just allege that the banks were part of a membership association.

"They have alleged that the member banks used the bankcard associations to adopt and enforce a supracompetitive pricing regime for ATM access fees," Wilkins wrote. "That is enough to satisfy the plausibility standard."

The membership associations no longer exist, since Visa and MasterCard went public in 2006 and 2008, respectively, and were no longer owned by a group of banks. But the plaintiffs claim the banks continued to hold interests in Visa and MasterCard and that the ATM fee rules did not change after the public offering.

The banks and networks said in their cert petition that the D.C. Circuit's decision conflicted with a 2008 ruling by the Ninth Circuit that rejected an antitrust class action against Visa, MasterCard and banks over merchant discount and credit card interchange fees. The Ninth Circuit held in Kendall v. Visa that membership in an association and adopting the rules of a particular consortium wasn't enough to make out antitrust claims.

The operators and users said their case was different because, as Wilkins wrote, they alleged more than just membership as the basis for the conspiracy.

Skadden, Arps, Slate, Meagher & Flom partner Boris Bershteyn, a lead counsel for the banks and networks, declined to comment. Skadden represents Chase; Arnold & Porter represents Visa; Morrison & Foerster represents Bank of America; Patterson Belknap Webb & Tyler represents Wells Fargo; and Paul, Weiss, Rifkind, Wharton & Garrison represents MasterCard.

Hagens Berman Sobol Shapiro managing partner Steve Berman, a lead attorney for the plaintiffs, said in an email that he was surprised the Supreme Court agreed to hear the case but was "confident we will win." Quinn Emanuel Urquhart & Sullivan also represents the operators and users.

“Judge Reinstates ATM Antitrust Case Against Visa, MasterCard”

The Wall Street Journal

Angela Chen

August 4, 2015

The District of Columbia Circuit Court of Appeals on Tuesday reinstated an antitrust lawsuit brought against Visa Inc. and MasterCard Inc. by a trade association of ATM operators.

Representatives for the two payment-card networks weren’t immediately available for comment.

Consumers, independent ATM operators and the National ATM Council filed the lawsuit in 2011. They alleged Visa’s and MasterCard’s ATM-fee policies suppressed competition because they barred ATM operators from offering discounts to customers who complete transactions over less-costly payment networks.

In 2013, a fedral judge in a 39-page ruling, found several problems with the lawsuits and dismissed them.

“The complaints bristle with indignation, but when one strips away the conclusory assertions and the inferences proffered without factual support, there is very little left to consider,” wrote Judge Amy Berman Jackson at the time.

In reversing the dismissal, the D.C. appellate court ruled that there were grounds for a case because Visa and MasterCard “member banks used the bank associations to adopt and enforce a supracompetitive pricing regime for ATM access fees,” which then made the networks more expensive for ATM operators and consumers to use.

The lawsuit seeks damages against Visa and MasterCard and asks the court to prevent Visa and MasterCard from continuing to restrict how operators charge ATM access fee.

National Labor Relations Board v. SW General, Inc.

15-1251

Ruling Below: *SW Gen., Inc. v. N.L.R.B., 796 F.3d 67 (D.C. Cir. 2015)*

Question Presented: Whether the precondition in 5 U.S.C. 3345(b)(1) on service in an acting capacity by a person nominated by the President to fill the office on a permanent basis, requiring that a person who is nominated to fill a vacant office that is subject to the Federal Vacancies Reform Act may not perform the office's functions and duties in an acting capacity unless the person served as first assistant to the vacant office for at least 90 days in the year preceding the vacancy, applies only to first assistants who take office under subsection (a)(1) of 5 U.S.C. 3345, or whether it also limits acting service by officials who assume acting responsibilities under subsections (a)(2) and (a)(3).

SW GENERAL, INC., doing business as Southwest Ambulance, Petitioner
v.
NATIONAL LABOR RELATIONS BOARD, Respondent.

United States Court of Appeals, District of Columbia Circuit

Decided on August 7, 2015

[Excerpt; some citations and footnotes omitted]

This case involves a labor dispute between an ambulance company and its employees. We do not reach the merits of that dispute, however, because we conclude that Lafe Solomon, the former Acting General Counsel of the National Labor Relations Board (NLRB or Board), served in violation of the Federal Vacancies Reform Act of 1998 (FVRA), 5 U.S.C. §§ 3345 et seq. Accordingly, the unfair labor practice (ULP) complaint issued against the ambulance company was unauthorized. We grant the petition for review, deny the cross-application for enforcement and vacate the Board's order.

I. BACKGROUND

A. Vacancy Statutes

The FVRA is a response to what Chief Justice John Marshall called "the various crises of human affairs"—problems that arise when our Constitution confronts the realities of practical governance. Specifically, the Appointments Clause generally requires "Officers of the United States" to be nominated by the President "by and with the Advice and Consent of the Senate." Advice and consent is "more than a matter of etiquette or protocol"; it is a "structural safeguard[ ]" intended to "curb Executive abuses of the appointment power" and to "promote a judicious choice of persons for filling the offices of the union." But vacancies can occur unexpectedly (due to death, resignation, illness, etc.) and the confirmation process takes time. To keep the federal bureaucracy humming, the President needs the power to appoint acting officers who can serve on a temporary basis without first obtaining the Senate's blessing.

Since the "beginning of the nation," the Congress has given the President this power through vacancy statutes. The predecessor to the FVRA, the Vacancies Act, was first enacted in 1868. The Vacancies Act allowed the President to fill vacancies with temporary acting officers, subject to limitations on whom he could appoint and how long the appointee could serve.

Presidents, however, have not always complied with the Vacancies Act. By 1998, an estimated 20% of all officers in positions requiring presidential nomination and Senate confirmation (PAS positions) were serving in a temporary acting capacity, many well beyond the time limits prescribed in the Vacancies Act. Nor was the Vacancies Act particularly amenable to judicial enforcement. In *Doolin*, for example, we did not decide whether the acting director of the Office of Thrift Supervision lacked statutory authority because we determined that any error in his appointment was cured. We relied on the doctrine of ratification: because the director's decision was later approved by a properly appointed director, any defect in his appointment was immaterial. Our decision in *Doolin*, along with the President's appointment of Bill Lann Lee to be Acting Attorney General of Civil Rights in 1997, prompted congressional action.

In June 1998, Senators Fred Thompson, Robert Byrd, Strom Thurmond and others introduced the FVRA to strengthen, and ultimately replace, the Vacancies Act. The statute was framed as a reclamation of the Congress's Appointments Clause power. After some amendment, the FVRA was enacted in October 1998.

The FVRA provides that, in the event of a vacancy in a PAS position, the "first assistant" automatically takes over in an acting capacity. 5 U.S.C. § 3345(a)(1). The President can also choose to appoint a senior employee from the same agency or a PAS officer from another agency to serve as the acting officer. Generally speaking, an acting officer can serve no longer than 210 days and cannot become the permanent nominee for the position. Moreover, in response to *Doolin*, the FVRA renders actions taken by persons serving in violation of the Act void ab initio.

B. NLRB General Counsel Vacancy

Under the National Labor Relations Act (NLRA), the General Counsel of the NLRB must be appointed by the President with the advice and consent of the Senate. He is primarily responsible for prosecuting ULP cases before the Board. Indeed, the Board cannot adjudicate a ULP dispute until the General Counsel decides a charge has merit and issues a formal complaint. To manage the volume of ULP charges filed each year, the General Counsel has delegated his authority to investigate charges and issue complaints to thirty-two regional directors. The General Counsel, however, retains "final authority" over charges and complaints and exercises "general supervision" of the regional directors.

In June 2010, Ronald Meisburg resigned as NLRB General Counsel. The President directed Lafe Solomon, then—Director of the NLRB's Office of Representation Appeals, to serve as the Acting General Counsel in Meisburg's stead. The President cited the FVRA as the authority for Solomon's appointment. On January 5, 2011—six months into Solomon's temporary appointment—the President nominated him to be General Counsel. The Senate, however, returned Solomon's nomination. The President resubmitted Solomon's nomination on May 24, 2013, but ultimately withdrew it and nominated Richard Griffin instead, who was confirmed by the Senate on October 29, 2013. All told, Solomon served as Acting General Counsel from June 21, 2010 to November 4, 2013.

C. Board Proceedings Against Southwest

SW General, Inc. (Southwest) provides ambulance services to hospitals in Arizona. Its emergency medical technicians, nurses and paramedics are represented by the International Association of Fire Fighters Local I–60, AFL–CIO (Union). The most recent collective bargaining agreement between Southwest and the Union contained a "Longevity Pay" provision, guaranteeing annual bonuses to Southwest employees who had been with the company for at least ten years. In December 2012—after the collective bargaining agreement expired but before the parties negotiated a replacement—Southwest stopped paying the longevity bonuses.

The Union immediately filed a ULP charge with the NLRB. Regional Director Cornele Overstreet issued a formal complaint on January 31, 2013, alleging that Southwest had unilaterally discontinued longevity payments in violation of sections 8(a)(1) and 8(a)(5) of the NLRA. After a hearing, an administrative law judge (ALJ) agreed that Southwest had committed a ULP. Southwest filed fifteen exceptions to the ALJ's decision, the second of which challenged the ULP complaint on the ground that Acting General Counsel Solomon was serving in violation of the FVRA. In May 2014, the NLRB adopted the ALJ's recommended order with only minor modifications and it did not address Southwest's FVRA challenge.

Southwest petitioned this Court for review and the Board cross-petitioned for enforcement. We have jurisdiction pursuant to 29 U.S.C. § 160(f), (e).

II. ANALYSIS

Southwest maintains that, as of January 2011, Acting General Counsel Solomon was serving in violation of the FVRA and, thus, the ULP complaint issued against it in January 2013 was invalid. Specifically, Southwest argues that Solomon became ineligible to serve as Acting General Counsel once the President nominated him to be General Counsel. In its original brief, the Board vigorously contested Southwest's reading of the statute but made no argument—except in a lone footnote—about the consequences of an FVRA violation. We therefore asked the parties to submit supplemental briefs addressing whether an FVRA violation, assuming one occurred, would nonetheless be harmless error. With the benefit of the parties' arguments, we now conclude that (A) Solomon was serving in violation of the FVRA when the complaint issued against Southwest and (B) the violation requires us to vacate the Board's order.

A.

The key provision of the FVRA, for present purposes, is section 3345. For ease of reference, we quote the provision in full:

> § 3345. Acting officer
> (a) If an officer of an Executive agency (including the Executive Office of the President, and other than the Government Accountability Office) whose appointment to office

is required to be made by the President, by and with the advice and consent of the Senate, dies, resigns, or is otherwise unable to perform the functions and duties of the office—

(1) the first assistant to the office of such officer shall perform the functions and duties of the office temporarily in an acting capacity subject to the time limitations of section 3346;

(2) notwithstanding paragraph (1), the President (and only the President) may direct a person who serves in an office for which appointment is required to be made by the President, by and with the advice and consent of the Senate, to perform the functions and duties of the vacant office temporarily in an acting capacity subject to the time limitations of section 3346; or

(3) notwithstanding paragraph (1), the President (and only the President) may direct an officer or employee of such Executive agency to perform the functions and duties of the vacant office temporarily in an acting capacity, subject to the time limitations of section 3346, if—

(A) during the 365–day period preceding the date of death, resignation, or beginning of inability to serve of the applicable officer, the officer or employee served in a position in such agency for not less than 90 days; and

(B) the rate of pay for the position described under subparagraph (A) is equal to or greater than the minimum rate of pay payable for a position at GS–15 of the General Schedule.

(b)(1) Notwithstanding subsection (a)(1), a person may not serve as an acting officer for an office under this section, if—

(A) during the 365–day period preceding the date of the death, resignation, or beginning of inability to serve, such person—

(i) did not serve in the position of first assistant to the office of such officer; or

(ii) served in the position of first assistant to the office of such officer for less than 90 days; and

(B) the President submits a nomination of such person to the Senate for appointment to such office.

(2) Paragraph (1) shall not apply to any person if—

(A) such person is serving as the first assistant to the office of an officer described under subsection (a);

(B) the office of such first assistant is an office for which appointment is required to be made by the President, by and with the advice and consent of the Senate; and

(C) the Senate has approved the appointment of such person to such office.

(c)(1) Notwithstanding subsection (a)(1), the President (and only the President) may direct an officer who is nominated by the President for reappointment for an additional term to the same office in an Executive department without a break in service, to continue to serve in that office subject to the time limitations in section 3346, until such time as the Senate has acted to confirm or reject the nomination, notwithstanding adjournment sine die.

(2) For purposes of this section and sections 3346, 3347, 3348, 3349, 3349a, and 3349d, the expiration of a term of office is an inability to perform the functions and duties of such office.

Solomon became Acting General Counsel pursuant to subsection (a)(3)—the senior agency employee provision. As the Director of the Office of Representation Appeals for the previous ten years, Solomon easily met the salary and experience requirements of that subsection. According to Southwest, however, Solomon could no longer serve as Acting General Counsel once the President nominated him in January 2011 to be General Counsel. Subsection (b)(1) of the FVRA prohibits a person from being both the acting officer and the permanent nominee unless (1) he served as the first assistant to the office in question for at least 90 of the last 365 days or (2) he was confirmed by the Senate to be the first assistant. Solomon was never a first assistant at all so the exceptions plainly do not apply to him. The Board, however, contends that the prohibition in subsection (b)(1) governs only an acting officer who assumes the position pursuant to subsection (a)(1), not an acting officer who is directed to serve by the President pursuant to subsections (a)(2) or (a)(3). Thus, the pivotal question is whether the prohibition in subsection (b)(1) applies to all acting officers, as Southwest contends, or just first assistants who become acting officers by virtue of subsection (a)(1), as the Board contends. Considering this question de novo, we think Southwest has the better argument.

The first independent clause of subsection (b)(1) is the clearest indication of its overall scope. That clause states that “a person may not serve as an acting officer for an office under this section.” The term “a person” is broad; it covers the full spectrum of possible candidates for acting officer. And the phrase “this section” plainly refers to section 3345 in its entirety. Throughout the FVRA, the Congress was precise in its use of internal cross-references. If the Congress had wanted to enact the Board's understanding, it would have said “first assistant” and “that subsection” instead of “a person” and “this section.” Thus, the plain language of subsection (b)(1) manifests that no person can serve as both the acting officer and the permanent nominee (unless one of the exceptions in subsections (b)(1)(A) or (b)(2) applies).

The Board's main argument to the contrary focuses on the first dependent clause in subsection (b)(1): “Notwithstanding subsection (a)(1).” According to the Board, the “notwithstanding” clause limits subsection (b)(1)'s prohibition to first assistants who become acting officers pursuant to subsection (a)(1). There are several flaws with this argument. For starters, it is not what the word “notwithstanding” means. “Notwithstanding” means “in spite of,” not, as the Board would have it, “for purposes of” or “with respect to.” Here, then, the “notwithstanding” clause means “to the extent that subsection (a)(1) deviates from subsection (b)(1), subsection (b)(1) controls.” The Congress likely referenced subsection (a)(1) to clarify that its command—that the first assistant “shall” take over as acting officer—does not supersede the prohibition in subsection (b)(1). But, apart from setting out an order of operations, the “notwithstanding” clause has no significance for the ultimate scope of subsection (b)(1).

Context further refutes the Board's “notwithstanding” argument. As discussed, the Board's interpretation of “notwithstanding” is irreconcilable with the breadth of the words “a person” and “this section” in the remainder of the introductory clause. Indeed, the only other time section 3345 uses the phrase “a person” is in subsection (a)(2) and, there, the phrase is plainly not limited to a first assistant. Moreover, the Congress used the word “notwithstanding” several times in section

3345. Each time, it plainly meant “in spite of” rather than “with respect to.” “It is a well established rule of statutory construction that a word is presumed to have the same meaning in all subsections of the same statute.” Similarly, the Congress used the phrase “For purposes of” in subsection (c)(2), which shows that it knew how to use limiting language when it wanted to. The Board's crabbed interpretation of “notwithstanding” simply does not pass muster.

Further, the Board's reading of subsection (b)(1)—but not Southwest's—renders other provisions of section 3345 superfluous. In the Board's view, subsection (b)(1) applies only to subsection (a)(1)—the first assistant provision. Although we do not decide its meaning today, subsection (a)(1) may refer to the person who is serving as first assistant when the vacancy occurs. Under this reading, subsection (a)(1) provides a default rule that automatically promotes someone (the current first assistant) to be the acting officer without a break in service and without action by the President. But if subsection (a)(1) refers to the first assistant at the time of the vacancy, then the condition in subsection (b)(1)(A)(i)—that the person “did not serve in the position of first assistant to the office” in the prior 365 days—is inoperative because the current first assistant necessarily served as the first assistant in the previous year. If Southwest is correct that subsection (b)(1) applies to all acting officers, however, then subsection (b)(1)(A)(i) is not superfluous because many PAS officers (subsection (a)(2)) and senior agency employees (subsection (a)(3)) will not have served as the first assistant in the prior year.

At oral argument, the Board argued—consistent with a revised OLC opinion—that subsection (a)(1) also applies to a person who becomes first assistant after the vacancy occurs. This interpretation, the Board contends, gives a nonsuperfluous meaning to subsection (b)(1)(A)(i). Yet, the Board's interpretation faces another surplusage problem. Section 3345(b)(2)(A) allows an acting officer to also be the permanent nominee if, inter alia, he “is serving as [a] first assistant.” But the current first assistant—whether he became first assistant before or after the vacancy—is necessarily serving as a first assistant. The Board's interpretation (which reads “person” in subsection (b) to mean “first assistant”) creates surplusage whereas Southwest's interpretation (which reads “person” to mean “first assistant, PAS officer or senior agency employee”) does not.

Perhaps sensing the weakness of its textual arguments, the Board falls back on legislative history and statutory purpose to support its interpretation. Its argument needs to be quite strong because, to repeat, the text of the FVRA plainly supports Southwest. As we shall see, however, the Board's argument is anything but.

The Board first points to a floor statement by Senator Thompson, the chief sponsor of the FVRA. Thompson presaged the Board's view, stating, “Under § 3345(b)(1), the revised reference to § 3345(a)(1) means that this subsection applies only when the acting officer is the first assistant, and not when the acting officer is designated by the President pursuant to §§ 3345(a)(2) or 3345(a)(3).” Yet, a statement of a single Senator—even the bill's sponsor—is only weak evidence of congressional intent. Moreover, Thompson was immediately contradicted by Senator Byrd—an “original sponsor” of the FVRA. Byrd's statement6 hewed much more closely to the statutory text and suggested that subsection (b)(1) applies to all categories of acting officers. Thus, the floor statements are a wash. And Senator Thompson's statement is certainly not enough to overcome the FVRA's clear text.

The Board next cites a Senate committee report to buttress its interpretation. The report states that “a first assistant who has not received Senate confirmation, but who is nominated to fill the office permanently, can be made the acting officer only if he has been the first assistant for at least 180 days in the year preceding the vacancy.” The committee report, however, is inapposite because it discusses a different version of the FVRA from the one ultimately enacted. Specifically, an earlier draft of subsection (b) provided:

(b) Notwithstanding section 3346(a)(2), a person may not serve as an acting officer for an office under this section, if—

(1) on the date of the death, resignation, or beginning of inability to server of the applicable officer, such person serves in the position of first assistant to such officer;

(2) during the 365–day period preceding such date, such person served in the position of first assistant to such officer for less than 180 days; and

(3) the President submits a nomination of such person to the Senate for appointment to such office.

This version of subsection (b) manifestly applies to first assistants only. But the version ultimately enacted looks quite different. In fact, the change in phraseology weighs somewhat against the Board's interpretation. Finally, the Board contends that Southwest's interpretation of subsection (b)(1) defeats the purpose behind subsections (a)(2) and (a)(3): namely, “expanding the pool of potential acting officers beyond first assistants.” But accepting Southwest's interpretation in no way decreases the pool of people eligible to be an acting officer; it merely decreases the pool of people eligible to be both the acting officer and the permanent nominee.

In short, the text of subsection (b)(1) squarely supports Southwest's interpretation and neither the legislative history nor the purported goal of the FVRA helps the Board. We therefore hold that the prohibition in subsection (b)(1) applies to all acting officers, no matter whether they serve pursuant to subsection (a)(1), (a)(2) or (a)(3). Because Solomon was never a first assistant and the President nominated him to be General Counsel on January 5, 2011, the FVRA prohibited him from serving as Acting General Counsel from that date forward.

B.

Having concluded that Solomon was serving in violation of the FVRA when the ULP complaint issued against Southwest, we must now determine the consequence of that violation. Southwest believes we must vacate the Board's order. If the violation had occurred in the typical federal office, we might agree. The FVRA renders any action taken in violation of the statute void ab initio: section 3348(d) declares that “[a]n action taken by any person who is not acting [in compliance with the FVRA] shall have no force or effect” and “may not be ratified.” Moreover, without a valid complaint, the Board could not find Southwest liable for a ULP.

But this is not the typical case. Section 3348(e)(1) exempts “the General Counsel of the National Labor Relations Board” from the provisions of “section [3348],” including the void-ab-initio and no-ratification rules. The Board contends that section 3348(e)(1) allows it to raise arguments like harmless error and the de facto officer doctrine. We therefore assume that section 3348(e)(1) renders the actions of an improperly serving Acting General Counsel voidable, not void, and consider the two arguments the Board posits in its supplemental brief. We express no view on whether section 3348(e)(1) could be understood more broadly to wholly insulate the Acting General Counsel's actions even in the event of an FVRA violation. We similarly express no view on defenses the Board never raised.

i. Harmless Error

We first address the "rule of prejudicial error." As previously discussed, we held in *Doolin* that any statutory defect in the acting director's authority was cured because a subsequent, properly appointed director ratified his actions. The Board does not rely on *Doolin*'s holding—understandably, inasmuch as no properly appointed General Counsel ratified the ULP complaint against Southwest. The Board instead relies on a paragraph of dicta from *Doolin*. In *Doolin*, we analogized a complaint in an administrative enforcement proceeding to a grand jury indictment in a criminal proceeding. Defects in a grand jury indictment do not constitute reversible error, *Doolin* noted, unless they "prejudiced" the defendant. And a defect does not prejudice the defendant if a petit jury subsequently finds him guilty beyond a reasonable doubt. The same logic might apply, we postulated in *Doolin*, if an agency adjudicator finds a petitioner liable despite a defective administrative complaint. *Doolin* ultimately declined to rely on this hypothesis, however, because the parties had not briefed it. Here, on the other hand, the Board brings *Doolin* 's dicta to the forefront and argues that the NLRB's final order renders harmless any defect in the ULP complaint against Southwest.

The grand jury analogy in *Doolin*, like the doctrine of harmless error generally, focuses on the existence vel non of "prejudice[ ]" to the petitioner. But a petitioner need not demonstrate prejudice in the first place if the alleged error is "structural" in nature. In the grand jury context, for example, the occurrence of race or sex discrimination in the selection of grand jurors constitutes a structural error that warrants automatic reversal. In the agency context, we concluded in *Landry* that "[i]ssues of separation of powers" are structural errors that do not require a showing of prejudice because "it will often be difficult or impossible for someone subject to a wrongly designed scheme to show that the design—the structure—played a causal role in his loss." "[D]emand for a clear causal link to a party's harm" would frustrate the " 'prophylactic' " goal of the separation of powers—i.e., " 'establishing high walls and clear distinctions because low walls and vague distinctions will not be judicially defensible in the heat of interbranch conflict.' " *Landry* rejected the argument that subsequent de novo review by the Federal Deposit Insurance Commission could render harmless the fact that the ALJ was serving in violation of the Appointments Clause. "If the process of final de novo review could cleanse the violation of its harmful impact," Landry reasoned, "then all such arrangements would escape judicial review."

Southwest contends that an FVRA violation is a structural error that cannot be rendered harmless by subsequent de novo review. We do not reach that question, however, because we agree with another one of Southwest's arguments. Specifically, the grand jury analogy from *Doolin* is ill-suited in this case. In a criminal proceeding, the grand jury and petit jury are similarly situated and have the same basic task: determining the defendant's guilt under the requisite standard of proof ("probable cause" and "beyond a reasonable doubt," respectively). As such, "[a] later conviction by a petit jury supplies virtual certainty that a properly constituted grand jury would have indicted." Here, however, we lack the same certainty. The NLRB General Counsel is statutorily independent from the Board, and he has "final authority" over the issuance of ULP complaints. He essentially exercises prosecutorial discretion: he need not issue a complaint even if he believes a ULP was committed. Moreover, the General Counsel sets the enforcement priorities for the NLRB and generally supervises its lawyers. During oral argument, the Board conceded that, if the General Counsel's office were vacant, the NLRB "would not be issuing complaints." The Board nonetheless argued that, because the type of ULP charged against Southwest was not "of substantial legal interest" to Acting General Counsel Solomon, that particular complaint did not require submission to the General Counsel's Office for review beforehand. Southwest rightly points out, however, that a different General Counsel may have imposed different requirements and procedures during his tenure. Accordingly, notwithstanding the final Board order, we cannot be confident that the complaint against Southwest would have issued under an Acting General Counsel other than Solomon. Our uncertainty is sufficient to conclude that Southwest has carried its burden of demonstrating that the FVRA violation is non-harmless under the Administrative Procedure Act. We therefore conclude that the NLRB order did not ratify or otherwise render harmless the FVRA defect in the ULP complaint against Southwest. We note, however, that our conclusion does not control whether the ineligibility of an official with prosecutorial responsibilities in other contexts should be considered harmless.

ii. De Facto Officer Doctrine

The only other argument in the Board's supplemental brief is the de facto officer doctrine. This oft-forgotten doctrine has "feudal origins," dating back to the 15th century. The doctrine "confers validity upon acts performed by a person acting under the color of official title even though it is later discovered that the legality of that person's appointment or election to office is deficient." In its most recent cases, however, the Supreme Court has limited the doctrine, declining to apply it when reviewing Appointments Clause challenges, and important statutory defects to an adjudicator's authority.

In its traditional form, the de facto officer doctrine distinguishes between "direct" and "collateral" attacks on an officer's authority. A collateral attack challenges "government action on the ground that the officials who took the action were improperly in office." The de facto officer doctrine bars such attacks. A direct attack, by contrast, challenges "the qualifications of the officer, rather than the actions taken by the officer." The de facto officer doctrine allows such attacks but they can be brought via writ of quo warranto only. To obtain quo warranto against a federal official, an interested party must petition the Attorney General of the United States to institute a proceeding in federal district court. If the Attorney General declines, the interested party can petition the court to issue the writ instead. Both the Attorney General and the court, however, have "broad discretion" to decline to make use of quo warranto.

This Court has rejected the traditional version of the de facto officer doctrine. Direct action via quo warranto is too "cumbersome," we explained in Andrade, and "could easily operate to deprive a plaintiff with an otherwise legitimate claim of the opportunity to have his case heard." We disapprove of any "interpretation of the de facto officer doctrine that ... would render legal norms concerning appointment and eligibility to hold office unenforceable." Instead, we have held that collateral attacks on an official's authority are permissible when two requirements are satisfied:

> First, the plaintiff must bring his action at or around the time that the challenged government action is taken. Second, the plaintiff must show that the agency or department involved has had reasonable notice under all the circumstances of the claimed defect in the official's title to office.

Both requirements are met here.

The first requirement, as stated in *Andrade*, appears on its face not to fit this case. The plaintiffs in *Andrade* filed a separate suit for injunctive and declaratory relief, which explains the Court's instruction to "bring [an] action at or around the time the challenged government action is taken." Here, by contrast, Southwest is subject to an enforcement action brought by the NLRB. In these circumstances, we have held, a party satisfies the first *Andrade* requirement if it challenges an officer's authority as a defense to the enforcement action. Of course, the ordinary rules of exhaustion and forfeiture still apply. In the administrative proceedings below, Southwest raised its FVRA challenge as an exception to the ALJ decision. It therefore complied with the NLRA's jurisdictional exhaustion requirement. And the Board does not assert that Southwest's challenge was otherwise untimely or forfeited. Thus, we assume it was properly preserved.

Nor does the Board contest that the second Andrade requirement—notice—is also satisfied here. To meet this requirement, "the agency ... [must] actually know[ ] of the claimed defect." Notice ensures that the agency has a chance to "remedy any defects (especially narrowly technical defects) either before it permits invalidly appointed officials to act or shortly thereafter." Here, Southwest notified the NLRB of the defect in Solomon's authority by excepting to the ALJ decision. The Board does not challenge the adequacy of this notice. Moreover, the notice requirement is satisfied if the agency learns of the defect from any source, not only the petitioner. The Board has not informed us when it first became aware of Solomon's problematic service. We therefore cannot say that its notice of the FVRA defect was inadequate. Accordingly, we conclude that the de facto officer doctrine does not bar Southwest from challenging Solomon's authority.

Finally, we emphasize the narrowness of our decision. We hold that the former Acting General Counsel of the NLRB, Lafe Solomon, served in violation of the FVRA from January 5, 2011 to November 4, 2013. But this case is not Son of Noel Canning and we do not expect it to retroactively undermine a host of NLRB decisions. We address the FVRA objection in this case because the petitioner raised the issue in its exceptions to the ALJ decision as a defense to an ongoing enforcement proceeding. We doubt that an employer that failed to timely raise an FVRA objection—regardless whether enforcement proceedings are ongoing or concluded—will enjoy the same success.

For the foregoing reasons, we grant the petition for review, deny the cross-application for enforcement and vacate the NLRB order. So ordered.

“U.S. justices to mull president's power to nominate officials”

Reuters

Robert Iafolla

June 20, 2016

The U.S. Supreme Court agreed on Monday to review a lower court decision that invalidated part of a former U.S. labor board official’s tenure, in a case that could curb the next president’s power to staff top positions in his or her administration.

The justices will hear an appeal of a 2015 decision by the U.S. Court of Appeals for the D.C. Circuit saying that once President Barack Obama nominated Lafe Solomon in 2011 to be general counsel of the National Labor Relations Board (NLRB), Solomon should not have continued to fill the position on a temporary or "acting" basis pending Senate confirmation.

The appeals court said a 1998 federal law bars anyone from serving in an acting role while they are the nominee unless they were previously the "first assistant" to that post.

The Supreme Court’s ruling in the case could decide if the White House can temporarily fill high-level administration positions with nominees waiting for confirmation, which could take on added importance if the next president faces protracted nomination battles in the Senate.

The case will give the Supreme Court a second chance to weigh in on executive branch authority related to filling positions at the NLRB. In 2014, the court in *NLRB v. Noel Canning* ruled that three 2013 appointments Obama made to the board while Congress was in recess were invalid.

Although Obama withdrew Solomon’s stalled nomination in 2013, about six current high-level officials are serving on an acting basis while they await a Senate vote, including officials at the Department of Health and Human Services and the Environmental Protection Agency, the NLRB said in its petition for review.

Former presidents Bill Clinton and George W. Bush also tapped officials to permanently fill the posts that they were manning in a temporary capacity, the NLRB said.

Clinton, Bush and Obama all relied on an interpretation of the Federal Vacancies Reform Act that viewed the restriction on first assistants as only applying to people who automatically become acting officers under a chain of command, rather than those nominated by the president, the NLRB said.

But the D.C. Circuit, as well as the 9th U.S. Circuit Court of Appeals in a 2016 ruling, have disagreed.

The case is *NLRB v. SW General Inc*, No. 15-1251, in the U.S. Supreme Court.

“Again, the president’s power to appoint is at issue”

SCOTUSblog

Lyle Denniston

June 20, 2016

For the second time in two years, the Supreme Court on Monday assigned itself the task of clarifying the president’s power to fill government posts — even as the Court awaits a nominee to join its own ranks. The new case — like one in 2014 — involves the staffing of the National Labor Relations Board. At issue this time is when the president may name someone to perform a high-level federal office in an “acting” capacity, affecting many posts throughout the bureaucracy.

In another newly granted case, the Court will clarify the federal government’s power to hold in detention people who have no legal right to enter or be in the country, pending their deportation. Both that and the appointments case will be heard and decided at the Court’s next Term, starting in October. At this point, it may be that both cases will be heard by an eight-Justice Court, because of the continuing uncertainty over a nominee to succeed the late Justice Antonin Scalia. There is no provision in federal law for naming an “acting” Justice when there is a vacancy.

In a third significant action on Monday, the Court declined to consider Second Amendment challenges to state bans on assault weapons, in Connecticut and New York. That echoed a similar refusal last December to review the constitutionality of such a ban in a Chicago suburb, Highland Park. Turned aside this time were the Connecticut case of *Shew v. Malloy* and the New York case of *Kampfer v. Cuomo*. No Justice noted a dissent from either denial. Justice Clarence Thomas had dissented when the Court passed up the issue in December; he was joined at that time by Scalia.

In addition, the Court asked for the federal government’s view on whether it should hear two new patent disputes. The combined cases of *Amgen v. Sandoz* and *Sandoz v. Amgen* grow out of a decision by the U.S. Court of Appeals for the Federal Circuit adding more time to the supposedly abbreviated process of government approval of the marketing of “biosimilars” — that is, products that are similar to existing biologics, now a major source of new products for medical treatment. In the case of *Impression Products v. Lexmark International*, a dispute over the sale of refilled toner cartridges for computer printers raises the issue of when a patent holder loses exclusive rights after the item has been sold, if post-sale restrictions have been imposed. There is no time limit for the U.S. Solicitor General to offer the government’s views.

The new dispute over presidential appointment powers — NLRB v. SW General Inc. — revolves around the meaning of a federal law that was passed in 1998 in a move by Congress to curb the use of "acting" appointments to fill spots in government offices without going through the Senate confirmation process. There is no constitutional issue involved this time, as there was in 2014 when the Court ruled in *NLRB v. Noel Canning* that the president has limited authority under the Constitution to fill a government position when the Senate was in recess and thus unable to act on a nominee.

Congress has been controlling the authority of the president to fill vacancies since it first passed a law on that subject in 1898. The lawmakers decided to put new limits on that authority in 1998; at that time, one out of every five officials whose job required presidential nomination and Senate confirmation were serving in an "acting" capacity well beyond the time limits specified in the 1898 law.

The Federal Vacancies Reform Act was passed to reclaim the Senate's role on filling vacancies to high-level government posts. At issue in the new NLRB case is the scope of presidential authority to give someone an "acting" assignment if the president has nominated that person to the position but the Senate has not yet acted. The dispute involves President Obama's appointment of an "acting" general counsel of the NLRB. The general counsel has the final authority to issue complaints of unfair labor practices in management-labor dealings.

Contents of the article, broken into two separate columns, like so

SW General Inc., which operates ambulance services in Arizona, challenged a decision that it had committed an unfair labor practice in ending a system of annual bonuses for emergency technicians, nurses, and paramedics. The board's action was illegal because the case was initiated by an "acting" general counsel whom the president did not have the power to appoint, the company contended.

The Supreme Court will act on the question of presidential power without ruling on the particular unfair labor practice case that gave rise to that question.

In the other case in which the Court granted review on Monday, *Jennings v. Rodriguez*, the Court is being asked by the federal government to reinforce its authority to hold foreign nationals in detention while the issue of deportation is under review. The specific issue is whether the government must hold a hearing, at which a foreign national may seek release, every six months for all people held in detention after entering or being in the country without legal permission.

In taking that question to the Court, the Justice Department contended that the U.S. Court of Appeals for the Ninth Circuit had "replaced the carefully tailored regime [for detention of illegal foreign nationals] with a rigid, one-size-fits-all rule that every alien in detention" must be given a release hearing automatically every six months. That approach, the department contended, will jeopardize its authority to hold those who have committed crimes or acts of terrorism.

"D.C. Circuit Court Invalidates Solomon's Appointment As Acting NLRB General Counsel– What Does It Mean?"

The National Law Review

Peter M. Panken

August 13, 2015

On August 7, in SW General Inc. v. NLRB 2015 US App LEXIS 13812, a federal appellate court ruled that the January 5, 2011 appointment of Lafe Solomon as Acting General Counsel to the NLRB violated the Federal Vacancies Reform Act 5 U.S.C. Sections 3345 et. seq. (FVRA) (PDF). For that reasons it held that his authorizations to issue an unfair labor practice ("ULP") complaint in the case was invalid and the NLRB's decision finding the employer guilty of ULPs must be vacated. Since Solomon served as Acting General Counsel until November 4, 2013, the Court's decision renders potentially suspect any and all NLRB ULP decisions based upon complaints issued during that period.

Noel Canning

In *NLRB v. Noel Canning* 134 S. Ct. 2550 (2014) the Supreme Court invalidated a plethora of NLRB decisions based on its finding that the appointments of Board members who had participated in the decisions were invalid recess appointments because the Court found that the Senate was not in fact in recess at the time the appointments were made. In the wake of Noel Canning, the Board, then composed of members whose appointments had been properly confirmed by the Senate reconsidered and reissued most of those decisions. *SW General* seems to be another decision invalidating a scheme by the Administration to get around Senate roadblocks to appointments which has been invalidated by the Courts.

The Impact of SW General

But the Court in *SW General* made clear that its holding in that case would actually be much narrower in its impact. That is because it held that if an employer had not timely raised the issue of the General Counsel's appointment, the defense was waived:

> We hold that the former Acting General Counsel of the NLRB, Lafe Solomon, served in violation of the FVRA from January 5, 2011 to November 4, 2013. But this case is not Son of Noel Canning and we do not expect it to retroactively undermine a host of NLRB decisions. We address the FVRA objection in this case because the petitioner raised the issue in its exceptions to the ALJ decision as a defense to an ongoing enforcement proceeding. We doubt that an employer that failed to timely

> raise an FVRA objection—regardless whether enforcement proceedings are ongoing or concluded—will enjoy the same success. See 29 U.S.C. § 160(e); *Andrade*, 729 F.2d at 1499.

In *SW General*, the defense was raised in exceptions to the Administrative Law Judge's decision. Whether it can be raised after the decision by the NLRB is questionable. 29 U.S.C. Sec 160 (e) specifically provides: No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances In *Andrade v. Lauer*, 729 F2d 1475 (D.C. Cir. 1984), the DC Circuit set forth the requirements needed to attack decisions by an invalidly appointed official:

> The core purposes of the doctrine are served if a plaintiff challenging government action on the ground that the officials taking that action improperly hold office meets two requirements. First, the plaintiff must bring this action at or around the time that the challenged government action is taken. Second, the plaintiff must show that the agency or department involved has had reasonable notice under all the circumstances of the claimed defect in the official's title to office. This does not require that the plaintiff perform any particular rituals before bringing suit, nor does it mandate that the agency's knowledge of the alleged defect must come from the plaintiff. It does, however, require that the agency or department involved actually knows of the claimed defect.

What This Means for Employers

Thus, employers found to have committed unfair labor practices in proceedings between January 5, 2011 and November 4, 2013, during Lafe Solomon's tenure as Acting General Counsel should review the status of the proceedings against them and determine whether they are still able to raise this issue as quickly as possible in any proceeding which has not yet been decided by the NLRB.