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# When the Government Pays a Visit, Will You Be Ready?

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The federal stimulus package approved by Congress in 2009 means that an unprecedented amount of federal spending will occur throughout the country. Entities that receive these funds will be subject to oversight and scrutiny. Just as night follows day, claims of abuse will arise as the public becomes aware of the ways in which some of this money is spent. Egregious examples may become the subject of official investigations. Indeed, Grand jury and administrative subpoenas from special inspector generals to obtain documents and other evidence from businesses who obtained federal stimulus money is in the news on a daily basis. Sometimes government prosecutors and investigators don't choose this formal route, but simply ask a business to "consent" to a search of its premises or certain files. Knowing that the government may be using such tactics to obtain information is important. Knowing what to say when such requests are made is critical.

The recently emerging preference of federal agents to pursue search warrants over subpoenas is understandable, albeit troubling. Search warrants allow the government to cart off file cabinets full of original business records before they can be photocopied or reviewed by the business to make sure that the seized documents are called for by the search warrant. They also give government agents a chance to seek interviews with company employees when they are under stress and do not have counsel present. Only someone who has experienced a government search or has been interrogated by federal or state agents really knows how intimidating it can be. Government agents come prepared, and there is little one can do to resist. But you do have rights. Knowing them and how to respond is essential information that needs to be well known to those who might be confronted by a visit from the federal government.

Do you have a process of protocol to follow when agents with a search warrant arrive? Do your

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employees know what to do and what not to do? Detailed below are practical considerations for surviving a search by the government.

### 1. Don't Panic. Be Polite, But Assert Your Rights.

There is nothing to be gained by hostility or rudeness. In fact, some agents may interpret such conduct as suggesting guilt or liability, or even, in an extreme case, obstruction. The goal is to be pleasant, but fully aware of your rights and the rights of the business under the law.

### 2. Contact designated legal counsel.

Do not try to "wing it" on your own. Call the person in the legal counsel's office who has been designated to handle situations like this, or call outside legal counsel trained to respond to government investigations. If the only thing you do in preparation for a government visit is designate an in-house or outside counsel who should be called—and ensure their phone numbers are close at hand—you will have done much to protect yourself and the business.

### 3. Find out and record the identity of the agents.

Ask the agents to identify themselves and their agencies. Frequently, several different agencies are involved in an investigation. Ask to see the credentials the agents are required to carry. Get their business cards or have someone write down their names, titles, and phone numbers. If you have a sign-in policy for visitors, ask them to sign in.

### 4. Caution: the agents may be pleasant but they are not your friends.

While agents may be polite and professional, do not be lulled into a false sense of security. The agents are not your friends; they are not on a social call. Remember: these agents are most likely there to develop evidence against you and/or your business. Your assumption should be, at least until you get careful advice from counsel, that you must do everything legally possible to protect yourself and your company.

### 5. Ask to see a search warrant. If there is none, do not consent to a search of any kind without first consulting counsel.

If the agents tell you they want to search the premises, or want a particular item or file, ask them if they have a search warrant. If they do, ask for a copy of the warrant—you are entitled to it. The face of the warrant should give a trained eye some clue as to the nature of the investigation. Also, ask for a copy of the affidavit supporting the warrant. Often, this will be sealed by the issuing court, and it is unlikely you will get a copy at this point. Ask anyway. If the agents don't have a warrant, but ask you or others to "consent" to a search or provide access to a file or other item, politely but clearly refuse. Tell them you are not free to consent without first consulting with legal counsel. (This should be the policy the business has trained its personnel in beforehand.) If they tell you they will get a search warrant if you do not consent, tell them again that it is not within your power to consent. Make a record of your refusal, and have a witness to the conversation if possible.

### 6. DO NOT IMPEDE OR OBSTRUCT THE SEARCH.

If the agents have a warrant, do not in any way impede their ability to search. A search warrant is an authorization from the court to enter and search within the parameters approved by the judge. If the agents have a signed search warrant, don't obstruct or hinder them. It may be wise to offer them an office or conference room to work in. The validity of the warrant can be challenged later, but not at the time of search.

### 7. IF POSSIBLE, MONITOR THE SEARCH AND MAKE A RECORD OF WHAT THE AGENTS EXAMINE AND TAKE.

If it can be done without impeding the search, attempt to have one or more people monitor what the agents do. Make notes recording which agents search what areas. To the extent it is possible to do so, record what they examined and where they found it. List what they carry away. If the material is important for the operation of the business, ask to make (under an agent's supervision) copies of seized originals before the agents depart. Ask to make a backup of any electronically stored information. Ask for a complete written inventory of what has been seized and from where.

### 8. PREPARE FOR PUBLICITY. DON'T SPEAK TO THE MEDIA WITHOUT PREPARING TEXT WITH COUNSEL.

Contact company public affairs personnel to alert them about possible inquiries from the press. Statements of any kind to the media should be carefully vetted with legal counsel. What an employee says to the media can be detrimental to the speaker and/or the business.

### 9. ADVISE EMPLOYEES CONCERNING THEIR RIGHTS SHOULD THE GOVERNMENT ATTEMPT TO INTERVIEW THEM.

Executing a search warrant provides government investigators with an opportunity to seek interviews with company employees about the subject matter of the investigation. Advise employees—both as part of standard company policy and at the time an investigation commences—that they are under no duty to answer questions posed by government agents without first consulting legal counsel. Moreover, advise them that if they do choose to answer questions about the subject matter of the investigation—even in what the employee may consider an informal interview—they can be charged with federal crimes if agents later allege any of the statements to have been false or misleading. It may be prudent to designate a supervisor trained for the task to be the sole point of contact with the agents during the search. Employees also need to be informed of their rights should government investigators seek to interview them later, whether at work or their home.

### 10. BE PREPARED. HAVE A RESPONSE PLAN IN PLACE.

Training in how to handle government investigations, including search requests and warrants, is simply a matter of smart, responsible management. Failing to implement a clear, simple response policy can have catastrophic consequences for the business. It also exposes employees to an unnecessary level of anxiety and risk of prosecution. Being the target of a search warrant is always a serious matter. The mere fact that it was issued means a judge has already found probable cause to believe wrongdoing has occurred, and that the evidence may be found at your business. But all is not lost. Warrant applications are one-sided affairs in which only the government's view is presented. And responding appropriately when government agents show up at your door is essential to ensure that misinformation doesn't carry the day.


# Class Action Alert

Recent developments in class action law

A publication of Nixon Peabody LLP

MARCH 2009


## Third Circuit, refusing to apply the law chosen on the face of a contract, reverses and remands for consideration of a class action waiver in an arbitration clause

*By Christopher Mason, Vivian Quinn, and Matthew McLaughlin*

In a decision of significant interest to the credit card industry in tightening markets, and of importance to attorneys representing parties to arbitration agreements generally, the United States Court of Appeals for the Third Circuit has held that a class arbitration waiver in an arbitration clause in a credit card agreement could not be upheld by referring to Utah law as specified in the agreement, but would have to be analyzed in light of—and might potentially be unconscionable under—New Jersey law, the state of the cardholder's residence. *Homa v. American Express, Co.*, No. 07-2921, 2009 U.S. App. LEXIS 3688 (3d Cir. Feb. 24, 2009). This is because, according to the majority's opinion, "the Supreme Court of New Jersey might well find that the application of Utah law allowing class-arbitration waivers in the context of a low-value consumer credit suit violates a fundamental policy of New Jersey." *Id.,* 2009 U.S. App. LEXIS 3688, at *7.

As a concurring opinion suggests, the question of unconscionability under New Jersey law, and the ultimate enforceability of the class waiver itself, remains open for consideration on remand from this decision. But the majority's choice of law analysis alone complicates the use of standardized arbitration clauses by national companies.

**The underlying dispute**

American Express Centurion Bank, a Utah industrial bank, issues "Blue Cash Cards" to qualified customers. *See Homa v. American Express*, 496 F. Supp. 2d 440, 443 (D.N.J. 2007). In 2004, the plaintiff, a resident of New Jersey applied for and received one of those cards. *Id.*

To encourage cardholders to make use of their Blue Cash Cards, American Express offers a loyalty reward program of up to 5% cash back on purchases made with the card. *Id.* The plaintiff, dissatisfied with the rewards, sued American Express on behalf of himself and other cardholders in New Jersey for alleged violations of the New Jersey Consumer Fraud

Act (a statute that, like many such state statutes, is "construed liberally in favor of protecting consumers"). *Homa*, 2009 U.S. App. LEXIS 3688, at *18-19 (citation and internal quotations omitted).

In response to the lawsuit, American Express pointed to a clause in the plaintiff's cardholder agreement providing that:

"If either party elects to resolve a Claim by arbitration, that Claim shall be arbitrated on an individual basis. There shall be no right or authority for any Claims to be arbitrated on a class action or on bases involving Claims brought in a purported representative capacity on behalf of the general public, other Cardmembers, or other persons similarly situated." *Homa*, 496 F. Supp. 2d at 443.

American Express then moved to compel arbitration on an individual basis, pursuant to Section 4 of the Federal Arbitration Act (the "FAA"), 9 U.S.C.A. § 4 (West 2009), and to dismiss the plaintiff's lawsuit in favor of such arbitration. *Homa*, 2009 U.S. App. LEXIS 3688, at *1.

The district court granted this motion. *See*, *e.g.*, *Homa,* 496 F. Supp. 2d at 451. It held the arbitration clause valid and enforceable under the FAA, that Utah law applied, and that Utah law permitted the class action waiver in the arbitration clause. *Id.* at 446, 451; *see* Utah Code Ann. §§ 70-C-3-104, 70-C-4-105 (2009) (permitting various class action waivers in credit contracts). The district court saw no barrier to the applicability of Utah law because the cardholder agreement stated clearly that:

> This Agreement and your Account, and all questions about their legality, enforceability, and interpretation, are governed by the laws of the state of Utah (without regard to internal principles of conflicts of law), and by applicable federal law. We are located in Utah, hold your Account in Utah, and entered into this Agreement with you in Utah.

496 F. Supp. 2d at 444.

Thus, Utah had a substantial relationship to the parties and the transaction and, in the district court's view, applying Utah law would not have violated any fundamental public policy of the plaintiff's home state, New Jersey. *Id.* at 445.

The Third Circuit disagreed, however. Without any analysis of what would make any particular policy of a state "fundamental" or not (and instead, apparently, assuming that, if the exclusion of something in a contract can be "unconscionable" under state law, then its inclusion must be "fundamental" to a state's policy), and without any true balancing of the relative interests of Utah and New Jersey, it held that New Jersey would likely not honor the Utah choice of law in the cardholder agreement to enforce a class waiver. 2009 U.S. App. LEXIS 3688, at *14. "Instead, it believed that "the Supreme Court of New Jersey would determine that New Jersey has a materially greater interest than Utah in the enforceability of a class-arbitration waiver that could operate to preclude a New Jersey consumer from relief under the NJCFA." *Id.* at *20."

Of course, every state has an interest of some kind in its citizens being able to pursue claims under their own state's laws against a corporation from another state, but this does not seem, by itself, to be an interest that must be a "fundamental" public policy. To remedy this gap, the Third Circuit, in effect, held that New Jersey's preference for the application of its own laws to its own citizens on issues such as class waivers would become "fundamental" when it involved "small-sum cases." *Id.* at *15. The size of the plaintiff's claim, based on the Blue Cash rewards program, might make his lawsuit a "small-sum case" and, if so, "then the Supreme Court of New Jersey would apply New Jersey law to the class-arbitration waiver" in the cardholder arbitration clause. *Id.* at *21.

The Third Circuit relied for this proposition on *Muhammad v. County Bank of Rehoboth Beach, Del.*, 912 A.2d 88 (N.J. 2006), which held unconscionable a class waiver in a consumer contract between a customer and bank that provided "payday loans." The *Muhammad* court noted that a class action waiver becomes "problematic 'when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties *predictably* involve small amounts of damages.'" *Id.* at 99 (emphasis in original). The Third Circuit, therefore, concluded that, if the claims in *Homa* are of "such a low value as effectively to preclude relief if decided individually, then under *Muhammad*, the application of Utah law to the class-arbitration waiver is invalid and the class waiver is unconscionable." 2009 U.S. App. LEXIS 3688, at *21. It then reversed and remanded to the district court for its determination in the first instance of such open issues. *Id.*

In reaching this result, the Third Circuit also distinguished its prior holding in *Gay v. CreditInform*, 511 F.3d 369 (3d Cir. 2007), and rejected any argument that the FAA could preempt the plaintiff's challenge to the class waiver in his cardholder agreement. 2009 U.S. App. LEXIS at *11-12. In *Gay,* the Third Circuit had held that neither the federal Credit Repair Organizations Act, 15 U.S.C. §§ 1679, *et seq.* (2000), nor a Pennsylvania state law on the same subject, would be violated by a class waiver because, in any individual arbitration, a claimant would still retain his or her substantive rights under those statutes. *See* 511 F.3d at 392-94. The same would seem to have been true as to the plaintiff's rights under substantive Utah law (or even substantive New Jersey law) in the *Homa* case. According to the Third Circuit, however, the decision in *Gay* was in part *dictum* and, in any event, did not provide a "blanket prohibition on unconscionability challenges to class-arbitration provisions." 2009 U.S. App. LEXIS 3688, at *12-13.

Like other such decisions, *see, e.g., Discover Bank v. Superior Ct.*, 36 Cal. 4th 148, 161-63 (Cal. 2005), the majority in *Homa* failed to explain how a statute in which a legislature has already provided a special economic remedy designed to adjust for potentially low-value claims (such as providing for attorneys' fees) could be the basis for claiming that a fundamental policy will be violated by applying the law of a state that also has a statute that includes similar protections. *Compare, e.g.,* N.J. Stat. Ann. § 56:8-19 (2009) (providing for treble damages and attorneys' fees) with Utah Code Ann. § 13-11-19 (2008) (providing for attorneys' fees). The majority in *Homa* also failed to explain how class action procedure is "fundamental" to an entire state's public policy if waived when constitutional rights—for example, a jury trial—can be waived without violating that policy. *See, e.g., LaManna v. Proformance Ins. Co.*, 876 A.2d 785, 792 (N.J. 2005) ("Our jurisprudence recognizes that constitutional rights may be waived").

The concurrence by Judge Weis in *Homa* at least provides some discussion of the likely issues of these kinds that may arise on remand. The concurrence points, for example, to various factors mentioned in the *Muhammad* opinion, including the complexity of the lawsuit, amount of damages involved, and availability of attorneys' fees and statutory multipliers. 2009 U.S. App. LEXIS 3688, at *23 (Weis, J., concurring) (citing *Muhammad,* 912 A.2d at 100). Because the *Muhammad* court did not define low-value claims, the issue of complexity (and the relative importance of attorneys' fees versus statutory multipliers) in the underlying *Homa* claim "may be an important factor to be explored." 2009 U.S. App. LEXIS 3688, at *23. As Judge Weis noted, because the New Jersey Consumer Fraud Act provides for both treble damages and attorneys' fees, the damages in *Homa* may not be low-value at all. *Id.* at *24. (The damages might not be low-value even by applying Utah law, for that matter.) In addition, if the class waiver were stricken from the cardholder agreement in *Homa*, this might call into question the entire arbitration clause itself. The cardholder agreement provided that, "should any portion of th[e] '*Restrictions on Arbitration*' provision be deemed invalid or unenforceable, then the entire Arbitration Provision (other than this sentence) shall not apply." *Id.*, 2009 U.S. App. LEXIS 3688, at *24.

A number of opinions have now held class waivers unconscionable under various states's laws. *See, e.g., Fiser v. Dell Computer Corp.*, 188 P.3d 1215, 1221 (N.M. 2008); *McKee v. AT&T Corp.*, 191 P.3d 845, 857-58 (Wash. 2008); *Wigginton v. Dell, Inc.*, 890 N.E.2d 541, 548-49 (Ill. App. Ct. 2008); *Olson v. Bon, Inc.*, 183 P.3d 359, 364-65 (Wash. Ct. App. 2008); *Woods v. QC Fin. Servs., Inc.*, No. ED 90949, 2008 WL 5454124, at *7 (Mo. Ct. App. Dec. 23, 2008); *Gatton v. T-Mobile USA, Inc.*, 152 Cal. App. 4th 571, 589 (Cal. Ct. App. 2007); *Cohen v. DIRECTV, Inc.*, 142 Cal. App. 4th 1442, 1446 (Cal. Ct. App. 2006); *cf.*, *e.g., Doe 1 v. AOL LLC*, 552 F.3d 1077, 1084 & n.14 (9th Cir. 2009) (finding Virginia forum selection clause in agreement unenforceable as to California resident plaintiffs bringing class action claims under California consumer law, because such forum selection would amount to a class waiver, but not deciding whether such clause was enforceable as to non-California plaintiffs).

A number of opinions have also held such waivers valid. *See, e.g., Pleasants v. American Express Co.*, 541 F.3d 853, 858-59 (8th Cir. 2008) (agreeing with district court that class-action waiver was enforceable and granting motion to compel arbitration of claim on individual basis); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 639 (4th Cir. 2002) (vacating district court's order denying defendant's motion to compel arbitration); *Omstead v. Dell, Inc.*, 533 F. Supp. 2d 1012, 1039-40 (N.D. Cal. 2008) (denying reconsideration of earlier decision that class action waiver did not conflict with fundamental California policy); *Davis v. Dell, Inc.*, No. 07-630 (RBK), 2008 U.S. Dist. LEXIS 62490, at *13-14 (D.N.J. Aug. 15, 2008) (affirming magistrate's order staying proceedings and compelling arbitration because there was "no such fundamental policy" in New Jersey of ensuring availability of consumer class actions); *Discover Bank v. Superior Ct.*, 134 Cal. App. 4th 886, 894-95 (Cal. Ct. App. 2005) (finding that class action waivers are enforceable and not unconscionable under Delaware case law, notwithstanding California's policy on such waivers, as California does not have a materially greater interest in determination of the issue than Delaware); *Ranieri v. Bell Atl. Mobile*, 759 N.Y.S.2d 448, 449 (N.Y. App. Div. 2003) (in arbitration clause of cellular service agreement, "given the strong public policy favoring arbitration . . . and the absence of a commensurate policy favoring class actions, we are in accord with authorities holding that a contractual proscription against class actions . . . is neither unconscionable nor violative of public policy"); *see also, e.g., AutoNation USA Corp. v. Leroy*, 105 S.W.3d 190, 200 (Tex. App. 2003); *Edelist v. MBNA America Bank*, 790 A.2d 1249, 1261 (Del. Super. Ct. 2001); *cf,* e.g., *Guadagno v. E*Trade Bank*, No. CV 08-03628 SJO (JCX), 2008 U.S. Dist. LEXIS 106486, at *11 (C.D. Cal. Dec. 29, 2008) (class action waiver enforceable where plaintiff had meaningful opportunity to opt out of arbitration clause containing it).

Sooner or later, these splits must become large enough that, notwithstanding the state law basis for most of the relevant opinions, the issue will rise to the United States Supreme Court.

We welcome your questions and comments. If you need assistance on any matter, please call or e-mail Christopher Mason (cmason@nixonpeabody.com or 212-940-3017), Vivian Quinn (vquinn@nixonpeabody.com or 716-853-8134), or Matthew McLaughlin (mmclaughlin@nixonpeabody.com or 617-345-6154).


# Class Action Alert

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A publication of Nixon Peabody LLP


DECEMBER 22, 2008

## *Altria Group, Inc. v. Good*: Supreme Court rejects pre-emption in "light" cigarette consumer fraud class action

**Introduction**

On December 15, 2008, the United States Supreme Court issued a decision in *Altria Group, Inc. v. Good*, the latest in a series of cases over the last two decades addressing pre-emption under the Federal Cigarette Labeling and Advertising Act ("Labeling Act"). In a divided five-to-four opinion, the Court held that the Labeling Act did not expressly or impliedly[1] pre-empt claims of fraudulent advertising under the Maine Unfair Trade Practices Act (MUTPA). The opinions by the majority and the dissent reveal that the widely divergent views regarding pre-emption expressed in the Court's highly fractured decision in *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504 (1992), have further crystallized on opposite extremes of the jurisprudential spectrum. Like *Cipollone*, *Altria* raises more questions than it answers.

**The plaintiffs' consumer fraud claims**

*Altria* involves claims by a putative class of Maine consumers against Altria Group and Philip Morris in connection with their sale of certain brands of "light" cigarettes. Op. at 1. As in a number of similar consumer fraud actions brought in other jurisdictions against "light" cigarette manufacturers, *see, e.g., Watson v. Philip Morris Co.*, 127 S. Ct. 2301 (2007); *Brown v. Brown & Williamson Tobacco Corp.*, 479 F.3d 383 (5th Cir. 2007); *Price v. Philip Morris, Inc.* 2005 Ill. LEXIS 2071, *1 (Ill. S. Ct. Dec. 15, 2005); *Aspinall v. Philip Morris Co.*, 442 Mass. 381 (2004), the *Altria* plaintiffs do not allege that they suffered any personal injuries caused by smoking. Op. at 13. Instead, they contend that the cigarette manufacturers knew that consumer smoking behaviors are such that individuals often inhale as much tar and nicotine from "light" cigarettes as from "regular" cigarettes.[2] *Id.* at 2-3. They further allege that, by concealing this information, the cigarette manufacturers fraudulently marketed their "light" cigarettes as less harmful than "regular" cigarettes. *Id.*

Altria Group and Philip Morris moved for summary judgment on the grounds that the Labeling Act pre-empted plaintiffs' claims under the MUPTA. *Id.* at 3. Relying on *Cipollone*, the district court agreed and allowed the defendants' motion. *Id.* On appeal, the First Circuit applied and interpreted *Cipollone* differently and reversed the entry of summary judgment. *Id.* at 4. To resolve an apparent

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1 In Chief Justice Roberts' view, the defendants effectively conceded their implied pre-emption theory during oral argument. For that reason, although both theories are discussed in the opinion, our analysis focuses exclusively on the express pre-emption aspects of the *Altria* decision.

2 For years, cigarette manufacturers have categorized "light" cigarettes based on levels of tar and nicotine by utilizing a test methodology known as the Cambridge Filter Method that employs a smoking machine designed to mimic human smoking behaviors. *Id.* at 2.

conflict between the First Circuit's decision and a prior decision regarding pre-emption under the Labeling Act by the Fifth Circuit, *Brown*, 479 F.3d 392-93, the Supreme Court granted certiorari. *Id.*

**The "hodgepodge" of *Cipollone* revisited**

Any analysis of *Altria* necessarily begins with *Cipollone*. Mr. Cipollone alleged that his mother contracted lung cancer as a result of smoking cigarettes sold by three different manufacturers. 505 U.S. at 508. He asserted traditional common law product liability claims, including breach of express warranty and failure to warn. *Id.* at 509. In addition, he alleged that the manufacturers had fraudulently misrepresented the known health effects of cigarettes, attempted to "neutralize" information concerning the health risks described in federally mandated warning labels through advertisements that purportedly diluted the consumers' perception of hazards posed by cigarettes, and otherwise had conspired to defraud purchasers such as Mrs. Cipollone. *Id.* at 509-10. As in *Altria*, the defendants moved for summary judgment based upon the express pre-emption provision set forth in Section 5(b) of the Labeling Act, which provides:

> No requirement or prohibition *based on smoking and health* shall be imposed under State law with respect to the advertisement or promotion of any cigarettes the packages of which are labeled in conformity with the provisions of this act.

*Id.* at 510; 15. U.S.C. § 1334(b) (emphasis supplied). In a sharply splintered opinion, the Court held that Mr. Cipollone's failure-to-warn claim and his claim that the defendants had fraudulently "neutralized" the federally mandated warning label were expressly pre-empted, while the claims for breach of warranty and the remaining claims sounding in fraud and conspiracy were not. *Cipollone*, 505 U.S. at 530-31.

Writing for a plurality that included Chief Justice Rehnquist, Justice White, and Justice O'Connor, Justice Stevens began his analysis with the premise that there is a "strong presumption against pre-emption" and, therefore, the statutory language must be "fairly … but narrowly construed." *Id.* at 523. Focusing on the language of Section 5(b), Justice Stevens then set forth a "predicate-duty" methodology for evaluating whether a particular claim should be pre-empted under the Labeling Act:

> The central inquiry in each case is straightforward: we ask whether the legal duty that is the predicate of the common-law damages action constitutes a "requirement of prohibition based on smoking and health."

*Id.* at 523-24. Applying this standard, the plurality concluded that Mr. Cipollone's failure-to-warn claim was pre-empted because the underlying duty—"to provide a warning necessary to make a product safe"—fundamentally implicated a "requirement" that was "based on safety and health." Id. at 524. The plurality found that Mr. Cipollone's "warning neutralization" claim—which centered on the theory that defendants' advertisements tended to downplay the hazards of smoking—was also pre-empted because it was "inextricably related" to the plaintiff's failure-to-warn claim. *Id.* at 528.

Conversely, the plurality held that both the express warranty claim and the remaining fraud and conspiracy claims were not pre-empted. *Id.* at 525-526, 528-29. While acknowledging that the "duty not to breach" an express warranty "arises under state law," the plurality concluded that the duty ultimately derives from a contract that the manufacturer entered into voluntarily. Thus, liability under a breach-of-warranty claim is not a "requirement imposed under State law"; rather, it is a "requirement imposed by the *warrantor*." *Id.* at 525-26 (emphasis in original). With respect to the fraudulent misrepresentation claim, the plurality reasoned that the cause of action was "not predicated on a duty 'based on smoking and health' but rather on a more general obligation—the duty not to deceive." *Id.* at 528-29. Therefore, the statutory intent of ensuring the uniformity of warnings on cigarette packages sold nationwide would not be compromised because "state law prescriptions on intentional fraud rely on a single uniform standard: falsity." *Id.* at 529. Finally, the plurality held that, because the conspiracy claim required Mr. Cipollone to establish an underlying fraud, the "predicate duty" for the conspiracy claim was the same as that for fraudulent misrepresentation. *Id.* at 530.

Despite Justice Stevens's assurance that the predicate-duty standard was "straightforward," the plurality received pointed criticism from the other five members of the Court who coalesced into two camps, at odds with each other as well as the plurality, on opposite ends of the continuum. Writing for one camp, Justice Scalia, with whom Justice Thomas joined, concluded that the Labeling Act pre-empted *all* of Mr. Cipollone's claims. *Id.* at 549-54. Justices Scalia and Thomas urged the adoption of a "proximate application methodology" that ignored "the source of the duty" and focused instead on whether the state requirement imposed an "obligation … because of the effect of smoking upon health." *Id.* at 554. Justice Blackmun, in an opinion joined by Justices Kennedy and Souter, stated that he would find *none* of the plaintiff's claims to be pre-empted. *Id.* at 531-44. Justices Blackmun, Kennedy and Souter reasoned that there was simply no basis for concluding that Congress intended to pre-empt any common law claims, regardless of the source of the duty. *Id.* at 534. In addition, noting the malleability and apparent doctrinal inconsistency of the predicate-duty approach, *both* the Scalia-led faction and the Kennedy-led faction expressed skepticism that the "hodgepodge" nature of the results generated by the plurality's analysis truly reflected the outcome that Congress had intended in enacting the Labeling Act. *Id.* at 542-44, 555-56. They further lamented the "difficulty the lower courts will encounter in attempting to implement" the plurality's standard. *Id.* at 543-44, 555.

**Much uncertainty remains following *Altria***

The concerns that Justices Scalia and Blackmun voiced proved prescient during the 16-year interregnum between *Cipollone* and *Altria,* as district courts and circuit courts alike struggled to apply the predicate-duty standard with any consistency. Although the Supreme Court had the opportunity to address Section 5(b) of the Labeling Act again in 2001, *see Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525), the Court's decision did little to lend certainty to the landscape. Unfortunately, while *Altria* did clarify the Labeling Act's application to consumer fraud actions, many questions remain unresolved.

Again writing for the Court, this time with a majority that included Justices Ginsberg, Breyer, Souter, and Kennedy, Justice Stevens, as he had done in *Cipollone*, began his analysis with the principle that there is a presumption against pre-emption based on the "the assumption that the historic police powers of the State are not to be superseded by Federal Act unless that was the clear and manifest purposes of Congress." Op. at 5 (internal punctuation omitted). Whether or not the Court considered scrapping the predicate-duty regime due to the criticism that it engendered—and Justice Stevens did acknowledge that the standard "lack[ed] theoretical elegance"—it formally adopted that framework, concluding that the standard "represents a fair understanding of congressional purpose." *Id.* at 13-14.

As they had below, Altria Group and Philip Morris argued that, under the predicate-duty methodology, the plaintiffs' consumer fraud claims should be addressed in the manner that the *Cipollone* plurality dealt with Mr. Cipollone's "warning neutralization" claim. *Id.* at 11. "Like the pre-empted warning neutralization claim," they argued, the contention that the defendants violated the MUPTA ultimately is "based on statements that 'might create a false impression' rather than statements that are 'inherently false.'" *Id.* Furthermore, like Mr. Cipollone's failure-to-warn claim, the plaintiffs' allegations are necessarily "based on the relationship between smoking and health," which, on some level, even the plaintiffs conceded was true. *Id.* at 13. In addition, the defendants contended that the application of the predicate-duty framework would directly conflict with the Court's post-*Cipollone* jurisprudence, including *American Airlines, Inc. v. Wolens*, 513 U.S. 219 (1995) and *Reigel v.*

*Medtronic, Inc.*, 552 U.S. __ (2008). However, the Stevens-lead majority found none of these argument persuasive. *Id.* at 14.

The majority first rejected the notion that the predicate-duty analysis "turns in any way on the distinction between misleading and inherently false statements." In its view, the defendants' alleged misconduct constitutes "a breach of a duty not to deceive," in the same manner as *Cipollone* defendants' fraudulent misrepresentations. *Id.* at 11. The majority then side-stepped the plaintiffs' concession with respect to the ultimate relationship between the defendants' actions and their impact on the plaintiffs' health by drawing a distinction between "*harms* related to smoking and health," which the majority concluded Section 5(b) does not implicate, and "*requirements and prohibitions* … that are based on smoking and health," which the majority found did fall within Section 5(b)'s embrace. *Id.* at 13 (emphasis in original). Finally, the majority distinguished the language of Section 5(b) from the language of the statutes in *Wolens* and *Reigel*. In *Wolens* and *Reigel*, the at-issue statutes contained the phrase "relating to," which the majority construed as meaning "having a connection with," and, therefore, having broader applicability. *Id.* at 15. Conversely, the phrase "based on" that appears in Section 5(b) "describes a more direct relationship," and, by inference, a more limited scope. *Id.*

Given the ephemeral (if not, puzzling) logic of the majority's rationale, it is not surprising that the dissent in *Altria* was as vigorous as it was in *Cipollone*. In an opinion joined by Chief Justice Roberts, Justice Scalia, and Justice Alito, Justice Thomas variously described the majority's opinion as "ill-conceived," "un-workable," "mischievous," "distorted," and "seriously flawed." Among other things, highlighting the same doctrinal irrationality expressed in *Cipollone* by Justice Scalia and Justice Blackmun, the dissent urged the abandonment of predicate-duty approach in favor of Justice Scalia's "more workable and textually sound 'proximate application test.'" Dissent at 6. In addition, as Justice Scalia had also argued in *Cipollone*, the dissent asserted that ordinary rules of statutory construction—and not a presumption against pre-emption—should apply in the express pre-emption context "once there is conclusive evidence to pre-empt in the express words of the statute itself." *Id.* at 8-9. Justice Thomas further noted that the application of such a presumption directly conflicts with *Reigel*, which was just decided in the prior term. *Id.* at 11.

## Conclusion

It remains to be seen how much traction *Altria* will gain outside the tobacco litigation, particularly the application of the presumption against pre-emption, which has many observers rightfully concerned. It would appear that the addition of Chief Justice Roberts, Justice Alito, and Justice Ginsburg since *Cipollone* has only served to entrench the Court's conflicting ideologies. If the last two decades have taught us anything, however, it is that results-driven pre-emption decisions are not unusual, and the Supreme Court is certainly not immune to that temptation. More often than not in this area, we do not truly learn the contours of the landscape until the next decision (at which point, we are usually left wondering again). This much can be said with some certainty: The Court's decision in *Wyeth v. Levine*, 76 U.S.L.W. 3391, argued on November 3, 2008, will be a critical landmark.

We welcome your questions and comments. If you need assistance on any matter, please call or e-mail Christopher M. Mason (cmason@nixonpeabody.com 212-940-3017) or Paul J. Hall (phall@nixonpeabody.com 415-984-8266) as the coordinating heads of our class action defense practice across our substantive litigation teams, or contact any of our partners listed below.

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# Government Investigations & White Collar Defense Alert

A publication of Nixon Peabody LLP


DECEMBER 19, 2008

## FCPA update: The stakes just went up

*By Anjali Chaturvedi & Kelly B. Kramer*

This week, Siemens AG, Europe's largest engineering company, pled guilty to violating the United States Foreign Corrupt Practices Act ("FCPA") and German anti-corruption laws. Siemens will pay $1.6 billion—by far the largest penalty ever for corporate bribery—to resolve investigations by American and German authorities into its business conduct. But despite the huge payment, Siemens' executives and employees continue to face potential civil and criminal exposure.

What does this mean to you? If you conduct business overseas—or if you are considering establishing a presence abroad—you must pay close attention to your foreign operations. Businesses that do not already have FCPA compliance programs need to take immediate action to educate employees about the requirements of the law. The United States has served notice that it intends to escalate enforcement of the FCPA. Smart businesses will respond by ensuring that their foreign operations are operated lawfully and ethically.

### The Siemens settlement

On December 15, 2008, Siemens AG announced a global resolution to long-running bribery investigations involving American and German authorities. To resolve these probes, Siemens agreed to pay $1.6 billion in civil and criminal penalties, including $854 million to German authorities, and $800 million to U.S. authorities. The Munich-based company, which had revenue of $77.3 billion in the year ending in September, has been embroiled in a bribery scandal since 2006, leading to investigations in at least a dozen countries.

As part of this resolution, Siemens AG pled guilty to a two-count information charging criminal violations of the internal controls and books-and-records provisions of the FCPA. Three Siemens subsidiaries pled guilty to additional FCPA violations.

The plea documents provide an intimate view of the conduct that gave rise to the charges. Beginning in the mid-1990s, Siemens AG falsified its corporate books and records and knowingly failed to implement and circumvented existing internal controls. As a result, from the time of its listing on the New York Stock Exchange on March 12, 2001 through approximately 2007, Siemens AG made questionable payments totaling approximately $1.36 billion through various mechanisms.

From 2000 to 2002, four Siemens AG subsidiaries were awarded 42 contracts with a combined value of more than $80 million with the Ministries of Electricity and Oil of the government of the Republic of Iraq under the United Nations Oil for Food Program. To obtain these contracts, Siemens' subsidiaries paid a total of at least $1,736,076 in kickbacks to the Iraqi government, and they collectively earned more $38 million in profits on those 42 contracts. Siemens's subsidiaries inflated the price of the contracts by approximately 10 percent before submitting them to the United Nations for approval and improperly characterized payments to purported business consultants, part of which were paid as kickbacks to the Iraqi government as "commissions" to the business consultants. For the relevant years, the books and records of Siemens's subsidiaries, including those containing false characterizations of the kickbacks paid to the Iraqi government, were part of the books and records of Siemens AG.

The Department of Justice ("DOJ") claimed that it could have sought as much as $2.7 billion in criminal fines from Siemens. In agreeing to a lesser amount, DOJ cited the "extraordinary" steps taken by Siemens to cooperate with authorities and to enhance its compliance procedures. Under the terms of the plea agreement, Siemens AG agreed to retain an independent compliance monitor for a four-year period to oversee the continued implementation and maintenance of a robust compliance program and to make reports to the company and the DOJ. Siemens AG also agreed to continue fully cooperating with the Justice Department in ongoing investigations of corrupt payments by company employees and agents. The DOJ refused to state what charges, if any, might be brought against Siemens' executives or employees.

Siemens AG also settled a related civil complaint filed by the SEC, charging Siemens AG with violating the FCPA's anti-bribery, books-and-records, and internal controls provisions in connection with many of its international operations, including those discussed in the criminal charges.

## The implications

FCPA investigations, prosecutions, and penalties have steadily and steeply increased over the past several years. This upward trend will continue. The DOJ has devoted increased resources in this area and has emphasized international coordination and cooperation in corporate bribery investigations. Moreover, the DOJ and the SEC are increasingly partnering to conduct far-reaching FCPA investigations.

Companies that do business in foreign markets must pay increased attention to their marketing and business development practices to ensure that they do not violate the anti-bribery provisions. Companies must recognize that unlawful conduct is likely to be exposed. Competitors and whistleblowers know that reports of improper payments will be investigated by law enforcement authorities. Corporate officers must embrace a zero-tolerance-for-bribery standard and that message must flow to all individuals within an organization. Effective compliance programs, combined with regular, relevant training, are critical in this environment. Without these steps, a company cannot hope to get favorable treatment from the government if an impropriety is detected. With these steps, a company can at least say that it did whatever it could to avoid illegal activity.

Most companies will never have problems as overt and as deep-seated as those at Siemens, but this historic settlement demonstrates that the stakes are now even higher than before.

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# Government Investigations & White Collar Defense Alert

A publication of Nixon Peabody LLP

DECEMBER 22, 2008

## New mandatory disclosure requirements for government contractors

*By Grayson Yeargin and Colin W. O'Sullivan*

On December 12, 2008, a controversial new Federal Acquisition Regulation (FAR) rule requiring contractors to disclose government overpayments and their own criminal contracting violations went into effect. The rule represents a drastic departure in the way government contractors must handle information about possible wrongdoing within their organizations.

Under the new FAR rule, federal contractors and most subcontractors must make mandatory disclosures to the appropriate agency's Office of the Inspector General and Contracting Officer whenever they have "credible evidence" of certain criminal violations, a civil False Claims Act violation, or a "significant overpayment" in connection with a government contract or subcontract. Contractors who knowingly fail to make these disclosures in a timely manner are subject to debarment and suspension. The rule applies to contracts in excess of $5 million and with performance periods of 120 days or more.

The rule also requires large and medium-sized companies to establish ongoing business ethics awareness and compliance programs and internal control systems designed to ensure timely disclosure of improper conduct and full cooperation with any government agencies responsible for audit, investigation, or corrective actions.

It is critical that companies administering or planning to bid on government contracts determine how this new rule impacts them and reassess the effectiveness of their compliance programs. Many companies will need to strengthen their internal controls and procedures governing internal investigations.





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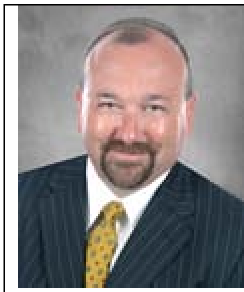


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Mr. O'Connell is admitted to practice in all federal and state courts in New Hampshire, Massachusetts, Vermont, Maine, New York and the District of Columbia, and before the U.S. courts of appeals for the First, Second, and Tenth circuits.

### Education

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Scott O'Connell represents integrated financial service companies—including banks, securities firms, insurance companies, and regulated subsidiaries of nonfinancial parents—in federal and state court litigation and before regulatory agencies.

Mr. O'Connell has extensive experience defending financial institutions in class actions concerning lender liability, breach of contract, breach of fiduciary duty, breach of good faith, unfair and deceptive trade practices, fraud, misrepresentation, fair debt collection practices, and civil RICO. He has particular trial experience litigating complex financial relationships between parties. His trial experience includes disputes between majority/minority shareholders in closely held businesses, partners, joint venturers, and co-developers. He has also successfully defended companies and their professional advisors sued under various theories of securities fraud.

While at law school, Mr. O'Connell served as an editor of the *Cornell Law Review* and as chancellor of the Moot Court Board. He was also an instructor in the Cornell undergraduate government course, "Law: Its Nature and Function."

Mr. O'Connell has been recognized for exceptional standing in the legal community in *Chambers USA: America's Leading Lawyers for Business 2008* for his securities litigation work. He has also been recognized as a "New England Super Lawyer" in securities litigation based on a peer-review survey by *Boston Magazine* (2007). Mr. O'Connell has earned an AV rating from Martindale Hubbell. Mr. O'Connell is a Fellow of the Litigation Counsel of America, an invitation-only and highly selective national trial lawyer honorary society composed of less than one-half of one percent of American lawyers.