Some of Our Business: Supreme Court Hearing Arguments on Significant Business Cases This Fall

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Corporate Counsel

As the Supreme Court heard oral arguments for the second month of its 2010 term, business cases continued to comprise a significant portion of its docket. Two cases argued before the court in November present issues of interest to the corporate world.

As the court grapples with them, court watchers will be studying the impact on recent changes in court personnel. The two newest justices, Justice Elena Kagan and Justice Sonia Sotomayor, are widely viewed as likely to lean more toward the court's liberal wing on tort cases.

How this shakes out in business cases remains to be seen – and firm conclusions may have to wait until 2011 because of the large number of cases from which Justice Kagan has recused herself. She will not participate in approximately half of the cases to be decided this term, including *Costco Wholesale Corp. v. Omega, S.A.* and *AT&T Mobility LLC v. Concepcion*.

Costco, which was argued on Nov. 8, presents the court with the question of whether a U.S. corporation that resells foreign manufactured goods obtained through a third-party importer may defend a copyright infringement suit on the grounds of the first sale doctrine.

The decision of the court is vitally important to the retail industry since commerce in imported goods continues to expand and copyright challenges threaten mass retailers who purchase goods for resale from wholesale importers and distributors. The decision will also be significant to businesses engaged in the automotive industry and many other sectors of the U.S. economy, including entities engaged in Internet commerce such as eBay Inc., Google Inc., and Amazon.com, Inc. It has implications for manufacturers who currently employ copyright law as a means of attempting to control unlawful distribution of copies of their products.

Costco Wholesale Corporation is a U.S. corporation that sells name brand goods in wholesale stores throughout the country. Omega SA, a Swiss watchmaker, sued Costco claiming it obtained and sold Omega watches in California without Omega's permission. Omega had sold the watches outside the U.S. but had not authorized their importation into the U.S. or the subsequent domestic resales. Costco raised the first sale doctrine, a defense to copyright suits grounded in language in Section 109(a) of Title 17, which codified the "first sale doctrine" initially adopted in *Bobbs-Merrill Co. v. Straus* (1908).

Justice Kagan has recused herself because the U.S. filed a brief opposing the grant of certiorari in this case on the basis that the Ninth Circuit's decision reaffirmed well-settled law and did not create a conflict.

Relying on the leading copyright treatises, the U.S. argued that the first sale defense is unavailable to importers who acquire ownership of overseas goods that are unlawfully imported into the country. In addition, the U.S. asserted that the Ninth Circuit embraced the best reading of the statute in light of the court's decision in *Quality King Distributors, Inc. v. L'Anza Research Int'l, Inc.* (1998).

Writing for a unanimous court, Justice Stevens in *Quality King* held that the first sale doctrine applied to goods that were first sold in the U.S., exported overseas, and then resold in the U.S. without permission.

There too, the U.S. had argued strenuously that the first sale doctrine did not apply to the protection of imported goods and that allowing unauthorized copies of goods to be sold within the U.S. would be inconsistent with treaties that the U.S. had negotiated. But the court rejected that position and concluded that the doctrine applied.

The players involved in the briefing this time largely mirror those involved in *Quality King*. And thus, the outcome may well be the same despite the obvious persuasive strength of the government's brief urging the court to overrule the Ninth Circuit's ruling. At oral argument, questions focused on the statutory text, and the extent to which the court could find support for the Ninth Circuit's position in the legislative history.

A second significant case heard by the Supreme Court this month is *AT&T Mobility LLC v. Concepcion*, a case that will decide whether the Federal Arbitration Act preempts states from conditioning the enforceability of an arbitration agreement on the availability of class-wide arbitration. Although the case arises in the context of a challenge to a service contract for a wireless phone service, the decision will be significant for businesses generally.

The court will need to decide the extent to which state law can prevent enforcement of a contractual arbitration clause, which agrees to arbitration of disputes and waives any right to class-wide resolution. The Federal Arbitration Act makes arbitration agreements "valid, irrevocable, and enforceable save on such grounds as exist at law or in equity for the revocation of any contract."

The California Supreme Court held that under California law, a class waiver is considered unenforceable because it is unconscionable if the provision is in a consumer contract of adhesion where damages are likely to involve small amounts and it is claimed that the party with the superior bargaining strength included the provision to deprive consumers of recovery to which they are entitled.

The decision will be significant to businesses with such provisions in their contracts.

AT&T Mobility LLC contended that the Ninth Circuit ruling, which makes such class waivers unenforceable, will mean the end to consumer arbitration. Last term, in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.* the court ruled that a "party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so."

Justice Alito wrote the majority opinion with 4 justices concurring, Roberts, Scalia, Kennedy, and Thomas. Justice Ginsburg wrote a dissenting opinion, in which Stevens and Breyer joined. A number of the briefs filed on behalf of AT&T and its amici have argued that the principles adopted in *Stolt-Nielsen* support a reversal of the Ninth Circuit in this appeal.

Justice Kagan was not on the court when *Stolt-Nielsen* was decided, and Justice Sotomayor recused herself from that case. Both of these justices will participate in the decision of this case. Where they come down is likely to illuminate their perspectives on important questions involving preemption, federalism, and class actions.

Last term, Justice Sotomayor crossed ideological lines to side with Chief Justice Roberts, and Justices Scalia and Thomas, on the question of whether states can limit the right to file a class action lawsuit in federal court in diversity cases. *Shady Grove Orthopedics Associates P.A. v. Allstate Insurance Co.* (2009).

Since *Shady Grove* also implicated the states' rights to limit or favor class action litigation for the resolution of disputes arising under state law, *Shady Grove* may offer some insight into the approach some members of the court may take.

Concerns about the problems created by class litigation have prompted the inclusion of class waiver provisions in many consumer contracts that call for arbitration.

Arbitrations are particularly dangerous for class-wide decisions because they do not offer the protections that litigation through the courts provides. For example, arbitrations do not offer the same wide-ranging discovery, the process tends to be expedited, no formal transcript or record is typically prepared, and no right to appellate review is ordinarily available.

Given the potential for class-wide arbitrations to result in large aggregate recoveries, businesses are understandably concerned about the Ninth Circuit's decision and its impact on the availability and usefulness of this dispute resolution technique. But proponents of arbitration argue that the Ninth Circuit's decision has the potential to eviscerate the benefits of arbitration by permitting a state to oppose any procedure proposed for arbitration that is not the same as that used in litigation.

Questions during oral argument focused extensively on the federalism concerns raised by the case and whether overturning the state law rule of decision would require the Supreme Court to second-guess the states on matters of state law.

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