No.

In the Supreme Court of the United States

BOWERS + KUBOTA CONSULTING, INC.,
BRIAN J. BOWERS, *and* DEXTER C. KUBOTA,

Petitioners,

v.

JULIE A. SU,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This case concerns the Equal Access to Justice Act (EAJA), which was enacted to curb abusive and costly lawsuits involving the federal government. EAJA authorizes a party who prevails in litigation against a federal agency to seek attorneys' fees and costs when the agency's litigating position was not "substantially justified." 28 U.S.C. § 2412.

EAJA's fuzzy standard has spawned disagreement among the lower federal courts over when fees are authorized. This appeal is emblematic of the disunity. It involves a meritless lawsuit by the Department of Labor (DOL) that was unjustified from the start. DOL's case depended entirely on an expert valuation that was riddled with obvious errors, making it wholly unreliable. The district court thus rejected the entire opinion and entered judgment for petitioners. But the court denied EAJA fees, and a divided panel of the Ninth Circuit affirmed.

The majority below held that DOL met its burden to show that its position was substantially justified because—although the government "knew or should have known" that the report was brimming with errors—the report had not *yet* been rejected by the district court, and the expert "stood firm in his conviction" that he was correct. Four other circuits have confronted similar circumstances; applying materially different legal standards, they would have reversed the denial of fees.

The question presented is whether the government's decision to take a case to trial is "substantially justified" (28 U.S.C. § 2412) when the government's case relies solely on expert evidence that it knew or should have known was error-ridden and thus unreliable.

RELATED PROCEEDINGS

United States District Court for the District of Hawaii:

- *Su* v. *Bowers*, No. 18-cv-155 (Sept. 17, 2021) (order granting final judgment for Petitioners)
- *Su* v. *Bowers*, No. 18-cv-155 (Feb. 7, 2022) (order denying motion for fees under EAJA)

United States Court of Appeals for the Ninth Circuit:

- *Su* v. *Bowers*, No. 22-15378 (Oct. 25, 2023) (opinion affirming district court)
- *Su* v. *Bowers*, No. 22-15378 (Jan. 8, 2024) (amended opinion and denial of rehearing)

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6, petitioner Bowers + Kubota Consulting, Inc. states that it has no parent company and that no publicly held company owns 10% or more of its stock.

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INTRODUCTION

The Equal Access to Justice Act (EAJA) was enacted in 1980 to protect ordinary citizens and small businesses from governmental overreach and wrongdoing by giving them the means to pursue otherwise prohibitively expensive litigation. It does so by authorizing courts to grant fees and costs to parties who prevail against the United States in court when the government's litigating position was not "substantially justified." 28 U.S.C. § 2412.

Although EAJA applies regardless of whether the government serves as the plaintiff or defendant, it has its most urgent application in regulatory enforcement actions. A federal agency, with near limitless resources, should not be able to use litigation to brow-beat regulated entities into accepting extra-regulatory requirements simply because those entities cannot afford to defend themselves in court. Regrettably, "[t]he legislative history of this law is strewn with references to the United States and its agencies' abuse of the litigation process" to extract just such concessions from hapless citizens and small businesses. *National Lawyers Guild* v. *Attorney General*, 94 F.R.D. 600, 615 n.32 (S.D.N.Y. 1982) (citing H.R. Rep. No. 96-1418 (1980)).

Against the backdrop of the ever-growing authority of the administrative state, the question presented in this case is thus a matter of pressing practical importance: whether the government's decision to take a case to trial is "substantially justified" within the meaning of EAJA when the government's case relies exclusively on expert evidence that, objectively speaking, it knows or should know is unreliable. The answer should be an easy "no," and the party against whom the government is litigating should be entitled to EAJA fees and all costs. But

breaking from the legal standard applied by four other circuits, the Ninth Circuit answered with a "yes."

Because it deepens confusion among the lower courts and creates a circuit split on a matter of great practical importance, that decision warrants the Court's attention. The Ninth Circuit's approach to EAJA is especially problematic in the context of ERISA-protected retirement benefits, as here. It was one of Congress's primary goals with ERISA to reduce the administrative costs to employers of providing retirement benefits, thereby encouraging the formation of such plans. To allow the Department of Labor (DOL) to bring baseless enforcement actions under ERISA, free from the check of EAJA, is utterly inconsistent with that purpose.

OPINIONS BELOW

The Ninth Circuit's opinion (App., *infra*, 1a-25a) is published at 89 F.4th 1169. The opinion of the district court denying EAJA fees (App., *infra*, 88a-117a) is unreported but available in the Westlaw database at 2022 WL 355126. The opinion of the district court granting judgment to petitioners on the merits (App., *infra*, 26a-87a) is reported at 561 F. Supp. 3d 973.

JURISDICTION

The Ninth Circuit entered an amended opinion and denied rehearing on January 8, 2024. On March 28, 2024, Justice Kagan extended the time for filing a petition for a writ of certiorari to June 6, 2024. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 2412(d)(1)(A) of Title 28 of the U.S. Code states that "a court shall award to a prevailing party other than the United States fees and other expenses, in addition to any costs awarded pursuant to subsection (a),

incurred by that party in any civil action (other than cases sounding in tort), including proceedings for judicial review of agency action, brought by or against the United States in any court having jurisdiction of that action, unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust."

STATEMENT

A. Legal background

1. Congress enacted EAJA "to eliminate the barriers that prohibit small businesses and individuals from securing vindication of their rights in civil actions and administrative proceedings brought by or against the Federal Government." *Scarborough* v. *Principi*, 541 U.S. 401, 406 (2004) (quoting H.R. Rep. No. 96-1005, at 9 (1980)). The Act thus "entitles a prevailing party to fees absent a showing by the Government that its position in the underlying litigation 'was substantially justified.'" *Id.* at 408 (quoting 28 U.S.C. § 2412(d)(1)(A)).

In enacting EAJA, Congress understood that the federal government is "the richest, most powerful, and best represented litigant to appear" in court. *Greenlaw* v. *United States*, 554 U.S. 237, 244 (2008). And the resource disparity between the government and most private entities can work unjust and unfair results. Congress' chief concern with EAJA was that the "Government with its greater resources and expertise can in effect coerce compliance with its position" no matter the position's merits. H.R. Rep. No. 96-1418, at 10. "When the cost of contesting a government order, for example, exceeds the amount at stake, a party has no realistic choice and no effective remedy." S. Rep. No. 98-586, at 6 (1984).

Given the resource disparity between the government and private litigants, it is often "more practical to endure an injustice than to contest it." *Ibid.* That "the Government, with its vast resources, could force citizens into acquiescing to adverse Government action, rather than vindicating their rights, simply by threatening them with costly litigation" is intolerable on its own. *Pierce* v. *Underwood*, 487 U.S. 552, 575 (1988) (Brennan, J., concurring). Such abuses also "undermine[] the integrity of the decision making process" by insulating agency action and short-circuiting judicial review. S. Rep. No. 98-586, at 6.

Faced with this power imbalance, Congress enacted EAJA "on the premise that a party who chooses to litigate an issue against the Government is not only representing his or her own vested interest but is also refining and formulating public policy." *Ibid.* And "the expense of correcting error on the part of the Government should not rest wholly on the party whose willingness to litigate or adjudicate has helped to define the limits of Federal authority." *Ibid.* Instead, "[w]here parties are serving a public purpose, it is unfair to ask them to finance, through their tax dollars, unreasonable government action and also bear the costs of vindicating their rights." *Ibid.*

EAJA thus reverses the so-called American Rule, which presumes that parties in litigation bear their own costs and attorneys' fees regardless of who wins. Under the Act, "a court shall award to a prevailing party * * * fees and other expenses, in addition to any costs * * * in any civil action (other than cases sounding in tort) * * * brought by or against the United States * * * unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust." 28 U.S.C. § 2412(d)(1)(A).

Early on, this Court noted "an obvious need to elaborate upon the meaning of" the phrase "substantially justified." *Underwood*, 487 U.S. at 564. In essence, when faced with a demand for fees and costs under Section 2412(d), the government bears the burden of demonstrating that its position is "justified to a degree that could satisfy a reasonable person." *Id.* at 565.

Put differently, the government must show that its position has a "reasonable basis both in law and in fact." *Ibid*. Congress admonished "courts and agencies" to "be faithful to one of the EAJA's core purposes: that only sound, well-prepared cases be initiated * * * and that the government must make a 'strong showing' that its position was substantially justified." S. Rep. No. 98-586, at 12. Any less should result in an award to the movant. *Ardestani* v. *INS*, 502 U.S. 129, 138 (1991).

2.a. The underlying controversy in this case involves an ERISA-covered retirement benefit plan called an employee stock ownership plan (ESOP). ESOPs allow employers to "increas[e] productivity by giving employees a stake in a firm." *RCM Securities Fund, Inc.* v. *Stanton*, 928 F.2d 1318, 1333 (2d Cir. 1991). Employees participating in an ESOP can grow their retirement savings in part by contributing to the success of the company, because the higher the value of the company, the higher the value of their retirement benefit. Staff of S. Comm. On Finance, 95th Cong., *ESOPs: An Explanation for Employees* 9 (Mar. 1978), perma.cc/9TRS-AN4Q.

Recognizing the benefit of such a tool to employers and workers alike, "Congress [has] sought to encourage the creation of ESOPs." *Fifth Third Bancorp* v. *Dudenhoeffer*, 573 U.S. 409, 424 (2014).

b. When a closely-held company first establishes an ESOP, it typically creates a trust, which buys the shares of company stock held by the company's shareholders (typically its founders, as in this case). In a leveraged ESOP transaction, the founders extend credit to the trust or lend the trust the funds needed to purchase the shares. This means that the trust will pay the founders for the cost of their shares over time, plus interest, according to an amortization schedule.

In a leveraged ESOP transaction involving a complete acquisition of the company, as in this case, the trust's *net* value often nears $0 at the time of the ESOP's formation. That is because the trust comes to own all the founders' stock, but it also holds debt offsetting the value of the stock. To put it in the more familiar terms of a home purchase: If a homeowner buys a $400,000 house with a $350,000 mortgage, the house is valued at $400,000 at the time of the sale, but the homeowner's equity in the house is only $50,000 because she has taken on the offsetting mortgage debt. Her equity increases over time, both as she pays down the debt and as the value of the home rises.

Just so in a leveraged ESOP transaction. As the company makes retirement contributions to the trust on behalf of its employees, the trust uses the contributions to pay down the acquisition debt. The trust's net equity thus increases. And with each contribution, the shares of company stock held by the trust are allocated to individual employee accounts according to the terms of the plan—usually proportionally to each employee's compensation, years of service, or both.

c. When a company first creates an ESOP, the ESOP's trustee must ensure that "the plan receives no

less, nor pays [any] more, than adequate consideration" for the company's stock. 29 U.S.C. § 1108(b)(17)(A). In the context of closely held corporations (as in this case), the statute defines "adequate consideration" to be "the fair market value of the asset as determined in good faith by the trustee or named fiduciary." 29 U.S.C. § 1002-(18)(B). Simply put, it is a violation of ERISA for a company's founders to sell their stock to an ESOP trust for more than fair market value.

B. Factual background

1. Petitioners Brian Bowers and Dexter Kubota founded Bowers + Kubota Consulting, Inc. (B+K), a successful construction management, architecture, and engineering design firm based in Hawai'i. App., *infra*, 3a.

Bowers and Kubota eventually began exploring the sale of B+K to a variety of entities. *Id.* at 34a. They approached URS Corporation to discuss a potential sale of B+K to URS. *Ibid.* URS sent B+K a "preliminary nonbinding indication of interest" stating its interest in purchasing the company. *Id.* at 34a. As part of its discussions with URS, B+K hired GMK Consulting to provide a valuation for negotiation purposes. *Id.* at 36a. GMK provided a valuation of approximately $38 million. *Id.* at 37a. B+K did not reach an agreement with URS and abandoned its attempt to negotiate a sale.

Soon thereafter, Bowers and Kubota engaged an attorney to explore a potential sale of B+K to an ESOP trust. *Id.* at 38a. To inform their deliberations, they hired Libra Valuation Advisors (LVA) to prepare a fair-market valuation of the company. *Id.* at 40a. Consistent with the preliminary valuation by GMK Consulting, LVA's initial estimate of B+K's value was between approximately $37 million and $42 million. *Id.* at 41a.

Bowers and Kubota moved forward with the ESOP sale. As B+K board members, they signed a resolution adopting the ESOP and appointing a nationally-recognized independent fiduciary and sole ESOP trustee. *Id.* at 42a. Negotiations over the sale price and structure commenced thereafter. Bowers and Kubota initially offered to sell 100% of the company to the ESOP for $41 million, which they offered to finance at a 10% annual interest rate amortized over 20 years. *Id.* at 43a. The trustee counteroffered $39 million financed by a 25-year loan at 6% interest. *Ibid.* Bowers and Kubota countered again with a price of $40 million, with a 25-year loan at 8%. *Ibid.* The trustee agreed to those terms, except that he insisted on a 7% interest rate, which Bowers and Kubota accepted. *Ibid.* The trustee's negotiation saved the B+K ESOP trust "millions of dollars." *Id.* at 44a.

The trustee undertook his own due diligence. While the negotiations were ongoing, he obtained his own appraisal, independently selecting LVA because of its familiarity with the company. *Ibid.* Consistent with its prior valuation, LVA provided an initial estimate to the trustee of $37.47 million to $41.25 million. *Id.* at 45a. After the terms of the sale were conditionally settled, LVA provided a final opinion of fair market value, which pegged the price of B+K's stock at $40.15 per share, or $40.15 million in total for the company. *Id.* at 46a. LVA also concluded that the terms of the deal's financing were "at least as favorable to the ESOP, from a financial standpoint, as would be the terms of a comparable loan resulting from arm's-length negotiation between independent parties." *Ibid.* The deal closed on those terms. *Ibid.*

2. Two weeks after the sale of B+K to the B+K ESOP trust, LVA prepared a year-end valuation of the company's post-transaction value for government reporting

purposes. As in every leveraged ESOP formation, the estimated value of the company stock held by the B+K ESOP trust—only about $5 million—was far less than what the ESOP had paid for the stock because the assets were offset by the debt "obligations relating to the sale of the Company stock to the ESOP." *Id.* at 52a. The fact that the value of the company stock exceeded the offsetting debt by approximately $5 million indicated that the trust had gotten a good deal; if it had paid too much, the 100% debt financing would have exceeded the value of the stock, resulting in a negative net value.

Since that initial post-closing valuation, the ESOP has delivered a tremendous return to the company's employees. In 2013, the first full year following the transaction, the trust reported assets of $6.8 million. See Bowers & Kubota Consulting, Inc. ESOP, *Form 5500*, DOL (2013), perma.cc/6DZR-9FPC. Just eight years later, in 2021, its assets were valued at more than $110 million. See Bowers & Kubota Consulting, Inc. ESOP, *Form 5500*, DOL (2021), perma.cc/5SZP-YTTE.

3. Two years after the B+K ESOP's formation, DOL undertook a review of all Hawai'i-based leveraged ESOP transactions above a $5 million value. Based on B+K's initial report of net assets, DOL became concerned that the $40 million purchase price that the ESOP had paid could have exceeded the company's fair market value. App., *infra*, 4a. After further investigation from 2014 through 2017, DOL sued petitioners in 2018, alleging they had sold their stock to the ESOP trust in excess of fair market value (without "adequate consideration" to the plan), in violation of 29 U.S.C. § 1002(18)(B). *Ibid.*

Petitioners denied the allegations, and the case proceeded for another three years through discovery and

trial. At the trial, "the only question that mattered was whether B+K was sold for more than its fair market value." *Ibid.* The government's case rested entirely on a valuation performed by its expert witness, Steven Sherman. *Id.* at 5a. Sherman believed that LVA had overvalued the company based on improper projections from B+K's 2012 earnings. *Ibid.* LVA had placed B+K's 2012 earnings at $9.2 million, but Sherman concluded that the proper figure was actually $4.8 million. *Ibid.* Jumping off that figure, Sherman's resulting estimate of B+K's value in 2012 was far less than LVA's had been—just $26.9 million. *Ibid.*

But as it turns out, Sherman's expert opinion was replete with errors and thus wholly "unreliable." App., *infra*, at 53a. The court found that Sherman's analysis had simply "ignored the Uniform Standards of Professional Appraisal Practice," application of which is "mandatory" for practitioners in the field. *Ibid.* Sherman also failed basic diligence steps, such as interviewing B+K management about their operations and practices. *Ibid.* Thus, Sherman erroneously identified $10.5 million in certain fees as company expenses, which he concluded had to be deducted from the company's value. *Id.* at 54a. In reality, the identified fees (the amount of which appears to have been made up) were, as matter of practice, "passed [through] to clients * * * without any markup." *Ibid.* Sherman's "resulting valuation of the Company was correspondingly too low." *Ibid.*

Sherman also deducted nearly $3 million from his valuation to reflect "what he called 'limited control.'" *Id.* at 55a. In essence, this was an arbitrary deduction to reflect Sherman's impression that Bowers and Kubota continued to exercise some measure of control over B+K after the sale, despite the ESOP's full ownership of the com-

pany. *Ibid.* But in deducting this nearly $3 million, Sherman "reli[ed] on matters occurring after the sale," in contravention of basic "appraisal standards." *Ibid.* The district court thus found that the limited control deduction was improper. *Id.* at 56a.

Those two substantial errors were enough to explain Sherman's underestimate of B+K's value—adding them to Sherman's initial estimate yielded a value above $40 million. *Ibid.* But there was more. The court also noted that Sherman impermissibly ignored upward trends in B+K's earnings, including an undisputed backlog of contracts. *Id.* at 50a-51a. The failure to incorporate these "relevant circumstances" rendered Sherman's estimate of B+K's forward-looking EBITDA "unreliable." *Id.* at 50a. In particular, the court noted that "Sherman should have known that his 'corrected' EBITDA was too low because the *actual* EBITDA as of December 31, 2012, was $7,047,000." *Id.* at 50a-51a. The gulf between his obviously deflated estimate and the company's real-life results "should have at least caused him to reexamine the historical results that he claimed required him to 'correct' the EBITDA." *Id.* at 51a.

Weighing all of the evidence at trial, the district court concluded that the sale price for the company's stock did not exceed fair market value. *Id.* at 58a-59a. The *only* evidence that the government offered for a contrary conclusion was Sherman's expert report, which, "[u]nfortunately for the government * * * contained notable errors." *Id.* at 59a. In fact, "Sherman significantly and unreasonably undervalued the Company * * * render[ing] his ultimate valuation unreliable" and "undermin[ing] his critique of LVA's valuation." *Id.* at 53a.

Discarding Sherman's estimate, there was nothing in the record to suggest that the value of B+K's stock was any less than the actual sales price. The district court thus held that petitioners had not violated "any provision of ERISA with respect to the sale of the Company" and directed the entry of judgment in their favor. *Id.* at 86a.

C. Resolution of petitioners' EAJA application

1. After their complete victory at trial, petitioners sought fees and costs under EAJA. App., *infra*, 6a. The district court adopted the magistrate's recommendation granting partial costs but denying fees. *Id.* at 90a.

The court had no trouble concluding that petitioners were all "prevailing parties" under EAJA. *Id.* at 93a. The court had "ruled that Bowers and Kubota did not violate ERISA," resulting in a judgment in their favor and "preserv[ing] the very status quo the Government was seeking to change." *Id.* at 94a. Nonetheless, the court found cursorily that "based on the evidence submitted at trial" the government was "substantially justified" in bringing its claims. *Id.* at 115a.

2. A divided panel of the Ninth Circuit affirmed in relevant part. App., *infra* 1a-14a.

a. As a starting point, the majority concluded that the "central issue" in the appeal was "whether the government's position *at trial* was reasonable, despite its ultimate failure to prove that position." App., *infra*, at 7a-8a. Because the focus was the government's decision to proceed to trial after discovery, the majority held that the government could not rely on aspects of the transaction that it thought generally suspicious. *Id.* at 8a-9a. While those features were grounds to "justify the *investigation*," they were not grounds to justify "proceeding to trial" after the investigation had concluded. *Id.* at 8a.

From there, the majority observed that the government's entire case "depended on its claim that the ESOP improperly relied on LVA's opinion and paid well above the fair market value of the company." *Ibid.* To support that claim, "the government relied only on its expert's valuation opinion." *Id.* at 9a. The majority noted that the district court found the report was riddled with errors. It also agreed that "[t]he government either knew or should have known" about most of the errors. *Ibid*. Indeed, Sherman's errors "would have been apparent had Sherman" simply followed "the Uniform Standards of Professional Appraisal Practice." *Id*. at 10a. And the majority noted that "Sherman should have known that his projection was too low" based on the fact that his unexplained estimate for B+K's 2012 EBIDTA was far lower than the actual EBITDA that B+K reported just a few weeks after the transaction. *Id*. at 11a.

But, the majority explained, Sherman had "stood firm in his conviction" that the company had been overvalued in the ESOP transaction, despite the plain flaws in his analysis. *Id.* at 10a. In particular, he had insisted that the hypothetical expenses that he deducted from the company's value—the ones that were actually passed through to clients and that accounted for more than 75% of the difference between his valuation and LVA's—were "more illustrative than anything" of the company's overvaluation. *Ibid.*

The majority reasoned that the government was reasonably justified to rely upon Sherman's opinion—the same opinion that the government either knew or should have known was full of with errors—because the government "did not *know* heading to trial that the district court would reject Sherman's entire opinion," and it still "rationally believed that LVA's valuation analysis was

faulty," albeit for reasons not supported by Sherman's report or any other evidence. *Id.* at 11a (emphasis added). Thus, while the government's position at the time of trial was weak on evidence, the court concluded that the district court did not abuse its discretion in finding that it still had a reasonable basis. *Id.* at 11a.

b. Judge Collins dissented in relevant part. App., *infra*, 14a-25a. He observed that the majority "replace[d] the statutory standard for when attorney's fees may be denied (*viz.* whether 'the position of the United States was substantially justified') with a standard that is much more forgiving to the Government (*viz.* when the United States *reasonably believed* that its position was substantially justified)." *Id.* at 14a.

Judge Collins agreed with the majority that liability "ultimate[ly] hinged dispositively on whether [petitioners] had inflated the value of B+K when selling it to an ESOP in December 2012." *Id.* at 19a-20a. But, as the district court had observed, "the evidence of *both* sides at trial showed that B+K was worth more than $40 million at the time it was sold to the ESOP." *Id.* at 20a.

That is, correcting the admitted errors in Sherman's analysis—which all three judges agreed the government either knew or should have known of—"leads to a valuation of more than $40 million." *Id.* at 20a. There was simply no other evidence to support the government's contrary claims. *Id.* at 22a. It was thus "established * * * that the Government's case on the merits was unsupported by substantial evidence." *Ibid.* In Judge Collins's view, the majority's disregard for the weakness of the government's case constitutes "a dilution of the EAJA's standard, which does not allow the Government to defeat a fee request based on its failure to subjectively appreciate

that its case was not supported by substantial evidence." *Id.* at 25a.

Petitioners moved for rehearing en banc, which the full Ninth Circuit denied after a poll. *Id.* at 1a-2a.

REASONS FOR GRANTING THE PETITION

This Court's intervention is needed in light of the widespread disagreement among the courts of appeals over how to interpret and apply EAJA's "substantially justified" standard. Because the federal government is the richest and most frequent federal litigant, the issue is necessarily a recurring one. Moreover, proper application of EAJA is necessary to prevent government abuse—as this case well shows. The Ninth Circuit's approach to EAJA in this case is indefensible, and the Court should grant the petition to bring uniformity to the law.

A. Courts are applying the "substantially justified" standard in divergent ways

EAJA authorizes a party who prevails in litigation against a federal agency—either as plaintiff or defendant—to seek attorneys' fees and costs if the agency's litigating position was not "substantially justified." 28 U.S.C. § 2412(d)(1)(A). The meaning of those words is ambiguous, and "there is an * * * obvious need to elaborate upon the meaning of the phrase." *Underwood*, 487 U.S. at 564.

The elaboration that *Underwood* provided—that an action is substantially justified when it has a "reasonable basis in both law and in fact" (*ibid.*)—has not proven any more concrete or reliable than the language it purported to interpret. Today, just as before *Underwood*, there remains a "broad range of interpretations" of the relevant phrase, producing disparate results across jurisdictions despite similarity of facts. *Ibid.* As the Third and Fourth

Circuits have put it, even after *Underwood*, "determining whether the government's position is substantially justified for the resolution of an EAJA claim has proved to be an issue of considerable conceptual and practical difficulty." *Roanoke River Basin Assoc.* v. *Hudson*, 991 F.2d 132, 138 (4th Cir. 1993); *Morgan* v. *Perry*, 142 F.3d 670, 685 (3d Cir. 1998).

The Court should take this opportunity to clarify the "substantially justified" standard and ensure that EAJA is being applied consistently throughout the country.

1. In proceedings below, the **Ninth Circuit** held that the government's position was substantially justified because, in effect, that government is not required to confirm the strength of its own case—or, more accurately, to come to grips with "just how weak its case was." App., *infra*, 14a.

At bottom, the court did not require the government to come forward with competent evidence that supported its theory at the time it made the decision to go to trial. All three judges below agreed that the government knew or should have known of the errors in Sherman's expert report. All three judges thus also agreed that the government was not justified in relying on Sherman's analysis to go to trial. *Id.* at 10a-11a. The majority nonetheless denied EAJA fees, on the ground that the government reasonably relied on its "conviction" that the company had been overvalued and the fact the Sherman's report had not *yet* been held utterly unreliable. *Id.* at 10a.

Thus, as Judge Collins noted in dissent, the majority below considered not whether the government's position *was* substantially justified, but rather whether the government *reasonably believed* its position was substantially justified in light of the firmly-stated but plainly mistaken

belief of an expert witness whose report was wholly unreliable. This "fooled by a confident expert" standard relieves the government of any obligation to do its homework and permits the government in these types of cases to rely upon a host of shady valuation characters. Any time an expert confirms a regulator's ungrounded suspicion of wrongdoing, that will be enough, no matter how indefensible and inaccurate the expert's analysis.

2. The Ninth Circuit's decision below conflicts with authoritative decisions of the Third, Fifth, Seventh, and Eighth Circuits. These other courts have recognized that the government's failure to point to competent, reliable evidence means necessarily that the government's position lacks a "reasonable basis both in law and fact." *Underwood*, 487 U.S. at 565.

Consider first the **Seventh Circuit,** which held squarely that a federal agency is liable for fees and costs under EAJA "if the agency has knowledge that the presumed facts supporting its position are without merit." *Phil Smidt & Son, Inc.* v. *NLRB*, 810 F.2d 638, 642 (7th Cir. 1987). In *Phil Smidt*, the court emphasized that to persist with an ongoing litigation, the government must have "a reasonable basis in fact" to support its theory of the case. *Id.* at 643. That inquiry turns on whether "the evidence in the record supports the [agency's] conclusion that [its] position was substantially justified." *Ibid.* The government necessarily flunks that inquiry when "there [is] conflicting evidence" weighing against the government's theory and it "fail[s] to take adequate measures to assess that evidence" and more generally "fail[s] to exercise the proper care in the formulation of its [own] factual submission[s]." *Ibid.* On those grounds, the Seventh Circuit reversed the district court, holding that it had abused its discretion to deny EAJA fees.

That is precisely the approach that the Ninth Circuit rejected below. The court of appeals in this case forgave DOL any obligation to take adequate measures to assess the evidence that B+K was fairly valued, or to take care that its own expert's analysis was defensible. The Ninth Circuit affirmed the denial of fees despite that the government "knew or should have known" of the objective errors in Sherman's report. App., *infra*, at 9a. There is no doubt that the Seventh Circuit would have reversed the denial of an EAJA award in this case.

The **Fifth Circuit** has similarly held that the government's position is not substantially justified if it "should have known that [its] position was invalid at the onset of the litigation." *Nalle* v. *Commissioner*, 55 F.3d 189, 191 (5th Cir. 1995).

In *Nalle*, the Fifth Circuit explained that an agency "may still be substantially justified in defending an ultimately unsuccessful position" if "the error" in the government's evidence "was not obvious" at the relevant time. *Id.* at 192. But when the error is plain, and when the agency has "failed to conduct a reasonable investigation that would have revealed the flaw in its position," the agency cannot rely on the flawed evidence to establish substantial justification. *Ibid.* As the Fifth Circuit put in a later case applying *Nalle*, an agency cannot be substantially justified within the meaning of EAJA if it "did not present any credible evidence or call any competent witnesses to support the reasonableness of its position during the course of the litigation." *Estate of Baird* v. *Commissioner*, 416 F.3d 442, 454 (5th Cir. 2005). For those reasons, the Fifth Circuit reversed the denial of EAJA fees in both *Nalle* and *Baird*.

Those holdings conflict with the decision below. If DOL had undertaken the most basic investigation—for example, by interviewing the managers of B+K or simply reading their deposition testimony and that of the defense experts in the case—it would have uncovered the factual errors in its case. See App., *infra*, 9a-10a. Indeed, all agree that those errors were plain and were either known or should have been known to DOL long before the trial started. *Ibid.* And all agree that, at bottom, DOL did not present any credible evidence to support the reasonableness of its position. Thus, like the Seventh Circuit, the Fifth Circuit would have reversed the denial of fees.

The **Third Circuit** also would have reversed the denial of an EAJA award in this case. That court's "law of substantial justification" requires the government to show (1) a reasonable basis in truth for the facts it has alleged; (2) a reasonable basis in law for the theory it has propounded; and (3) a reasonable connection between the facts alleged and the legal theory advanced. *Hanover Potato Products, Inc.* v. *Shalala*, 989 F.2d 123, 128 (3d Cir. 1993); *Taylor* v. *Heckler*, 835 F.2d 1037, 1042 (3d Cir. 1987). According to the Third Circuit, the government does not satisfy its burden "merely because [it] adduces 'some evidence' in support of its position." *Edge* v. *Schweiker*, 814 F.2d 125, 128 (3d Cir. 1987). And it necessarily fails its burden when there is "*no* evidence" in the record to support its position. *Ibid.* When "the government's strongest arrow in its quiver was faulty," and it should have known of the errors, it cannot be said to be substantially justified. *Id.* at 129. Thus, the Third Circuit also would have reached a different result in this case, given that there was no evidence in the district court to support the government's case.

The **Eighth Circuit** likewise requires the government to point to competent evidence in the record to meet its burden of showing substantial justification. See *Lauer* v. *Barnhart*, 321 F.3d 762, 763-764 (8th Cir. 2003). In *Lauer*, the court explained that "the government's position must be well founded in fact to be substantially justified." *Id.* at 765. And, according to that court, "[a] position which lacks any evidence in its support is no more well founded in fact than a position that ignores overwhelming adverse evidence." *Ibid.* The court thus reversed the denial of EAJA fees in that case, holding that "the district court [had] applied an incorrect legal standard" when it concluded that the government is substantially justified unless it "disregard[s] overwhelming evidence" against its position. *Id.* at 764.

The Eight Circuit, too, would have reversed the district court's denial of EAJA fees in this case. As we have explained, the *only* evidence in support of the government on the dispositive issue was an error-filled, unreliable expert report that the government, if acting reasonably, never could have relied on to begin with. EAJA's substantially-justified standard is therefore being applied in divergent ways in cases involving analytically similar facts. In cases like this one, the Ninth Circuit affirms the denial of fees, whereas the Third, Fifth, Seventh, and Eighth Circuits reverse. Such variability in the application of a federal statutory standard is intolerable.

B. This is a suitable vehicle to resolve a question of substantial importance

This case provides an attractive vehicle for clarifying EAJA's "substantially justified" standard. To begin, the question presented was raised and addressed at each stage of the proceedings below. The EAJA issue was the exclu-

sive focus of the court of appeals below, which addressed the issue thoroughly and in light of an equally thorough dissent. In short, there are no procedural barriers or alternative issues that would inhibit the Court's consideration and resolution of the question presented.

Moreover, the question is important. Given the ever-brighter role that agencies play in the federal legal firmament and the possibility that they may abuse (or carelessly misuse) their authority, a clear enunciation of EAJA's fee-shifting rule is essential. Indeed, it was the risk of bureaucratic abuse that drove Congress to adopt EAJA in the first place. As we noted at the outset, EAJA's "legislative history * * * is strewn with references to the United States and its agencies' abuse of the litigation process" to extract undue concessions from unlucky citizens and small businesses. *National Lawyers Guild*, 94 F.R.D. at 615 n.32 (citing H.R. Rep. No. 96-1418).

Private parties should not be discouraged from vindicating their rights by the cost of litigating against the government. And the present uncertainty surrounding EAJA's legal standard is having a chilling effect in its own right. As Justice Sotomayor recognized not long ago, "EAJA's admirable purpose will be undercut if lawyers fear that they will never actually receive attorney's fees" when the statute's standard is met. *Astrue* v. *Ratliff*, 560 U.S. 586, 600 (2010) (Sotomayor, J., concurring).

These concerns have particular salience in the ERISA context. One of the principal "congressional purposes" underlying ERISA was to ensure that plans' "litigation expenses" would not "unduly discourage employers from offering [ERISA] plans in the first place." *Varity Corp*. v. *Howe*, 516 U.S. 489, 497 (1996). EAJA is the primary restraint on the government's ability to bring unfounded

cases based on flimsy investigations and unsupported hunches, which are extremely costly for plans to settle or oppose in court. The Ninth Circuit's decision below means that defendants must bear the costs of DOL's generalized suspicions of nearly all ESOP transactions. The result is a potent disincentive to the creation of ESOPs in the first place—precisely the result Congress sought to avoid with ERISA.

Finally, the issue arises with great frequency. The Westlaw database indicates that litigants seek EAJA fees in between 500 and 600 cases every year. Many of these cases involve suits for benefits under the Social Security, Medicare, and Veterans Affairs programs. These suits are often brought or defended by the neediest Americans, those most vulnerable to overlitigation by the government and least able to pay attorneys' fees. Many other cases involve requests for fees in suits under the Administrative Procedure Act, when an agency has engaged in particularly indefensible enforcement activities. Ensuring that the government is held to account when its position in court is unjustified is essential to the vindication of the wide range of rights at stake in these many cases.

C. EAJA fees were authorized here

The clean presentation of a question of significant practical importance that has divided the lower courts is ground enough to grant the petition. But it bears emphasis that the decision below is also manifestly wrong. Under any reasonable interpretation of the words "substantially justified," the government's position here fell far short of the mark. The standard that the Ninth Circuit applied to reach a contrary decision is simply wrong.

As this Court explained in *Underwood*, the substantially-justified analysis considers "not merely what was

the law, but what was the evidence regarding the facts." 487 U.S. at 560. In basing the inquiry to the "evidence," the Court tied "substantially justified" to the actual facts and evidence adduced during discovery and at trial. And the question of what evidence may and may not be relied upon need not await the district court's reliability or admissibility determination. No, "such matters as whether particular evidence was worthy of being relied upon, or whether critical facts could easily have been verified by the Government" are relevant to ascertaining whether the government's position had a reasonable basis in fact at the time it decides to proceed to trial. *Ibid.*

That is emphatically not the standard that the Ninth Circuit applied below. All four judges below agreed that Sherman's expert report—the *sole* piece of evidence that the government proffered in support of its position on the dispositive valuation issue—was plainly unreliable. App., *infra*, 9a ("the government relied only on its expert's valuation opinion"), 59a. All four judges observed that the errors in Sherman's analysis were flagged early on by petitioners and easily could have been remedied or avoided by simply interviewing Bowers or Kubota, reviewing deposition testimony of them or experts, or following the standard rules for appraisals of closely-held businesses. App., *infra*, 10a, 49a-51a.

But the majority of the Ninth Circuit ignored both conclusions and held that the government's position was "perhaps not without a reasonable basis" because Sherman's report had not yet been deemed unreliable and Sherman himself had "stood firm in his conviction" that B+K had been overvalued in the transaction. *Id.* at 10a.

As Judge Collins explained, the majority was wrong in both its analysis and conclusion. It supplanted the

statutory test "with the much looser standard of whether the Government 'rationally believed' that its position was substantially justified." *Id.* at 24-25a. "This is a dilution of the EAJA's standard, which does not allow the Government to defeat a fee request based its failure to subjectively appreciate that its case was not supported by substantial evidence." *Id.* at 25a.

There is a world of difference between the Ninth Circuit's standard and the correct test. As this Court held in *Underwood*, the government must be able to demonstrate that its position had a reasonable basis in *actual fact*. 487 U.S. at 565. That places a burden on the government to produce verifiable, admissible evidence sufficient to prove its case at trial; it does not allow the government to rely blindly on the "conviction" of a sloppy, results-driven, hired-gun expert whose analysis was full of plain errors.

At bottom, the alternative approach adopted by the Ninth Circuit below will allow the government to proceed to trial *without* reliable evidence whenever it or its expert witness has a firm belief about the facts, in the abstract. The majority below would, for example, deny fees where the government pursues litigation based on an argument it undeniably waived, so long as it believed that the litigant would miss the issue and thus not press a waiver argument before a judge. Such a permissive test eliminates the safeguards against governmental overreach and sloppiness that Congress sought to ensure with EAJA.

Because the Ninth Circuit's contrary decision conflicts with decisions of other courts of appeals on a matter of great importance, the Court should grant the petition.

CONCLUSION

The Court should grant the petition.

Respectfully submitted.

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