No. 18-

IN THE

Supreme Court of the United States

YOUNG ADULT INSTITUTE, INC., d/b/a YAI National Institute for People with Disabilities, *et al.*,

Petitioners,

v.

JOEL M. LEVY *et al.*,

Respondents.

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

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

State and federal law prohibit non-profit corporations from paying excessive or unreasonable executive compensation. This prohibition applies equally to deferred-compensation plans regulated under the Employee Retirement Security Income Act (ERISA). Petitioner Young Adult Institute (YAI) determined that the multi-million-dollar retirement package for its former CEO, Respondent Joel Levy, violated this rule. YAI thus reduced Levy's remaining retirement benefits to a reasonable level. When Levy challenged this determination in federal court, YAI argued that his ERISA-regulated plan was unenforceable under state and federal common law because it violated the public policy against excessive compensation. The magistrate judge, the district judge, and the Second Circuit all rejected YAI's public-policy argument as a matter of New York law, but none of them addressed this issue under federal common law, which categorically bars federal courts from enforcing contracts that call for illegal performance.

The question presented is:

Whether the decision below should be summarily reversed because it refused to decide YAI's public-policy argument that arises under federal common law.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioners are Young Adult Institute, Inc., d/b/a YAI National Institute for People with Disabilities (YAI); Board of Trustees of Young Adult Institute, Inc.; Pension Retirement Committee of the Board of Trustees of Young Adult Institute; Supplemental Pension Plan and Trust for Certain Management Employees of Young Adult Institute, and Life Insurance Plan and Trust for Certain Management Employees of YAI.

YAI is a not-for-profit corporation organized under the New York Not-For-Profit Corporation Law. YAI does not have a parent corporation, and no publicly held corporation owns 10% or more of YAI's stock. The remaining Petitioners are not corporations.

Respondents are Joel M. Levy and Judith W. Lynn.

Eliot P. Green and Israel Discount Bank Of New York were defendants below.

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PETITION FOR A WRIT OF CERTIORARI

Young Adult Institute, Inc. (YAI), and the related parties listed on page ii above, respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The Second Circuit's opinion is available at 744 F. App'x 12 (2d Cir. 2018), and is reproduced at Petition Appendix ("Pet. App.") 1a–7a. The magistrate judge's report and recommendation and the relevant district court opinions are unpublished. They are reproduced at Pet. App. 8a–106a.

JURISDICTION

The Second Circuit entered judgment on August 9, 2018. YAI timely petitioned for panel and *en banc* rehearing on August 23, 2018. That petition was denied on October 4, 2018. Pet. App. 107a–108a. On December 14, 2018, Justice Ginsburg granted a 30 day extension of time within which to file this petition. The Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

26 U.S.C. § 501(a) and (c)(3) provide that the following organizations "shall be exempt from taxation":

> Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes . . . no part of the net earnings of which inures to the benefit of any private shareholder or indi-

vidual.

New York's Not-for-Profit Corporation Law provides, as relevant:

> (a) A corporation shall not pay dividends or distribute any part of its income or profit to its members, directors, or officers.
>
> (b) A corporation may pay compensation in a reasonable amount to members, directors, or officers, for services rendered, and may make distributions of cash or property to members upon dissolution or final liquidation as permitted by this chapter. . . .

N.Y. Not-for-Profit Corp. Law § 515.

STATEMENT OF THE CASE

This Court's decisions "leave no doubt that illegal promises will not be enforced in cases controlled by the federal law." *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. 72, 77 (1982). Thus, the ERISA-regulated employee-benefit contracts at issue here are unenforceable to the extent they require petitioner YAI to violate either state or federal laws barring non-profits from paying excessive compensation. Nonetheless, the district court enforced these contracts without regard to whether, in doing so, it was violating federal law. It reached that result because it considered YAI's public-policy defense only under New York state law, and simply ignored the proper federal common law rule. The Second Circuit, in the face of YAI's vigorous contention that the district court ignored federal law, adopted the district court's supposed holding that the contracts are "not voided or altered by the public policy defense *under either the federal common law or New York state law*." Pet. App. 6a (emphasis added). But the district court

made no such "determin[ation]" under "the federal common law." The lower courts simply ignored the federal standard in favor of the state one.

That was error. As the lower courts themselves recognized in this litigation, Pet. App. 41a, federal common law governs "ERISA-regulated plans" like these. *Firestone Tire & Rubber Co.* v. *Bruch*, 489 U.S. 101, 110 (1989) (quoting *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S. 41, 56 (1987)). And under that federal common law, each and every reason the lower courts gave for rejecting YAI's public-policy defense is invalid. See *Kaiser Steel*, 455 U.S. at 77–86. In particular, federal common law has long rejected the notion—on which the lower courts relied under New York law—that a contract that violates "a law against something that is inherently wrong[,] such as murder or arson," is "void or voidable," but a contract "that violates a regulatory prohibition" is not. Pet. App. 101a. This Court dismissed that distinction as "exploded" over a century ago. *Gibbs* v. *Consol. Gas Co. of Balt.*, 130 U.S. 396, 411–12 (1889).

The federal rule is instead that *any* "illegal promises"—that is, any contracts whose enforcement would require "commanding unlawful conduct"—"will not be enforced." *Kaiser Steel*, 455 U.S. at 77, 79. Because ordering a non-profit to pay excessive compensation would require "commanding unlawful conduct," a federal court cannot do it. Yet the courts below enforced the contracts at issue without regard to the federal common law prohibition. See Pet. App. 103a. They thus breached their "well established . . . duty to determine whether a contract violates federal law before enforcing it." *Kaiser Steel*, 455 U.S. at 83.

Summary reversal is therefore appropriate. This admittedly "rare disposition" is proper where "the law is settled and stable, the facts are not in dispute, and

the decision below is clearly in error." *Schweiker* v. *Hansen*, 450 U.S. 785, 791 (1981) (Marshall, J., dissenting) (per curiam). All of these criteria are satisfied here. The Court should summarily reverse the Second Circuit's decision and remand for further proceedings so that the courts below "may determine the merits of [YAI's excessive-compensation] defense" under the proper federal standards. *Kaiser Steel*, 455 U.S. at 85.

A. Factual Background.

1. YAI provides programs and services for people with intellectual and developmental disabilities. See Pet. App. 87a. It is a non-profit corporation organized under New York's Not-For-Profit Corporation Law and is a tax-exempt § 501(c)(3) organization under federal law.

As such, YAI is prohibited by law from paying excessive or unreasonable executive compensation. Under the tax code, "no part of the net earnings of" a § 501(c)(3) organization may "inure[] to the benefit of any private shareholder or individual." 26 U.S.C. § 501(c)(3). "While 'payment of a reasonable salary to an employee of the organization does not automatically result in inurement, . . . an excessive salary will.'" *Family Tr. of Mass., Inc.* v. *United States*, 892 F. Supp. 2d 149, 156 (D.D.C. 2012), *aff'd*, 722 F.3d 355 (D.C. Cir. 2013) (citation omitted); *accord Bubbling Well Church of Universal Love, Inc.* v. *Comm'r*, 74 T.C. 531, 537 (1980), *aff'd*, 670 F.2d 104 (9th Cir. 1981).

New York law similarly prohibits unreasonable compensation. A non-profit may not "distribute any part of its income or profit to its members, directors, or officers," and may only "pay compensation in a reasonable amount to members, directors, or officers,

for services rendered." N.Y. Not-for-Profit Corp. Law § 515(a)–(b); see also *id.* § 202(a)(12) (a non-profit may "fix [officers' or employees'] reasonable compensation"). Payments to executives that exceed "'reasonable' compensation 'commensurate with services performed'" are "unlawful." *People ex rel. Spitzer* v. *Grasso*, 836 N.Y.S.2d 40, 42 (N.Y. App. Div. 2007), *aff'd*, 893 N.E.2d 105 (N.Y. 2008).

2. Respondent Joel Levy joined YAI as executive director in 1970. Pet. App. 3a, 21a. He became CEO in 1979 and served in that role until he retired in 2009. *Id.*

Levy was extremely well compensated. From 2004 to 2009, his yearly salary exceeded $500,000; he was paid annual cash bonuses ranging from nearly $175,000 to $250,000; and he received an annual car allowance, international business-class travel, healthcare benefits, life insurance, and long-term disability benefits. Joint Appendix at 1407–09, 2152, *Levy* v. *Young Adult Inst., Inc.*, 744 F. App'x 12 (2d Cir. 2018) (No. 17-1797) [hereinafter CAJA]. Even after he retired in 2009, Levy received $500,000 under a two-year consulting agreement. Pet. App. 87a; CAJA 2742, 2744.

Levy's retirement benefits were also extravagant. He participated in several tax-qualified and non-qualified retirement programs sponsored by YAI. YAI covered the cost of Levy's healthcare in retirement and provided him with $3,127,762 in life insurance benefits. See Pet. App. 3a. Finally, Levy and four other executives participated in a Supplemental Pension Plan and Trust (the SERP). First adopted in 1985—when the executives' compensation was quite modest—the SERP provided for a lifetime annuity based on retired participants' years of service and highest annual earnings (offset by the amount of

their benefits under the other retirement programs). *Id.* at 21a–22a. A long-tenured executive like Levy would receive a yearly payment equal to his highest annual salary at YAI, plus a cost-of-living adjustment—not only throughout his retirement, but also for the lifetime of his spouse. *Id.* at 3a.

3. In 2011, the New York Times ran a front-page story about Levy's (and his brother's) compensation at YAI. See Ross Buettner, *Reaping Millions in Nonprofit Care for Disabled*, N.Y. Times (Aug. 2, 2011), https://goo.gl/kmehH6. The article described Levy's compensation and his opulent lifestyle, explaining that "[n]o organization in the field in New York has paid its executives as well." *Id.* Indeed, a "database of tax returns filed by every nonprofit organization in the country shows nothing close to the Levys' compensation." *Id.*

The Times article, combined with YAI's settlement of a *qui tam* lawsuit alleging Medicaid overbilling, drew the attention of New York's Office for People with Developmental Disabilities (OPDD). Pet. App. 4a–5a. The Office placed YAI on "early alert" status, *Id.* at 91a–92a, which is a "scarlet letter" that restricts an organization's ability to provide new services until it addresses the issues identified by OPDD, CAJA 1282, 1300–01. In particular, OPDD was greatly concerned by "recent disclosures on executive compensation at YAI." *Id.* at 2340. OPDD made clear that YAI needed to reform its executive compensation arrangements and that YAI would not be removed from "early alert" "until such time as we see where things end up with the supplemental pension funds." *Id.* at 2461. The government attorneys who negotiated the *qui tam* settlement expressed similar concerns. They observed that YAI's "[e]xec-

utives are egregiously highly-compensated"—indeed, they are "stinking rich." See *id*. at 1280–81, 2318–19.

By this time, Levy (and his ex-wife) had already received $500,000 under the consulting agreement and an additional *$5.5 million* in retirement benefits, including nearly a million dollars under the SERP. CAJA 2144.

In light of OPDD's scrutiny, YAI's Board decided to suspend all payments under the SERP. CAJA 2021, 2024. YAI retained the law firm Morgan Lewis & Bockius to review the SERP and advise the Board on the legal risks associated with enforcing it. Pet. App. 30a. Morgan Lewis, in turn, hired an employment consultant, Mercer LLC, "to examine both past compensation paid to the SERP beneficiaries and, in light of appropriate compensation levels, what retirement benefits are reasonable, appropriate and consistent with YAI's charitable status and the Board's fiduciary obligations as stewards of YAI's assets." CAJA 2464; see Pet. App. 92a. While this process was ongoing, OPDD asked YAI to confirm that "no payments [were] being made to the Levy[s] from either the qualified plan or the SERP" and asked YAI "not to make any (further) payments to . . . Levy until such time a settlement agreement is reached." CAJA 2477–78.

Mercer determined that Levy's post-employment benefits—the SERP payments, the life insurance, and the other benefits—totaled nearly *$17 million*. CAJA 2516. These benefits exceeded the non-profit market median by more than $10.5 million. *Id.* Mercer found "no justification for a retirement package of this magnitude particularly given [that] the organization is a tax-exempt social services agency." *Id*. at 2519. Given Levy's generous pre-retirement salary and the $5.5 million in retirement benefits he had al-

ready received, Mercer recommended limiting his additional retirement benefits to no more than $929,200. *Id.* At OPDD's insistence, YAI adopted Mercer's recommendation and amended the SERP to cap Levy's remaining benefits at the "maximum reasonable benefit as determined by Mercer LLC." *Id.* at 2164. YAI also limited Levy's life insurance benefit.

B. Proceedings Below.

Levy and his wife, Judith Lynn, sued YAI under ERISA § 502, which authorizes a civil action by a participant or beneficiary "to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan." 29 U.S.C. § 1132(a)(1)(B). Levy sought additional SERP payments and to clarify his rights under the life insurance policies. CAJA 120. The case was referred to a magistrate judge.

YAI sought partial summary judgment on the ground that, as a tax-exempt non-profit, it is barred by New York and federal law from paying benefits that would result in excessive or unreasonable compensation. A "top hat" benefit plan like Levy's—*i.e.*, a "plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly trained employees"—is largely exempt from ERISA's substantive requirements and is instead governed by contract law. *E.g.*, *Goldstein* v. *Johnson & Johnson*, 251 F.3d 433, 436 (3d Cir. 2001); see Pet. App. 41a, 100a. YAI thus argued that, as a matter of both state and federal contract law, Levy's plan could not be enforced to the extent it provided excessive compensation. See Supplemental Appendix for Plaintiffs-Appellees-Cross-Appellants at 41–42, *Levy*, 744 F. App'x 12 (No. 17-1797), ECF No. 102

[hereinafter CASA]. In particular, YAI relied on *Kaiser Steel*, the leading case on the public-policy defense provided by federal common law. *Id.* at 42.

The magistrate judge recommended denying YAI's motion. She rejected YAI's public-policy argument under New York law, but did not address the issue under federal common law. She explained that, "[u]nder New York law, a contract that violates a regulatory prohibition, as opposed to a law against something that is inherently wrong such as murder or arson, is not necessarily void or voidable." Pet. App. 101a. Thus, "the violation of a statute that is merely *malum prohibitum* will not necessarily render a contract illegal and unenforceable." *Id.* (quoting *Benjamin* v. *Koeppel*, 85 N.Y.2d 549, 553 (1995)). "If the statute does not provide expressly that its violation will deprive the parties of their right to sue on the contract, and the denial of relief is wholly out of proportion to the requirements of public policy . . . the right to recover will not be denied." *Id.* (omission in original) (quoting *Benjamin*, 85 N.Y.2d at 553).

Applying this standard, the magistrate judge held Levy's benefits enforceable. She said that "enforcement of Levy's SERP benefits does not endanger public health or morals or constitute fraud"; neither state nor federal law "include[s] a provision prohibiting enforcement of the SERP"; and statutes and regulations provide for adequate sanctions for excessive-compensation violations. Pet. App. 102a–103a. She also observed that Levy had already completed his performance. Thus, in her view, "public policy actually favors the enforcement of his contract." *Id.* at 103a–104a.

The magistrate judge did not address the public-policy defense under federal common law, did not cite or mention *Kaiser Steel* or any other cases applying

the federal standard rather than the New York standard, and did not offer any reason for failing to do so. See Pet. App. 100a–104a.

The district judge agreed with the magistrate judge's recommendation. In his view, the magistrate judge had "determined that enforcement of Levy's SERP would not endanger public health or constitute fraud, and thus, that the SERP was not *per se* unenforceable *under New York law*." Pet. App. 80a–81a (emphasis added). Having framed the analysis that way, he found "no error": He concluded that her report "contains a well-reasoned analysis of the enforceability of contracts under New York law." *Id.* at 84a. Again, he did not analyze the public-policy issue under federal law or cite any cases establishing or applying the federal standard.

The parties completed discovery and cross-moved for summary judgment. The district judge recognized that "[a]s a vested top-hat plan, the SERP is a unilateral contract governed by federal common law," Pet. App. 41a, and thus applied federal common law to decide whether Levy waived any benefits under the plan, see *id.* at 55a–56a. But he rejected YAI's remaining defenses. As to the public-policy issue, he denied YAI's motion to reconsider without addressing whether state or federal governed, finding "no evidence that a regulator concluded that Levy's SERP benefit violated state and federal law." See *id.* at 38a–39a.

After a bench trial, the district judge held that YAI must pay Levy the full benefits required under the SERP and the life insurance policies. Pet. App. 16a–18a. Because of his threshold ruling rejecting YAI's public-policy argument, he ordered payment of these benefits without ever determining whether they were excessive or unreasonable.

The Second Circuit affirmed. YAI argued vigorously that the district court had erred by ignoring the federal common law public-policy defense to enforcement of a contract embodied in an ERISA plan. Nevertheless, the court of appeals held that the district court "properly determined that . . . [t]he SERP and [life insurance plan] are enforceable and not voided or altered by the public policy defense under either the federal common law or New York state law." Pet. App. 2a, 6a. Despite the court's reference to "the federal common law," the district court had not addressed that standard, and the Second Circuit did not do so either. Through this sleight of hand, the lower courts eliminated YAI's federal common law defense.

YAI petitioned for panel and *en banc* rehearing, arguing that the panel's decision "overlooks the federal common law defense and conflicts with" this Court's decision in *Kaiser Steel*. Petition for Panel Rehearing or Rehearing En Banc at 7–9, *Levy*, 744 F. App'x 12 (No. 17-1797), ECF No. 167 (capitalization altered). The court of appeals denied the petition.

REASONS FOR SUMMARY REVERSAL

The decision below should be summarily reversed because it purports to reject YAI's federal public-policy defense on the merits, but none of the lower courts addressed that issue, instead applying New York law alone. That was manifest error, as federal common law governs the interpretation and enforceability of employee benefits contracts. And that error was dispositive, because federal common law rejects the reasoning on which the lower courts relied. This clear failure to apply settled law warrants summary reversal.

I. THE COURTS BELOW FAILED TO APPLY FEDERAL LAW TO DETERMINE THE ENFORCEABILITY OF AN ERISA PLAN.

The lower courts erred in evaluating YAI's public-policy argument under New York law and refusing to consider the effect of federal common law on the enforceability of the ERISA plan. Levy brought suit under ERISA § 502 to recover benefits he was allegedly owed under the SERP and to clarify his rights under the life insurance plan. See 29 U.S.C. § 1132(a)(1)(B). ERISA claims, of course, are governed exclusively by federal law. *Aetna Health Inc.* v. *Davila*, 542 U.S. 200, 207–08 (2004). And with good reason: "The purpose of ERISA is to provide a uniform regulatory regime over employee benefit plans." *Id.* at 208. That purpose would be defeated "if the remedies available to ERISA participants and beneficiaries under § 502(a) could be supplemented or supplanted by varying state laws." *Pilot Life Ins.*, 481 U.S. at 56.

This Court has thus "held that courts are to develop a 'federal common law of rights and obligations under ERISA-regulated plans.'" *Firestone Tire*, 489 U.S. at 110 (quoting *Pilot Life Ins.*, 481 U.S. at 56). The courts of appeals have executed that command, "appl[ying] the federal common law of contracts to interpret ERISA plans," *Plotnick* v. *Comput. Scis. Corp. Deferred Comp. Plan*, 875 F.3d 160, 166 (4th Cir. 2017), and to decide contract-law questions related to those plans, such as waiver, *e.g.*, *HECI Expl. Co., Emps.' Profit Sharing Plan* v. *Holloway* (*In re HECI Expl. Co.*), 862 F.2d 513, 523 (5th Cir. 1988). This federal common law applies equally to "top hat" deferred-compensation plans like Levy's. *Goldstein*, 251 F.3d at 435–36; see also, *e.g.*, *Senior Exec. Benefit Plan Participants* v. *New Valley Corp.* (*In re New Val-*

ley Corp.), 89 F.3d 143, 149 (3d Cir. 1996) ("Top hat plans are . . . governed by general principles of federal common law."); *Cogan* v. *Phx. Life Ins. Co.*, 310 F.3d 238, 242 (1st Cir. 2002) (similar). Moreover, "the effect of illegality under a federal statute is a matter of federal law." *Kelly* v. *Kosuga*, 358 U.S. 516, 519 (1959). The enforceability of Levy's benefits is thus a question of federal law.

The lower courts' abject failure to apply federal law was wholly unjustified. Indeed, the district court recognized that "the SERP is a unilateral contract governed by federal common law," Pet. App. 41a, and it correctly applied federal common law to decide *other* contract-law issues arising from the SERP, such as whether Levy waived any benefits thereunder, see *id.* at 55a–56a. Moreover, YAI consistently raised the federal public-policy standard. Each of YAI's filings in the lower courts cited or discussed this Court's *Kaiser Steel* opinion for the proposition that "under federal law, illegal contracts are unenforceable." See CASA 42, 66. And YAI's appellate brief argued at length that, "in deciding the public policy defense, the [district] court erred in failing to analyze and apply the federal common law." Brief and Special Appendix for Defendants-Counter-Claimants-Appellants-Cross-Appellees at 29–32, *Levy*, 744 F. App'x 12 (No. 17-1797), ECF No. 77 (capitalization altered). The Second Circuit's response—to affirm the district court's supposed federal common law holding—is utterly mystifying. YAI's public-policy defense was never judged under the appropriate legal standard. Only this Court can correct that failure.

To be sure, YAI did argue that New York law supports the conclusion that Levy's benefits agreement is unenforceable. But that does not justify applying New York law to the exclusion of federal law. And

while Levy asserted on appeal that YAI had failed to raise the federal public-policy argument below, that was wrong. YAI raised this argument, citing *Kaiser Steel*, from the outset. See CASA 42, 66. YAI also explained in response to Levy's waiver argument that, under *Kaiser Steel*, the federal public-policy defense cannot be waived. Reply and Response Brief for Defendants-Counter-Claimants-Appellants-Cross-Appellees at 19–20, *Levy*, 744 F. App'x 12 (No. 17-1797), ECF No. 127.

It is thus unsurprising that the Second Circuit did not accept Levy's assertion of waiver: It held that "the district court properly determined that . . . [t]he SERP and [the life insurance plan] are enforceable and not voided or altered by the public policy defense under either the federal common law or New York state law." Pet. App. 6a. This is not a conclusion that YAI waived the public-policy argument. It is a conclusion that the district court "properly" addressed and "determined" that issue on the merits. *Id*. But that never happened. Both courts below failed to evaluate YAI's public-policy defense under the federal common law that governs Levy's benefit plans.

II. THIS COURT HAS REJECTED ALL OF THE LOWER COURTS' REASONS FOR DISMISSING YAI'S PUBLIC-POLICY DEFENSE.

The lower courts' failure to consider the federal public-policy standard was dispositive. All of the reasons the courts gave for enforcing Levy's benefits under New York law—that the excessive-compensation ban is merely a "regulatory prohibition," that Levy had already completed his performance, that there are existing remedies for excessive compensation, and

that no regulator had found Levy's compensation to be excessive—fail under federal law.

1. The crux of the lower courts' public-policy analysis was a supposed distinction, drawn from New York law, between "a contract that violates . . . a law against something that is inherently wrong such as murder or arson" (which is "necessarily void or voidable") and "a contract that violates a regulatory prohibition" (which is not). Pet. App. 101a. That is, "the violation of a statute that is merely *malum prohibitum* will not necessarily render a contract illegal and unenforceable," *Benjamin* v. *Koeppel*, 650 N.E.2d 829, 830 (N.Y. 1995), and the courts below concluded that the bar on excessive compensation falls into this category, Pet. App. 6a, 84a, 101a.

But federal common law does not recognize this rule. Over a century ago, this Court described the "distinction between *malum in se* and *malum prohibitum*" as "exploded," because "'there can be no legal remedy for that which is itself illegal.'" *Gibbs*, 130 U.S. at 411–12 (quoting *Bank of United States* v. *Owens*, 27 U.S. (2 Pet.) 527, 539 (1829)); see 6A Arthur Linton Corbin, *Corbin on Contracts* § 1378 (1962) (describing this distinction as a "falsity"). *Gibbs* thus refused to enforce an anticompetitive agreement that violated a state statute—without asking whether restraining competition is akin to murder or arson. See 130 U.S. at 406–12.

This Court's modern cases similarly "leave no doubt that illegal promises will not be enforced in cases controlled by the federal law." *Kaiser Steel*, 455 U.S. at 77. "The power of the federal courts to enforce the terms of private agreements is at all times exercised subject to the restrictions and limitations of the public policy of the United States as manifested in . . . federal statutes." *Id.* at 83–84 (quoting *Hurd* v.

Hodge, 334 U.S. 24, 34–35 (1948)). "Where the enforcement of private agreements would be violative of that policy, it is the obligation of courts to refrain from such exertions of judicial power." *Id.* at 84 (quoting *Hurd*, 334 U.S. at 35). The essential question is whether the contract "could be enforced without commanding unlawful conduct." *Id.* at 79. If "the judgment of the Court would itself be enforcing the precise conduct made unlawful" by statute, a court cannot enforce the agreement. See *id.* at 80 (quoting *Kelly*, 358 U.S. at 520).

This standard does not turn on the relative immorality of the underlying conduct. In *Kaiser Steel*, the disputed contracts required the defendant steel company to pay a penalty into the plaintiff union's health and retirement funds for any coal the company purchased from suppliers that did not contribute to the union funds. 455 U.S. at 74–75. These contracts were allegedly anticompetitive, in violation of federal antitrust and labor law. *Id.* at 78. After the plaintiff (as here) sued under ERISA § 502 to enforce the benefits contracts, *id.* at 76, this Court held that the steel company was entitled to raise an illegality defense. As in *Gibbs*, the Court did not ask whether such allegedly anticompetitive conduct was immoral; the only question was whether it violated the law. *Id.* at 78–79. Moreover, the Court discussed with approval other cases refusing to enforce contracts that violated similar regulatory prohibitions, such as bid-rigging agreements. See *id.* at 77 (citing *Cont'l Wall Paper Co.* v. *Louis Voight & Sons Co.*, 212 U.S. 227 (1909); *McMullen* v. *Hoffman*, 174 U.S. 639 (1899)).

In short, while New York has chosen to retain the "distinction between *malum in se* and *malum prohibitum*" contracts, this Court long ago jettisoned it. *Gibbs*, 130 U.S. at 411–12. The lower courts should

not have enforced Levy's benefits based on this doctrine.

2. *Kaiser Steel* similarly invalidates the lower courts' other reasons for dismissing YAI's public-policy defense.

First, the magistrate judge concluded that reducing Levy's benefits would be unfair because he had already performed his side of the bargain. Pet. App. 103a–104a. But *Kaiser Steel* dismissed the argument that "when a contract is wholly performed on one side, the defense of illegality to enforcing performance on the other side will not be entertained." 455 U.S. at 81. While that proposition may be true in some cases, it is "subject to the limitation that the illegality defense should be entertained . . . where its rejection would be to enforce conduct that the [federal] laws forbid." *Id.* at 81–82. This Court thus permitted the steel company to raise an illegality defense even though the contracts had been completed. See *id.* at 82, 81 n.6.

Similarly, the magistrate judge's belief that YAI's "dissatisf[action] with [Levy's] performance" did not justify reducing his compensation, Pet. App. 104a, misunderstands the basis of the public-policy defense. Courts refuse to enforce illegal bargains "not out of any regard for the defendant . . . but only on account of the public interest." *Kaiser Steel*, 455 U.S. at 77 (quoting *McMullen*, 174 U.S. at 669). The defendant's subjective reasons for raising the defense are irrelevant.

Second, the magistrate judge believed that the existing "regulatory sanctions and statutory penalties" for excessive compensation "need not be supplemented" with the remedy of contract illegality. Pet. App. 103a. But *Kaiser Steel* rejected the argument "that

the express remedies provided by [statutory law] are not to be added to by including the avoidance of contracts as a sanction." 455 U.S. at 81. Statutory remedies and contract enforcement are distinct issues: "Refusing to enforce a promise that is illegal . . . is not providing an additional remedy contrary to the will of Congress. A defendant proffering the defense seeks only to be relieved of an illegal obligation and does not ask any affirmative remedy based on the [statutes]." *Id.* at 81 n.7. Federal courts cannot be conscripted to enforce unlawful bargains simply because "another remedy" is available. See *id.* at 82 n.7.

Third, the magistrate judge and the district judge both emphasized that no "regulator [had] concluded that Levy's SERP benefit violated state and federal law." See Pet. App. 38a–39a, 99a–100a. This point echoes the claim in *Kaiser Steel* that only the National Labor Relations Board could determine whether the disputed contracts violated the labor laws. See 455 U.S. at 83. This Court rejected that position as an abdication of the federal courts' "well established . . . duty to determine whether a contract violates federal law before enforcing it." *Id.* Just as the courts' duty is unaffected by the NLRB's "primary jurisdiction to determine what is or is not an unfair labor practice," *id.*, it is unaffected by the IRS's or New York State's authority to determine that Levy's compensation is excessive or unreasonable. The lower courts should have evaluated for themselves whether enforcing Levy's benefit plans would have violated the public policy expressed in state and federal law. Their failure to do so breached their clear duty under federal common law. *Id.*

III. SUMMARY REVERSAL IS APPROPRIATE.

The lower courts' failure to apply settled federal law, under which all of their reasons for rejecting YAI's public-policy defense are invalid, warrants summary reversal. "[A] summary reversal does not decide any new or unanswered question of law, but simply corrects a lower court's demonstrably erroneous application of federal law." *Maryland* v. *Dyson*, 527 U.S. 465, 467 n.* (1999) (per curiam). This "rare disposition" is "usually reserved by this Court for situations in which the law is settled and stable, the facts are not in dispute, and the decision below is clearly in error." *Schweiker*, 450 U.S. at 791 (Marshall, J., dissenting). This is precisely such a case.

The relevant law is settled and stable. There is no question that federal common law governs benefit plans like Levy's. *Firestone Tire*, 489 U.S. at 110. Moreover "the effect of illegality under a federal statute is a matter of federal law." *Kelly*, 358 U.S. at 519. Thus, federal courts have a "duty to determine whether a contract violates federal law before enforcing it." *Kaiser Steel*, 455 U.S. at 83. The decisions below inexplicably abdicated that duty and thereby clearly erred. *Kaiser Steel* specifically rejected every one of the lower courts' reasons for dismissing YAI's public-policy defense. See *supra* § II. Those arguments might justify upholding the contract under New York law, but they are woefully inadequate under federal law. Because the federal defense was properly raised and litigated from the outset, *supra* § I, there was no justification for the lower courts' refusal to address it under the correct federal common law standards. *Cf. Gonzales* v. *Thomas*, 547 U.S. 183, 185 (2006) (per curiam) (summarily reversing where the lower court's error was "obvious in light of" this Court's precedent).

The Court should summarily reverse the decision below and remand for further proceedings so the lower courts can determine whether, as the expert consultant found, Levy's benefits constitute unreasonable or excessive compensation. If so, "it is the obligation of courts to refrain from" enforcing Levy's contract to that extent. *Kaiser Steel*, 455 U.S. at 84 (quoting *Hurd*, 334 U.S. at 35).

CONCLUSION

The Court should grant the petition, summarily reverse the lower courts' rejection of YAI's public-policy defense under federal common law, and remand for further proceedings.

Respectfully submitted,

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