

# NEW IS NOT ALWAYS BETTER - THE IMPORTANCE OF PRESERVING ARGUMENTS FOR APPEAL

Date: 16 April 2018

## U.S. Appellate Litigation/Commercial Disputes Alert

By: Noah Siegel, Desiree F. Moore

In the wake of a trial, where tensions and emotions are running high and there is much work to be done, how does trial counsel ensure that key arguments are preserved for appeal? Perhaps more importantly, how much grace and latitude will an appellate court extend in the face of arguments on appeal that differ, whether in form or substance, from those arguments made in the trial court?

A recent Third Circuit decision, *Spireas v. Commissioner of Internal Revenue*, No. 17-1084, 2018 WL 1463506 (3d Cir. Mar. 26, 2018), sheds light on this issue and underscores the significance of keeping a close watch on potential appellate issues throughout the course of a trial to avoid the risk of losing them altogether.

## THE THIRD CIRCUIT'S "IDENTICAL ARGUMENT" STANDARD

Broadly speaking, Third Circuit precedent regarding proper fodder for appellate review reflects that the court takes a somewhat stringent approach. Specifically, the Third Circuit adheres to the commonly accepted notion that "failure to raise an issue in the district court constitutes a waiver of the argument." *Belitskus v. Pizzigrilli*, 343 F.3d 632, 645 (3d Cir. 2003). Thus, in order to preserve any argument for appeal, a party "must unequivocally put its position before the trial court at a point and in a manner that permits the court to consider its merits." *Shell Petroleum, Inc. v. United States*, 182 F.3d 212, 218 (3d Cir. 1999). But the Third Circuit has gone even further: it has said that the "degree of particularity" with which an argument is raised in the trial court is determinative, and parties must make such arguments with "exacting specificity." *United States v. Joseph*, 730 F.3d 336, 339, 341 (3d Cir. 2013). In other words, the arguments must be essentially "identical." *Id.* at 342 (there are "at least two characteristics that identical arguments always have . . . [f]irst, they depend on the same legal rule or standard . . . [s]econd, the arguments depend on the same facts").

Despite this, however, the Third Circuit has also recognized that "while parties may not raise new arguments, they may place greater emphasis on an argument or more fully explain an argument on appeal" and may even "reframe their argument within the bounds of reason". *Gen. Refractories Co. v. First State Ins. Co.*, 855 F.3d 152, 162 (3d Cir. 2017) (internal citations and quotations omitted).

## SPIREAS V. COMMISSIONER OF INTERNAL REVENUE

It is against this legal background that the Third Circuit reviewed *Spireas*. In that case, appellant Spireas, an inventor, took an appeal from the Tax Court when it was determined that he improperly characterized his earnings in connection with an invention as capital gains instead of ordinary income. Spireas had invented medical technology that helps the delivery and absorption of orally ingested drugs. In 1998, Spireas entered into an agreement with a pharmaceutical company whereby the company would develop certain related products with

Spireas's guidance. In exchange, Spireas would earn a 20% royalty payment on the gross profits earned from the products. Notably, Spireas reserved the right to approve which products would be developed. As that 1998 agreement allowed, Spireas signed an engagement letter with the company and together they developed a product to facilitate the treatment of high blood pressure. In connection with the production and sale of the product, Spireas earned just north of \$40M in royalty payments.

On his tax return, Spireas characterized these earnings as capital gains pursuant to 1235(a) of the Internal Revenue Code, which allows for capital-gains treatment on money received in consideration of a "transfer of property consisting of all substantial rights to a patent" and are taxed at 15%. The IRS disagreed with the characterization. The IRS believed the royalty payments should have been characterized as ordinary income instead, which would have been taxed at 35% in this case. The IRS sent Spireas a notice of a \$5.8M deficiency and Spireas petitioned the Tax Court for a redetermination.

After a trial, the Tax Court held that Section 1235(a) was available only in those instances where an inventor transfers all substantial rights to a patented technology. In this case, Spireas could not have transferred all rights to a particular product at the time of the 1998 agreement, since no product existed yet. At best, the only rights Spireas could have granted via that agreement were general rights to use his technology. What's more, he had reserved for himself the specific right to approve which products would be developed; by definition, then, he had not transferred all substantial rights. Thus, the court held that the elements of Section 1235(a) had not been met, and the royalty payments should have been characterized as ordinary income. Spireas filed an appeal to the Third Circuit.

## SPIREAS'S APPEAL

On appeal, Spireas modified the narrative he had set forth in the Tax Court. Specifically, Spireas now argued that the 1998 agreement *prospectively* assigned the pharmaceutical company all rights in the blood pressure product *before* the product had been invented. For its part, the IRS noted that Spireas had not asserted this fact or raised any legal theory about a prospective assignment in the Tax Court, and that he was accordingly precluded from arguing that theory on appeal.

The Third Circuit disagreed. It found the newly framed narrative "contrary to the record" and dismissed it out of hand. The court reasoned that Spireas's original argument explicitly was based on a "post-invention transfer of rights" but his argument on appeal was based on a transfer of rights that had occurred "at least two years before the invention" of the blood pressure product. The court concluded that Spireas's appellate argument was not identical to the one he had asserted in the Tax Court since it did not hinge on the same "legal standard" and did not "depend on the same facts" as those argued in the trial court. Thus, the court held that Spireas had waived his right to assert the argument on appeal.

## CONCLUSION

The lesson of *Spireas* is plain: in the Third Circuit, at least, both the facts and the law must be consistently pleaded and presented in the lower and appellate courts. Even seemingly minor deviations—or newly crafted arguments based on the reframing of similar facts—will not be well received on appeal. Also, while *Spireas* arose in the Third Circuit, its lesson is far broader since essentially all appellate courts reject new arguments on appeal even if their formulations of the rules are different. To avoid a similar fate, litigants may wish to engage

experienced appellate counsel early in the trial-court proceedings. While trial counsel must stay focused on the fast-paced, minute-to-minute work that a trial so demands, an appellate lawyer can take a more holistic view. An appellate lawyer can serve as an outside observer, a creative thinker and a key strategist, assisting in characterizing facts and developing arguments in the trial court that will best resonate on appeal. More important still, an appellate lawyer can act as a safety net, ensuring that, from an appeals standpoint, nothing slips through the cracks.

---

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.