

Dennis J. Gerschick, Esq.
Taylor, English & Duma, LLP
1600 Parkwood Circle, Suite 400
Atlanta, Georgia 30339
www.taylorenghish.com
Cell: (770) 853-5755
dgerschick@aol.com

2010 Business Law Update ©

By Dennis J. Gerschick, Attorney, CPA, CFA

DISCLAIMER: The following is **not** intended to be legal advice. Competent legal counsel should be consulted **before** taking action. Today's discussion is general in nature. There may be exceptions to a general rule which are not discussed.

I. Preliminary Considerations

- A. Individuals and businesses often take action that has legal implications.
 - 1. Sometimes, the failure to act has legal implications.
 - 2. Individuals and entities should understand the obligations and duties they owe to others and what their liability exposure is if they do not comply with the law.
 - 3. Legal problems are sometimes created because people often take action and ask questions later, if ever, and sometimes because they fail to act.
- B. Legal issues arise in a variety of contexts including:
 - 1. Selecting the legal form of the business
 - 2. Financing the business or the purchase of property
 - 3. Hiring, promoting, and firing employees
 - 4. Compensating employees
 - 5. Advertising and marketing

6. Warranties given to customers
 7. Pricing the company's product
 8. If manufacturing a product - potential product liability
 9. Corporate governance
 10. Leasing and/or buying/selling property
 11. Personal injuries incurred on the business' premises
 12. Entering into any contract – either express or implied
 13. Protecting the company's intellectual property
 14. Complying with applicable laws, regulations, and ordinances
 15. Resolving disputes
- C. The law is complex and is constantly changing.
1. New legislation is being passed at both the federal and state level.
 2. New regulations are issued.
 3. Thousands of court decisions are published each year.
 4. No lawyer, no matter how brilliant or experienced, can be an expert in every area of the law.
 5. Ignorance of the law is no excuse and it is often costly.
- D. Key Point: We should all learn from our own mistakes. However, it is better to learn from the mistakes made by others.
- E. Important Questions:
1. Is your company publicly-traded or closely-held?
 2. In what industries does your company operate?
 3. Where does your company operate geographically?

4. Size of your company in terms of number of locations, number of employees, number of different businesses,

II. Recent Federal Legislation

- A. Health Care
- B. Job creation including tax provisions for small business & job creation

III. Upcoming Federal Legislation

- A. Financial regulatory reform
- B. Immigration Reform
- C. Other tax legislation including addressing the repeal of the estate tax
- D. Sometimes, Congress enacts legislation in response to a U.S. Supreme Court decision. For example, in Lilly Ledbetter v. Goodyear Tire & Rubber Co., Inc., 550 U.S. ____ (5-29-07), another 5-4 decision, the Supreme Court ruled against her as follows:

During most of the time that petitioner Ledbetter was employed by respondent Goodyear, salaried employees at the plant where she worked were given or denied raises based on performance evaluations. Ledbetter submitted a questionnaire to the Equal Employment Opportunity Commission (EEOC) in March 1998 and a formal EEOC charge in July 1998. After her November 1998 retirement, she filed suit, asserting, among other things, a sex discrimination claim under Title VII of the Civil Rights Act of 1964.

The District Court allowed her Title VII pay discrimination claim to proceed to trial. There, Ledbetter alleged that several supervisors had in the past given her poor evaluations because of her sex; that as a result, her pay had not increased as much as it would have if she had been evaluated fairly; that those past pay decisions affected the amount of her pay throughout her employment; and that by the end of her employment, she was earning significantly less than her male colleagues. Goodyear maintained that the evaluations had been nondiscriminatory, but the jury found for Ledbetter, awarding back pay and damages. On appeal, Goodyear contended that the pay discrimination claim was time barred with regard to all pay decisions made before September 26, 1997—180 days before Ledbetter filed her EEOC questionnaire—and that no discriminatory act relating to her pay occurred after that date.

The Eleventh Circuit reversed, holding that a Title VII pay discrimination claim cannot be based on allegedly discriminatory events that occurred before the last pay decision that affected the employee's pay during the EEOC charging period, and concluding that there was insufficient evidence to prove that Goodyear had acted with discriminatory

intent in making the only two pay decisions during that period, denials of raises in 1997 and 1998.

Holding: Because the later effects of past discrimination do not restart the clock for filing an EEOC charge, Ledbetter's claim is untimely. An individual wishing to bring a Title VII lawsuit must first file an EEOC charge within, as relevant here, 180 days “after the alleged unlawful employment practice occurred.” 42 U. S. C. §2000e–2(a)(1). In addressing the issue of an EEOC charge's timeliness, this Court has stressed the need to identify with care the specific employment practice at issue. Ledbetter's arguments—that the paychecks that she received during the charging period and the 1998 raise denial each violated Title VII and triggered a new EEOC charging period—fail because they would require the Court in effect to jettison the defining element of the disparate-treatment claim on which her Title VII recovery was based, discriminatory intent. *United Air Lines, Inc. v. Evans*, 431 U. S. 553, *Delaware State College v. Ricks*, 449 U. S. 250, *Lorance v. AT&T Technologies, Inc.*, 490 U. S. 900, and *National Railroad Passenger Corporation v. Morgan*, 536 U. S. 101, clearly instruct that the EEOC charging period is triggered when a discrete unlawful practice takes place. A new violation does not occur, and a new charging period does not commence, upon the occurrence of subsequent nondiscriminatory acts that entail adverse effects resulting from the past discrimination. But if an employer engages in a series of separately actionable intentionally discriminatory acts, then a fresh violation takes place when each act is committed. Ledbetter makes no claim that intentionally discriminatory conduct occurred during the charging period or that discriminatory decisions occurring before that period were not communicated to her. She argues simply that Goodyear's nondiscriminatory conduct during the charging period gave present effect to discriminatory conduct outside of that period. But current effects alone cannot breathe life into prior, uncharged discrimination. Ledbetter should have filed an EEOC charge within 180 days after each allegedly discriminatory employment decision was made and communicated to her. Her attempt to shift forward the intent associated with prior discriminatory acts to the 1998 pay decision is unsound, for it would shift intent away from the act that consummated the discriminatory employment practice to a later act not performed with bias or discriminatory motive, imposing liability in the absence of the requisite intent. Her argument would also distort Title VII's “integrated, multi step enforcement procedure.” *Occidental Life Ins. Co. of Cal. v. EEOC*, 432 U. S. 355, 359. The short EEOC filing deadline reflects Congress' strong preference for the prompt resolution of employment discrimination allegations through voluntary conciliation and cooperation. *Id.*, at 367–368. Nothing in Title VII supports treating the intent element of Ledbetter's disparate-treatment claim any differently from the employment practice element of the claim.

In response to the Ledbetter decision, Congress passed and President Obama signed within days of his inauguration, the Lilly Ledbetter Fair Pay Act which extends the statute of limitations for filing charges of discrimination in compensation beyond the statutory 180 days by making each new pay check a separate violation triggering a new statute of limitation.

IV. Upcoming State Legislation

- A. Each State is in a different financial position; some far worse than others.
 - 1. Several States are facing large budget shortfalls – the question will be how to address it.
 - 2. States are questioning whether the federal government has the authority to mandate healthcare coverage – is it constitutional?
- B. Most States need revenue, but to attract businesses to locate there States need to be viewed as “business friendly.”
- C. There may be more friction or disputes between the Federal government and the States.
 - 1. Lawsuits have been filed by a number of states challenging the federal health care provision requiring individuals to buy medical insurance. Is that requirement constitutional?
 - 2. Another issue is the medical use of marijuana – allowed by statute in some States but it is against federal law.
- D. Nineteen states ban text messaging while driving; more are expected. Many states will also ban use of cell phones while driving or require hands free use.

V. Upcoming U.S. Supreme Court Decisions

A. **Fraud.** The U.S. Supreme Court will review both Jeff Skilling & Conrad Black’s convictions. In both cases, the Court will focus on what constitutes “honest services” fraud. In Skilling’s case, the Court will also consider his argument that he could not obtain a fair trial in Houston because of anger in the community after Enron’s collapse. Oral argument was heard on March 1, 2010.

B. **Seized Property.** The Court will consider whether owners of property, that is seized by the police, are entitled to a prompt, informal hearing to argue that they should get their property back while waiting for a formal forfeiture proceeding that could be scheduled months or years in the future.

C. **Patents.** In Bilski v. Kappos, the Court will consider the standards for obtaining a patent on a business process. The lower court denied a patent for a commodities trading strategy.

D. **PCAOB.** In Free Enterprise Fund v. PCAOB, the Court will consider whether the PCAOB is constitutional.

E. **Copyright Law.** On April 19, 2010, the Supreme Court agreed to decide if Costco Wholesale Corp. can be held liable to the manufacturer, Omega SA, a unit of Swatch Group, Ltd., for copyright infringement. Costco sold luxury swiss watches it bought from a third party. Costco sold the watches for \$1,299 well below the manufacturer's suggested retail price of \$1,999. The watches were engraved with a small emblem Omega had registered with the U.S. Copyright Office.

VI. Recent U.S. Supreme Court Decisions

Securities Laws

A. What is a "security"?

1. A "security" is **not** limited to just common or preferred stock.
2. Securities include many items including, but not limited to, limited partnership interests, notes, bonds, debentures, passive interests in trusts and other arrangements.
 - a. Loans may not be "securities" but many factors should be considered.
 - (i) Rebuttable presumption that notes with a maturity longer than nine months are securities. Reeves v. Ernst & Young, 110 S. Ct. 94 (1990).
 - (ii) Is the loan made for a "commercial purpose" or an "investment purpose"? See Sanders v. John Noveen & Co., 463 F.2d 1075 (7th Cir. 1972).
3. An "investment contract" is any contract involving (1) the investment of money; (2) in a common enterprise; (3) with an expectation of profits; (4) solely from the efforts of others. SEC v. W. J. Howey Co., 328 U.S. 293 (1946).
4. The sale of all of the stock of a company is a "securities transaction" subject to the antifraud provisions. Landreth Timber Co. v. Landreth, 471U.S. 681.

B. General Rule: every offer and sale of a security must be registered with the U.S. Securities & Exchange Commission ("SEC") and applicable state securities laws authorities.

1. Registration is both expensive and time consuming!

2. Registration may be cost-prohibitive based on a cost vs. benefit analysis.
 3. Securities laws prohibit false or misleading statements in connection with the purchase or sale of a security.
 - a. All material facts regarding a security must be disclosed. Liability can be imposed if:
 - (i) An untrue statement of a material fact is made, or
 - (ii) A material fact is omitted.
 - b. What is a “material fact”? One that an investor should reasonably consider in making their investment decision.
 4. The federal and state securities laws are complex and may be different.
- C. Both federal and state “blue sky” laws may apply.
1. What state securities laws apply? The answer may depend upon the domicile of the parties to whom the sale of securities are offered and/or where the purchasers of the securities are domiciled.
 2. State securities laws vary. In Georgia, see O.C.G.A. §10-5-1 et. seq.
 3. Securities laws are applicable to closely-held companies – their application is not limited to public corporations.
- D. Exemptions from Registration
1. Federal law, regulations, and case law provides some exemptions from the registration process.
 2. The registration requirement does not apply to:
 - a. Exempt securities, or
 - b. Securities transactions that are exempt.
 3. The party claiming the exemption bears the burden of proof. The plaintiff simply must prove that the security was not registered.
 4. Exempt transactions include:
 - a. §4(2) exempts transactions by an issuer not involving a public offering.

- (i) See SEC. v. Ralston Purina Co., 346 U.S. 199 (1953). In Ralston Purina, the company offered securities to employees beyond the executive suite who did not otherwise have access to the same information that would be included in a registration statement. Consequently, they could not fend for themselves and the Supreme Court found the offering was a “public offering”.
- (ii) Each offeree must have access to, or be given full disclosure of, all material information regarding the security and the issues, and the officer must have sufficient sophistication to understand the risks of the offering.
- (iii) There can be no general solicitation or advertising of the offering. See SEC Release No. 33-4552.

b. Regulation D

- (i) Reg. D consists of Rules 501-508.
- (ii) Rules 504, 505, and 506 provide exemptions from registering the security with the SEC.

E. Regulation D

1. Rule 504 – allows offerings up to \$1 million during any 12 month period
2. Rule 505 exempts an offering up to \$5 million in any 12 month period to up to 35 persons, even if the persons are not “accredited” or financially sophisticated.
3. Rule 506 exempts an unlimited amount of securities to be sold to an unlimited number of “accredited” investors and up to 35 non-accredited investors.
4. An “accredited investor” is:
 - a. A person with a net worth of at least \$1 million (excluding their personal residence); or
 - b. An annual income of \$200,000 (\$300,000 on a joint return).

5. There are pitfalls and restrictions in the rules. Competent securities counsel should be consulted before offering securities.
 - a. Restrictions regarding solicitation and advertising. See Rule 502(c).
 - b. Restrictions must be placed on the resale of the securities. See Rule 502(d).
 - c. Understand the concept of “integration” of offerings – two or more offerings may be aggregated.
6. The company must file Form D with the SEC within 15 days of the first sale to report summary information.

F. Consequences of a Securities Violation

1. If the investor still owns the security they can rescind the transaction – the investor can get their money back in full with interest, less any income they have received from the security.
2. Alternatively, if the investor does not own the security, the investor can sue for damages.
3. The entity, including any corporation, that sold the securities does not get the benefit of the corporate veil.
4. The “promoters” of the sale of the “security” are personally liable to the investors.
 - a. Who are the “promoters”? Focus on who is involved in selling the securities.
5. Failure to comply with the law can result in both civil and criminal penalties.
6. The SEC and state authorities can get an injunction.

Fraud

A. What is "fraud"?

1. Black's Law Dictionary defines it to include:

- a. An intentional perversion of truth for the purpose of inducing another in reliance upon it to part with some valuable thing belonging to him or to surrender a legal right.
- b. A false representation of a matter of fact, whether by words or by conduct, by false or misleading allegations, or by concealment of that which should have been disclosed, which deceives and is intended to deceive another so that he shall act upon it to his legal injury.
- c. Any kind of artifice employed by one person to deceive another.
- d. A generic term, embracing all multifarious means which human ingenuity can devise and which are resorted to by one individual to get advantage over another by false suggestions or by suppression of truth, and includes all surprise, trick, cunning, disassembling, and any unfair way by which another is cheated.
- e. As distinguished from negligence, it is always positive, intentional... and includes anything calculated to deceive, whether it be a single act or combination of circumstances, whether the suppression of truth or suggestion of what is false, whether it be by direct falsehood or innuendo, by speech or by silence, by word of mouth, or by look or gesture.

2. Georgia statutes

- a. O.C.G.A §23-2-56 provides:

Fraud may be consummated by signs or tricks or through agents employed to deceive or by any other unfair way used to cheat another.

- b. O.C.G.A. §23-2-57 provides:

Fraud may not be presumed but, being in itself subtle, **slight circumstances may be sufficient** to carry conviction of its existence. See Chandler v. MVM Constr., 232 Ga. App. 385, 389, 501 S.E.2d 533 (1998).

3. The tort of fraud has five elements. These are: (1) false representation by a defendant; (2) scienter; (3) intention to induce the plaintiff to act or refrain from acting; (4) justifiable reliance by

the plaintiff; and (5) damage to the plaintiff. For an action for fraud to survive a motion for summary judgment, there must be some evidence from which a jury could find each element of the tort. See Miller v. Lomax, 266 Ga. App. 93, 96, 596 S.E.2d 232.

4. How do you prove fraud?
 - a. Confessions are not likely.
 - b. Investigators often try to get lower-level employees to talk and provide evidence about higher level executives.
 - c. Actionable fraud may be proved by circumstantial evidence. Actionable fraud is a matter peculiarly within the province of a jury to determine. Marshall v. W. E. Marshall Co., 189 Ga. App. 510, 513, 376 S.E.2d 393 (1988).
 - d. Circumstantial evidence may be sufficient to defeat a motion for summary judgment. Tronitec, Inc. v. Shealy, 249 Ga. App. 442, 451 (2001) citing Furlong v. Dyal, 246 Ga. App. 122, 123, 539 S.E.2d 836 (2000).
 - e. Circumstantial evidence has no less weight than direct evidence as long as it reasonable establishes that fact rather than anything else. Burrell v. Bd. of Trustees of Ga. Military College, 970 F.2d 785, 788 (11th Cir. 1992).
5. Proof of fraud is seldom if ever susceptible of direct proof thus recourse to circumstantial evidence usually is required. Moreover, it is peculiarly the province of the jury to pass on these circumstances, showing fraud. **Except in plain and indisputable cases, scienter in actions based on fraud is an issue of fact for jury determination.** Brown v. Mann, 237 Ga. App. 247, 249, 514 S.E.2d 922 (1999).
 - a. "Scienter" is a mental state embracing intent to deceive, manipulate, or defraud. SEC. v. Adler, 137 F.3d 1325, 1340 (11th Cir. 1998) quoting Aaron v. SEC, 446 U.S. 680, 695-96 (1980).
6. It is not just what is said that is important, what is not said or disclosed is also important.
 - a. An omitted fact is "material" if there is a substantial likelihood a reasonable shareholder would consider it important in deciding how to vote. TSC Indus. Inc. v. Northway Inc., 426

U.S. 438, 449 (1976). Materiality is proved by showing a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

- b. The determination of materiality requires delicate assessments of the inferences a reasonable shareholder would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. TSC. Indus. Inc., 426 U.S. at 450.
7. A defendant cannot simply deny his fraudulent conduct under oath and ask that any contrary circumstantial evidence simply disappear in the fact of a sworn denial. Quill v. Newberry, 238 Ga. App. 184, 188-190, 518 S.E.2d 189 (1999).
8. Consider whether an individual's words are consistent with their actions, the relevant documents, and common sense

Securities Fraud – Statute of Limitations

Merck & Co., Inc. v. Reynolds, 559 U.S. ____ (4-27-2010)

Statute: 28 U.S.C. §1658(b) provides that a private right of action may be brought not later than the **earlier of**:

- (1) 2 years after the discovery of the facts constituting the violation; or
- (2) 5 years after such violation.

This case involves construing this statute.

Facts: Investors alleged that Merck & Co. and others knowingly misrepresented the risk of heart attacks accompanying the use of Merck's pain-killing drug, Vioxx. The plaintiffs brought an action for securities fraud under section 10(b) of the Securities Exchange Act of 1934. The case was filed on November 6, 2003 and no one doubts it was filed within five years of the alleged violation. Consequently, the critical date is November 6, 2001 – two years before the complaint was filed. Merck claims that before this date the plaintiffs had or should have discovered by the critical date those "facts" and so their complaint was not timely filed.

Procedure: Merck filed a Motion to Dismiss. The District Court agreed and dismissed the complaint. The Court of Appeals for the Third Circuit reversed.

Issue: Was the complaint in this private securities fraud action timely filed?

Holdings: A cause of action accrues (1) when the plaintiff did in fact discover, or (2) when a reasonably diligent plaintiff would have discovered “the facts constituting the violation” – whichever comes first. The limitations period does not begin to run until the plaintiff discovered or a reasonably diligent plaintiff would have discovered the facts constituting the violation including scienter – irrespective of whether the actual plaintiff undertook a reasonably diligent investigation.

The “facts constituting the violation” include the fact of scienter, “a mental state embracing intent to deceive, manipulate, or defraud.” A plaintiff cannot recover without proving that a defendant made a material misstatement with an intent to deceive – not merely innocently or negligently. Congress has enacted special heightened pleading requirements for the scienter elements of §10(b) fraud cases. See U.S.C. §78u-4(b)(2) requiring plaintiffs to state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. As a result, unless a §10(b) plaintiff can set forth facts in the complaint showing that it is at least likely as not that the defendant acted with the relevant knowledge or intent, the claim will fail.

The word “discovery” in the statute refers not only to a plaintiff’s actual discovery of certain facts, but also to the facts a reasonably diligent plaintiff would have discovered.

Decision: The complaint was timely filed; Court of Appeals decision is affirmed.

Mutual Funds – Investment Advisor Fees

Jones v. Harris Associates, L.P., 559 U.S. ____ (3-30-2010)

Issue: What a mutual fund shareholder must prove in order to show that a mutual fund investment adviser breached the fiduciary duty with respect to the receipt of compensation for services” that is imposed by §36(b) of the Investment Company Act of 1940 (15 U.S.C §80a et seq.)?

Procedure: Petitioners filed suit in the Northern District of Illinois alleging Harris Associates violated §36(b) by charging fees that were disproportionate to the services rendered and not within the range of what would have been negotiated at arm’s length in light of all the surrounding circumstances. The District Court granted summary judgment to Harris Associates. Applying the standard adopted in Gartenberg v. Merrill Lynch Asset Management, Inc., 694 F.2d 923 (2nd Cir. 1982) the District Court concluded petitioners failed to raise a triable issue of fact as to whether the fees charged were so disproportionately large that they could not have been the result of arm’s-length bargaining.” The Seventh Circuit affirmed but it explicitly disapproved the Gartenberg approach. The Supreme Court vacated the Court of Appeals’ decision..

Facts: Assets in the mutual fund industry grew from \$38.2 billion in 1966 to over \$9.6 trillion in 2008. The number of mutual fund investors grew from 3.5 million in 1965 to 92 million in 2008. There are now more than 9,000 open and closed-end funds. Citing the Investment Company Institute's 2009 Fact Book.

In *Gartenberg*, the Second Circuit noted Congress had not defined what it meant by "fiduciary duty" with respect to compensation but concluded that the test is essentially whether the fee schedule represents a charge within the range of what would have been negotiated at arm's length in the light of all of the surrounding circumstances. To be guilty of a violation of §36(b) the advisor-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining. To make this determination all pertinent facts must be weighed including the adviser-manager's cost in providing the services, the extent to which the adviser-manager realizes economies of scale as the fund grows larger, and the volume of orders which must be processed by the manager. Observing that competition among advisers for the business of managing a fund may be virtually non-existent, the Second Circuit rejected the suggestion that the principal factor to be considered in evaluating a fee's fairness is the price charged by other similar advisers to funds managed by them, although this factor could be taken into account.

Holding: To face liability under §36(b), an advisor-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining.

Analysis: While both sides agreed with the *Gartenberg* approach, they disagreed on several important questions. First, can a court compare the fees that an adviser charges a captive mutual fund and the fees its charges independent clients? Petitioners argued that such a comparison is appropriate while *Harris Associates* disagreed. The Supreme Court noted that "since the Act requires consideration of all relevant factors, we do not think that there can be any categorical rule regarding the comparisons of fees charged different types of clients. Courts may give such comparisons the weight that they merit in light of the similarities and differences between the services that the clients in question require, but courts must be wary of inapt comparisons. If the services rendered are sufficiently different that a comparison is not probative, then courts must reject such a comparison. Even if the services provided and fees charged to an independent fund are relevant, courts should be mindful that the Act does not necessarily ensure fee parity between mutual funds and institutional clients contrary to petitioners' contentions. Courts should also not rely too heavily on comparisons with fees charged to mutual funds by other advisers.

A court's evaluation of an investment adviser's fiduciary duty must take into account both procedure and substance. Where a board's process for negotiating and reviewing investment-adviser compensation is robust, a reviewing court should afford commensurate deference to the outcome of the bargaining process. Thus, if the disinterested directors considered the relevant factors, their decision to approve a

particular fee agreement is entitled to considerable weight, even if a court might weigh the factors differently. This is not to deny that a fee may be excessive even if it was negotiated by a board in possession of all relevant information, but such a determination must be based on evidence that the fee is so disproportionately large that it bears no relationship to the services rendered and could not have been the product of arm's-length bargaining. In contrast, where the board's process was deficient or the adviser withheld important information, the court must take a more rigorous look at the outcome.

An adviser's compliance or noncompliance with its disclosure obligations is a factor that must be considered in calibrating the degree of deference that is due a board's decision to approve an adviser's fees.

The Supreme Court stated "It is also important to note that the standard for fiduciary breach under §36(b) does not call for judicial second-guessing of informed board decisions. In reviewing compensation under §36(b), the Act does not require courts to engage in a precise calculation of fees representative of arm's length bargaining.

Campaign Finance/Freedom of Speech.

On January 21, 2010, the Supreme Court issued its 183 page opinion in Citizens United v. Federal Election Commission; this is perceived to be a landmark decision. It allows corporation to contribute to political campaigns; that is "free speech."

Title VII

Ricci v. Destefano, 557 U.S. ____ (6-29-09) Syllabus 5-4 Decision

New Haven, Conn. (City), uses objective examinations to identify those firefighters best qualified for promotion. When the results of such an exam to fill vacant lieutenant and captain positions showed that white candidates had outperformed minority candidates, a rancorous public debate ensued. Confronted with arguments both for and against certifying the test results—and threats of a lawsuit either way—the City threw out the results based on the statistical racial disparity. Petitioners, white and Hispanic firefighters who passed the exams but were denied a chance at promotions by the City's refusal to certify the test results, sued the City and respondent officials, alleging that discarding the test results discriminated against them based on their race in violation of, *inter alia*, Title VII of the Civil Rights Act of 1964. The defendants responded that had they certified the test results, they could have faced Title VII liability for adopting a practice having a disparate impact on minority firefighters. **The District Court granted summary judgment for the defendants, and the Second Circuit affirmed.**

Held: The City's action in discarding the tests violated Title VII. Pp. 16–34.

(a) Title VII prohibits intentional acts of employment discrimination based on race, color, religion, sex, and national origin, 42 U. S. C. §2000e–2(a)(1) (disparate treatment), as

well as policies or practices that are not intended to discriminate but in fact have a disproportionately adverse effect on minorities, §2000e–2(k)(1)(A)(i) (disparate impact). Once a plaintiff has established a prima facie case of disparate impact, the employer may defend by demonstrating that its policy or practice is “job related for the position in question and consistent with business necessity.” *Ibid.* If the employer meets that burden, the plaintiff may still succeed by showing that the employer refuses to adopt an available alternative practice that has less disparate impact and serves the employer’s legitimate needs. §§2000e–2(k)(1)(A)(ii) and (C). Pp. 17–19.

(b) Under Title VII, before an employer can engage in intentional discrimination for the asserted purpose of avoiding or remedying an unintentional, disparate impact, the employer must have a strong basis in evidence to believe it will be subject to disparate-impact liability if it fails to take the race-conscious, discriminatory action.

The Court’s analysis begins with the premise that the City’s actions would violate Title VII’s disparate-treatment prohibition absent some valid defense. All the evidence demonstrates that the City rejected the test results because the higher scoring candidates were white. Without some other justification, this express, race-based decision making is prohibited. **The question, therefore, is** whether the purpose to avoid disparate-impact liability excuses what otherwise would be prohibited disparate-treatment discrimination.

The Court has considered cases similar to the present litigation, but in the context of the Fourteenth Amendment’s Equal Protection Clause. Such cases can provide helpful guidance in this statutory context. See *Watson v. Fort Worth Bank & Trust*, 487 U. S. 977, 993. In those cases, the Court held that certain government actions to remedy past racial discrimination—actions that are themselves based on race—are constitutional only where there is a “strong basis in evidence” that the remedial actions were necessary. *Richmond v. J. A. Croson Co.*, 488 U. S. 469, 500; see also *Wygant v. Jackson Bd. of Ed.*, 476 U. S. 267, 277. In announcing the strong-basis-in-evidence standard, the *Wygant* plurality recognized the tension between eliminating segregation and discrimination on the one hand and doing away with all governmentally imposed discrimination based on race on the other. 476 U. S., at 277. It reasoned that “[e]videntiary support for the conclusion that remedial action is warranted becomes crucial when the remedial program is challenged in court by nonminority employees.” *Ibid.* The same interests are at work in the interplay between Title VII’s disparate-treatment and disparate-impact provisions. Applying the strong-basis-in-evidence standard to Title VII gives effect to both provisions, allowing violations of one in the name of compliance with the other only in certain, narrow circumstances. It also allows the disparate-impact prohibition to work in a manner that is consistent with other Title VII provisions, including the prohibition on adjusting employment-related test scores based on race, see §2000e– 2(l), and the section that expressly protects bona fide promotional exams, see §2000e–2(h). Thus, the Court adopts the strong-basis-in-evidence standard as a matter of statutory construction in order to resolve any conflict between Title VII’s disparate-treatment and disparate-impact provisions. Pp. 19–26.

(c) The City's race-based rejection of the test results cannot satisfy the strong-basis-in-evidence standard. Pp. 26–34.

(i) The racial adverse impact in this litigation was significant, and petitioners do not dispute that the City was faced with a prima facie case of disparate-impact liability. The problem for respondents is that such a prima facie case—essentially, a threshold showing of a significant statistical disparity, *Connecticut v. Teal*, 457 U. S. 440, 446, and nothing more—is far from a strong basis in evidence that the City would have been liable under Title VII had it certified the test results. That is because the City could be liable for disparate impact discrimination only if the exams at issue were not job related and consistent with business necessity, or if there existed an equally valid, less discriminatory alternative that served the City's needs but that the City refused to adopt. §§2000e–2(k)(1)(A), (C). Based on the record the parties developed through discovery, there is no substantial basis in evidence that the test was deficient in either respect. Pp. 26–28.

(ii) The City's assertions that the exams at issue were not job related and consistent with business necessity are blatantly contradicted by the record, which demonstrates the detailed steps taken to develop and administer the tests and the painstaking analyses of the questions asked to assure their relevance to the captain and lieutenant positions. The testimony also shows that complaints that certain examination questions were contradictory or did not specifically apply to firefighting practices in the City were fully addressed, and that the City turned a blind eye to evidence supporting the exams' validity. Pp. 28–29.

(iii) Respondents also lack a strong basis in evidence showing an equally valid, less discriminatory testing alternative that the City, by certifying the test results, would necessarily have refused to adopt. Respondents' three arguments to the contrary all fail. First, respondents refer to testimony that a different composite-score calculation would have allowed the City to consider black candidates for then open positions, but they have produced no evidence to show that the candidate weighting actually used was indeed arbitrary, or that the different weighting would be an equally valid way to determine whether candidates are qualified for promotions. Second, respondents argue that the City could have adopted a different interpretation of its charter provision limiting promotions to the highest scoring applicants, and that the interpretation would have produced less discriminatory results; but respondents' approach would have violated Title VII's prohibition of race-based adjustment of test results, §2000e–2(l). Third, testimony asserting that the use of an assessment center to evaluate candidates' behavior in typical job tasks would have had less adverse impact than written exams does not aid respondents, as it is contradicted by other statements in the record indicating that the City could not have used assessment centers for the exams at issue. Especially when it is noted that the strong-basis in-evidence standard applies to this case, respondents cannot create a genuine issue of fact based on a few stray (and contradictory) statements in the record. Pp. 29–33.

(iv) Fear of litigation alone cannot justify the City's reliance on race to the detriment of individuals who passed the examinations and qualified for

promotions. Discarding the test results was impermissible under Title VII, and summary judgment is appropriate for petitioners on their disparate-treatment claim. If, after it certifies the test results, the City faces a disparate-impact suit, then in light of today's holding the City can avoid disparate-impact liability based on the strong basis in evidence that, had it not certified the results, it would have been subject to disparate-treatment liability. Pp. 33–34. 530 F. 3d 87, reversed and remanded.

KENNEDY, J., delivered the opinion of the Court, in which ROBERTS, C.J., and SCALIA, THOMAS, and ALITO, JJ., joined. SCALIA, J., filed a concurring opinion. ALITO, J., filed a concurring opinion, in which SCALIA and THOMAS, JJ., joined. GINSBURG, J., filed a dissenting opinion, in which STEVENS, SOUTER, and BREYER, JJ., joined.

VII. Other Noteworthy Court Decisions

Federal Jurisdiction

In general, Federal Courts are courts of limited jurisdiction; that is, not every case can be filed in a Federal Court. To obtain jurisdiction, the case must either: (1) present a question of federal law, or (2) be between or among parties of complete diversity (from different states) and the amount in controversy must exceed \$75,000.

In Delay v. Rosenthal Collins Group, LLC, ___ F.3d ___ (6th Cir. 10-27-09), the Sixth Circuit addressed the issue of whether the Court had jurisdiction when a LLC was named as a party. Delay is a citizen of Ohio and RCG is a LLC organized under the laws of Illinois with its principal place of business in Illinois. (citing numerous cases including OnePointSolutions, LLC v. Borchert, 486 F.3d 342, 346 (8th Cir. 2007).

The general rule is that all unincorporated entities, including a LLC, have the citizenship of each partner or member. Accordingly, a LLC has the citizenship of each of its members. To determine diversity jurisdiction, a court must know the citizenship of each of the LLC's members. If one member were a citizen of Ohio then complete diversity, and with it federal jurisdiction, would be destroyed.

SEC v. Goldman Sachs

Exhibit “A”

“Selecting a Law Firm & Lawyer”

Selecting a law firm and/or a particular lawyer is often a significant decision. Many factors should be considered including:

1. The client – individual or entity
 - a. Size of the client?
 - b. Location of the client?
 - c. Type of business?
 - d. Specific legal need vs. ongoing need for representation
2. General full service firm vs. boutique firm
3. Law firm vs. sole practitioner
4. Area of expertise
 - a. Reputation
 - b. Track record that can be verified
5. Billing practices
 - a. Hourly rates for all professionals who are involved
 - b. Padding of hours
 - c. Expense reimbursement policy
 - d. Flat fee? Contingency fee?
 - e. Hybrid fee arrangement
6. Responsiveness
 - a. Ability to respond quickly?
 - b. Ability to work under pressure?
7. Does the lawyer offer practical solutions?

Dennis J. Gerschick, JD, CPA, CFA

Dennis Gerschick has a unique background. He is the only individual who is an Attorney, CPA, Chartered Financial Analyst, and Venture Capitalist and has work experience in each field.

Mr. Gerschick graduated Florida Atlantic University in 1978 (major in accounting). He passed the May, 1978 CPA exam on his first attempt. He then worked as a CPA with Ernst & Young, one of the Big 4 accounting firms, before graduating from Drake Law School in 1983.

After law school, Mr. Gerschick worked in the tax department of one of Atlanta's largest law firms, Powell, Goldstein. Later, Mr. Gerschick opened his own law firm. His practice focused on representing closely-held businesses and their owners. For many clients, he also acts as a business and financial advisor.

Mr. Gerschick is the President of VenCap Advisory Group, Inc. which is the sole general partner of VenCap Opportunities Fund, L.P., a venture capital fund. Mr. Gerschick's duties include finding companies in which to invest, reviewing and evaluating hundreds of business plans, as well as negotiating, structuring, documenting, and monitoring the fund's investments. He has also served on several boards of directors and audit committees.

Mr. Gerschick served on the American Institute of CPA's Business Valuation Subcommittee.

Mr. Gerschick also provides a variety of legal and consulting services. He provides tax, investment, financial and business advice to a variety of companies and investors. He consults with other CPAs and attorneys to help them better serve their clients, or he provides a second opinion. See www.Gerschick.com

Mr. Gerschick speaks frequently at seminars and conferences throughout the country regarding a variety of investment, legal, and tax topics. He has spoken about the purchase or sale of a business, real estate, corporate governance, financing businesses, financial statement analysis, and many other topics. See www.RegalSeminars.com

Mr. Gerschick has written many articles, relating to growing and financing businesses that have been published by the Technology Law Section of the Georgia Bar and the Michigan Association of CPAs. Mr. Gerschick has authored two monographs, Raising Capital and Attracting Investors to Your Start-Up, both of which are offered by the Capital Formation Finance Institute in Washington DC. See www.cfi-institute.org. An interview with Mr. Gerschick was also published in American Venture, a magazine targeted at entrepreneurs and accredited investors.