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Absence of Legislative History Obscures the Plain Meaning of Bankruptcy Code 503(b)(1)(A)

By Teddy M. Kapur

Many jurists and scholars have ridiculed the reliance on legislative history in judicial opinions. These textualists abide by the "plain meaning" rule and admonish references to external sources if a statute has a plain meaning. Despite the textualist view that legislative history should rarely play a role in statutory interpretation, the absence of statutory history can perplex courts and obscure a statute's intended purpose.

Efforts to interpret the relatively recent amendment to section 503(b)(1)(A) of the Bankruptcy Code are a telling example. When section 503(b)(1)(A) was amended in 2005, Congress provided no explanation for the purpose of the amendment. Without guidance from Congress, the three courts that have interpreted the amendment have given it three different meanings. The diverging interpretations of the "plain" and "unambiguous" meaning of this section of the Bankruptcy Code demonstrate that, without legislative history, courts are left to labor in the dark. Although legislative history cannot—and should not— supplant the text, it can shine a light on the legislature's purpose, thereby illuminating the statute's intended meaning.

Section 503(b)(1)(A) of the Bankruptcy Code

Section 503 of the Bankruptcy Code governs administrative expense claims. Administrative expenses are actual and necessary costs and expenses involved in preserving the value of a bankrupt entity's estate. Section 503(b)(1)(A), in particular, pertains to administrative expense claims consisting of wages, salaries, and commissions for services rendered to the bankrupt entity. Section 503 authorizes payment of administrative expenses ahead of other kinds of obligations owed by an entity operating in bankruptcy because administrative expenses are critical to preserving the value of the debtor's estate and therefore benefit the creditor body at-large. As a result, creditors seek administrative priority status for their claims because often such claims are paid in full while lower priority claims are only partially paid.

Section 503(b)(1)(A) has become the subject of much dispute because former employees of bankrupt companies have relied on this provision to demand administrative priority status for WARN Act claims and other wage-related claims so that they can receive distributions before other creditors.

Courts have struggled to uniformly apply section 503(b)(1)(A) since it was amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Before BAPCPA, section 503(b)(1)(A) stated, in its entirety:

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—
>
> (1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.

BAPCPA divided (1)(A) of section 503(b) into two subsections, whereby subsection (i) retained the text of the former provision (1)(A) and subsection (ii) added a new category of administrative expense claims. Section 503(b)(1)(A) of the Bankruptcy Code now provides:

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than the claims allowed under section 502(f) of this title, including—
>
> (1)(A) the actual, necessary costs and expenses of preserving the estate including—
>
> (i) wages, salaries, and commissions for services rendered after the commencement of the case; and
>
> (ii) wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of

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> the occurrence of unlawful conduct on which such award is based or to whether any services were rendered, if the court determines that payment of wages and benefits by reason of the operation of this clause will not substantially increase the probability of layoff or termination of current employees, or of nonpayment of domestic support obligations, during the case under this title.

Absence of Legislative History

Only three decisions have discussed amended section 503(b)(1)(A)(ii) (the Amendment), and each observed that the legislative history on the Amendment is "sparse," "nearly silent," and consists of "only one comment, which, for the most part, simply paraphrases the statutory language."

Without guidance from legislative history, the three courts discerned the "plain," "straightforward" and "unambiguous" meaning of the Amendment and reached different interpretations.

In re First Magnus Financial Corporation

The first decision to interpret the Amendment was *First Magnus Financial Corp.*, 390 B.R. 667 (Bankr. D. Ariz. 2008). There, former employees of First Magnus who were fired five days before the company filed for bankruptcy sought allowance of an administrative expense claim under the Amendment as a result of damages caused by the debtor's alleged violation of the Worker Adjustment and Retraining Notification (WARN) Act. The WARN Act requires certain employers to give affected workers 60 days' notice of plant closures and mass layoffs to provide them time to look for new jobs.

The bankruptcy court focused on the plain language of the Amendment and interpreted the connector "and" between subsections (i) and (ii) of 503(b)(1)(A) to "require that *both* parts of the subsections must exist in order for a claimant to be entitled to an administrative expense." Accordingly, since the employees were terminated before First Magnus filed for bankruptcy and did not render any services after that point, their WARN Act claims failed to satisfy subsection (i) of section 503(b)(1)(A) and thus were ineligible for administrative treatment under the Amendment.

This ruling was affirmed on appeal, and the district court praised the bankruptcy court for its "thorough and well-reasoned opinion."

In re Powermate Holding Corporation

A few months after *First Magnus* in a case with a substantially similar facts, the Delaware bankruptcy court ascribed a different plain meaning to the Amendment. In *In re Powermate Holding Corporation*, 394 B.R. 765 (Bankr. D. Del. 2008), former employees of Powermate Holding Corporation who were terminated before Powermate went into bankruptcy alleged that their WARN Act damages were entitled to administrative expense priority under the Amendment.

Powermate rejected the *First Magnus* interpretation that the connector "and" between subsections (i) and (ii) of the Amendment means that the two provisions must be read together. Instead, the court emphasized the role of the word "including" that appears before subsection (i) and reasoned that the use of "and" means that subsections (i) and (ii) are "categories within a particular subset of allowable administrative expenses," namely the "'actual necessary costs and expenses of preserving the estate.'"

The court thereafter reasoned that the primary consideration for determining whether a claim fits within the Amendment is the timing of when the claim vests or accrues. According to the court, "[i]f a claim vests [before the company files for bankruptcy], then the back pay is attributable to the time occurring prior to the commencement of the case and therefore it is not an administrative expense claim." In contrast, if a claim vests after the bankruptcy filing, then it would satisfy the Amendment and receive administrative expense priority treatment. The court reviewed the connection between WARN Act damages and severance pay, and ruled that the employees' claims were priority wage claims rather than administrative expenses because they vested prior to the petition date at the time the employees were terminated. Furthermore, having concluded that the vesting date was the pivotal issue, the court concluded it was irrelevant to consider whether the back pay was due for the time prior to or following the date the claims accrued.

In re Philadelphia Newspapers, LLC

Most recently, a Pennsylvania bankruptcy court attempted to resolve the conflict between *First Magnus* and *Powermate*, supplying a third interpretation of "the plain and straightforward language of the [Amendment]."

In *In re Philadelphia Newspapers, LLC*, 433 B.R. 164 (Bankr. E.D. Pa. 2010), a union representing a former Philadelphia Newspapers employee sought to have the portion of an arbitration award comprised of wages and healthcare premiums that accrued after Philadelphia Newspapers filed for bankruptcy treated as an administrative expense. The union initiated the grievance because it alleged that the employee's termination violated the terms of its collective bargaining agreement with Philadelphia Newspapers. Although the employee was fired before Philadelphia Newspapers filed for bankruptcy, the arbitrator entered the award after the bankruptcy case commenced.

The court reviewed the *First Magnus* and *Powermate* decisions and sided with *Powermate's* ruling that the use of "and" between subsections (i) and (ii) means that the subsections are subsets of the category of allowable administrative expenses under section 503(b)(1)(A). *Philadelphia Newspapers*, however, disagreed with *Powermate's* conclusion that the claim's vesting date is critical to determining if it qualifies as an administrative expense under the Amendment. Based on its reading of the plain meaning of the Amendment, the court observed: "Had Congress intended to condition subsection (ii) on when a right or claim for back pay 'vested' or 'accrued,' it could have said so. It did not and, for that reason, this Court will not impose that requirement on this new subsection to § 503(b)(1)(A)."

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Moreover, the court criticized the decisions in both *First Magnus* and *Powermate* for ignoring the clause in the Amendment that allows certain administrative expense claims "without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered." Contrary to those decisions, *Philadelphia Newspapers* concluded that back pay could constitute an administrative expense under the Amendment without regard to whether services have been rendered, as long as it is awarded for any period of time "attributable to any time occurring after commencement of a case" and meets the other requirements listed in subsection (ii).

The court observed that the Amendment "could not be more plain in its language" and reduced it to a four-part test. According to *Philadelphia Newspapers*, wages and benefits qualify as administrative expenses under the Amendment if they meet the following four requirements:

1. they were awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board;
2. they were awarded as back pay attributable to a period of time occurring after commencement of the debtor's bankruptcy case;
3. they were awarded as a result of a violation of federal or state law by the debtor; and
4. the court determines that payment of the wages and benefits will "not substantially increase the probability of layoff or termination of current employees, or of nonpayment of domestic support obligations, during the" debtor's bankruptcy case.

Applying these criteria, the court concluded that the union's claim failed to satisfy the Amendment's third requirement because the arbitration award resulted from a breach of the collective bargaining agreement rather than a violation of federal or state law.

Conclusion

First Magnus, *Powermate*, and *Philadelphia Newspapers* each followed their own interpretation of the plain meaning of the Amendment and were led in different directions. Whereas *First Magnus* interpreted the Amendment to limit the scope of section 503(b)(1)(A) by adding new statutory requirements, *Powermate* and *Philadelphia Newspapers* read the same provision to broaden the applicability of that section by recognizing a new type of allowable administrative expense. Similarly, whereas *Powermate* believed that a claim's vesting date was pivotal to the applicability of the Amendment, *Philadelphia Newspapers* concluded that such date was inconsequential as long as the claim was attributed to any time occurring after the company filed for bankruptcy protection.

When a statute is unclear, Congress bears responsibility for clarifying its meaning. In this instance, however, Congress has proven an unreliable partner for the judiciary. The Protecting Employees and Retirees in Business Bankruptcies Act of 2010 (the Act) was introduced in the 111th Congress in February 2010, presumably to clarify the purpose of the Amendment, but the Act failed to make it out of the House Committee on the Judiciary and did not become law. The Act would have revised amended section 503(b)(1)(A)(ii) to specifically include awards of WARN Act damages as administrative expenses if any time period attributed to such damage award occurs after the commencement of a bankruptcy case and the other requirements of the Amendment have been met. The Act supported the *Philadelphia Newspapers* view that a claim's "vesting date" is immaterial and that a back pay claim can constitute an administrative expense even if it is awarded for services rendered before the commencement of a bankruptcy case. The Act has not been reintroduced in the current Congress and faces uncertain prospects. Until it is signed into law, the Act does not represent the will of Congress and provides no assistance to judges struggling to interpret the Amendment.

The divergent judicial interpretations of the plain meaning of the Amendment demonstrate that without the guiding light of legislative history, courts may well veer off in unintended directions and subvert the intent of a statute. Legislative history should not, of course, be the sole basis of interpretation because the congressional record is not the law and legislative intent often can be difficult to discern. But it can be particularly useful in situations where, as here, a statute is ambiguous and courts cannot easily agree on its meaning. Clear legislative history can undoubtedly shed light on the purpose of a new law. Here, such direction likely would have prevented the confusion that ensued and guided courts to a uniform interpretation of the Amendment.

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"Pay-for-Delay" Settlements: Antitrust Violation or Proper Exercise of Pharmaceutical Patent Rights?

By Kendyl Hanks, Sarah Jacobson, Kyle Musgrove, and Michael Shen

In recent years, there has been a surge of agreements between pharmaceutical patent holders and generic drug manufacturers in which the market entry of competing generic drugs is delayed by agreement, effectively extending the patent holder's market exclusivity and profit. Known as "reverse payment settlements" or "pay-for-delay" settlements, these arrangements are characterized by payments from pharmaceutical patent holders to generic manufacturers in return for settling challenges to the patent's validity, and for delaying the introduction of generics into the market. As these settlements have become increasingly popular among pharmaceutical companies, they have also become increasingly controversial. The issue is whether reverse payment settlements are illegal restraints of trade under the Sherman Antitrust Act.

The Federal Trade Commission (FTC) has taken a strong stance in both courts and in Congress that reverse payment settlements are per se illegal. As FTC Chairman Jon Leibowitz has written, "One of the Commission's top competition priorities is stopping 'pay-for-delay' agreements between brand-name pharmaceutical companies and generic competitors that delay the entry of lower priced generic drugs into the market." Because of what the FTC calls "the inherently anticompetitive nature of these deals and the enormous consumer harm caused by pay-for-delay," the FTC continues to challenge these arrangements in court and by initiating investigations.

The FTC's opposition to reverse payment settlements has had limited success in the courts. The Circuit Courts of Appeals have split over the antitrust implications of reverse payment settlements. Most courts that have ruled on the issue have held that these settlements are a valid by-product of a patent holder's exclusionary rights, while only the Sixth Circuit has adopted the FTC's per se argument. Ultimately, however, the issue may be resolved not in the courts, but by Congress, which is currently considering legislation that would end the practice of reverse payment settlements.

The resolution of this question involves billions of dollars, and will have far-reaching consequences for drug manufacturers and the public. According to the FTC, "[d]elays in generic competition harm all those who pay for prescription drugs: individual consumers, the federal government (which purchases roughly one-third of all prescriptions), state governments struggling with the cost of providing access to health care, and American businesses striving to compete in a global economy." Reverse payment settlements currently protect at least $20 billion in sales of branded drugs from generic competition, and the FTC estimates that reverse payment settlement cost consumers $3.5 billion a year—or $35 billion over the next 10 years.

This article examines how reverse payment settlements were born out of the Hatch-Waxman framework, and explores how the judiciary and Congress are dealing with the increased use of reverse payment settlements in the pharmaceutical industry.

Hatch-Waxman Statutory Framework

In the pharmaceutical industry, reverse payment settlements are a common way of resolving patent infringement suits filed under the Hatch-Waxman Act (Hatch-Waxman). Hatch-Waxman, which was designed to promote the availability of generic drugs in the pharmaceutical market while simultaneously advancing the financial incentive to research and develop new pharmaceuticals, allows generic manufacturers to achieve marketing approval from the U.S. Food and Drug Administration (FDA) in a cost- and time-efficient manner. Rather than performing independent human trials on pharmaceuticals, Hatch-Waxman allows generic manufacturers to submit bio-equivalence studies to achieve FDA approval.

Hatch-Waxman permits a generic pharmaceutical manufacturer to file an Abbreviated New Drug Application (ANDA) with the FDA prior to the expiration of a brand-name manufacturer's patent without infringing the brand-name manufacturer's patent. Prior to the enactment of Hatch-Waxman, any preparatory acts to file an ANDA constituted infringement. Thus, work toward filing an ANDA in many instances could not begin in a meaningful way until after expiration of the applicable

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patents. In effect, this rule granted the patentee an extension on its patent term to include the period of time after expiration that the ANDA applicant required to run bioequivalence studies and file its ANDA.

A brand-name pharmaceutical manufacturer seeking approval from the FDA must file a New Drug Application (NDA). The NDA details safety and efficacy studies conducted on the brand-name drug, the components of the drug, the methods used in the "manufacture, process and packaging of the drug," and any patents issued on the composition or methods of using the drug. The FDA publishes the patent information in the "Approved Drug Products with Therapeutic Equivalence Evaluations," also known as the "Orange Book."

When a generic pharmaceutical manufacturer wishes to enter into the market a generic version of a pharmaceutical already listed in the Orange Book, it may rely on the brand-name manufacturer's previous research and the FDA's determination concerning the brand-name pharmaceutical's safety. Instead of filing an NDA, the generic manufacturer may file an ANDA, typically a less costly way of entering the pharmaceutical market. An ANDA requires that a generic manufacturer demonstrate bioequivalence between its generic drug and the FDA-approved brand-name drug. Additionally, an ANDA filer must select one of the following certifications: (1) that the "patent information has not been filed" on the generic brand's equivalent (Paragraph I certification); (2) that a patent on the branded pharmaceutical has expired (Paragraph II certification); (3) that a brand-name patent exists, including "the date on which such patent will expire," with a promise not to market the generic drug until that date (Paragraph III certification); or (4) "that such patent is invalid or will not be infringed by the manufacture, use, or sale if the new drug for which the application is submitted." (Paragraph IV certification).

A Paragraph IV certification is deemed an act of infringement on the brand-name manufacturer's patent, and can be challenged by the brand-name manufacturer in court. Paragraph IV certification permits challenges to patents of questionable validity. To incentivize early challenges to such patents, the first generic pharmaceutical manufacturer to submit a Paragraph IV certification with regard to a particular ANDA obtains a 180-day exclusivity period during which no other ANDA filer may compete in the pharmaceutical market.

In practice, Hatch-Waxman has had the unintended effect of encouraging patent infringement suits and reverse payment settlements, especially with regard to first-filers. In order to protect the brand-name manufacturer's patent, the brand-name manufacturer and the first ANDA filer sometimes agree to a settlement that delays the entry of the generic drug into the market. Given the 180-day exclusivity period that (unless forfeited) prevents other ADNA filers from marketing their own generic versions of the patent-holder's brand-name drug, such a settlement can also effectively delay the market entry of *any* generic version of the drug.

Given the delayed entry generated by such settlements (and the harm to consumers by denying them earlier access to cheaper generic pharmaceuticals), the FTC has not looked fondly upon reverse payment settlements, particularly if a first-filer receives payments from the brand manufacturer. According to the FTC, these settlements are per se violations of Section 1 of the Sherman Antitrust Act. As discussed below, the FTC's position is currently supported only by the Sixth Circuit Court of Appeals. All other circuits that have weighed in on the issue, including the Federal Circuit, the Eleventh Circuit, and the Second Circuit, have upheld reverse payment settlements.

A Circuit Split Emerges

The increasing popularity of reverse payment settlements in recent years has given rise to a split among the United States Circuit Courts of Appeals on the question of whether and to what extent reverse payment settlements are lawful. Although it has had numerous opportunities (including a current pending petition for certiorari), the Supreme Court has yet to decide whether reverse payment settlements are enforceable, or if they violate the Sherman Antitrust Act.

The Sixth Circuit––Per Se Illegal Restraints

In *In re Cardizem CD Antitrust Litig.*, 332 F.3d 896, 914-15 (6th Cir. 2003), the Sixth Circuit adopted the FTC's view and held that a reverse payment settlements are per se violations of section 1 of the Sherman Antitrust Act. Defendant Hoechst Marion Roussel (HMR), a brand-name manufacturer, produced Cardizem CD. Andrx was the first to file an ANDA with a Paragraph IV certification seeking approval to market a generic Cardizem product, entitling it to the 180-day exclusivity period once it received FDA approval. After HMR sued Andrx for patent infringement (and while the litigation was pending), HMR and Andrx entered into an agreement whereby HMR would make quarterly payments of $10 million to Andrx. In exchange, Andrx agreed to stay out of the market until either: (1) there was a final decision in the patent infringement case allowing Andrx to market the pharmaceutical; (2) HMR and Andrx entered into a license agreement; or (3) HMR entered into a license agreement with a third party. Andrx also agreed not to "relinquish or otherwise compromise" its 180-day exclusivity period.

The Sixth Circuit held that the agreement was "an illegal per se restraint on trade" under the Sherman Antitrust Act because it was "a horizontal agreement to eliminate competition." In finding the agreement per se illegal, the Sixth Circuit was particularly troubled by the fact that HMR's agreement with Andrx effectively used the 180-day exclusivity period to delay the entry of other generic competitors. In this regard, the court noted: "By delaying Andrx's entry into the market, the Agreement also delayed the entry of other generic competitors, who could not enter until the expiration of Andrx's 180-day period of marketing exclusivity, which Andrx had agreed not to relinquish or transfer."

As of the date of this writing, no other appellate court or district court has followed the Sixth Circuit in holding that reverse payment settlements are a per se illegal restraint on trade.

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The Federal Circuit and the Eleventh Circuit Reject the Sixth Circuit Rule

Three months after the *Cardizem* decision, the Eleventh Circuit reached a different conclusion in *Valley Drug Co. v. Geneva Pharms., Inc.*, 344 F.3d 1294 (11th Cir. 2003). Unlike the Sixth Circuit, the Eleventh Circuit adopted an "exclusionary zone" test to evaluate the validity of reverse payment settlements. As applied to the facts before it, the court refused to invalidate a reverse payment settlement.

Valley Drug involved settlement agreements between Abbott Laboratories and two generic competitors, Geneva Pharmaceuticals and Zenith Goldine Pharmaceuticals. Geneva and Zenith both filed ANDAs challenging Abbott's patents relating to Hytrin, a brand-name hypertension drug. Abbott sued Geneva alleging patent infringement. Geneva admitted infringement but alleged that Abbott's patent was invalid. Zenith filed its own lawsuit against Abbott seeking to delist Abbott's patent from the Orange Book and requesting a declaratory judgment that its proposed generic drug did not infringe Abbott's patent. Abbott entered into reverse payment agreements with both Zenith and Geneva, paying each generic manufacturer to delay the release of its generic drug. The district court found the agreements constituted per se antitrust violations.

The Eleventh Circuit reversed, holding that the grant of patent rights necessarily encompasses the right to exclude generics from the market. The court reasoned that a threshold analysis of the exclusionary scope of the patent must precede any specific antitrust inquiry. If the terms of the agreements are found to have effects "beyond the exclusionary effects of [the] patent," they "may then be subject to traditional antitrust analysis to assess their probable anticompetitive effects in order to determine whether those provisions violate § 1 of the Sherman Act." The court held the Zenith and Geneva agreements to be valid because they were within the scope of Abbott's patent rights.

The Eleventh Circuit subsequently reaffirmed the reasoning set forth in *Valley Drug* in *Schering-Plough Corp. v. Fed. Trade Comm'n*, 402 F.3d 1056, 1065 (11th Cir. 2005) (holding that pay-for-delay agreements with the generic manufacturers fell well within the scope of the patent). The court emphasized the fact that the agreements permitted the generic manufacturers to enter the market before the expiration of the patent. The court further restated its view that "neither the rule of reason nor the per se analysis is appropriate" in the context of reverse payment settlements. Rather, the Eleventh Circuit clarified the standard adopted in *Valley Drug*, explaining that the proper analysis of antitrust liability requires an examination of: "(1) the scope of the exclusionary potential of the patent; (2) the extent to which the agreements exceed that scope; and (3) the resulting anticompetitive effects."

The Federal Circuit subsequently adopted the Eleventh Circuit's "exclusionary zone" test to evaluate reverse payment settlements. *In re Ciprofloxacin Hydrochloride Antitrust Litig*., 544 F. 3d 1323, 1341 (Fed. Cir. 2008). In *Ciprofloxacin*, Barr filed an ANDA seeking approval to market a generic version of Bayer's Cipro pharmaceutical. Bayer sued Barr for patent infringement. The parties entered into a settlement agreement whereby Barr agreed not to market its generic version of Cipro until after Bayer's patent expired. In exchange, Bayer agreed to make payments to Barr totaling almost $400 million. Indirect purchasers of Cipro and several advocacy groups challenged the settlement as a violation of antitrust laws. The district court granted summary judgment to defendants, holding that any anticompetitive effects "were within the exclusionary zone of the patent." The Federal Circuit affirmed, holding that the mere presence of a patent entitles the patent holder to purchase protection from generic competition, absent fraud or sham litigation.

The Second Circuit––A New Approach

The Second Circuit has also rejected the FTC's per se rule and held that reverse payment settlements do not violate antitrust laws where they fall within the exclusionary zone of the patent. *In re Tamoxifen Citrate Antitrust Litig.,* 466 F.3d 187, 228 (2d Cir. 2006).

In *Tamoxifen*, Barr submitted an ANDA seeking approval to market a generic version of Zeneca's pharmaceutical. Zeneca filed suit for patent infringement, and the district court held Zeneca's patent to be invalid. Thereafter, Barr and Zeneca entered into a settlement agreement whereby Zeneca paid Barr $21 million and granted Barr a non-exclusive license to sell brand-name tamoxifen. As part of that settlement, the parties agreed to vacate the district court's judgment finding the patent invalid. Barr further agreed not to market a generic tamoxifen product until either Zeneca's patent expired or another party successfully challenged the Zeneca patent as invalid. Consumer groups filed lawsuits challenging the reverse payment settlement, in part because the settlement was alleged to violate the Sherman Antitrust Act by preventing competition by other generic manufacturers. The district court dismissed these claims, finding that although an agreement between a monopolist and a potential competitor ordinarily violates the Sherman Antitrust Act, such agreements are not necessarily unlawful when the monopolist is a patent holder because of the nature of the patent right.

The Second Circuit affirmed, agreeing with the Eleventh Circuit that simply because a brand-name pharmaceutical company pays a generic competitor to stay out of the market, there is no antitrust violation unless the exclusionary effects of the agreement exceeded the scope of the patent. Finding that the agreement did not exceed the scope of the patent, the Second Circuit opined that the antitrust plaintiff could only prevail by proving either fraud or that the underlying infringement lawsuit was a sham.

The Second Circuit reaffirmed the approach it took in *Tamoxifen* when it upheld a reverse payment settlement in *Arkansas Carpenters Health and Welfare Fund v. Bayer, AG*, 604 F.3d 98, 105-106 (2d Cir. 2010). In *Arkansas Carpenters*, Barr agreed to delay entry of its generic pharmaceutical into the market in exchange for payments amounting to $398.1 million. The Second Circuit held that it was bound by the *Tamoxifen* decision and thus the

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only potential basis for an antitrust violation would be if the settlement agreement "exceeded the scope of the [ ] patent."

In its decision, however, the Second Circuit identified several reasons for revisiting that precedent and invited plaintiffs to petition for rehearing en banc. Most notably, the court cited the Department of Justice's (DOJ) urging to repudiate *Tamoxifen*, and cited an FTC report that the practice of entering into reverse payment settlements has increased since the *Tamoxifen* decision. The DOJ and FTC filed amicus briefs recommending that the Second Circuit reconsider its decision.

On September 7, 2010, the Second Circuit denied the request for rehearing en banc. Circuit Judge Rosemary S. Pooler filed a vigorous dissent criticizing the *Tamoxifen* decision and reverse payment settlements in general. Judge Pooler noted that reverse payment settlements, "once unheard of, [have] become increasingly common. This Court has played a significant role in encouraging this unfortunate practice." *Arkansas Carpenters Health & Welfare Fund v. Bayer, AG*, Nos. 05-2851, 05-2852, 05-2863, 2010 U.S. App. LEXIS 18893, at *3 (2d Cir. Sept. 7, 2010). Judge Pooler noted that in the five years before *Tamoxifen* was decided, "there were no settlements involving exclusion payments, and even pharmaceutical industry representatives appear to have conceded the illegality of the practice . . ." However, "[i]n the four years since *Tamoxifen,* by contrast, the Federal Trade Commission has identified fifty-three pharmaceutical patent settlements involving exclusion payments." Judge Pooler stated that reverse payment settlements serve "no obvious redeeming social purpose" and opined that the *Tamoxifen* decision should be reconsidered:

> The *Tamoxifen* majority recognized the "troubling dynamic" of permitting exclusion payments that "inevitably protect patent monopolies that are, perhaps, undeserved." Subsequent experience has shown that the majority was right to be "troubled." . . . It will be up to the Supreme Court or Congress to resolve the conflict among the Courts of Appeals.

On December 7, 2010, a group of drug purchasers filed a petition for writ of certiorari in the Supreme Court in the *Arkansas Carpenters* case, arguing that reverse payment settlement agreements cost consumers and taxpayers billions of dollars each year. The petition echoed Judge Pooler's concern that reverse payment settlements have become an increasingly controversial practice, and urged the Supreme Court to side with the FTC and DOJ in rejecting these settlements. Attorneys general from 32 states have filed amicus briefs siding with the FTC and urging the Court to review the case.

It remains to be seen if the Supreme Court will capitalize on this opportunity to resolve the continuing controversy over the validity of reverse payment settlements. It may be, with the DOJ's new opposition, a growing circuit split, and a strong dissenting opinion from the Second Circuit, that pay-for-delay settlements will finally pique the Supreme Court's interest.

Pending Federal Legislation

At the same time as reverse payment settlements have been litigated in the courts, Congress has become increasingly focused on passing legislation to prohibit (or severely limit) the use of reverse payment settlements.

Federal legislation on reverse payment settlements has been pending in both the House and the Senate since 2009. In March 2009, the House introduced H.R. 1706 (which has since been tabled), proposing to amend the Federal Tort Claims Act by prohibiting an ANDA filer from receiving anything of value in exchange for an agreement with a brand-name manufacturer "not to research, develop, manufacture, market, or sell [the generic product] . . . for any period of time." A similar bill was introduced in the Senate in February 2009 (S. 369, entitled the "Preserve Access to Affordable Generics Act"), stating that "settlements which include a payment from a brand-name manufacturer to a generic manufacturer to delay entry by generic pharmaceuticals are anti-competitive and contrary to the interests of consumers," and therefore, the bill's intention was "to prohibit payments from brand-name to generic pharmaceutical manufacturers with the purpose to prevent or delay the entry of competition from generic pharmaceuticals."

The House thereafter adopted S. 369 as an amendment to the War Funding Bill in H.R. 4899, the Supplemental Appropriations Act of 2010. H.R. 4899 would allow the FTC to act on any settlement believed to be illegal. Proposed penalties under the amendment included forfeiture of up to three times the value received in the reserve payment settlement or the value reasonably attributable to violation of H.R. 4899. However, not all reverse payment settlements would be prohibited. For a settlement to be excluded from penalties, it must allow for at least one of the following: (1) the right of the generic manufacturer to market the generic pharmaceutical in the market; (2) payment to the generic manufacturer for litigation expenses that does not exceed $7,500,000; or (3) a covenant not to sue the generic pharmaceutical manufacturer for patent infringement.

H.R 4899 was cleared for White House approval on July 27, 2010, but not before the Senate stripped away the amendment on reverse payment settlements. Senate Majority Leader Harry Reid (D-NV) moved to adopt the House amendment, but the Senate disagreed by unanimous consent. The bill was returned to the House, and the House agreed to accept the Senate's earlier version of the bill.

It remains to be seen what will happen with the pending federal legislation on reverse payment settlements, but it is unlikely that this debate is over. This is particularly true given the president's past support of such legislation. Should such legislation be passed in the future, the FTC will be able to curtail the use of reverse payment settlements, essentially abrogating the federal court decisions discussed above.

Will the High Court Weigh In?

The United State Supreme Court has passed on a number of opportunities to resolve the circuit split over the validity of reverse payment settlements, suggesting that the most likely solution may come

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from Congress. However, the Supreme Court's unwillingness to weigh in on the issue in the past may have been influenced by the Bush administration's position on the issue—which has markedly shifted with the new Obama administration.

During his presidential campaign, Senator Barack Obama was especially critical of the Bush administration's record of enforcement against what he saw as anticompetitive conduct, and promised that his administration would focus on "reinvigorate[ing] antitrust enforcement," specifically focusing on competition in health care and pharmaceuticals. This position departed from the Bush administration's approach to reverse payment settlements. In the *Schering-Plough* case, the DOJ under Bush filed an amicus brief disagreeing with the FTC and encouraging the Supreme Court to deny review. Now, however, the DOJ has changed course to reflect the Obama administration's disfavor for reverse payment settlements. In the *Arkansas Carpenters* case, the DOJ accepted the Second Circuit's invitation to weigh in on the issue. In its amicus brief in the Second Circuit, the DOJ for the first time sided with the FTC and argued that reverse payment settlements should be treated as "presumptively unlawful" as antitrust violations. Should the Supreme Court grant certiorari in the *Arkansas Carpenters* case, it is reasonable to assume that the DOJ will weigh in again as an amicus—but this time, on the side of the FTC.

Conclusion

It is unclear whether reverse payment settlements will continue to be a viable means of resolving patent infringement lawsuits. If Congress continues to pursue federal legislation limiting the legitimacy of these agreements—or if the Supreme Court finally takes up the issue in *Arkansas Carpenters*—the landscape of reverse payment settlements may soon change. Both brand-name and generic pharmaceutical manufacturers should stay tuned.

The authors are attorneys at Haynes and Boone LLP. Kendyl Hanks is a partner in the Appellate Practice Group in New York City, and Sarah Jacobson is an associate in the Business Litigation Group at the same location. Kyle Musgrove and Michael Shen are partners in the Intellectual Property Litigation Group in the firm's Washington, D.C., office.

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BUSINESS LAW **TODAY**
The ABA Business Law Section's Online Resource

The Legal and Business Case for LEED Certification in the Post-Recession World

By Michael Mergens and Julie Perrus

Before the Great Recession and the near collapse of the commercial real estate market, one of the hottest trends in development was the desire for sustainable buildings and the advent of the private sustainability rating system known as LEED (Leadership in Energy and Environmental Design), which was created by the United States Green Building Council (USGBC). LEED quickly caught on not only with private builders, but also local governments looking at ways to encourage sustainable design and practice. Of course, when commercial and residential construction came to a standstill, the LEED discussion shifted and those involved looked to find ways to maintain its vigor. As we discuss later in the article, the USGBC has responded to that need by expanding its rating system and continuing to make revisions to existing systems in order to improve the overall LEED product.

It is clear that LEED has become the referenced standard in green building. With membership of USGBC nearing 20,000 companies and organizations, LEED dominates the sustainable design conversation. LEED is a recognizable tool that allows governments to communicate a commitment to sustainability while allowing developers to showcase innovation and increase demand. Even during the economic downturn and the collapse of the housing bubble, companies have begun to determine that in order to stand out to consumers, "green" is the new gold standard, driving higher returns and lease rates as well as increased occupancy and customer satisfaction.

But this is not to say that there are not risks that should be recognized and accounted for in pursuing LEED certification. Indeed, since LEED first came into prominence, numerous articles have been written regarding the legal liabilities that might arise from the decision to pursue LEED certification for a new building. The potential legal issues from LEED certification even caused one commentator to write on the possibility for "LEEDigation."

As we begin down the slow track to recovery, it is worthwhile to review not only how LEED has changed, but to also review LEED's impacts on business and the potential "LEEDigation" and other legal hurdles that are relevant in this expanding green marketplace. In this article, we will discuss the recent changes to the certification process and the latest news on government incentives or regulations designed to encourage green buildings. Then, we provide a short update on the business costs and benefits from green buildings. Finally, we will discuss the legal risks and benefits that should be considered and accounted for once the decision is made to pursue LEED certification.

The Evolution of Green Building and LEED

Although commercial construction remains slow, the construction that is occurring, particularly of public buildings or publically-funded private projects, continue to emphasize green, or sustainable, construction. Green building, whether utilizing LEED, Green Globes, Energy Star, or a local standard, is a universally accepted component of the overall climate change mitigation strategy and method to address the need for sustainable development practices. While all of the various standards provide a symbol at some level of a project's sustainable features, LEED is most recognized and utilized in the building industry; and governments, both state and local, are utilizing LEED certification as a benchmark for approvals as well as funding. As potential building occupants and regulators have become familiar with LEED and the advantages of sustainable buildings, LEED certification has evolved from a marketing tool or a standard touted by green builders to a quasi-governmental sustainability code.

Since LEED first arrived as a private rating system, more and more state and local governments are using LEED certification in the entitlement process or are offering specific incentives for LEED certification. It has become common across the nation to require all new public buildings or publicly-funded construction to reach a certain level of LEED certification. But some cities continue to raise the bar. Many cities and counties now offer specific development incentives for LEED certification that in some cases can provide for

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larger-scale development than what would traditionally be allowed as well as an expedited project approval process. Perhaps more importantly, many cities have now enacted tax breaks for residential and commercial buildings that vary based on the level of certification. For example, in Baltimore, Maryland, the city council approved a bill in April 2008 that provides tax credits for LEED certified homes at the following levels: 40 percent property tax credit for LEED Silver, 60 percent for LEED Gold, and 100 percent for LEED Platinum. There is an existing county-based tax credit for any new commercial building that meets LEED Silver. In 2007, New Mexico passed legislation providing statewide tax credits, with an aggregate limit of $5 million, for the construction of sustainable building, which can be met through LEED certification. Some cities, such as El Paso, Texas, have gone a step farther to offer grants. Still other cities require certain private construction to meet LEED standards. As municipal ordinances and state statutes are continuing to be revised to meet the demand for sustainable design, it is critical that developers create a team that has the capacity to review local ordinances and state standards for development carefully; not only to prevent the failure to meet a requirement, but also to take advantage of any potential financing or development incentives.

While LEED has become a standard tool for governments and developers, USGBC has continued to evolve the LEED rating system as a response to market demands. LEED, now overseen by the Green Building Certification Institute (GBCI), is no longer just for new construction. The USGBC has developed specific rating systems for schools, health care facilities, and retail, and has increased its focus on interiors and existing buildings. The latest versions of LEED also respond to criticism within the development community that LEED did not go far enough to address energy costs, and the latest iterations of the certification process increase the focus on energy efficiency, renewable energy, and the overall carbon footprint of a site.

Traditionally, LEED for New Construction and Major Renovations (LEED-NC) has been the most utilized LEED certification measure to date. However, while extremely valuable, all new buildings become existing buildings on the date of occupancy. USGBC has begun to focus more of its efforts on recognizing that sustainable design is only truly effective if it actually remains sustainable. Ongoing monitoring in order to ensure on-site water usage and waste reduction remain at the levels committed to during the certification process is important, as is monitoring building maintenance and tenant improvements. While LEED-NC may ultimately become more prescriptive in its monitoring requirements, USGBC has also prioritized LEED for Existing Building Operations & Maintenance (LEED EB-O&M) as a tool to ensure that existing buildings get sufficient attention. Currently, the USGBC is just completing a public comment period on all of its rating systems and expects to hold additional public informational hearings on the continual changes to the LEED rating system this fall.

As LEED continues to develop, businesses are responding to a changed economic environment, many seeing increased fixed expenses, like energy costs, eating away at already impacted profit margins. In addition, shareholders and consumers have an increased interest in sustainability, and even though this interest is largely undefined, it requires a response. LEED, as a green building standard, can provide at least a partial solution.

The Business Case for LEED

While it is still true that in residential retrofits and new construction a premium often exists on green building, the cost gap for commercial and industrial green building has not only closed, the return on investment in both energy and water savings can provide more than a payback of the LEED certification costs within the first year of occupancy. But it is no longer just about energy and water.

Increasingly, we see decisions regarding sustainable development being driven by consumer expectations. A study out of University of California, Berkeley, in 2009 compared buildings that had been certified, under LEED and Energy Star, to control buildings. Certified buildings had sales prices that were, on average, 16 percent higher than those in the control group. Similar studies have shown increased occupancy rates and higher rents for certified buildings.

And businesses are starting to demand green design based on new links that are being made to sustainable design and productivity, attendance, and overall job satisfaction. Consider the scenario of a corporate headquarters with 500 full-time staff and an average salary of $36,000 plus benefits. Assume the company spends $150,000 on LEED certification as a premium over traditional development for its new headquarters. Not only would the green building provide significant increases in energy efficiency, but based on a CBRE survey conducted in 2009, the company would save over $1.2 million per year in reduced absenteeism and increased productivity.

While all of these links are becoming more accepted as marketplace realities, businesses must still be cognizant of the potential legal issues that are hanging around the edges of this discussion.

The Legal Risks in LEED Certification

One of the most common questions we hear is "what is a lawyer's role in LEED certification?" The short answer is that since failing to achieve LEED certification in the manner it was contemplated will likely cause real world losses for the owner, the decision to pursue LEED certification or to construct a building to that certification carries with it legal rights and liabilities. So the role of the lawyer is, first and foremost, to assure that any contract is properly drafted to account for and allocate the legal rights and liabilities. Property defining the respective rights and responsibilities of the parties requires that you understand where the concerns lie.

In advising your client, you must be aware of the most current LEED requirements. LEED is an ever evolving standard with new requirements and new certification options. The latest version, LEED v3, has made changes to address the perception that LEED was a one-time

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compliance scheme that had little teeth if a project failed to live up to its expected performance. Version 3 includes a requirement to provide whole-project energy and water usage "information on a regular basis in a free, accessible, and secure online tool or, if necessary, taking any action to authorize the collection of information directly from service or utility providers." Access to the information must be granted within one year of LEED certification and be available annually for five years. Version 3 also grants the GBCI the power to revoke LEED certification from a non-compliant building. In other words, long after the contractor has completed its work, there is still the potential for exposure. A wise practitioner must account for this risk in the construction contract and consider the insurance ramifications under a completed-operations policy.

Further, whether it is a construction contract to build a LEED certified building or a lease that requires the owner provide a LEED certified building, it is important to define the certification desired and who bears responsibility should a third party cause the loss of certification. For new construction, the first issue is easy; is the certification level Silver, Gold or Platinum? But the contract should also address whether there are ongoing obligations. As discussed above, LEED also provides for the opportunity to certify the ongoing operation and maintenance of existing buildings. In fact, GBCI offers free LEED EB-O&M registration for most previously certified LEED buildings. A property owner who seeks certification for the initial construction, or a tenant who desires to rent a sustainable building, may naturally wish to ensure the ongoing benefits of LEED. Projects certified under LEED EB-O&M must be recertified every two years. A contractor will likely want to disclaim any responsibility to maintain or achieve LEED EB-O&M certification. For a lease that calls for a LEED building, it should be clear if the tenant requires just LEED NC or also the ongoing LEED EB-O&M. Further, if a lease requires LEED EB-O&M, especially in a multi-tenant building, consideration must be given to who would bear responsibility for the loss of certification for third parties. For example, if the janitorial service fails to abide by the green cleaning requirements or the actions of a second tenant who has no LEED requirements, pushes a building into non-compliance, is the landlord in default of the lease?

Finally, it is important to account for the consequences of not reaching, or losing, the desired certification level whether by acts of third parties or otherwise. This is especially important in those areas where LEED has been incorporated into state or local building regulations either as a mandate for public or publicly-funded building or as trigger for valuable incentives. In these jurisdictions, the failure to receive the required certification level will likely have clearly quantifiable damages. In addition, a property owner may also seek to recover the less tangible losses that could result from such as lower rent or the loss of expected increased employee productivity and reduced absenteeism. Whether such damages are recoverable and whether there are limits to recovery should be accounted for in the contract. When considering damage allocation and limits, it is also important to note that the new versions grant third parties the ability to challenge an award of points.

But construction contracts and leases are not the limits of legal implications arising from the LEED rating system. Nor are all the legal implications negative. Below, we outline the legal benefits LEED certification can provide for advertising and marketing.

Advertising and Marketing Issues

One of the growing legal issues in the new era of consumer-focused sustainable marketing is "greenwashing" and the potential for deceptive marketing claims from broad, subjective environmental claims. While this has not traditionally been an issue for real estate, as data on the direct benefits for the occupants of green buildings continue to grow and the battle for viable retail and commercial tenants continues, the need to market the sustainable features of an office building or retail location will increase as well. As tenants and purchasers recognize the benefits of green buildings in a very tight market, advertising your client's building as LEED Gold or LEED Platinum provides a clear and objective standard to tout and will help avoid any claims of greenwashing or misleading marketing claims.

This is especially important in light of the Federal Trade Commission's (FTC) recent decision to update its "Green Guides." The Green Guides apply to environmental claims included in labeling, advertising, promotional materials, and all other forms of marketing, whether asserted directly or by implication. Conduct inconsistent with the positions articulated in the Green Guides may result in corrective action. While the current Green Guides may be directed primarily toward product advertisement, the scope of coverage is broadly written and the proposed revisions would expressly cover claims relating to renewable energy and carbon offsets.

The most interesting component of the proposed changes is the FTC's concern with consumers' perceptions. Research suggests that consumers could be misled by factually-accurate claims because consumers interpret them differently than marketers intend. For example, in responding to comments that companies should be allowed to market that their buildings "host" a renewable energy facility, the FTC responded that claiming a location "hosts a renewable energy facility" may under some circumstances be misleading advertising. The FTC reached the conclusion because a significant majority of consumers did not understand the technical difference between hosting a renewable energy facility, having an on-site solar array where the owner has sold renewable energy credits, and having the property powered by renewable energy.

The FTC's reasoning can be important if you client is considering a building that is "LEED compliant" rather than "LEED certified." LEED compliance refers to a building that is build using the LEED principle without spending the additional money to pursue certification from GBCI. It is a technical distinction that many consumers are unlikely to understand. Applying the FTC's reasoning, there is a potential that that the FTC, or state agency

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interpreting state marketing statutes, could determine that marketing a commercial building or new home as "LEED compliant" is misleading or deceptive.

Conclusion

In sum, it is clear that the LEED rating system is here to stay and has evolved well beyond the point of being a mere marketing symbol. As the real estate market begins to recover and state and local governments increasingly look to incorporate LEED certification or LEED standards within their regulatory structures, property owners, contractors, business tenants, and consumers will be looking more and more for guidance on what it means to own, build, or occupy a LEED certified building or home. As questions arise, businesses must understand the unique positives and negatives of this private rating system that has become so deeply ingrained in the governmental push for sustainability.

Mike Mergens and Julie Perrus are both LEED accredited professionals and associates at the law firm of Larkin Hoffman Daly & Lindgren, Ltd., in Minneapolis. Mike focuses on real estate litigation and regulatory compliance matters and Julie focuses on land use, regulatory compliance, and government relations.

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BUSINESS LAW TODAY
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Training for Tomorrow

Doing Good to Train Well

By Rachel Gallegos and Stefanie Fleischer Seldin

Training new lawyers in interviewing, counseling, and negotiation is a costly process and in many contexts, there are few opportunities for new lawyers to work with clients. While we often think of pro bono programs as offering younger lawyers a chance to develop professional habits of public service, these programs can also help meet a firm's or organization's core training objectives: they supply relatively rare opportunities for lawyers to develop the complex skills needed to work with clients.

In 2008 there were approximately 10,000 mortgage foreclosure complaints filed in the city of Philadelphia. This number was indicative of the nationwide epidemic facing Americans everywhere. We are living in extraordinary times requiring extraordinary measures, and in 2008, Philadelphia's First Judicial District took measures to address this crisis: the Philadelphia Mortgage Foreclosure Diversion Program.

This program is centered on informed, professional negotiation. It rests on the theory that if you bring homeowners and lenders face to face, and give the homeowners professional representation to level the negotiating playing field, deals can be struck and houses saved. The action takes place each Thursday in courtroom 676 City Hall where court regulations require all cases involving residential owner-occupied properties to be noticed for a conciliation conference before the property can be put up for sheriff's sale. The foreclosure complaint served on the homeowner includes a case management order scheduling a conciliation conference and instructions directing the homeowner to contact the Save Your Home Philly Hotline, which sets up an appointment with a local housing counselor. The housing counselor assists the homeowner in gathering necessary financial information that is given to the attorney for the plaintiff. Both parties then attend the conciliation conference on a designated Thursday where they attempt to negotiate a resolution.

It is here that the volunteer lawyers—and real training opportunities for newer lawyers—comes in. On the spot, volunteer lawyers are paired with homeowners and housing counselors and told who lender's counsel is. The volunteer will work with the client and housing counselor to understand the facts, come to a negotiation strategy, and then conduct the negotiation with lender's counsel that same afternoon.

Inexperienced lawyers do not enter these negotiation opportunities cold. Rather, they are first trained in the basic concepts of mortgage foreclosure law, negotiation, and the specifics of the Diversion Program. The Philadelphia Bar Association's pro bono arm, Philadelphia Volunteers for the Indigent Program (VIP), requires 3.5 hours of training before an attorney may represent homeowners in the Diversion Program. This free training is conducted by a VIP staff attorney, a volunteer attorney, and a housing counselor and, once the lawyer assists clients at least twice after the training, he or she receives 3.5 hours of free Continuing Legal Education credits.

The program also helps newer lawyers develop their skills through a robust mentoring program. New volunteers can choose to shadow an experienced volunteer during their first visits to court and, in addition, there are always both VIP staff and a legal services lawyer in the courtroom to offer assistance to volunteers as needed. The housing counselors also have a wealth of knowledge about homeowners' circumstances and the various programs designed to help them and work with the volunteer attorney to assist homeowners. This information becomes part of the substance of volunteer's negotiation strategy.

At the conclusion of the negotiation conference, the volunteer lawyer and plaintiff's lawyer will report the outcome of their negotiation and a court order will be entered to reflect that outcome. The range of possible solutions, and therefore the breadth of negotiating possibilities, is enormous. Resolutions can be a lender forbearance, a stay of the sale, a settlement of the entire action, a loan modification, a loan reinstatement, payment plans, and in some instances, a "graceful exit." The latter refers to those instances where the homeowner vacates the property

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voluntarily, usually in exchange for help from the lender with resettlement expenses or a delay of the sheriff's sale.

Often the case will not be resolved at the first conference and, while it is not required, many volunteer lawyers will follow the case through several conferences to a resolution. This provides additional opportunities to develop client-centered professional skills and gives the volunteer lawyer an even better sense of the professional service commitments of the profession. Since the inception of the program, VIP volunteers have provided over $1.5 million in free legal services to distressed homeowners and their families.

Resolutions, when finally reached, are not resolutions of hypothetical, simulated negotiation problems; rather, these resolutions follow negotiations involving real people threatened with loss of their homes. There is very little available to most younger lawyers that will bring home the sense of professional responsibility and professionalism that representing clients in these cases provides.

Additional Resources

You can find more information on the Philadelphia Residential Mortgage Foreclosure Diversion Program at the First Judicial District of Pennsylvania website. Detailed information including the Save Your Home Philly Hotline is available.

The Diversion Program has been touted as the first effort by bench and bar in the country to do something in the wake of the financial crisis and has become the national model contacted daily by others. Substantively, the program is without a doubt a success in saving many homeowners from losing their housing. But its success reaches beyond the numbers of homes saved. As a model for training lawyers in working with live clients, the program has many of the elements of clinical legal education, an experience unavailable to young lawyers once they have graduated from law school. Its legacy will, of course, be one of reduced homelessness, protected families, and saved neighborhoods. But it will also be one of producing a generation of better trained younger lawyers who have early on developed a taste for the power of pro bono work to change the quality of peoples' lives, including their own.

Rachel Gallegos is a law clerk in the Philadelphia Common Pleas Court, First Judicial District of Pennsylvania. Stefanie Fleischer Seldin is a managing attorney at Philadelphia Volunteers for the Indigent Program.

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BUSINESS LAW **TODAY**
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Focusing on Pro Bono

A State Bar Steps up for Small Business

By Allyn O'Connor

Like many small business owners, the catering company proprietor was trying to contain expenses. Her heating costs were impacting her bottom line and regardless of what she did, the bills remained high. Unreasonably and inexplicably high. After she took the time to compare her square footage with her heat usage, she realized the landlord was billing her business to heat vacant space in the building. The owner needed assistance in renegotiating the terms of her lease. She received it from volunteer Wisconsin business lawyer Joshua Kons, who helped eliminate the overbilling.

This business owner connected with Kons through the Business Assistance Program. The Business Assistance Program (BAP) is a project of the Entrepreneurial Law Committee of the State Bar of Wisconsin's Business Law Section. Under BAP, section members volunteer to provide up to two hours' free counseling to small and emerging businesses throughout Wisconsin. BAP is administered through the Wisconsin Entrepreneurs' Network (WEN), a statewide coalition of over 100 organizations that provide entrepreneurs and small businesses with access to expertise, resources and other services.

A small business in need of legal assistance contacts WEN staff directly or on-line, providing basic information about the enterprise, its location, and the nature of its legal need. WEN staff then identifies the volunteer whose expertise and location are the best match for the client. If the volunteer agrees to take the matter, WEN staff exchanges contact information between the client and the volunteer attorney. "The attorneys who participate in the Business Assistance Program have been very willing to help when they are asked," notes Ashwini Rao, WEN Program Manager.

Fifty-two law firms have volunteered to provide assistance under BAP, as well as a clinic at the University of Wisconsin Law School. Volunteer lawyers have assisted hundreds of Wisconsin businesses since BAP was created. In the last six months alone, WEN staff has successfully placed 25 requests for assistance, and WEN staff typically is able to match a business with a volunteer in less than a week.

Volunteer lawyers have assisted a variety of businesses across the state, including construction firms, wholesale and retail businesses, and small manufacturers. They also have assisted many professional services firms, including those in the marketing, graphic design, education, and health fields. Volunteers often work with entrepreneurs to create organizational documents. Established businesses typically need assistance with lease contract negotiation or regulatory matters, such as obtaining licenses, registrations, and permits.

Business owners reflect positively on their experience with BAP. Anthony Mlachnik sought start-up assistance for his elite basketball training business. While starting his business, Mlachnik had legal questions on formation, operation, and intellectual property matters. BAP connected Mlachnik with Todd Goodwin at Schober Schober and Mitchell, S.C. Goodwin "really helped us get our company off the ground," says Mlachnik, and has been available for follow-up questions. He recommends BAP to entrepreneurs as "an opportunity to not only create a better company but to be educated by legal professionals."

Dance/exercise studio owner Jackie Steinhauer also recommends BAP. BAP paired her with Sam Wayne of the Madison-based firm Erhard & Payette, LLC. Wayne reviewed an agreement and later a lease for Steinhauer. Steinhauer eventually became a paying client, seeking advice on a separate matter. Wayne was pleased to have the opportunity to work with Steinhauer. Wayne appreciated the chance to work pro bono on matters within his areas of expertise. He believes the experience can benefit business owners in many ways—one of Wayne's BAP clients, for instance, was afraid the cost of consulting a lawyer would be prohibitive. Now, Wayne says, the client "is more likely to consider using a lawyer in the future."

Other volunteers also appreciate the experience. In addition to assisting the gourmet caterer, volunteer Joshua Kons has worked with small consulting firms, landscaping and land surveying businesses, and a floral and plant wholesaler. Kons

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concedes some clients come to BAP on a reactive basis, often with litigation-based matters needing attention. Still, he has not hesitated to assist. While he was growing up, Kons' parents ran a small business. "Legal services were the last thing they could afford," says Kons. "Clients benefit a great deal from no-cost advice," he observes. "It helps them get the lay of the land on a matter."

Both Wayne and Kons recommend volunteering to assist entrepreneurs and small businesses. As a BAP volunteer, a business lawyer can hone legal skills and work on business development. Most of all, providing pro bono legal assistance to small businesses enables a lawyer to be in touch with and meet the legal needs of the local business community. For business owners like Anthony Mlachnik, pro bono legal assistance programs are a great resource. "It really shows that there are individuals [and] firms out [there] concerned about small business owners."

Allyn O'Connor is ABA assistant staff counsel, Business Law Pro Bono Project, in Chicago.

ABA Business Law Pro Bono Project

The ABA Business Law Pro Bono Project is a joint effort between the ABA Standing Committee on Pro Bono and Public Service and the Business Law Section. The Project provides resources, technical assistance, training and other information to business lawyers and legal service providers in order to enhance and expand the delivery of a variety of business law pro bono legal services programs. The goals of the Project are to develop, support, and foster the growth of pro bono and public service opportunities for Business Law Section members that maximize their unique skill sets; maximize the Business Law Section's volunteer and paid resources through centralized administrative support, planning, and funding; and, coordinate the Business Law Section's pro bono and public service efforts with those of other ABA and non-ABA legal professional organizations. The Project is a national clearinghouse for information on starting and operating a business pro bono project and acts as a national catalyst for expanding provision for business law pro bono services.

For news and information on the Section's pro bono opportunities, visit the ABA Business Law Pro Bono Project.

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BUSINESS LAW **TODAY**
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Keeping Current:

Ninth Circuit BAP Finds Wells Fargo Freeze Policy Violates Automatic Stay

By Stephen W. Sather

Breaking with judges in Texas and New Mexico, the Ninth Circuit Bankruptcy Appellate Panel has found that an administrative freeze policy utilized by Wells Fargo Bank violates the automatic stay under 11 U.S.C. § 362(a). *Mwangi v. Wells Fargo Bank, N.A.*, 432 B.R. 812 (B.A.P. 9th Cir., June 30, 2010). The automatic stay is an injunction which arises upon the filing of a bankruptcy proceeding. Among other things, it prohibits attempts to collect a debt which arose prior to bankruptcy or to exercise control over property of the bankruptcy estate.

Wells Fargo's Policy

Every night, Wells Fargo compares newly-filed bankruptcy cases to its list of account holders. If one of its account holders files Chapter 7 bankruptcy, Wells Fargo places an administrative freeze upon the account and sends a letter to the Chapter 7 trustee requesting instructions on disposition of the funds. Wells Fargo does this regardless of whether any money is owed to Wells Fargo.

In the *Mwangi* case, the debtors did not owe any money to Wells Fargo. They initially disclosed that they had only $1,300.00 in their Wells Fargo accounts. After Wells Fargo froze the accounts, they amended their schedules to disclose $17,075.06 and claimed 75 percent of this amount as exempt. The Bankruptcy Code allows individual debtors to retain certain property defined by statute as exempt in order to facilitate their fresh start. The debtors then demanded that Wells Fargo release the funds based upon their claim of exemption. When Wells Fargo refused, the debtors filed a motion for sanctions. By the date of the hearing, the exemption had become final. The bankruptcy court ruled that Wells Fargo had not violated the stay. Because Wells Fargo was not a creditor, it could not be attempting to collect a debt through its administrative freeze, the court reasoned. The court also concluded that Wells Fargo was not exercising control over property of the bankruptcy estate.

The BAP Doesn't Like the Bank's Policy

The bankruptcy court's ruling was appealed to the Ninth Circuit Bankruptcy Appellate Panel (BAP). The BAP disagreed with the bankruptcy court's conclusions. It found that the funds were property of the estate, so that 11 U.S.C. § 362(a)(3), which prohibits acts to "exercise control over property of the estate," applied. The court found that continuing to hold the funds constituted exercise of control over property of the estate. The court further found that the debtors had standing to assert the violation of the stay because they had an inchoate interest in the funds as a result of their claim of exemption. The panel wrote:

> Wells Fargo asserts that it did not exercise control over property of the estate. We disagree. Wells Fargo could have paid the account funds to the trustee; it did not. Wells Fargo could have released the account funds claimed exempt to the Appellants when demand was made; it did not. Wells Fargo could have sought direction from the bankruptcy court, by way of a motion for relief from stay or otherwise, regarding the account funds; it did not. Instead, it chose to hold the funds until a demand was made for payment that it alone deemed appropriate. *If that is not "exercising control over" the funds, we don't know what is.* (Emphasis added.)
>
> . . .
>
> The impact of Wells Fargo's national policy is to turn on its head the balance between rights of parties legislatively created. As a result of the policy, every party, except Wells Fargo, whose rights are impacted by the administrative freeze will need to take action.

The BAP remanded for a determination of whether the violation of the stay was willful and whether the debtors were entitled to damages.

The BAP Disagrees With Other Courts

The Ninth Circuit BAP's opinion contrasts with the decisions in *Wells Fargo Bank v. Jimenez*, 406 B.R. 935 (D. N.M. 2008) and *In re Calvin*, 329 B.R. 589 (Bankr. S.D. Tex. 2005). In each of those

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cases, the courts found that until the funds became exempt, they were property of the estate. While the trustee could demand that the funds could be turned over to him, the debtors had no similar right until their exemption became final. As a result, both courts found that the debtors lacked standing to enforce the automatic stay and that no violation of the stay had occurred.

Judge Jeff Bohm was sympathetic to the dilemma faced by the bank, writing:

> Under the Bankruptcy Act of 1898, entities owing debts, such as the Bank were shielded from liability even if they paid a debtor post-petition as long as the entities were "acting in good faith." (citation omitted). The Bankruptcy Reform Act of 1978 eliminated this provision with the passage of Sec. 542. Entities owing a debt now have exposure to Chapter 7 trustees if payment on the debt is made to the debtor because that debt is owed to the estate until such time as it is abandoned or any exemption becomes final. Under these circumstances, it makes good business sense for the Bank to have instituted a policy that freezes the accounts of depositors who file a Chapter 7 petition. In this manner, the Bank can shield itself from any liability to a trustee while that trustee determines whether the funds are exempt, or nonexempt (or, even if nonexempt, of inconsequential vale to the estate). It is its potential exposure to trustees, not to debtors upon which the Bank must properly focus.

A Big Mess

These cases point out an enormous practical problem. 11 U.S.C. § 541 provides that money in the debtor's bank account is property of the estate. 11 U.S.C. § 542 provides that an entity holding property of the estate "shall deliver to the trustee" the property. But what if the trustee doesn't want the money?

As a practical matter, most funds held by debtors will be exempt or of inconsequential value to the trustee so that the trustee will not administer the asset. Debtors have the expectation that they will continue to be allowed access to the funds since the odds are that they will ultimately receive them. From the trustee's point of view, it is burdensome to hold funds which will not be administered, but potentially more burdensome to recover those funds from the debtor once they have been spent.

At first blush, the bank appears to be an officious intermeddler. It froze the funds even when it had no claim to them. Instead of turning them over to the trustee, it held them. However, Judge Bohm (who was a banker prior to attending law school), has a legitimate point. The Bankruptcy Code says turn over the funds. Recognizing that the trustee might not want the funds, the bank agreed to hold the funds pending direction from the trustee. That direction never came and eventually the funds became the debtors' exempt property.

The Ninth Circuit BAP faulted the bank for not taking a permissible alternate course:

> Wells Fargo could have paid the account funds to the trustee; it did not. Wells Fargo could have released the account funds claimed exempt to the Appellants when demand was made; it did not. Wells Fargo could have sought direction from the bankruptcy court, by way of a motion for relief from stay or otherwise, regarding the account funds; it did not. Instead, it chose to hold the funds until a demand was made for payment that it alone deemed appropriate.

While the BAP outlined multiple options, they were not very practical. Paying the funds to the trustee in every case would be burdensome to both the bank and the trustees. Since most cases turn out to be no-asset cases, trustees would likely return the funds in most cases. Freezing the funds and then turning them over to the debtor places the bank at risk if the exemption is not sustained. Seeking direction from the bankruptcy court is also not feasible in large numbers of cases. The only feasible option under the BAP's opinions is not to freeze the funds in the first place.

Wells Fargo filed an appeal to the Ninth Circuit Court of Appeals. Because the BAP's decision was not yet final, the court of appeals dismissed the appeal for lack of jurisdiction in December 2010. As a result, the case will return to the Bankruptcy Court for determination of damages.

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