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PREVIEW

OF UNITED STATES SUPREME COURT CASES

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and

United States v. Skrmetti

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FOOD AND DRUG REGULATION

Did the Food and Drug Administration Wrongly Deny Applications for Authorization to Market New e-Cigarette Products?

CASE AT A GLANCE

In September 2020, Triton Distribution and Vapetasia LLC sought authorization from the Food and Drug Administration (FDA) to market and sell flavored e-cigarette products. FDA denied their applications, stating that they did not provide sufficient evidence that the benefits of their products outweighed the risks. Triton and Vapetasia appealed to the Fifth Circuit, arguing that FDA imposed standards on their applications that FDA had not previously disclosed.

Food and Drug Administration v. Wages and White Lion Investments LLC
Docket No. 23-1038

Argument Date: **December 2, 2024** From: **The Fifth Circuit**

by Steven D. Schwinn
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Introduction

The Fifth Circuit ruled for Triton and Vapetasia. The court found that the Food and Drug Administration (FDA) denied their applications because they failed to produce scientific studies of the benefits and risks of their products, even though FDA had not previously stated that applicants must produce such studies. As a result, the court ruled that FDA's denial orders were arbitrary and capricious in violation of the Administrative Procedure Act.

Issue

Did the Fifth Circuit err in setting aside FDA's denial orders as arbitrary and capricious?

Facts

In 2009, Congress enacted the Family Smoking Prevention and Tobacco Control Act. Congress designed the act to curb tobacco use by minors, which, it found, "is a pediatric disease of considerable proportions." Congress also found that "[v]irtually all new users of tobacco products are under the minimum legal age to purchase such products," and that an "overwhelming majority" of tobacco users "become addicted to the nicotine in those products before reaching the age of 18." Congress concluded that past efforts to curb tobacco use by minors failed because tobacco companies continued to regard "young people" as "an important and often crucial segment of the tobacco market." According to Congress, those companies had "dramatically increased their advertising and promotional spending in ways that encourage[d] youth to start smoking."

To address these findings, the act imposes special restrictions on "new tobacco product[s]," that is, those products that were not commercially marketed in the United States as of February 15, 2007. A manufacturer may introduce a new tobacco product into the market only if it obtains authorization from FDA.

Under the act, an applicant for authorization to market a new tobacco product must demonstrate that marketing the new product would be "appropriate for the protection of the public health." 21 U.S.C. § 387j(c)(2)(A). In applying that standard, FDA must consider "the risks and benefits to the population as a whole." 21 U.S.C. § 387j(c)(4). In particular, FDA must consider both the "likelihood that

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existing users of tobacco products will stop using such products" and the "likelihood that those who do not use tobacco products will start using such products." 21 U.S.C. § 387j(c)(4)(A) and (B).

FDA must assess an application based on "the information submitted" by the applicant and "other information" before it. 21 U.S.C. § 387j(c)(2). FDA's decision must, "when appropriate," rest on "well-controlled investigations." 21 U.S.C. § 387j(c)(5)(A). FDA may rely on "valid scientific evidence" aside from "well-controlled investigations" if such evidence "exists" and "is sufficient to evaluate the tobacco product." 21 U.S.C. § 387j(c)(5)(B).

An unsuccessful applicant may appeal FDA's decision to a federal court of appeals. The court must review FDA's decision under the Administrative Procedure Act (APA).

In 2016, FDA issued a rule stating that it would regulate e-cigarettes and e-liquids under the Tobacco Control Act. (These qualify as "new tobacco products" because they were not on the market as of February 15, 2007. The manufacturers of these products sometimes call them "electronic nicotine delivery systems," or "ENDS.")

FDA then hosted informational meetings, issued guidance documents, and proposed a rule on how it would assess applications by e-cigarette and e-liquid manufacturers, including manufacturers who already had products on the market. (Those manufacturers had to submit a premarket tobacco product application, or PMTA, in order to avoid FDA enforcement actions.) FDA did not say that it expected applications for sweet-flavored ENDS to include data showing that their products were more effective than a tobacco-flavored ENDS in helping smokers to reduce their use of cigarettes or to quit smoking. Instead, FDA said that "[n]o specific studies are required for a PMTA" and that "it may be possible to support a marketing order for an ENDS produce without conducting new nonclinical or clinical studies given other data sources can support the PMTA." The latest FDA guidance set a September 2020 deadline for PMTAs.

In January 2020, FDA issued another guidance document. Under the 2020 document, FDA said that its top enforcement priority was "[f]lavored, catridge-based ENDS products (other than tobacco- or menthol-flavored ENDS products)." (In general, the parties use "flavored" to refer only to sweet-, dessert-, or candy-flavored ENDS products.) FDA explained that flavored products had small, easily concealable "design features" that made "products so popular with young people." FDA stated that its other priorities included "other ENDS products for which the manufacturer has failed to take (or is failing to take) adequate measures to prevent minors' access" and any "ENDS product that is targeted to minors or whose marketing is likely to promote use of ENDS by minors."

By the September 2020 deadline, FDA received applications for about 6.5 million products, including the two applications at issue in this case. In September 2020, Triton Distribution, which makes e-liquids for its own brands and for Vapetasia LLC, sought authorization for e-liquids in flavors such as "Jimmy The Juice Man Peachy Strawberry," "Signature Series Mom's Pistachio," and "Suicide Bunny Mother's Milk and Cookies." Vapetasia sought authorization for e-liquids in flavors such as "Blackberry Lemonade," "Iced Pineapple Express," and "Killer Kustard Blueberry." Triton and Vapetasia described their applications as "nearly identical," and we'll describe them together as "the applicants."

The applicants acknowledged in their applications that "a number of surveys" indicated that "minors are increasingly using flavored [e-cigarettes]." But they contended that these flavors "appeal to adults as well." They said that a "growing body of scientific evidence" showed that "flavors are crucial to getting adult smokers to make the switch and stay away from combustible cigarettes."

In support of their claims, the applicants pointed to a "comprehensive review of the scientific literature," which, according to the applicants, provided "important insight into the impact" of flavored e-liquids. Still, they conceded that "there is not enough evidence from well-designed studies to determine whether e-cigarette flavors aid in smoking cessation."

On July 9 and August 17, 2021, FDA issued two internal memorandums stating how the agency would assess the applications. In the July memorandum, FDA said that it would "conduct a Fatal Flaw review…a simple review in which the reviewer examines the submission to identify whether or not it contains the necessary type of studies." In the August memorandum, FDA said that applicants would have to provide evidence that their "flavored products have an added benefit relative to tobacco-flavored ENDS in facilitating smokers completely switching away from or significantly reducing their smoking." The memo said that this evidence would "most likely" need to be in the form of a "randomized control trial" or a "longitudinal cohort study." The memo also stated that its assessment of youth risk "includes evaluating the appropriateness of

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the proposed marketing plan." FDA rescinded the August memo on August 25, 2021.

FDA then denied Triton's and Vapetasia's applications in September 2021. FDA found insufficient evidence that the benefits of the flavored e-cigarette products outweighed their risks. On the benefits side of the balance, FDA concluded that e-cigarette products offered the same type of benefit that the applicants claimed for their flavored products, but without "the same degree of risk of youth uptake." FDA determined that the applicants failed to provide "reliable and robust evidence" that said otherwise.

On the risks side of the balance, FDA found a "known and substantial risk to youth." It found that nearly 1 in 5 high-school students and nearly 5 percent of middle-school students used e-cigarettes, and that they were "the most widely used tobacco product among youth by far." FDA also found that "youth users consistently select[ed] flavors as a top reason" for using e-cigarettes. FDA concluded that flavored e-cigarettes were "more palatable for novice youth and young adults, which can lead to initiation, more frequent and repeated use, and eventually establishing regular use."

The applicants provided marketing plans that proposed mitigating the risk to youth by restricting how they would market their products (by using age-verification technology for online sales, for example). But FDA declined to evaluate the plans. FDA concluded that it was "not aware of access restrictions that, to date, have been successful in sufficiently decreasing the ability of youth to obtain and use" e-cigarettes.

FDA similarly denied other applications for flavored ENDS. FDA found that these products pose a serious and well-documented risk of attracting young people to use tobacco. In contrast, FDA has granted applications for authorization to market certain tobacco-flavored e-cigarette products. FDA found that these can benefit "established cigarette smokers" who prefer the tobacco flavor and who use them "as a way to reduce or stop smoking." It also found that "interest in tobacco flavor is low among youth."

The applicants appealed to the United States Court of Appeals for the Fifth Circuit. A merits panel of the court denied the applicants' petitions. But the *en banc* Fifth Circuit reversed. The court set aside FDA's orders denying authorization and remanded the case to the agency. This appeal followed.

Case Analysis

FDA argues first that the Fifth Circuit was wrong when it held that FDA unlawfully imposed new standards to evaluate the applicants' flavored products. FDA says that the Tobacco Control Act itself requires applicants to support their claims with "valid scientific evidence," 21 U.S.C. § 387j(c)(5)(B), and that FDA's guidance said that such evidence could include either new studies or other forms of evidence. FDA contends that it "denied [the applicants'] applications because they failed to support their claims with sufficient evidence in any form," consistent with the act and its own prior guidance.

FDA claims that the Fifth Circuit's contrary ruling rested on a misunderstanding of the record and administrative law. As to the record, contrary to the Fifth Circuit's reading, FDA claims that it never *required* certain studies; instead, it only said that the applicants *could have* included them in their applications, and that they didn't. As to the law, again contrary to the Fifth Circuit's interpretation, FDA asserts that it went "far beyond anything demanded by the APA" in notifying the applicants of its evaluation standards, and that the court improperly deferred to the applicants' interpretation of agency guidance.

FDA argues next that the Fifth Circuit erred in holding that the agency unlawfully declined to evaluate the applicants' efforts to mitigate their products' risks by restricting how the applicants would market them. FDA says that its failure to evaluate these efforts did not affect the agency's final decision, and was therefore harmless. According to FDA, that's because the applicants' marketing plans "replicate[d] only measures that FDA has considered and rejected."

Finally, FDA argues that the Fifth Circuit's other objections to its analysis are also incorrect. For example, FDA says that the Fifth Circuit wrongly concluded that FDA arbitrarily changed its 2020 position that it would not prioritize enforcement against certain flavored e-cigarettes when it evaluated the applicants' applications. In fact, FDA claims that it prioritized enforcement against those products only after learning new information—that flavor in these products drove their appeal for youth. Moreover, FDA contends that the Fifth Circuit wrongly concluded that the agency imposed a categorical ban on flavored e-cigarettes, when in fact FDA granted some applications for flavored products even "while the petition for a writ of certiorari in this case was pending." Finally, FDA claims that the Fifth

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Circuit wrongly concluded that the agency approved menthol-flavored products, but not the applicants' flavored products. According to FDA, at the time of the applicants' applications, the agency had not approved any menthol-flavored products, and it only later approved menthol-flavored products "after evaluating them under the same framework that it has applied to other flavored e-cigarettes."

The applicants counter that FDA unlawfully switched its standards without prior notice when it evaluated their applications. The applicants say that FDA originally announced "that applications should focus on whether the proposed products had lower levels of harmful constituents than traditional tobacco products and whether the proposed products would lead to an overall decrease in adverse health effects by transitioning smokers to less harmful products." They contend that FDA also announced that its assessment of applicants' marketing plans (to keep the products out of the hands of youth) would be "critical."

The applicants contend that their applications "included data and information in line with [these] publicly stated expectations." But they say that FDA unexpectedly changed its standards—to authorize flavored e-cigarette products only "if they were more effective than tobacco-flavored ENDS at helping smokers quit or reduce their use of cigarettes"—and required more rigorous studies. Moreover, they contend that "FDA decided that it would ignore applicants' plans to keep their products out of the hands of youth."

The applicants argue that FDA made its surprise change "through a substantive rule"—the 2021 internal memorandum. They claim that FDA failed to provide notice of this "rule" and provide the public an opportunity to comment, or at least to give the public advance notice, in violation of the APA.

Finally, the applicants argue that FDA's failure to consider their marketing plans was prejudicial, not harmless. They assert that FDA "never identified the specific measures it had previously considered and rejected when reviewing other applications," and so there's no way to know if FDA's failure affected its decision. Moreover, they say that FDA more recently approved marketing plans for menthol-flavored products that "were no more restrictive than [the applicants'] proposed restrictions," demonstrating that the agency's failure to consider their marketing plans was not harmless.

Significance

This case tests how much flexibility FDA (and possibly, by extension, other administrative agencies) have in setting regulatory standards in policy areas where the agency is adapting to new information. After FDA initially announced that it would regulate e-cigarette products in 2016, the agency's guidance on its approval standards for flavored e-cigarette products seemed to evolve and sharpen, at least by the applicants' reckoning. The applicants characterize this as an unfair "surprise," while FDA says that its standards always complied with the act, and in any event only evolved in response to new information that it learned about flavored products.

The difference in the parties' positions matters. According to the applicants, FDA's approach undermines government transparency and unfairly denies them approval under standards that they do not, and cannot, know. On the other hand, according to the government, the Fifth Circuit's approach would undermine public health and the act's "central objective" to "ensur[e] that another generation of Americans does not become addicted to nicotine and tobacco products."

E-cigarette manufacturers have repeatedly challenged FDA's denials as arbitrary and capricious, often using similar arguments to those that the applicants used here. Seven courts of appeals have rejected those challenges; the Fifth and Eleventh Circuits are the only courts to rule in manufacturers' favor (although FDA contends that the Eleventh Circuit's ruling is distinguishable).

Although the Fifth Circuit seems like a distinct outlier, the lopsided circuit split is not necessarily a good predictor of how the Court might rule. If the Court's trend against agencies' regulatory authorities holds in this case, look for it to lean toward the applicants.

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BANKRUPTCY LAW

Can a Bankruptcy Trustee Avoid a Transaction if No Creditor Could Have Done So Outside of Bankruptcy?

CASE AT A GLANCE

Prior to bankruptcy, debtor All Resort Group paid its principals' federal tax debts to the Internal Revenue Service. The bankruptcy trustee subsequently sought to avoid those transfers using a Bankruptcy Code provision that allows the trustee to avoid a transfer that is voidable under state law by an actual creditor. The United States objected, arguing that because sovereign immunity would have precluded relief under state law, the trustee could not obtain a different result in bankruptcy.

United States v. Miller
Docket No. 23-824

Argument Date: **December 2, 2024** From: **The Tenth Circuit**

by Laura N. Coordes
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Introduction

Section 544(b) of the Bankruptcy Code allows a bankruptcy trustee (or debtor-in-possession) to avoid any transfer of an interest of the debtor in property that is voidable under applicable law by an unsecured creditor. In this case, the bankruptcy trustee used Section 544(b) to avoid transfers that debtor All Resort Group (ARG) had made to the Internal Revenue Service (IRS). In doing so, the trustee asserted that these transfers would have been voidable by an unsecured creditor under state law, but for sovereign immunity. However, since the Bankruptcy Code provides for a waiver of sovereign immunity, the trustee argued that there was no barrier to him avoiding the transfers. The United States (the government) argued that because no actual unsecured creditor could have avoided the transfers outside of bankruptcy, the trustee could not use Section 544(b) to avoid the transfers in the bankruptcy case.

Issue

May a bankruptcy trustee avoid a debtor's transfers to the United States using Section 544(b) when no actual creditor could have used applicable state fraudulent-transfer law to obtain such relief outside of bankruptcy?

Facts

Prior to filing for bankruptcy, debtor ARG transferred funds to the IRS to cover personal tax debts owed by two of its principals. When it made these transfers, ARG was insolvent. ARG subsequently filed for chapter 11 bankruptcy and later converted the case to chapter 7. The chapter 7 bankruptcy trustee, David Miller, sued the United States in the bankruptcy proceedings, seeking to avoid the tax payments ARG had made on behalf of its principals. To do so, Miller used Section 544(b) of the Bankruptcy Code, asserting that there was an actual creditor—a former ARG employee with an employment-discrimination settlement—who could have brought suit outside of bankruptcy under Utah's fraudulent-transfer law.

The government argued that, outside of bankruptcy, sovereign immunity would prohibit the employee's suit against the United States to recover the tax payments. Because sovereign immunity would have barred any such suit outside of bankruptcy, the government argued that the trustee could not avoid the transfers in bankruptcy, because the Bankruptcy Code provision the trustee was relying on to avoid the transfers requires the transfers to

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be "voidable under applicable law." Miller contended that, because the Bankruptcy Code abrogates the sovereign immunity of a "governmental unit" with respect to Section 544, the government could not raise sovereign immunity as a defense in the bankruptcy proceedings.

The bankruptcy court held that Miller could avoid the transfers using Section 544(b). The court agreed with Miller that Section 106(a) of the Bankruptcy Code abrogates a government's sovereign immunity in bankruptcy with respect to Section 544(b) and so held that, in order to bring an avoidance action under Section 544(b), the trustee need only identify an unsecured creditor who, but for sovereign immunity, could have brought the claim under state law. The bankruptcy court rejected the government's argument that the Internal Revenue Code would preempt a state-law suit to recover the tax payments as irrelevant, holding that because a Section 544(b) claim is a federal cause of action, it cannot be preempted. The bankruptcy court thus avoided the relevant tax payments and awarded Miller a judgment against the United States.

The government appealed to the district court, which affirmed and adopted the bankruptcy court's reasoning in full. The Tenth Circuit Court of Appeals also affirmed, holding that Section 106(a)'s waiver of sovereign immunity reaches the underlying state law cause of action that Section 544(b) authorizes the trustee to rely on when seeking to avoid a transfer. With this determination, the Tenth Circuit aligned itself with the Ninth and Fourth Circuits on this issue and further entrenched a circuit split with the Seventh Circuit.

Case Analysis

This case concerns the interaction of two provisions of the Bankruptcy Code: Sections 544(b) and 106(a).

Section 544(b) of the Bankruptcy Code provides that a bankruptcy trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim. Put more plainly, a trustee seeking to avoid a transfer under Section 544(b) must find an actual unsecured creditor that could avoid the transfer under "applicable"—state—law. Although the Bankruptcy Code contains its own provision allowing the trustee to avoid voidable transactions (Section 548), that provision only has a two-year lookback period. Most state voidable transactions laws have longer lookback periods. Thus, Section 544(b) is an attractive mechanism because it allows a bankruptcy trustee to take advantage of the longer lookback period available under state law—that is, if the trustee can find an actual unsecured creditor that could have avoided the transfer under state law.

Section 106(a) provides that, in bankruptcy, a governmental unit's sovereign immunity is abrogated with respect to numerous sections of the Bankruptcy Code, including Section 544. In Section 101(27), the Bankruptcy Code defines "governmental unit" to include the United States.

In this case, the United States is arguing that a trustee that invokes Section 544(b) is subject to all of the same limitations that would apply to any existing creditor who could have sought the same relief outside of bankruptcy. Thus, if the "actual creditor" the trustee is relying on could not have succeeded with its state-law avoidance action for any reason, the trustee similarly cannot succeed in avoiding the transfer. The government points out that, under the "applicable law" in this case—Utah's fraudulent-transfer law—no actual creditor could have successfully sued the IRS to avoid the tax payments, because sovereign immunity would bar the suit.

The government acknowledges that Section 106(a)(1)'s abrogation of sovereign immunity allows a bankruptcy trustee to assert a Section 544(b) claim against the government in bankruptcy court but contends that the bankruptcy court must still adjudicate the merits of that claim. This means, according to the government, that the court must determine whether there is an actual avenue for relief under state law. In support of this contention, the government points to Section 106(a)(5), which provides that "[n]othing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law." Put differently, the government is arguing that its waiver of sovereign immunity in bankruptcy with respect to Section 544 does not give the bankruptcy trustee a cause of action that a creditor couldn't otherwise assert under state law.

The government has criticized the Tenth Circuit's reading of these statutory provisions as conflating sovereign-immunity and merits issues. Although the government acknowledges that Section 106(a) waives sovereign immunity "with respect to" Section 544, it urges a narrow reading of that phrase and contends that Congress did not intend the sovereign immunity waiver to be so broad that it would alter Section 544(b)'s substantive requirements. In support of this argument, the government relies on the

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clear-statement rule, which provides that, in the absence of a clear statement from Congress, courts should interpret a statute in a way that maintains the status quo. As nothing in Section 106(a) clearly states that the sovereign immunity waiver extends to the underlying state-law suit on which Section 544(b) is predicated, the government urges the Court to reject that interpretation.

The government has also asserted that a creditor attempting to use state fraudulent-transfer law to avoid tax payments outside of bankruptcy would face constitutional difficulties. In particular, the Supremacy Clause would preempt a state-law fraudulent-transfer action brought by a creditor to avoid and recover the payment of a third party's taxes to the U.S. government.

For his part, Miller (the bankruptcy trustee) is arguing that the phrase "with respect to" in Section 106(a) should be read broadly to cover all aspects of Section 544(b) claims, including the "applicable law" that forms the basis of the trustee's cause of action. Thus, because Section 106(a) "wholly abrogates sovereign immunity within the bankruptcy case," and because the trustee's Section 544(b) claim occurs within the bankruptcy case, Section 106(a)'s abrogation of sovereign immunity applies to the entirety of the Section 544(b) analysis. In support of this reading, Miller has pointed out that, under the government's interpretation of this statutory language, it would be impossible for a Section 544(b) claim against the government to ever succeed—a result Congress could not have intended given that the text of Section 106(a) explicitly mentions a waiver of immunity with respect to Section 544.

Miller also points out that, if the government is correct, Congress would have to pass two waivers of sovereign immunity for trustees to succeed against the government: one for Section 544(b)'s federal cause of action, and one for the underlying state law that supplies the elements of that cause of action. Miller points out that the Court recently rejected a similar argument that would have effectively required two sovereign immunity waivers in another case, *Department of Agriculture Rural Development Rural Housing Service v. Kirtz*, 601 U.S. 42 (2024). In the case at bar, Miller argues that the Bankruptcy Code gives trustees both a waiver of sovereign immunity (through Section 106(a)) and a cause of action (through Section 544(b)), and therefore, nothing more is required.

Looking to history, Miller points out that when Congress enacted Section 106(a), there was already a long history of trustees using state law to avoid fraudulent transfers such as the one at issue in this case. Consequently, Miller argues that when Congress waived immunity "with respect to" Section 544, Congress was effectively authorizing those fraudulent transfer avoidance actions against the United States.

Finally, Miller has pointed out that Section 544(b) is written in the passive voice, merely asking whether a transfer "is voidable under applicable law by a creditor," and not asking whether the creditor could sue any particular Section 544(b) defendant. In this case, Miller argues that the transfers are "voidable under applicable law by a creditor" because all of Utah fraudulent-transfer law's requirements are met. Miller points out that the creditor would not have to sue the United States specifically to avoid these transfers—the creditor could, for example, have instead sued the beneficiaries of the transfers for a money judgment, or the creditor could have sued the debtor for an injunction. In neither of these cases would sovereign immunity be implicated. In response, the government has argued that Miller waived this argument because it was "neither pressed nor passed upon below."

Significance

This case has several significant implications. Ultimately, this case is about the extent of a bankruptcy trustee's (or debtor-in-possession's) avoidance powers in bankruptcy, as well as the reach of a government's sovereign immunity waiver in bankruptcy.

The U.S. government has emphasized that cases like this one have the potential to affect the federal *fisc* by forcing the government to return transfers it otherwise could retain. However, Miller, and the amici supporting him, have argued that a ruling for the government would make it more difficult to hold governmental units liable in bankruptcy and could encourage abuse of the bankruptcy system. Specifically, corporate insiders could use the assets of a troubled or insolvent corporation to pay their personal tax liability, then hold off on filing the corporation for bankruptcy for more than two years in order to create an unrecoverable fraudulent conveyance.

By contrast, a ruling for Miller would make it clear that trustees can use state avoidance laws to bring avoidance actions against governmental units that have received voidable transfers. When a trustee in bankruptcy recovers such transfers, he does so on behalf of all of the debtor's unsecured creditors, and so allowing the government to avoid and recover these transfers for

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the benefit of all creditors promotes the bankruptcy principle of equality of distribution among creditors. On the other hand, the government has warned that a ruling in Miller's favor would subject governments to avoidance suits years after the transfers occurred, long after any right to a refund would expire under state law.

Whichever way the Court rules, we are likely to get some clarity on just how far a sovereign immunity waiver goes in bankruptcy law, and in particular, on the interaction between the Bankruptcy Code's sovereign immunity provision and a bankruptcy trustee's ability to use state voidable transactions law to recover from a governmental unit.

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FOREIGN SOVEREIGN IMMUNITIES ACT

When Does the Commingling of Assets Satisfy the Expropriation Exception Under the Foreign Sovereign Immunities Act?

CASE AT A GLANCE

This case concerns Holocaust survivors and relatives of Holocaust survivors seeking money vindication for the taking of property by the Hungarian government and its national railway during the Hungarian Holocaust, a horrific event in which 500,000 Jewish people were killed. The petitioners, including the Republic of Hungary, contend that the Foreign Sovereign Immunities Act provides them with immunity and that the expropriation exception cannot be applied under a broad commingling of assets theory. The respondents counter that a broader commingling theory is necessary and consistent with the expropriation exception.

Republic of Hungary v. Simon
Docket No. 23-867

Argument Date: **December 3, 2024** From: **The D.C. Circuit**

by David L. Hudson Jr.
Belmont Law School, Nashville, TN

Issues

1. Is the historical commingling of assets sufficient to establish that proceeds of seized property have a commercial nexus with the United States under the expropriation exception to the Foreign Sovereign Immunities Act (FSIA)?
2. Must a plaintiff make out a valid claim that an exception to the FSIA applies at the pleading stage, rather than merely raising a plausible inference?
3. Does a sovereign defendant bear the burden of producing evidence to affirmatively disprove that the proceeds of property taken in violation of international law have a commercial nexus with the United States under the expropriation exception to the FSIA?

Facts

This case arises out of the Hungarian government's confiscation of property owned by Jews during the Holocaust. During the Hungarian Holocaust, the Hungarian government exterminated 500,000 Jewish people. The government also confiscated a great deal of property. Key to this atrocity, plaintiffs allege, was the conduct of the Hungarian government's national railway, Magyar Államvasutak Zrt (MAV).

Fourteen survivors of the Hungarian Holocaust sued the Republic of Hungary and MAV in 2010, seeking compensation for the seizure of their property during the Holocaust. The plaintiffs sued under the FSIA, claiming that they were not Hungarian nationals, but either stateless or nationals of Czechoslovakia.

The defendants asserted immunity under the FSIA. Plaintiffs contended that they could proceed under the expropriation exception to the FSIA. Under this exception, defendants are subject to suit if any of the taken property—or "any property exchanged for such property"—is present in the United States as commercial activity or commercially within the United States or owned by an instrumentality of a foreign state "engaged in a commercial activity in the United States."

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In 2014, the district court ruled "that the FSIA's treaty exception immunized [petitioners] from suit." However, the U.S. Court of Appeals for the District of Columbia reversed and reinstated the lawsuit, reasoning that the treaty is not the exclusive means by which plaintiffs could proceed with their legal claims.

On remand, the district court dismissed the case on forum *non conveniens* (meaning the court should dismiss a case when there is a more convenient court available to hear it) and comity grounds. The court of appeals once again reversed.

On the next pass, the federal district court refused to dismiss the plaintiffs' claims. On appeal, the D.C. appeals court allowed the claims of most of those claiming Czechoslovakian nationality to proceed. The appeals court determined that the FSIA's exception does not bar their claims.

The Republic of Hungary and MAV petitioned the Supreme Court for review. The Court granted review.

Case Analysis

Foreign states and their instrumentalities are "presumptively immune from the jurisdiction of United States courts" under the FSIA. *Federal Republic of Germany v. Philipp*, 59 U.S. 169 (2021); see 28 U.S.C. § 1603(a). This means that unless an exception applies, a U.S. court lacks subject-matter jurisdiction over a claim against a foreign government.

A key exception is the expropriation exception. It reads:

> A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case…in which rights in property taken in violation of international law are in issue and that property or any property exchanged for such property is present in the United States in connection with a commercial activity carried on in the United States by the foreign state; or that property or any property exchanged for such property is owned or operated by an agency or instrumentality of the foreign state and that agency or instrumentality is engaged in a commercial activity in the United States.

Under this exception, the property at issue must be taken in violation of international law. A connection must also exist between the defendants and commercial activity in the United States.

Petitioners contend that the D.C. Circuit applied a "novel commingling theory" to allow the respondents' claim to proceed. To petitioners, the FSIA disallows suits against foreign governments to be brought in domestic courts and narrowly interprets the expropriation exception. They write that the commingling theory adopted by the D.C. Circuit is inconsistent with the text, structure, and history of the FSIA.

Petitioners also assert that Congress intended the expropriation exception to be interpreted only to "specifically identifiable property." Petitioners argue that the novel commingling theory "threatens to subject all manner of sovereign public acts to judicial scrutiny under the FSIA by transforming the expropriation exception into an all-purpose jurisdictional hook for adjudicating human rights violations."

Petitioners emphasize that the property in question "must be either present in the United States in connection with a commercial activity or owned by an instrumentality of a foreign state engaged in commercial activity in this country."

Petitioners also contend that the D.C. Circuit applied the wrong procedural standard. "Rather than imposing a burden of production on defendants, plaintiffs bear the burden of producing evidence sufficient to support a finding that current assets were exchanged for expropriated items."

To respondents, the key to this case is the commingling of assets. Respondents emphasize that commingling satisfies the "any property exchanged" element of the expropriation exception.

Respondents contend that "[h]istory and context confirm that Congress didn't want foreign states to get away with stealing property in violation of international law, especially by the simple expedient of commingling funds."

Respondents also assert that they have already shown in the lower courts that both petitioners commingled assets from their ancestors and that they commingled them in connection with commercial activity in the United States.

Respondents allege that the Republic of Hungary stole their money, liquidated it, and commingled the proceeds with national monies. Respondents then allege the Republic of Hungary used those commingled funds to issue bonds and pay bond interest in the United States. As to petitioner MAV, respondents allege that the railroad

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stole their property, liquidated the property, and deposited the money into its accounts. According to respondents, the railroad then engaged in commercial activity in the United States by selling tickets in the United States.

Two other questions presented before the Court are worth noting in brief. Petitioners assert that the lower courts committed two procedural errors, which create separate issues for review in the case. The first one, according to petitioners, is that the lower court imposed a burden of production on sovereign defendants to disprove a commercial nexus with the United States. Petitioners state that the burden should reside with the respondents. Second, petitioners contend that respondents "must make a valid claim that an FSIA exception applies, not an arguable or plausible one."

Respondents contend that the Court does not need to get to second and third questions presented, as they have satisfied the expropriation exception.

Significance

The Federal Republic of Germany, in its amicus brief in support of petitioners, emphasizes that the Court's ruling is significant lest the Court unwisely expand the expropriation exception beyond Congress's intent. It writes that "[r]equiring specific factual allegations, as opposed to merely plausible allegations, prevents the expansion of the expropriation exception far beyond its intended limits."

Similarly, the United States, in its amicus brief in support of petitioners, contends that the commingling theory must be cabined. It explains that "a foreign sovereign's commingling of the proceeds from the sale of expropriated property with its general treasury funds does not transform all of those funds into property 'exchanged for' the expropriated property within the meaning of" federal law.

The 1939 Society and others, in their amicus brief in support of respondents, emphasize that the case is significant because U.S. courts are the "only viable venue" for ensuring justice for Holocaust survivors. They also emphasize how important and prevalent property theft was during the Hungarian Holocaust.

The amici also assert that this case is important to understanding and expanding upon the Court's previous ruling three years ago in *Federal Republic of Germany v. Philipp*, where the Court "unanimously reaffirmed that the expropriation exception of 28 U.S.C. § 1605(a)(3) can apply to Holocaust takings."

Meanwhile, Members of the United States House of Representatives and Senate, in their amicus brief in support of respondents, emphasize that sovereign immunity is a defense that must be affirmatively pled and proven by the defendants. It is a defendant who must prove that an exception does not apply, according to the Members.

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TRANSGENDER RIGHTS

Does Tennessee's Ban on Puberty Blockers and Hormone Therapy to Facilitate a Minor's Sex Transition Violate the Equal Protection Clause?

CASE AT A GLANCE

In March 2023, Tennessee adopted a law that prohibits health-care providers from delivering puberty blockers and hormone therapy to transgender minors to facilitate their transition to another sex. At the same time, the law specifically allows health-care providers to deliver puberty blockers and hormone therapy to treat a minor's congenital defect, precocious puberty, or other conditions. Tennessee contends that the law advances its interests in the health and safety of minors in the state and in protecting the integrity and ethics of the medical profession.

United States v. Skrmetti
Docket No. 23-477

Argument Date: **December 4, 2024** From: **The Sixth Circuit**

by Steven D. Schwinn
University of Illinois Chicago School of Law, Chicago, IL

Introduction

Transgender minors, their parents, and a doctor sued, arguing that Tennessee's ban violates the Fourteenth Amendment's Equal Protection Clause. The United States intervened on behalf of the plaintiffs under a federal law that authorizes the government to intervene in a private equal-protection case. The district court granted a preliminary injunction halting the state's enforcement of the measure, but the Sixth Circuit Court of Appeals reversed.

Issue

Does the Equal Protection Clause prohibit a state from banning health-care providers from delivering puberty blockers and hormones to facilitate a minor's transition to another sex?

Facts

In March 2023, Tennessee adopted a law that bans certain medical treatments for transgender minors to facilitate their transition to another sex. In particular, the law, Senate Bill 1 (SB1), prohibits health-care providers from "[p]rescribing, administering, or dispensing any puberty blocker or hormone" to "[e]nabl[e] a minor to identify with, or live as, a purported identity inconsistent with the minor's sex" or to "[t]reat[] purported discomfort or distress from a discordance between the minor's sex and asserted identity." Tenn. Code Ann. §§ 68-33-102(5)(B) and 68-33-103(a)(1). (SB1 also prohibits surgical procedures for the same purposes, but that ban is not at issue in this case.) SB1 defines "sex" as the "immutable characteristics of the reproductive system that define the individual as male or female, as determined by anatomy and genetics existing at the time of birth." Tenn. Code Ann. § 68-33-102(9).

SB1 says that Tennessee has a "compelling interest in encouraging minors to appreciate their sex, particularly as they undergo puberty," and in prohibiting treatments "that might encourage minors to become disdainful of their sex." Tenn. Code Ann. § 68-33-101(m). The law's findings also describe alleged risks associated with using puberty blockers and hormones to treat minors with gender dysphoria.

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Importantly, SB1 does not ban the provision of puberty blockers or hormones for any other purpose. Indeed, SB1 specifically exempts those treatments for "a minor's congenital defect, precocious puberty, disease, or physical injury." Tenn. Code Ann. § 68-33-103(b)(1)(A).

SB1 specifies that health-care providers who violate the law are subject to civil penalties of $25,000 for each prohibited treatment, professional discipline, and potential civil liability in private lawsuits.

Three transgender minors, their parents, and a Tennessee doctor who treats adolescents with gender dysphoria sued the state and state officials responsible for enforcing SB1, arguing that the law violates the Equal Protection Clause, among other things. The United States intervened in support of the plaintiffs under a federal statute that authorizes the government to intervene in private equal-protection lawsuits "if the Attorney General certifies that the case is of general public importance." 42 U.S.C. § 2000h-2. (As a result, the government is listed as the petitioner in the case caption. The plaintiffs are listed as the respondents in support of the petitioner.)

The district court granted the plaintiffs' motion for a preliminary injunction. The Sixth Circuit Court of Appeals reversed. This appeal followed.

Case Analysis

The government argues that the Court should apply heightened scrutiny in reviewing SB1 for two reasons. For one, the government says that SB1 discriminates based on sex: "Put simply, an adolescent assigned female at birth cannot receive puberty blockers or testosterone to live as a male, but an adolescent assigned male at birth can." For another, the government contends that SB1 discriminates by transgender status. It asserts that "transgender individuals satisfy all of the hallmarks of a quasi-suspect class," including that they are subject to discrimination, that their status is unrelated to their ability to contribute to society, that they are "a discrete and identifiable minority," and that they "have not been able to meaningfully vindicate their rights through the political process in much of the country—as evidenced by the recent wave of laws targeting transgender individuals in Tennessee and other States."

Because the Sixth Circuit did not apply heightened scrutiny (it applied rational basis review), the government argues that the Court should remand the case to allow the Sixth Circuit to apply heightened scrutiny in the first instance.

But if the Court itself applies heightened scrutiny, the government argues that SB1 fails, because the ban is not substantially related to an important government interest. The government says that the state's interest in preventing minors from becoming "disdainful of their sex" is not an important government interest, because it's based on mere stereotype. And the government claims that SB1 is not substantially related to the state's interest in protecting the health and welfare of adolescents. In particular, the government asserts that the state "ignored the benefits of gender-affirming care, substantially overstated the risks of that care, and adopted a categorical prohibition that is both severely overinclusive and severely underinclusive when viewed in light of those risks."

The plaintiffs make substantially similar arguments and add that SB1 fails even rational basis review. According to the plaintiffs, that's because SB1 is so far removed from the state's asserted interests that "it is impossible to credit those interests" as even legitimate.

Tennessee counters that the Court should not apply heightened scrutiny. The state says that SB1 does not classify by sex; instead, it merely distinguishes between "minors seeking drugs for gender transition and minors seeking drugs for other medical purposes." Moreover, the state says that "boys and girls are not similarly situated for purposes of receiving testosterone and estrogen," and that heightened scrutiny therefore does not apply. Tennessee contends that SB1 similarly does not discriminate by transgender status, and even if it did, "this Court should not get back in the fraught business of creating suspect classes."

The state argues that SB1 easily meets rational basis review, and even satisfies heightened scrutiny. Tennessee contends that it has "compelling" interests (even more than what heightened scrutiny requires) in the health and safety of minors in the state and "in protecting the integrity and ethics of the medical profession." The state says that SB1 substantially advances these interests, especially under the deference that the Court should grant to SB1, given the "medical and scientific uncertainty" involved.

Significance

Despite the state's claim about "medical and scientific uncertainty," health-care providers have a long history of safely prescribing puberty blockers and hormone therapy for adolescents and adults with gender dysphoria and other conditions. For example, providers have prescribed puberty blockers to treat gender dysphoria for 20 years

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and precocious puberty for more than 30 years. They have prescribed hormone therapy to treat gender dysphoria in adults for at least 60 years and in adolescents for at least 20 years.

According to leading medical organizations, research shows that these treatments for adolescents reduce depression, anxiety, and suicidal ideation. Several studies show that hormone therapy is associated with reduced suicide attempts and significant improvement in quality of life.

Still, Tennessee is far from alone in banning these treatments. In the last three or four years, state legislatures have adopted a wave of prohibitions on gender-affirming care for minors. Today, at least 22 states ban such care.

The parties argue the case under traditional equal protection doctrine. As a threshold issue under this approach, the Court will need to determine whether SB1 classifies by sex or transgender status. Recall that just four years ago the Court ruled that an employer who fires an employee "merely for being gay or transgender" unlawfully discriminates "because of such individual's sex" in violation of Title VII. *Bostock v. Clayton County, Georgia*, 590 U.S. 644 (2020). *Bostock* does not necessarily foretell the result here, though, for two reasons. First, this case involves the Equal Protection Clause, not Title VII, and the Court could rule that they operate differently. Next, Tennessee argues that SB1's classification is based on age (minor status) and on whether a person seeks puberty blockers or hormone therapy to transition sexes, or for some other purpose. If the Court adopts Tennessee's approach, SB1 doesn't classify based on sex or transgender status at all.

Finally, note what this case does *not* involve: a parent's right to obtain medical treatment for their minor children under the Due Process Clause. The plaintiffs raised this issue below; the district court ruled in their favor, but the Sixth Circuit reversed. The government did not seek review on this issue in its writ of *certiorari*.

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CRIMINAL LAW

Does Deceiving a Party to Enter into a Contract Qualify as Mail or Wire Fraud, Even if Inflicting Economic Harm on the Victim Was Not the Object of the Scheme?

CASE AT A GLANCE

This case brings fraudulent inducement to the forefront as the justices are being asked to decide how far criminal law extends to cover deceptive acts. The petitioner lied about its compliance with a disadvantaged business enterprise (DBE) program to gain a lucrative contract but claimed its criminal conviction was unjustified since the petitioner performed all of the work it promised.

Kousisis v. United States
Docket No. 23-909

Argument Date: **December 9, 2024** From: **The Third Circuit**

by David Weisenfeld
Princeton, NJ

Introduction

While federal law has long criminalized mail and wire fraud, this dispute involves how broadly these statutes can reach to obtain a fraud conviction. The federal appellate courts have been divided as to whether someone commits mail or wire fraud by fraudulently inducing a commercial exchange or whether that person or company must intend to inflict economic harm.

Adding intrigue is that this case involves a company's clear end-run around a government agency's disadvantaged business enterprise (DBE) program. The deceit seemingly could not be more obvious, but did it rise to the level of mail or wire fraud?

The Supreme Court has pumped the brakes on finding criminal liability in recent years where a party did not intend to obtain property from the victim and monetary losses were not the object of the scheme.

This occurred most notably in the infamous "Bridgegate" scandal in which the Court threw out the convictions of two former aides to then-New Jersey Governor Chris Christie for improperly closing down access lanes to the George Washington Bridge. The Court held that while the evidence showed deception, corruption, and abuse of power, the aides should not have been prosecuted under the fraud statutes because they did not obtain money or property for themselves through their actions.

The current case presents a much different scenario, though, while also including a racial element to the contract that may pique the interest of several of the justices.

Issues

Does deception to induce a commercial exchange constitute mail or wire fraud, even if inflicting monetary harm was not the goal of the scheme?

Is a sovereign's statutory, regulatory, or policy interest a property interest when compliance is a material term of payment for goods or services?

Facts

When the Pennsylvania Department of Transportation (PennDOT) put a pair of major construction projects up

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for bid, including one to repair and repaint Philadelphia's 30th Street Station, the Alpha Painting and Construction Company went all in for the work.

PennDOT conditioned that bidders comply with its DBE participation goals for each project. Specifically, the agency required that at least 7 percent of the contract amount for the 30th Street Station project and at least 6 percent of the contract amount for the bridge project go to a DBE.

To qualify as a DBE, a business must be "at least 51 percent owned by one or more individuals who are both socially and economically disadvantaged," and must have its management and daily business operations controlled by one or more of the socially and economically disadvantaged individuals who own it.

Once hired for a project, a DBE must then perform a commercially useful function, such as actually performing, managing, and supervising some of the work involved.

The contracts singled out any failure to comply with the DBE-inclusive requirements as a "material breach of the agreement."

Alpha was undeterred and submitted the winning bids for both projects. In submitting its bids, Alpha committed to working with Markias, Inc., a prequalified DBE in Pennsylvania. As part of the contracts, Alpha represented that it would obtain $6.4 million in paint supplies from Markias.

But as the Romans might say, a funny thing happened on the way to the Forum. Markias did not do any work on the projects or supply any of the projects' materials.

Alpha employee Stamatios "Tom" Kousisis sent Markias a letter specifying that Alpha would identify the actual suppliers for the products that it needed. Alpha would then negotiate prices and terms with those suppliers and create fraudulent purchase orders in Markias's name.

In short, Markias was a mere "pass-through" to show DBE compliance. Throughout the process, Alpha concealed that Markias was doing no work by having the real paint suppliers send their invoices to Markias. The ostensible DBE then issued its own invoices for its troubles, which added a 2.25 percent fee to Alpha, and Alpha submitted those marked-up invoices to PennDOT.

Alpha delivered all of the requested work on both projects but without real help from a DBE. In reliance on the submissions certifying that Markias acted as a "regular dealer" in supplying products on both Philadelphia projects, PennDOT paid the petitioners as though they were complying with the DBE requirements.

Alpha turned a gross profit of more than $21 million on the projects. Meanwhile, Markias received more than $170,000 by adding its agreed-upon 2.25 percent to each transaction that petitioners passed through it.

Upon learning of the scheme, the government brought criminal charges. Following a jury trial in federal district court, the petitioners were convicted on one count of conspiring to commit wire fraud, three counts of wire fraud, and seven counts of causing a false statement to a government agency.

The district court sentenced Kousisis to 70 months in jail, ordered Alpha to forfeit 100 percent of its profits on the projects, and imposed a $500,000 fine.

On appeal, the Third Circuit affirmed the petitioners' convictions, though it reversed the district court's loss calculation and remanded for resentencing. In upholding the convictions, the appeals court reasoned that "DBE participation was an essential component of the contract" without which the contract certainly would have been different.

The Third Circuit also found that the petitioners secured PennDOT's money using false pretenses, and that the value PennDOT received from the petitioners' services was no defense to criminal prosecution for fraud.

Case Analysis

While the facts may appear rather bleak at first glance for the petitioners, they claim that another recent Supreme Court ruling, *Ciminelli v. U.S.*, 598 U.S. 306 (2023), cuts in their favor.

In *Ciminelli*, the justices found that a scheme to defraud contemplates harm to a traditional property interest. They noted that the mail and wire fraud statutes do not criminalize garden-variety disputes that typically have been the province of "state contract and tort law."

That case also involved a defendant procuring a multi-million-dollar government contract by way of misrepresentation. The Court held unanimously that a person who schemes to deprive the victim of potentially valuable economic information needed to make economic decisions does not commit wire fraud.

Citing *Ciminelli*, the petitioners claim that they did not deprive PennDOT of any property interest. The petitioners assert that the quality of their workmanship on the projects

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was uncontested. What's more, they argue, there is no evidence that the people who supplied the paint for the repairs raised PennDOT's price or lowered the value of the petitioners' work.

The petitioners reiterate that not every deception rises to the level of fraud and cite a host of hypotheticals to illustrate the dangers of the government's fraud rule. For instance, the used car salesperson's false assertion that another person is coming to look at the same car later that day could be prosecuted for fraud. The same holds true, the petitioners claim, for any job applicant that embellishes tasks performed in a past position.

The government painstakingly disputes each of those points and calls the petitioners' scheme "classic property fraud." The petitioners' misrepresentations went to the very essence of the bargain in avoiding DBE compliance and securing PennDOT's money under false pretenses.

The respondent rejects the petitioners' contention that the wire fraud statute's text requires proof of a net pecuniary loss. It should be enough, the respondent claims, that PennDOT was induced to take something different than what it thought it had bargained for in the contract. But even if one accepts the petitioners' argument, the respondent contends that the petitioners would still lose.

For instance, PennDOT overpaid for what it received due to the fake DBE's 2.25 percent markup for doing nothing. In essence, the agency paid extra for something that was worthless through the more than $170,000 that it paid to Markias, an amount it would not have paid but for the petitioners' false certification of DBE participation. Thus, the government says, it indeed suffered a monetary loss as a result of the fraud.

If the petitioner wins, the government adds, a contractor that obtained a valuable contract by misrepresenting their business as veteran-owned might avoid liability by arguing they performed satisfactory work.

Finally, the government notes that Congress judged the protecting of property rights from frauds to be an important federal interest. For all of these reasons, the government urges the Supreme Court to affirm the Third Circuit's ruling.

Significance

This dispute presents the Supreme Court with another opportunity to define the scope of criminal mail and wire fraud under federal law. It also marks the second time in less than two years that the justices have delved into a criminal law case involving a fraudulent inducement theory.

A ruling in the government's favor would better protect agencies like PennDOT if they are duped by a party's false pretenses with an intent to defraud. As the Third Circuit noted, the petitioners set out to obtain millions of dollars they would not have obtained but for their fraudulent misrepresentations. The risk of harsh criminal penalties would also provide a deterrent for parties from evading key contract terms with falsehoods.

In addition, it would safeguard disadvantaged business enterprise programs like the one PennDOT seeks to enforce. PennDOT's willingness to pay more for DBE-compliant projects should highlight the materiality of the DBE conditions in the contracts. Without such protections, these DBE programs could become little more than empty promises.

But the amici have all lined up on the petitioner's side. They argue that the government's theory would overcriminalize a vast array of conduct and transform every scheme to deceive—from fibbing on a college application to home selling—into a crime.

A ruling for the petitioner would likely leave claims like the one at issue in this case to state contract or tort law. It also would place limits on the reach of fraud. It also would limit the reach of fraud statutes to those instances when a traditional property interest is harmed.

One possibility is that the Supreme Court may agree that a victim must show a money or property loss for there to be a finding of criminal mail and wire fraud but decide that the government met its burden in this case. After all, at minimum, PennDOT suffered a loss by overpaying for the fee Markias obtained as a fake DBE doing no actual work on the projects.

Then again, the justices rejected the government's fraudulent inducement claim in *Ciminelli*, so perhaps it is telling that the Supreme Court agreed to hear the petitioner's appeal when they easily could have sidestepped the case. Whatever the Court decides is likely to affect a host of white-collar prosecutions going forward.

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David Weisenfeld has reported on the Supreme Court for many years and hosted a podcast for LexisNexis Risk Solutions from 2012–2022 that won national and regional first place awards for his Supreme Court coverage. He can be reached at davesdugout@yahoo.com or 609-571-7375.

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VETERANS RIGHTS

Is a Federal Civilian Employee Called to Active Duty During a National Emergency Entitled to Differential Pay Even if the Duty Is Not Directly Connected to the National Emergency?

CASE AT A GLANCE

This case involves an important pay question affecting hundreds of thousands of Americans who serve their country both as federal civilian employees and members of the Armed Services' Reserves. At issue is whether these service members can maintain their civilian salaries when they are called up or ordered to active duty during an ongoing national emergency.

Feliciano v. Department of Transportation
Docket No. 23-861

Argument Date: **December 9, 2024** From: **The Federal Circuit**

by David Weisenfeld
Princeton, NJ

Introduction

The financial burden on reservists, and their families, is significant if they can be called to active duty without safeguards in place to protect their income. To ease that burden, Congress enacted a differential pay statute shortly after the September 11, 2001, terrorist attacks requiring the government to make up the difference between reservists' civilian pay and their military pay, which is typically much lower.

The Reservists Pay Security Act provided that these employees are entitled to receive their ordinary civilian pay during active-duty service so long as they are called to active duty under any "provision of law during a war or during a national emergency declared by the President or Congress."

The Supreme Court is being asked to decide whether the differential pay statute covers all active-duty service or if there are limits to the law's reach, such as more of a direct connection to a national emergency or a war.

Many states also have enacted differential pay statutes, and many private employers have adopted similar policies as well to aid employees who serve in the reserves. They have taken a keen interest in this case as a result.

Issue

When the military orders a federal civilian employee to active duty during a national emergency, is it relevant for purposes of receiving differential pay if the individual's duty is not directly connected to the emergency?

Facts

Nick Feliciano worked as a civilian air traffic controller with the Department of Transportation (DOT) and also served as a member of the Coast Guard Reserve. From 2012 to 2017, he was absent from his air traffic controller position to perform active-duty military service in the Coast Guard.

After completing a period of involuntary active-duty service, Feliciano performed an additional 14 months of consensual active-duty military service. His activation orders for the latter service stated that his call-up was in support of a Department of Defense "contingency

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operation." More specifically, the order noted that the military activated Feliciano in support of Operation Iraqi Freedom.

Under both activation orders, Feliciano manned a Coast Guard vessel to escort other military vessels to and from safe harbor while protecting both the ships and the harbor. But despite performing identical duties when called to serve under each order, Feliciano experienced an unpleasant surprise. Namely, the DOT failed to provide him differential pay for the portion of his service performed under the latter order.

Feliciano challenged the differential pay denial as a violation of the Uniformed Services Employment and Reemployment Rights Act (USERRA), but the Merit Systems Protection Board (the "Board") refused to grant him relief.

Citing a new Federal Circuit ruling in *Adams v. DHS*, 3 F.4th 1375 (2021), *cert.* denied, 142 S. Ct. 2835 (2022), the Board found that *Adams* required a reservist seeking differential pay to present evidence that he was "directly involved in a contingency operation" to qualify for the pay.

In light of its recent holding, the Federal Circuit affirmed that ruling for the DOT in a nonprecedential decision. Citing *Adams*, the appellate court held that Feliciano was ineligible to receive differential pay because it found his service did not qualify as an active-duty contingency operation.

For voluntary activation to qualify as a contingency operation, the Federal Circuit reasoned, "there must be a connection between the voluntary military service and the declared national emergency." The court concluded that such evidence of a direct connection was lacking and that Feliciano failed to show why his case merited a different outcome from the *Adams* decision.

Case Analysis

In urging the Supreme Court to reverse, the petitioner argues that this case could not possibly be any clearer. It claims that Congress crafted the Reservists Pay Security Act to sweep broadly to cover all active-duty service members.

The petitioner asserts there is nothing in the statutory text limiting the act only to situations with a substantive connection between a reservist's service and an ongoing national emergency. In addition, it notes the goal of the legislation was to ensure that federal employees serving in the military reserves get the same pay as they earn in their civilian jobs when they are called up for active duty.

To eliminate any doubt about congressional intent, the petitioner adds that the drafters of the legislation filed an amicus brief backing their position about the law's intent. But even if there is any question in the justices' minds, the petitioner argues that the proveteran canon requires resolving any ambiguity in the petitioner's favor.

The government counters that Congress, in fact, rejected broad language that would have accomplished the petitioner's preferred outcome of differential pay for all active-duty service. It contends that the petitioner's argument would effectively redefine a "contingency operation" to mean any operation resulting in a call to active-duty service.

The government notes that there are 43 ongoing national emergencies with one continuously in effect since 1979 and others in effect for more than 25 years. Many of those emergencies have no direct connection to any U.S. military activities because they were declared mainly as predicates for imposing economic sanctions on certain countries or entities.

If a specific operation listed on a service member's orders is part of a declared national emergency, the government asserts that they have been called up during a national emergency and are entitled to differential pay.

But it claims that situation did not occur in this case, and notes that the petitioner neither submitted a request for differential pay nor provided the Federal Aviation Administration with the necessary documentation. In short, the petitioner argued he was entitled to differential pay simply because there has been a national emergency declared by the president since 9/11.

To bolster its point, the government contends that if in late 2020 a service member was called to active-duty service via orders relying on the COVID-19 national emergency, their service would have been in the course of that national emergency and they would have been entitled to differential pay. But if they were called up at the same time under "non-contingency activation orders," they would not be entitled to differential pay.

The petitioner argues, however, that the government's assertions are little more than a hodgepodge that badly misses the mark. The petitioner concludes that the government and the Federal Circuit have contradicted

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the statute's mandate that qualifying reservists reserve differential pay as Congress intended.

Significance

It is no secret that the salary gap between military duty and civilian work can be considerable. A Supreme Court ruling for the government would have disastrous consequences for the nation's reservists, according not just to the petitioner but to the many amici lined up on its side.

Multiple veterans groups, a government employees union, the aforementioned drafters of the legislation, plus a group of 21 states and the District of Columbia are all urging the justices to reverse the Federal Circuit's ruling.

More than one million Americans serve in the reserves, of whom about 200,000 work for the federal government as civilian employees. A ruling for the DOT would potentially obstruct access to differential pay for many of these reservists.

Such a result also could make the military's recruiting efforts more difficult while also acting as a disincentive for private employers to offer differential pay because they may be subject to criminal liability if they provide this compensation in error.

In contrast, a ruling in the petitioner's favor would undoubtedly open the door to numerous other reservists in Feliciano's situation receiving differential pay. That may not appear to be such a bad outcome considering the sacrifices these reservists make. But the government asserts why it believes that differential pay should not apply for all service members.

"Reservists can be called to active duty to be court-martialed for offenses they previously committed while on active duty or inactive duty for training," the government notes. Under the petitioner's interpretation, that reservist would be entitled to receive differential pay because they were called to active duty and national emergencies happen to be ongoing at the time of the court-martial.

While many of the justices are certainly known to enjoy a good hypothetical on occasion, they need not go that far to resolve this case, and will likely look to the congressional intent behind the Reservists Pay Security Act for guidance.

David Weisenfeld has reported on the Supreme Court for many years and hosted a podcast for LexisNexis Risk Solutions from 2012–2022 that won national and regional first place awards for his Supreme Court coverage. He can be reached at davesdugout@yahoo.com or 609.571.7375.

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ENVIRONMENTAL LAW

Does the National Environmental Policy Act Require an Agency to Study the Environmental Impacts of an Action Beyond the Proximate Effects of the Action over Which the Agency Has Regulatory Authority?

CASE AT A GLANCE

Seven County Infrastructure Coalition petitioned the Surface Transportation Board for approval of a new 88-mile railway line connecting the Uinta Basin, a 12,000-square-mile area spanning northeastern Utah and northwestern Colorado, to the existing interstate freight rail network in Kyune, Utah. The principal purpose of the new railway line was to facilitate the transportation of waxy crude oil from the Uinta Basin to oil refineries. Pursuant to the National Environmental Policy Act (NEPA), the board assessed the environmental impacts of the project and issued an environmental impact statement (EIS). The EIS did not examine the downstream effects of the railway on the environmental harm to communities where the refineries are located, climate change, or downline effects, such as wildfires, rail accidents, and water contamination, in Colorado.

Seven County Infrastructure Coalition v. Eagle County, Colorado
Docket No. 23-975

Argument Date: **December 4, 2024** From: **The D.C. Circuit**

by Steven D. Schwinn
University of Illinois Chicago School of Law, Chicago, IL

Introduction

The National Environmental Policy Act (NEPA) requires federal agencies to consider the reasonably foreseeable environmental effects of a proposed agency act. In *Department of Transportation v. Public Citizen*, 541 U.S. 752 (2004), the Court held that NEPA does not require an agency to study the environmental effects of a project when the agency cannot prevent those effects because it has "limited authority over the relevant actions." Applying these principles, the parties dispute whether the Surface Transportation Board sufficiently considered upstream, downstream, and downline effects of the Seven County Infrastructure Coalition's (the Coalition) proposed railway line.

Issue

Did the Surface Transportation Board sufficiently assess the upstream, downstream, and downline effects of the Seven County Infrastructure Coalition's proposed railway line?

Facts

In May 2020, the Seven County Infrastructure Coalition, an "independent political subdivision of the State of Utah" that includes seven different member counties, petitioned the federal Surface Transportation Board (the Board) for approval of a new railway line in the state. The Coalition sought to develop an 88-mile-long railway line connecting the Uinta Basin (the Basin), a 12,000-square-mile area spanning northeastern Utah and northwestern

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Colorado, to the existing interstate freight rail network in Kyune, Utah.

The Coalition's proposed railway line would provide a new option for transporting goods in and out of the Basin. At the time, because of the geography of the Basin, only trucks could gain access to it, and only by way of two-line highways that cross high mountain passes. Although the new railway would facilitate the transportation of any goods produced or consumed in the Basin, its "predominant and expected primary purpose [was] the transport of waxy crude oil produced in the Basin."

Pursuant to requirements under the NEPA, the Board issued a lengthy environmental impact statement (EIS) for the railway. (The Board conducted its review through its Office of Environmental Analysis (OEA).) The EIS included an assessment of the project's impact on the environment in and around the Basin and the construction site. As part of the "cumulative impacts," the EIS estimated the amount of new oil and gas that might be produced and analyzed the environmental effects of that increased production "on each relevant resource in the Basin to the extent that it could without any information regarding specific projects and plans."

The EIS also included some assessment of the "downstream" effects of the railway. For example, the EIS concluded that new gas and oil production from the project "would represent approximately 0.8% of nationwide greenhouse gas emissions and 0.1% of global emissions" at the high end.

The Board also issued an appendix to the final EIS that responded to public comments on the earlier draft. In response to some comments that asked the Board to consider the environmental impacts of potential future oil and gas development projects in the Basin, the Board explained that further analysis of those effects "would not inform the Board's decision." The Board also addressed the downstream effects on oil refineries in and around Salt Lake City, which have "limitations on the volume of crude oil" they can accept. But the Board did not address the downstream effects on refineries in other locations, although it acknowledged that the railway might increase the transportation of oil to those other refineries.

The Board then approved the project. In its final decision, the Board reviewed and reaffirmed its analysis in the EIS and rejected the contention that it did not sufficiently consider the upstream and downstream effects of oil production and refining.

Eagle County, Colorado, and several environmental organizations (the plaintiffs) appealed the Board's decision, arguing that the Board's EIS ignored the upstream and downstream effects of the railway in violation of NEPA, among other things. The United States Court of Appeals for the D.C. Circuit ruled for the plaintiffs, and the *en banc* court denied review. This appeal followed.

Case Analysis

As originally enacted, NEPA required federal agencies to prepare a "detailed environmental impact statement" for proposed projects that included the project's "environmental impact" and any unavoidable "adverse environmental effects." NEPA § 102(c)(i) and (ii). Regulations adopted by the Council on Environmental Quality (CEQ), the agency charged with implementing NEPA, specified that federal agencies should consider the "reasonably foreseeable" environmental effects of their actions. 40 C.F.R. § 1508.8(b). CEQ refined that regulation in 2020 to define "[r]easonably foreseeable" to mean "sufficiently likely to occur such that a person of ordinary prudence would take it into account in reaching a decision." 40 C.F.R. § 1508.1(aa). (In 2023, after the Board's decision in this case, Congress amended NEPA to say that agencies should consider the "reasonably foreseeable environmental effects of the proposed agency action." 42 U.S.C. § 4332(C)(i).)

In *Department of Transportation v. Public Citizen*, 541 U.S. 752 (2004), the Court held that NEPA does not require an agency to study the environmental effects of a project when the agency cannot prevent those effects because it has "limited authority over the relevant actions."

The parties wrangle over the extent of the "reasonably foreseeable" environmental effects of the railway in light of *Public Citizen*. In particular, the parties dispute whether NEPA required the Board to consider environmental effects that fell outside the Board's regulatory authority. More generally, the parties dispute whether NEPA required the Board to consider the upstream, downstream, and downrail effects of the railway.

The Coalition argues that NEPA and the Court's cases interpreting it only require the Board to consider the railway's closely related environmental impacts. According to the Coalition, this means that NEPA only requires an agency to consider environmental effects with a "reasonably close causal relationship" to the

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project such that there's a "proximate cause" "between the environmental effect and the alleged cause," and only when the agency "has…statutory authority over" the environmental "effect."

The Coalition argues that the D.C. Circuit improperly required the Board to consider more. For example, it says that any remote effects of the railway on climate change, the environment in Gulf Coast communities (where refineries are located), and downline train accidents or other downline effects "are far removed in geography and time" or "are separated by multiple intervening causes that themselves are non-environmental and highly uncertain" and therefore well beyond NEPA's requirements. Moreover, the Coalition contends that the D.C. Circuit wrongly concluded that the Board bound itself to consider these kinds of remote effects by assessing them in the EIS.

The Coalition also argues that the D.C. Circuit's ruling violates NEPA's "rule of reason." According to the Board, this rule gives an agency discretion to ignore or to give more cursory treatment to the remote effects of a project, and it prevents courts from requiring agencies to consider those effects. The Coalition claims that the D.C. Circuit did just that.

In sum, the Coalition contends that NEPA only requires agencies "to consider a proposed project's environmental impact," not "to operate as a substantive obstacle to" it. The Coalition says that the D.C. Circuit's ruling crossed this line.

The government intervened in support of the Coalition and makes similar arguments about the scope of NEPA's requirements. But unlike the Coalition, the government contends that NEPA does not allow an agency to "impose artificial restrictions on its NEPA analysis." For example, according to the government "[a]n agency may not… exclude consideration of an effect merely because the agency does not directly regulate it or because other agencies share regulatory authority…." Moreover, the government contends that an agency may not "impose arbitrary bright-line limits based on rigid measures of geographic distance, the timing of an effect, or the number of other actors that may contribute to it." Finally, the government says that "agencies cannot apply the same tort-law standards of proximate cause given NEPA's different purposes and framework." All that said, the government agrees with the Coalition that the Board's EIS reasonably satisfied NEPA's requirements.

As an initial matter, Eagle County counters that the Coalition's objection to the D.C. Circuit's evaluation of downline impacts is not properly before the Court. Eagle County says that the Coalition's petition for *certiorari* was limited to its argument that the D.C. Circuit erred in declining to consider the upstream and downstream effects of oil and gas development. It claims that these effects do not include the *downline* impacts (wildfires, rail accidents, and water contamination) in Colorado. In any event, Eagle County asserts that the Court should not disturb the D.C. Circuit's *vacatur* of the Board's EIS with respect to downline impacts.

Eagle County argues next that NEPA requires agencies to assess the "reasonably foreseeable" impacts of a project. Eagle County says that "decades of circuit precedent and…CEQ regulations" teach that this "turns on the materiality of information for the decisionmaker": "If an effect is sufficiently likely to occur that a prudent person would take it into account in reaching a decision, then it is reasonably foreseeable."

Eagle County contends that this standard must be broader than the scope of private tort liability (as the Coalition would have it) in order to serve "NEPA's goal of ensuring that the agency and the public writ large are informed of the reasonably foreseeable outcomes of a project." Moreover, Eagle County claims that the scope of NEPA review is not limited to effects over which the lead agency has jurisdiction. According to Eagle County, NEPA contemplates that the lead agency (in this case the Board) will cooperate with any other state or federal agencies that share expertise or jurisdiction.

Eagle County argues that the Board's EIS failed to meet these standards. In particular, Eagle County says that the Board improperly disregarded the increased risk of wildfires from the increase in train traffic, failed to evaluate the effect of increased rail traffic on the Colorado River, and incorrectly evaluated the risk of accidents on the line by relying on nationwide rates of derailment. Eagle County claims that the D.C. Circuit properly rejected the Board's EIS for failing to assess these downrail effects.

Significance

At bottom, this case tests the extent of the "reasonably foreseeable" environmental effects that a federal agency must consider as part of its EIS for a proposed project. In particular, the case tests whether an agency must consider downstream effects that fall outside its regulatory

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authority. (The parties argue this point in their briefs, but they also argue more generally over the scope of "reasonably foreseeable" environmental effects.)

On the one hand, by the Coalition's reckoning, the D.C. Circuit's overly broad approach has caused significant delays and costs for proposed projects. The Coalition writes,

> NEPA litigation has flooded in, swelling agency wait-times and project costs. On average, completing an EIS takes an agency 4.5 years; 25% take more than 6 years; some take more than 15 years. The average length of a final EIS runs 661 pages; 25% stretch past 748 pages; some—including the 3,600-page EIS here—balloon to over 2,000 pages.
>
> Fearing the risk of being sued in the D.C. Circuit—where most agencies are headquartered—"[a]gencies will seek to protect EISs from legal challenges by producing piles of paperwork that exhaustively discuss every potential impact of the proposed action." Although that may sometimes help "creat[e] a 'bullet-proof' EIS," it also engenders "prolonged delays" in a world where agencies are working on hundreds of EISs at any given time.

On the other hand, as Eagle County and some of its amici argue, NEPA's very purpose (as evidenced by the most recent amendments) is to require agencies to consider all reasonably foreseeable results, not just those that fall within the agency's regulatory purview, and to take a more holistic view of the results.

To state the obvious: the Coalition's position would limit an agency's review of the environmental impacts of a proposed action and thus most likely increase the agencies' rate and speed of approval, while Eagle County's position would have the opposite effect.

Given the Court's trend of striking environmental regulations and restricting agencies' powers, look for it to lean toward the Coalition as it draws the line of "reasonably foreseeable" effects in this case.

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TRADEMARK LAW

The Many Pockets of *Dewberry*: Do the Principles of Equity Allowing District Courts to Fashion Remedies in Lanham Act Cases Support a Damages Award Based on Profits of Nonparty Corporate Affiliates?

CASE AT A GLANCE

The litigants in this long-running dispute both use the surname "Dewberry" to market their respective services in the real estate development industry. Plaintiff Dewberry Engineers, Inc., prevailed in its trademark infringement action brought under the federal Lanham Act against defendant Dewberry Group, Inc. The parties disagree as to whether revenues from Dewberry Group's corporate affiliates not named in the lawsuit can be considered in the calculation of profit disgorgement.

Dewberry Group, Inc. v. Dewberry Engineers, Inc.
Docket No. 23-900

Argument Date: **December 11, 2024** From: **The Fourth Circuit**

by Kelly Casey Mullally
Atlanta, GA

Introduction

The Lanham Act provides that a successful plaintiff "shall be entitled…subject to the principles of equity, to recover…defendant's profits," among other remedies. In awarding damages here, the district court used its discretion to look beyond the pockets of defendant Dewberry Group to the pockets of Dewberry Group's affiliates, even though the affiliates were not named in the lawsuit and are separate corporate entities. The district court's decision, affirmed by the Fourth Circuit, that Dewberry Group and its affiliates should be treated as a single corporate entity for purposes of calculating the revenues generated by Dewberry Group's infringement was the difference between $0 and nearly $43 million in profit disgorgement.

Issue

Can an award of the "defendant's profits" under the Lanham Act include an order for the defendant to disgorge the distinct profits of legally separate nonparty corporate affiliates?

Facts

The trademark dispute underlying this case spans two decades. The litigants both claim rights to the Dewberry name. Respondent Dewberry Engineers, Inc., was founded in the 1950s as a civil engineering and surveying firm in Virginia. Over the years, it expanded its operations to include real estate development services across the nation. Respondent owns two federally registered trademarks for the name "Dewberry."

Petitioner Dewberry Group, Inc., formerly known as Dewberry Capital Corporation, is owned by real estate developer John Dewberry. Petitioner is based in Georgia and is engaged in commercial real estate development through numerous separately incorporated, affiliated companies that are also owned and controlled by John Dewberry. The affiliated companies own commercial properties for lease in Georgia, Virginia, South Carolina, and Florida. Petitioner provides accounting, human resources, legal, and real estate development services exclusively to those affiliates and, on a more limited

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basis, to John Dewberry himself. The affiliates have no employees, and their business address is the same as petitioner's. Petitioner is neither the parent nor the subsidiary of any of the affiliates, but petitioner maintains the affiliates' financial records. In exchange for its various services, petitioner receives fees from the affiliates in amounts set by contract. The fees were the result of "non-arm's length" negotiations and are insufficient to cover petitioner's operating costs.

After confronting each other regarding their respective uses of "Dewberry," the parties first became engaged in litigation in 2006. The parties resolved the lawsuit through a confidential settlement agreement in 2007 that allowed respondent to continue to use its registered marks and restricted petitioner's use of "Dewberry." The parties peacefully coexisted on this basis for a time.

Ten years later, petitioner rebranded its business from "Dewberry Capital," a name allowed under the settlement agreement, to "Dewberry Group" and created subbrands that used "Dewberry" in the names, such as "Dewberry Office" and "Studio Dewberry." Petitioner also sought federal registration of a series of "Dewberry" marks and provided its affiliates with new marketing materials, such as leasing and loan documents and physical signs for use at the commercial properties owned by the affiliates. Petitioner's affiliates then used those materials to market commercial properties and services to prospective clients.

Respondent sued in 2020, asserting breach of the settlement agreement along with trademark claims under the Lanham Act based on petitioner's rebranding. Respondent named petitioner as the only defendant, and during the course of the case, the parties litigated only the liability of petitioner. Ultimately, the district court entered summary judgment in favor of respondent on each claim, holding that petitioner was liable for breach of contract and trademark infringement. The focus of the case then shifted to remedies.

After a three-day bench trial directed solely to the appropriate quantum of damages stemming from petitioner's infringing activities, the district court awarded respondent relief that included nearly $43 million in disgorgement profits. To arrive at that figure, the court could not use petitioner's profits because it was undisputed that, based on its tax returns, petitioner was operating at a loss. Instead, the district court determined that revenues from petitioner's affiliates belong in the calculation of profit disgorgement. Judge Liam O'Grady found that the affiliates "do not and cannot perform the work and services necessary to generate revenues," noting "the economic reality of how…[petitioner's] business actually operates." The court pointed out that all revenues generated through petitioner's services show up exclusively on the affiliates' books and that John Dewberry has contributed at least $23 million to cover petitioner's losses over the past 30 years. The opinion further explained that "but-for the revenue generated by [the affiliates,]…[petitioner] as a single tax entity would not exist."

On appeal, a split Fourth Circuit panel affirmed. The court acknowledged that it would ordinarily be necessary to determine that circumstances warrant "piercing the corporate veil"—a judicial determination that allows legally separate corporate entities to be treated as each other's alter egos—to justify imposing damages based on the profits of another corporation that was not a named party. The majority noted, however, that in this case, the district court had authority under the Lanham Act to weigh the equities of the dispute and fashion remedies accordingly. Ultimately, the Fourth Circuit majority held that the district court had properly exercised its discretion to include the profits of petitioner's nonparty affiliates in arriving at the damages award.

Judge Marvin Quattlebaum dissented. In his view, respondent should have either joined the affiliates as parties or made the showing necessary for piercing the corporate veil. He wrote that he "know[s] of no law that allows courts, in assessing the profits of a defendant, to disregard those options and simply add the revenues from nonparties to a defendant's revenues for purposes of evaluating the defendant's profits."

Case Analysis

The Lanham Act entitles a successful plaintiff, "subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action." 15 U.S.C. § 1117(a). The statute further provides in relevant part:

> The court shall assess such profits and damages or cause the same to be assessed under its direction. In assessing profits the plaintiff shall be required to prove defendant's sales only; defendant must prove all elements of cost or deduction claimed. In assessing damages the court may enter judgment, according to the circumstances of the case, for any sum above the amount found as actual damages, not exceeding three times such amount. If the court

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shall find that the amount of the recovery based on profits is either inadequate or excessive the court may in its discretion enter judgment for such sum as the court shall find to be just, according to the circumstances of the case. Such sum in either of the above circumstances shall constitute compensation and not a penalty.

The dispute before the Court centers on the corporate entities that can be considered in awarding profit disgorgement under Section 1117(a).

Petitioner takes issue with the lower courts' "disregard of corporate separateness," asserting that the Lanham Act does not allow profit disgorgement of nonparty affiliates without piercing the corporate veil. Emphasizing the statutory text of "*defendant's* profits," petitioner begins by arguing that the plain language of the statute makes clear than profits earned by nonparties cannot be included in a disgorgement award. Petitioner asserts that its affiliates, nonparties to the case, "received" and "earned" all of the profits from the infringing activities. Further, petitioner—the sole defendant—has no profits stemming from the infringement to disgorge. It is undisputed that petitioner suffered net losses for the years relevant to the case and thus, petitioner asserts, disgorgement of "defendant's profits" is impossible.

Petitioner also argues that the principles of equity relied upon by the courts below are limited. In particular, they cannot override the "bedrock rule of corporate separateness that controls absent veil-piercing[.]" Petitioner asserts that the Lanham Act must be read against the background of preexisting common-law principles, which cannot be displaced unless Congress "speak[s] directly to the question." Congress did not do so here, and courts cannot step in and rewrite the rule of corporations' limited liability, petitioner asserts. Petitioner also argues that the courts' equitable discretion under the Lanham Act is cabined by traditional restrictions on disgorgement awards. For instance, requiring a defendant to disgorge profits that accrued to a separate entity would constitute a penalty, petitioner says, and "equity will not enforce a penalty." Countering an argument advanced by respondent related to Section 1117(a)'s "just-sum provision" discussed further below, petitioner reiterates the importance of corporate separateness and the constraints inherent in principles of equity and argues that they apply to the just-sum argument as well.

Lastly, petitioner argues that the Fourth Circuit's "policy-driven solution" was improper and "profoundly harmful" to business operations, pointing to the court of appeals' concern that allowing defendants to insulate their infringement from financial consequences through the use of corporate formalities would contravene "Congress's fundamental desire to give trademark registrants under the Lanham Act 'the greatest protection that can be given them.'" Petitioner notes the existence of other remedies available to trademark holders under the Lanham Act to fulfill the goals of the act. It further warns that allowing "[f]reewheeling disregard of corporate separateness would introduce substantial uncertainty into business operations" and that the Fourth Circuit's approach, if adopted by the Supreme Court, would extend to other statutory schemes that authorize profit disgorgement.

Respondent in turn asserts that this case is not about a challenge to corporate separateness. Instead, respondent reframes the threshold issues as relating to the evidence relevant to determining an infringer's true infringement-related economic gain. Leading with an argument that was not a focus of the courts below, respondent points to language in Section 1117(a) providing, "[i]f the court shall find that the amount of the recovery based on profits is either inadequate or excessive the court may in its discretion enter judgment for such sum as the court shall find to be just, according to the circumstances of the case." According to respondent, profits are "inadequate" under the statute where the infringer's accounting records do not reflect the infringer's true financial benefit from the infringement. It further argues that the foregoing just-sum provision supports the award in this case even though the district court did not state it was relying on that statutory language.

Respondent also emphasizes the structure of the financial and operating arrangements among petitioner, its affiliates, and their common owner, John Dewberry. It points out that petitioner's services promoting, managing, and operating all of the affiliates' properties—which petitioner did using the infringing marks—were indispensable to generating the affiliates' substantial profits. That petitioner did not receive or retain all the funds attributable to its infringement, or treat the funds as its own money for accounting and tax purposes should not allow petitioner to avoid the economic consequences of its infringing behavior, respondent asserts. It further argues that petitioner chose to accept fees that were negotiated in a non-arm's-length transaction and that did not cover

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petitioner's operating expenses. Respondent posits that the Court should not ignore this "economic reality" in considering the district court's exercise of its statutorily mandated discretion to impose and quantify awards for infringement under the Lanham Act.

Countering arguments raised by petitioner and in Judge Quattlebaum's dissent, respondent asserts that it could not have joined petitioner's affiliates as parties to the lawsuit, as the affiliates reside outside the court's jurisdiction, contrary to the applicable Federal Rules of Civil Procedure. Respondent also argues that it need not rely on piercing the corporate veil. According to respondent, the principle of corporate separateness is not violated "so long as facts separate from the mere corporate relationship tie the second company's finances to the infringer's gain." Respondent notes its own interest, as a corporation itself, in maintaining corporate distinctions and asserts that corporate separateness is only violated when entities are treated as interchangeable based purely on their corporate relationship. The Lanham Act, respondent says, allows courts to consider all relevant and competent evidence in setting remedies. Respondent asserts that profits of affiliates constitute relevant evidence because, for example, an infringer may have directed revenues to an affiliate in exchange for benefits not reflected on the infringer's books and commonly owned affiliates may be able to easily transfer benefits among themselves in ways that avoid detection.

The government weighs in as amicus in support of neither party, noting, among other things, its interests in the interpretation and application of the Lanham Act and the United States Patent and Trademark Office's administration of the federal trademark registration process. The government has been granted leave to participate in oral argument and sees problems with the courts' dispositions below and both parties' positions.

On the one hand, the government argues that the district court and Fourth Circuit erred in broadly treating the petitioner and its affiliates as a single corporate entity for purposes of calculating petitioner's profits. Instead, the government says, the court should identify the specific funds that that petitioner received from John Dewberry that were derived from money that the affiliates had obtained as a result of petitioner's infringing conduct.

On the other hand, the government argues that the petitioner is nevertheless wrong that legal doctrines such as piercing the corporate veil and secondary liability based on contributory infringement are the exclusive means for a trademark owner to recover for an infringer's conduct when the relevant funds have flowed to a third party. Further, the government takes issue with the notion that petitioner's own "creative financial maneuvers" should control the court's quantification of petitioner's profits from the infringing activities. Rather, when an infringer receives payment, even indirectly, as a result of its infringement, those funds could be assessed as "defendant's profits" under the Lanham Act, regardless of how the infringer categorizes them.

Therefore, the government argues that the judgment should be vacated and the case remanded for further proceedings for the district court to undertake additional analysis to determine what portion of the combined revenues of petitioner and its affiliates are properly viewed as the petitioner's profits. The government also noted that respondent's argument based on the just-sum provision provides another reason to vacate and remand, because neither the district court nor the Fourth Circuit relied on that portion of the statute.

Amicus curiae Washington Legal Foundation joins petitioner in arguing that Congress limited disgorgement under the Lanham Act to the profits of the specific party named in a lawsuit and found liable. It further argues that ignoring corporate form would harm the economy in unsettling business expectations. The American Intellectual Property Law Association (AIPLA), in support of neither party, argues that while the Lanham Act gives a district court discretion, that discretion relates to adjusting the amount awarded if "the recovery based on profits is either inadequate or excessive," 15 U.S.C. § 1117(a), and does not extend to giving "a court discretion simply to treat profits earned by unnamed third-party entities as profits earned by a party defendant in assessing the amount of recovery[.]" The AIPLA also faults the Fourth Circuit for providing little guidance on how courts should exercise their discretion under Section 1117(a). AIPLA urges the Court to remand the case to allow the respondent an opportunity to make the showing required to pierce the corporate veil, consider liability theories based on contributory infringement, or for compulsory joinder of the affiliates to bring them into the case.

A group of intellectual property law professors filed an amicus brief in favor of respondent. They point to the unique nature of trademark rights and "the reality that trademarks often bestow value beyond the specific ledgers of the infringer" and "routinely spill over to affiliates."

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As they explain, consumers naturally think of a brand's various associations, and positive associations routinely inure to the benefit of affiliates, such as subbrands. When a company's branding strategy seeks to capitalize on that association, as the professors assert is the case here where petitioner referenced "Dewberry" in each of the affiliates' names, limiting recovery only to petitioner's profits provides an incomplete view of the benefits gained from the infringement. According to the group of academics, the district court's remedy afforded sufficient respect for corporate formalities because affiliates' profits are "evidence of an infringer's own gain[.]" They also assert that piecemeal litigation against affiliates is not practical.

Significance

Accountability for trademark infringement and corporate autonomy are in tension in this case. The lower court ruling set a precedent in favor of trademark accountability by increasing damages exposure under the Lanham Act. If the Supreme Court affirms, filing such actions will become even more attractive for plaintiffs, while defendants will of course correspondingly need to take the risk of higher damages into account. The degree of that risk would depend on any guidance the Court provides for exercising the discretion to award profit disgorgement. On the other hand, reversal of the Fourth Circuit's decision would fortify the value of corporate separateness but potentially create a playbook for trademark infringers to effectively sew their pockets shut by using corporate formalities and indirect payments to evade the financial consequences of infringing behavior. Petitioner argued that its payment arrangement is common in certain industries; reversal could increase that practice. There is also an obvious form-versus-substance aspect of this case. Where an entity has undisputed control over third parties that benefit from infringing acts of another, courts may be reluctant to endorse a legal fiction that allows a person or entity to place property in another's hands while actually retaining all the benefits. The nominal transfer of control over property to insulate it from economic consequences is at odds with the equitable foundations of remedies such as a profit-disgorgement award. Similarly, focusing only on what a defendant labels as "profits" may obscure the actual effects of infringement. At the same time, the statutory language is on its face straightforward in referring to "defendant's profits." In addition, limited liability and clear and predictable corporate boundaries are important to incentivize business growth. Eroding the lines of corporate form in the context of profit disgorgement under the Lanham Act could result in greater substantive impact as an entrée to blurring distinctions among corporate entities in other areas of law and for other unanticipated purposes.

Although corporate separateness is a focal point of the parties' and amici arguments, affirmance might not effect large-scale changes in corporate-formation practice. There are myriad reasons that have nothing to do with trademark law driving choices related to corporate structure, even if an entity might take into account that it would one day become a defendant in a trademark infringement lawsuit. Corporations may be unable or unwilling to unravel existing complex arrangements, particularly those involving a large number of affiliates. The amicus brief of Washington Legal Foundation points out that Berkshire Hathaway has over 60 related corporate entities in the United States, for example.

Affirmance could, however, impact trademark defendants' litigation strategies and allocation of income among multiple entities. First, during the lawsuit, petitioner here denied any connection between the affiliates' revenues and the infringement and did not offer argument or expert analysis that distinguished between infringing and noninfringing revenues. In the future, litigants might opt for a more moderate approach, offering courts evidence of a number other than $0. Second, in a similar but prelitigation vein, business arrangements among separate but related corporate entities might more accurately and transparently take into account the value of the services offered by a corporation to its affiliates. Although compensation agreements among affiliated companies may not be arm's length, they could more closely reflect the economic realities that were of concern to Judge O'Grady and the Fourth Circuit majority.

Trademark plaintiffs' litigation strategies would also be impacted by the outcome of the case. Respondent's decision to not name, or inability to name, the affiliates played a role in this case, and reversal would counsel in favor of a broader identification of defendants but might require multidistrict litigation due to jurisdictional requirements. Future plaintiffs may also focus more on arguments relating to secondary liability and in favor of piercing the corporate veil if appropriate legal conditions, such as fraud, exist. If the Supreme Court vacates the district court's judgment, we will likely see at least the piercing the corporate veil argument play out on remand, as respondent notes that it has preserved the issue.

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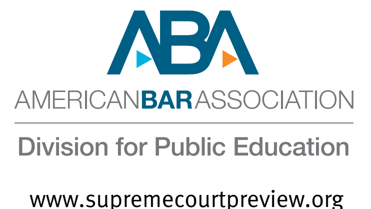

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