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Washington Legal Foundation Media Briefing; The October 2010 U.S. Supreme Court Term

Featured Speakers: The Honorable ***Dick Thornburgh****, K&L Gates LLP and Chairman of the Legal Policy Advisory Board of the Washington Legal Foundation;* ***Jerrold J. Ganzfried****, Chair of the Appellate Practice Group, Howrey LLP and Chair-elect of the ABA counsel of appellate lawyers;* ***Jonathan Hacker****, O'Melveny & Myers LLP and a lecturer at the Harvard Law School on appellate practice;* ***Eric G. Lasker****, Hollingsworth LLP.*

Thornburgh: The U.S. Supreme Court is taking up its 2010-11 session. We shall discuss the general tone and tenor of the Court's activities, and the focus will include pre-emption issues and securities cases.

Ganzfried: When talking about important Supreme Court cases, I find it helpful to consider the docket in three categories, although they are not mutually exclusive.

First, there are cases that develop real changes in the law; milestone cases that provide structural, developmental and analytical changes in the way that the law progresses. These cases typically are interesting to scholars and historians. Sometimes they are cases that one does not anticipate will be a milestone, and sometimes the impact isn't even clear when the decision comes along. To wit, *Erie v. Tompkins*.

Secondly, there are cases that have the potential to change conduct or behavior, such as how the government acts, how companies conduct business or how people behave. Conduct that is legal now becomes illegal. Conduct that was illegal is now legal.

The third category is cases that change or effect how we litigate. The prime impact is on litigators, trial lawyers or appellate lawyers. Often these questions are jurisdictional or procedural. *Twombly* and *Iqbal* would be cases that have certainly impacted the way cases are litigated, but I don't think that either is going to change the way that business is conducted.

Today, I am going to talk about a case whose decision might impact how cases are litigated. In *AT&T Mobility vs. Concepcion,* essentially, the issue is if you have an arbitration agreement between AT&T Mobility, a wireless cell phone provider, and its individual customers, can a claim against the company brought by customers proceed as a class action arbitration rather than either as a series of individual arbitrations or as a class action litigation in court?

The contract provided for free or discounted cell phones, but state law required the vendor to collect a sales tax on the full retail value of the phone. The plaintiffs filed a lawsuit claiming that contrary to the advertisement, the phones weren't free if they had to pay the taxes on them. The defendant moved for the case to proceed as individual arbitrations per their contracts, which had arbitration agreements and an express waiver of class action proceedings. The district court and the court of appeals held that the class action waiver in the contracts was unconscionable.

Under California law, in the *Discover Bank* case, the court established a standard for determining if a class action waiver is unconscionable. Essentially, this test makes a consumer contract such as the ones in this case very close to presumptively unconscionable. The standards that they set up are: is it a contract of adhesion; are the disputes under it predictably disputes that are going to involve small amounts of damages; and are there allegations that a party with superior bargaining power has carried out a scheme to deliberately cheat a large number of customers out of individually small sums of money?

The contract in question is one that even the trial court commented was the most pro-consumer contract he had ever seen. There were a number of provisions and incentives for the individual claimants to proceed with arbitration. Having nonetheless concluded that this was such a pro-consumer contract, the district court nonetheless held that it was unconscionable because when applying the California Supreme Court test from the *Discover Bank* case, it fell into those categories.

As petitioner, AT&T Mobility argued in its brief to the Supreme Court that this would allow states to end arbitration by requiring that full litigation procedures be provided in arbitration, lest the arbitration provision be deemed unconscionable. There is a provision under the Federal Arbitration Act that declares that states can apply their individual laws, but it's got to be the law of general application. So one of the great debates here is whether the unconscionability test that applies in the context of choosing between individual and class arbitration is actually the same unconscionability test that applies across the board in California. The plaintiff's position essentially is that it is because it applies both to class action waivers in arbitration agreements and class action waivers in the litigation context.

Essentially, AT&T Mobility's response was that it would wipe out the

parties' ability to agree by contract to have an arbitration procedure that may differ somewhat from what you would have if the case went to litigation. The timing is interesting, coming on the heels of the *Stolt-Neilsen* case when the court held that if an arbitration agreement is silent on the question of class-wide arbitration, then it is essentially something that the parties had not agreed to, and it couldn't be imposed on a party that had not agreed to it. Bear in mind that, at its core, the basis of the Federal Arbitration Act is that parties are free to contract for the dispute resolution mechanism that they wish, and the function of the Federal Arbitration Act is to implement the intent of the parties as expressed in their contracts.

That case is certainly going to be one that is going to impact how cases are litigated. Depending on how it is decided, there is going to be an impact, particularly in the consumer contract context of how those contracts are written, particularly when you look at the *Stolt-Neilsen* decision where the court goes through all of the protections that are afforded both to plaintiffs and defendants in litigation when it is in a class action in a court room litigation context. Those protections are pretty much gone in the arbitration context, and it is not likely that many parties who are in a position where they may be defendants in class-action arbitration expressly are going to agree to that in their contracts.

Basically they would be faced with all the disadvantages of class action litigation - large exposure, which is the leverage that the plaintiffs have in this context where there is large exposure. Even in the event of minimal individual damages or even minimal validity to the claims, the size of the exposure does have an impact on how these cases are resolved. But in class action arbitration, you wouldn't have any of the benefits of litigation. No discovery and no rigorous application of the rules of evidence, and you would have less appellate review.

Hacker: I shall summarize two securities law cases, *Matrix Initiative vs. Siracusano* and *Janice Capital Corp. vs. First Derivative Traders*. In the interest of full disclosure, I am counsel of record in the *Matrix* case. Both cases are consistent with what is at least a 20-25 year trend in the court, which some would characterize as pro defense outcomes occurring mostly in securities law cases. Another perspective would be that the court has been insisting on more clarity and certainty in the securities laws, which in individual cases and in general may benefit defendants. I think the court is not just narrowly focused on how to make the defendant win, but how to make the securities laws a little more rational to the extent that the court has interpretive responsibilities over them.

Matrix is a drug company, a homeopathic pharmaceutical company, that makes a cold remedy called Zycam. There were literally a handful of reports, called adverse event reports, early in the product's life from consumers that said that they had lost their smell after using the product. The company became aware of the allegations, but there was no particular information about the circumstances, i.e., who these consumers were or what the nature of the use was. There were just reports in which somebody said that 12-23 people had said that they had lost their smell.

The question in this case is whether Matrix had a duty to disclose that information to the markets and its investors, saying that we have these reports of individuals who have lost their smell. Would a reasonable investor care about that? Would that be an important investment decision? Basically, the plaintiff's argument was that reasonable investors would run for the hills. Obviously, we don't agree with that. The question that has divided the courts in this area is whether it is efficient to just plead the small number of raw reports like that, or does the plaintiff have to say that the reports reflect a statistically significant correlation between the use of the product and the condition of the reporting. It is particularly important in a case like this because it turns out that the main cause of losing smell is having a cold. People take cold remedies such as Zycam because they have a cold. So it is almost impossible to tell. All you have are people who have a cold, who are that part of the population literally most likely to lose their smell – who take a product because they have a cold, and then they lose their smell, or they say they lost their smell. So you have to sort that out. It is a huge causation problem, and all we have from the allegation and all that Matrix had was this handfull of reports. And so our submission was that under those kinds of circumstances, a company doesn't have to run to investors and file an 8-k if someone reports that they have lost their sense of smell, particularly when you are talking about literally millions of uses in the time period of purchases. Also, there is the problem that the product that the consumers are taking is used as a remedy for the very disease or problem that creates the condition. So under these circumstances at least, we say no. You have to plead more than that. You have to plead that there is a statically significant correlation between the use of the product and the condition that you are complaining about. That part of the case is quite easy in my view. A handful of unnamed reports with very little information can't possibly be considered material such that a company can be subject to securities law liability after the fact for not disclosing it to the markets.

Now, the court is going to have to sort out what the rule is for other companies and other investors; what is an intelligible principle by which we can tell companies the circumstances under which we disclose. The ruling could be a narrow decision because it involves a particular fact pattern of 12-23 individual reports, but this case might be a potential sleeper. There could be some other important principles of law developed in the opinion, depending on how the court decides it.

There are at least three possible sleeper issues in the case. One is that we haven't heard much from the Supreme Court in the last couple decades on the meaning and application of materiality in the securities law context. We know that the verbal formulation is that it is whatever would affect the total mix of information for a reasonable investor, but what does that mean? We only know more about that from the way that courts have applied that over the years. So in the course of explaining to the world, hopefully, why we are right that these reports aren't material, the court may well say important things about that standard that will have ramifications in a number of other securities cases.

Another area is part of the decades-long legal trend toward clarifying and creating more certainty in the securities laws. There has been congressional action, one of which is the PSLRA,

which heightened the pleading requirements for plaintiffs in securities law cases and required them to plead more specific facts about the defendant's state of mind. That is an issue in this case, and the Washington Legal Foundation filed a wonderful brief in our case developing that issue that whatever is true about materiality is certainly true that pleading just a raw number of reports doesn't tell if the defendant at the time knew that those reports were material; if those reports said something important about the product; and what was going to happen in the market. So the court could further develop the scienter principles and requirements for pleading in the case.

Third, and perhaps most significantly because the case involves these adverse event reports involving product harms, there has been a number of amicus briefs filed by groups not so much interested in the securities law implications, but in products liability cases. There were six or seven briefs filed by groups focused specifically on the proper use of adverse event reports in litigation. Our argument draws from the products liability cases. The cases almost uniformly say that these reports, in and of themselves, don't prove causation. They don't prove that the products in this case cause the loss of smell; you need to do more work. The cases say, and we draw on this, that when you are talking about statistics, you need to have statistically significant correlation. And so the court in the course of commenting on that, either agreeing or disagreeing with us, is likely to say something significant and may very well say something important about AER's that will have impact in products liability cases. So that is why we see the involvement of groups on the defense side and products liability cases. I suspect that we will see a similar number of amicus briefs on the plaintiff's side in those cases making the same point.

Lasker: The issue that I shall address is one that the Supreme Court has been struggling with for the past two or three decades, i.e., the question of preemption and cases involving state tort law. More specifically, the issue here is whether and under what circumstances a federal regulatory determination on a safety standard should preclude a state tort law claim that would set forth a different or a conflicting requirement. One case before the court involves vaccine, and the other involves seatbelts. A third involves generic drugs, which is up on a petition for cert.

Just to review the history in a nutshell, the court has been schizophrenic on preemption of state tort law claims. It literally has gone back and forth from one case to the other, finding preemption or not finding preemption. To be sure, there have been unique facts and specific statutes involved, but there also has been a battle, at least within the minds of some of the Supreme Court justices, about how the court should view preemption, and particularly whether state tort law claims advance the cause of safety, regulatory safety, or whether state tort law claims are contrary to public safety. And that conflict historically is demonstrated in two cases that the court decided within the past five years.

In 2005, the court decided *Bates*, which involved preemption or potential preemption involving a pesticide. The vote was 7 to 2 against preemption, and the court stated that state tort law claims can act as a catalyst for safety regulations. Three years later in the *Regal* case, in an 8 to 1 decision, the court says exactly the opposite. It says state tort law claims are not a useful mechanism for safety regulations because in an individual case, the jury only sees the injured party, and not all the other people who benefited from the product. Therefore federal regulators should make that determination. There are a number of justices who signed on to both opinions, and part of the current battle is which way those justices are going to rule.

The first case is *Bruesewitz vs. Wyeth,* which involves vaccines, a medical miracle of the past century that has saved millions of lives. An important part of the story is that the vaccine industry is a very low margin industry. In the 1980s, vaccine manufacturers directly were being driven out of business because of state tort law liability, which had a negative impact on public health.

In response, Congress enacted the National Childhood Vaccine Injury Act of 1986, which did two things. First, for the consumers there was an administrative claim process established where they could submit a claim directly to the government alleging that they have been injured by a vaccine. It has a no fault system, and there are a lot of procedures that will allow them to recover. The second part, which was to ensure that the vaccine industry was protected, was an express preemption provision, which states that no vaccine manufacturer shall be liable in a state tort law action for an injury or a death that was unavoidable, as long as the vaccine was properly prepared and had proper warnings. The question before the court in *Bruesewitz* is what is the meaning of that express preemption provision? The parties agree that the provisions specifically carve out two types of claims that can go forward, manufacturing defect claims and failure to warn claims. Although the stature separately has protections for the industry for failure to warn claims if the warning is consistent with the FDA-approved label, there is a presumption in the industry's favor.

The issue is how to deal with design defect claims, i.e., the vaccine was not designed properly. Plaintiff's position is that this preemption provision only requires, on a case by case basis, that a jury make a determination as to whether the injury was unavoidable, and therefore the case still should be submitted to the jury. Defendant's position is that the specific language of the express preemption provision, which carves out manufacturing defects and failure to warn, does not carve out design defects. It is intended to preempt those types of claims, and the very purpose of the statute was to protect vaccine manufacturers against such claims because of the impact on the industry. The United States has filed an amicus brief in favor of preemption, which is one of two key issues.

During the Bush Administration, the FDA came under a lot of political flack because it was filing amicus briefs arguing that federal preemption was good for public health in prescription drugs and medical devices cases. The argument on the other side was that this was a political decision. It was a Bush about-face, and it had nothing to do with public health.

Here we have the first opportunity for the Obama administration and the Obama FDA to speak to the Supreme Court on the issue of preemption of state tort law claims, and they are taking the exact same position in this case. Preemption is good for public health and should be upheld. So, the second point is that at least with respect to vaccines, the FDA is

continuing to take a consistent position, that preemption actually advances public health and can have a very significant impact on public health. The reason for the preemption provision is to protect the vaccine industry. There is no question that protecting the vaccine industry is of crucial importance to the public health, and if the vaccine industry is sent back into the state courts and now has to defend these state tort law claims again, we are going to face the same public health crisis that the country was facing in the early 1980s.

The second case is W*illiamson vs. Mazda,* which deals specifically with whether there should be shoulder straps in addition to lap straps and seatbelts in the rear of an automobile. In the 1980s, there were two citizen petitions that were submitted to the National Highway Traffic Safety Administration (NHTSA). At that time, the rule was that lap belts were required only in the back seat. These petitioners were filed seeking a requirement that there be shoulder straps. Subsequently, NHTSA required shoulder straps only for rear seats adjacent to windows. In *Williamson,* a child in the center rear seat unfortunately died in an auto accident. The question then was whether a state tort law claim was preempted by the NHTSA regulatory determination. The solicitor general filed an amicus brief, arguing that there should not be preemption. Hence, the debate in this case is which of two prior Supreme Court decisions should govern.

In addition, in 2000, in the *Guyer* case, the court held that NHTSA's determination that airbags should not be required in autos, but instead a mix of different passive restraint systems. It held that that was preemptive of a state tort law claim, and the defendants in *Williamson* argued that *Guyer* governed. Two years later, in the *Spritzma* case, the court was faced with the question of whether a state tort law claim should be allowed regarding a motorboat without a propeller guard despite the fact that the Coast Guard had decided not to impose a safety requirement requiring a propeller guard. In that case, the court said that there was no preemption, and the distinction, which is a subtle one, is that the court determined that the Coast Guard had not determined that a regulation was inappropriate or that there should be that requirement and decided they were not going to regulate at all in the area. This is the sort of the schizophrenia that I was talking about before.

Going back to *Williamson*, one issue in the briefing is that the NHTSA regulatory determination, particularly the second determination not to require a shoulder strap – at least on the record – was driven in large part by a cost benefit analysis. There are some issues in the case about whether or not shoulder straps are actually a safety risk with respect to child seats, booster seats and also blocking pathways in a van. But on the record, it was a cost benefit analysis. So one question that the court may face is, does that matter? Does it matter that the federal government is using cost benefit analysis to determine whether to preempt a state tort law claim, or is cost benefit analysis equally valid as a safety determination for federal preemption. A second issue that may come up is whether the court should be viewing this in the *Guyer* context, which was a frustration of purpose argument that the federal government was trying to achieve something, and the state tort law would frustrate this, which is a doctrine that Justice Thomas is vehemently opposed to.

Will *Madza* be viewed as a direct conflict case because here again, NHTSA was specifically asked to impose a safety requirement, and the court determined that they would not do so. If you think back to the *Wyeth vs. Levine* case, although the court found against preemption for prescription drugs, in its opinion the court had indicated that if the FDA had been presented with a warning label and said "no, this warning label is not approved," then there might be preemption. And that is essentially what has happened in the *Mazda* case. NHTSA said no to this requirement, which would seem to provide a direct conflict. My prediction is that this is going to be a tougher case for *Mazda*, largely because it is implied preemption, and implied preemption is a much more difficult argument. I expect that they are going to have a hard time convincing Justice Thomas, and this is a case where Justice Kagan's recusal might be important. A 4-4 decision would be a win for Mazda.