BARNES & THORNBURG LLP

RELATED PEOPLE

Kian Hudson
Partner
Indianapolis

P 317-229-3111
F 317-231-7433
kian.hudson@btlaw.com

RELATED PRACTICE AREAS

Appeals and Critical Motions
Litigation
Trial and Global Disputes

ALERTS

SCOTUS Cert Recap: Spending Clause Statute Enforcement, Overtime Pay Exemptions, And The Bankruptcy Fraud Exception

May 13, 2022

Highlights

On May 2, the Supreme Court agreed to consider the following three questions:

Can legislation passed under the Spending Clause confer rights that are privately enforceable via Section 1983?

Does 29 C.F.R. § 541.601 — a regulation defining "highly compensated employees" —operate as a stand-alone basis for exempting daily-rate employees from federal law's overtime pay requirements, or does the exemption apply only when such an employee's pay also complies with the separate rules in 29 C.F.R. § 541.604?

Does the Bankruptcy Code bar discharge of a liability for fraud committed by a debtor's agent or business partner even when the debtor has no knowledge of the fraud?

On May 2, the U.S. Supreme Court added three more cases to its docket for next term. The first raises the question whether Spending Clause legislation may ever confer a privately enforceable "right" under Section

1983. The second concerns when an employee is "highly compensated" and thus not subject to federal overtime pay rules. And the third addresses whether the U.S. Bankruptcy Code's bar on discharging liabilities incurred from fraud applies when the debtor has no knowledge of the fraud.

The Spending Clause and overtime pay cases will be closely followed, as they are likely to affect thousands of public entities and private businesses. A number of amicus briefs were filed in these cases while they were pending before their respective circuit courts, and both cert. petitions had multiple supporting amicus briefs. And while the bankruptcy case drew no cert-stage amicus briefs, it too is likely to have significant consequences, especially for bankruptcy cases involving allegations of fraud.

Using Section 1983 to Enforce Rules in Spending Clause Statutes

Section 1983 provides a cause of action for the deprivation, under color of state law, of "any rights … secured by the Constitution and laws." This provision is famous as a tool for vindicating constitutional rights, but in 1980 the Supreme Court held that the reference to "and laws" means Section 1983 can be used to enforce certain statutory rights as well. In *Health and Hospital Corporation of Marion County v. Talevski*, the Supreme Court will consider whether federal laws enacted under the Spending Clause – which include a wide variety of statutes regulating Medicaid and other federal spending programs – can create the sort of statutory rights that are privately enforceable via Section 1983.

Notably, in 1990, in *Wilder v. Virginia Hospital Association*, the Supreme Court allowed private parties to use Section 1983 to enforce rights contained in Spending Clause statutes. But in the three decades since *Wilder*, the Court has not found any other privately enforceable rights in Spending Clause legislation. And the defendants in *Health and Hospital Corporation of Marion County* – an Indiana long-term care facility, its public-entity owner, and its privately held management company – asked the Court to reconsider *Wilder* and to hold categorically that Spending Clause statutes do not implicitly confer such rights. They insist that Spending Clause statutes function as contracts between the federal government and the recipient of federal funding, and they further contend that when Congress enacted Section 1983 contracts did not create rights enforceable by third-party beneficiaries. Accordingly, the defendants argue, Spending Clause statutes cannot create statutory "rights" within the meaning of Section 1983. If the Court were to disagree with that contention, the defendants also asked the Court to consider whether the Federal Nursing Home Reform Act's transfer and medication rules create such rights.

Opposing the cert. petition, the plaintiffs contended that there is no justification for reconsidering *Wilder*, arguing that it has been ratified by Congress and that there is no reason to single out Spending Clause statutes for special treatment. The plaintiffs also pointed out that there is no circuit split on the Federal Nursing Home Reform Act question. Nevertheless, the Court has agreed to consider both questions. And because Spending Clause statutes regulate numerous entities across several extensive benefit programs – such as Medicare and Medicaid, which in 2020 reached spending nationwide that exceeded $829 billion and $670 billion, respectively – the Court's decision will have considerable economic consequences.

Applying Overtime Pay Rules to Highly Compensated, Daily-Rate Employees

In *Helix Energy Solutions Group, Inc. v. Hewitt* the Court will address when the overtime pay rules of the Fair Labor Standards Act (FLSA) apply to employees who are both highly compensated and paid on a daily basis. The FLSA generally requires employers to pay "time and a half" for time worked beyond the standard 40-hour workweek, but exempts from this requirement those "employed in a bona fide executive, administrative, or professional capacity." Department of Labor regulations provide detailed rules governing which employees fall within this exception, and one such regulation deems employees exempt if 1) they perform at least one of a set of defined executive, administrative, and professional duties, 2) earn at least $107,432 per year, and 3) earn "at least $684 per week paid on a salary or fee basis."

This case – which involves an employee who earned more than $200,000 per year supervising 12 to 14 other employees on offshore oil and gas operations – turns on the last of these criteria, which is commonly known as the "salary basis" requirement. The employer paid the employee once every two weeks based on a daily rate of nearly $1,000 per day, without regard to how many hours he worked that day. And the employer argues that because the employee received nearly $1,000 in any week in which he worked, he earned "at least $684 per week paid on a salary or fee basis" and therefore satisfies the salary basis requirement.

The U.S. Court of Appeals for the Fifth Circuit issued a sharply divided, 12-6 en banc decision rejecting this argument. The Fifth Circuit majority held that the key fact was not the employee's high compensation, but was instead the fact that his compensation was computed on a daily basis. Because he was paid a daily rate, it concluded, the employee could qualify as an exempt employee only pursuant to a separate regulation that, the majority explained, provides "a special rule that must be satisfied before an hourly or daily rate will be regarded as a 'salary.'" Because the employer did not argue that it met the requirements of this regulation, the Fifth Circuit majority held that the employee was not exempt and was thus entitled to retroactive overtime pay.

The Supreme Court is now set to consider this complex question for itself. And as the cert. petition notes, the Court's answer will have widespread consequences, especially for the wide range of employers, such as those in the oil and gas industry, that often pay workers daily rates.

Discharging Liability for the Frauds of Others

The U.S. Bankruptcy Code provides a way for debtors to discharge their debts and thereby obtain a fresh start – yet the law exempts certain debts from discharge, among those debts for money or property obtained by "false pretenses, a false representation, or actual fraud." And in *Bartenwerfer v. Buckley*, the Court will decide whether this fraud exception applies to bar discharge of a liability for fraud committed by a debtor's agent or business partner even when the debtor was unaware of the fraud.

The fraud at issue here arises from a husband's failure to disclose alleged defects in a house he and his wife sold together as partners. After the husband incurred a state court judgment for nondisclosure of material facts – a judgment imputed to the wife under common law partnership principles – the couple filed a joint bankruptcy case. The bankruptcy court held that the judgment against the husband was non-dischargeable under the fraud exception, but – applying a "knew or should have known" standard developed by the U.S. Court of Appeals for the Eighth Circuit – it held that the fraud exception did not apply to the wife because she was entirely unaware of the fraud. The U.S. Court of Appeals for the Ninth Circuit, however, reversed. In a brief, unpublished opinion, the Ninth Circuit departed from the Eighth Circuit and held that a debtor's liability for fraud is non-dischargeable "regardless of her knowledge of the fraud."

The Supreme Court will now resolve this inter-circuit dispute, and its answer likely will provide a uniform rule governing partner and agency relationships in a wide variety of contexts. Bankruptcy practitioners across the country will be watching for the Court's decision.

To obtain more information, please contact the Barnes & Thornburg attorney with whom you work or Kian Hudson at 317-229-3111 or kian.hudson@btlaw.com.