Legal Backgrounder

Washington Legal Foundation
Advocate for freedom and justice®
2009 Massachusetts Ave., NW
Washington, D.C. 20036
202.588.0302

Vol. 18 No. 52 December 5, 2003

FINANCIAL, SECURITIES & TELECOM: KEY CASES BEFORE THE SUPREME COURT

by

Donald B. Verrilli, Jr.

This LEGAL BACKGROUNDER will discuss bankruptcy, securities, tax, telecommunications, and other cases of interest on the Supreme Court's docket in its 2003 Term. A prior Washington Legal Foundation LEGAL BACKGROUNDER addressed employment and environmental law cases. Donald B. Verrilli, Jr., *Environment and Employment Law: Key Cases Before the Supreme Court*, Vol. 18, No.50 (Nov. 14, 2003).

This Term, the Court will decide a number of cases raising important issues that affect businesses in a variety of areas. The Court will address significant financial issues, including the responsibilities of credit card lenders under the Truth in Lending Act; the proper interpretation of provisions of the Bankruptcy Code regarding case deadlines and interest rates; and the appropriate procedure for the government to enforce the derivative liability of partners for the tax debts of a partnership. The Court will also decide several noteworthy telecommunications issues, including the scope of the preemption provision of the Telecommunications Act of 1996 and the interaction between the 1996 Act and the Sherman Act. On the securities and retirement fronts, the Court will consider the meaning of "investment contract" under the Securities Exchange Act of 1934 and the meaning of "participant" under ERISA. Finally, the Court will determine the extent of carrier liability under the Warsaw Convention, which defines passengers' right to recovery for harm sustained during international air travel. All of these cases deserve the close attention of the business community.

Bankruptcy, Financial, and Tax Cases

***Household Credit Services, Inc. & MBNA American Bank v. Pfennig* (02-857)**. At issue in *Pfennig* is the proper interpretation of a provision of the Truth in Lending Act that defines a credit card lender's "finance charge" to include "all charges" imposed on the consumer "as an incident to the extension of credit." 15 U.S.C. § 1605(a). In "Regulation Z," the Board of Governors of the Federal Reserve System has interpreted "finance charge" to exclude fees imposed "for exceeding a credit limit," and has instead classified such fees as "other charges which may be imposed" under the account. 12 C.F.R. § 226.4(c)(2).

In this case, a divided panel of the U.S. Court of Appeals for the Sixth Circuit held that Regulation Z was invalid when "the creditor knowingly permits the credit card holder to exceed his or her credit limit." The court concluded that in such circumstances an over-the-credit-limit fee constitutes a "finance charge" under § 1605(a) and that any other interpretation of the statute is not entitled to deference.

Donald B. Verrilli, Jr. serves as Chair of the law firm Jenner & Block's Telecommunications Practice and a Co-Chair of its Appellate and Supreme Court Practices.

The Sixth Circuit's decision creates uncertainty with respect to credit card companies' disclosure obligations, which now vary from jurisdiction to jurisdiction. The Supreme Court's resolution will clarify those obligations and shed light on the degree of deference owed to Regulation Z and similar regulations.

***Kontrick v. Ryan* (02-819)**. In this bankruptcy case, which was argued on November 3, 2003, the Supreme Court will consider whether the deadline established by Bankruptcy Rule 4004 – which requires objections to a debtor's discharge in bankruptcy to be filed within 60 days of the first date set for the meeting of creditors – may be waived or forfeited by the debtor. In the decision below, the U.S. Court of Appeals for the Seventh Circuit held that Kontrick, a Chapter 7 debtor, waived any timeliness argument under Rule 4004 because he failed to raise such an argument until after the court's initial ruling on the merits of a judgment creditor's objection to Kontrick's bankruptcy discharge. Lower courts have divided on the question of whether bankruptcy rules such as Rule 4004 are jurisdictional and therefore not subject to the traditional equitable defense of waiver.

The Supreme Court's decision in this case may well be a narrow one, based on the text and purpose of Rule 4004 and its interaction with a number of other specific rules of bankruptcy procedure, including Rule 4007 (which also governs objections to discharge) and Rule 9006 (which discusses excusable neglect). But the Court's decision may also have broader implications for the waivability of other time limitations contained in the Bankruptcy Rules.

***Till v. SCS Credit Corp.* (02-1016)**. In *Till*, which was argued on December 2, 2003, the Supreme Court will confront the question of the appropriate interest rate for determining the present value of an allowed secured claim under the cramdown provision of Chapter 13 of the Bankruptcy Code. The U.S. Court of Appeals for the Seventh Circuit ruled that there was a "rebuttable presumption" in favor of using the contract rate of interest when discounting deferred payments to present value under 11 U.S.C. § 1325(a)(5)(B)(ii), which permits plan confirmation if "the value, as of the effective date of the plan, of property to be distributed under the plan on account of [an allowed secured] claim is not less than the allowed amount of such claim." But a number of other circuits (including the Second and Ninth) have adopted an alternative "formula approach" to making this determination, explaining that payments should be discounted to present value using a readily accessible rate of interest (such as the Treasury Rate) plus a risk premium to reflect the creditor's risk in receiving deferred payments. The Sixth Circuit has recently taken yet another approach, ruling earlier this year that the interest rate a secured creditor should receive under § 1325(a)(5)(B)(ii) is "the current conventional market rate for similar loans in the region, and not necessarily the contract rate."

The Supreme Court's resolution of this issue will most directly affect the individual debtors who use Chapter 13, but will also have implications for the interpretation of the cramdown provisions found in other chapters of the Bankruptcy Code.

***United States v. Galletti* (02-1389)**. The United States sought review in this case in order to resolve the recurring question of whether, in order to enforce the derivative liability of partners for the tax debts of their partnership, the government must make a separate assessment of the taxes owed by the partnership against each of the partners directly.

In this case, the IRS made a timely assessment of federal employment tax obligations owed by a partnership. When the partnership failed to pay, the government sought to enforce these tax liabilities against the partners, who were liable under state law for valid debts of the partnership under certain circumstances. The U.S. Court of Appeals for the Ninth Circuit rejected this attempt, concluding that, while the government had a valid claim against the partnership, the government could not enforce its derivative claim against the partners without first assessing the tax against the partners individually. Because the assessment of the taxes owed by the partnership had not been made directly against the partners within the statutorily required period, the court held the government's claim against the partners to be barred.

There is some disagreement among the circuits on the issue presented by this case, the resolution of which will affect the IRS's collection of billions of dollars in outstanding partnership tax liabilities that the IRS has not

Copyright © 2003 Washington Legal Foundation

ISBN 1056 3059

separately assessed against individual partners (and that, in many cases, the IRS can no longer individually assess in a timely fashion).

Telecommunications

Nixon, Attorney General of Missouri v. Missouri Municipal League **(02-1238)**. In this case, which will be argued on January 12, 2004, the Supreme Court has consolidated several petitions to address whether Section 253 of the Telecommunications Act of 1996, 47 U.S.C. § 253, which provides that "[n]o State . . . regulation . . . may prohibit . . . the ability of any entity to provide any interstate or intrastate telecommunications service," preempts a state law prohibiting political subdivisions of the state from offering telecommunications service to the public.

The FCC has taken the position that it is impermissible for the federal government to block such a law, on the ground that "any entity" as used in § 253 does not plainly include a political subdivision of a state. In a 1999 decision, the U.S. Court of Appeals for the D.C. Circuit agreed, holding that it was not certain that in enacting § 253 Congress intended to govern state-local relationships regarding the provision of telecommunications services, and that such certainty is required under *Gregory v. Ashcroft*, 501 U.S. 452 (1991), in order to interfere with a state's traditional sovereignty over its subdivisions. In the instant case, however, the Eighth Circuit expressly rejected the D.C. Circuit's view, holding that "the words 'any entity' plainly include municipalities and so satisfy the Gregory plain-statement rule."

The Supreme Court's decision in the instant case will therefore resolve a clear split in authority, and will definitively determine whether the 1996 Act permits states to bar their own political subdivisions from entering the market for telecommunications services.

Verizon Communications v. Law Offices of Curtis Trinko **(02-682)**. This case presents several significant issues at the intersection of antitrust and telecommunications law. Under the Supreme Court's precedents, monopolization is unlawful under Section 2 of the Sherman Act, 15 U.S.C. § 2, if it is carried out through predatory or exclusionary conduct. The Law Offices of Curtis Trinko brought a Section 2 monopolization claim against Verizon, alleging that Verizon engaged in exclusionary conduct and used its monopoly power to block competitors' access to the "local loop," a facility that competitors need in order to provide customers such as Trinko with local telephone service. The Second Circuit found that Trinko's complaint withstood Verizon's motion to dismiss, both because Trinko had standing to challenge Verizon's conduct and because the complaint adequately alleged a violation of the antitrust laws.

In deciding whether the Second Circuit was correct, the Supreme Court has been asked by the parties to address questions that include: (1) whether a customer in the market that the defendant is alleged to monopolize has standing to bring an antitrust claim absent contractual privity between the customer and the defendant; (2) whether the phrase "exclusionary or predatory conduct" should be defined narrowly or broadly, particularly in the context of a monopolist's refusal to make an essential facility available to its competitors; and (3) whether the antitrust analysis is altered by the Telecommunications Act of 1996, which imposes certain sharing duties on incumbent companies such as Verizon and states that nothing in the Act shall be construed to "modify, impair or supercede the applicability of the antitrust laws."

The Court heard argument in the case on October 14, 2003.

Securities and Retirement

S.E.C. v. Edwards **(02-1196)**. In this case, which was argued on November 4, 2003, the Supreme Court will consider whether the U.S. Court of Appeals for the Eleventh Circuit erred in determining that an investment scheme is outside the ambit of the term "investment contract" as used in the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10), if the promoter of the scheme promises a fixed rather than variable return or if the investor is contractually entitled to a particular amount or rate of return.

Copyright © 2003 Washington Legal Foundation

ISBN 1056 3059

Under the investment scheme at issue here, an investor would purchase a pay telephone from one of Edwards' companies, and then lease the phone back to an affiliated company in exchange for a fixed monthly payment. The SEC asserted that Edwards' business venture was actually a "massive Ponzi scheme" and that he engaged in widespread fraud in violation of the federal securities laws. However, the Eleventh Circuit dismissed the action for lack of subject matter jurisdiction, holding that Edwards' business did not fall within the scope of the securities laws because it did not involve an "investment contract." According to the court, such a contract exists only if there is an "expectation of profits to be derived solely from the efforts of others," and the telephone rental scheme did not involve "profits" (since the phone purchasers did not expect to have to share in the company's losses) and did not derive "solely from the efforts of others" (but rather from the leases that contractually entitled the purchasers to a fixed return every month).

The Eleventh Circuit's decision is at odds with the S.E.C.'s interpretation of the securities laws, which the S.E.C. has applied in several formal adjudications. The Supreme Court's decision determining the breadth of the term "investment contract" will therefore have a significant effect on the S.E.C.'s exercise of its enforcement authority and on the scope of businesses' securities – law obligations.

***Yates v. Hendon* (02-458)**. The Supreme Court is asked in this case to decide whether a sole shareholder of a business who works for that business is precluded from being a "participant" in the business's ERISA plan under Section 3(7) of ERISA, 29 U.S.C. § 1002(7). This is an issue as to which the circuits diverge: the Sixth Circuit in this case agreed with the First Circuit that a sole shareholder may not be a "participant" in a plan covered by Title I of ERISA, while the Fourth and Fifth Circuits have reached the opposite conclusion. Courts of Appeals have indicated similarly inconsistent approaches to the question of whether "working owners" of other business forms, such as sole proprietorships and partnerships, may be ERISA plan participants.

This case will shed further light on the Supreme Court's 1992 decision in *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318 (1992), which addressed whether an insurance salesman was a "participant" in an ERISA retirement plan and decided the issue by applying a traditional common-law test to determine whether the salesman was an employee or an independent contractor. More fundamentally, the Court's decision in *Yates* will settle the conflict over an important issue that rears its head in a variety of contexts, such as when a sole shareholder invokes ERISA's protection against alienation of pension benefits or when an insurance company invokes ERISA preemption in response to a working owner's claim for personal insurance benefits.

Liability

***Olympic Airways v. Husain* (02-1348)**. In this case, which was argued on November 12, 2003, the Supreme Court will consider the scope of Article 17 of the Warsaw Convention, which conditions carrier liability for harm to international air travelers on the occurrence of an "accident." The case involves the death of an asthmatic passenger on a flight from Athens to New York. The passenger was seated in the non-smoking section of the plane several rows away from the smoking section; his family requested that he be moved further from the smoking section, but he collapsed and died mid-way through the flight.

The Supreme Court has previously held that an "accident" under the Warsaw Convention is defined as "an unexpected or unusual event or happening that is external to the passenger," and does not encompass situations in which an injury results from "internal reactions to the usual, normal, and expected operation of the aircraft." Here, District Judge Charles Breyer held the airline liable for the death, determining that the carrier's failure to reseat the passenger was an accident under the Warsaw Convention because it was negligent and therefore constituted an "unexpected or unusual event." The U.S. Court of Appeals for the Ninth Circuit affirmed, holding that the district court's factual findings were not clearly erroneous.

The Supreme Court now must decide whether an "accident" has taken place within the meaning of the Warsaw Convention under the circumstances presented. The case raises interesting issues of causation and will have

Copyright © 2003 Washington Legal Foundation ISBN 1056 3059

serious implications for international carriers' exposure to liability.

Copyright © 2003 Washington Legal Foundation

ISBN 1056 3059