Section 5: Business Law

Institute of Bill of Rights Law at The College of William & Mary School of Law
V. Business Law

IN THIS SECTION:

New Case: *Lorenzo v. SEC* ........................................................................................................ 244

“ARE FALSE STATEMENTS ENOUGH TO PROVE FRAUD”

Peter J. Henning .......................................................................................................................... 270

“U.S. SUPREME COURT WILL CONSIDER NARROWING SECURITIES-FRAUD LAWS”

Greg Stohr .................................................................................................................................. 273

“LORENZO v. SEC: WILL HIGH COURT FURTHER CURTAIL RULE 10b-5?”

Roger Cooper, Matthew Solomon and Leslie Silverman............................................................. 274

“BROKER DIDN’T ‘MAKE’ FALSE STATEMENTS, APPEALS COURT SAYS”

Phyllis Diamond......................................................................................................................... 279

**NEW CASE: Apple, Inc. v. Pepper** .......................................................................................... 281

“APPLE GETS U.S. SUPREME COURT REVIEW ON iPHONE APP FEE SUIT”

Greg Stohr .................................................................................................................................. 293

“TRUMP ADMINISTRATION BACKS APPLE IN SUPREME COURT ANTITRUST SUIT OVER APPS”

Marcia Coyle ............................................................................................................................. 295

“THE SUPREME COURT WILL DECIDE IF APPLE’S APP STORE IS A MONOPOLY”

Louise Matsakis.......................................................................................................................... 298

“What happens if Apple loses its Supreme Court App Store antitrust appeal?”

Adi Robertson ............................................................................................................................ 301

“9TH CIRCUIT APPLE ANTITRUST RULING SPLITS WITH 8TH, IS BOON TO CONSUMERS”

Alison Frankel ........................................................................................................................... 303

**NEW CASE: Mount Lemmon Fire District v. Guido** ............................................................... 305

“US SUPREME COURT TO KICK OFF NEXT SESSION WITH AZ AGE-DISCRIMINATION CASE”

242
Howard Fischer ........................................................................................................................................... 312

“AGE LAW SHIELD FOR STATE WORKERS DOESN’T TURN ON UNIT SIZE”
Kevin McGowan ........................................................................................................................................... 314

“ADEA APPLIES TO SMALL STATE OFFICES, FEDS TELL HIGH COURT”
Branden Campbell ........................................................................................................................................... 316

NEW CASE: Frank v. Gaos ................................................................................................................................... 318

“GOOGLE PRIVACY DEAL IS ‘CLEAR ABUSE,’ HIGH COURT TOLD”
Shayna Possess .............................................................................................................................................. 331

“FRANK V. GAOS: CY PRES GETS ITS DAY AT THE SUPREME COURT”
Jonah M. Knobler and Sam A. Yospe .................................................................................................................. 334

“NINTH CIRCUIT CONFIRMS THAT A CY PRES ONLY SETTLEMENT CAN WORK IN PRIVACY CLASS ACTION”
Jay Ramsey .......................................................................................................................................................... 340

NEW CASE: Jam v. International Finance Corp. ........................................................................................................ 342

“JUSTICES TO REVIEW SCOPE OF IMMUNITY FOR INT’S ORGS”
Jimmy Hoover ......................................................................................................................................................... 353

“SUPREME COURT GRANTS CERT IN JAM V. INTERNATIONAL FINANCE CORPORATION”
Elliot Kim ............................................................................................................................................................. 355

“INDIAN FISHERMAN HAIL U.S SUPREME COURT DECISION TO HEAR WORLD BANK SUIT”
Rina Chandran ....................................................................................................................................................... 361

“CAN YOU SUE INTERNATIONAL ORGANIZATIONS? THE SUPREME COURT DECIDES TO WEIGH IN”
Kristina Daugirdas .................................................................................................................................................. 363
Ruling Below: Lorenzo v. SEC, 872 F.3d 578 (D.C. Cir. 2017)

Overview: Francis Lorenzo, an investment banker, was charged with securities fraud after he sent potential investors emails containing false statements. The U.S. Court of Appeals for the District of Columbia Circuit ruled that Lorenzo had not violated Rule 10b-5(b) because his boss had actually made the misleading statements, but it also held that Lorenzo had violated Rule 10b-5(a) by engaging in a fraudulent scheme.

Issue: Whether a misstatement claim that does not meet the elements set forth in Janus Capital Group, Inc. v. First Derivative Traders can be repackaged and pursued as a fraudulent-scheme claim.

Francis V. LORENZO, Petitioner
v.
SECURITIES AND EXCHANGE COMMISSION, Respondent

United States Court of Appeals, District of Columbia Circuit

Decided on September 29, 2017

[Excerpt; some citations and footnotes omitted]

SRINIVASAN, Circuit Judge:

The Securities and Exchange Commission found that Francis Lorenzo sent email messages to investors containing misrepresentations about key features of a securities offering. The Commission determined that Lorenzo’s conduct violated various securities-fraud provisions. We uphold the Commission’s findings that the statements in Lorenzo’s emails were false or misleading and that he possessed the requisite intent.

We cannot sustain, however, the Commission’s determination that Lorenzo’s conduct violated one of the provisions he was found to have infringed: Rule 10b-5(b). That rule bars the making of materially false statements in connection with the purchase or sale of securities. We conclude that Lorenzo did not “make” the false statements at issue for purposes of Rule 10b-5(b) because Lorenzo’s boss, and not Lorenzo himself, retained “ultimate authority” over the statements. Janus Capital Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 142 (2011).

While Lorenzo’s boss, and not Lorenzo, thus was the “maker” of the false statements under Rule 10b-5(b), Lorenzo played an active role in perpetrating the fraud by folding the statements into emails he sent
directly to investors in his capacity as director of investment banking, and by doing so with an intent to deceive. Lorenzo’s conduct therefore infringed the other securities-fraud provisions he was charged with violating. But because the Commission’s choice of sanctions to impose against Lorenzo turned in some measure on its misimpression that his conduct violated Rule 10b-5(b), we set aside the sanctions and remand the matter to enable the Commission to reassess the appropriate penalties.

I.

A.

In February 2009, Francis Lorenzo became the director of investment banking at Charles Vista, LLC. Charles Vista was a registered broker-dealer owned by Gregg Lorenzo, no relation to Francis. (For clarity of reference, we will refer to Francis Lorenzo as “Lorenzo” and will use Gregg Lorenzo’s first name when referring to him.)

Charles Vista’s biggest client, and Lorenzo’s only investment-banking client at the time, was a start-up company named Waste2Energy Holdings, Inc. (W2E). W2E claimed to have developed a “gasification” technology that could generate electricity by converting solid waste to gas. W2E’s business model relied on the technology’s living up to its potential. If it failed to do so, the great majority of W2E’s assets—the “intangibles,” in balance-sheet lingo—would have to be written off entirely.

W2E’s conversion technology never materialized. In September 2009, W2E sought to escape financial ruin by offering up to $15 million in convertible debentures. (Debentures are “debt secured only by the debtor’s earning power, not by a lien on any specific asset.” Black’s Law Dictionary 486 (10th ed. 2014)). Charles Vista would serve as the exclusive placement agent for W2E’s debenture offering.

W2E’s most recent SEC filing at the time, its June 3, 2009 Form 8-K (used to notify investors of certain specified events), contained no indication of any possible devaluation of the company’s intangible assets. Rather, the form stated that W2E’s intangibles were worth just over $10 million as of the end of 2008. On September 9, 2009, W2E issued a Private Placement Memorandum as a guidebook for potential investors in the debentures. That guidebook, like the June 2009 Form 8-K, included no mention of any devaluation of the company’s intangibles.

Following a lengthy audit, however, W2E changed its public tune. On October 1, 2009, the company filed an amended Form 8-K in which it reported a total “impairment” of its intangible assets because “management made a determination that the value of the assets acquired were of no value.” J.A. 703. As of March 31, 2009, W2E now clarified, its gasification technology should have been valued at zero, and its total assets at only $370,552. On the same day it filed its amended Form 8-K, October 1, 2009, W2E also filed a quarterly Form 10-Q in which it
valued its total assets at $660,408 as of June 30, 2009.

Later on October 1, Lorenzo’s secretary alerted him (via email) about W2E’s amended Form 8-K filing. The next day, Lorenzo emailed all Charles Vista brokers links to both of W2E’s October 1 filings. On October 5, he received an email from W2E’s Chief Financial Officer explaining the reasons for “[t]he accumulated deficit we have reported.” Id. at 740. The CFO reiterated that W2E had written off “all of our intangible assets . . . of about $11 million” due to “our assessment of the value of what those asset[s] are worth today.” Id.

On October 14, Lorenzo separately emailed two potential investors “several key points” about W2E’s pending debenture offering. Id. at 794, 796. His emails, however, omitted any mention of the wholesale devaluation of W2E’s intangibles. On the contrary, Lorenzo’s emails assured both recipients that the offering came with “3 layers of protection: (I) [W2E] has over $10 mm in confirmed assets; (II) [W2E] has purchase orders and LOI’s for over $43 mm in orders; (III) Charles Vista has agreed to raise additional monies to repay these Debenture holders (if necessary).” Id. One of Lorenzo’s messages said it had been sent “[a]t the request of Gregg Lorenzo,” id. at 796, and the other stated it had been sent “[a]t the request of Adam Spero [a broker with Charles Vista] and Gregg Lorenzo,” id. at 794. In both messages, Lorenzo urged the recipients to “[p]lease call [him] with any questions.” Id. at 794, 796. And he signed both messages with his name and title as “Vice President – Investment Banking.” Id.

B.

On February 15, 2013, the Commission commenced cease-and-desist proceedings against Lorenzo, Gregg Lorenzo, and Charles Vista. It charged each with violating three securities-fraud provisions: (i) Section 17(a)(1) of the Securities Act of 1933, 15 U.S.C. § 77q(a)(1); (ii) Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j; and (iii) Securities Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5. Gregg Lorenzo and Charles Vista settled the charges against them, but the claims against Lorenzo proceeded to resolution before the agency.

An administrative law judge concluded that Lorenzo had “willfully violated the antifraud provisions of the Securities and Exchange Acts by his material misrepresentations and omissions concerning W2E in the emails.” Gregg C. Lorenzo, Francis V. Lorenzo, and Charles Vista, LLC, SEC Release No. 544, 107 SEC Docket 5934, 2013 WL 6858820, at *7 (Dec. 31, 2013). The ALJ deemed “[t]he falsity of the representations in the emails . . . staggering” and Lorenzo’s mental state with respect to those misstatements at least “reckless.” Id. As a result, the ALJ ordered Lorenzo to: (i) cease and desist from violating each securities-fraud provision giving rise to the charges against him; (ii) forever refrain from participating in the securities industry in several enumerated respects; and (iii) pay a civil monetary penalty of $15,000. Id. at *10.
Lorenzo petitioned the Commission for review. Following “an independent review of the record,” the full Commission sustained the ALJ’s decision, including her “imposition of an industry-wide bar, a cease-and-desist order, and a $15,000 civil penalty.” Francis V. Lorenzo, SEC Release No. 9762, 111 SEC Docket 1761, 2015 WL 1927763, at *1 (Apr. 29, 2015) (Lorenzo). The Commission found that Lorenzo “knew each of [the emails’ key statements] was false and/or misleading when he sent them.” Id. It concluded that the sanctions were “in the public interest to deter Lorenzo and others in similar positions from committing future violations.” Id. at *17. The Commission later denied Lorenzo’s motion for reconsideration.

Lorenzo filed a timely petition for review in this court. He challenges only the Commission’s imposition of an industry-wide bar and a $15,000 civil penalty, not the cease-and-desist order.

II.

We first consider Lorenzo’s challenges to the Commission’s findings that the relevant statements in his email messages were false or misleading and were made with the requisite mental state. The three pertinent statements are the three “layers of protection” enumerated in both of Lorenzo’s October 14, 2009, email messages to potential investors about the debenture offering. Lorenzo challenges he Commission’s determination that two of the three statements were false or misleading, and he also challenges the Commission’s conclusion that he possessed the requisite intent with respect to all three of the statements.

With regard to his intent, establishing a violation of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, or Exchange Act Rule 10b-5 “requires proof of scienter.” Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 639 (D.C. Cir. 2008). That standard in turn requires demonstrating “an intent to deceive, manipulate, or defraud.” Id. (quoting SEC v. Steadman, 967 F.2d 636, 641 (D.C. Cir. 1992)). The scienter requirement can be satisfied by a showing of “[e]xtreme recklessness,” which exists when “the danger was so obvious that the actor was aware of it and consciously disregarded it.” Id.

The question whether Lorenzo acted with scienter, like the question whether the statements were false or misleading, is a question of fact. Id. at 639. The Commission’s “factual findings are conclusive if supported by substantial evidence.” Seghers v. SEC, 548 F.3d 129, 132 (D.C. Cir. 2008). Although “[s]ubstantial evidence is more than a mere scintilla,” Kornman v. SEC, 592 F.3d 173, 184 (D.C. Cir. 2010), we have repeatedly described the standard as a “very deferential” one, e.g., Siegel v. SEC, 592 F.3d 147, 155 (D.C. Cir. 2010); Dolphin & Bradbury, 512 F.3d at 639; Nat’l Ass’n of Sec. Dealers v. SEC, 801 F.2d 1415, 1419 (D.C. Cir. 1986). Applying that standard here, we conclude that the Commission’s findings as to falsity and scienter are supported by substantial evidence with regard to each of the three pertinent statements in Lorenzo’s emails.
A.

The first of the three statements at issue advised potential investors that the “Company has over $10 mm in confirmed assets.” J.A. 794, 796. Lorenzo does not directly dispute the falsity of that statement. Nor could he: by the time Lorenzo sent the October 14, 2009, email messages containing that statement, W2E had entirely written off its intangibles and disclosed that its remaining assets were worth far less than $1 million. And Lorenzo himself testified that W2E “would be lucky to get a million” for its intangibles after they had been marked down. Id. at 128.

As to the question of scienter, Lorenzo contends that, when he sent the emails, he held a good-faith belief that W2E had over $10 million in confirmed assets. The Commission concluded otherwise, and its finding of scienter is supported by substantial evidence.

One of Lorenzo’s chief duties involved conducting due diligence on his clients, including reviewing their financial statements and public SEC filings. During the relevant time, W2E was Lorenzo’s sole investment-banking client. He knew that W2E’s financial situation was “horrible from the beginning” and that its gas-conversion technology had not worked as planned. Id. at 124. He also knew that he stood to gain seven to nine percent of any funds he raised from the debenture offering.

The record shows that, when Lorenzo viewed W2E’s June 2009 Form 8-K, he disbelieved the Form’s valuation of the company’s intangible assets at $10 million. He agreed that the intangibles were a “dead asset” that would be “hugely discounted,” id. at 127-28, and that W2E would be “lucky [to] get a million dollars for that asset,” id. at 128-29. He also thought it significant that the $10 million valuation had not been audited, because without such scrutiny, “there is way too much risk for investors.” Id. at 126. He acknowledged that he had warned Gregg Lorenzo as early as April 2009 to refrain from collateralizing a debenture offering with W2E’s intangibles, because those assets “provided no protection” to investors. Id. at 159. Lorenzo understood that, if a default occurred, “clients would not be able to recoup their money based on a liquidation of this asset.” Id. He instead viewed the debenture offering as a “toxic convertible debt spiral.” Lorenzo, 2015 WL 1927763, at *5.

Evidence concerning Lorenzo’s state of mind can also be gleaned from his actions in helping prepare Charles Vista’s Private Placement Memorandum for the debenture offering. On August 26, 2009, he asked W2E’s principals to value the company’s intangibles at $10 million in the upcoming Memorandum. He received no response. He broached the subject again on September 1, this time leaving the intangibles’ value blank, because he “w[asn’t] sure what [it] was worth anymore.” J.A. 135, 739. The final Memorandum assigned no concrete value to W2E’s intangibles; it instead divulged that the company had experienced “significant operating losses” and did “not expect to be profitable for at least the foreseeable future.” Lorenzo, 2015 WL 1927763, at *3.
In its October 1 SEC filings, W2E publicly disclosed the wholesale write-off of its intangibles. It did so in a tri-column chart entitled “Goodwill and Technology,” and it followed that numerical presentation with a textual explanation for the mark-down. Lorenzo acknowledged that he read the amended Form 8-K on October 1 (although, according to him, “[p]robably not as closely as I should have”). J.A. 140. And he received an email from W2E’s CFO on October 5 succinctly contextualizing the massive devaluation of W2E’s intangible assets.

The evidence therefore supports concluding that, at least by October 5, Lorenzo knew that W2E’s intangibles were valueless. He gave testimony on the issue as follows: “Q. So it is fair to say . . . that on October 5, 2009, you were aware that the $10 million asset had been written off by [W2E]. Correct? A. Okay. I will agree to that. That’s correct. Q. That is a fair statement? A. Yes.” Id. at 151. That admission is difficult to reconcile with Lorenzo’s statement that he “unintentional[ly] miss[ed]” the import of the October 5 email. Id. at 148. The Commission justifiably credited his more inculpatory rendition of events, especially in light of his broader, scienter-related concession: “Q. [D]id you know that those statements were inaccurate and misleading? A. Yes. Q. You knew at the time? A. At the time? I can’t sit here and say that I didn’t know.” Id. at 158.

According to the Commission, “[t]hat Lorenzo could have looked at [W2E’s] filings, which was his job, and missed what was one of the most pertinent facts in them—the valuation of the company’s assets—is either untrue or extreme recklessness.” Lorenzo, 2015 WL 1927763, at *9. The Commission considered it “at least extremely reckless” for Lorenzo to have sent email messages claiming that W2E had over $10 million in “confirmed” assets, given his “longstanding concern about the legitimacy” of those assets. Id. We perceive no basis for setting aside the Commission’s conclusions as unsupported by substantial evidence.

In resisting that conclusion, Lorenzo relies in part on a $14 million valuation of W2E’s assets in a W2E research report emailed by Charles Vista’s Chief Compliance Officer to the firm’s brokers on the same day Lorenzo sent his pertinent emails (October 14, 2009). The Commission sensibly reasoned that “the mere fact that, for whatever unknown reason, a compliance officer sent an inaccurate research report internally to the firm’s brokers is neither analogous to, nor an excuse for, Lorenzo’s knowingly sending misleading emails to prospective investors.” Id. at *9 n.23.

B.

The second contested statement is the assertion in Lorenzo’s emails that “[t]he Company has purchase orders and LOI’s for over $43 mm in orders.” J.A. 794, 796. He maintains that the Commission erred in deeming that statement false or misleading. He notes that, at one point, Charles Vista did in fact receive a $43 million letter of intent from a potential customer in the Caribbean, and that W2E’s CEO “put a lot of confidence” in such letters. Id. at 160. But as the Commission rightly notes, the Caribbean
letter did not obligate its drafter to do anything, and the transaction proceeded no further. By the time Lorenzo sent his emails on October 14, 2009, W2E had no outstanding purchase orders. Lorenzo’s emails nonetheless assured the recipients that W2E had over $43 million in “purchase orders and LOI’s.” The Commission thus was fully justified in finding that statement false or misleading. See Lorenzo, 2015 WL 1927763, at *6.

Lorenzo also disputes the Commission’s finding of scienter concerning the extent of W2E’s anticipated cash flow. Asked whether he knew at the time that the $43 million figure was misleading, Lorenzo testified as follows: “I can’t say that with a hundred percent because they did have LOI’s for 43 million.” J.A. 160. As his other testimony revealed, however, Lorenzo understood that W2E’s sole letter of intent was “non-binding,” a mere potentiality that the company “hoped would materialize.” Id. at 162. And by September 2009, he “didn’t think that the 43 million LOI was ever going to turn into purchases.” Id. at 164. Lorenzo testified repeatedly to that effect. See id. at 163-64 (“Q. And by September 2009 you didn’t think it was ever going to come through, right? A. . . . That is correct.”); id. at 164 (“Q. So sometime in September you lost confidence that this 43 million was ever going to happen? A. Yes.”).

The clear implication of the statement in Lorenzo’s email messages was that W2E anticipated a $43 million influx of capital from past and future orders. Yet the record reveals grave doubts on Lorenzo’s part that “$43 mm in orders” (or any orders) would actually occur. Substantial evidence therefore supports the Commission’s finding of scienter as to that statement.

C.

The third statement at issue is the assertion in Lorenzo’s email messages that “Charles Vista has agreed to raise additional monies to repay these Debenture holders (if necessary).” Id. at 794, 796. Lorenzo disputes the Commission’s conclusion that the statement was false or misleading. He contends that Gregg Lorenzo could have made such an agreement for Charles Vista, had done so on prior occasions for debenture holders, and had allegedly met with additional brokers about raising funds for W2E. The Commission permissibly regarded those assertions as “establish[ing] only the theoretical possibility that Charles Vista could have raised additional money to repay investors, not that it had agreed to do so (as Lorenzo’s emails claimed).” Lorenzo, 2015 WL 1927763, at *7.

With regard to scienter, Lorenzo observes that the Commission included no specific citations to the record in support of its finding. It is true that, although the Commission quoted the evidentiary record at length, it did not cite the particular page numbers on which certain arguments and quotations appeared. But we “uphold a decision of less than ideal clarity if the agency’s path may reasonably be discerned.” Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (quoting Bowman Transp., Inc. v. Arkansas-

Lorenzo allowed, at least in hindsight, that “you can interpret this [statement] as being misleading.” J.A. 167. Moreover, according to his own testimony, at the time he sent the emails, he did not believe Charles Vista could raise enough money to repay debenture holders. For instance, he testified that, as of October 2009, “it is accurate to say that Charles Vista would not have the buying power or the resources to properly fund [W2E] in order to repay the debentures.” Id. at 172. Given Lorenzo’s knowledge that Charles Vista could not have repaid debenture holders, the Commission could certainly conclude that Lorenzo believed that no such agreement existed. As a result, substantial evidence supports the Commission’s finding that Lorenzo acted with scienter with regard to the assurance to investors that Charles Vista had made such a promise.

III.

The Commission found that Lorenzo’s actions in connection with his email messages violated Section (17)(a)(1) of the Securities Act and Section 10(b) of the Exchange Act, as implemented by the Commission’s Rule 10b-5. The Rule contains three subsections, and the Commission concluded that Lorenzo had violated all three.

We now consider Lorenzo’s argument that he did not “make” the relevant statements within the meaning of the express terms of one of Rule 10b-5’s subsections, Rule 10b-5(b). We agree with Lorenzo that, under the Supreme Court’s decision in Janus Capital Group, Inc. v. First Derivative Traders, 564 U.S. 135, 131 S.Ct. 2296, 180 L.Ed.2d 166 (2011), he did not “make” the statements at issue for purposes of Rule 10b-5(b). Even so, we conclude that his status as a non-“maker” of the statements under Rule 10b-5(b) does not vitiate the Commission’s conclusion that his actions violated the other subsections of Rule 10b-5, as well as Section 17(a)(1).

A.

Under Rule 10b-5(b), it is unlawful to “make any untrue statement of a material fact TTT in connection with the purchase or sale of any security.” 17 C.F.R. § 240.10b-5(b). In Janus, the Supreme Court explained what it means to “make” a statement within the meaning of that prohibition:

For purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not “make” a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker.

564 U.S. at 142, 131 S.Ct. 2296. “[I]n the ordinary case,” the Court continued, “attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed.” Id. at 142-43.
The Janus Court held that an investment adviser that had assisted in preparing a mutual fund’s prospectuses did not “make” the statements contained therein, because the adviser lacked “ultimate control” over the statements’ content and dissemination. Id. at 148, 131 S.Ct. 2296. The investment adviser had merely “participate[d] in the drafting of a false statement”—“an undisclosed act preceding the decision of an independent entity to make a public statement.” Id. at 145. The Court illustrated the operation of its test through the following analogy: “Even when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit—or blame—for what is ultimately said.” Id. at 143.

Under the Janus test, a person cannot have “made” a statement if he lacked ultimate authority over what it said and whether it was said, including if he prepared or published it on behalf of another. In light of that understanding, we find that Lorenzo was not the “maker” of the pertinent statements set out in the email messages he sent to potential investors, even viewing the record in the light most favorable to the Commission.

Lorenzo contends that he sent the email messages at the behest of his boss, Gregg Lorenzo, and that Gregg Lorenzo supplied the content of the false statements, which Lorenzo copied and pasted into the messages before distributing them. As a result, Lorenzo contends, Gregg Lorenzo (and not Lorenzo himself) was the “maker” of the statements under Janus. The Commission found otherwise, concluding that Lorenzo “was ultimately responsible for the emails’ content and dissemination.” Lorenzo, 2015 WL 1927763, at *10. We cannot sustain the Commission’s conclusion that Lorenzo had “ultimate authority” over the false statements under Janus. 564 U.S. at 142. Gregg Lorenzo, and not Lorenzo, retained ultimate authority.

Voluminous testimony established that Lorenzo transmitted statements devised by Gregg Lorenzo at Gregg Lorenzo’s direction. For instance, Lorenzo said: “I cut and paste[d] an e-mail and sent it to [investors],” J.A. 153; “I was asked to send these e-mails out by Gregg Lorenzo,” id. at 156; and “I cut and pasted and sent it,” id. at 157. He also stated: “I remember getting—getting the e-mail address from [Gregg Lorenzo] and then cut and past[ed] this—this thing and sent it,” id. at 199; “[Gregg Lorenzo] gave me the e-mail address, I typed it into the ‘to’ column and cut and pasted this—the content and sent it out,” id.; “My boss asked me to send these e-mails out and I sent them out,” id. at 200; “[I] sent these emails out at the request of my superior,” id. at 208; and “I simply was asked to send the e-mail out,” id. at 208-09.

In the face of that consistent testimony, the Commission anchored its conclusion almost entirely in the following remark from Lorenzo: “If memory serves me—I think I authored it and then it was approved by Gregg and Mike [Molinaro, Charles Vista’s Chief Compliance Officer].” J.A. 155. That assertion, even apart from its equivocation, must be read alongside the rest
of Lorenzo’s testimony. Immediately before and after uttering that line, Lorenzo explained that “I cut and paste[d] an e-mail and sent it” and “I cut and pasted and sent it.” Id. at 153, 157. And he consistently testified to the same effect throughout. In that light, Lorenzo’s remark that he “authored” the emails cannot bear the weight given it by the Commission. Rather, the statement is fully consistent with Lorenzo’s repeated account that, while he produced the email messages for final distribution from himself to the investors—and in that sense “authored” the messages—he populated the messages with content sent by Gregg Lorenzo.

In the line of testimony on which the Commission relies, moreover, Lorenzo stated that, before he sent the messages, they were “approved” by Gregg Lorenzo. That observation reinforces Gregg Lorenzo’s ultimate authority over the substance and distribution of the emails: Gregg Lorenzo asked Lorenzo to send the emails, supplied the central content, and approved the messages for distribution. To be sure, Lorenzo played an active role in perpetrating the fraud by producing the emails containing the false statements and sending them from his account in his capacity as director of investment banking (and doing so with scienter). But under the test set forth in Janus, Gregg Lorenzo, and not Lorenzo, was “the maker” of the false statements in the emails. 564 U.S. at 142.

The Commission’s remaining observations do not alter our conclusion. For instance, the Commission noted that Lorenzo “put his own name and direct phone number at the end of the emails, and he sent the emails from his own account.” Lorenzo, 2015 WL 1927763, at *10. That sort of signature line, however, can often exist when one person sends an email that “publishes a statement on behalf of another,” with the latter person retaining “ultimate authority over the statement.” Janus, 564 U.S. at 142.

The Commission also referenced Lorenzo’s testimony that “he did not recall ever discussing either of the emails or their subject matter with Gregg Lorenzo.” Lorenzo, 2015 WL 1927763, at *10. That comment, however, is consistent with the understanding that Lorenzo played a minimal role in devising the emails’ false statements. And although the email messages said that the Investment Banking Division—which Lorenzo headed—was “summariz[ing] several key points” about the debenture offering, J.A. 794, 796, the content of those points evidently had been supplied by Gregg Lorenzo. The emails, moreover, began by stating that they were being sent at Gregg Lorenzo’s request. Lorenzo testified elsewhere that Gregg Lorenzo had remarked, “I want this [to] come from our investment banking division. Can you send this out for me?” Id. at 217.

Under the Supreme Court’s decision in Janus, in short, Lorenzo cannot be considered to have been “the maker” of the statements in question for purposes of Rule 10b-5(b)—i.e., “the person . . . with ultimate authority” over them. 564 U.S. at 142. That person was Gregg Lorenzo, and not (or not also) Lorenzo.
B.

Lorenzo next argues that, if he was not “the maker” of the false statements at issue within the meaning of Rule 10b5(b), his conduct necessarily also falls outside the prohibitions of Exchange Act Section 10(b), Rules 10b-5(a) and (c), and Securities Act Section 17(a)(1). The Commission concluded otherwise, incorporating by reference its reasoning in John P. Flannery & James D. Hopkins, SEC Release No. 3981, 110 SEC Docket 2463, 2014 WL 7145625 (Dec. 15, 2014), vacated, Flannery v. SEC, 810 F.3d 1 (1st Cir. 2015) (rejecting the Commission’s key factual determinations on substantial-evidence grounds). The Commission determined that, “[i]ndependently of whether Lorenzo’s involvement in the emails amounted to ‘making’ the misstatements for purposes of Rule 10b-5(b), he knowingly sent materially misleading language from his own email account to prospective investors,” thereby violating those other provisions. Lorenzo, 2015 WL 1927763, at *11.

We sustain the Commission’s conclusion to that effect. At least in the circumstances of this case, in which Lorenzo produced email messages containing false statements and sent them directly to potential investors expressly in his capacity as head of the Investment Banking Division—and did so with scienter—he can be found to have infringed Section 10(b), Rules 10b-5(a) and (c), and Section 17(a)(1), regardless of whether he was the “maker” of the false statements for purposes of Rule 10b-5(b).

1. Rules 10b-5(a) and (c), along with Sections 10(b) and 17(a)(1)—all unlike Rule 10b-5(b)—do not speak in terms of an individual’s “making” a false statement. Indeed, “[t]o make any . . . statement” was the critical language construed in Janus: what the Court described as the “phrase at issue.” 564 U.S. at 142 (alteration in original) (quoting 17 C.F.R. § 240.10b-5(b)). That language appears in Rule 10b-5(b), but not in the other provisions Lorenzo was found to have violated.

In particular, Rule 10b-5(a) prohibits “employ[ing] any device, scheme, or artifice to defraud . . . in connection with the purchase or sale of any security.” 17 C.F.R. § 240.10b5(a). And Rule 10b-5(c) bars “engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . in connection with the purchase or sale of any security.” Id. § 240.10b-5(c). Consequently, Rule 10b-5(b) “specifies the making of an untrue statement of a material fact and the omission to state a material fact. The first and third subparagraphs are not so restricted.” Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 152-53 (1972).

Nor are Securities Act Section 17(a)(1) and Exchange Act Section 10(b). Section 17(a)(1) makes it unlawful “to employ any device, scheme, or artifice to defraud” in offering or selling a security. 15 U.S.C. § 77q(a)(1). And Section 10(b) forbids “us[ing] or employ[ing] . . . any manipulative or deceptive device or contrivance” in contravention of rules.
prescribed by the Commission. 15 U.S.C. § 78j(b).

Here, Lorenzo, acting with scienter (i.e., an intent to deceive or defraud, or extreme recklessness to that effect), produced email messages containing three false statements about a pending offering, sent the messages directly to potential investors, and encouraged them to contact him personally with any questions. Although Lorenzo does not qualify as the “maker” of those statements under Janus because he lacked ultimate authority over their content and dissemination, his own active “role in producing and sending the emails constituted employing a deceptive ‘device,’ ‘act,’ or ‘artifice to defraud’ for purposes of liability under Section 10(b), Rule 10b-5(a) and (c), and Section 17(a)(1).” Lorenzo, 2015 WL 1927763, at *11.

Lorenzo’s conduct fits comfortably within the ordinary understanding of those terms. Indeed, he presents no argument that his actions fail to satisfy the statutory and regulatory language. He does not examine—or even reference—the text of those provisions in arguing that they should be deemed not to apply to his conduct.

Lorenzo does not contend before us, for instance, that he simply passed along information supplied by Gregg Lorenzo without pausing to think about the truth or falsity of what he was sending to investors. If those were the facts, he might attempt to argue that he cannot be considered to have “employed” any fraudulent device or artifice, or “engaged” in any fraudulent or deceitful act, within the meaning of Rules 10b-5(a) and (c), and of Sections 10(b) and 17(a)(1). But while Lorenzo argued before the Commission that he produced and sent the emails at Gregg Lorenzo’s request without giving them thought, the Commission found “implausible” any suggestion that he merely passed along the messages in his own name without thinking about their content. Lorenzo, 2015 WL 1927763, at *9. Lorenzo does not challenge that finding here.

We therefore consider the case on the understanding that Lorenzo, having taken stock of the emails’ content and having formed the requisite intent to deceive, conveyed materially false information to prospective investors about a pending securities offering backed by the weight of his office as director of investment banking. On that understanding, the language of Sections 10(b) and 17(a)(1), and of Rules 10b5(a) and (c), readily encompasses Lorenzo’s actions.

2. Instead of presenting any argument that his conduct falls outside the language of those provisions, Lorenzo asserts that, if he could be found to have violated the provisions, the decision in Janus would effectively be rendered meaningless. See SEC v. Kelly, 817 F. Supp. 2d 340, 344 (S.D.N.Y. 2011). He notes the Janus Court’s interest in interpreting the term “make” in a manner that would avoid undermining the Court’s previous holding that private actions under Rule 10b5 cannot be premised on conceptions of secondary (i.e., aiding-and-abetting) liability. See Janus, 564 U.S. at 143 (discussing Central Bank of Denver, N.A. v.
As the Court explained in *Janus*, whereas the Commission can bring actions under Rule 10b-5 based on an aiding-and-abetting theory, private parties—after *Central Bank*—cannot. *Id.* The *Janus* Court reasoned that a “broader reading of ‘make,’” encompassing “persons or entities without ultimate control over the content of a statement,” could mean that “aiders and abettors would be almost nonexistent.” *Id.* That result, the Court believed, would have undercut an implicit understanding from *Central Bank*: that “there must be some distinction between those who are primarily liable . . . and those who are secondarily liable.” *Id.* at 143 n.6. The same considerations, Lorenzo contends, should weigh in favor of concluding that his conduct did not violate Section 10(b), Rules 10b-5(a) and (c), and Section 17(a)(1). We are unpersuaded.

To the extent the *Janus* Court’s concerns about aiding-and-abetting liability in private actions under Rule 10b-5(b) should inform our interpretation of those other four provisions, the conduct at issue in *Janus* materially differs from Lorenzo’s actions in this case. *Janus* involved an investment adviser that initially drafted false statements which an independent entity subsequently decided to disseminate to investors in its own name. The investment adviser’s role in originally devising the statements was unknown to the investors who ultimately received them. The Court thus described the investment adviser’s conduct as “an undisclosed act preceding the decision of an independent entity to make a public statement.” 564 U.S. at 145.

In this case, by contrast, Lorenzo’s role was not “undisclosed” to investors. The recipients were fully alerted to his involvement: Lorenzo sent the emails from his account and under his name, in his capacity as director of investment banking at Charles Vista. While Gregg Lorenzo supplied the content of the false statements for inclusion in Lorenzo’s email messages, Lorenzo effectively vouched for the emails’ contents and put his reputation on the line by listing his personal phone number and inviting the recipients to “call with any questions.” J.A. 794, 796. Nor did the dissemination of the false statements to investors result only from the separate “decision of an independent entity.” *Janus*, 564 U.S. at 145. Lorenzo himself communicated with investors, directly emailing them misstatements about the debenture offering.

Unlike in *Janus*, therefore, the recipients of Lorenzo’s emails were not exposed to the false information only through the intervening act of “another person.” *Id.* For the same reasons, Lorenzo’s conduct also differs from the actions considered in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008). There, the Supreme Court held that parties who allegedly played a role in a scheme to make false statements to investors could not be held liable in a private action under Rule 10b-5. The Court explained that the parties’ acts “were not disclosed to the investing
public” and they “had no role” in “disseminating” the misstatements in question. Id. at 155, 161. Lorenzo, unlike the defendants in Janus and Stoneridge, transmitted misinformation directly to investors, and his involvement was transparent to them.

As a result, insofar as the Janus Court declined to bring the investment adviser’s actions in that case within the fold of Rule 10b-5 because doing so might reach too many persons fairly considered to be aiders and abettors, the same is not true of Lorenzo’s distinct conduct in this case. The Court’s concern that “aiders and abettors would be almost nonexistent” if a private action under Rule 10b-5 reached “an undisclosed act preceding the decision of an independent entity to make a public statement,” Janus, 564 U.S. at 143, 145, need not obtain in the case of a person’s self-attributed communications sent directly to investors (and backed by scienter). Lorenzo’s actions thus can form the basis of a violation of Rules 10b-5(a) and (c) (as well as Sections 10(b) and 17(a)(1)) while still leaving ample room for “distinction between those who are primarily liable . . . and those who are secondarily liable.” Id. at 143 n.6; see Stoneridge, 552 U.S. at 166 (“[T]he implied right of action in § 10(b) continues to cover secondary actors who commit primary violations.” (citing Central Bank, 511 U.S. at 191)).

3. Lorenzo intimates more broadly that actions involving false statements must fit within Rule 10b-5(b) and cannot be brought separately under Rules 10b-5(a) or (c) (or Section 17(a)(1)). We know of no blanket reason, however, to treat the various provisions as occupying mutually exclusive territory, such that false-statement cases must reside exclusively within the province of Rule 10b-5(b). And any suggestion that the coverage of Rule 10b-5(b) must be distinct from that of Rules 10b-5(a) and (c) presumably would mean that each of the latter two provisions likewise must occupy entirely separate ground from one another. In our view, however, the provisions’ coverage may overlap in certain respects.

Significantly, the Supreme Court recently described Rule 10b-5 in a manner confirming that conduct potentially subject to Rule 10b-5(b)’s bar against making false statements can also fall within Rule 10b-5(a)’s more general prohibition against employing fraudulent devices: the Court explained that “Rule 10b-5 . . . forbids the use of any ‘device, scheme, or artifice to defraud’ (including the making of any ‘untrue statement of material fact’ or any similar ‘omission’).” Chadbourne & Parke LLP v. Troice, 134 S. Ct. 1058, 1063 (2014) (emphasis added).

The Court has also held that, although Section 14 of the Exchange Act establishes “a complex regulatory scheme covering proxy solicitations,” the inapplicability of Section 14 to false statements in proxy materials does not preclude the application of Rule 10b-5 to the same statements. SEC v. Nat’l Sec., Inc., 393 U.S. 453, 468 (1969). “The fact that there may well be some overlap is neither unusual nor unfortunate,” the Court explained. Id. Here, correspondingly, Rules 10b-5(a) and
(c), as well as Sections 10(b) and 17(a)(1), may encompass certain conduct involving the dissemination of false statements even if the same conduct lies beyond the reach of Rule 10b-5(b).

In accordance with that understanding, a number of decisions have held that securities-fraud allegations involving misstatements can give rise to liability under related provisions even if the conduct in question does not amount to “making” a statement under Janus. See, e.g., SEC v. Big Apple Consulting USA, Inc., 783 F.3d 786, 795-96 (11th Cir. 2015); SEC v. Monterosso, 756 F.3d 1326, 1334 (11th Cir. 2014); SEC v. Benger, 931 F. Supp. 2d 904, 905-06 (N.D. Ill. 2013); SEC v. Familant, 910 F. Supp. 2d 83, 93-95 (D.D.C. 2012); SEC v. Stoker, 865 F. Supp. 2d 457, 464-65 (S.D.N.Y. 2012). We reach the same conclusion here with respect to the role played by Lorenzo in disseminating the false statements in his email messages to investors.

4. Our dissenting colleague would find that Lorenzo’s actions did not violate Rules 10b-5(a) or (c), or Sections 10(b) or 17(a)(1). He advances two reasons for reaching that conclusion, each of which, in our respectful view, is misconceived.

a. The dissent’s central submission is that Lorenzo acted without any intent to deceive or defraud. As our colleague sees things, Lorenzo simply transmitted false statements supplied by Gregg Lorenzo without giving any thought to their content. See infra at 1, 6 (Kavanaugh, J., dissenting). And Lorenzo ostensibly paid no attention to the content of the statements he sent even though: he included the statements in messages he produced for distribution from his own email account; he sent the statements in his name and capacity as investment banking director; and he encouraged the recipients to contact him personally with questions about the content. Under our colleague’s understanding, that is, Lorenzo offered to answer any questions about his emails even though he had supposedly paid no attention to what they said.

In adopting that understanding, the dissent relies on a finding by the ALJ that Lorenzo sent the emails without thinking about their contents. But the Commission, as we have noted, rejected the ALJ’s conclusion to that effect as “implausible” in the circumstances. Lorenzo, 2015 WL 1927763, at *9. In our colleague’s view, the court should accept the ALJ’s finding, notwithstanding the Commission’s rejection of it, because the ALJ could assess Lorenzo’s credibility as a witness.

The dissent’s (and ALJ’s) factual understanding, however, is contradicted by Lorenzo’s own account of his mental state to this court. Lorenzo raises no challenge to the Commission’s rejection of any notion that he paid no heed to his messages’ content. What is more, his argument on the issue of scienter rests on his affirmative contemplation—indeed, his ratification—of the content of his emails.

Unlike in his arguments before the ALJ and Commission, Lorenzo, in this court, does not take the position that he simply
passed along statements supplied by Gregg Lorenzo without thinking about them. Such a suggestion appears nowhere in his briefing. To the contrary, he argues that, “[a]t the time the email was sent [he] believed the statements to be true and he did not act with scienter.” Pet’r Reply Br. 6 (emphasis added). He further asserts that he “had a good faith belief in the veracity of the statements contained in the email that was drafted by Gregg Lorenzo.” Pet’r Opening Br. 18 (emphasis added); id. at 22 (“Petitioner had a good faith belief in the accuracy of the statements contained in the email.”). He then attempts to explain why he could have believed the truth of the materially misleading statements contained in his email messages, arguments that we have already rejected in affirming the Commission’s findings of scienter. See supra Part II.

For present purposes, what matters is that a person cannot have “believed statements to be true” at the time he sent them, or possessed a “good faith belief in their veracity,” if he had given no thought to their content in the first place. In that light, our dissenting colleague relies on an account of Lorenzo’s state of mind that stands in opposition to Lorenzo’s account to us of his own state of mind. (As for our colleague’s theory that Lorenzo could have formed a belief about the statements’ truthfulness without even reading them, based purely on his trust of Gregg Lorenzo, see infra at 7 n.1 (Kavanaugh, J., dissenting), even if we assume that theory were viable as a conceptual matter, Lorenzo’s arguments to us about his belief in the statements’ truth rest solely on their content, not on any trust-

without-verifying level of confidence in Gregg Lorenzo’s veracity. Indeed, he testified that, at least as of November 2009, “there is no way on God’s green earth [he] thought Gregg Lorenzo was an honest guy.” J.A. 176.)

Perhaps Lorenzo concluded he could not overcome the Commission’s assessment that it would be implausible to suppose he had blinded himself to the statements’ content before sending them to investors and offering to answer any questions about them. Or perhaps he determined that, insofar as he did so, he would have difficulty denying that he had acted with extreme recklessness—and therefore with scienter—in any event. Regardless, Lorenzo now takes the position that he took stock of the content of the statements, so much so that he formed a belief as to their truthfulness. And we are in no position to embrace an understanding of Lorenzo’s mental state that is disclaimed by Lorenzo himself.

To be clear, the point here is not that Lorenzo failed to preserve an argument about scienter. Lorenzo devoted considerable attention to the issue of scienter in his briefing. But Lorenzo’s arguments on the issue contain no suggestion that he sent his emails without giving thought to their contents. He instead contends he did think about the contents (and reasonably believed them to be truthful). In those circumstances, we do not so much defer to the Commission’s assessment of Lorenzo’s state of mind over the ALJ’s finding that Lorenzo gave no thought to his emails’ content. Rather, we accede to Lorenzo’s account of his own
mental state, which is incompatible with the finding of the ALJ.

But what if Lorenzo in fact had sought to argue to us, in concert with the ALJ’s finding, that he gave no thought to the content of his email messages when sending them? In that event—which, again, is not the situation we face—the issue for us would have been whether the Commission’s contrary conclusion is supported by substantial evidence, not whether the Commission or the ALJ has the better of the dispute between them on the matter. See, e.g., Kay v. FCC, 396 F.3d 1184, 1189 (D.C. Cir. 2005); Swan Creek Communications, Inc. v. FCC, 39 F.3d 1217, 1221 (D.C. Cir. 1994); see also Universal Camera Corp. v. NLRB, 340 U.S. 474, 496 (1951).

The Commission’s finding meets the deferential, substantial-evidence standard. After all, Lorenzo’s emails marked the only time he communicated directly with prospective investors, the emails concerned a securities offering by his sole investment banking client, the emails said he would personally answer questions about their content, and the emails carried his professional imprimatur as director of investment banking—all of which support the Commission’s rejection of the idea that Lorenzo simply sent his emails without taking any stock of what they said.

b. Even accepting that Lorenzo thought about the statements in his emails and sent them with an intent to deceive, the dissent would still conclude that Lorenzo’s conduct falls outside the ambit of Rules 10b-5(a) and (c), and Sections 10(b) and 17(a)(1). See infra at 9 (Kavanaugh, J., dissenting). Our colleague grounds that conclusion in his agreement with the proposition put forward by certain other courts of appeals to the effect that “scheme liability”—i.e., the conduct prohibited by Rules 10b-5(a) and (c)—requires something more than false or misleading statements. See Pub. Pension Fund Grp. v. KV Pharma. Co., 679 F.3d 972, 987 (8th Cir. 2012); WPP Luxembourg Gamma Three Sari v. Spot Runner, Inc., 655 F.3d 1039, 1057-58 (9th Cir. 2011); Lentell v. Merill Lynch & Co., 396 F.3d 161, 177 (2d Cir. 2005).

Our colleague appears to read those decisions’ embrace of that proposition to rest on the need to maintain a distinction between primary liability and secondary liability under Rule 10b-5. We have described the Janus Court’s reliance on that concern and explained our conclusion that it does not carry the day in the specific circumstances of Lorenzo’s conduct. See supra Part III.B.2.

Moreover, we do not read the referenced courts of appeals’ decisions to rest on concerns about preserving a distinction between primary and secondary liability. None of those decisions discusses (or mentions) the concepts of primary and secondary liability or any need to maintain a separation between them. Indeed, two of the three decisions postdate Janus, yet neither cites Janus, much less invokes Janus’s concerns with construing the scope of Rule 10b-5(b) in a manner that would encompass too many aiders-and-abettors.
In addition, it is far from clear that the rule articulated by those decisions could suitably be grounded in concerns with preserving a distinction between primary and secondary liability. According to the decisions, a “defendant may only be liable as part of a fraudulent scheme based upon misrepresentations and omissions under Rules 10b-5(a) or (c) when the scheme also encompasses conduct beyond those misrepresentations or omissions.” *WPP Luxembourg*, 655 F.3d at 1057; *see KV Pharma.*, 679 F.3d at 987; *Lentell*, 396 F.3d at 177. That understanding would be overinclusive if the objective in fact were to assure that aiders-and-abettors are not held primarily liable under those provisions.

Consider, for instance, the facts of *WPP Luxembourg*. There, the plaintiffs alleged sufficient facts to make out a claim of materially misleading omissions under Rule 10b-5(b). 655 F.3d at 1051. There was no question that the defendants faced primary (not secondary) liability if the facts as pleaded were proved. *Id.* Yet the court held that the defendants could not be liable under Rules 10b-5(a) or (c) because there were no allegations against them apart from misstatements or omissions. *Id.* at 1057-58. The court’s requirement that plaintiffs prove more than misstatements thus barred liability under those provisions even though there could have been no concerns about blurring the distinction between primary and secondary liability. Perhaps it is unsurprising, then, that, while Lorenzo relies on the importance of maintaining the primary-secondary liability distinction, he makes no reference to *WPP Luxembourg* or the other two decisions in his briefing.

For those reasons, we disagree with our dissenting colleague’s suggestion that our holding conflicts with those decisions with regard to the primary-secondary liability distinction. *See infra* at 9 (Kavanaugh, J., dissenting). We do not understand those decisions to turn on that distinction.

Those decisions do generally state, however, that Rules 10b-5(a) and (c) require something more than misstatements. But they did not have occasion to elaborate on that understanding to any significant extent—including, importantly for purposes of this case, whether the same interpretation would extend to Section 17(a)(1). Insofar as those courts of appeals would find Lorenzo’s actions to lie beyond the reach of those provisions, we read the provisions differently. Lorenzo’s particular conduct, as we have explained, fits comfortably within the language of Rules 10b5(a) and (c), along with that of Sections 10(b) and 17(a)(1).

Finally, we briefly respond to our dissenting colleague’s belief that there is an incongruity in deciding both that Lorenzo was not a maker of the false statements under Rule 10b-5(b) and that he nonetheless employed a fraudulent device and engaged in a fraudulent act under Rules 10b-5(a) and (c) and Section 17(a)(1). *See infra* at 11 (Kavanaugh, J., dissenting). Those combined decisions, in our view, follow naturally from the terms of the provisions. Lorenzo was not the “maker” of the false statements because he lacked ultimate authority over them. Still,
he “engaged” in a fraudulent “act” and “employed” a fraudulent “device” when, with knowledge of the statements’ falsity and an intent to deceive, he sent the statements to potential investors carrying his stamp of approval as investment banking director. One can readily imagine persons whose ministerial acts in connection with false statements would fail to qualify either as “making” the statements or as “employing” any fraudulent device. Lorenzo, in our view, is not such a person.

IV.

Lorenzo’s final challenge concerns the sanctions imposed against him. The Commission permanently barred Lorenzo “from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in an offering of penny stocks.” Lorenzo, 2015 WL 1927763, at *17. The Commission also ordered him to pay a $15,000 monetary penalty. Lorenzo argues that those penalties are arbitrary and capricious for various reasons, including that they are disproportional to the severity of his misconduct and to the sanctions imposed in similar cases.

We decline to reach the merits of Lorenzo’s challenges. The Commission chose the level of sanctions based in part on a misimpression that Lorenzo was the “maker” of false statements in violation of Rule 10b-5(b). Because we have now overturned the Commission’s finding of liability under Rule 10b-5(b), we vacate the sanctions and remand the matter to enable the Commission to reconsider the appropriate penalties.

We have no assurance that the Commission would have imposed the same level of penalties in the absence of its finding of liability for making false statements under Rule 10b-5(b). The Commission expressly grounded its sanctions on its perceptions about the “egregiousness of Lorenzo’s conduct” and the “degree of scienter involved,” as well as the need to deter others “from engaging in similar misconduct.” Id. at *12, *14. But the Commission operated under the assumption that Lorenzo devised, and had ultimate authority over, the substance of the false statements contained in the email messages he sent to investors. That assumption, as we have concluded, is unsupported by the record evidence. The Commission in fact specifically based its sanctions in some measure on a belief that Lorenzo improperly sought to “shift blame” by asserting “that he sent the emails at Gregg Lorenzo’s direction.” Id. at *13. But as the record indicates, that is essentially what happened.

Because we “cannot be certain what role, if any,” the Commission’s misperception that Lorenzo was the “maker” of the false statements ultimately played in its choice of sanctions, “we must remand” to enable it to reassess the appropriate penalties. Alliance for Cannabis Therapeutics v. DEA, 930 F.2d 936, 940-41 (D.C. Cir. 1991). When the Commission does so under a correct understanding about the nature of Lorenzo’s
misconduct, it can assess “whether the sanction is out of line with the agency’s decisions in other cases” involving comparable misconduct—which, as we have observed, is one consideration informing review of penalties for arbitrariness and capriciousness. *Collins v. SEC*, 736 F.3d 521, 526 (D.C. Cir. 2013).

The Commission, in this regard, notes our previous observation that the “Commission is not obligated to make its sanctions uniform, so we will not compare this sanction to those imposed in previous cases.” *Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004) (citing *Butz v. Glover Livestock Comm’n Co.*, 411 U.S. 182, 186-87 (1973)). In that vein, we have explained that a mere absence of uniformity will not necessarily render a particular action “unwarranted in law,” id. at 488, or “unwarranted as a matter of policy,” *Kornman*, 592 F.3d at 188. But we have never declined to compare past-and-present Commission sanctions in the context of an arbitrary-and-capricious challenge. In fact, our decision in *Collins* clarified that such a challenge may be brought to review the propriety of the Commission’s choice of sanction in a given case as compared with sanctions in comparable situations. See 736 F.3d at 526.

* * * * *

For the foregoing reasons, we grant the petition for review in part, vacate the sanctions imposed by the Commission, and remand the matter for further consideration.

*Kavanaugh, Circuit Judge, dissenting:*

Suppose you work for a securities firm. Your boss drafts an email message and tells you to send the email on his behalf to two clients. You promptly send the emails to the two clients without thinking too much about the contents of the emails. You note in the emails that you are sending the message “at the request” of your boss. It turns out, however, that the message from your boss to the clients is false and defrauds the clients out of a total of $15,000. Your boss is then sanctioned by the Securities and Exchange Commission (as is appropriate) for the improper conduct.

What about you? For sending along those emails at the direct behest of your boss, are you too on the hook for the securities law violation of willfully making a false statement or willfully engaging in a scheme to defraud?

According to the SEC, the answer is yes. And the SEC concludes that your behavior – in essence forwarding emails after being told to do so by your boss – warrants a lifetime suspension from the securities profession, on top of a monetary fine.

That is what happened to Frank Lorenzo in this case. The good news is that the majority opinion vacates the lifetime suspension. The bad news is that the majority opinion – invoking a standard of deference that, as applied here, seems akin to a standard of “hold your nose to avoid the stink” – upholds much of the SEC’s decision on
liability. I would vacate the SEC’s conclusions as to both sanctions and liability. I therefore respectfully dissent.

* * *

The SEC initiated an enforcement action against Frank Lorenzo and his boss. The boss eventually reached a settlement agreement with the SEC. Apparently thinking he had done little wrong by merely sending emails to two clients at the request of his boss, Lorenzo did not settle.

The case then proceeded through three stages: a trial before an SEC administrative law judge, review by the Commission itself, and then review by this Court. To understand my disagreement with the majority opinion, it is necessary to describe all three acts in this drama.

**Act One: The Administrative Law Judge**

The case proceeded to trial before an administrative law judge. This was not your usual trial. Surprisingly, the SEC did not present testimony from Lorenzo’s boss or from anyone else at the securities firm where Lorenzo worked. Instead, only Lorenzo testified about the extent of his involvement in drafting and sending the emails.

After hearing Lorenzo’s testimony and weighing his credibility, the judge concluded that Lorenzo’s boss had “drafted” the emails in question and that Lorenzo’s boss had “asked” Lorenzo to send the emails to two clients. ALJ Op. at 5 (Dec. 31, 2013), J.A. 906. The judge also concluded that Lorenzo did not read the text of the emails and that Lorenzo “sent the emails without even thinking about the contents.” Id. at 7, J.A. 908; see id. at 9, J.A. 910 (“Had he taken a minute to read the text . . .”). Furthermore, the judge noted that the emails themselves expressly stated that they were being sent at “the request” of Lorenzo’s boss. Id. at 5, J.A. 906.

Those factual findings were very favorable to Lorenzo and should have cleared Lorenzo of any serious wrongdoing under the securities laws. At most, the judge’s factual findings may have shown some mild negligence on Lorenzo’s part. The judge, however, went much further than that. The judge somehow concluded that those findings of fact demonstrated that Lorenzo *willfully* violated the securities laws – meaning that Lorenzo acted with an intent to deceive, manipulate, or defraud. (A finding of willfulness, as opposed to a finding of negligence, matters because it subjects a defendant to much higher penalties.) As a sanction, the judge not only fined Lorenzo, but also imposed a *lifetime suspension* that prevents Lorenzo from ever again working in the securities industry.

The administrative law judge’s factual findings and legal conclusions do not square up. If Lorenzo did not draft the emails, did not think about the contents of the emails, and sent the emails only at the behest of his boss, it is impossible to find that Lorenzo acted “willfully.” That is Mens Rea 101. Establishing that a defendant acted willfully in this context requires proof at least of the defendant’s “intent to deceive, manipulate, or
defraud.” *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (internal quotation marks omitted). How could Lorenzo have intentionally deceived the clients when he did not draft the emails, did not think about the contents of the emails, and sent the emails only at his boss’s direction?

The administrative law judge’s decision in this case contravenes basic due process. A finding that a defendant possessed the requisite mens rea is essential to preserving individual liberty. See, e.g., *Morissette v. United States*, 342 U.S. 246, 250-51, 263 (1952); see also *United States v. Burwell*, 690 F.3d 500, 527 (D.C. Cir. 2012) (en banc) (Kavanaugh, J., dissenting); *United States v. Moore*, 612 F.3d 698, 703 (D.C. Cir. 2010) (Kavanaugh, J., concurring); *Bluman v. FEC*, 800 F. Supp. 2d 281, 292 (D.D.C. 2011) (three-judge panel). As Justice Jackson explained: “The contention that an injury can amount to a crime only when inflicted by intention is no provincial or transient notion. It is as universal and persistent in mature systems of law as belief in freedom of the human will and a consequent ability and duty of the normal individual to choose between good and evil. A relation between some mental element and punishment for a harmful act is almost as instinctive as the child’s familiar exculpatory ‘But I didn’t mean to.’” *Morissette*, 342 U.S. at 250-51 (footnote omitted).

The administrative law judge’s opinion in this case did not heed those bedrock mens rea principles. Given the judge’s pro-Lorenzo findings of fact, a legal conclusion that Lorenzo “willfully” violated the securities laws makes a hash of the term “willfully,” and of the deeply rooted principle that punishment must correspond to blameworthiness based on the defendant’s mens rea.

**Act Two: The Securities and Exchange Commission**

Fast forward to the Securities and Exchange Commission, which heard the appeal of the administrative law judge’s decision. Surely the Commission would realize that the administrative law judge’s factual findings did not support the judge’s legal conclusions and sanctions?

And indeed, the Commission did come to that realization. But instead of vacating the order against Lorenzo, the Commission did something quite different and quite remarkable. In a Houdini-like move, the Commission rewrote the administrative law judge’s factual findings to make those factual findings correspond to the legal conclusion that Lorenzo was guilty and deserving of a lifetime suspension.

Recall what the administrative law judge found: that Lorenzo’s boss “drafted” the emails, that Lorenzo did not think about the contents of the emails, and that Lorenzo sent the emails only after being asked to do so by his boss. ALJ Op. at 5, J.A. 906. The judge reached those conclusions only after hearing Lorenzo testify and assessing his credibility in person.

Without hearing from Lorenzo or any other witnesses, the Commission simply swept the judge’s factual and credibility
findings under the rug. The Commission concluded that Lorenzo himself was “responsible” for the emails’ contents. In the Matter of Francis V. Lorenzo, Securities Act Release No. 9762, Exchange Act Release No. 74836 at 16 (Apr. 29, 2015), J.A. 930. How did the Commission magically explain its decision to discard the administrative law judge’s findings of fact? Easy. In a footnote, the Commission said that it did not need to “blindly” accept the administrative law judge’s factual findings and credibility judgments. Id. at 16 n.32, J.A. 930 n.32. Voila.

The Commission’s handiwork in this case is its own debacle. Faced with inconvenient factual findings that would make it hard to uphold the sanctions against Lorenzo, the Commission – without hearing any testimony – simply manufactured a new assessment of Lorenzo’s credibility and rewrote the judge’s factual findings. So much for a fair trial.

Act Three: This Court

Fast forward to this Court. To its credit, the majority opinion rightly concludes that Lorenzo did not “make” the statements in the emails for purposes of Rule 10b-5(b) liability. See Janus Capital Group, Inc. v. First Derivative Traders, 564 U.S. 135 (2011). And the majority opinion, also to its credit, vacates the grossly excessive lifetime suspension of Lorenzo and sends the case back to the SEC for reconsideration of the appropriate penalties.

So far, so good. But applying what it calls “very deferential” review, the majority opinion upholds the finding of liability against Lorenzo under Section 10(b), Rule 10b-5(a) and (c), and Section 17(a). Maj. Op. 7, 18-25. The majority opinion does so on the ground that Lorenzo willfully engaged in a scheme to defraud even though he did not “make” the statements in the emails.

I disagree on two alternative and independent grounds with the majority opinion’s merits analysis.

First, the majority opinion does not heed the administrative law judge’s factual conclusions, which were based on the judge’s in-person assessment of Lorenzo’s testimony at trial. Those factual conclusions demonstrate that Lorenzo lacked the necessary mens rea of willfulness.

To show that Lorenzo willfully engaged in a scheme to defraud, the SEC had to prove that Lorenzo acted with an intent to deceive, manipulate, or defraud. But recall that, as findings of fact, the administrative law judge concluded (after hearing Lorenzo testify) that Lorenzo did not draft the emails, did not think about the contents of the emails, and sent the emails only at the behest of his boss.

In light of the administrative law judge’s factual findings, how can Lorenzo be deemed to have willfully engaged in a scheme to defraud? The majority opinion says that the facts found by the administrative law judge are not the right facts. Instead, in reaching its conclusion, the majority opinion
relies on the SEC’s alternative facts, which the SEC devised on its own without hearing from any witnesses. See Maj. Op. 20-21, 26-29 (adopting the SEC’s view of the facts over the administrative law judge’s view).

It is true that, under certain circumstances, an agency such as the SEC may re-examine and overturn an administrative law judge’s factual findings. See Universal Camera Corp. v. NLRB, 340 U.S. 474, 492 (1951). But an agency does not have carte blanche to rewrite an administrative law judge’s factual determinations. Rather, an agency must act reasonably when it disregards an administrative law judge’s factual findings, a point the SEC’s attorney expressly acknowledged at oral argument. See Tr. of Oral Arg. at 28. It is black-letter law, therefore, that “a contrary initial decision” by an administrative law judge “may undermine the support for the agency’s ultimate determination.” Ronald M. Levin & Jeffrey S. Lubbers, Administrative Law and Process 101 (6th ed. 2017). And here is the key principle that speaks directly to this case: “When the case turns on eyewitness testimony . . . the initial decision should be given considerable weight: the ALJ was able to observe the demeanor of the witnesses and assess their credibility and veracity first hand.” Id.

In my view, the majority opinion misapplies those blackletter principles. Contrary to the majority opinion’s acceptance of the SEC’s reconstruction of the facts in this case, I would conclude that the SEC’s rewriting of the administrative law judge’s findings of fact was utterly unreasonable and should not be sustained or countenanced by this Court. Given that Lorenzo was the only relevant witness at trial (dwell again on that point for a few moments) and given that his credibility was central to the case, the SEC had no reasonable basis to run roughshod over the administrative law judge’s findings of fact and credibility assessments. In short, the SEC’s rewriting of the findings of fact deserves judicial repudiation, not judicial deference or respect.

Instead of deferring to the SEC’s creation of an alternative factual record, as the majority opinion does, we should examine the administrative law judge’s underlying findings of fact and ask whether those findings suffice to support the conclusion that Lorenzo willfully engaged in a scheme to defraud. The answer to that question, as explained above, is a clear no.

Second, put that aside. Even if I am wrong about the first point, the majority opinion still suffers from a separate flaw, in my view.

The majority opinion creates a circuit split by holding that mere misstatements, standing alone, may constitute the basis for so-called scheme liability under the securities laws – that is, willful participation in a scheme to defraud – even if the defendant did not make the misstatements. No other court of appeals has adopted the approach that the majority opinion adopts here. Other courts have instead concluded that scheme liability must be based on conduct that goes beyond a defendant’s role in preparing mere
misstatements or omissions made by others. See, e.g., Public Pension Fund Group v. KV Pharmaceutical Co., 679 F.3d 972, 987 (8th Cir. 2012); WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc., 655 F.3d 1039, 1057 (9th Cir. 2011); Lentell v. Merrill Lynch & Co., 396 F.3d 161, 177 (2d Cir. 2005); see also SEC v. Kelly, 817 F. Supp. 2d 340, 343-44 (S.D.N.Y. 2011). Otherwise, the SEC would be able to evade the important statutory distinction between primary liability and secondary (aiding and abetting) liability. After all, if those who aid and abet a misstatement are themselves primary violators for engaging in a scheme to defraud, what would be the point of the distinction between primary and secondary liability?

The distinction between primary and secondary liability matters, particularly for private securities lawsuits. For decades, however, the SEC has tried to erase that distinction so as to expand the scope of primary liability under the securities laws. For decades, the Supreme Court has pushed back hard against the SEC’s attempts to unilaterally rewrite the law. See Janus, 564 U.S. 135; Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc. 552 U.S. 148 (2008); Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994). Still undeterred in the wake of that body of Supreme Court precedent, the SEC has continued to push the envelope and has tried to circumvent those Supreme Court decisions. See, e.g., In the Matter of John P. Flannery & James D. Hopkins, Release No. 3981 (Dec. 15, 2014). This case is merely the latest example.

I agree with the other courts that have rejected the SEC’s persistent efforts to end-run the Supreme Court. I therefore respectfully disagree with the majority opinion that Lorenzo’s role in forwarding the alleged misstatements made by Lorenzo’s boss can be the basis for scheme liability against Lorenzo.

Taking a step back on the scheme liability point, moreover, think about the oddity of the majority opinion’s combined legal rulings today. The majority opinion emphatically holds that Lorenzo did not “make” the statements in the emails. In reaching that conclusion, the majority opinion accurately says that “Lorenzo transmitted statements devised by” Lorenzo’s boss at his boss’s “direction.” Maj. Op. 16. The majority opinion also correctly notes that Lorenzo’s boss “asked Lorenzo to send the emails, supplied the central content, and approved the messages for distribution.” Maj. Op. 17. At the same time, however, the majority opinion emphatically holds that Lorenzo nonetheless willfully engaged in a scheme to defraud solely because of the statements made by his boss. That combined holding makes little sense (at least to me) under the facts of this particular case. Nor does it make much sense under the law, which is presumably why the other courts of appeals have rejected that kind of legal jujitsu. In these circumstances, perhaps the alleged offender (here, Lorenzo) could have been charged with aiding and abetting, if the relevant mens rea requirements for aiding and abetting liability were met. But Lorenzo may not be held liable as a primary violator, in my view.
Administrative adjudication of individual disputes is usually accompanied by deferential review from the Article III Judiciary. That agency-centric process is in some tension with Article III of the Constitution, the Due Process Clause of the Fifth Amendment, and the Seventh Amendment right to a jury trial in civil cases. See generally PHILIP HAMBURGER, IS ADMINISTRATIVE LAW UNLAWFUL? 227-57 (2014). That tension is exacerbated when, as here, the agency’s political appointees—without hearing from any witnesses—disregard an administrative law judge’s factual findings. That said, the Supreme Court has allowed administrative adjudication ever since Crowell v. Benson, 285 U.S. 22 (1932). But the premise of Crowell v. Benson is that, putting aside any formal constitutional problems with the notion of administrative adjudication, the administrative adjudication process will at least operate with efficiency and with fairness to the parties involved. This case, among others, casts substantial doubt on that premise.

Securities brokers such as Frank Lorenzo obviously do not tug at the judicial heartstrings. And maybe Lorenzo really is guilty of negligence (or worse). But before the SEC reaches such a conclusion, Lorenzo is entitled to a fair process just like everyone else. Cf. United States v. Burwell, 690 F.3d 500, 527 (D.C. Cir. 2012) (en banc) (Kavanaugh, J., dissenting). He has not received a fair process in this case.

I hope that the SEC on remand pays attention, comes to its senses, and (at a minimum) dramatically scales back the sanctions in this case. Indeed, notwithstanding the majority opinion, I hope that the SEC, on its own motion, goes further than that: The SEC should vacate the order against Lorenzo in its entirety and either end this case altogether or (if appropriate and permissible) fairly start the process anew before the administrative law judge.

I firmly disagree with the majority opinion’s decision to sustain the SEC’s findings of liability under Section 10(b), Rule 10b-5(a) and (c), and Section 17(a). I respectfully dissent.
“Are False Statements Enough to Prove Fraud”

The New York Times

Peter J. Henning

July 3, 2018

Frauds usually start with some type of deception that leads victims to hand over their money. But what if false statements are not enough to prove a person engaged in a scheme to defraud?

The Supreme Court will take up that issue this year when it hears an appeal in Lorenzo v. Securities and Exchange Commission, and the justices’ decision could result in cutting back on the scope of Rule 10b-5, the primary federal securities fraud prohibition. The decision could affect how the S.E.C. pursues fraud cases when defendants are accused of making false statements to investors.

Francis V. Lorenzo was the director of investment banking at a brokerage firm when he sent emails to two potential investors in a $15 million convertible debenture offering. The company issuing the debt was working to generate electricity by converting solid waste into gas. A few days before sending the emails, Mr. Lorenzo learned that the “gasification” technology was not working and that the company had written off $11 million worth of intangible assets related to that.

Mr. Lorenzo’s emails failed to mention the accounting change and stated that the company had purchase orders for $43 million. That information came from his boss at the brokerage firm, and Mr. Lorenzo claimed that he had merely copied and pasted it into the emails he sent the investors. The S.E.C. accused him of committing a primary violation of Rule 10b-5, not just being an accomplice to a fraud. The administrative law judge assigned to hear the evidence wrote that the falsity in the emails was “staggering.”

Rule 10b-5 prohibits three types of violations: employing any “device, scheme or artifice to defraud”; making a false statement or omitting information that misleads investors; or engaging in conduct that “would operate as a fraud or deceit.” The S.E.C. found that Mr. Lorenzo had violated all three provisions. It barred him from the securities industry and imposed a $15,000 penalty.

Mr. Lorenzo took his case to the federal appeals court in Washington. The issue was whether an earlier Supreme Court decision, Janus Capital Group v. First Derivative Traders, prevented finding him to be a primary violator of Rule 10b-5. In that case, the justices held that liability for false statements was limited to “the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.” Mr. Lorenzo argued that he could not be held directly
responsible because he had just copied and pasted the false statements, and that only his boss had acted willfully.

The appeals court agreed that he did not make the statement. But it upheld the S.E.C.’s sanctions, finding that he had engaged in a scheme to defraud. That meant he had violated the other two parts of Rule 10b-5. Because Mr. Lorenzo “conveyed materially false information to prospective investors about a pending securities offering backed by the weight of his office as director of investment banking,” the court said, he joined in an effort to defraud investors and was liable.

The problem was that the decision opened a back door around the Janus Capital ruling.

That approach usually does not play well with the Supreme Court justices, who have not been receptive to efforts to avoid its more restrictive readings of Rule 10b-5. In the 2008 decision in Stoneridge Investment Partners v. Scientific-Atlanta, the justices rejected “scheme liability,” which could make third parties responsible for helping a company file misleading financial statements by engaging in sham transactions. The court viewed “scheme liability” as an effort to avoid its earlier rejection of aiding and abetting liability for securities fraud in private cases.

Unlike Janus Capital and Stoneridge, which were private cases, the Lorenzo case involves the S.E.C.’s trying to protect investors through an enforcement action. It is possible the court might be more forgiving and allow the agency to take a broader approach to the law than private litigants can.

But the Supreme Court has rejected the regulator’s broader readings of the securities laws over the past two years, at least outside the context of insider trading. In Kokesh v. Securities and Exchange Commission, decided in June last year, the justices limited the period in which the S.E.C. can seek to compel a defendant to disgorge ill-gotten gains to five years and even questioned whether federal District Courts can order that remedy.

On June 21, the Supreme Court found in Lucia v. Securities and Exchange Commission that the S.E.C.’s method for appointing administrative law judges was flawed. The ruling threw into doubt a number of recent cases decided by its in-house court and caused the agency to stop pending administrative proceedings until it can figure out how to proceed.

These decisions are part of a trend in which the justices have shown greater skepticism to government’s arguments that statutes need to be read expansively. In Marinello v. United States, decided in March, the court rejected the Justice Department’s reading of what constitutes obstructing the Internal Revenue Service. The department’s view would have made a felony out of almost any conduct that made the process of collecting taxes more difficult.

Although the S.E.C. can bring cases against those who aid another in committing a fraud, it prefers to pursue defendants as primary violators so it can impose harsher penalties
that require proof of a willful violation. It would not be a surprise to see the Supreme Court read Rule 10b-5 more restrictively in Mr. Lorenzo’s case.

That would mean only those who were directly responsible for a misstatement or who failed to disclose important information would be liable as the primary person engaging in fraudulent conduct. That could make the agency’s job of policing the markets more difficult and could require it to pursue future targets as accomplices to wrongdoing rather than as the principal bad guy.
The U.S. Supreme Court agreed to consider narrowing the nation’s securities-fraud laws, accepting an appeal from an investment banker found by the Securities and Exchange Commission to have duped investors about a startup company’s financial condition.

The banker, Francisco V. Lorenzo, said the SEC didn’t have enough proof to hold him liable for taking part in a scheme to defraud investors.

A divided federal appeals court said it was enough that Lorenzo, who worked at Charles Vista LLC, sent two emails misrepresenting the financial condition of a client, Waste2Energy Holdings Inc. The company was seeking to develop a way to generate electricity from solid waste, but the technology never materialized.

An in-house judge at the SEC concluded the emails were “staggering” in their falsity.

In his appeal, Lorenzo says allegations of false statements, without more, aren’t enough to hold someone liable for a fraudulent scheme.

Lorenzo was also accused of violating securities-fraud provisions that specifically concern false statements, but the appeals court threw those claims out. The panel said Lorenzo wasn’t the one who actually made false statements, because the emails were drafted by Lorenzo’s boss and sent at his direction.

The SEC judge fined Lorenzo $15,000 and barred him from the securities industry for life. As part of its ruling, the appeals court told the SEC to reconsider those penalties.

The case, which the court will hear in the nine-month term that starts in October, is Lorenzo v. Securities and Exchange Commission, 17-1077.
“Lorenzo v. SEC: Will High Court Further Curtail Rule 10b-5?”

Law360

Roger Cooper, Matthew Solomon and Leslie Silverman

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Last month, the U.S. Supreme Court granted a writ of certiorari in Lorenzo v. U.S. Securities and Exchange Commission,[1] a case where Francis Lorenzo, a registered representative of a broker-dealer, allegedly emailed false and misleading statements to investors that were originally drafted by his boss. After administrative and commission findings of liability, a divided panel of the D.C. Circuit determined that, while Lorenzo was not the “maker” of the statements, he did use them to deceive investors, and thereby violated the so-called scheme liability provisions of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. As described in the petitioner’s motion seeking certiorari, the case presents the question whether, under the court’s 2011 Janus Capital Group Inc. v. First Derivative Traders decision,[2] the scheme liability provisions of Rule 10b-5(a) and (c) may be used to find liability in connection with false or misleading statements by persons who are not themselves the maker of those statements and, thus, not liable under the false-and-misleading statements provision of Rule 10b-5(b).[3] The answer to this question could have implications for the SEC’s Enforcement Division, as well as potentially significant implications for private securities litigants who principally rely on Section 10(b) to bring private causes of action sounding in fraud.

In particular, the court’s decision may well bring more clarity to the case law that has developed after the Supreme Court held in Central Bank of Denver NA v. First Interstate Bank of Denver NA that private plaintiffs may not maintain aiding-and-abetting suits brought under Section 10(b) and Rule 10b-5.[4] Since that decision, a number of courts have taken the position that each clause of Rule 10b-5 is meant to capture different types of conduct, and therefore cases based primarily on misstatements or omissions that give rise to liability under Rule 10b-5(b) cannot also be charged under the scheme liability provisions of (a) and (c) of that same rule. Because Lorenzo allegedly involved the use of a misleading statement by a nonmaker under Janus that nevertheless, according to the D.C. Circuit majority, amounted to a scheme, it provides the court a vehicle, should it wish, to impose restrictions on scheme liability cases and thus limit claims available to private plaintiffs where the fact pattern involves the use of a material misrepresentation by a nonmaker, but no additional deceptive conduct.

The court’s ultimate approach on this appeal may turn on whether President Donald Trump’s nominee to fill the Kennedy vacancy on the court, Judge Brett Kavanaugh, is confirmed and, if so, whether
he participates in the appeal. Judge Kavanaugh penned a strong dissent from portions of the underlying D.C. Circuit decision. If he is confirmed and recuses himself on the basis of having heard the case below, any attempt to limit the ability of the SEC or private plaintiffs to bring scheme liability claims could meet resistance from the court’s four more liberal justices, each of whom dissented from Janus, potentially resulting in a 4-4 split that would in effect affirm the D.C. Circuit’s decision below. In any event, it is worth pausing to consider the issues this appeal presents because the grant of certiorari suggests that the court may be looking for a vehicle to more clearly demarcate the line between misstatements and scheme liability cases, and possibly even to rein in the scope of Rule 10b-5(b) cases more broadly, either here or in a future appeal.

Primary vs. Secondary Liability

The significance of this case rests on the difference between primary (misstatements and/or scheme) liability and secondary (aiding-and-abetting) liability for securities law violations under Rule 10b-5 and its three clauses. Following Central Bank’s foreclosure of aiding-and-abetting liability, private litigation has focused on determining what constitutes either a false or misleading statement, actionable under Rule 10b-5(b), or otherwise deceptive conduct, which may or may not include a material misrepresentation, actionable under Rules 10b-5(a) and (c), which broadly prohibit deceptive devices, schemes or other similar acts. This case highlights two questions relevant to that determination. First, who is the “maker” of the statement and thus potentially liable under Section 10b-5(b)? And, second, is the mere use of a false or misleading statement by someone who is not himself the “maker” sufficiently deceptive on its own to constitute scheme liability under Rules 10b-5(a) and (c), or is such an attempt to turn mere use into a scheme an end-run around 10b-5(b)’s primary liability requirements?

Addressing the first question — who “makes” a statement under 10b-5(b) — the Supreme Court held in Janus that “the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.”[5] On that question, the court held that, “in the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by — and only by — the party to whom it is attributed.”[6] The second question — what conduct is deceptive under 10b-5(a) and (c) — has elicited somewhat mixed approaches from the federal bench. A number of courts have taken the position that each clause of Rule 10b-5 is intended to capture different types of conduct. Cases primarily based on misstatements or omissions that would give rise to liability under Rule 10b-5(b) therefore cannot also be charged as scheme liability under Rule 10b-5(a) or (c) absent additional deceptive conduct separate and apart from the use of the misstatement itself.[7] The commission has (unsurprisingly) taken the more expansive view that Rules 10b-5(a) and (c) can be used in appropriate circumstances
to reach persons who disseminate a false or misleading statement made by another.[8]

Lorenzo

The D.C. Circuit took a somewhat surprising route in deciding a case implicating both of these questions. Lorenzo was the director of investment banking at a registered broker-dealer, Charles Vista LLC.[9] At the direction of his boss, Lorenzo sent an email to prospective investors lauding a number of purported “layers of protection” against default — including $10 million in assets — of a startup company looking to issue debentures.[10] Lorenzo sent the email from his account and above his signature block, the email identified him as Charles Vista’s head of investment banking, and the email finished with an invitation to call him if investors had questions.[11] The email also included a note that it was sent at the request of his boss,[12] and Lorenzo later testified that he copied and pasted the content from his boss.[13] After a hearing, an SEC administrative law judge found that Lorenzo understood when he sent the email that none of these protections existed, that the company had virtually no assets to its name, and, as a result, that Lorenzo violated all three clauses of Rule 10b-5.[14] The commission upheld the ALJ’s decision.[15]

On appeal from the commission decision, a 2-1 panel majority of the D.C. Circuit agreed that the statements in the email were false or misleading and that Lorenzo acted with the requisite scienter in sending it.[16] However, the court also found that, under Janus, Lorenzo was not the maker of the false or misleading statements because he sent the email “at the behest of his boss” who “supplied the content” and “approved” the email.[17] As a result, the court held that Lorenzo did not violate Rule 10b-5(b).[18] Interestingly, the court did not address the issue of attribution, instead focusing on the notion that Lorenzo’s boss was the one with ultimate authority over when and how to communicate the email.

The court further held, however, that Lorenzo violated 10b-5(a) and (c) by sending the email.[19] In other words, Lorenzo’s use of the statement to deceive was sufficient to invoke the scheme liability provisions of Rule 10b-5(a) and (c), even though Lorenzo was not himself the “maker” of the statement under Janus and even though the court identified no additional deceptive conduct apart from the use of the misstatement itself. In reaching that conclusion, the court rejected Lorenzo’s argument that, at most, his conduct amounted to aiding-and-abetting and not primary liability.[20] Instead, the court found that because Lorenzo interacted directly with investors in supplying the false emails, he was primarily liable. The court also found that claims involving false statements did not need to sit exclusively within 10b-5(b): “Rules 10b-5(a) and (c), as well as Sections 10(b) and 17(a)(1) [of the Securities Act], may encompass certain conduct involving the dissemination of false statements even if the same conduct lies beyond the reach of Rule 10b-5(b).”[21]

In dissent, Judge Kavanaugh characterized the commission’s tactics as decades of trying to “circumvent” Supreme Court decisions
designed to distinguish primary and secondary liability.[22] He criticized the shifting interpretations of the record at each level of the proceeding, and believed the administrative law judge’s factual findings did not support the required scienter.[23] He also indicated that he would have ruled, in accordance with the Second, Eighth and Ninth Circuits, that “scheme liability must be based on conduct that goes beyond a defendant’s role in preparing mere misstatements or omissions made by others.”[24]

What’s Next?

Lorenzo has asked the Supreme Court to answer the question whether a misstatement claim “that does not meet the elements set forth in Janus can be repackaged and pursued as a fraudulent scheme claim.”[25] A number of possible outcomes present themselves.

Prior to Judge Kavanaugh’s nomination to the court, the most likely outcome in view of the court’s recent securities law decisions is that a majority would subscribe to his dissent and use Lorenzo to clarify what type of conduct constitutes deception under scheme liability by finding that allegations of conduct involving use of a misleading statement alone can only give rise potentially to primary liability under Rule 10b-5(b) and not the scheme liability provisions of Rule 10b-5(a) and (c). This approach, which would accord with the majority of federal courts to have considered the issue, seems the most likely given the court’s past concerns — reflected in Central Bank, Janus and Stoneridge Investment Partners v. Scientific-Atlanta[26] — with clearly demarcating the line between primary and secondary liability. While such an approach would work to cabin private actions, it would have less of an impact on SEC enforcement actions in this area given the commission’s ability to bring aiding-and-abetting charges against nonmakers who use misstatements to deceive, as well as the commission’s ability to use Section 17 of the Securities Act — to which most courts have said Janus does not apply[27] — to capture fraud in the offer or sale of securities “by means of any untrue statement of a material fact.”[28]

Should Judge Kavanaugh be confirmed and recuse himself, on the other hand, the Supreme Court may well reach a 4-4 stalemate on the scope of scheme liability, which would result in an affirmance of the D.C. Circuit’s majority decision. This result would leave in place — at least for the moment — circuit court precedent that takes an expansive view of the scope of 10b-5 liability, allowing the SEC and private plaintiffs to bring primary liability claims involving misrepresentations as scheme liability claims, even without additional deceptive conduct, against someone who is not the statement’s “maker.”

One thing to keep an eye out for is whether the Supreme Court, either in this appeal or perhaps a future appeal, further restricts primary liability claims under Rule 10b-5(b) by endorsing the D.C. Circuit’s holding that only the person or entity with ultimate authority over a statement can be a “maker” for Janus purposes, without regard to explicit attribution within a statement. This reading,
while not necessary to answer the question presented in Lorenzo, could, if followed by the lower courts, dramatically curtail the reach of Rule 10b-5 in both private and SEC actions, particularly when combined with a reversal of the D.C. Circuit on the scope of scheme liability. For example, this interpretation could affect whether investment banks can be held liable for statements in issuers’ offering documents. While such documents state that they are the words of, and only of, the issuer, underwriters are often credited on the cover of such documents, which some courts have held can furnish the necessary attribution under Janus.[29] However, under the D.C. Circuit’s reading, such attribution is likely insufficient to reflect the necessary ultimate authority required by Janus.[30]

In sum, the Supreme Court appears likely to endorse the more restrictive view of Rule 10b-5’s scheme liability provisions either in this case or, were a recusal to result in a 4-4 split, a future case on similar facts, to the detriment of private plaintiffs. A majority conservative court seems unlikely to endorse the commission’s and the minority of courts’ views that a misstatement alone can be the basis for a scheme liability primary violation. And, in the likely worst outcome for the SEC and private litigants, the court ultimately could not only hem in scheme liability claims but also take the additional step of expressly endorsing the D.C. Circuit’s seeming cabining of Janus’ holding on maker liability. This latter outcome could significantly complicate both SEC enforcement actions and private lawsuits against underwriters and others similarly situated. Additional clues to the court’s leanings should present themselves at oral argument in the fall.
A divided D.C. Circuit set aside SEC sanctions against Charles Vista LLC broker Francis Lorenzo for sending out emails that misrepresented the key features of a securities offering in a start-up alternative energy company.

The U.S. Court of Appeals for the District of Columbia Circuit agreed Sept. 29 with the Securities and Exchange Commission that the statements in Lorenzo’s emails were false or misleading and that he acted with culpable intent (Lorenzo v. SEC, 2017 BL 345755, D.C. Cir., No. 15-1202, 9/29/17).

However, Judge Sri Srinivasan said, Lorenzo didn’t “make” the misstatements for purposes of a 1934 Securities Exchange Act rule that bars the making of materially false statements in connection with a securities transaction. Rather, Lorenzo’s boss, who supplied the content of the false statements and had “ultimate authority” over them, did.

Because the commission’s sanctions were at least partly based on the “misimpression” that Lorenzo’s conduct violated Rule 10b-5(b) they must be set aside and the case remanded.

Dissenting, Judge Brett Kavanaugh said the “good news” is that the court vacated the lifetime suspension imposed by the SEC. “The bad news,” he said, is that the opinion “upholds much of the SEC’s decision on liability. I would vacate the SEC’s conclusions as to both sanctions and liability,” Kavanaugh said.

The decision sheds light on a six-year-old U.S. Supreme Court decision on what it means to “make” a material misstatement for securities fraud purposes. The case “is a useful reminder that the ‘making’ test can serve as an important limitation on claims brought under Section 10(b) and Rule 10b-5,” Denver lawyer Michael MacPhail, Faegre Baker Daniels LLP, told Bloomberg BNA.

Through a spokeswoman, the SEC declined to comment.

Janus Test
In 2013, the SEC sued Charles Vista, a New York-based brokerage firm, and two unrelated brokers—Lorenzo and his boss Gregg Lorenzo—for allegedly using false and unfounded statements to secure investments in Waste2Energy Holdings Inc., a purported clean energy company.

An SEC administrative law judge found Lorenzo liable for sending investors emails that he knew contained false and misleading information. She fined him $15,000, ordered him to cease and desist from future
misconduct, and barred him from the industry. The SEC affirmed and Lorenzo appealed to the D.C. Circuit.

Vacating and remanding, the appeals court said that under the U.S. Supreme Court’s decision in Janus Capital Grp. Inc. v. First Derivative Traders, 564 U.S. 135 (2011), a person can’t have ”’made’ a misstatement if he lacked ultimate authority over what it said and whether it was said, including if he prepared or published it on behalf of another.”

Applying that reasoning to this case, it said Lorenzo wasn’t the “maker” of the misstatements in the emails he sent potential investors. “Voluminous testimony established that Lorenzo transmitted statements devised by Gregg Lorenzo at Gregg Lorenzo’s direction,” the appeals court said.
Apple, Inc. v. Pepper

Ruling Below: IN RE APPLE IPHONE ANTITRUST LITIGATION, 846 F.3d 313 (9th Cir. 2017)

Overview: Purchasers of iPhones and iPhone apps argue that Apple monopolized the market for the apps by requiring app developers to sell their apps exclusively to Apple’s App Store and charging them a 30-percent commission on each sale. The iPhone users contend that, as a result, they paid more for the apps than if they had bought them elsewhere. They asked a federal court in California to award them, under federal antitrust law, three times the amount that Apple allegedly overcharged them.

Issue: Whether consumers may sue anyone who delivers goods to them for antitrust damages, even when they seek damages based on prices set by third parties who would be the immediate victims of the alleged offense.

IN RE APPLE IPHONE ANTITRUST LITIGATION, Robert Pepper; Stephen H. Schwartz; Edward W. Hayter; Eric Terrell, Plaintiffs-Appellants v. APPLE, INC., Defendant-Appellee

United States Court of Appeals, Ninth Circuit

Decided on January 12, 2017

[Excerpt; some citations and footnotes omitted]

W. FLETCHER, Circuit Judge:

In their current complaint, Plaintiffs allege that they purchased iPhones and iPhone applications (“apps”) between 2007 and 2013, and that Apple has monopolized and attempted to monopolize the market for iPhone apps. In ruling on Apple’s fourth motion to dismiss, the district court held that Plaintiffs lacked antitrust standing under Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

We must decide two questions. First, we must decide whether Rule 12(g)(2) barred the district court from considering on the merits Apple’s fourth motion to dismiss, brought under Rule 12(b)(6), in which Apple contended that Plaintiffs lack statutory standing under Illinois Brick. We conclude that the district court may have erred in considering this motion on the merits, but that its error, if any, was harmless. Second, we must decide whether Plaintiffs lack statutory standing under Illinois Brick. We hold that Plaintiffs are direct purchasers from Apple within the meaning of Illinois Brick and therefore have standing.

I. Factual Allegations
The following factual narrative is drawn from Plaintiffs’ current complaint. Because the district court dismissed Plaintiffs’ suit under Rule 12(b)(6) for failure to state a claim, we take as true all plausible allegations.

Apple released the iPhone in 2007. The iPhone is a “closed system,” meaning that Apple controls which apps— such as ringtones, instant messaging, Internet, video, and the like—can run on an iPhone’s software. In 2008, Apple launched the “App Store,” an internet site where iPhone users can find, purchase, and download iPhone apps. Apple has developed some of the apps sold in the App Store, but many of the apps sold in the store have been developed by third-party developers. Apple earns a commission on each third-party app purchased for use on an iPhone. When a customer purchases a third-party iPhone app, the payment is submitted to the App Store. Of that payment, 30% goes to Apple and 70% goes to the developer.

Apple prohibits app developers from selling iPhone apps through channels other than the App Store, threatening to cut off sales by any developer who violates this prohibition. Apple discourages iPhone owners from downloading unapproved apps, threatening to void iPhone warranties if they do so.

II. Procedural History

The procedural history of this case is complex. We describe as much of the history as is necessary to resolve the procedural question before us. Four named plaintiffs filed a putative antitrust class action complaint (“Complaint 1”) against Apple on December 29, 2011. Counts I and II of Complaint 1 alleged monopolization and attempted monopolization of the iPhone app market by Apple. Count III alleged a conspiracy between Apple and AT&T Mobility, LLC (“ATTM”) to monopolize the voice and data services market for iPhones. Plaintiffs alleged that they had purchased iPhones, but did not allege that they had ever purchased, or attempted to purchase, iPhone apps. On March 2, 2012, Apple moved to dismiss the entire complaint under Rule 12(b)(7) for failure to join ATTM as a defendant. This motion to dismiss was mooted when the district court consolidated the action with another action.

Seven named plaintiffs, including the original four plaintiffs, then filed a consolidated putative class action complaint (“Complaint 2”) against Apple on March 21, 2012. The allegations in Complaint 2 were essentially the same as those in Complaint 1, and the same three Counts were alleged. None of the named plaintiffs alleged that they had bought, or attempted to buy, an iPhone app. ATTM was not added as a defendant. On April 16, 2012, Apple moved again to dismiss the entire complaint under Rule 12(b)(7) for failure to join ATTM as a defendant. In the alternative, it moved to dismiss Count III under Rule 12(b)(6) for failure to state a claim for conspiracy between Apple and ATTM. The district court granted without prejudice the motion to dismiss the entire complaint, even though Counts I and II alleged no wrongdoing by
ATTM. The court specifically ordered Plaintiffs either to add ATTM as a defendant or to forgo Count III. It denied without prejudice Apple’s motion to dismiss Count III under Rule 12(b)(6) on the ground that, in the absence of ATTM, the motion was premature.

Plaintiffs filed an amended consolidated complaint (“Complaint 3”) on September 28, 2012. Complaint 3 was essentially the same as Complaint 2, except that Count III was now labeled as “Preserved for Appeal.” None of the named plaintiffs alleged that they had ever purchased, or sought to purchase, iPhone apps, and ATTM was not named as a defendant. On November 2, 2012, Apple moved under Rule 12(f) to strike Claim III on the ground that ATTM had still not been named as a defendant. As part of the same motion, Apple moved to dismiss Counts I and II under Rule 12(b)(1) for lack of subject matter jurisdiction, holding that Plaintiffs lacked Article III standing to bring those counts because Plaintiff failed to allege that they had purchased or attempted to purchase an iPhone app. The court declined to rule on the Rule 12(b)(6) motion to dismiss under Illinois Brick, concluding that, in the absence of an alleged Article III injury, any ruling would be advisory. The district court dismissed with leave to amend.

Plaintiffs filed a second amended consolidated complaint (“Complaint 4”) on September 5, 2013. Complaint 4 alleged only the iPhone app monopolization claims, which had been Counts I and II of all of the earlier complaints. For the first time, Plaintiffs alleged that they had purchased iPhone apps, thereby alleging sufficient injury under Article III to support Counts I and II. Complaint 4 added the following allegation specifically addressed to statutory standing under Illinois Brick

When an iPhone customer buys an app from Apple, it pays the full purchase price, including Apple’s 30% commission, directly to Apple. . . . Apple sells the apps (or, more recently, licenses for the apps) directly to the customer, collects the entire purchase price, and pays the developers after the sale. The developers at no time directly sell the apps or licenses to iPhone customers or collect payments from the customers.

On September 30, 2013, Apple filed a motion to dismiss under Rule 12(b)(6), contending that Plaintiffs lacked statutory standing under Illinois Brick. The district court agreed and dismissed Complaint 4 with prejudice. Plaintiffs timely appealed.

III. Standard of Review
We review de novo alleged errors of law in interpreting Rule 12. See Whittlestone, Inc. v. Handi-Craft Co., 618 F.3d 970, 973 (9th Cir. 2010). We review de novo dismissals for failure to state a claim under Rule 12(b)(6). Carlin v. DairyAmerica, Inc., 705 F.3d 856, 866 (9th Cir. 2013).

IV. Discussion

Plaintiffs make three arguments on appeal, of which we need to reach only two. First, Plaintiffs argue that Rule 12(g)(2) barred Apple from raising its Illinois Brick statutory standing defense in its fourth Rule 12 motion to dismiss, and that the district court erred in deciding the motion on the merits. Second, Plaintiffs argue that the district court erred in characterizing them as indirect purchasers from Apple, and therefore without statutory standing under Illinois Brick. We address these two arguments in turn.

A. Late-filed Motions to Dismiss under Rule 12(b)(6)

Rule 12(g)(2) provides, “Except as provided in Rule 12(h)(2) or (3), a party that makes a motion under this rule must not make another motion under this rule raising a defense or objection that was available to the party but omitted from its earlier motion.” The consequence of omitting a defense from an earlier motion under Rule 12 depends on type of defense omitted. A defendant who omits a defense under Rules 12(b)(2)-(5)—lack of personal jurisdiction, improper venue, insufficient process, and insufficient service of process—entirely waives that defense. Fed. R. Civ. P. 12(h)(1)(A). A defendant who omits a defense under Rule 12(b)(6)—failure to state a claim upon which relief can be granted—does not waive that defense. Rule 12(g)(2) provides that a defendant who fails to assert a failure-to-state-a-claim defense in a pre-answer Rule 12 motion cannot assert that defense in a later pre-answer motion under Rule 12(b)(6), but the defense may be asserted in other ways. Fed. R. Civ. P. 12(h)(2).

Our sister circuits disagree about the proper interpretation and application of Rule 12(g)(2). The Seventh Circuit has held that Rule 12(g)(2) does not foreclose a motion to dismiss under Rule 12(b)(6) when there has been a previous motion to dismiss under Rule 12. See Ennenga v. Starns, 677 F.3d 766, 773 (7th Cir. 2012) (“Rule 12(g)(2) does not prohibit a new Rule 12(b)(6) argument from being raised in a successive motion.”). The Seventh Circuit misunderstands Rule 12, reading Rule 12(h)(1) to provide the only sanction for failure to raise a Rule 12 defense in a prior motion under the Rule. It is true that Rule 12(h)(1) singles out several Rule 12 defenses for an especially severe sanction. If a defense under Rule 12(b)(2)-(5) is not asserted in the first Rule 12 motion to dismiss, Rule 12(h)(1) tells us that the defense is entirely waived. But Rule 12(h)(2) provides a less severe sanction for failure to assert a defense under Rule 12(b)(6). If a failure-to-state-a-claim defense under Rule 12(b)(6) was not asserted in the first motion to dismiss under Rule 12, Rule 12(h)(2) tells us that it can be raised, but only in a pleading under Rule 7, in a post-answer motion under
Rule 12(c), or at trial. See, e.g., English v. Dyke, 23 F.3d 1086, 1091 (6th Cir. 1994) (correctly describing the operation of the rule).

The Third and Tenth Circuits have read Rule 12 correctly, but have been very forgiving of a district court’s failure to follow Rule 12(g)(2). See Leyse v. Bank of Am. Nat. Ass’n, 804 F.3d 316, 321–22 (3d Cir. 2015) (“So long as the district court accepts all of the allegations in the complaint as true, the result is the same as if the defendant had filed an answer admitting these allegations and then filed a Rule 12(c) motion for judgment on the pleadings, which Rule 12(h)(2)(B) expressly permits.”); Albers v. Bd. of Cty. Comm’rs of Jefferson Cty., Colo., 771 F.3d 697, 704 (10th Cir. 2014) (“[W]hether the district court dismissed the complaint based on a motion under Rule 12(b)(6) or rule 12(c) makes no difference for purposes of our review. Therefore, any procedural error that may have been committed would be harmless and does not prevent us from reaching the merits of the district court’s decision.”).

We agree with the approach of the Third and Tenth Circuits. We read Rule 12(g)(2) in light of the general policy of the Federal Rules of Civil Procedure, expressed in Rule 1. That rule directs that the Federal Rules “be construed, administered, and employed by the court and the parties to secure the just, speedy, and inexpensive determination of every action and proceeding.” Fed. R. Civ. P. 1. Denying late-filed Rule 12(b)(6) motions and relegating defendants to the three procedural avenues specified in Rule 12(h)(2) can produce unnecessary and costly delays, contrary to the direction of Rule 1.

District courts in this circuit and others are well aware of this. For example, as the late Judge Pfalzer recently wrote:

Rule 12(g) is designed to avoid repetitive motion practice, delay, and ambush tactics. If the Court were to evade the merits of Defendants’ . . . defenses here, Defendants would be required to file answers within 14 days of this Order. They would presumably assert [the same defenses] in those answers. Defendants would then file Rule 12(c) motions, the parties would repeat the briefing they have already undertaken, and the Court would have to address the same questions in several months. That is not the intended effect of Rule 12(g), and the result would be in contradiction of Rule 1’s mandate[.]

Allstate Ins. Co. v. Countrywide Fin. Corp., 824 F. Supp. 2d 1164, 1175 (C.D. Cal. 2011) (citations omitted); see also Banko v. Apple, Inc., No. 13-02977 RS, 2013 WL 6623913, at *2 (N.D. Cal. Dec. 16, 2013) (internal quotations omitted) (“Although Rule 12(g) technically prohibits successive motions to dismiss that raise arguments that could have been made in a prior motion . . . courts faced with a successive motion often exercise their discretion to consider the new arguments in the interests of judicial economy.”); Davidson v. Countrywide Home Loans, Inc., No. 09-CV-2694-IEG JMA, 2011 WL 1157569, at *4 (S.D. Cal. Mar. 29, 2011) (internal quotations omitted) (“Rule 12(g) applies to situations in which a party
files successive motions under Rule 12 for the sole purpose of delay[.]); Doe v. White, No. 08-1287, 2010 WL 323510, at *2 (C.D. Ill. Jan. 20, 2010) (citing the “substantial amount of case law which provides that successive Rule 12(b)(6) motions may be considered where they have not been filed for the purpose of delay, where entertaining the motion would expedite the case, and where the motion would narrow the issues involved.”). Moore’s Federal Practice endorses this approach. See 2-12 Moore’s Federal Practice - Civil § 12.23 (“[B]ecause [a 12(b)(6) defense] is so basic and was not waived, [a district] court might properly entertain a second motion if it were convinced it was not interposed for delay and that addressing it would expedite disposition of the case on the merits.”).

Recognizing the practical wisdom of these district courts, and of the Third and Tenth Circuits, we conclude that, as a reviewing court, we should generally be forgiving of a district court’s ruling on the merits of a late-filed Rule 12(b)(6) motion. With that in mind, we turn to the case now before us.

Apple’s first two motions to dismiss under Rule 12(b)(7), directed to Complaints 1 and 2, were designed to force Plaintiffs to add ATTM as a necessary and indispensable party under Rule 19. These were appropriate motions, given that Count III alleged a conspiracy between Apple and ATTM to monopolize voice and data services, and given that Plaintiffs had sufficiently alleged Article III injury to make that claim. After Plaintiffs filed Complaint 3, which had been amended to recognize the success of Apple’s motions under Rule 12(b)(7), Apple moved again to dismiss. It now moved for the first time to dismiss Counts I and II, relying on Rules 12(b)(1) and 12(b)(6). A Rule 12(b)(1) motion to dismiss for lack of subject matter jurisdiction, including for failure to allege injury sufficient for Article III standing, may be made at any time. See F. R. Civ. P. 12(b)(1) and 12(h)(3). Apple’s earlier Rule 12 motions to dismiss thus in no way foreclosed its late-filed motion to dismiss Counts I and II for lack of Article III standing. The district court granted Apple’s Rule 12(b)(1) motion to dismiss. It refused to decide Apple’s Rule 12(b)(6) motion to dismiss for lack of statutory standing on the ground that, in the absence of an Article III case or controversy, a ruling on the motion would be an advisory opinion.

Complaint 4 realleged Counts I and II, and finally alleged, for the first time, that Plaintiffs had purchased iPhone apps. That is, Complaint 4 finally alleged sufficient injury to confer Article III standing to support Counts I and II. Apple moved to dismiss for the fourth time, this time only under Rule 12(b)(6) for lack of statutory standing under Illinois Brick.

Apple’s motions to dismiss for lack of standing under Rule 12(b)(6), made in its third and fourth motions to dismiss under Rule 12, may not have been late-filed within the meaning of Rule 12(g)(2). Indeed, there is an argument that Apple’s motion to dismiss Complaint 3 under Rule 12(b)(6), made as part of its third Rule 12 motion to dismiss, was not late but premature. At that point,
Plaintiffs had not alleged injury sufficient to confer subject matter jurisdiction over Counts I and II. For that reason, the district court properly refused to rule on Apple’s Rule 12(b)(6) motion, holding that, in the absence of an allegation of Article III standing, any ruling would be advisory. See Steel Co. v. Citizens for a Better Env’t, 523 U.S. 83 (1998). The district court was willing to decide Apple’s Rule 12(b)(6) motion to dismiss for lack of statutory standing only when Plaintiffs finally alleged, in Complaint 4, sufficient injury to confer Article III standing to bring the challenged counts.

Even if we assume arguendo that Apple’s motion to dismiss under Rule 12(b)(6), made in its fourth Rule 12 motion, was late, any error by the district court in considering the motion on the merits was harmless. First, the four motions to dismiss, culminating in the motion to dismiss Complaint 4 under Rule 12(b)(6), do not appear to have been filed for any strategically abusive purpose. Apple promptly moved to dismiss each of Plaintiffs’ four complaints. Apple’s first two motions to dismiss were made on March 2 and April 16, 2012, immediately after the filing of Plaintiffs’ first two complaints. Plaintiffs filed Complaint 3 on September 28, 2012. Apple moved to dismiss under Rules 12(b)(1) and 12(b)(6) on November 2, 2012. Plaintiffs filed Complaint 4 on September 5, 2013. Apple moved to dismiss under Rule 12(b)(6) on September 30, 2013. We recognize that Apple could have moved, along with its motion to dismiss for failure to join ATTM under Rule 12(b)(7), to dismiss Counts I and I for lack of subject matter jurisdiction under Rule 12(b)(1). If that motion had been made and granted, Plaintiffs would likely have amended their complaint earlier to allege purchases of iPhone apps. But we see no harm to Plaintiffs caused by Apple’s delay in making its Rule 12(b)(1) motion. Second, resort to any of the three default alternatives specified in Rule 12(h)(2)—a pleading under Rule 7(a), a post-answer motion to dismiss on the pleadings under Rule 12(c), or a defense asserted at trial—would have substantially delayed resolution of the Illinois Brick statutory standing question, and would have done so for no apparent purpose. The district court’s decision on the merits of Apple’s Rule 12(b)(6) motion materially expedited the district court’s disposition of the case, which was a benefit to both parties.

We therefore conclude that any error committed by the district court in ruling on Apple’s motion to dismiss under Rule 12(b)(6) for lack of statutory standing under Illinois Brick, if indeed there was error, was harmless. We now turn to the merits of the district court’s decision.

B. Standing Under Illinois Brick

1. The Direct-Purchaser Rule

Under § 4 of the Clayton Act, “any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue . . . and shall recover threefold the damages by him sustained[.]” 15 U.S.C. § 15(a). Notwithstanding the statutory term “any person,” the Supreme Court has limited those who may sue for antitrust damages. The
general rule is that only “the overcharged direct purchaser, and not others in the chain of manufacture or distribution,” has standing to sue. *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 729 (1977).

The rule originated in *Hanover Shoe v. United Shoe Machinery Co.*, 392 U.S. 481 (1968). *Hanover*, a shoe manufacturer, alleged that the United Shoe Machinery Corporation had used its monopoly over shoe-manufacturing machinery to lease machines to Hanover at supracompetitive rates. *Id.* at 483–84. United argued that Hanover had no legally cognizable injury under the antitrust laws because it had passed any illegal overcharge on to its customers. *Id.* at 491. The Court rejected United’s “defensive” use of the passon theory. For purposes of antitrust damages, the Court held, the direct purchaser is injured by the full amount of the overcharge irrespective of who ultimately bears the cost of that injury. *Id.* at 494.

The Court gave two reasons for its holding. First, the dollar figures necessary to demonstrate that an intermediary has avoided economic injury by passing an overcharge onto his customers were, the Court found, “virtually unascertainable.” *Id.* at 493. A litigant would need to show, among other things, that the intermediary raised the price of his product as a result of the illegal overcharge; that the higher price charged by the intermediary did not affect the intermediary’s profits by reducing the volume of sales; and that the intermediary could not or would not have raised its price absent the overcharge. The challenges to making such a showing, the Court observed, would “normally prove insurmountable.” *Id.* Second, if an antitrust violator were permitted to defend against suit by showing that the intermediary passed the alleged overcharge onto its customers, those customers would logically be entitled to damages for any portion of the overcharge they paid. In many cases, however, there would be a large number of customers, each of whom would have “only a tiny stake in a lawsuit,” and who, in the view of the Court, would thus have “little interest in attempting a class action.” *Id.* at 494. As a result, according to the Court, antitrust violators would “retain the fruits of their illegality because no one . . . would bring suit against them.” *Id.*

Nine years after *Hanover Shoe*, the Supreme Court rejected an attempt to use the pass-on theory “offensively.” In *Illinois Brick*, 431 U.S. 720 (1977), the State of Illinois sued a concrete block manufacturer for allegedly fixing the price of concrete blocks. The manufacturer had sold the blocks to masonry contractors who had used the blocks to build masonry structures. The masonry contractors sold the structures to general contractors who put the structures in buildings they sold to the State. The State alleged that the contractors had passed on the manufacturer’s illegal overcharge at both stages of the distribution chain, driving up the State’s costs by $3 million.

The Supreme Court refused to recognize the passed-on overcharges as a basis for antitrust standing. As in *Hanover Shoe*, the challenges of tracing the effects of
an overcharge at each stage of a distribution chain were, in the Court’s view, insurmountable. Even if indirect purchasers could meet these challenges, sorting out the complicated variables would clog the courts with protracted and expensive litigation. Id. at 732. And even then problems of administrability and enforcement would remain. Allowing an indirect purchaser to sue for whatever portion of an overcharge it was assessed would either “create a serious risk of multiple liability for defendants,” id. at 730, or reduce the effectiveness of antitrust laws by diluting the share of damages better-situated direct purchasers might secure by bringing suit. Id. at 731–35.

The Supreme Court has reaffirmed the Hanover Shoe/Illinois Brick rule in a case where the practical considerations that gave rise to the rule were not nearly as compelling as in the two foundation cases. In Kansas v. UtiliCorp United, Inc., 497 U.S. 199 (1990), customers of public utilities sued natural gas producers for alleged violations of Section 4 of the Clayton Act. Plaintiffs conceded that they were direct purchasers from the public utilities and indirect purchasers from the producers. But they argued that the direct purchasers, because they were regulated public utilities, had the incentive and ability to build into their pricing structure their entire cost of purchasing natural gas. Id. at 205. On the other side of the coin, because they were public utilities, they had the obligation to pass on the entirety of any cost savings resulting from a reduced purchasing cost. Id. at 212. Therefore, the complications in determining the amount of illegal overcharge that had been, or could be, passed on that had so concerned the Court in Hanover Shoe and Illinois Brick were largely absent. The Court nonetheless applied the direct/indirect purchaser rule, holding that “[i]n the distribution chain,” the customers were “not the immediate buyers from the alleged antitrust violators.” UtiliCorp, 497 U.S. at 207.

The transactions in Hanover Shoe and Illinois Brick have the same structure. In both cases, a monopolizing or price-fixing manufacturer sold or leased a product to an intermediate manufacturer at a supracompetitive price. The intermediate manufacturer (in Illinois Brick, two intermediate manufacturers) then used that product to create another product, which was ultimately sold to the consumer. The details in UtiliCorp are different, but the basic structure is the same. In UtiliCorp, a monopolizing producer sold a product to a distributor at an allegedly supracompetitive price. The distributor then sold the product to the consumer. In all three cases, the consumer was an indirect purchaser from the manufacturer or producer who sold or leased the product to the intermediary. The consumer was a direct purchaser from the intermediate manufacturer (Hanover Shoe and Illinois Brick) or from the distributor (UtiliCorp). The consumer did not have standing to sue the manufacturer or producer, but did have standing to sue the intermediary, whether the intermediate manufacturer or the distributor

2. Plaintiffs Are Direct Purchasers
The question before us is whether Plaintiffs purchased their iPhone apps directly from the app developers, or directly from Apple. Stated otherwise, the question is whether Apple is a manufacturer or producer, or whether it is a distributor. Under Hanover Shoe, Illinois Brick, and UtiliCorp, if Apple is a manufacturer or producer from whom Plaintiffs purchased indirectly, Plaintiffs do not have standing. But if Apple is a distributor from whom Plaintiffs purchased directly, Plaintiffs do have standing.

We do not write on a clean slate in this circuit. In Delaware Valley Surgical Supply, Inc. v. Johnson & Johnson, 523 F.3d 1116 (9th Cir. 2008), plaintiff Bamberg County Memorial Hospital & Nursing Center (“Bamberg”) brought suit against Johnson & Johnson (“J & J”) alleging that J & J “impermissibly leveraged its monopoly power in sutures to create a monopoly” in the market for endomechanical products. Id. at 1118. Bamberg did not purchase medical supplies directly from J & J. Instead, a group purchasing organization (“GPO”), of which Bamberg was a member, negotiated purchasing contracts with J & J and a distributor, Owens & Minor (“O & M”). J & J and O & M, in turn, had a distributorship agreement specifying that O & M would pay J & J the price negotiated by the GPO. Bamberg would purchase from O & M, paying O & M this price plus a set percentage markup. Pursuant to this agreement, J & J supplied products to the distributor, O & M, which in turn sold and delivered the products to Bamberg, at a price equal to the cost O & M paid for the products plus the set markup determined by a contract between O & M and Bamberg. Id. at 1119.

Applying the “straightforward,” “bright line” rule of Illinois Brick, we held in Delaware Valley that Bamberg was an indirect purchaser from J & J, the manufacturer, and a direct purchaser from O & M, the distributor. Id. at 1122, 1120. That Bamberg and J & J had a contract setting the wholesale price of the products, and that the price Bamberg paid O & M was “set, in part, by an agreement negotiated . . . on behalf of Bamberg” with J & J were not determinative. Id. at 1122. The determinative fact was that O & M was a distributor who sold the products directly to Bamberg. Because Bamberg bought directly from O & M, the distributor, it lacked standing to sue J & J, the manufacturer. The necessary corollary of Delaware Valley is that Bamberg would have had standing to sue O & M, the distributor.

The Eighth Circuit has considered a transaction closely resembling the transaction in the case before us. In Campos v. Ticketmaster Corp., 140 F.3d 1166 (8th Cir. 1998), plaintiffs alleged that Ticketmaster used its monopolistic control over concert ticket distribution services to charge supracompetitive fees for those services. The majority in Ticketmaster held that a party’s status as a “direct” or “indirect” purchaser turned on whether “an antecedent transaction between the monopolist and another, independent purchaser” absorbed or passed on all or part of the monopoly overcharge. Id. at 1169. Plaintiffs bought concert tickets directly from Ticketmaster, but the majority nevertheless concluded that
plaintiffs were indirect purchasers who lacked standing under Illinois Brick. Id. at 1171. Using an analysis keyed to the “antecedent transaction,” the majority concluded that the ticket buyers were indirect purchasers.

We disagree with the majority’s analysis in Ticketmaster. As Judge Morris Arnold pointed out in dissent, the majority’s “antecedent transaction” analysis has no basis in Supreme Court precedent. Id. at 1174 (M. Arnold, J., dissenting). Illinois Brick held that where plaintiffs are in a “direct vertical chain of transactions” and an intermediary “pass[es] on” monopolistic overcharges originating further up the chain, subsequent buyers lack standing. Id. (internal quotation marks omitted). In Ticketmaster, “[t]he monopoly product at issue . . . is ticket distribution services, not tickets.” Id. The distributor who “supplies the product directly to” plaintiffs, rather than the producer of the product, is the appropriate defendant in an antitrust suit. Id.

Apple argues that it does not sell apps but rather sells “software distribution services to developers.” In Apple’s view, because it sells distribution services to app developers, it cannot simultaneously be a distributor of apps to app purchasers. Apple analogizes its role to the role of an owner of a shopping mall that “leases physical space to various stores.” Apple’s analogy is unconvincing. In the case before us, third-party developers of iPhone apps do not have their own “stores.” Indeed, part of the anti-competitive behavior alleged by Plaintiffs is that, far from allowing iPhone app developers to sell through their own “stores,” Apple specifically forbids them to do so, instead requiring them to sell iPhone apps only through Apple’s App Store.

We do not address the question whether Apple sells distribution services to app developers within the meaning of Illinois Brick. If it did, this would necessarily imply that the developers, as direct purchasers of those services, could bring an antitrust suit against Apple. But whether app developers are direct purchasers of distribution services from Apple in the sense of Illinois Brick makes no difference to our analysis in the case now before us.

We do not rest our analysis on the fact that Plaintiffs pay the App Store, which then forwards the payment to the app developers, less Apple’s thirty percent commission. Whether a purchase is direct or indirect does not turn on the formalities of payment or bookkeeping arrangements. See Freeman v. San Diego Ass’n of Realtors, 322 F.3d 1133, 1146 (9th Cir. 2003). If Plaintiffs were direct purchasers from Apple solely because Apple collected their payments, Apple could escape anti-trust liability simply by tinkering with the order in which digital banking data zips through cyberspace during a sales transaction.

Nor do we rest our analysis on the form of the payment Apple receives in return for distributing iPhone apps. Apple does not take ownership of the apps and then sell them to buyers after adding a markup of thirty percent. Rather, it sells the apps and adds a thirty percent commission. But the
distinction between a markup and a commission is immaterial. The key to the analysis is the function Apple serves rather than the manner in which it receives compensation for performing that function.

Nor, finally, do we rest our analysis on who determines the ultimate price paid by the buyer of an iPhone app. In the case before us, the price is determined as a practical matter by the app developer who sets a price, to which Apple’s thirty percent commission is added automatically. Our opinion in Delaware Valley makes clear that this does not make app purchasers direct buyers from the app developers. In Delaware Valley, the price paid by the distributor, O & M, to the manufacturer, J & J, was determined through a negotiation between J & J and a GPO of which Bamberg was a member. Despite the fact that Bamberg, through its GPO, had a say in the wholesale price charged by J & J to O & M, to which the distributor added its predetermined markup, we held that Bamberg was a direct purchaser from O & M. Here, the case is even stronger in favor of Plaintiffs. Unlike Bamberg, Plaintiffs have no say whatsoever in determining the price set by the app developer to which the distributor adds its predetermined commission.

Instead, we rest our analysis, as compelled by Hanover Shoe, Illinois Brick, UtiliCorp, and Delaware Valley, on the fundamental distinction between a manufacturer or producer, on the one hand, and a distributor, on the other. Apple is a distributor of the iPhone apps, selling them directly to purchasers through its App Store. Because Apple is a distributor, Plaintiffs have standing under Illinois Brick to sue Apple for allegedly monopolizing and attempting to monopolize the sale of iPhone apps.

Conclusion

We conclude that any error, if indeed there was error, in the district court’s consideration of the merits of Apple’s Rule 12(b)(6) motion to dismiss for lack of statutory standing was harmless. We conclude further that Plaintiffs are direct purchasers of iPhone apps from Apple under Illinois Brick and that they therefore have standing to sue. The district court dismissed Plaintiffs’ complaint on the ground that they lacked statutory standing under Illinois Brick. We therefore reverse and remand for further proceedings.

REVERSED and REMANDED.
The U.S. Supreme Court agreed to hear Apple Inc.’s bid to kill an antitrust lawsuit over the market for iPhone apps in a case that could shield e-commerce companies from consumer claims over high commissions.

The lawsuit accuses Apple of monopolizing the app market so it can charge excessive commissions of 30 percent. Apple, backed by the Trump administration, says it can’t be sued because the commission is levied on the app developers, not the purchasers who are suing.

A victory for Apple could insulate companies that run online marketplaces and interact with consumers on behalf of third-party sellers. Companies that could be affected include Alphabet Inc.’s Google, Amazon.com Inc. and Facebook Inc., Apple told the Supreme Court in its appeal.

"This is a critical question for antitrust law in the era of electronic commerce," Apple argued.

The suit accuses Apple of thwarting competition by approving apps only if the developer agrees to let them be distributed exclusively through the App Store. The suit, filed in federal court in Oakland, California, seeks class action status. A lawyer pressing the case has said Apple could be on the hook for hundreds of millions of dollars.

A federal appeals court let the suit go forward. The panel said Apple is serving as a distributor, selling directly to consumers through its App Store and pocketing part of the price of each app.

The Supreme Court said in 1977 that only direct purchasers -- and not those who buy a product further downstream -- can sue under federal antitrust law. The court said that rule was necessary to avoid "duplicative recoveries."

The lawyers pressing the case say the consumers who filed the lawsuit meet that test. They "are undoubtedly the first party in the distribution chain to buy from the monopolist," the group said in court papers.

Apple said it ultimately charges the commission to the developers, making consumers "indirect purchasers" who are precluded under the 1977 ruling from suing. The appeals court "expressly opened the door to duplicative recoveries by different plaintiff groups," Apple argued.

Apple credited the App Store and with helping create a "dynamic new industry." In
2016 alone, developers earned more than $20 billion through the App Store, which offers more than 2 million apps to consumers, the company said.

The court will hear arguments and rule in the nine-month term that starts in October. The case is Apple v. Pepper, 17-204.
The Trump administration’s U.S. Department of Justice is urging the U.S. Supreme Court to reverse a federal appellate court decision that would allow an antitrust class action to go forward against Apple Inc., exposing the company to treble damages for its alleged monopoly of the market for iPhone apps.

U.S. Solicitor General Noel Francisco, in an amicus brief, said the U.S. Court of Appeals for the Ninth Circuit misapplied a 40-year-old Supreme Court decision when it held last year that Apple was a distributor of iPhone apps, selling them directly to purchasers through its App Store. The Justice Department filed its brief at the invitation of the justices for the government’s views in the case Apple v. Pepper.

Francisco warned that how courts view Apple’s app business model—an agency or consignment sales model—“will significantly affect” private enforcement of federal antitrust law “because other existing and emerging e-commerce platforms use similar models.”

In urging the justices to grant review and reverse the Ninth Circuit, the Justice Department wrote:

“…”The importance of the question presented will only grow as commerce continues to move online. The Ninth Circuit is home to a disproportionate share of the nation’s e-commerce companies, and its erroneous decision creates uncertainty and a lack of uniformity about the proper application of Section 4 to this increasingly common business model. This court should grant certiorari and correct the Ninth Circuit’s error.”

The high court case stems from an antitrust class action brought under the Sherman Act on behalf of those who purchased software applications from Apple’s online store for use of their iPhones from Dec. 29, 2007, to the present. The consumer class claims that Apple illegally monopolized the distribution of iPhone apps, and that the commissions charged to app developers inflate the prices consumers ultimately pay for apps.

At the center of the case is Apple’s method of connecting app developers to those who purchase the apps.

After the launch of the iPhone, Apple created the App Store, an electronic portal through which consumers could buy and download apps. Apple earns 30 percent of every third-
party app sold through its store and the app developer retains 70 percent. Payment for an app goes to the App Store which, in turn, credits the developer with the 70 percent share.

In the 1977 case *Illinois Brick v. Illinois*, the Supreme Court ruled that consumer antitrust lawsuits could be brought only against the party that represents the final point of sale of the good or service in question. Plaintiffs cannot state a claim for treble damages, according to the Supreme Court, by relying on a “pass-on theory”—where a defendant unlawfully overcharged a third party and the third party passed on all or part of the overcharge to the plaintiff.

Purchasers of apps are “indirect” purchasers, according to Francisco. “To prove damages, respondents would need to establish the extent to which Apple’s allegedly unlawful practices have caused developers to set higher prices for their apps than they otherwise would have,” argued Francisco. “That is precisely the pass-on inquiry this court has disapproved.”

Latham & Watkins partner Daniel Wall, representing Apple, argued the Ninth Circuit “has approached this case as if all commerce fits the traditional resale distribution model, where the party who delivers goods is also the party who sets the price the consumer pays. But increasingly this is a world of electronic commerce based on electronic marketplaces that—like Apple’s App Store—are structured around an agency or consignment sales model where the marketplace sponsor has nothing to do with the pricing of the goods it sells.”

Wall cited as examples of agency-based electronic marketplaces StubHub, eBay, Google Play marketplace, Amazon.com Inc.’s “Amazon Marketplace” business and Facebook’s “Marketplace.”

Representing Robert Pepper and the consumer class, Mark Rifkin of New York’s Wolf Haldenstein Adler Freeman & Herz, wrote in opposition to review that Apple is not seeking to correct a misapplication of *Illinois Brick* but to change the law.

“The price paid by purchasers for an app is the amount set by the apps developer, plus Apple’s own supra-competitive 30 percent markup, both of which are paid directly to Apple, the alleged monopolist, every time an app is purchased,” Rifkin told the justices. He added: “The apps developers do not sell their apps to iPhone customers or collect any payment from iPhone customers, and iPhone customers are the only purchasers in the entire chain of distribution. Respondents seek damages based solely on the 30 percent markup.”

Apple, Rifkin argued, wants the justices to “jettison the straightforward direct purchaser requirement of *Illinois Brick* and replace it with a new ‘antecedent transaction’ analysis, an approach to antitrust standing that finds no support in this court’s precedent, would invite the same factual complications and speculation on damages that the bright-line standing test of *Illinois Brick* seeks to avoid, and would often leave nobody with standing to sue a monopolist (as would be the case here).”
The Washington Legal Foundation and the App Association have filed amicus briefs supporting Apple’s petition for review.
HAS APPLE MONOPOLIZED the market for iPhone apps? That's the question at the heart of *Apple Inc. v. Pepper*, a case the Supreme Court agreed to hear Monday, which could have wide-reaching implications for consumers as well as other companies like Amazon. The dispute is over whether Apple, by charging app developers a 30 percent commission fee and only allowing iOS apps to be sold through its own store, has inflated the price of iPhone apps. Apple, supported by the Trump administration, argues that the plaintiffs in the case—iPhone consumers—don't have the right to sue under current antitrust laws in the US.

The case marks a rare instance in which the court has agreed not only to hear an antitrust case, but also one where no current disagreement exists in the circuit courts. The outcome could change decades of antitrust legal precedent—either strengthening or weakening consumer protections against monopolistic power. The case also represents a huge source of revenue for Apple; the company raked in an estimated $11 billion last year in App Store commissions alone.

**The Illinois Brick Doctrine**

At the core of the lawsuit is another Supreme Court case from 1977, *Illinois Brick Co. v. Illinois*, which established what is known as the Illinois Brick Doctrine. That rule says you can't sue for antitrust damages if you're not the direct purchaser of a good or service. If I have a monopoly on bread and the local deli sells you a sandwich, you can't sue me. It's just too hard to figure out how much of your sandwich price was inflated due to my illegal activity.

Here's where things get complicated. Apple isn't buying apps from developers and then reselling them to consumers. It merely charges a 30 percent commission fee, and only makes them available in its own App Store. Because of that, Apple argues that it's protected from antitrust lawsuits lodged by consumers because it's not the direct seller, the developers are. It views the App Store like a mall; it's merely charging developers rent to sell in it.

"Apple is trying to argue that the consumers don't have the standing to sue here because the app developers set the price," says Sandeep Vaheesan, an antitrust lawyer at the Open Markets Institute, a nonprofit that advocates against monopolistic power. "What the consumers are really upset at is how the apps are being priced by developers."
But the plaintiffs in the suit argue that Apple monopolized the *distribution* of the apps, not the apps themselves. In a world where app stores could actually compete for developers' products, the commission rates might be lower, resulting in lower-priced apps. This plays out on Android already; the majority of app downloads go through the Google Play Store, but users can also go to the Amazon Appstore for occasionally discounted apps, or F-Droid for exclusively open source apps.

By comparison, Apple is less like a mall, and more like the only store in town. iOS app developers have to abide by Apple's lengthy guidelines if they want to sell their products to iPhone consumers and the company can exclusively decide when it doesn't want certain apps on its phones.

"On the face of it, I certainly think [the plaintiffs] have got a strong case. Whether it's a winning case, I don't know yet," says John Lopatka, an antitrust professor at Penn State Law School and the author of *Federal Antitrust Law and The Microsoft Case: Antitrust, High Technology, and Consumer Welfare.* "If they lose, it's because the court is going to want to change to some extent just what this Illinois Brick rule is." Apple did not return a request for comment.

**What Happens If Apple Wins?**

In 2013, a district court in California initially sided with Apple, agreeing that the tech giant was shielded by the Illinois Brick Doctrine. But the plaintiffs appealed to the 9th Circuit Court of Appeals, which reversed the lower court's opinion last year. Now, in a somewhat surprising decision, the Supreme Court will hear the case.

Typically, the Supreme Court looks for disagreement between the lower courts when deciding to take up a case, but here none currently exists. "It's unusual to take this one because there's no pressing and strong circuit split on the issue," Lopatka says.

The case that most closely addresses the same issues is from nearly 20 years ago, when the 8th Circuit Court of Appeals dismissed a lawsuit brought by concertgoers against Ticketmaster. The court ruled that concertgoers weren't the direct purchaser, the venues were. It agreed that Ticketmaster was just a ticket marketplace, rather than a distribution monopoly.

This time, though, the highest court could rule that Apple is, in fact, a distribution monopoly. A ruling in the plaintiffs' favor could have serious implications for other tech companies with similar business models, like Amazon, which sells a wide range of products from third-party companies. And it could make it harder for them to argue that they're merely neutral intermediaries. That means the Illinois Brick Doctrine might get squashed, or significantly altered.

The case is "really significant for platforms in general," says Vaheesan. "Platforms and other intermediaries that rely on a commission-based model might be able to avoid antitrust liability in the form of lawsuits" if Apple wins.

But even if Apple loses, the plaintiffs still face a long, uphill battle. A favorable ruling from the Supreme Court would allow the suit
to go to trial, but it may get settled out of court before that even happens. In trial, the plaintiffs would have to face a host of other issues in order to successfully argue that Apple's App Store really constitutes a monopoly. For example, consumers can buy other kinds of smartphones aside from iPhones, which come with access to other app stores.

"Apple created the iPhone, Apple created the entity that can use apps, has it monopolized anything?" Lopatka says. "Is it fair to say that there is a market in Apple apps, when you can get a Samsung phone or lots of other phones and get different apps? That would be an issue."

If Apple wins, though, consumers would continue to have one less avenue to legally fight back against increasingly powerful technology corporations.

"This would just be another thumb on the scale in favor of corporate defendants and against antitrust plaintiffs," Vaheesan says. "It would mean that the DOJ and the FTC would have to do more to compensate for the reduced private enforcement."
Earlier this week, the Supreme Court officially picked up the long-running antitrust case Apple v. Pepper. The court will decide whether iPhone users can sue Apple for locking down the iOS ecosystem, something the suit’s plaintiffs say is creating an anti-competitive monopoly.

Apple v. Pepper could theoretically affect how tech companies can build walled gardens around their products. The Supreme Court isn’t going to make a call on that specific issue, but its decision could affect people’s relationship with all kinds of digital platforms. Here’s what’s at stake when the Supreme Court case starts, which should happen sometime in the next year.

WHAT IS APPLE V. PEPPER?
*Apple Inc. v. Robert Pepper* is the latest salvo in a legal fight over Apple’s iOS App Store. A group of iPhone buyers are claiming that Apple’s locked-down ecosystem artificially inflates the prices of apps because all developers must go through a single store that takes a cut of their revenue. The buyers argue that Apple has established an unlawful monopoly over iOS apps, and they’re asking the courts to make Apple allow third-party iOS apps, in addition to repaying every iOS user it’s overcharged in the past.

HOW DID WE GET HERE?

*Apple v. Pepper* began as a broader antitrust complaint in 2011. Robert Pepper and three other iPhone owners claimed that Apple had stifled competition and driven up prices on its iPhone — partly by locking out third-party apps and partly by signing a five-year exclusivity deal with AT&T. A court struck the latter claim in 2013. Since then, the class action case has focused purely on the App Store.

In 2014, Apple won a judgment against Pepper, and the complaint was dismissed. But the Ninth Circuit Court of Appeals reversed that decision in early 2017, allowing the case to move forward. Now, Apple is petitioning the Supreme Court to throw it out again.

WHAT’S THE ACTUAL ARGUMENT?
The central dispute is relatively simple: Apple only allows iOS users to install apps through its App Store. Any third-party stores require jailbreaking your phone and voiding the warranty. Apple also takes a 30 percent commission on apps that are sold through the App Store. Pepper’s complaint concludes that developers are logically passing that cost along to consumers.

The complaint says that iPhone users have paid “hundreds of millions of dollars more”
for apps “than they would have paid in a competitive market.” That’s a claim that could be challenged in court, but there are real-world examples of apps passing costs to customers. Spotify, for instance, charged iTunes subscribers a higher fee before simply disabling that payment option.

Apple denies the claim that its closed ecosystem is an unlawful monopoly. It says users can buy apps on other platforms, and that by definition, opening the App Store in 2008 created new competitive opportunities.

But courts haven’t made a call on this argument yet. Instead, they’ve focused on whether iPhone users can sue Apple at all.

In 1977, the Supreme Court established what’s known as the Illinois Brick doctrine, which says that “indirect purchasers” can’t sue a company for antitrust damages. Pepper’s lawsuit portrays Apple as directly selling iOS apps to users at a markup. But Apple claims that iOS users are essentially buying apps from developers, who are buying Apple’s software distribution services, which would make developers the only direct purchasers with the right to sue Apple.

If Apple convinces the Supreme Court that this is correct, it doesn’t even have to worry about the monopoly question. Sure, a developer could sue the company later, but developers have a strong incentive to stay friendly with Apple — and they actually benefit from iOS’s locked-down, piracy-unfriendly system.

**IS APPLE TECHNICALLY SELLING APPS TO USERS?**

Yes, according to the 2017 ruling that Apple is appealing. The Ninth Circuit appeals court disregarded Apple’s arguments — like the fact that it’s taking a commission from developers rather than adding a fee to user transactions — as hair-splitting. It determined that regardless of who’s making the apps or setting the exact prices, Apple is acting as a distributor, which gives it a direct relationship with its customers.

But a lower court didn’t agree with that interpretation, and there’s no guarantee the Supreme Court will either.

**SO... WHAT DOES HAPPEN IF APPLE LOSES?**

Nothing — yet. If a court rules that Apple has an unlawful monopoly, it could require Apple to pay out hundreds of millions of dollars or even change its App Store model. If the Supreme Court upholds the Ninth Circuit’s decision, though, it will just send the case back to a lower court, where the fight will keep going.

But the decision will also affect how much power consumers have over digital platforms. In 1998, a major appeals court ruling shot down concertgoers who sued Ticketmaster for driving up ticket prices, saying that Ticketmaster was actually selling distribution services to concert venues. The Ninth Circuit’s opinion explicitly says that decision was wrong. So a favorable Supreme Court ruling wouldn’t just keep this particular lawsuit alive. It could make other powerful online stores — or, in Reuters’ ‘less-charitable estimation, “toll-keepers” — more accountable toward their users.
If music fans want to see a show at a major concert venue, they have just about no choice but to buy tickets through Ticketmaster, which has exclusive ticket distribution contracts with virtually every concert promoter in the country. Similarly, if iPhone owners want to purchase an app, they must buy through Apple’s App Store. Apple doesn’t allow app developers to sell iPhone apps through any other platform. Ticketmaster and Apple are the toll-keepers of their markets.

Consumers don’t much like paying tolls. Both Ticketmaster and Apple were sued in antitrust class actions accusing them of taking advantage of their distribution strangleholds, Ticketmaster back in the 1990s and Apple in 2011. In 1998, the 8th U.S. Circuit Court of Appeals dismissed concertgoers’ antitrust claims in Campos v. Ticketmaster. But on Thursday, the 9th U.S. Circuit Court of Appeals ruled that iPhone app buyers can proceed - despite the 8th Circuit’s Ticketmaster decision and parallels in consumer claims against the two companies.

The 9th Circuit split with the 8th on the dispositive question of whether consumers are direct or indirect purchasers of the distribution services Ticketmaster and Apple provide. As you probably know, that’s a critical difference in antitrust cases. The U.S. Supreme Court has held - first in 1968’s Hanover Shoe v. United Shoe and then, more famously, in 1977’s Illinois Brick v. State of Illinois - that purchasers at the end of a tainted supply chain can’t bring antitrust claims against a monopolist because it’s too hard for courts to figure out what portion of the product’s ultimate cost is attributable to illegal conduct. Under the court’s so-called Illinois Brick precedent, only direct purchasers have standing to sue monopolists.

In the sort of classic manufacturing supply chains at issue in Hanover Shoe, which involved allegedly inflated lease prices for shoemaking equipment, and Illinois Brick, in which the state claimed masonry contractors passed along inflated charges for concrete blocks, it’s easy to discern a bright line between direct and indirect purchasers. The split between the 8th and 9th Circuits in the Ticketmaster and Apple cases shows how the line blurs when the alleged monopolist is selling a service instead of a tangible product.

The 8th Circuit majority in Ticketmaster found concertgoers to be indirect purchasers who were forced to use the company’s services only because Ticketmaster first pushed concert venues into exclusive ticket
distribution contracts. “Such derivative dealing is the essence of indirect purchaser status,” the majority said. “The plaintiffs’ inability to obtain ticket delivery services in a competitive market is simply the consequence of the antecedent inability of venues to do so.”

In a dissent, Judge Morris Arnold suggested his colleagues weren’t paying attention to Ticketmaster’s real product: not tickets but ticket distribution services. “Ticketmaster supplies the product directly to concertgoers; it does not supply it first to venue operators who in turn supply it to concertgoers,” Arnold wrote. “It is immaterial that Ticketmaster would not be supplying the service but for its antecedent agreement with the venues. But it is quite relevant that the antecedent agreement was not one in which the venues bought some product from Ticketmaster in order to resell it to concertgoers.”

The 9th Circuit’s Apple opinion, written by Judge William Fletcher for a panel that also included Judge Wallace Tashima and U.S. District Judge Robert Gettleman of Chicago, sitting by designation, said the Ticketmaster dissent was right. In selling iPhone apps, Apple is not an ordinary manufacturer or producer, the opinion said. It is a distributor, selling apps directly to consumers through the App Store.

The 9th Circuit insisted on figuring out the essential relationship between Apple and app purchasers instead of taking the easy way out by basing its ruling on the mere fact that consumers pay the App Store for purchases. “Whether a purchase is direct or indirect does not turn on the formalities of payment or bookkeeping arrangements,” the opinion said. “The key to the analysis is the function Apple serves rather than the manner in which it receives compensation for performing that function.”

Apple’s lawyers at Latham & Watkins had argued that the company is indeed a distributor, but that its customers are app developers, not the consumers who buy apps. It compared itself to a shopping mall owner that leases space to stores, but the 9th Circuit disputed Apple’s brick-and-mortar analogy. “Third-party developers of iPhone apps do not have their own ‘stores,’” the opinion said “Indeed, part of the anti-competitive behavior alleged by plaintiffs is that, far from allowing iPhone app developers to sell through their own ‘stores,’ Apple specifically forbids them to do so, instead requiring them to sell iPhone apps only through Apple’s App Store.”

It seems to me the 9th Circuit’s reasoning could be problematic for other tech companies that could be defined as distributors. I expect amici to weigh in if Apple asks for en banc reconsideration.

Wolf Haldenstein Adler Freeman & Herz represented plaintiffs in the iPhone case. Apple declined a Reuters request for comment on the 9th Circuit opinion.
Mount Lemmon Fire District v. Guido

Ruling Below: John Guido; Dennis Rankin v. Mount Lemmon Fire District, 859 F.3d 1168 (9th Cir. 2017)

Overview: Mount Lemmon Fire District fired two of their captains who were the oldest employees, John Guido and Dennis Rankin, under the guise of budget cuts. Guido and Rankin were terminated supposedly not because of their age, rather because they failed to participate in volunteer wildland assignments.

Issue: Whether, under the Age Discrimination in Employment Act, the same 20-employee minimum that applies to private employers also applies to political subdivisions of a state, as the U.S. Courts of Appeals for the 6th, 7th, 8th and 10th Circuits have held, or whether the ADEA applies instead to all state political subdivisions of any size, as the U.S. Court of Appeals for the 9th Circuit held in this case.

John Guido; Dennis Rankin, Plaintiffs-Appellants,
v.
Mount Lemmon Fire District, Defendant-Appellee

United States Court of Appeals, Ninth Circuit

Decided on June 19, 2017

[Excerpt; some citations and footnotes omitted]
O'Scannlain, Circuit Judge:

We must decide whether the Age Discrimination in Employment Act of 1967 applies to a political subdivision of Arizona.

I

John Guido and Dennis Rankin were both hired in 2000 by Mount Lemmon Fire District, a political subdivision of the State of Arizona. Guido and Rankin served as full-time firefighter Captains. They were the two oldest full-time employees at the Fire District when they were terminated on June 15, 2009, Guido at forty-six years of age and Rankin at fifty-four.

Guido and Rankin subsequently filed charges of age discrimination against the Fire District with the Equal Employment Opportunity Commission (“EEOC”), which issued separate favorable rulings for each, finding reasonable cause to believe the Fire District violated the Age Discrimination in Employment Act, 29 U.S.C. §§ 621–34 (“ADEA”). They then filed this suit for age discrimination against the Fire District in April 2013.
The district court granted the Fire District’s motion for summary judgment, concluding that it was not an “employer” within the meaning of the ADEA.

Guido and Rankin timely appealed.

II

Guido and Rankin challenge the district court’s conclusion that the Fire District was not an “employer” within the meaning of the ADEA.

A

The ADEA applies only to an “employer.” Under 29 U.S.C. § 630(b):

The term “employer” means a person engaged in an industry affecting commerce who has twenty or more employees for each working day in each of twenty or more calendar weeks in the current or preceding calendar year . . . . The term also means (1) any agent of such a person, and (2) a State or political subdivision of a State and any agency or instrumentality of a State or a political subdivision of a State, and any interstate agency, but such term does not include the United States, or a corporation wholly owned by the Government of the United States.

Under § 630(a):

The term “person” means one or more individuals, partnerships, associations, labor organizations, corporations, business trusts, legal representatives, or any organized groups of persons.

The parties agree that the twenty-employee minimum applies to “a person engaged in an industry affecting commerce” and that the term “person” does not include a political subdivision of a State. However, they dispute whether the twenty-employee minimum also applies to a “political subdivision of a State.” § 630(b).

B


1

Guido and Rankin contend that § 630(b) is not ambiguous and applies to the Fire District. They assert that its plain meaning creates distinct categories of “employers” and that the Fire District fits within one of them. See Young v. Sedgwick County, 660 F. Supp. 918, 924 (D. Kan.
1987); see also EEOC v. Wyoming, 460 U.S. 226, 233 (1983) (“In 1974, Congress extended the substantive prohibitions of the [ADEA] to employers having at least 20 workers, and to the Federal and State Governments.”) (emphasis added). Section 630(b), they argue, is deconstructed as follows: The term “employer” means [A—person] and also means (1) [B—agent of person] and (2) [C—State-affiliated entities].

They note that each of the three “employer” categories is then further defined. For example, the “person” category is elaborated upon in § 630(a), which provides multiple definitions of the term “person” and then narrows the category to those persons “engaged in an industry affecting commerce who has twenty or more employees for each working day.” The “State-affiliated entities” category lists the various types of State-affiliated entities covered, such as a “political subdivision of a State,” and also contains clarifying language.

For example, imagine someone saying: “The password can be an even number. The password can also be an odd number greater than one hundred.” These are two separate definitions of what an acceptable password can be, and the clarifying language does not apply to both definitions. If the sentences are reversed, the “greater than one hundred” limiting language would still not carry over to the second sentence discussing even numbers. See Holloway, 24 F. Supp. 3d at 1117. This becomes more obvious when it would be illogical to carry clarifying language over. If a statute said “The word bank means ‘the rising ground bordering a lake, river, or sea’ and the word also means ‘a place where something is held available,’” the second definition would not be describing a place that must border a lake, river, or sea. Merriam-Webster, https://www.merriam-webster.com/ dictionary/bank. The phrase “also means” indicates that a second, additional definition is being described. See § 630(b) (using the phrase “also means”).
The EEOC, as amicus curiae, expressing its views in support of Guido and Rankin, contends that the English language provided Congress many ways to apply clarifying language across multiple definitions of a term, had it wanted to. The EEOC cites the 1972 amendment to Title VII of the Civil Rights Act of 1964 as an example (the “1972 Title VII Amendment”). This amendment extended Title VII protections to States and State-related entities, including political subdivisions of a State. Pub. L. 92-261, § 2, 86 Stat. 103 (codified as 42 U.S.C. § 2000e). The EEOC emphasizes that the 1972 Title VII Amendment used language making clear that the twenty-employee minimum applied to political subdivisions, stating:

(a) The term “person” includes one or more individuals, governments, governmental agencies, political subdivisions, labor unions, partnerships, associations, corporations, legal representatives, mutual companies, joint-stock companies, trusts, unincorporated organizations, trustees, trustees in cases under Title 11, or receivers.

(b) The term “employer” means a person engaged in an industry affecting commerce who has fifteen or more employees.

42 U.S.C. § 2000e (emphasis added). The EEOC argues that Congress knew how to use language to ensure that an employee minimum applied to political subdivisions when it wanted. Congress could have also added the limiting language to each definition discussed in § 630(b), or at least to the definition covering political subdivisions, but it chose not to.

In the face of such a strong textual argument, the Fire District has a powerful rebuttal: four other circuits have considered this issue and all have declared § 630(b) to be ambiguous. Cink v. Grant County, 635 F. App’x 470, 474 n.5 (10th Cir. 2015); Palmer v. Ark. Council on Econ. Educ., 154 F.3d 892, 896 (8th Cir. 1998); E.E.O.C. v. Monclova Twp., 920 F.2d 360, 363 (6th Cir. 1990); Kelly v. Wauconda Park Dist., 801 F.2d 269, 270 (7th Cir. 1986). Cink, Palmer, and Monclova Township all rely entirely on Kelly’s reasoning regarding the statute’s ambiguity.

The Seventh Circuit in Kelly concluded the statute was ambiguous. While acknowledging that the categorical reading was a reasonable one, it concluded the plaintiff “weaken[ed] his argument that the statute is unambiguous by arguing that we should look at ‘common sense’ and congressional intent in deciding that the statute is unambiguous.” 801 F.2d at 270. It is not clear to us why an appeal to “common sense” undermines this argument. Further, any appeal to congressional intent is a non-sequitur; it is not a factor that should affect the determination of whether a statute’s plain meaning is ambiguous. See Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 391 (2012).
The *Kelly* opinion further supports its conclusion by stating that the defendant presented a reasonable alternative construction:

More significantly, the Park District enunciates another fair and reasonable interpretation of section 630(b)—that Congress, in amending section 630(b), merely intended to make it clear that states and their political subdivisions are to be *included* in the definition of ‘employer,’ as opposed to being a separate definition of employer.

Id. at 270–71. Since the alternative reading was also deemed reasonable, the court concluded the statute was ambiguous. Id. at 270.

A serious problem with the alternative interpretation argument, however; is that the court in *Kelly* never explained how it is a “fair and reasonable interpretation” of the statute’s actual language. A statute must be “susceptible to more than one reasonable interpretation” to be ambiguous. *Alaska Wilderness League v. E.P.A.*, 727 F.3d 934, 938 (9th Cir. 2013). But, declaring that multiple reasonable interpretations exist does not make it so. None of the cases cited by the Fire District elaborate on how and why this alternative interpretation is a reasonable one—they simply declare it so.

As a matter of plain meaning, the argument that § 630(b) can be reasonably interpreted to include its second sentence definitions within its first is underwhelming. If Congress had wanted to include the second sentence definitions of employer in the first sentence, it could have used the word “include” or utilized one of the other alternative constructions described above. The word “also” is not used in common speech to mean “includes.” Webster’s New Collegiate Dictionary 34 (1973). As previously described, the use of separate sentences and the word “also” combine to create distinct categories, in which clarifying language for one category does not apply to other categories. See *United States v. Rentz*, 777 F.3d 1105, 1109 (10th Cir. 2015) (“[U]ntil a clue emerges suggesting otherwise, it’s not unreasonable to think that Congress used the English language according to its conventions.”). Even the Supreme Court defaults into the categorical approach when discussing the statute. E.g., *Wyoming*, 460 U.S. at 233; *Johnson*, 472 U.S. at 356.

3

We are persuaded that the meaning of § 630(b) is not ambiguous. The twenty-employee minimum does not apply to definitions in the second sentence and there is no reason to depart from the statute’s plain meaning. See *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004) (“It is well established that when the statute’s language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.”). We are satisfied that our reading comports with *Lamie* and certainly does not threaten to destroy the entire statutory scheme. See *King v. Burwell*, 135 S. Ct. 2480,
Courts should rarely depart from a statute’s clear meaning because it risks creating a perception that they are inserting their own policy preferences into a law. See id. at 2495–96 (citing Palmer v. Massachusetts, 308 U.S. 79, 83 (1939)). Here, there is no valid justification to depart from the plain meaning of the language and to adopt another interpretation.

C

Even if we agreed with the Fire District and concluded that the statute is ambiguous—which we do not—the outcome would not change. The best reading of the statute would be that the twenty-employee minimum does not apply to a political subdivision of a State. We reject the Fire District’s contention that considering the legislative history Kelly reviewed should lead us to an alternative interpretation.

After concluding that the statute is ambiguous, Kelly relied on “the parallel [1972] amendment of Title VII” and the legislative history around the 1974 Amendment to conclude “that Congress intended section 630(b) to apply the same coverage to both public and private employees.” 801 F.2d at 271–72. Kelly’s focus on divining congressional intent, rather than determining the ordinary meaning of the text, led it astray. See Meacham v. Knolls Atomic Power Lab., 554 U.S. 84, 102 (2008) (“We have to read [the ADEA] the way Congress wrote it.”); Scalia & Garner, Reading Law: The Interpretation of Legal Texts 391 (critiquing those who think “that the purpose of interpretation is to discover intent”). We need not read minds to read text.

Both parties argue that the 1972 Title VII Amendment supports their position. But, critically, Congress used different language than it used in the 1974 ADEA Amendment, which changes the ADEA’s meaning relative to Title VII, and such Congressional choice must be respected. See Univ. of Tex. SW Med. Ctr. v. Nassar, 133 S. Ct. 2517, 2528–29 (2013). If Congress had wanted the 1974 ADEA Amendment to achieve the same result as the 1972 Title VII Amendment, it could have used the same language.

Nor does the legislative history Kelly relies on address the specific question before us. Kelly, 801 F.2d at 271–72. It references a Senate report written a year before the bill was passed discussing how the same set of rules should apply to the private sector and the government. Id. (citing Senate Age Discrimination Report at 17). The Senate report never states that the twenty-employee minimum should apply to political subdivisions, but it does “urge that the law be extended . . . to include (1) Federal, State, and local governmental employees, and (2) employers with 20 or more employees.” Senate Age Discrimination Report at 18 (emphasis added). It also cites a House report containing the same vague language about ensuring the same rules apply and two floor statements by Senator Bentsen, one of which occurred in 1972, arguing that the amendment is needed so that government
employees receive the “same protection.” Id. (citing H.R. Rep. No. 93- 913 (1974); 118 Cong. Rec. 15,895 (1972); 120 Cong. Rec. 8768 (1974)).

Eventually, the Kelly court resorted to arguing that given its perception of Congressional intent, Congress could not have intended what it said. 801 F.2d at 273 (“We also believe that applying the ADEA to government employers with less than twenty employees would lead to some anomalous results which we do not believe Congress would have intended.”). However, there are plenty of perfectly valid reasons why Congress could have structured the statute the way it did.10 In any event, it is not our role to choose what we think is the best policy outcome and to override the plain meaning of a statute, apparent anomalies or not. See Michigan v. Bay Mills Indian Cmty., 134 S. Ct. 2024, 2033 (2014).

III

The district court erred in concluding that the twentyemployee minimum applies to political subdivisions; it does not. Therefore, the order granting summary judgment is reversed and the case is remanded for further proceedings consistent with this opinion.

REVERSED AND REMANDED.
The ability of a tiny Arizona fire district to fire its two oldest employees takes center stage in Washington as the U.S. Supreme Court will hear arguments the first day of its new session, possibly with a new justice already seated.

In a brief order Monday, the court put the case of John Guido and Dennis Rankin and their case against the Mount Lemmon Fire District on the Oct. 1 agenda. What the justices rule will most immediately affect whether the pair, the district’s two oldest employees before they were let go, have a right to sue under federal age discrimination law.

But whatever the high court decides clearly has broader implications, to the point that an alphabet soup of state and local government organizations and their allies filed their own legal brief telling the justices that they should side with the fire district and block the ability of the two fired workers to sue.

That argument is getting a fight from Tucson attorney Don Awerkamp who hopes to convince the justices that his clients’ rights were violated and they deserve their day in court.

The whole case turns on a single legal point: Can government employers be too small to have to comply with federal anti-discrimination laws.

Court records show the pair were hired in 2000, eventually rising to the rank of full-time fire captains.

In 2009, with the district facing a financial shortfall, it terminated the pair. At the time, they were the district’s oldest employees, with Guido at 45 and Rankin at 54.

Awerkamp said they were replaced as captains with two younger people, one them just 28 with only six years of experience as a firefighter.

The district argued that the pair were laid off because they had not participated in recent years in voluntary shifts fighting wildland fires. The pair then sued.

A trial judge threw out the claim, concluding the federal Age Discrimination Employment Act covers public employers only if they have 20 or more workers. But a federal appeals court reversed, saying while that’s true of private companies, it finds no such minimum number in statutes governing public employers.
That brought the case to the Supreme Court — and the attention of public employers nationwide who want the appellate ruling overturned.

“Small public sector employers are particularly vulnerable, sometimes operating with only a handful of staff,” wrote attorney Collin O. Udell. Among the groups he is representing are the National Conference of State Legislatures, the National Association of Counties, the National League of Cities and the U.S. Conference of Mayors.

The issue is particularly acute, he said, in rural special districts like this one.

“There are fewer alternatives to layoffs and terminations when budget cuts must be made,” Udell wrote.

“Small, rural special districts may not have other positions or locations to which they can transfer an employee in lieu of termination or layoffs,” he continued. “When resources are strained, already-leanly staffed special districts encountering employment discrimination lawsuits may find it impossible to remain financially viable.”

Awerkamp called those arguments “incorrect and overblown.”

He said most states have requirements that political subdivisions pay monetary damages if they discriminate on the basis of age. Awerkamp said that even includes rural and sparsely-populated places like Alaska and Wyoming which grant no exceptions to small public employers from their own age-discrimination laws.

“The fire district identifies no adverse consequences on those statutes,” he wrote. And Awerkamp said public employers can participate in insurance pools that cover the cost of discrimination lawsuits, so the burden does not fall on any one particular district.

But Awerkamp urged the justices not to be swayed by arguments by the district and its legal allies of financial hardship.

“It is important not to lose sight of what it actually seeks here — a free pass under federal law to discriminate on the basis of age,” he said. “No matter how blatant or unjustified its reliance on age, the first direct seeks immunity for inflicting on individual workers the economic and psychological injury accompanying the loss of opportunity to engage in productive and satisfying occupations.”

Even if the court hears the case in early October, it is likely to be sometime in 2019 before there is a ruling.
A federal statute prohibiting age bias in employment applies to an Arizona state fire district regardless of whether it had 20 employees, a federal appeals court ruled (Guido v. Mount Lemmon Fire Dist., 2017 BL 208360, 9th Cir., No. 15-15030, 6/19/17).

The U.S. Court of Appeals for the Ninth Circuit’s June 19 decision creates a split among the federal appeals courts by ruling the Age Discrimination in Employment Act’s 20-employee threshold for coverage applies only to private employers.

A petition for U.S. Supreme Court review is “likely,” said Jeffrey Matura of Graif Barrett & Matura PC in Phoenix, who represented the fire district.

The act’s “plain language” establishes that a state’s political subdivisions, such as the Mount Lemmon Fire District in Arizona, are covered by the ADEA regardless of how many workers they employ, the Ninth Circuit said.

Four other federal appeals courts have ruled state political subdivisions must employ at least 20 workers to fall within the act’s purview. The Ninth Circuit is the only federal circuit to “interpret the relevant language differently,” Matura told Bloomberg BNA June 19.

“It’s the classic circuit split,” Matura said. The fire district hasn’t made a final decision, but it likely will ask the Supreme Court to provide “clarity once and for all” on the ADEA coverage issue, he said.

It’s “been a long road” for John Guido and Dennis Rankin, two captains who were terminated by the fire district in 2009 at ages 46 and 54, respectively, said Shannon Giles of Awerkamp, Bonilla & Giles PLC in Tucson, Ariz., who represented them.

Discovery in the lower court was completed before a district judge summarily ruled for Mount Lemmon based on his reading of the ADEA employee threshold, Giles told Bloomberg BNA June 19.

Guido and Rankin hope the Ninth Circuit’s decision means a trial soon on their bias claims, she said.

ADEA’s Meaning Is Clear, Court Says

Three other federal appeals courts have followed the Seventh Circuit’s lead in Kelly v. Wauconda Park District, finding that the ADEA is “ambiguous.” Those courts said the better reading of the act is that Congress
intended the 20-employee threshold to apply to all employers, public as well as private.

The Ninth Circuit, however, said there’s no ambiguity. The ADEA’s 1974 amendment can only be read as extending the act’s protections to all state government workers, regardless of the size of the unit in which they work, Judge Diarmuid F. O’Scanlonlain wrote in an opinion joined by Judges Ronald M. Gould and Milan D. Smith Jr.

The Equal Employment Opportunity Commission, which filed an amicus brief supporting the fired firefighters, is “gratified” the court agreed with the commission that the ADEA covers all political subdivisions, even if they don’t have 20 employees, Anne Noel Occhialino, an EEOC senior appellate attorney, said in an email June 19.
Federal bias law doesn’t give small state subdivisions a free pass to discriminate against older workers, the government said Thursday in a U.S. Supreme Court case that will clarify the Age Discrimination in Employment Act’s scope.

The government in an amicus brief urged the Supreme Court to uphold a Ninth Circuit ruling that a section of the ADEA barring “state or political subdivision[s]” from discriminating against older workers describes a different class of covered employer than a section limiting enforcement to only those private businesses with “twenty or more employees.”

That Congress in a 1974 amendment to the ADEA said the law, which originally covered only private businesses of a certain size, “also” covers state entities shows the categories are separate, the government said.

“Because the ordinary meaning of ‘also’ is ‘in addition to,’ the second sentence defines an additional category of covered employers—namely states and political subdivisions,” the government said. “Congress did not apply any minimum-employee requirement to that category.”

The ADEA bars “employers” from discriminating against workers or job applicants age 40 or older. In its current form, the law defines “employer” as a “person engaged in an industry affecting commerce” that had “twenty or more employees” during much of the preceding calendar year. The law says employer “also means” states or political subdivisions.

The high court in February agreed to hear a challenge by an Arizona firefighting service to a Ninth Circuit ruling reviving a suit by two fired workers. The Ninth Circuit said a district court incorrectly applied the 20-worker minimum to the Mount Lemmon Fire District, a public office that had fewer than 20 workers when the plaintiffs sued.

The government’s brief argues the background of the 1974 amendment makes clear that Congress meant the ADEA to apply separately to public and private employers. It notes the ADEA shares “several key features” with the Fair Labor Standards Act, which Congress in the same 1974 package extended to public agencies regardless of their size.

“Because the FLSA does not include a minimum-employee requirement, it is reasonable to infer that Congress similarly extended the ADEA to governmental entities
without imposing such a requirement,” the government said.

The government also pushed back against Mount Lemmon’s argument that small government offices would be deluged with litigation should the high court rule the ADEA’s minimums don’t apply to state employers. It notes the U.S. Equal Employment Opportunity Commission, which administers the ADEA, has said for decades that the law applies to government offices with fewer than 20 workers, and that most states have passed separate laws forbidding government employers of any size from discriminating against older workers.

A coalition of worker groups led by the AARP also filed an amicus brief Thursday backing the workers and the Ninth Circuit. The groups argue the 1974 amendment plainly applies to state offices of any size and distinguish the ADEA from Title VII of the Civil Rights Act, which only applies to government offices if they have 15 or more workers. The National Employment Lawyers Association is also on the brief.

Orrick Herrington & Sutcliffe LLP attorney Joshua Rosenkranz, who represents Mount Lemmon, said Friday neither brief "persuasively reconciles the result they advocate with the language and structure of the statute."

"They don’t explain why Congress would have opted [in Title VII] to exempt small political subdivisions as to all antidiscrimination claims—for race, ethnicity, gender, etc.—but not for age," he said. "And neither grapples with the devastating effect the Ninth Circuit’s ruling will have on tiny political subdivisions that provide crucial government services."

Representatives for the AARP Foundation and the U.S. Department of Justice declined comment.

The government is represented by James Lee, Jennifer Goldstein, Anne Noel Occhialino, Noel Francisco, Jeffrey Wall and Morgan Goodspeed of the U.S. Department of Justice.

The AARP is represented by Daniel Kohrman, Laurie McCann, Dara Smith and William Alvarado Rivera of the AARP Foundation.

Mount Lemmon is represented by Jeffrey C. Matura and Amanda J. Taylor of Graif Barrett & Matura PC and Joshua Rosenkranz, Robert Loeb, Thomas Bondy, Ned Hirschfeld and Logan Dwyer of Orrick Herrington & Sutcliffe LLP.

The workers are represented by Don Awerkamp and Shannon Giles of Awerkamp Bonilla & Giles PLC.

The case is Mount Lemmon Fire District v. John Guido et al., case number 17-587, in the U.S. Supreme Court.
Frank v. Gaos

Ruling Below: IN RE GOOGLE REFERRER HEADER PRIVACY LITIGATION, 869 F.3d 737 (9th Cir. 2017)

Overview: The Cy Pres doctrine gives courts the power to interpret a will or a charitable gift to implement the giver’s intent when it is impossible to carry out the terms as they are written. The Cy Pres doctrine has recently been applied to distribute to charity the proceeds of a class-action settlement that have not been claimed by class members, usually because the award to each person is relatively small. Some object to the use of the Cy Press doctrine for class actions because unaffected entities—like charities and non-profits—would unfairly benefit.

Issue: Whether, or in what circumstances, a cy pres award of class action proceeds that provides no direct relief to class members supports class certification and comports with the requirement that a settlement binding class members must be “fair, reasonable, and adequate.”

IN RE GOOGLE REFERRER HEADER PRIVACY LITIGATION, Paloma GAOS; Anthony Italiano; Gabriel Priyev, individually and on behalf of all others similarly situated, Plaintiffs–Appellees

v.

Melissa Ann Holyoak; Theodore H. Frank, Objectors–Appellants

v.

GOOGLE, INC., a Delaware corporation, Defendant-Appellees

United States Court of Appeals, Ninth Circuit

Decided on August 22, 2017

[Excerpt; some citations and footnotes omitted]

McKEOWN, Circuit Judge:

Google’s free Internet search engine (“Google Search”) processes more than one billion user-generated search requests every day. This case arises from class action claims that Google violated users’ privacy by disclosing their Internet search terms to owners of third-party websites. We consider whether the district court abused its discretion in approving the $8.5 million cy

press–only settlement and conclude that it did not.

BACKGROUND

In these consolidated class actions, three Google Search users—Paloma Gaos, Anthony Italiano, and Gabriel Priyev (collectively “plaintiffs”)—asserted claims for violation of the Stored Communications Act, 18 U.S.C. § 2701 et seq.; breach of
contract; breach of the covenant of good faith and fair dealing; breach of implied contract; and unjust enrichment. The plaintiffs sought statutory and punitive damages and declaratory and injunctive relief for the alleged privacy violations.

The claimed privacy violations are the consequence of the browser architecture. Once users submit search terms to Google Search, it returns a list of relevant websites in a new webpage, the “search results page.” Users can then visit any website listed in the search results page by clicking on the provided link.

When a user visits a website via Google Search, that website is allegedly privy to the search terms the user originally submitted to Google Search. This occurs because, for each search results page, Google Search generates a unique “Uniform Resource Locator” (“URL”) that includes the user’s search terms. In turn, every major desktop and mobile web browser (including Internet Explorer, Firefox, Chrome, and Safari) by default reports the URL of the last webpage that the user viewed before clicking on the link to the current page as part of “referrer header” information. See In re Zynga Privacy Litig., 750 F.3d 1098, 1102 (9th Cir. 2014) (explaining how “referrer headers” operate).

The genesis of the plaintiffs’ complaints is the application of the search protocol, coupled with Google’s “Web History” service, which tracks and stores account holders’ browsing activity on Google’s servers. Following mediation, the parties reached a settlement, which they submitted to the district court for preliminary approval in July 2013. The settlement provided that Google would pay a total of $8.5 million and provide information on its website disclosing how users’ search terms are shared with third parties, in exchange for a release of the claims of the approximately 129 million people who used Google Search in the United States between October 25, 2006 and April 25, 2014 (the date the class was given notice of the settlement).

Of the $8.5 million settlement fund, approximately $3.2 million was set aside for attorneys’ fees, administration costs, and incentive payments to the named plaintiffs. The remaining $5.3 million or so was allocated to six _cy pres_ recipients, each of which would receive anywhere from 15 to 21% of the money, provided that they agreed “to devote the funds to promote public awareness and education, and/or to support research, development, and initiatives, related to protecting privacy on the Internet.” The six recipients were AARP, Inc.; the Berkman Center for Internet and Society at Harvard University; Carnegie Mellon University; the Illinois Institute of Technology Chicago-Kent College of Law Center for Information, Society and Policy; the Stanford Center for Internet and Society; and the World Privacy Forum. Each of the recipients submitted a detailed proposal for how the funds would be used to promote Internet privacy.

After a hearing, the district court certified the class for settlement purposes and preliminarily approved the settlement. Notice
was given to the class on April 25, 2014, via a website, toll-free telephone number, paid banner ads, and press articles. Thirteen class members opted out of the settlement, and five class members, including Melissa Ann Holyoak and Theodore H. Frank (collectively “Objectors”), filed objections.

Following a final settlement approval hearing at which the district court heard from both the parties and Objectors, the district court granted final approval of the settlement on March 31, 2015. With respect to the objections, the district court found that: (1) a cy pres–only settlement was appropriate because the settlement fund was nondistributable; (2) whether or not the settlement was cy pres–only had no bearing on whether Rule 23(b)(3)’s superiority requirement was met; (3) the cy pres recipients had a substantial nexus to the interests of the class members, and there was no evidence that the parties’ preexisting relationships with the recipients factored into the selection process; and (4) the attorneys’ fees were commensurate with the benefit to the class. The district court awarded $2.125 million in fees to class counsel and $15,000 in incentive awards to the three named plaintiffs. Objectors appealed.

ANALYSIS

The settlement at issue involves a cy pres–only distribution of the $5.3 million or so that remains in the settlement fund after attorneys’ fees, administration costs, and incentive awards for the named plaintiffs are accounted for. Cy pres, which takes its name from the Norman French expression _comme possible_ (or “as near as possible”), is an equitable doctrine that originated in trusts and estates law as a way to effectuate the testator’s intent in making charitable gifts. _Nachshin v. AOL, LLC_, 663 F.3d 1034, 1038 (9th Cir. 2011). In the class action settlement context, the _cy pres_ doctrine permits a court to distribute unclaimed or non-distributable portions of a class action settlement fund to the “next best” class of beneficiaries for the indirect benefit of the class. _Id_.

Here, the _cy pres_ recipients were six organizations that have pledged to use the settlement funds to promote the protection of Internet privacy. We review for abuse of discretion the district court’s approval of the proposed class action settlement. _Id_. In addition, because the settlement took place before formal class certification, settlement approval requires a “higher standard of fairness.” _Lane v. Facebook, Inc._, 696 F.3d 811, 819 (9th Cir. 2012) (quoting _Hanlon v. Chrysler Corp._, 150 F.3d 1011, 1026 (9th Cir. 1998)), _cert. denied sub nom. Marek v. Lane_, 134 S. Ct. 8 (2013). Recognizing that, at this early stage of litigation, the district court cannot as effectively monitor for collusion and other abuses, we scrutinize the proceedings to discern whether the court sufficiently “account[ed] for the possibility that class representatives and their counsel have sacrificed the interests of absent class members for their own benefit.” _Id_.

I. Appropriateness of the Cy Pres–Only Settlement

As an initial matter, we quickly dispose of the argument that the district court
tered by approving a *cy pres*–only settlement. Notably, Objectors do not contest the value of the settlement nor do they plead monetary injury. To be sure, *cy pres*–only settlements are considered the exception, not the rule. *See Klier v. Elf Atochem N. Am., Inc.*, 658 F.3d 468, 474 (5th Cir. 2011) (explaining that direct distributions to class members are preferable because “[t]he settlement-fund proceeds, having been generated by the value of the class members’ claims,” are “the property of the class”); *accord* William B. Rubenstein, *Newberg on Class Actions* § 12:26 (5th ed. 2017). However, they are appropriate where the settlement fund is “non-distributable” because “the proof of individual claims would be burdensome or distribution of damages costly.” *Lane*, 696 F.3d at 819 (quoting *Nachshin*, 663 F.3d at 1038). We have never imposed a categorical ban on a settlement that does not include direct payments to class members.

The district court’s finding that the settlement fund was non-distributable accords with our precedent. In *Lane*, we deemed direct monetary payments “infeasible” where each class member’s individual recovery would have been “*de minimis*” because the remaining settlement fund was approximately $6.5 million and there were over 3.6 million class members. *Id.* at 817–18, 820–21. The gap between the fund and a miniscule award is even more dramatic here. The remaining settlement fund was approximately $5.3 million, but there were an estimated 129 million class members, so each class member was entitled to a paltry 4 cents in recovery—*a de minimis* amount if ever there was one. The district court found that the cost of verifying and “sending out very small payments to millions of class members would exceed the total monetary benefit obtained by the class.”

To begin, the district court found that the amount of the fund was appropriate given the shakiness of the plaintiffs’ claims. Objectors do not contend that it would have been feasible to make a 4-cent distribution to every class member. Instead, they ask us to impose a mechanism that would permit a miniscule portion of the class to receive direct payments, eschewing a class settlement that benefits members through programs on privacy and data protection instituted by the *cy pres* recipients. Objectors suggest, for example, that “it is possible to compensate an oversized class with a small settlement fund by random lottery distribution,” or by offering “$5 to $10 per claimant” on the assumption that few class members will make claims. Our review of the district court’s settlement approval is not predicated simply on whether there may be “possible” alternatives; rather, we benchmark whether the district court discharged its obligation to assure that the settlement is “fair, adequate, and free from collusion.” *Lane*, 696 F.3d at 819 (quoting *Hanlon*, 150 F.3d at 1027). If we took their objections at face value, Objectors would have us jettison the teachings of *Lane*. Objectors would also have us ignore our prior endorsement of *cy pres* awards that go to uses consistent with the nature of the underlying action. *Nachshin*, 663 F.3d at 1039–40.

Likewise, we easily reject Objectors’ argument that if the settlement fund was non-
distributable, then a class action cannot be the superior means of adjudicating this controversy under Rule 23(b)(3). “[T]he purpose of the superiority requirement is to assure that the class action is the most efficient and effective means of resolving the controversy.” Wolin v. Jaguar Land Rover N. Am., LLC, 617 F.3d 1168, 1175 (9th Cir. 2010) (alteration in original) (quoting 7AA Charles Alan Wright et al., Federal Practice and Procedure § 1779 (3d ed. 2005)). Not surprisingly, there is a relationship between the superiority requirement and the appropriateness of a cy pres–only settlement. The two concepts are not mutually exclusive, since “[w]here recovery on an individual basis would be dwarfed by the cost of litigating on an individual basis, this factor weighs in favor of class certification.” Id. The district court did not abuse its discretion in finding the superiority requirement was met because the litigation would otherwise be economically infeasible. This finding dovetails with the rationale for the cy pres–only settlement.

II. The Cy Pres Recipients

We now turn to the crux of this appeal: whether approval of the settlement was an abuse of discretion due to claimed relationships between counsel or the parties and some of the cy pres recipients. We have long recognized that the cy pres doctrine, when “unbridled by a driving nexus between the plaintiff class and the cy pres beneficiaries[,] poses many nascent dangers to the fairness of the distribution process,” because the selection process may then “answer to the whims and self interests of the parties, their counsel, or the court.” Nachshin, 663 F.3d at 1038–39; see also Dennis v. Kellogg Co., 697 F.3d 858, 865 (9th Cir. 2012); Six (6) Mexican Workers v. Ariz. Citrus Growers, 904 F.2d 1301, 1308–39 (9th Cir. 1990). Due to these dangers, we require cy pres awards to meet a “nexus” requirement by being tethered to the objectives of the underlying statute and the interests of the silent class members. Nachshin, 663 F.3d at 1039.

Objectors suggest that the district court rubber-stamped the settlement, by “simply holding] that the Ninth Circuit and district courts have approved other all-cy-pres settlements and class members effectively had no right to complain about the parties’ choice of compromise.” That characterization is unfair and untrue. And oddly, despite this claim, Objectors do not dispute that the nexus requirement is satisfied here.

The district court found that the six cy pres recipients are “established organizations,” that they were selected because they are “independent,” have a nationwide reach and “a record of promoting privacy protection on the Internet,” and “are capable of using the funds to educate the class about online privacy risks.” Although the district court expressed some disappointment that the recipients were the “usual suspects,” it recognized that “failure to diversify the list of distributees is not a basis to reject the settlement . . . when the proposed recipients otherwise qualify under the applicable standard.” Accordingly, the district court appropriately found that the cy pres
distribution addressed the objectives of the Stored Communications Act and furthered the interests of the class members. Previous *cy pres* distributions rest on this same understanding of the nexus requirement. See, e.g., *Dennis*, 697 F.3d at 866–67 (no nexus between false advertising claims relating to the nutritional value of Frosted Mini-Wheats® and charities providing food for the indigent); *Lane*, 696 F.3d at 817, 820–22 (nexus between Facebook privacy claims and charity giving grants promoting online privacy and security); *Nachshin*, 663 F.3d at 1039–41 (no nexus between breach of privacy, unjust enrichment, and breach of contract claims relating to AOL’s provision of commercial e-mail services and the Legal Aid Foundation of Los Angeles, the Boys and Girls Clubs of Santa Monica and Los Angeles, and the Federal Judicial Center Foundation); *Six (6) Mexican Workers*, 904 F.2d at 1307–09 (no nexus between Farm Labor Contractor Registration Act claims and foundation operating human assistance projects in areas where plaintiffs resided).

Nonetheless, Objectors take issue with the choice of *cy pres* recipients because Google has in the past donated to at least some of the *cy pres* recipients, three of the *cy pres* recipients previously received Google settlement funds, and three of the *cy pres* recipients are organizations housed at class counsel’s alma mater. See *In re Google Buzz Privacy Litig.*, No. C 10-00672 JW, 2011 WL 7460099, at *3 (N.D. Cal. Jun. 2, 2011). The Objectors point to a comment from the American Law Institute’s (“ALI”) Principles of the Law of Aggregate Litigation which suggests that “[a] *cy pres* remedy should not be ordered if the court or any party has any significant prior affiliation with the intended recipient that would raise substantial questions about whether the selection of the recipient was made on the merits.” Principles of the Law of Aggregate Litig. § 3.07 cmt. b (Am. Law Inst. 2010) (emphasis added).

The benchmark for “significant prior affiliation” is left undefined. Id. Of course it makes sense that the district court should examine any claimed relationship between the *cy pres* recipient and the parties or their counsel. But a prior relationship or connection between the two, without more, is not an absolute disqualifier. Rather, a number of factors, such as the nature of the relationship, the timing and recency of the relationship, the significance of dealings between the recipient and the party or counsel, the circumstances of the selection process, and the merits of the recipient play into the analysis. The district court explicitly or implicitly addressed this range of considerations.

We do not need to explore the contours of the “significant prior affiliation” comment because in the context of this settlement, the claimed relationships do not “raise substantial questions about whether the selection of the recipient was made on the merits.” See id. § 3.07 cmt. b. As a starting premise, Google’s role as a party in reviewing the *cy pres* recipients does not cast doubt on the settlement. In *Lane*, we approved a *cy pres*–only settlement in which the distributor of the settlement fund was a newlycreated entity run by a three-member board of directors, one of whom was
defendant Facebook’s Director of Public Policy. 696 F.3d at 817. We rejected the claim that this structure created an “unacceptable conflict of interest,” explaining that “[w]e do not require . . . that settling parties select a cy pres recipient that the court or class members would find ideal” since “such an intrusion into the private parties’ negotiations would be improper and disruptive to the settlement process.” Id. at 820–21. Instead, we recognized that, as the “‘offspring of compromise,’” settlement agreements “necessarily reflect the interests of both parties to the settlement.” Id. at 821 (quoting Hanlon, 150 F.3d at 1027). Thus, we concluded that Facebook’s ability to have “its say” in the distribution of cy pres funds was “the unremarkable result of the parties’ give-and-take negotiations” and acceptable so long as the nexus requirement was satisfied. Id. at 821–22.

Given the burgeoning importance of Internet privacy, it is no surprise that Google has chosen to support the programs and research of recognized academic institutes and nonprofit organizations. Google has donated to hundreds of third-party organizations whose work implicates technology and Internet policy issues, including university research centers, think tanks, advocacy groups, and trade organizations. These earlier donations do not undermine the selection process employed to vet the cy pres recipients in this litigation. The district court conducted a “careful[] review” of the recipient’s “detailed proposals” and found a “substantial nexus” between the recipients and the interests of the class members. Notably, some of the recipient organizations have challenged Google’s Internet privacy policies in the past. Most importantly, there was transparency in this process, with the proposed recipients disclosing donations received from Google. Each recipient’s cy pres proposal identified the scope of Google’s previous contributions to that organization, and, unlike in Lane, explained how the cy pres funds were distinct from Google’s general donations. See Dennis, 697 F.3d at 867–68 (casting doubt on the value of cy pres funds that a defendant “has already obligated itself to donate”). Citing Lane, the district court found that “[t]he chosen recipients and their respective proposals are sufficiently related so as to warrant approval; they do not have to be the recipients that objectors or the court consider ideal.”

The objection that three of the cy pres recipients had previously received cy pres funds from Google does not impugn the settlement without something more, such as fraud or collusion. See Rodriguez v. W. Publ’g Corp., 563 F.3d 948, 965 (9th Cir. 2009). That “something more” is missing here. Indeed, the proposition that cy pres funds should not be awarded to previous recipients would be in some tension with our nexus requirements. As we have recognized, it is often beneficial for a cy pres recipient to have a “‘substantial record of service,’” because such a record inspires confidence that the recipient will use the funds to the benefit of class members. See Dennis, 697 F.3d at 865 (quoting Six (6) Mexican Workers, 904 F.2d at 1308); Lane, 696 F.3d at 822. But in emerging areas such as Internet and data privacy, expertise in the subject
matter may limit the universe of qualified organizations that can meet the strong nexus requirements we impose upon cy pres recipients. Given that, over time, major players such as Google may be involved in more than one cy pres settlement, it is not an abuse of discretion for a court to bless a strong nexus between the cy pres recipient and the interests of the class over a desire to diversify the pick via novel beneficiaries that are less relevant or less qualified. See Nachshin, 663 F.3d at 1040 (considering whether the cy pres distribution “provide[s] reasonable certainty that any member will be benefitted”).

Finally, we reject the proposition that the link between the cy pres recipients and class counsel’s alma maters raises a significant question about whether the recipients were selected on the merits. There may be occasions where the nature of the alumni connections between the parties and the recipients could cast doubt on the propriety of the selection process. But here, we have nothing more than a barebones allegation that class counsel graduated from schools that house the Internet research centers that will receive funds.

The claim that counsel’s receipt of a degree from one of these schools taints the settlement can’t be entertained with a straight face. Each of these schools graduates thousands of students each year. Objectors have never disputed that class counsel have no ongoing or recent relationships with their alma maters and have no affiliations with the specific research centers. Nor did the district court simply accept this concession or put the burden on the Objectors. The district court appropriately considered the substance of the objections and explained why those challenges did not undermine the overall fairness of the settlement. See In re Pac. Enters. Sec. Litig., 47 F.3d 373, 377 (9th Cir. 1995). The court affirmatively analyzed the issue and was cognizant of the claim of a potential conflict. All class counsel swore that they have no affiliations with the specific research centers. Class counsel repeated that attestation at the final settlement approval hearing and added that they sit on no boards for any of the proposed recipients. As one class counsel put it, “I simply got my law degree [at Harvard], and that’s simply the end of it.” The recipients are well recognized centers focusing on the Internet and data privacy, and the district court conducted a “careful[] review” of the recipients’ “detailed proposals” and found a “substantial nexus” between the recipients and the interests of the class members. No one suggested that any of the centers acted with any impropriety, and the Objectors provided no alternative suggestions for other law schools with more qualified centers or institutes. The district court found “no indication that counsel’s allegiance to a particular alma mater factored into the selection process,” particularly since the identity of the recipients “was a negotiated term included in the Settlement Agreement and therefore not chosen solely by . . . alumni.” Thus, the district court gave a “sufficient[ly] reasoned” response to the objections as to the claimed preexisting relationships. In re Pac. Enters. Sec. Litig., 47 F.3d at 377. We can hardly say that the alumni connections cloud the fairness of the settlement.
As an overarching matter, nothing in this record “raise[s] substantial questions about whether the selection of the recipient was made on the merits.” See Principles of the Law of Aggregate Litig. § 3.07 cmt. b. We do not suggest, however, that a party’s prior relationship with a *cy pres* recipient could not be a stumbling block to approval of a settlement. *Cf. Marek*, 134 S. Ct. at 9 (mem.) (statement of Roberts, C.J., respecting the denial of certiorari) (recognizing that given the “fundamental concerns surrounding” *cy pres* awards and their increasing prevalence, the Court “may need to clarify the limits on the use of such remedies” in the future). We hold merely that, under the circumstances here, the district court did not abuse its discretion in approving the *cy pres* recipients.

### III. Attorneys’ Fees

Turning to the issue of attorneys’ fees, the district court did not abuse its discretion by approving $2.125 million in fees and $21,643.16 in costs. As an initial matter, there is no support for Objectors’ view that the settlement should have been valued at a lower amount for the purposes of calculating attorneys’ fees simply because it was *cy pres*– only. See generally *Lane*, 696 F.3d at 818 (acknowledging a 25% fee award that also involved a *cy pres*–only settlement). Rather, the question is whether the amount of attorneys’ fees was reasonable. *In re Bluetooth Headset Prod. Liab. Litig.*, 654 F.3d 935, 941 (9th Cir. 2011).

In a settlement that produces a common fund for the benefit of the entire class, a court has discretion to employ either the “percentage-of-recovery” method or the “lodestar” method to calculate appropriate attorneys’ fees, so long as its discretion is exercised so as to achieve a reasonable result. See *id.* at 942. Here, the district court found that the requested fees were appropriate under either metric.

Under the percentage-of-recovery method, the requested fee was equal to 25% of the settlement fund. According to the district court, this percentage was commensurate with the risk posed by the action and the time and skill required to secure a successful result for the class, given that class counsel faced three motions to dismiss and participated in extensive settlement negotiations. The district court also found that this percentage hewed closely to that awarded in similar Internet privacy actions. See, e.g., *In re Netflix Privacy Litig.*, No. 5:11-CV-00379 EJD, 2013 WL 1120801, at *9–10 (N.D. Cal. Mar. 18, 2013); *see also In re Bluetooth*, 654 F.3d at 942 (noting that 25% is our “benchmark” for a reasonable fee award).

Although not required to do so, the district court took an extra step, cross-checking this result by using the lodestar method. See *In re Bluetooth*, 654 F.3d at 941–44 (checking the district court’s percentage-of-recovery fees calculation against the lodestar method, which is “calculated by multiplying the number of hours the prevailing party reasonably expended on the litigation . . . by a reasonable hourly rate for the region and the experience of the lawyer”). The district court found that class counsel
provided sufficient support for its lodestar calculation that fees totaled $2,126,517.25.

AFFIRMED.

WALLACE, Circuit Judge, concurring in part and dissenting in part:

I concur in Sections I and III of the majority opinion. I agree that a cy pres-only settlement was appropriate in this case and do not contend that the district court abused its discretion in calculating class counsel’s fees.

I dissent, however, from Section II of the opinion, in which the majority blesses the district court’s approval of the settlement, despite the preexisting relationships between class counsel and the cy pres recipients. To me, the fact alone that 47% of the settlement fund is being donated to the alma maters of class counsel raises an issue which, in fairness, the district court should have pursued further in a case such as this. The district court made no serious inquiry to alleviate that concern. Accordingly, I would vacate the district court’s approval of the class settlement, and remand with instructions to hold an evidentiary hearing, examine class counsel under oath, and determine whether class counsel’s prior affiliation with the cy pres recipients played any role in their selection as beneficiaries.

I.

As the majority opinion outlines, plaintiffs in this case alleged that Google violated class members’ privacy rights by disclosing personal information (such as search terms) to unauthorized third parties. Google’s practice allegedly violated the federal Stored Communications Act, along with various state laws. After several rounds at the motion to dismiss stage, the parties agreed to a class-wide settlement (before formal class certification by the district court). The parties estimated the size of the class to be 129 million people.

The settlement contained the following key terms: (1) Google agreed to pay $8.5 million into a settlement fund; (2) Google would provide notice of the settlement on its website; (3) each class representative would receive $5,000, claims administration costs would be $1 million, and attorney’s fees would be $2.125 million (25% of the settlement fund); and (4) the remainder of the settlement fund (about $5 million) would go to six cy pres recipients. The six cy pres recipients were to be Carnegie Mellon University (21% of the remainder), the World Privacy Forum (17%), Chicago-Kent College of Law Center for Information, Society and Policy (16%), the Stanford Center for Internet and Society (16%), the Berkman Center for Internet and Society at Harvard University (15%), and that the AARP Foundation (15%).

II.

We review a district court’s approval of a class action settlement for an abuse of discretion. Rodriguez v. W. Publ’g Corp., 563 F.3d 948, 963 (9th Cir. 2009). Here, however, the parties reached the settlement before the class certification stage. “Prior to formal class certification, there is an even greater
potential for a breach of fiduciary duty owed the class during settlement. Accordingly, such agreements must withstand an even higher level of scrutiny for evidence of collusion or other conflicts of interest than is ordinarily required.” In re Bluetooth Headset Prod. Liab. Litig., 654 F.3d 935, 946 (9th Cir. 2011).

As stated above, three of the cy pres distribution payments in our case are to Chicago-Kent College of Law (16%), Stanford (16%), and Harvard (15%). Attorneys for the class attended all three of these institutions. We, along with other courts and observers, have pointed out the unseemly occurrence of cy pres funds being doled out to interested parties’ alma maters. See, e.g., Nachshin v. AOL, LLC, 663 F.3d 1034, 1039 (9th Cir. 2011); Securities & Exchange Comm’n v. Bear, Stearns & Co., Inc., 626 F.Supp.2d 402, 414–16 (S.D.N.Y. 2009); Adam Liptak, Doling out Other People’s Money, N.Y. Times, Nov. 26, 2007 (“Lawyers and judges have grown used to controlling these pots of money, and they enjoy distributing them to favored charities, alma maters and the like”).

In response to this all-too-common development, the American Law Institute has set forth, in its Principles of the Law of Aggregate Litigation, that “[a] cy pres remedy should not be ordered if the court or any party has any significant prior affiliation with the intended recipient that would raise substantial questions about whether the selection of the recipient was made on the merits.” American Law Institute (ALI), Principles of the Law of Aggregate Litigation § 3.07 comment b (2010) (emphasis added). Although the majority tells us correctly that no circuit has adopted the specific “prior affiliation” language, circuits have endorsed § 3.07’s guidance regarding scrutinizing cy pres disbursements. See, e.g., In re BankAmerica Corp. Sec. Litig., 775 F.3d 1060, 1064–65 (8th Cir. 2015) (vacating a cy pres settlement because “class counsel and the district court entirely ignored this now-published ALI authority”); In re Baby Prods. Antitrust Litig., 708 F.3d 163, 172 (3d Cir. 2013) (quoting ALI § 3.07, comment a (2010)); In re Lupron Marketing and Sales Practices Litig., 677 F.3d 21, 33 (1st Cir. 2012) (citing to ALI § 3.07 and asserting that “[c]ourts have generally agreed with the ALI Principles”).

I conclude that our circuit should adopt the ALI’s guidance as set forth in § 3.07. District courts should be required to scrutinize cy pres settlements when the proffered recipients of the funds have a “prior affiliation” with counsel, a party, or even the judge, especially when one of those players is a loyal alumni of a cy pres recipient. I do not mean to suggest that class counsel’s alma mater can never be a cy pres beneficiary. Rather, I propose that the burden should be on class counsel to show through sworn testimony, in an on-the-record hearing, that the prior affiliation played no role in the negotiations, that other institutions were sincerely considered, and that the participant’s alma mater is the proper cy pres recipient.

The majority responds to this line of argument by asserting that “here, we have
nothing more than a barebones allegation that class counsel graduated from schools that house the Internet research centers that will receive funds.” The majority then salutes the district court’s conclusion that there is “no indication that counsel’s allegiance to a particular alma mater factored into the selection process,” and stresses that the cy pres recipients were a negotiated term, not chosen solely by alumni. In essence, the majority holds that despite the nascent dangers posed by apportioning cy pres funds to the distributing parties’ alma maters, the burden is entirely on the objectors to show that the settlement might be tainted.

I disagree fundamentally with this analysis. Our precedent requires that district courts “must be particularly vigilant not only for explicit collusion, but also for more subtle signs that class counsel have allowed pursuit of their own self-interests and that of certain class members to infect the negotiations.” In re Bluetooth, 654 F.3d at 947. In our case, we have a cy pres-only settlement. That alone raises a yellow flag. Furthermore, we have a class settlement before formal class certification. That raises another yellow flag. Lastly, we have almost half of the settlement fund, several million dollars, being given to class counsel’s alma maters. To me, that raises a red flag. I am especially dubious of the inclusion of the Center for Information, Society and Policy at Chicago-Kent Law School (a law school attended by class counsel), which center appears to have inaugurated only a year before the parties herein agreed to their settlement. Even with these red and yellow flags, under the majority’s holding, the burden is still on the objectors to prove more, despite the objectors’ lack of access to virtually any relevant evidence that would do so.

I would hold that the combination of a cy pres-only award, a pre-certification settlement, and the fact that almost half the cy pres fund is going to class counsel’s alma maters, is sufficient to shift the burden to the proponents of the settlement to show, on a sworn record, that nothing in the acknowledged relationship was a factor in the ultimate choice. Here, the only sworn-to items in the record on this issue are boiler plate, one-line declarations from class counsel stating “I have no affiliation” with the subject institutions. While the majority asserts that the district court conducted a “careful review,” these terse declarations are the only shred of sworn-to evidence in the record. There was essentially nothing for the district court to review—carefully or not. Although there was some discussion between counsel and the district court during the hearings on the settlement, this was nothing more than unsworn lawyer talk during an oral argument.

I still have many questions surrounding how these universities were chosen, such as: What other institutions were considered? Why were the non-alma mater institutions rejected? What relationship have counsel had with these universities? Have counsel donated funds to their alma maters in the past? Do counsel serve on any alma mater committees or boards? Do counsel’s family members? How often do counsel visit their alma maters? There are many questions still lingering that have not been answered under
oath. Here, as we have directed before, “the district court should have pressed the parties to substantiate their bald assertions with corroborating evidence.” *Id.* at 948.

Although I would vacate the parties’ settlement, I express no opinion on the definitive fairness of the parties’ agreement. It is not the province of appellate judges to “substitute our notions of fairness for those of the district judge,” *Officers for Justice v. Civ. Serv. Commission of the City and County of San Francisco*, 688 F.2d 615, 626 (9th Cir. 1982) (internal citations omitted). Instead, I would remand the case to the district court for further fact finding in accordance with the concerns I have expressed.
“Google Privacy Deal is ‘Clear Abuse,’ High Court Told”

Law360

Shayna Possess

July 10, 2018

Challengers to an $8.5 million settlement resolving claims that Google shared user search histories urged the U.S. Supreme Court to overturn the deal Monday, saying the agreement — which provides millions to class counsel and the rest to third parties, including organizations tied to class counsel and the tech giant — is "clear abuse."

The opening brief by Theodore H. Frank and Melissa Ann Holyoak of the Competitive Enterprise Institute asserted that the Ninth Circuit's decision upholding the deal sets a dangerous precedent by potentially making cy pres settlements, which other circuits have been reluctant to endorse, more common.

Cy pres deals involve distributing funds to charities and other third parties rather than class members and are typically used when the sheer number of individuals makes distribution impossible or impracticable. But Frank and Holyoak asserted that they should be used sparingly, contending that in the process of approving the deal in this case, the appeals court adopted holdings that run the risk of encouraging gamesmanship at the expense of absent class members and the filing of meritless actions that only benefit attorneys.

"Because of conflicts of interest inherent in the class-action process — especially with regard to settlements — careful judicial scrutiny is necessary lest class counsel and the defendant bargain away the rights of the class members on terms that minimize payoff by the defendant, maximize benefit to class counsel, and leave injured class members out in the cold," the challengers said. "Yet the Ninth Circuit below took the opposite approach, declaring that close scrutiny of the terms of a cy pres settlement would be 'an intrusion into the private parties' negotiations' and therefore 'improper and disruptive to the settlement process.'"

The high court granted the challengers' petition for a writ of certiorari in April over the objections of Google and class counsel, who argued the deal is appropriate because divvying up the fund among class members isn't feasible.

In the underlying case, Google struck a deal with users in 2014 to end privacy claims accusing it of selling users' search terms containing personally identifiable information to advertisers, allegedly in violation of the Stored Communications Act.

At the time, class counsel had argued that without accounting for attorneys' fees and costs, the $8.5 million settlement would have
had to be divided among 129 million class members — yielding just 4 cents per person.

After U.S. District Judge Edward J. Davila signed off on the settlement in March 2015, Frank and Holyoak brought their objections before the Ninth Circuit, arguing that in an era of massive class actions, allowing class counsel to invoke cy pres would set a dangerous precedent of converting every class action into an "all-cy pres settlement."

In October, the Ninth Circuit stood by its split decision to leave the settlement undisturbed, prompting the objectors to take their challenge to the high court. They argued in January that cy pres awards demand heightened scrutiny since they can "facilitate tacit or explicit collusion between defendants" eager to settle and class counsel, "who are seeking to maximize their fees and may be willing to accommodate defendants' interests in exchange for a 'clear sailing' agreement not to challenge the fee request."

The objectors got support from several amici in February, including 16 state attorneys general, who argued that these settlements hurt consumers and that the Google deal was the "ideal vehicle" to address when, if ever, such arrangements are permissible.

The justices previously passed up the opportunity to tackle the issue in 2013 when they refused in Marek v. Lane to review a divided Ninth Circuit opinion approving Facebook’s settlement agreeing to terminate its short-lived Beacon feature — which allegedly shared data about users' activity on third-party sites with their Facebook friends without consent — and pay $9.5 million to set up an online privacy foundation and compensate class counsel.

At the time, Chief Justice John Roberts issued a rare statement explaining that while the Marek case wasn't the right vehicle, it could be time for the court to determine the limits of cy pres awards.

Ultimately, the Supreme Court agreed to take up the Google case, and the objectors lodged their opening brief Monday, telling the justices it's high time to decide whether, or under what circumstances, a cy pres settlement with no direct benefit to class members meets requirements that a deal be "fair, reasonable and adequate."

The challengers asserted that these sorts of deals are rare for a reason, saying the high court has consistently shot down the use of procedural tactics to game class actions like cy pres, which they called "one of the most notorious devices used to create the 'illusion of compensation.'"

Though the Ninth Circuit treated the arrangement as equivalent to a settlement providing $8.5 million to class members, the class members are actually getting nothing, while the attorneys are set to receive more than $2 million and the rest of the money is slated to go to third parties like class counsel's alma maters and nonprofits Google already contributes to, Frank and Holyoak contended. That is neither fair nor reasonable, they argued.
Frank, who will be arguing the case before the high court in the fall, said in a Tuesday statement that they hope the review will result in a standard that aligns class counsel's incentives with those of the class.

"The lawyers claim it's too difficult to distribute money to such a large class," he said. "But we have seen that when courts agree that attorneys should only get paid when their clients do, lawyers magically discover ways to get money to class members. Incentives work."

Representatives for Google and the class didn't immediately return requests for comment Tuesday.

The challengers are represented by Theodore H. Frank, Melissa Holyoak and Anna St. John of the Competitive Enterprise Institute.

The Google users are represented by Kassra P. Nassiri of Nassiri & Jung LLP and Michael Aschenbrener of KamberLaw LLC.

Google is represented by Randall W. Edwards of O'Melveny & Myers LLP and Donald M. Falk, Edward D. Johnson and Daniel E. Jones of Mayer Brown LLP.

The case is Frank et al. v. Gaos et al., case number 17-961, in the Supreme Court of the United States.

--Additional reporting by Christopher Crosby. Editing by Marygrace Murphy.
Increasingly, courts presiding over class actions employ a controversial practice called cy pres (“see-pray”) that diverts damages owed to injured class members to non-party charitable institutions. The theory behind cy pres is that, when getting damage awards to class members is difficult, giving that money to a relevant charity is the next-best result. The U.S. Supreme Court has never considered whether cy pres is legitimate or how it is supposed to work. That may soon change: on April 30, the Court granted certiorari in Frank v. Gaos (No. 17-961), which presents these questions. The decision in Frank may have enormous implications for class-action practice. At minimum, however, it should provide much-needed clarity on this contentious subject.

Origins of Cy Pres

The term cy pres derives from the French cy pres comme possible (“as near as possible”). In trust law, it is a doctrine providing that, when the proceeds of a charitable trust can no longer be paid to the intended beneficiary (e.g., because it is defunct), a court may designate a new beneficiary “as near as possible” to the original one, so that the donor’s intent may be substantially vindicated. For example, after the Emancipation Proclamation, “a 19th-century court applied the [cy pres] doctrine to repurpose a trust that had been created to support the abolition movement to instead provide assistance to poor African Americans.” Frank v. Gaos, Cert. Pet. at 5. This trust-law version of cy pres has existed in one form or another since ancient Rome.

By contrast, the class-action version of cy pres is relatively new. In 1966, Fed. R. Civ. P. 23(b)(3) was enacted, and the money-damages class action was born. A fundamental problem with this new form of litigation soon became evident. Even when it was possible to calculate the aggregate damage caused by a defendant, it was often difficult or impossible to locate the injured class members and notify them of an available damage award (and when class members were notified, they often failed to complete the claims process). Courts faced with this scenario were in a bind. They could allow the unclaimed portion of the aggregate damage award to revert to the defendant—but this would permit the defendant to keep the fruits of its wrongful conduct. They could permit the unclaimed funds to escheat to the state—but this would provide no benefit to the class. Or they could pay the unclaimed funds out as a bonus to those class members who had already claimed and received damages—but this would provide a windfall to those class members at the expense of the “nonclaiming or unidentified class members.”
who “have superior equitable interests in the remaining fund[s].” Powell v. Georgia-Pacific Corp., 843 F. Supp. 491, 496 (W.D. Ark. 1994), aff’d 119 F.3d 703 (8th Cir. 1997).

Class-action cy pres developed in the 1970s and 1980s as a purported solution to this problem. See Miller v. Steinbach, No. 66-cv-356 (S.D.N.Y. 1974) (first recorded application of class-action cy pres). As courts now apply it, the doctrine provides that, when it is impracticable to pay out some or all of the damages fund to injured class members—e.g., because they cannot be located, because they do not submit claims, or because the per-person award is de minimis—that money may instead be paid to a charity or nonprofit whose mission relates to the subject matter of the lawsuit. See Redish, Julian & Zyontz, Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis, 62 Fla. L. Rev. 617, 618-20 (2010) (“Redish”). In a consumer-protection case, for example, a cy pres award might go to a consumer advocacy group; in a race-discrimination case, a cy pres award might go to a civil-rights organization. In this way, the theory goes, class members who do not receive money damages still derive some benefit from the lawsuit—however indirect—because they will supposedly feel the positive impact of the cy pres recipient’s charitable work.

The analogy to trust-law cy pres is somewhat strained. See Mirfasihi v. Fleet Mortg. Corp., 356 F.3d 781, 784 (7th Cir. 2004) (Posner, J.) (describing class-action cy pres as “something parading under [the] name” of trust-law cy pres that is “applied … for a reason unrelated to the reason for the trust doctrine”). In both of its forms, cy pres involves courts picking a “next best” recipient for money originally intended for someone else. But that is where the similarity ends. In the trust context, the donor who created a charitable trust obviously intended to give his money away to charity; thus, it can be safely assumed that he would have wanted the trust to benefit a related charitable cause rather than having the trust fail and the corpus revert to his heirs. In the class-action context, by contrast, cy pres does not even arguably effectuate the intent of the injured class members whose money is being given away. If given a choice, they would prefer to be made whole for their injuries, rather than make a charitable donation that will benefit them indirectly at best. Thus, rather than substantially vindicating the intent of the “donor,” class-action cy pres usually subverts it. Nevertheless, the analogy has taken root, and cy pres is now widely employed in class-action practice, especially when classes are certified for settlement. See Frank v. Gaos, Cert. Pet. at 32 (noting that “cy pres settlements [are now] at their highest levels ever”).

Criticisms of Cy Pres

Unlike trust-law cy pres, class-action cy pres is controversial. For starters, the legal basis for it is unclear. Rule 23, which governs class actions in federal court, says nothing about cy pres. No statute affirmatively authorizes it. The Supreme Court has never said a word about it. Rather, it appears that the notion of class-action cy pres “can be traced largely to a pioneering student comment, published in the University of Chicago Law Review in
Two years later, the first court to employ the doctrine, Miller v. Steinbach, No. 66-cv-356 (S.D.N.Y. 1974), acknowledged that “neither counsel nor the Court ha[d] discovered [any] precedent for [it]” (aside from the questionable analogy to trust law). That is a shaky foundation for a practice that redistributes many millions of dollars each year.

Some argue that cy pres is affirmatively prohibited by the Rules Enabling Act, the statute under which the Federal Rules of Civil Procedure were promulgated. The Act states that those Rules—including Rule 23—“shall not abridge, enlarge or modify any substantive right.” 28 U.S.C. §2072(b). Thus, the use of Rule 23 to aggregate individual claims does not permit courts to alter the substantive law governing those claims. That includes the remedies that are authorized, and not authorized, by the underlying substantive law. For example, if a given statute permits only injunctive relief in an individual action, then Rule 23 does not permit a court to award money damages in a class suit; that would be a prohibited “modification of … substantive right[s].” The same arguably goes for cy pres: if a statute does not authorize a court to deny compensation to an individual plaintiff and order the defendant to make a charitable donation instead, then the Rules Enabling Act prohibits courts from doing so in the class-action context.

Indeed, some go even further and argue that class-action cy pres is unconstitutional. See, e.g., Redish, supra, at 641. For example, Article III’s “case or controversy” requirement may prohibit federal courts from ordering monetary awards to non-parties that are strangers to an adversarial proceeding and lack an injury-in-fact traceable to the defendant. The Due Process Clause may prohibit courts from appropriating funds rightfully belonging to absent class members and transferring them to someone else. And when cy pres awards are made to groups that engage in expressive or political activity, as is often the case, this may infringe on class members’ First Amendment right not to subsidize “speech” with which they disagree. Cf. Janus v. Am. Fed. of State, Cnty., and Mun. Empls., Council 31, No. 16-1466 (argued Feb. 26, 2018) (case challenging mandatory union “agency fees” under First Amendment on grounds that such fees fund advocacy with which some employees disagree).

Even if it is not unlawful, however, cy pres can be deeply problematic. For starters, the notion at the heart of cy pres that charitable awards provide a meaningful benefit to unidentified or non-claiming class members is often a fiction. See Pearson v. NBTY Inc., 772 F.3d 778, 784 (7th Cir. 2014) (Posner, J.) (“The $1.13 million cy pres award to [an] orthopedic foundation [in a consumer class action involving joint-health supplements] did not benefit the class, except insofar as armed with this additional money the foundation may contribute to the discovery of new treatments for joint problems—a hopelessly speculative proposition.”). In addition, cy pres can create an appearance of impropriety—if not outright corruption—by permitting judges and lawyers to direct millions of dollars to institutions they are personally connected to, such as their own alma maters. Frank v. Gaos, Cert. Pet. at 26.
Cy pres can also permit defendants to reduce or even eliminate their effective liability by selecting a recipient charity that they were already planning to sponsor independently of the litigation. *Id.* at 28. Moreover, cy pres creates an inherent conflict of interest between class counsel and the class members they ostensibly represent. *Id.* at 25-26. Specifically, class counsel’s fee award is usually based on the size of the total recovery obtained, and cy pres “recovery” is usually considered part of that total-no different from money paid to class members. Class counsel, therefore, have no incentive to fight for a settlement that maximizes their clients’ recovery. To the contrary, since locating class members and providing notice is expensive and time-consuming, and writing a check to a charity is quick and easy, class counsel are incentivized to prefer a cy pres award that minimizes, or even eliminates, their own clients’ recovery. In Judge Posner’s words, to “s[ell] [their clients] down the river.” Mirfasihi, 356 F.3d at 785. Finally, because cy pres allows attorneys to reap large fee awards in cases that might not otherwise be certified for class treatment, its existence may motivate lawyers to file many suits that they would not otherwise file-and, some would argue, ought not be filed. See Redish, supra, at 653-56 (discussing cy pres’ enablement of “faux” class actions”).

**Frank v. Gaos**

In Frank v. Gaos, many of these concerns are prominently on display. The case began as a consolidated class action brought against Google. In the underlying case, web users allege that Google violated the Stored Communications Act and committed various privacy torts by disclosing their search queries to the websites that they access through Google searches. See *In re Google Referrer Header Privacy Litig.*, No. 5:10-cv-04809 (N.D. Cal.).

Google reached an early settlement with class counsel. It agreed to pay $8.5 million in exchange for a release of all the privacy claims of the approximately 129 million Americans who used its search engine between 2006 and 2014. However, none of that $8.5 million would go to the allegedly wronged web searchers giving up their claims. Instead, $3.2 million of the fund would go toward the fees and costs of plaintiffs’ counsel, and the remainder would be paid as a cy pres award to institutions that research or advocate for Internet privacy. Together, class counsel and Google selected six awardees, which included the alma maters of the parties’ lawyers; institutions with which Google had a preexisting donor relationship; and a nonprofit (AARP) that lobbies on controversial legislative and policy issues.

Ted Frank, a class member (who is also the Director of the Center for Class Action Fairness), objected to the proposed settlement. He argued that a cy pres-only settlement, under which every class member’s right to sue is extinguished without any corresponding compensation, is by definition not “fair, reasonable, and adequate” as Rule 23(e)(2) requires of any class settlement. The district court approved the settlement over Frank’s objection, *In re Google Referrer Header Privacy Litig.*, 87 F. Supp. 3d 1122 (N.D. Ca. 2015), and Frank appealed.
The Ninth Circuit affirmed. In re Google Referrer Header Privacy Litig., 869 F.3d 737, 742 (9th Cir. 2017). It relied on circuit precedent holding that cy pres-only settlements “are appropriate where the settlement fund is ‘non-distributable’” because “proof of individual claims would be burdensome or distribution of damages costly.” Id. at 741. Here, the court observed, the funds remaining after accounting for attorney’s fees amounted to just “a paltry four cents” per class member—“a de minimis amount if ever there was one.” Id. at 742. The cost of sending out 129 million four-cent checks would exceed the value of the settlement. In the Ninth Circuit’s view, therefore, cy pres was the only option. It dismissed out of hand Frank’s argument that this quandary indicated that the case should never have been certified for class treatment in the first place. As for the particular cy pres awardees, the court concluded that they were sufficiently related to “the objectives of the Stored Communications Act” and found no problem with their connections with Google or counsel. Id. at 743-46.

Frank petitioned for certiorari, supported by a coalition of amici—most notably, a bipartisan group of 16 state attorneys general. Google and the class plaintiffs opposed. On April 30, 2018, the Supreme Court agreed to hear the case in its upcoming Term. This was no great surprise: In 2013, when the Court denied certiorari in a class action against Facebook, Chief Justice John Roberts observed that cy pres awards are a “growing feature of class action settlements” and that there are “fundamental concerns surrounding the use of such remedies in class action litigation” that merited examination in an appropriate case. Marek v. Lane, 571 U.S. 1003, 1006 (2013) (Roberts, C.J., concurring in denial of certiorari). These concerns included:

when, if ever, such relief should be considered; how to assess its fairness as a general matter; … how [recipients] should be selected; what the respective roles of the judge and parties are in shaping a cy pres remedy; [and] how closely the goals of any enlisted organization must correspond to the interests of the class.

Id.

What To Expect

The Supreme Court may use Frank as a vehicle to resolve some or all of the concerns that Chief Justice Roberts posed in Marek. Notably, the very first question in that list—“when, if ever, such relief may be considered” (emphasis added)—suggests that the Court could potentially deem class-action cy pres illegitimate across the board, perhaps citing the statutory and constitutional concerns described above. If the Court issues such a ruling, class-action practice could be completely transformed: again, if cy pres were categorically unavailable, many class actions that now make sense for plaintiffs’ lawyers to pursue would no longer be economically viable and might not be filed at all. See Frank v. Gaos, Reply in Support of Cert. at 13 (“After all, without a cy pres award to inflate the settlement fund, it would have been impossible to justify paying class counsel over $2 million in fees, and so the case may never have been filed.”). Class-action filings could drop sharply in situations
where class members are difficult to locate or notify or where each class member’s damage award would be de minimis.

On the other hand, the Court may eschew any sweeping pronouncements and confine its ruling to cy pres-only settlements, like the one in Frank itself. Class-action cy pres was originally conceived, and is most often used, as a fallback method to dispose of funds remaining after reasonable efforts to make all of the injured class members whole. The situation in Frank is quite different: there, the district court certified the class and approved the proposed settlement with the express understanding that no attempt would even be made to pay any portion of the settlement fund to the class. If the Court finds this unorthodox use of cy pres improper, it may leave for another day whether and how cy pres may be used to distribute residual settlement funds after an initial attempt has been made to compensate class members. Because cy pres-only settlements like the one in Frank represent a modest percentage of all cy pres awards—perhaps as low as 3 percent (see Google Br. in Opp. to Cert at 21)—a ruling cabined to such settlements would be important, though perhaps not earth-shaking.

It is difficult to guess at what the Court will do. The odds may be that the Court will rule for Frank and reverse the Ninth Circuit—if only because the Supreme Court most often grants certiorari in cases that it believes were wrongly decided. What is certain, however, is that the class-action bar (and the charities who rely on cy pres awards for funding) will be watching closely.
The internet continues to expand into every aspect of our lives. With it, many companies have collected, tracked, and used an enormous amount of data. All of this has given rise to class action lawsuits challenging the privacy practices of these companies. But, these lawsuits often challenge practices that do not cause any actual damage, which can make it difficult to reach a settlement, particularly of a Rule 23(b)(3) class. So, how can parties wanting to settle proceed?

In a recent opinion, the Ninth Circuit upheld a district court’s approval of a class action settlement in a privacy litigation where the class received no damages, and the settlement funds went to cy pres recipients instead. In In re Google Referrer Header Privacy Litigation, No. 15-15858 (9th Cir. Aug. 22, 2017), the plaintiffs challenged Google’s practice of providing websites with the search terms that individuals used in Google’s search engine to reach the website. The plaintiffs claimed this violated their privacy.

The parties reached a settlement with an $8.5 million fund. Of that, $3.2 million was set aside for attorneys’ fees, administration costs, and incentive payments, the remaining $5.3 million was allocated to six cy pres recipients, and class members received nothing. The Ninth Circuit affirmed the district court’s approval of the settlement, holding that a cy pres only settlement was appropriate where the settlement fund was “non-distributable.” In the case, there were 129 million class members. If the $5.3 million settlement had been distributed, each class member would have received “a paltry 4 cents.” The court held that, because each class member’s recovery would have been de minimis, a cy pres only settlement was appropriate.

The Ninth Circuit went on to hold that the cy pres recipients were appropriate. The recipients included organizations to which Google had previously donated, organizations that had previously received settlement funds from Google, and organizations housed at plaintiffs’ counsel alma maters. The Ninth Circuit held that these connections did not raise any conflicts. For example, the Ninth Circuit stated: “Given the burgeoning importance of Internet privacy, it is no surprise that Google has chosen to support the programs and research of recognized academic institutes and nonprofit organizations. Google has donated to hundreds of third-party organizations whose work implicates technology and Internet policy issues, including university research centers, think
tanks, advocacy groups, and trade organizations. These earlier donations do not undermine the selection process employed to vet the *cy pres* recipients in this litigation.”

Going forward, we might see more _cy pres_ only settlements in cases alleging violations of privacy, particularly where the alleged violations cause no actual (or very little actual) damage to the class.
Overview: The Plaintiffs in the case are farmers and fishermen who live near a power plant in India—that they contend, ruined local water supplies, decimated fish populations, and contaminated the air around the plant—that was financed through loans from the IFC. Plaintiff’s filed a lawsuit in a federal district court in Washington, D.C., but the district court dismissed the case because it concluded that the IFC was immune from suit. IFC was held to be immune from suit because of the International Organizations Immunities Act, which gives international organizations the “same immunity from suit and every form of judicial process as is enjoyed by foreign governments.”

Issue: Whether the International Organizations Immunities Act—which affords international organizations the “same immunity” from suit that foreign governments have, 22 U.S.C. § 288a(b)—confers the same immunity on such organizations as foreign governments have under the Foreign Sovereign Immunities Act, 28 U.S.C. §§ 1602-11.

Appellants, a group of Indian nationals, challenge a district court decision dismissing their complaint against the International Finance Corporation (IFC) on grounds that the IFC is immune from their suit. The IFC provided loans needed for construction of the Tata Mundra Power Plant in Gujarat, India. Appellants who live near the plant alleged—which the IFC does not deny—that contrary to provisions of the loan agreement, the plant caused damage to the surrounding communities. They wish to hold the IFC financially responsible for their
injuries, but we agree with the well-reasoned district court opinion that the IFC is immune to this suit under the International Organizations Immunities Act, and did not waive immunity for this suit in its Articles of Agreement.

I.

Appellants are fishermen, farmers, a local government entity, and a trade union of fishworkers. They assert that their way of life has been devastated by the power plant.

The IFC, headquartered in Washington, is an international organization founded in 1956 with over 180 member countries. It provides loans in the developing world to projects that cannot command private capital. IFC Articles, art. III §3(i), Dec. 5, 1955, 7 U.S.T. 2197, 264 U.N.T.S. 117. The IFC loaned $450 million to Coastal Gujarat Power Limited, a subsidiary of Tata Power, an Indian company, for construction and operation of the Tata Mundra Plant. The loan agreement, in accordance with IFC’s policy to prevent social and environmental damage, included an Environmental and Social Action Plan designed to protect the surrounding communities. The loan’s recipient was responsible for complying with the agreement, but the IFC retained supervisory authority and could revoke financial support for the project.

Unfortunately, according to the IFC’s own internal audit conducted by its ombudsman, the plant’s construction and operation did not comply with the Plan. And the IFC was criticized by the ombudsman for inadequate supervision of the project. Yet the IFC did not take any steps to force the loan recipients into compliance with the Plan.

The appellants’ claims are almost entirely based on tort: negligence, negligent nuisance, and trespass. They do, however, raise a related claim as alleged third party contract beneficiaries of the social and environmental terms of the contract. According to appellants, the IFC is not immune to these claims, and, even if it was statutorily entitled to immunity, it has waived immunity.

II.

Appellants are swimming upriver; both of their arguments run counter to our long-held precedent concerning the scope of international organization immunity and charter-document immunity waivers.

The IFC relies on the International Organizations Immunities Act (IOIA), which provides that international organizations “shall enjoy the same immunity from suit . . . as is enjoyed by foreign governments, except to the extent that such organizations may expressly waive their immunity for the purpose of any proceedings or by the terms of any contract.” 22 U.S.C. § 288a(b). The President determines whether an organization is entitled to such immunity. 22 U.S.C. § 288. The IFC has been designated an international organization entitled to the “privileges, exemptions, and immunities” conferred by the statute. Exec. Order No. 10,680, 21 Fed. Reg. 7,647 (Oct. 5, 1956).
In response to the IFC’s claim of statutory entitlement under the IOIA, appellants rather boldly assert that Atkinson v. InterAm. Dev. Bank, 156 F.3d 1335 (D.C. Cir. 1998), our leading case on the immunity of international organizations under that statute, should not be followed. Atkinson held that foreign organizations receive the immunity that foreign governments enjoyed at the time the IOIA was passed, which was “virtually absolute immunity.” Id. at 1340 (quoting Verlinden B.V. v. Central Bank of Nigeria, 461 U.S. 480, 486 (1983)). And that immunity is not diminished even if the immunity of foreign governments has been subsequently modified, particularly by the widespread acceptance and codification of a “commercial activities exception” to sovereign immunity. E.g., 28 U.S.C. § 1605(a)(2).

Attacking Atkinson, appellants make two related contenions. First, Atkinson was wrong to conclude that when Congress tied the immunity of international organizations to foreign sovereigns, it meant the immunity foreign sovereigns enjoyed in 1945. Instead, according to appellants, who echo the arguments pressed in Atkinson itself, lawmakers intended the immunity of the organizations to rise or fall—like two boats tied together—with the scope of the sovereigns’ immunity. In other words, even assuming foreign sovereigns enjoyed absolute immunity in 1945, if that immunity diminished, as it has with the codification of the commercial activity exception, Congress intended that international organizations fare no better.

The problem with this argument—even if we thought it meritorious, which we do not—is that it runs counter to Atkinson’s holding, which explicitly rejected such an evolving notion of international organization immunity. See 156 F.3d at 1341. We noted that Congress anticipated the possibility of a change to immunity of international organizations, but explicitly delegated the responsibility to the President to effect that change—not the judiciary. Id. Moreover, when considering the legislation, Congress rejected a commercial activities exception—which is exactly the evolutionary step appellants wish to have us adopt. Id. As the district court recognized, we recently reaffirmed Atkinson, saying that the case “remains vigorous as Circuit law.” Nyambal v. Int’l Monetary Fund, 772 F.3d 277, 281 (D.C. Cir. 2014).

Recognizing that a frontal attack on Atkinson’s holding would require an en banc decision, appellants next argued that we can, and should, bypass its precedential impact because the Supreme Court has undermined its premise—that in 1945 the immunity of foreign sovereigns was absolute (or virtually absolute).

To be sure, the Court has said in dicta that in 1945, courts “‘consistently . . . deferred to the decisions of the political branches—in particular, those of the Executive Branch—on whether to take jurisdiction’ over particular actions against foreign sovereigns . . . .” Republic of Austria v. Altmann, 541 U.S. 677, 689 (2004) (quoting Verlinden, 461 U.S. at 486). But as a matter of practice, at that time, whenever a
foreign sovereign was sued, the State Department did request sovereign immunity. *Id.* The only arguable exception involved a lawsuit in rem against a ship owned but not possessed by Mexico; it was not a suit against Mexico. *See Republic of Mexico v. Hoffman,* 324 U.S. 30 (1945). And, even if appellants are correct that the executive branch played an important role in immunity determinations in 1945, that does not diminish the absolute nature of the immunity those sovereigns enjoyed; although Supreme Court dicta refers to the *mechanism* for conferring immunity on foreign sovereigns in 1945, Executive Branch intervention does not speak to the scope of that immunity.

In any event, the holding of *Atkinson*—regardless how one characterizes the immunity of foreign sovereigns in 1945—was that international organizations were given complete immunity by the IOIA unless it was waived or the President intervened. And as we noted, that holding was reaffirmed in *Nyambal* after the Supreme Court dicta on which appellants primarily rely. Therefore, we conclude our precedent stands as an impassable barrier to appellants’ first argument.

**III.**

That brings us to the waiver argument. There is no question that the IFC has waived immunity for some claims. Indeed, its charter, read literally, would seem to include a categorical waiver. But our key case interpreting identical waiver language in the World Bank charter, *Mendaro v. World Bank,* 717 F.2d 610 (D.C. Cir. 1983), read that language narrowly to allow only the type of suit by the type of plaintiff that “would benefit the organization over the long term,” *Osseiran v. Int’l Fin. Corp.,* 552 F.3d 836, 840 (D.C. Cir. 2009) (citing *Atkinson,* 156 F.3d at 1338 and *Mendaro,* 717 F.2d at 618).

To be sure, it is a bit strange that it is the judiciary that determines when a claim “benefits” the international organization; after all, the cases come to us when the organizations deny the claim, and one would think that the organization would be a better judge as to what claims benefit it than the judiciary. Perhaps that is why *Osseiran,* when applying *Mendaro,* refers to long-term goals, rather than immediate litigating tactics.

But whether or not the *Mendaro* test would be better described using a term different than “benefit,” it is the *Mendaro* criteria we are obliged to apply. Ironically, the line of cases applying *Mendaro* ended up tying waiver to commercial transactions, so there is a superficial similarity to the commercial activities test that appellants would urge us to accept. But whatever the scope of the commercial activities exception to sovereign immunity, that standard is necessarily broader than the *Mendaro* test; if that exception applied to the IFC, the organization would *never* retain immunity since its operations are *solely* “commercial,” i.e., the IFC does not undertake any “sovereign” activities.

The *Mendaro* test instead focused on identifying those transactions where the other party would not enter into negotiations or contract with the organization absent waiver.
See 717 F.2d at 617 (inferring waiver only insofar as “necessary to enable the [organization] to fulfill its functions”). Mendaro provided examples: suits by debtors, creditors, bondholders, and “those other potential plaintiffs to whom the [organization] would have to subject itself to suit in order to achieve its chartered objectives.” Id. at 615.

We have stretched that concept to include a claim of promissory estoppel, see Osseiran, 552 F.3d at 840-41, and a quasi-contract claim of unjust enrichment, see Vila v. Inter-Am. Invest. Corp., 570 F.3d 274, 278-80 (D.C. Cir. 2009). But all the claims we have accepted have grown out of business relations with outside companies (or an outside individual engaged directly in negotiations with the organization). Compare Lutcher S.A. Celulose e Papel v. Inter-Am. Dev. Bank, 382 F.2d 454 (D.C. Cir. 1967) (finding waiver in debtors’ suit to enforce loan agreement) with Mendaro, 717 F.2d at 611 (rejecting employee sexual harassment and discrimination claim); Atkinson, 156 F.3d at 1336 (rejecting garnishment proceeding against organization employee).

Appellants attempt to define “benefit” more broadly. They argue that holding the IFC to the very environmental and social conditions it put in the contract, conditions which the IFC itself formulated, would benefit the IFC’s goals. Even though appellants had no commercial relationship with the IFC (other than, allegedly, as third party beneficiaries of the loan agreement’s requirements), they contend that the IFC will benefit from their lawsuit because they are attempting to hold the IFC to its stated mission and to its own compliance processes. They argue that obtaining “community support” is a required part of any IFC project, and suggest that communities will be unlikely to support IFC projects if the IFC is not amenable to suit. Appellants’ ability to enforce the requirement that the IFC protect surrounding communities is as central to the IFC’s mission as a commercial partner’s ability to enforce the requirement that the IFC pay its electricity bill.

But Mendaro drew another distinction between claims that survive and those that don’t. Those claims that implicate internal operations of an international organization are especially suspect because claims arising out of core operations, not ancillary business transactions, would threaten the policy discretion of the organization. Accord Vila, 570 F.3d at 286-89 (Williams, J., dissenting).

That notion applies here. Should appellants’ suit be permitted, every loan the IFC makes to fund projects in developing countries could be the subject of a suit in Washington. Appellee’s suggestion that the floodgates would be open does not seem an exaggeration. Finally, if the IFC’s internal compliance report were to be used to buttress a claim against the IFC, we would create a strong disincentive to international organizations using an internal review process. So even though appellants convince us that the term “benefit” is something of a misnomer—its claim in some sense can be
thought of as a “benefit”—it fails the Mendaro test.

Accordingly, the district court decision is affirmed.

So ordered.

PILLARD, Circuit Judge, concurring:

I agree that Atkinson and Mendaro, which remain binding law in this circuit, control this case. I write separately to note that those decisions have left the law of international organizations’ immunity in a perplexing state. I believe both cases were wrongly decided, and our circuit may wish to revisit them.


We took a wrong turn in Atkinson when we read the IOIA to grant international organizations a static, absolute immunity that is, by now, not at all the same “as is enjoyed by foreign governments,” but substantially broader.

When a statute incorporates existing law by reference, the incorporation is generally treated as dynamic, not static: As the incorporated law develops, its role in the referring statute keeps up. Atkinson itself correctly acknowledged that a “statute [that] refers to a subject generally adopts the law on the subject,” including “all the amendments and modifications of the law subsequent to the time the reference statute was enacted.” Atkinson v. Inter-American Development Bank, 156 F.3d 1335, 1340 (D.C. Cir. 1998) (emphasis omitted); see El Encanto, Inc. v. Hatch Chile Co., 825 F.3d 1161, 1164 (10th Cir. 2016).

The IOIA references foreign sovereign immunity, but in Atkinson we did not apply the familiar rule of dynamic incorporation because we thought another IOIA provision showed that Congress intended that reference to be static. Section 1 of the IOIA authorizes the President to “withhold or withdraw from any such [international] organization or its officers or employees any of the privileges, exemptions, and immunities provided for” by the IOIA. IOIA § 1. We read that language to mean that Congress intended the President alone to have the ability, going forward, to adjust international organizations’ immunity from where it stood as of the IOIA’s enactment in 1945. Atkinson, 156 F.3d at 1341. That
presidential power was, we thought, exclusive of any shift in international organizations’ immunity that might be wrought by developments in the law of foreign sovereign immunity to which the IOIA refers.

Correctly read, however, section 1 merely empowers the President to make organization- and function-specific exemptions from otherwise-applicable immunity rules. It says that the President may “withhold or withdraw from any such organization”—note the singular—“or its officers or employees any of the privileges, exemptions, and immunities” otherwise provided for by the IOIA. IOIA § 1 (emphasis added). Section 1 thus empowers the President to roll back an international organization’s immunity on an organization-specific basis. See, e.g., Elizabeth R. Wilcox, Digest of United States Practice in International Law 405 (2009) (describing President Reagan’s 1983 exercise of section 1 authority to withhold immunity from INTERPOL, followed by President Obama’s 2009 restoration of the immunity after INTERPOL opened a liaison office in New York). Nothing about section 1 suggests that Congress framed or intended it to be the exclusive means by which an international organization’s immunity might be determined to be less than absolute.

The inference we drew from section 1 in Atkinson seems particularly strained because it assumes that Congress chose an indirect and obscure route to freezing international organizations’ immunity over a direct and obvious one. If Congress intended to grant international organizations an unchanging absolute immunity (subject only to presidential power to recognize organization-specific exceptions) it could have simply said so. It might have expressly tied international organizations’ immunity to that enjoyed by foreign governments as of the date of enactment. Or, even better, it might have avoided cross-reference altogether by stating that international organizations’ immunity is absolute. As it happens, the original House version of the IOIA did just that, providing international organizations “immunity from suit and every form of judicial process.” H.R. 4489, 79th Cong. (as introduced, Oct. 24, 1945; referred to H. Comm. on Ways and Means), but the Senate rejected that as “a little too broad,” 91 Cong. Rec. 12,531 (1945), even as it retained the absolute immunity language in provisions granting the property of international organizations immunity from search, confiscation and taxation. See IOIA §§ 2(c), 6. In lieu of the House version’s broad language, the Senate adopted the current formulation of section 2(b), which provides international organizations the “same immunity . . . as is enjoyed by foreign governments.” H.R. 4489, 79th Cong. (as reported by S. Comm. on Finance, Dec. 18, 1945).

The considered view of the Department of State, harking back to before Atkinson, is that the immunity of international organizations under the IOIA was not frozen as of 1945, but follows developments in the law of foreign sovereign immunity under the FSIA. In a 1980 letter, then-Legal Adviser Roberts Owen opined
that, by “virtue of the FSIA, . . . international organizations are now subject to the jurisdiction of our courts in respect of their commercial activities.” Letter from Roberts B. Owen, Legal Adviser, U.S. Department of State, to Leroy D. Clark, General Counsel, Equal Employment Opportunity Commission (June 24, 1980), reprinted in Marian L. Nash, Contemporary Practice of the United States Relating to International Law, 74 Am. J. Int’l L. 917, 917-18 (1980). Although the State Department’s interpretation of the IOIA is not binding on the court, the Department’s involvement in the drafting of the IOIA lends its view extra weight. See H.R. Rep. No. 79-1203, at 7 (1945) (referring to the draft bill as “prepared by the State Department”); see also Sosa v. Alvarez-Machain, 542 U.S. 692, 733 n.21 (2004) (citing a letter of the State Department’s Legal Adviser and encouraging courts to “give serious weight to the Executive Branch’s view” in cases that may affect foreign policy).

Reading the IOIA to dynamically link organizations’ immunity to that of their member states makes sense. The contrary view we adopted in Atkinson appears to allow states, subject to suit under the commercial activity exception of the FSIA, to carry on commercial activities with immunity through international organizations. Thus, the Canadian government is subject to suit in United States courts for disputes arising from its commercial activities here, but the Great Lakes Fishery Commission—of which the United States and Canada are the sole members—is immune from suit under Atkinson. See Exec. Order No. 11,059, 27 Fed. Reg. 10,405 (Oct. 23, 1962); see also Convention on Great Lakes Fisheries, Can.-U.S., Sept. 10, 1954, 6 U.S.T. 2836. Neither the IOIA nor our cases interpreting it explain why nations that collectively breach contracts or otherwise act unlawfully through organizations should enjoy immunity in our courts when the same conduct would not be immunized if directly committed by a nation acting on its own.

Were I not bound by Atkinson, I would hold that international organizations’ immunity under the IOIA is the same as the immunity enjoyed by foreign states. Accord OSS Nokalva, Inc. v. European Space Agency, 617 F.3d 756, 762-64 (3d Cir. 2010) (declining to follow Atkinson and holding that restricted immunity as codified in the FSIA, including its commercial activity exception, applies to international organizations under the IOIA).

2. Atkinson’s error is compounded in certain suits involving waiver under the Mendaro doctrine. In Mendaro v. World Bank, we decided that courts should pare back an international organization’s apparent waiver of immunity from suit whenever we believe the waiver would yield no “corresponding benefit” to the organization. 717 F.2d 610, 617 (D.C. Cir. 1983); see Osserian v. Int’l Fin. Corp., 552 F.3d 836, 840 (D.C. Cir. 2009) (holding organization’s facially broad waiver of immunity effective only as to types of plaintiffs and claims that “would benefit the organization over the long term”). That doctrine lacks a sound legal foundation and is awkward to apply; were I not bound by precedent, I would reject it.
It is undisputed that IOIA immunity may be waived, 22 U.S.C. § 288a(b), and the majority recognizes that the IFC’s charter “would seem to include a categorical waiver.” Maj. Op. 6-7 & n.2; see IFC Articles of Agreement art. 6, § 3, May 25, 1955, 7 U.S.T. 2197, 264 U.N.T.S. 118. Half a century ago, we read the Agreement establishing the Inter-American Development Bank (IADB) to effectuate a broad waiver of the Bank’s immunity. See Lutcher S. A. Celulose e Papel v. InterAmerican Development Bank, 382 F.2d 454, 457 (D.C. Cir. 1967) (Burger, J.). The IFC’s Articles of Agreement, which use the same waiver language as did the IADB in Lutcher, would appear to waive the IFC’s immunity here. Under the reasoning of Lutcher, the IFC, like the IADB in that case, may be sued in United States court.

But Lutcher was not our last word. As just noted, we decided in Mendaro to honor an international organization’s “facially broad waiver of immunity” only insofar as doing so provided a “corresponding benefit” to the organization. 717 F.2d at 613, 617. We thought it appropriate to look to the “interrelationship between the functions” of the international organization and “the underlying purposes of international immunities” to cabin a charter document’s immunity waiver. Id. at 615. The member states, we opined in Mendaro, “could only have intended to waive the Bank’s immunity from suits by its debtors, creditors, bondholders, and those other potential plaintiffs to whom the Bank would have to subject itself to suit in order to achieve its chartered objectives.” Id. We decided the waiver did not apply to the claim of Mendaro, a former Bank employee challenging her termination, because recognizing employment claims had no “corresponding benefit” for the Bank. Id. at 612-14.

We saw Mendaro as distinguishable from Lutcher. Allowing the debtor’s claims in Lutcher “would directly aid the Bank in attracting responsible borrowers,” whereas complying with the law governing the Bank’s “internal operations” in Mendaro would not “appreciably advance the Bank’s ability to perform its functions.” Id. at 618-20 (emphasis omitted). In other words, Mendaro assumes that business counterparties will be unwilling to transact with an international organization if they lack judicial recourse against it, but that making employees’ legal rights unenforceable against such an organization will not affect their willingness to work there. We thus held that a facially broad waiver of an organization’s immunity should be read not to allow employee claims.

The “corresponding benefit” doctrine calls on courts to second-guess international organizations’ own waiver decisions and to treat a waiver as inapplicable unless it would bring the organization a “corresponding benefit”—presumably one offsetting the burden of amenability to suit. The majority acknowledges that “it is a bit strange” that Mendaro calls on the judiciary to re-determine an international organization’s own waiver calculus. Slip Op. at 8. I agree that the organization itself is in a better position than we are to know what is in its institutional interests. But, whereas my colleagues point to the fact that “the cases
come to us when the organizations *deny* the claim,” *id.*., I would be inclined to think that organizations’ assessments of their own long-term goals are more reliably reflected in their charters and policies—here, in the broad waiver included in IFC’s Articles of Agreement—than in their litigation positions defending against pending claims.

It is not entirely clear why we have drawn the particular line we have pursuant to *Mendaro*. Why are suits by a consultant, a potential investor, and a corporate borrower in an international organization’s interest, but suits by employees and their dependents not? *Compare*, e.g., *Vila v. InterAmerican Investment, Corp.*, 570 F.3d 274, 276, 279-82 (D.C. Cir. 2009) (permitting suit by a consultant); *Osseiran*, 552 F.3d at 840-41 (permitting suit by a potential investor); *Lutcher*, 382 F.2d at 459-60 (permitting suit by a corporate borrower), *with*, e.g., *Atkinson*, 156 F.3d at 1338-39 (barring suit by a former wife seeking garnishment of former husband’s wages); *Mendaro*, 717 F.2d at 618-19 (barring suit by a terminated employee asserting a sex harassment and discrimination claim).

Our cases seem to construe charter-document immunity waivers to allow suits only by commercial parties likely to be repeat players, or by parties with substantial bargaining power. But the opposite would make more sense: Entities doing regular business with international organizations can write waivers of immunity into their contracts with the organizations. *See*, e.g., *OSS Nokalva*, 617 F.3d at 759 (contract clause authorizing software developer to sue European Space Agency in state and federal courts in New Jersey). Sophisticated commercial actors that fail to bargain for such terms are surely less entitled to benefit from broad immunity waivers than victims of torts or takings who lacked any bargaining opportunity, or unsophisticated parties unlikely to anticipate and bargain around an immunity bar.

The IFC successfully argued here that it would enjoy no “corresponding benefit” from immunity waiver. The local entities and residents that brought this suit contend that giving effect here to the IFC’s waiver would advance the Corporation’s organizational goals. The “IFC requires ‘broad community support’ before funding projects” like the Tata Mundra power plant, and “local communities may hesitate to host a high-risk project,” the appellants contend, “if they know that the IFC can ignore its own promises and standards and they will have no recourse.” Appellants Br. at 48-49. Without directly addressing the benefits of legal accountability to the communities it seeks to serve, the IFC contends that treating the waiver in its Articles of Agreement as effective here would open a floodgate of litigation in United States courts. That argument has it backwards: The IFC persuaded the majority to stem a litigation flood it anticipates only because the immunity waiver in the IFC’s own Articles of Agreement opened the gate.

The perceived need for *Mendaro*’s odd approach would not have arisen if we had, back in *Atkinson*, read the IOIA to confer on international organizations the same
immunity as is enjoyed by foreign governments—*i.e.* restrictive immunity that, today, would be governed by the FSIA. As the majority observes, Slip Op. at 8, the cases in which we have applied *Mendaro* to hold that claims are not immunity-barred look remarkably like cases that would be allowed to proceed under the FSIA’s commercial activity exception. The activities we held to be non-immunized—such as suits by “debtors, creditors, [and] bondholders,” *Mendaro*, 717 F.2d at 615, “suits based on commercial transactions with the outside world” affecting an organization’s “ability to operate in the marketplace,” *Osseiran*, 552 F.3d at 840, and unjust enrichment claims by commercial lending specialists, *Vila*, 570 F.3d at 276, 279-82—seem like just the kinds of claims that would be permitted under the commercial activity exception. We should have achieved that result, not via *Mendaro*’s “corresponding benefit” test, but by recognizing that the IOIA hitched the scope of international organizations’ immunity to that of foreign governments under the FSIA. There is a time-tested body of law under the FSIA that delineates its contours—including its commercial activity exception. The pattern of decisions applying *Mendaro* may approximate some of the results that would have occurred had international organizations been subject to the FSIA, but *Mendaro* begs other important questions that assimilation of IOIA immunity to the FSIA would resolve.

Our efforts to chart a separate course under the IOIA were misguided from the start, and the doctrinal tangle has only deepened in light of the amorphous waiver-curbing doctrine that has developed under *Mendaro*. I believe that the full court should revisit both *Atkinson* and *Mendaro* in an appropriate case. But because those decisions remain binding precedent in our circuit, I concur.
“Justices to Review Scope of Immunity For Int’s Orgs”

Law360

Jimmy Hoover

May 21, 2018

The U.S. Supreme Court has agreed to review a D.C. Circuit decision holding that international organizations enjoy even more immunity from lawsuits than do foreign governments, taking up a case Monday from a group of Indian nationals suing the International Finance Corp. over a power plant project they say has wreaked havoc on the surrounding environment.

In Jam v. International Finance Corp., the high court will decide the scope of immunity for international organizations such as the IFC — which is headquartered in Washington, D.C. — under the International Organizations Immunities Act. As is its custom, the court granted certiorari in the case without explanation, adding it to its October 2018 term.

The petitioners are farmers, fishermen and a local government entity claiming to have experienced devastating environmental damage from the Tata Mundra Power Plant in Gujarat, India, which was financed through $450 million in loans from the IFC. They say the international organization neglected its obligation to supervise the project and did not comply with the funding agreement and its own internal policies to protect the surrounding environment, and that as a result the water is contaminated and thermal pollution is killing off marine life.

A D.C. federal court granted the organization’s bid for immunity and threw out the lawsuit, a decision upheld by a D.C. Circuit panel and left untouched by the full circuit bench. The Supreme Court’s order granting certiorari has breathed hope into the group’s effort to revive the power plant lawsuit.

“We’re gratified that the court has taken up the case and look forward to the next stage,” said Stanford University law professor Jeffrey Fisher, an attorney for the group of Indian nationals that petitioned the high court’s review.

At issue is a provision of the IOIA stating that international organizations “shall enjoy the same immunity from suit ... as is enjoyed by foreign governments.” Relying on its precedent, the D.C. Circuit held in June 2017 that the provision refers to the “virtually absolute” status of sovereign immunity that existed when the IOIA was enacted in 1945, before the Foreign Sovereign Immunities Act codified a crucial exception for when countries engage in commercial activity.

The D.C. Circuit’s decision created an “entrenched circuit split” with the Third Circuit’s holding that the provision incorporates developments in the area of
sovereign immunity, such as the FSIA’s commercial exception, the farmers and fishermen wrote in a January petition asking the court to resolve the disagreement. The petitioners received a supporting brief from a group of international legal scholars from various law schools.

The IFC said in an opposition brief filed in late March that the IOIA conferred near-complete immunity that could only be waived by the organization itself or the president. “The immunity conferred in the IOIA was not altered, decades later, by the passage of the Foreign Sovereign Immunities Act — a different statute, covering different entities, with different motivating principles,” it said.

In any event, the IFC said, the D.C. Circuit’s disagreement with the Third Circuit created only a “shallow circuit split” that does not warrant review given the infrequency with which people bring lawsuits against international organizations, let alone those without founding treaties conferring such immunity such as the United Nations and the International Monetary Fund.

The case was first distributed for the justices’ regular conference on May 10, but relisted for the Thursday conference before the court decided to take the case Monday. The Supreme Court has not yet set a date for oral arguments in the case.

The IFC declined to comment on Monday.


The International Finance Corp. is represented by Francis A. Vasquez Jr., Dana E. Foster and Maxwell J. Kalmann of White & Case LLP.

The case is Jam v. International Finance Corp., case number 17-1011, in the U.S. Supreme Court.
On May 21, the Supreme Court granted certiorari in *Jam v. International Finance Corporation* to determine whether international organizations are afforded the same immunity from lawsuits under the International Organizations Immunities Act (IOIA) that foreign governments are conferred under the Foreign Sovereign Immunities Act. Since the IOIA was enacted in 1945, foreign sovereign immunity has been curtailed by the development and codification of the “commercial activities exception” doctrine. Under this doctrine, foreign governments cannot enjoy sovereign immunity when the lawsuit is based on those governments’ commercial activities.

*Jam* will determine whether such developments in foreign sovereign immunity apply in turn to international organization immunity. The case involves a power plant in India that was financed by the International Financial Corporation (IFC), the private-sector investment arm of the World Bank. By granting certiorari, the Supreme Court has a chance to bring much needed clarity to what Circuit Judge T.L. Pillard has described as the “perplexing state” of the law on international-organization immunity, at a time when these organizations are increasingly being sued in U.S. courts. The following is a summary of the factual and procedural background of this case and the D.C. Circuit’s opinion.

**Factual and Procedural Background**

The IFC is an international organization based in Washington D.C. comprised of over 180 member countries. The purpose of the IFC is “to further economic development by encouraging the growth of productive private enterprise in member countries.” The IFC focuses on funding private sector projects in developing countries that would otherwise have difficulty attracting capital.

This case arose from the IFC’s 2008 decision to lend $450 million to an Indian power company developing the Tata Mundra Power Plant in Gujarat, India. The plaintiffs—farmers and fisherman who lived near the plant, the government of village located near the plant, and a local trade union of fishworkers—claimed that the IFC failed to comply with its internal policies and with the specific environmental action plan that was part of the funding agreement for the plant. As a result, the plaintiffs claim the area surrounding the plant suffered disastrous environmental and social harm, including contamination of drinkable groundwater, degradation in local air quality, and displacement of local fisherman and farmers.
In 2015, the plaintiffs brought suit against the IFC in the U.S. District Court of the District of Columbia claiming negligence, negligent supervision, public nuisance, private nuisance, trespass and breach of contract. Judge John D. Bates dismissed the complaint on jurisdictional grounds, holding that the IFC was immune from the lawsuit under the IOIA. The IOIA provides that:

International organizations, their property and their assets, wherever located, and by whomsoever held, shall enjoy the same immunity from suit and every form of judicial process as is enjoyed by foreign governments, except to the extent that such organizations may expressly waive their immunity for the purpose of any proceedings or by the terms of any contract.

In interpreting the IOIA, Bates cited a 1998 D.C. Circuit case Atkinson v. Inter-American Development Bank, which held that international organizations receive the same foreign immunity as foreign governments at the time the IOIA was enacted in 1945. This interpretation excluded the developed commercial activities exception, so the plaintiffs urged Judge Bates to instead follow the Third Circuit’s decision in OSS Nokalva, Inc. v. European Space Agency, which held that the IOIA incorporates subsequent changes in foreign sovereign immunity, including the commercial activities exception. Noting that the District Court’s “role is to apply [D.C.] Circuit law,” Bates concluded that the IFC is entitled to “virtually absolute immunity” under Atkinson.

The court also rejected the plaintiffs’ alternative argument that the IFC waived its immunity in its Articles of Agreement. Specifically the plaintiffs referred to Article VI, Section 3 of the those articles, which states:

Actions may be brought against the [IFC] only in a court of competent jurisdiction in the territories of a member in which the [IFC] has an office, has appointed an agent for the purpose of accepting service of process, or has issued or guaranteed securities. No actions shall, however, be brought by members or persons acting for or deriving claims from members. The property and assets of the [IFC] shall, wheresoever located and by whomsoever held, be immune from all forms of seizure, attachment or execution before the delivery of final judgment against the [IFC].

Judge Bates rejected this claim by citing to the D.C. Circuit’s decisions in Osseiran v. International Financial Corporation and in Vila v. Inter-American Investment Corporation. In those cases, the D.C. Circuit rejected the argument that international organizations with “nearly identical language” in their founding documents had waived their immunity. The plaintiffs subsequently appealed to the D.C. Circuit.

D.C. Circuit Judgment

Judge Lawrence H. Silberman wrote the majority opinion, which Judge Harry T. Edwards joined and Judge Pillard joined in part. Judge Pillard wrote a separate concurrence.

Majority Opinion
The majority agreed with the District Court’s “well-reasoned” decision on both scope of immunity under the IOIA and the absence of waiver of immunity in a succinct, ten page opinion. Though majority acknowledged the “dismal picture” painted by the plaintiffs’ complaint, the court found the plaintiffs’ arguments foreclosed by its own prior case law.

The plaintiffs first argument was that IOIA intended to incorporate of changes to the law of foreign sovereign immunity, rather than preserving the prevailing understanding of foreign sovereign immunity from 1945. Thus according to the plaintiffs, the Atkinsion court misinterpreted Congress’s intent to keep immunity for foreign governments and international organizations connected. In response, the majority reiterated the rationales of Atkinsion, starting with the argument that the statute explicitly delegated the responsibility of changing the amount of immunity granted to international organizations to the president, not to the courts. In addition, the majority reiterated the point made in Atkinsion that the Congress that passed the IOIA in 1945 considered—yet ultimately rejected— inclusion of a commercial activities exception to international organization immunity. Finally, the majority rejected the plaintiffs argument by reminding the them that the D.C. Circuit “recently reaffirmed Atkinsion” in its 2014 decision, Nyambal v. International Monetary Fund.

The plaintiffs further contended that Atkinsion should be ignored because the Supreme Court has in recent years undermined the premise of Atkinsion that foreign sovereign enjoyed absolute immunity in 1945 when IOIA was enacted. Instead, the plaintiffs asserted that immunity was granted based on the deference to the judgment of political branches, specifically through express request by the State Department. However, the majority dismissed the relevance of the Supreme Court dicta cited by the plaintiffs. According to the majority, those cases’ references to State Department intervention refer to the mechanism for conferring immunity on foreign sovereigns in 1945, not the scope of that immunity. To support its position, the court again invoked its decision Nyambal, which came after the Supreme Court cited by the plaintiffs.

As in the lower court proceedings, the plaintiffs raised an alternative argument that the IFC waived its immunity. According to the plaintiffs, their position was consistent with Osseiran, Vila, and Mendaro v. World Bank, in which the D.C. Circuit first adopted the “corresponding benefits” test for determining whether an international organization waived its immunity. Under this test, courts determine ex post whether waiving immunity for certain plaintiffs and claims would have “benefitted” the international organization. An international organization is considered to have received a “corresponding benefit” for waiving its immunity if that waiver would have been “necessary to enable the [international organization] to fulfill its functions.” Thus according to Silberman, creditors or bondholders are types of plaintiffs for whom international organizations probably waived their immunity because the organizations would not have been able to borrow money without agreeing to waive their immunity.
The majority rejects the notion that the IFC would receive a corresponding benefit to waiving its immunity for the plaintiffs’ suit for two reasons. First, Silberman emphasized that prior case law has generally accepted waiver arguments only when the “claims have grown out of business relationships” between the plaintiffs and the international organizations. By contrast, the IFC has no direct commercial or contractual relationship with the plaintiffs. Silberman highlighted another fatal issue for the plaintiffs: their case “threaten the policy discretion of the organization” because the claims arise from “core operations [of the IFC], not ancillary business transactions.” As such, the court determined that the consequences of waiving immunity in this type of case would determined outweigh any benefit to the IFC. Accordingly, the majority affirmed the district court’s opinion.

Pillard’s Concurrence

Pillard agreed with the majority that the outcome of the case is decided by D.C. Circuit precedent. However, she wrote separately to urge her colleagues on the D.C. Circuit to reconsider Atkinson and Mendaro, two cases which she believes were “wrongly decided.”

Pillard began by looking at Section 1 of the IOIA, which reads in relevant part:

The President shall be authorized, in the light of the functions performed by any such international organization, by appropriate Executive order to withhold or withdraw from any such organization or its officers or employees any of the privileges, exemptions, and immunities provided for in this subchapter ...

According to Pillard, the mistake in Atkinson was the court’s incorrect interpretation of Section 1 of IOIA as authorizing “the President alone to have the ability, going forward to adjust international organizations’ immunity from where it stood as of the IOIA’s enactment in 1945.” Instead, Pillard noted that the use of the singular terms such as “any such organization” and “its officers or employees” in Section 1 suggests that Congress intended to authorize the President to limit immunity for organization on a case-by-case basis. In fact, no part of Section 1 of IOIA suggests that “Congress framed or intended [that section] to be the exclusive means by which an international organization’s immunity might be determined to be less than absolute.”

Pillard offered several additional arguments to support her reading of the IOIA. First, she contended that the interpretation in Atkinson rested on the flawed assumption that Congress chose “an indirect and obscure route to freezing international organizations’ immunity over a direct and obvious one.” Congress could have simply stated its intention to grant unchangeable, absolute immunity to international organizations; instead, Congress chose to set the level of international organization immunity by reference to the immunity of foreign governments.

Furthermore, Pillard compared the IOIA text to the unambiguous language of the original House version of the IOIA, which granted international organizations “immunity from
suit and every form of judicial process.” The fact that this draft language, untethered to the level of immunity enjoyed by foreign governments, was not included in the final version of the bill implied to Pillard that Congress intended the two levels of immunity to be dynamically linked.

In addition, Pillard cited to the State Department’s support for the dynamic view of international organizational immunity, noting that additional weight should be given to the State Department view given its involvement in drafting in the IOIA. Finally, Pillard highlighted the illogical consequences of Atkinson. Granting broader immunity to international organizations than to foreign governments would immunize “nations that collectively breach contracts or otherwise act unlawfully through organizations,” even if that same conduct would be subject to judicial process if a nation were acting on its own. Thus, according to Judge Pillard, the D.C. Circuit “took a wrong turn in Atkinson when [it] read the IOIA to grant international organizations a static, absolute immunity.”

Pillard added that the D.C. Circuit has “compounded” its errors in Atkinson by adopting the “corresponding benefits” test for waiver of immunity in Mendaro. Pillard dismissed the process of asking “the judiciary to re-determine an international organization’s waiver calculus” based on “amorphous” concepts of long-term benefit. Instead of using a test that “lacks a strong legal foundation,” Pillard suggested that an international organization’s intent to waive immunity should be determined either by referring directly to the language in an organization’s charter using the already well-developed case law under the FSIA for determining whether a sovereign nation has waived its immunity.

Pillard advised that the full D.C. Circuit “revisit” Atkinson and Mendaro. However, three months after its opinion, the D.C. Circuit denied a petition for an en banc rehearing on Jam v. IFC. In January 2018, the plaintiffs filed a petition for certiorari with the Supreme Court.

Supreme Court Review

Jam is the first case before the Supreme Court considering the scope of immunity for international organizations under IOIA. The court’s decision to grant cert in Jam may have come as a surprise because it recently declined to resolve a circuit split on the scope of immunity under the IOIA after the D.C. Circuit’s 2014 decision in Nyambal conflicted with the Third Circuit’s 2010 decision in OSS Nokalva. One reason the court may have now decided to resolve this issue is that international organizations are increasingly finding themselves in U.S. courts, facing serious allegations such as aiding and abetting violations of human rights. As noted by the plaintiffs in their cert-stage reply brief, international organizations are deeply involved in a range of matters from “international business to natural resource management to human health and safety.” As the portfolios of international organizations have expanded, the number of lawsuits against these organizations brought in U.S. courts has also increased in recent years. A decision on the merits that weakens the
immunity granted to international organizations could therefore have a chilling effect, especially on organizations like the IFC, which according to D.C. Circuit opinion primarily engages in “commercial activities.” Such a decision would also provide third parties who are being harmed by international organizations’ activities an important avenue of redress.

Although it agreed to address the scope of IOIA immunity, the Supreme Court declined to consider the second question raised by Jam: what are the rules governing immunity for international organizations? Thus, this case will leave unresolved several important questions on international organization immunity raised during the lower court proceedings. One such question raised by the plaintiffs is whether the executive branch intervention is necessary for an international organization to have immunity. The other issue is how courts can determine whether an international organization has waived its immunity. Specifically, the plaintiffs in their petition for cert claimed that the D.C. Circuit’s “corresponding benefits” test as a distorting the statutory language of the IOIA. Just as the court in recent terms has reconsidered the scope of foreign sovereign immunity, Jam could signal the beginning of a string of Supreme Court cases providing greater clarity on the status of international organizations within our legal system.
“Indian fisherman hail U.S Supreme Court decision to hear World Bank suit”

Reuters

Rina Chandran

May 22, 2018

Farmers and fishermen in western India have welcomed a U.S. Supreme Court decision to hear their lawsuit against a World Bank agency, which financed a power plant they blame for damaging the environment and their livelihoods.

The U.S. Supreme Court on Monday agreed to hear an appeal by the villagers of a lower court ruling that the International Finance Corp (IFC) was immune from such lawsuits under federal law.

The court must now consider for the first time whether international organizations are immune from such suits under federal law, according to the advocacy group EarthRights International (ERI), which is representing the plaintiffs.

“This is a big victory for us,” said Bharat Patel, a plaintiff and general secretary of the fishermen’s group Machimar Adhikar Sangharsh Sangatha.

“We fought for so many years to be heard. This decision gives us hope,” he told the Thomson Reuters Foundation.

The case revolves around the IFC’s decision in 2008 to provide $450 million in loans for a coal-fired plant operated by a Tata Power unit near Mundra, in Gujarat state.

Loans from the IFC include provisions requiring that certain environmental standards will be met.

But the 4,000 megawatt plant - billed as key to providing cheap energy and creating jobs - has had a “devastating and irreversible impact” on the coastal ecosystem, according to the submission by villagers who live near the plant.

Coal ash damages crops, water for drinking and irrigation have been contaminated, while discharges from the plant’s cooling system have reduced fish stocks, they said.

Lead plaintiff Budha Ismail Jam and others sued in federal court in Washington in 2015, saying the IFC had failed to meet its obligations.

Representatives for Tata Power and the World Bank in India did not respond to e-mails seeking comment.

A district court in 2016 and the U.S. Court of Appeals for the District of Columbia Circuit in 2017 ruled that the lawsuit was barred
because the IFC is immune from such litigation under a 1945 law.

The question before the Supreme Court now is whether there are limits to immunity for entities like the IFC under the 1945 International Organizations Immunity Act.

That law gives international organizations “the same immunity” from suit “as is enjoyed by foreign governments”.

However, governments “are not entitled to immunity from suits arising out of their commercial activities” under the 1976 Foreign Sovereign Immunities Act, according to ERI.

“Since a foreign government would not be immune from this suit, the IFC, which is made up of foreign states, should not be immune either,” it said.

The court will hear arguments and decide the case in its next term, which begins in October.
The International Finance Corporation (IFC) might sound like an ordinary private business, but it’s not. It’s an international organization that’s part of the World Bank. The IFC has all of the standard accoutrements of an international organization. It was created by treaty; it has member countries, 184 of them; and it has grand ambitions to improve the world “by encouraging the growth of productive private enterprise in member countries.”

The IFC, like other international organizations, is also very difficult to sue in U.S. courts because it has comprehensive immunities from suit. But that may change: last week, the Supreme Court granted certiorari in a case, Jam v. IFC, that may pare back those immunities. The implications would be significant—not just for the IFC, but for international organizations across the board.

The statutory question

The plaintiffs in Jam include farmers and fishermen whose lives and livelihoods were harmed by the construction of the coal-fired Tata Mundra Power Plant in Gujarat, India. According to their complaint, salt contaminated the local groundwater during construction, rendering the water useless for irrigation. The plant’s cooling system discharges thermal pollution into the sea, killing off marine life. And the open-air conveyor system that transports coal to feed the plant disperses coal dust and ash into the air along its route.

Although the power plant is the immediate source of the problem, the plaintiffs sued the IFC in federal district court in Washington, D.C, where the IFC is headquartered. The IFC had loaned $450 million for the construction and operation of the plant—roughly 10 percent of its total cost. Consistent with IFC policy, the loan agreement had incorporated an Environmental and Social Action Plan that should have prevented the harms the plaintiffs endured. But the IFC didn’t take any steps to ensure compliance with that plan. Indeed, the IFC’s own ombudsperson criticized the deficient supervision of the project. So the plaintiffs filed a suit against the IFC for negligence and other torts.

The question raised by the case is whether the IFC’s immunities preclude the lawsuit from going forward. In the United States, international organizations’ immunities stem from two sources: treaties and the
International Organizations Immunities Act (IOIA), a statute enacted in 1945. Once the president designates particular individual organizations by executive order, they enjoy the immunities set out in the IOIA. The key text on immunity provides:

International organizations . . . shall enjoy the same immunity from suit and every form of judicial process as is enjoyed by foreign governments, except to the extent that such organizations may expressly waive their immunity for the purpose of any proceedings or by the terms of any contract.

Thus, the IOIA itself doesn’t directly specify the scope of organizations’ immunities. It instead cross-references the immunities of foreign governments. But that presents a puzzle. Do international organizations get the immunity that foreign states had in 1945 when the IOIA was adopted? Or, instead, do they enjoy the immunity that foreign states receive today, which is more limited and governed by the 1976 Foreign Sovereign Immunities Act (FSIA)?

The D.C. Circuit has taken the former position; the Third Circuit has taken the latter, creating a genuine circuit split. The difference matters: in 1945 foreign states generally had absolute immunity from suit. Under the FSIA, however, foreign states are (as a rough cut) immune for their sovereign or governmental acts, but not immune with respect to their commercial activities.

Set aside for now whether the D.C. Circuit or the Third Circuit has the better claim on the merits. In this post, I’d like to get a handle on what’s at stake in the lawsuit. As a first cut, deciding that the IOIA measures immunity with reference to the FSIA could create real problems for international organizations operating in the United States. But no matter how the case is resolved, it’s unlikely to spur international organizations to make the kinds of changes that are genuinely needed—developing robust alternative mechanisms for resolving claims by individuals who are adversely affected by what international organizations do.

When do international organizations engage in commercial activities?

If the Supreme Court interprets the IOIA to confer absolute immunity, then the suit against the IFC can proceed only if the IFC has waived its immunity. If the Supreme Court goes the other way, then determining whether the IFC (and other international organizations) can be sued becomes quite complicated. The answer turns in part on the question of what counts as a commercial activity of an international organization. In a throwaway line in its opinion in Jam, the D.C. Circuit wrote that if the commercial activities exception applied to the IFC, “the organization would never retain immunity since its operations are solely ‘commercial,’ i.e., the IFC does not undertake any ‘sovereign’ activities.” But it’s not so clear that the IFC’s immunity could be wiped away so quickly.

The Supreme Court has said that to determine whether an act is commercial for purposes of the FSIA, the key question is “whether the particular actions that the foreign state performs (whatever the motive behind them)
are the type of actions by which a private party engages in ‘trade or traffic or commerce.’” At first blush, the IFC’s work indeed looks commercial—its main activity is lending to private actors, and a slew of banks in the private sector do exactly that.

But a lot depends on the level of generality at which a particular activity is described. Repaying a bank loan sounds like a “garden variety” commercial act, but the Second Circuit has held that repaying a loan from the International Monetary Fund is a sovereign act because of the particular way that the IMF and its loans are structured. Only states can be members of the IMF and borrow from it; the IMF’s lending is “part of a larger regulatory enterprise intended to preserve stability in the international monetary system and foster orderly economic growth.” If repaying an IMF loan isn’t a commercial activity, neither is making such a loan. The analogy to the IFC’s activities is obvious.

Likewise, hiring an employee might initially appear to be an obviously commercial act, but the executive branch has long taken the position that employing international civil servants is not a commercial activity, and a number of court decisions have adopted this reasoning. The bottom line is that there’s a lot of room to debate what’s commercial and what’s sovereign—and a conclusion that international organizations lack immunity for their commercial acts is only an interim step in the analysis.

What about treaties?

Even if the IOIA does not confer immunity for commercial activities, an international organization’s treaty might. But figuring out the effect that a treat might have on immunities is more complicated than it might at first appear. Even apart from interpreting the treaty language about immunity, courts will have to decide whether that language is self-executing; whether the treaty language overrides conflicting statutory provisions pursuant to the last-in-time rule; and whether the treaty should influence the interpretation of the IOIA pursuant to the *Charming Betsy* rule, which instructs courts to interpret statutes to avoid conflicts with international law.

It’s difficult to generalize about how this analysis would come out because the content of treaty provisions that address the immunities of international organizations vary considerably. The treaty that governs the immunity of the United Nations is quite sweeping: It provides that the United Nations “shall enjoy immunity from every form of legal process except insofar as in any particular case it has expressly waived its immunity.” The Charter of the Organization of American States, like that of a number of other organizations, is somewhat narrower. It says that each organization “shall enjoy in the territory of each Member such legal capacity, privileges, and immunities as are necessary for the exercise of its functions and the accomplishment of its purposes,” but it doesn’t specify exactly how much immunity is “necessary.” Still other charters are silent on immunity, like the one governing World Organization for Animal Health.
The upshot is that some organizations, like the United Nations, can make a treaty-based claim that their immunity remains absolute regardless of how the IOIA is interpreted. Other organizations can’t. An adverse decision from the Supreme Court will be especially consequential for this latter group.

Consider again the World Organization for Animal Health, which is known by its historical French acronym OIE. Its work focuses on preventing animal diseases—and thereby facilitating international trade in animals and animal products. President Barack Obama designated OIE pursuant to the IOIA right at the end of his term. Six months later, the OIE announced that it would establish a liaison office in College Station, Texas. The extension of immunity and the establishment of the office appear closely connected. Indeed, the OIE’s press release regarding the Texas office opens with a reference to the executive order in its very first sentence.

If the Supreme Court interprets the IOIA as conferring limited immunities, what will the OIE do? At a minimum, it will face considerable legal uncertainty. OIE might find itself on the receiving end of a lawsuit by a disgruntled employee, but unsure whether courts will find the commercial-activities exception to apply or not. The OIE might maintain the office in College Station, that risk notwithstanding. It could try to bolster its immunity through a new international agreement or a new statutory provision (good luck with that). Or it could decide that the legal risk is too great and shut down the office.

Alternative mechanisms for resolving disputes

Stepping back, there are two main rationales for providing immunity to international organizations. First, immunity shields the organization from member states that seek to undermine or influence the organization by subjecting it or its officials to lawsuits. This risk is real. The International Court of Justice, for example, affirmed the immunity of a UN Special Rapporteur on judicial independence after that rapporteur was sued for libel by individuals and companies who were incensed by comments the rapporteur made to the press. Second, immunity from employment-related lawsuits helps assure that international organizations can be genuinely international—and can develop employment policies that are suitable for an international workforce.

Although there are good reasons for according immunity to international organizations, that immunity often comes at a heavy price: it can leave individuals who are harmed by an international organization without recourse. The plaintiffs in the case against the IFC are alleging serious harm. Another recent high-profile example involves the United Nations. UN peacekeepers in Haiti unintentionally introduced cholera to the country in the wake of the 2010 earthquake. The cholera epidemic there has killed more than 9,000 individuals and sickened hundreds of thousands. The United Nations denied a claim for compensation and an apology that the victims submitted directly to the organization, and successfully invoked immunity to shut down
a lawsuit filed in U.S. courts. In December 2016, then-UN Secretary-General Ban Ki-moon issued a long-delayed apology and announced the establishment of a new $400 million program to benefit Haitian victims. But a year and a half later, the program has not delivered much, largely because UN member states have supplied only $7.5 million, a tiny fraction of what Ban had promised.

The plaintiffs in the case against the IFC do have some recourse. In 1999, IFC established an Office of the Compliance Officer/Ombudsman (CAO) and empowered it to hear complaints by people affected by projects financed by IFC “in a manner that is fair, constructive, and objective.” In 2011, the Association for the Struggle for Fishworkers’ Rights filed a complaint with the CAO about the Tata Mundra plant, arguing that that the IFC had violated its own economic and social policies in connection with that project. CAO proceeded with a formal investigation. After CAO produced reports that substantiated a number of the Association’s claims, CAO produced an Action Plan that contemplated a number of environmental, economic, and health studies, and indicated that “appropriate mitigation measures will be developed” in consultation with certain experts if those studies indicated an “adverse impact.” Since then, CAO has continued to monitor implementation of this action plan and subsequent developments. CAO’s most recent monitoring report, dated February 2017, described progress on completing some of these studies, but emphasized “an outstanding need for a rapid, participatory and expressly remedial approach to assessing and addressing project impacts raised by the complainants.” The case remains open, and CAO is continuing to monitor IFC’s response to its findings.

There are other examples of such alternative mechanisms that allow individuals who have been harmed by international organizations to challenge at least certain kinds of actions by the organizations. The UN Security Council created an Office of the Ombudsperson that allows individuals and entities subject to the ISIL and al-Qaeda sanctions regime to challenge their listings. The Human Rights Advisory Panel was established to hear human rights claims against the UN Administration in Kosovo.

One solution might be to make the immunity of international organizations contingent on the development of such mechanisms. (The European Court of Human Rights did that in Waite and Kennedy v. Germany.) But crafting an effective rule is very difficult. If any alternative mechanism suffices to assure immunity from suit, international organizations might be tempted to develop minimalist procedures that offer nothing meaningful to injured individuals. If, on the other hand, national courts recognized immunity only when they deem the alternative mechanism adequate, there’s a risk of recreating the problems that justify immunity in the first place: Courts might issue decisions that evaluate alternatives based on parochial standards, yielding inconsistent decisions from one jurisdiction to the next, and potentially subjecting organizations to undue influence of
individual member states outside of the organization’s formal governance mechanisms.

Suppose the IFC’s immunity from suits like the current one depended on the availability of a good-enough alternative mechanism. Would—and should—the CAO qualify? Reasonable minds could disagree. The plaintiffs presumably aren’t satisfied by the CAO process. At the same time, the oversight process can’t be dismissed as pure window dressing. The CAO seems to be taking the Association’s complaints seriously, and appears willing to publicly criticize the IFC and to maintain pressure over time.

Returning to the statutory question in *Jam v. IFC*, then, there are two take-away points. First, interpreting the IOIA to confer immunities only for governmental acts would create considerable legal uncertainty for international organizations across the board. Second, neither interpretation of the IOIA that’s on offer would do much to systematically advance the development of serious alternative dispute settlement mechanisms. The presence or absence of such mechanisms is irrelevant if the IOIA confers absolute immunity—and is likewise irrelevant if the IOIA confers immunity only for sovereign or governmental acts. The push to develop—and to improve—such alternative mechanisms will have to come from elsewhere.