



The Journal of the
Antitrust and Unfair Competition Law Section
of the State Bar of California

Chair's Column
Kenneth R. O'Rourke

Editor's Column
Thomas N. Dahdouh

*Recent Developments in
Competition and Antitrust Law*

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Competition and Antitrust Law*

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Law Section of the State Bar of California

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CHAIR'S COLUMN

Kenneth R. O'Rourke
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California is an exciting place to practice competition law. The heart of the country's high-tech (Silicon Valley), entertainment (Hollywood), wine (Napa/Sonoma), and agriculture (Central Valley) industries are located here. California is the country's gateway to Asia and the Pacific Rim, has the country's largest seaport complex (Long Beach/Los Angeles), and would be considered among the top ten largest economies in the world if California were counted as a country. California may be known as the state that pioneered freeways, but it's the digital highway and the cross-roads of intellectual property and antitrust law that put California on the legal map today.

This is also home to the U.S. Department of Justice Antitrust Division Northern California field office (San Francisco), the country's clear leader in investigating and prosecuting international price fixing cartels. These prosecutions in turn lead to an avalanche of complex civil litigation and private enforcement proceedings often filed in California courts. Indeed, our state attracts more antitrust class actions than any other state. We also have an active FTC regional office and most everyone would agree we have the number one state attorney general office for leading multi-state antitrust enforcement proceedings. Did I mention our terrific beaches, weather and national parks. . .

Seriously, we have it all. And at the very top of the professional chart is our strong and collegial Bar in which many of the nation's leading antitrust enforcers, in-house counsel and private practitioners actively participate. This is the main reason I'm so excited to take the helm of the California State Bar Antitrust & Unfair Competition Law Section for 2013-14. It's a great group, and we have exciting plans for the year as we carry out our Section's mission, to promote and teach antitrust and unfair competition laws while enhancing professionalism.

How does the Section do this? In several ways:

Journal of Competition. You have in your hand—or at your fingertips if you are reading this column on line—our latest edition. *Competition* is published twice a year with informative articles on antitrust and unfair competition law developments, policy points of view, and useful information such as antitrust trial tips and practice pointers. The current edition is outstanding. More about this edition in a moment.

Webinars. Every month or two our Section offers an MCLE program. Topics vary. A Webinar might consist of litigators discussing their recent trial experiences or certifying class actions; or practitioners discussing new developments in merger review proceedings; or perhaps government officials addressing enforcement developments. Typically our Webinars are scheduled so participants may listen by phone or log on to a website for a 60- or 90-minute presentation during lunchtime. What a great way to keep up to speed and earn

MCLE credits, while being enlightened if not entertained.

eBriefs. Several times a year we email summaries and short discussions of leading new cases that impact our practices. The focus is on California cases, but federal cases are also addressed. The aim is to be helpful and brief, and to inform Section members and other readers of key arguments and holdings in late-breaking decisions.

Treatise. We publish the country's single most authoritative and comprehensive treatise on the important California Cartwright Act and the seemingly ubiquitous California Unfair Competition Laws. The treatise, titled *California State Antitrust and Unfair Competition Law*, consists of over 1,000 pages in loose-leaf format. It is prepared or updated annually under the auspices of Editor-in-Chief Cheryl L. Johnson, the immediate past chair of our Section's Executive Committee. The treatise discusses statutes, decisions, policies, concerns and history unique to our state and the shaping of our antitrust and unfair competition laws. This is a "must have" as both a quick reference guide and for a substantive understanding of California's competition law. Information on purchasing the Treatise is available on the Section's website: <http://antitrust.calbar.ca.gov/Publications/AntitrustTreatise.aspx>

Presentations. At the State Bar's Annual Meeting and at other times during the year, we present panel discussions of interest to antitrust, unfair competition law and business litigators and trial lawyers, merger and regulatory advisors, transactional counselors, white collar and civil litigation lawyers, and other private practitioners, in-house counsel, and government enforcers, whether experienced in antitrust and unfair competition laws or new to the field. The subject matter varies. Look for our panels at the State Bar Annual Meeting in San Diego in September.

Golden State Institute. Our flagship educational and networking event is the annual *Golden State Institute*, known affectionately as *GSI*. *GSI* consists of a full day of programs, presentations and panels on a variety of antitrust and unfair competition law topics. This year, as in recent years, the nation's top trial lawyers will talk about their recent competition cases and trial outcomes. They will give us their insights, in a format of interest to litigators and non-litigators alike. These trial tales will entertain everyone. And this is just the morning session.

We will also hear from the judiciary—including an Associate Justice of the California Supreme Court and federal court judges—as well as leading government enforcers and regulators. The day will be capped off with a reception and awards dinner at which our Section will present its *Antitrust Lawyer of the Year* award to Phillip H. Warren, the long-time chief of the U.S. Department of Justice Antitrust Division's Northern California field office. Phil retired this year after a stellar career leading many of the country's largest and most important criminal antitrust prosecutions over the past decade.

Interspersed throughout the day and evening will be the chance to enjoy the company and collegiality of our Section members, the conference presenters and panelists, and many special guests. *GSI* will be a truly special event.

So save the date: **Thursday, October 16, 2014**, and look for registration information on our Section website and in mailings during the coming months. *GSI* will be held in San Francisco again this year.

Editor's Note

Thomas N. Dahdouh¹
Federal Trade Commission
San Francisco

Four Roundtables and a Symposium To Boot!

This issue offers four **Roundtables** growing out of discussions from the October 2013 Golden State Antitrust Institute, the premiere West Coast antitrust event. We also provide a Symposium of articles on *Noerr*, First Amendment and state action defenses, offering up the perennial question: **Do these defenses and immunities protect precious rights or do they serve as a last refuge for monopolists?** Finally, three articles round out this comprehensive issue of *Competition*.

The Roundtables canvass the major antitrust and unfair competition litigations of 2013:

- The year 2013 saw two major **price-fixing** trials: *Vitamin C*, litigated in the Eastern District of New York, and *Urethanes*, held in federal district court in Kansas City. Both trials resulted in a verdict for plaintiffs. **Heather Tewksbury**, a criminal antitrust trial attorney in the DOJ's San Francisco Field Office who has recently been named a partner at Wilmer, Hale, leads the discussion. Trial counsel from both matters dissect how the trials played out. **William A. Isaacson** and **Daniel S. Mason** duke out *Vitamin C*, while **Joseph Goldberg** and **Michael Tubach** hold forth on lessons learned from *Urethanes*.

- Following on the heels of the DOJ's successful criminal prosecutions against key participants in the LCD price-fixing matter, this past year saw two major civil trials brought against some of those same participants. First was a class action by direct purchasers against Toshiba, resulting in a \$87 million dollar verdict. Second was an action initiated by direct purchaser opt-out Best Buy. That action, somewhat contradictorily, resulted in no finding of liability against Toshiba. **Barkley Court Reporters** was able to capture live the discussion at the Golden State Antitrust Institute, allowing us to reprint it verbatim. In that discussion, **Aton Arbisser** moderates a stellar panel of trial counsel **Bruce Simon** and **Robert Freitas**, and jury consultant **Howard Varinsky**.

- Next, **Judges Berzon, Phillips, Wiley** and **Karnow** tackle the all-important question of class certification in civil antitrust litigation. This panel is moderated by **Penelope Preovolos**, with able editing assistance from **Dominique-Chantale Alepin**.

- Finally, we have a discussion about the *McAdams v. Monier* unfair competition trial in California state court. For this discussion, trial counsel **Jeffrey Cereghino** and **William Stern** discuss the "roller-coaster" nature of that trial. The judge found for the defense, but only after the jury came in with a verdict for the class plaintiffs. **Kimberly Kralowec** moderated this discussion, with help from editor **Asim Bhansali**.

The Symposium focuses on *Noerr*, First Amendment and state action. Two articles, one by **Chris O'Connell** and a second by **Stuart N. Senator** and **Gregory M. Sergi**,

1 The views expressed here are my own and do not necessarily represent the views of the Federal Trade Commission or any Commissioner.

provide respectively plaintiff and defense perspectives to the overall evolution of *Noerr*. Next, **Richard Epstein**, **Eugene Volokh** and **Paul L. Gibson** offer contrasting views on the relevance of the First Amendment to government investigations of monopolistic practices by Google and others in the world of the Internet. **David L. Meyer** and **Fabien Thayamballi** wrestle with recent FTC action in the area of standard essential patents. In these matters, the FTC has used its “standalone” Section 5 “unfair method of competition” authority to enforce promises made by holders of patents in standard-setting processes to license on a fair and reasonable, non-discriminatory (“FRAND”) basis to potential licensees who want to develop products based on the standard. The FTC has taken the position that threatening to seek an injunction to bar licensees’ products breaks the FRAND promise and could chill standard-setting and the procompetitive benefits of those processes. The question Meyer and Thayamballi wrestle with is whether *Noerr* and/or the First Amendment protect a patentholder’s ability to break its FRAND promise and seek an injunction against licensees. Finally, **Jarod Bona** and **Luke Wake** take on the state action defense in light of recent Supreme Court action.

This issue also has three articles on other important topics. First is an article by **Ara Jabachourian** on the proper standard for summary judgment in collusion cases. Second is an article on an area of growing importance – privacy and particularly data security. **Kathryn Russo** takes a look at whether the FTC Act and California’s UCL statute plays a role when a company fails to maintain consumers’ private financial information properly.

Lastly, we reprint **Tom Papageorge** and **Tom Greene’s** wonderful outline from the *Golden State Institute* updating practitioners on California antitrust and unfair competition law developments as well as state and federal procedural changes. Their presentations are always well-received, and this outline serves as a helpful compendium of new cases and developments.

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**LANDMARK CIVIL PRICE-FIXING VERDICTS OF 2013:
LESSONS FROM THE VITAMIN C AND URETHANES TRIALS**
*With Trial Counsel and Observers William A. Isaacson, Daniel S. Mason,
Joseph Goldberg, and Michael Tubach*
*Moderated by Heather Tewksbury**

I. INTRODUCTION

The Spring of 2013 witnessed blockbuster verdicts in two civil price-fixing cases. Although these cases share the distinction of resulting in significant verdicts for civil antitrust enforcement, their respective paths to those verdicts could not be more different. The first case hails from an alleged price fixing conspiracy formed in China, and represents many “firsts” for the U.S. judicial system. *In re Vitamin C Antitrust Litigation* resulted in the first civil price-fixing verdict against Chinese companies in the United States; the first known time that the foreign compulsion defense was presented to a jury at trial; and the first time a former Chinese government representative testified at trial in a U.S. court. On the other end of the spectrum is our second case, *In re Urethane Antitrust Litigation*, an alleged price-fixing conspiracy born here on U.S. soil. It is significant not only because it represents the largest verdict for a Sherman Act violation last year, but also because the plaintiffs obtained that verdict even without the benefit of criminal indictments or plea agreements. Both cases raise important issues that will impact the continued development of private antitrust enforcement against price-fixing conspiracies for years to come.

II. IN RE VITAMIN C ANTITRUST LITIGATION

On March 14, 2013, after a three week trial in the Eastern District of New York, a jury returned a \$54 million verdict against two Chinese Vitamin C producers, Hebei Welcome Pharmaceutical Company Ltd. (“Hebei”) and North China Pharmaceutical Group Corp. (“North China Pharmaceutical”). The seven member jury returned its verdict, which was trebled to \$162 million, after just a half day of deliberations. When the trial began on February 25, 2013, Hebei and North China Pharmaceutical were joined by co-defendants China Pharmaceutical Group Ltd. and its Weisheng Pharmaceutical unit. Both companies settled on the eve of closing arguments for a fraction of the final judgment, at \$22.5 million. Other Vitamin C producers, Jianngsu Jiangshan (Aland) and Northeast Pharmaceutical Group Co., settled before the trial.

The multi-district litigation began in 2005 when plaintiffs brought suit against China’s four main Vitamin C producers and an affiliate. Those five companies made approximately 70 percent of the world’s supply of Vitamin C¹. The producers were accused of fixing the prices and volume of Vitamin C products exported from China to

* Heather Tewksbury is a partner at Wilmer Cutler Pickering Hale and Dorr LLP in Palo Alto, California. Before joining Wilmer Hale earlier this year, she served as a Trial Attorney in the United States Department of Justice, Antitrust Division where she prosecuted international price fixing cartel cases.

1 Third Amended Complaint for Antitrust Violations, *Animal Science Prods., Inc. v. Hebel Welcome Pharm. Co.*, No. 1:05-CV-00453 (DGT)(JO) (E.D.N.Y. filed Dec. 2, 2008), ¶ 48.

the U.S. and worldwide, in violation of Section 1 of the Sherman Act. The complaint alleged that beginning in December 2001, the Vitamin C producers, who were members of a Chinese Chamber of Commerce (“Chamber”), reached agreements during subcommittee meetings, to raise the prices of Vitamin C in the United States from \$2.90 per kilogram to as high as \$7 per kilogram.² The complaint also alleged that the producers agreed to limit and suspend the manufacture of Vitamin C until prices stabilized.³

The basis for these allegations was found in the document below, which plaintiffs located on the China Chamber of Commerce of Medicines and Health Products Importers and Exporters Information website.



EXHIBIT
PX 72

2 *Id.* at ¶ 60.
3 *Id.* at ¶ 62.

In that document, the Chamber explains that between May 2000 and late December 2001, the Vitamin C industry was involved in a price war that caused export prices to plummet from \$5 per kilogram to less than \$2.80. Through the Vitamin C subcommittee of the Chamber, Vitamin C manufacturers in China reached a “self-regulated agreement whereby they would voluntarily control the quantity and pace of exports, to achieve the goal of stabilization while raising export prices.” The District Court did not admit this exhibit at trial.

After locating this document and filing suit, the plaintiffs’ cases were consolidated in the Eastern District of New York. Defendants unsuccessfully moved to dismiss the case in 2008 primarily on the ground that the complaint’s allegations were barred by the foreign sovereign compulsion doctrine. The court denied the motion because “the record as it stands [was] simply too ambiguous to foreclose further inquiry into the voluntariness of defendants’ actions.”⁴ In denying later motions to dismiss after the record was developed more fully, the district court further found that “Chinese law assuredly did not compel all of the defendants’ illegal conduct.”⁵

The court made this determination despite the defendants’ efforts to substantiate the foreign compulsion defense with facts about Vitamin C regulation, which had undergone two distinct periods during the cartel. The first period began in 1997, when the Ministry of Commerce issued export rules that explicitly set quotas for Vitamin C exports. Those rules also directed the Chamber responsible for Vitamin C to set a mandatory minimum export price. This regime changed in 2002 as China entered the World Trade Organization, at which point the Ministry repealed those rules, and instead implemented a “verification and chop” system. Through this system, the Vitamin C producers argued that they submitted export contracts to the Chamber for verification. Contracts that complied with export price requirements were affixed with the Chamber’s “chop” (an official stamp or seal of approval). According to the defendants, only those contracts that received the “verification and chop” were approved for export. This system was also repealed in 2008. This explanation did not satisfy the district court on defendants’ foreign compulsion defense, and the case was allowed to move forward.

The court’s position also did not waver even after the Chinese government, in an unprecedented act, filed an amicus brief in which it attempted to demonstrate that the defendants were compelled to set prices and coordinate production with their competitors. In the amicus brief filed early in the litigation and exerted below, the Ministry of Commerce argued that the “alleged conduct by the defendant Chinese Vitamin C exporters is the result of the defendants’ performing their obligations to comply with Chinese laws, rather than conduct on their own initiative.” The Ministry further contended that it was the Ministry that “required the Vitamin C exporting companies to coordinate among themselves on the export price and production volume.”

4 *In re Vitamin C Antitrust Litig.*, 584 F. Supp. 2d 546, 560 (E.D.N.Y. 2008).

5 *In re Vitamin C Antitrust Litig.*, 810 F. Supp. 2d 522, 554 (E.D.N.Y. 2011).

Authorized Translation

中华人民共和国商务部
MINISTRY OF COMMERCE OF THE PEOPLE'S REPUBLIC OF CHINA
2, DONG CHANG'AN STREET, BEIJING, CHINA 100731

Statement In *In Re Vitamin C Antitrust Litigation*, 06-MD-1738 (DGT)

August 31, 2009

Amicus The Ministry of Commerce of the People's Republic of China (the "Ministry") authorizes its Department of Treaty and Law to respectfully submit this Statement (together with an authorized English translation).

1. The Ministry has attached great importance to the antitrust litigation in the United States brought against Chinese vitamin C exporters. The Ministry submitted to this Court the *Brief of Amicus Curiae of the Ministry of Commerce of the People's Republic of China in support of the Defendants' Motion to Dismiss the Complaint* in June 2006 and its *Statement In Re Vitamin C Antitrust Litigation* in June 2008. Taking notice of the comments and views made by Your Honor, the plaintiffs, plaintiffs' counsels and the experts, and the relevant documents, the Ministry would like to draw the Court's attention to the positions taken by the Ministry in the above-mentioned two documents, and would like to reiterate here that the alleged conduct by the defendant Chinese vitamin C exporters is the result of the defendants' performing their obligations to comply with Chinese laws, rather than conduct on their own initiative.

2. In order to prevent self-destructive competition through distorted pricing by Chinese exporters caught unprepared for the drastic change of China's export policies, and to mitigate potential exposures to antidumping investigations in other countries against Chinese exporters, the Ministry took active measures by exerting export regulation over certain commodities that might encounter or have encountered such problems. Although different regulatory measures may have been implemented in line with changes of circumstances at different times, enterprises in regulated

The district court refused to dismiss the case even after considering the Chinese government's amicus. The defendants thereafter moved for summary judgment and resurrected a defense that they could not be held liable for price-fixing in the United States because they had been compelled to coordinate prices by the Chinese government.⁶ Specifically, they claimed that through China's complex regulatory system, informal directives were given by quasi-governmental agencies (the Chamber of Commerce) that required the producers to fix prices. Accordingly, they argued that the foreign compulsion doctrine precluded them from being held liable for violating the U.S. antitrust laws. The district court denied the defendants' motion for summary judgment, declining to defer to the Chinese government's interpretation of Chinese law and choosing instead to rely on "more traditional sources of foreign law." The court concluded that the directives issued by the Ministry of Commerce and its governing documents were among those traditional sources. The court further noted that the Chinese government's assertion in its amicus brief that it compelled the Vitamin C manufacturers to price fix was a "post hoc attempt to shield defendants' conduct from antitrust scrutiny."⁷

6 Motion for Summary Judgment by Hebei Welcome Pharm. Co., Ltd., No. 1:05-CV-00453 (DGT) (JO) (E.D.N.Y. filed Nov. 23, 2009).

7 *Id.* at 552.

After the class of purchasers was certified in January 2012, the first defendant to settle the matter was Aland, which settled the case for \$10.5 million in May 2012. Nine months later the case went to trial with the four remaining defendants. Those defendants again asserted the foreign compulsion doctrine defense throughout the trial. The defendants' key witness at trial was a retired Chinese Chamber of Commerce representative who oversaw the Vitamin C export industry. This was particularly significant because this also represented the first reported case of a Chinese government representative testifying in a U.S. court.⁸

The retired representative described the "verification and chop" system to the jury, and testified that the Vitamin C producers were compelled to comply with the Chamber's minimum export prices, or they would not receive the "chop" required to export the Vitamin C. This testimony was undermined, however, by the below document, authored by the retired representative himself.

CHAMBER OF COMMERCE FOR IMPORT & EXPORT OF MEDICINES & HEALTH
PRODUCTS (CCCMHPIE)

Suggestions to Establish a Credibility System

[2003] yi shang zi No.52

Re: Suggestions to establish a credibility system

The Office of the National Taskforce for the Rectification and Regulation of Market Economic Order,

According to the July-14 meeting requirement, CCCMHPIE now reports to you regarding our Chamber of Commerce's work in industry self-regulation and credibility building as follows:

1. Work in industry self-regulation and credibility building

This Chamber of Commerce's work in this regard is divided into two parts. One is in the category of western medicines, which is primarily focused on commodities that are exported in high amounts, or commodities that have surplus production capacity or the production capacity may become excessive, or which supply exceeds demand, or in severe low-priced competition in order to sell, or commodities that may lead to anti-dumping law suits. In this part of the work, the coordination of VC has yielded notable results: through industry self-regulation, prices of VC exports have increased significantly and thus have recovered economic losses for the country. From Jan. 2002 to May 2003, in comparison to the price of US\$2.80/kg at the end of 2001, VC exports brought in additional revenue of more than US\$63 million. Another part of the work is in the category of traditional Chinese medicines, which are primarily concentrated on the establishment of standards. CCCMHPIE formulated the "Green Industry Standard for the Import and Export of Medicinal Plants and Preparations". This standard was promulgated by the former MOFTEC in the form of a statute and went into effect on July 1, 2001. The publication of this green industry standard ended the history that our country didn't have a standard for the import and export of traditional Chinese medicinal products. This standard has been recognized by the Singaporean health administration, South Korean Import and Export Association and the British Association of TCM Suppliers.

So far, over 120 lots and products of more than 30 companies have submitted the application for standard compliance.

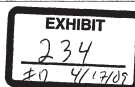
2. Thoughts on the work of industry self-regulation and credibility building

<http://www.ccmhie.org.cn/NewsDetail.aspx?ID=6001>

5/20/2005

JJPC005591

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8 Throughout the litigation and trial, plaintiffs disputed that a Chinese Chamber of Commerce representative was a government official, and argued instead that the Chambers were voluntary trade associations. In post-trial briefing, the district court agreed with plaintiffs that the jury could have found that the Vitamin C subcommittee of the Chamber was a trade association.

In the document, which was introduced into evidence at trial, the representative wrote that the export regulations were a mere formality that only “honest fellows will follow.” The witness testified that he was talking about a different industry in the document. This testimony was undermined during his cross-examination, however.

The testimony proved unpersuasive, and the jury returned a verdict against the two remaining corporate defendants for the full amount of damages sought by the plaintiffs.

Before describing our second blockbuster case of 2013, *In re Urethanes Antitrust Litigation*, we will first introduce our panelists for both cases and hear from two of the lead lawyers in the Vitamin C litigation. We will then turn to our panelists on Urethanes to get their perspectives on that litigation.

Our illustrious panel consists of:

- **William A. Isaacson** of Boies, Schiller & Flexner, LLP in Washington, D.C. is an accomplished trial lawyer and served as one of the lead lawyers representing plaintiffs in the *In re Vitamin C Litigation*. With over 25 years of experience, Mr. Isaacson has experience in complex civil matters and international arbitration. He has been recognized by the American Lawyer, Best Lawyers, and Super Lawyer.
- **Daniel S. Mason** is a senior partner at Zelle, Hoffmann, Voelbel & Mason, LLP in San Francisco. Having over 40 years of experience, Mr. Mason has litigated hundreds of cases in a wide variety of complex civil litigation matters. Mr. Mason has significant international law experience, and has represented clients all over the world, including the People’s Republic of China on international trade disputes. Mr. Mason was lead trial counsel representing Vitamin C producer, Weisheng Pharmaceutical, who settled before the conclusion of the trial in *In re Vitamin C Litigation*.
- **Joe Goldberg** is a senior shareholder in the Freedman Boyd Hollander Goldberg Urias & Ward P.A. law firm. Mr. Goldberg has taken leadership positions in a number of significant class actions and has tried a number of cases to multimillion dollar verdicts, including the *Urethanes* case. He has been designated by Best Lawyers in America as “bet-the-company” litigator of the year in New Mexico in 2009 and antitrust litigator of the year in 2011. He is also listed in Best Lawyers and in Chambers USA since its inception.
- **Michael Tubach** is a partner in O’Melveny & Myers LLP’s San Francisco office. Mr. Tubach is an accomplished trial lawyer who represents companies and individuals primarily in criminal and civil antitrust matters, as well as in internal corporate investigations. He is recommended by various legal ranking guides, including Legal 500, PLC Which Lawyer, and Chambers USA. He has also been recognized as a leader in the field of white-collar criminal defense in a survey conducted by Law & Politics Media Inc. His trial experience includes over 35 trials and 20 appellate arguments.

Heather Tewksbury, a partner in Wilmer Hale’s Antitrust and Competition Practice Group, moderated this discussion. This discussion builds upon the recent panel

discussion at the Antitrust Section's 2013 Golden State Institute in San Francisco. Ms. Tewksbury moderated the combined panel discussion and was joined by Messrs. Isaacson, Mason and Goldberg. The panel discussion can be accessed on-line by following the instructions for watching streaming audio and video.

III. VITAMIN C PANEL DISCUSSION

Moderator: *The Vitamin C litigation is particularly noteworthy because it was the first time that Chinese companies have been held liable for violating the U.S. antitrust laws. Is this case an aberration or do you believe it represents a sign of things to come?*

Isaacson: Cartel cases in the United States for several decades have focused on international cartels. The Antitrust Division of the Justice Department and private antitrust enforcement have tried to send the message to any company from any country in the world, if you want to sell products in the United States, you have to obey the antitrust laws and not engage in price fixing. China is one of the largest economies in the world to have escaped scrutiny under U.S. law. The Chamber in this case that was used to facilitate price fixing is typical of Chambers throughout the Chinese economy that cover all manner of exported products, including metals and minerals, machinery and electronic products, foodstuffs, and medicines and other health products. Another record within the Medicine & Health Products Chamber explains the awareness within Chinese industry of the opportunities for price fixing: "Attendees fervently indicated their wish to use the example of the Vitamin C Industry self-regulation as a management model." Another record from the Chamber has warned of the need "to prevent the mutual slaughtering of aggressive competition."

Mason: The core defense in this case is based on a doctrine that has not been much tested. In fact, to our knowledge, the Vitamin C litigation is the first case ever where a foreign sovereign compulsion defense has been tried by a jury. The remaining defendants have filed an appeal on the application. . . If the Court of Appeals affirms the District Court's decision, more plaintiffs' counsel will probably be encouraged to take upon such cases.

But given there is no bilateral treaty between the United States and China, plaintiffs will find it difficult to enforce judgments against Chinese companies that do not have assets in the United States. I suspect this is a practical concern for anyone who considers bringing a case against Chinese companies.

Moderator: *This case is particularly unique because of the defense asserted by the defendants. The Vitamin C defendants claimed that their conduct was immune from U.S. antitrust scrutiny under the foreign compulsion doctrine. What does a defendant have to show in order to succeed in asserting the foreign compulsion doctrine defense?*

Isaacson: The jury was instructed by the Court that it was to return a verdict in favor of the defendants if defendants proved, by a preponderance of the evidence, that an authorized member of the offices or agencies of the Government of China compelled them to enter into agreements fixing the price or limiting the supply of Vitamin C exported from China. There was also a special verdict on this point. The jury was also instructed that "Government enforcement, or government facilitation, of already existing agreements is not sufficient to prove that the parties were compelled to enter into the agreement in the first place." The instructions were agreed to by the

parties and derived from case law holding that private agreements are not immunized from antitrust liability by the defense of government compulsion if a foreign government merely approves, facilitates or enforces illegal cartel agreements. *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 705 (1962); *United States v. Sisal Sales Corp.*, 274 U.S. 268, 276 (1927).

Mason: A defendant would have to show that it was compelled by a foreign government to engage in conduct that violates the antitrust laws of the United States. To establish this defense, defendants must prove that an authorized member of the offices or agencies of the foreign government compelled defendants to enter into agreements fixing prices or limiting supply. Such compulsion can be shown with the prospect of penalties or sanctions for non-compliance with the directives or commands of the foreign government.

Moderator: *Typically this defense is raised and adjudicated at the summary judgment phase of litigation. The Vitamin C litigation, however, presented another first by being the first known case where the defense was litigated before a jury at trial. What were the challenges of litigating this defense before a jury?*

Isaacson: Prior to trial, our jury research indicated that the defense of compulsion by the Chinese government was an appealing one for the defense. U.S. citizens assume that the Chinese government compels everything. Our job was to show the jury the documents and teach them that their assumptions were wrong.

Plaintiffs therefore focused our case on showing the ample evidence that the Chinese government did not actually compel defendants' decisions to fix the price and limit the supply of Vitamin C—including evidence of voluntary agreements, that the “verification and chop” mechanism did not actually compel defendants to enter into anticompetitive agreements and that the Chamber was a voluntary trade association. Many such documents were shown to the jury on the issue of voluntary conduct, with statements such as: “each manufacturer will as usual have its own calculation;” “it is still an open question as to what extent the consensus made at the meeting will be implemented;” and “we have communicated with Weisheng and Welcome, hoping that they will maintain a similar pricing policy for our common interest.”

In focusing the trial on the facts of what happened, the district court wanted to ensure that “Chinese laws themselves were not placed on trial. Rather, the jury was only required to determine whether the Chinese government acted, not the propriety of its actions.”

Although the trial, like any other trial was about factual issues, the defense desired to read Chinese laws and regulation to the jury to support their case. The district court ruled that under Fed. R. Civ. P. 44.1, the determination of foreign law is a question of law. The court explained in its post-trial rulings that “It is for the Court, not for the jury, to decide questions of law and the Court did so when it ruled on summary judgment that, as a matter of law, Chinese law did not compel defendants' conduct.” Defendants then had the opportunity at trial to show that the Chinese government took actions that compelled their conduct, and the jury held otherwise.

Mason: In the Vitamin C litigation, the defense was hamstrung by the Court requiring that defendants prove foreign sovereign compulsion without any Chinese laws and Government regulations. The Court excluded Chinese laws and regulations from the trial on the grounds that the jury does not decide legal issues, and that the Court had previously ruled that Chinese law did not compel the alleged conduct. As a threshold matter, this made it very difficult for the key Chinese Government witness to establish that he had authority and received instructions from the Chinese Government to compel the defendants' conduct at issue.

There was also an inherent difficulty in asking American citizens to find that foreign companies should be permitted to fix prices of products sold into the U.S., and buy into the defense that American antitrust law should not apply to them. We believe the defense should be found as a matter of law by the Court, and not be the subject of the jury trial, but Judge Cogan disagreed. We thought this was inconsistent with the underpinnings of the foreign sovereign compulsion, act of state, and comity doctrines, which aim to prohibit trials that question or second guess the validity, credibility, or conduct of foreign government offices or officials. This will undoubtedly be a significant issue in the Court of Appeals.

It was also challenging to assist an American jury in appreciating the context of our defense from a different cultural and socio-economic perspective. The defense in this case—compulsion by the Chinese Government—rooted from a unique Chinese socialist market economy and regulatory structure where strong government intervention was a tradition. It was very important that the jury understand some of this backdrop, contrasted without the free market system Americans are used to.

During the trial, all defense fact witnesses came from China. They had no prior experience with jury trials and they testified in Chinese. Their testimony often contained special terms with special meanings and context that did not transpire from literal translation. The jury, who judged their credibility, could also misread their gestures and demeanors based on a different cultural setting.

***Moderator:** This case also marks the first time that the Chinese government has appeared in U.S. proceedings in support of a defendant's claim of immunity under the foreign compulsion doctrine. What role did the Chinese government play in the Vitamin C litigation and how were the Chinese government's efforts received by the judge and/or jury in this case?*

Isaacson: The Ministry of Commerce of China retained U.S. counsel during the motion to dismiss and summary judgment proceedings in the case, submitted an amicus brief supporting the compulsion defense of defendants, and argued its position before the District Court. During summary judgment, for example, defendants and the Ministry argued that the factual record from contemporaneous documents and deposition testimony should be ignored, and that all factual disputes should be resolved based on the statements of the Ministry in its amicus brief.

Mason: The Chinese Government appeared as an amicus curie and submitted a brief in support defendants' motion to dismiss at the beginning of the litigation, expressly stating that it directed and compelled defendants' conduct. It then submitted two

subsequent statements reiterating that it had directed and compelled defendants to engage in the conduct at issue. The court, however, in its Order denying motion to dismiss, held there were questions of facts related to these statements. Then in its Order denying summary judgment, the Court refused to give any deferential effect to the Chinese Government's statements. The Court concluded these statements were conclusory and were "post-hoc attempt to shield defendants' conduct from antitrust scrutiny." In the jury trial, the Court excluded the Chinese Government's Statements on the ground that they were hearsay and unfairly prejudicial to plaintiffs.

Moderator: *The Vitamin C litigation presented a number of interesting procedural issues. What role did FRCP 44.1 play in this case?*

Isaacson: FRCP 44.1 requires the court to interpret foreign law as it did in this case. In arguments to the court, plaintiffs emphasized that at the end of the day, there is no plain law or regulation that says to any Chinese company: you must fix prices. And the facts at trial showed that, however a court could interpret Chinese law, the conduct here was voluntary. The defense that the Chinese government fixed prices itself is an attack on the credibility of the Chinese government. The Chinese government has represented to the World Trade Organization that its "export prices are fixed by enterprises without government intervention" and "there are no State restrictions on price or output." The Chinese government has even told the WTO that: "China maintains export administration of a small number of products . . . From 1 January 2002, China gave up export administration of . . . vitamin C."

Mason: Rule 44.1 is key to this case. Pursuant to Rule 44.1, the court concluded in its Order denying defendants' summary judgment motion that Chinese law did not compel defendants' conduct in this case. In our opinion, the court improperly applied Rule 44.1 by declining to defer to the Chinese Government's statements. The court also took an unusual role of evaluating witnesses' credibility and weighing the record in this case.

Moderator: *The case also presented some unique evidentiary issues. What were some of the more significant evidentiary rulings at trial?*

Isaacson: The District Court followed the traditional rule that issues of law are not for the jury to decide. Fed. R. Civ. P. 44.1 (a court's determination of foreign law "shall be treated as a ruling on a question of law"); Fed. R. Civ. P. 44.1 advisory committee note to 1966 adoption ("It has long been thought . . . that the jury is not the appropriate body to determine [such] issues"). Qiao Haili testified at length for the defense that he acted for the government and he personally was responsible for requiring price fixing agreements by the companies.

Mr. Qiao's credibility was a key issue at trial because what he wrote at the time was that "Regulations and rules formulated by companies in the industry organized by the chambers of commerce lack legal basis and are difficult to gain support from government departments. These rules and regulations become formality and only 'honest fellows will follow.'" Mr. Qiao ultimately admitted at trial: "on the whole, the government did not involve itself in price fixing," with respect to minimum prices, the government "don't discuss that with me," and the Ministry of Commerce had never discussed a specific Vitamin C price with him. Based on documents, plaintiffs argued that the defense that

the government of China was responsible for price fixing was manufactured after the lawsuit was filed. One company document even stated: “If we won the lawsuit, it would be hard for foreigners to make more trouble. Even if we lost the case, government would take the foremost part of responsibility. After all, we need to do many things in a more hidden and smart way.”

Mason: We were essentially barred from using any laws or regulations to demonstrate the foreign sovereign compulsion defense. Mr. Qiao Haili, who was the highest ranking Government officer directly in charge of Vitamin C export regulation prior to his retirement, was permitted to testify somewhat as to his understanding of the laws and regulations and the authority he was given by the China Ministry of Commerce. The testimony Mr. Qiao himself was central to our case, and we provided some corroborating documents as well. But we were not permitted to show the laws and regulations to the jury.

***Moderator:** The trial involved the translation of documents originally written in Chinese and the interpretation of witness testimony. What were the unique challenges you faced in navigating these language issues?*

Isaacson: By the end of the trial, there were no exhibits that were objected to based on translation issues. The parties successfully worked together to resolve these issues. One very unexpected development at the pretrial conference, however, took place during a discussion of the translation issue. I think it is fair to say that all parties were surprised to learn that our District Judge, the Hon. Brian Cogan, spoke fluent Chinese.

Mason: All defense fact witnesses testified in Chinese through interpreters, and nearly all exhibits were translated, often with dueling translations from each side. Important phrases in English, such as “request” vs. “require/order” are very close in Chinese and depend heavily on context, which may or may not be understood by the translator.

Additionally, in some cases, literal translation of special terms, such as “industry self-discipline” does not convey the underlying cultural and economic rubric which is necessary for the jury to fully appreciate their meanings. In those cases, we went through those special terms through direct examination of Chinese witnesses in order to provide the necessary background.

***Moderator:** The district court gave a jury instruction on the foreign compulsion doctrine defense. What was the significance of that instruction in this case?*

Isaacson: The jury instruction and corresponding special verdict were the focus of the liability issues at trial. The instruction and verdict were agreed to because they followed established law (although law that is not at issue in many cases).

Mason: We believe the foreign compulsion defense should have been determined as a matter of law, based on the statements by the Chinese Government. We also believe it was wrong not to give deference to factual statements by a foreign government on what its laws required and to second guess the foreign government’s conduct. But the district court decided instead to have a jury decide this defense as a factual issue, and have the jury render a decision without the full context of the Chinese laws and regulations. We

appreciate the intricacy in putting forward the defense within this procedural framework. We also appreciate the challenges the jury faced in following the Court's instruction and in viewing the facts through the prism of Chinese culture and economic policy.

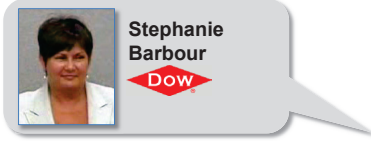
IV. IN RE URETHANES ANTITRUST LITIGATION

Now turning to allegations of a price fixing conspiracy formed on U.S. soil, the *Urethanes* antitrust litigation involved a conspiracy to fix the prices of chemicals used to make foam products in cars, furniture, and packaging. Lawsuits alleging antitrust violations against urethane makers started surfacing in 2004. In 2005, after multiple lawsuits were filed, the U.S. Judicial Panel on Multidistrict Litigation consolidated the cases before U.S. District Judge John W. Lungstrum in Kansas, where the case remained through trial. Direct purchaser plaintiffs Seagath Holdings, Inc., Industrial Polymers, Inc. and dozens of others brought the class action against chemical companies Dow, Bayer AG, BASF SE, Huntsman International LLC, and Lyondell Chemical Co.

Although the Department of Justice opened an investigation after plaintiffs' filed their complaint, no plea agreements were taken and no charges were filed. Despite the lack of plea agreements, over the course of the next seven years, all of the defendants in the civil litigation, except for Dow, settled with the class plaintiffs. In 2006, Bayer AG settled for \$55 million. Over five years later, Huntsman International agreed to pay \$33 million and BASF SE agreed to pay \$51 million. And Lyondell settled without damages because it was in bankruptcy. These settlements were worth nearly \$140 million in total.

Soon after the last settlement was inked, Dow filed for summary judgment, which the District Court denied, finding that plaintiffs had provided enough evidence to allow a reasonable jury to find that a conspiracy existed. The trial began several months later on January 23, 2013. Despite the lack of DOJ charges, the plaintiffs were able to paint a picture of a price-fixing conspiracy using circumstantial and consciousness of guilt evidence. Central to the plaintiffs' case was the colorful description witnesses gave of business executives acting in secret, including driving to gas stations and purchasing calling cards to reach out to competitor counterparts, meeting in dark hotel hallways, and avoiding conference rooms for fear of listening devices. The jury was presented with this consciousness of guilt evidence coupled with nearly identical price announcements over a five-year period. The plaintiffs were also able to present the testimony of a Dow executive, Stephanie Barbour, who served as Dow's North American head for one urethane chemical. Ms. Barbour testified that she attended meetings during which her boss and one of her counterparts at Dow discussed reaching agreements with competitor counterparts on price. A portion of Ms. Barbour's testimony is captured in the below demonstrative, which was used in plaintiffs' closing argument.

“There Was an Agreement”



18 | 07: A He said that he had met with the
19 | 08: competition, and that there was an agreement,
20 | 09: that they were all in a bad situation
21 | 10: financially, and that they were going to make
22 | 11: sure that these price increases stuck.

Source: Trial Tr. 689:18-22

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Beyond the testimony of percipient witnesses, the parties also used expert witnesses in support of their respective cases. Plaintiffs used expert witnesses on damages and class certification issues, and Dow sought to rebut that testimony through its own expert witness. In response to the testimony on parallel price announcements, Dow explained that similar price announcements is not probative of a price-fixing conspiracy, and that the customers did not pay those prices in any event. When Dow’s expert was questioned about those price announcements, however, he conceded that they were used to “forestall a price decline”. This testimony was captured in the below demonstrative used in closing argument at trial.

Price Announcements Used to Stabilize Prices



- 12 Q. I'll ask it a different way. You saw
13 evidence in this case of price increase announcements
14 being used to stabilize prices, that is, keep prices
15 from falling even further than they would have?
16 A. Yes. As I put it here in my notes, to
17 forestall a price decline.

Source: Trial Tr. 4605:12 – 4605:17

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The jury returned a \$400 million verdict in favor of plaintiffs after a five-week trial. Later, the district court trebled the damages, which were offset by the earlier settlements, resulting in a \$1.06 billion judgment. Before handing down the judgment, the court denied Dow's attempt to overturn the jury verdict citing the recent Supreme Court decision in *Comcast*. In its moving papers, Dow noted “Comcast offers powerful confirmation that the class in this case should be decertified. And like *Wal-Mart Stores Inc. v. Dukes*—a significant class certification decision issued since this court granted class certification in 2008—*Comcast* will provide much needed guidance to lower courts, to ensure that certification is granted only when consistent with Rule 23, the Rules Enabling Act, and the guarantees of the Due Process Clause and Seventh Amendment.” The court rejected Dow's arguments as untimely, but also addressed the merits by specifically stating that the *Comcast* decision was not relevant to the case because of the stage of litigation that was involved. The case is now on appeal before the United States Court of Appeals for the Tenth Circuit.

V. URETHANES PANEL DISCUSSION

Moderator: *Unlike the Vitamin C litigation where the defendants conceded there was price-fixing, but asserted that they had an absolute defense, the Urethanes case was a more traditional conspiracy case. What are some of the key pieces of evidence or tools that would be necessary to prove up the price-fixing conspiracy from the plaintiffs' perspective? From a defense perspective, what factors or themes are helpful in defending against traditional price-fixing allegations, like those in Urethanes?*

Goldberg: In most price-fixing conspiracies, absent a criminal plea bargain or conviction, the evidence is almost exclusively in the hands of the defendants. The

Urethanes case was no exception. There was no prior DOJ indictment or conviction.⁹ We were able to prove Dow's participation in a price-fixing conspiracy with its ostensible competitors through a combination of direct evidence, circumstantial evidence and expert opinion.

We had powerful direct evidence of both the existence of a cartel and Dow's participation. There was testimony of wide-spread and repeated communications among the top executives of the urethanes producers discussing coordinating pricing. For example, there was testimony of a golf outing at a trade association meeting, after which Dow's chief executive spoke with executives of its competitor, Bayer, about "getting prices up". While the Dow employees who were implicated in such conversations denied having pricing communications or reaching any agreements, there were colorful episodes that allowed the jury to determine this credibility battle in favor of a finding of collusion. For example, Larry Stern, the head of North American urethanes for Bayer testified about leaving his office, driving to a gas station, purchasing a calling card and then calling his counterpart at Dow to talk about pricing. A Bayer European senior executive told his subordinates, in encouraging them to hold firm on announced lock-step price increases, that they need not worry about customers being poached by competitors, as the competitors had been "talked to". When questioned whether that was illegal, the senior executive stated "not in this country," referring to Germany. There was testimony from Dow's North American head for one urethane chemical of attending numerous meetings in which her boss and one of her counterparts for a different urethane chemical at Dow discussed pricing communications with competitors, including reaching agreements.

The direct evidence was corroborated with circumstantial evidence creating strong inference of collusion. First, there were the lock-step price increase announcements, which Dow's expert, Professor Kenneth Elzinga, conceded were "hallmarks" of collusion. There was evidence of unusual patterns of telephone calls and meetings among key competitors just prior to these lock-step price increase announcements. One such episode was particularly incriminating. Just prior to a lock-step price increase announcement, a senior executive at BASF sent an email to one of his colleagues stating that he was seeking to determine what Huntsman was going to do about the price increase. There then was proof that just prior to sending that email, the BASF executive made a phone call (but apparently did not connect because the duration of the call was very short) to his counterpart at Huntsman; and just after the email, he made a number of calls to this Huntsman executive. Shortly thereafter, Huntsman and BASF both joined the price increase. Further circumstantial evidence included steps taken by the participants to keep their conduct secret. For example, one Dow executive who was meeting with Bayer counterparts about legitimate business issues then, expressing concern about possible eavesdropping bugs, suggested moving outside the building so they could talk privately about firming up adherence to previously announced, lock-step price increases.

Finally, we had excellent expert testimony supporting a finding of collusion. Our liability expert, Professor John Solow, testified that his economic investigation showed that the structure, conduct and performance of the urethanes industry were consistent

9 There was no DOJ investigation prior to the filing of these class action complaints. Subsequent to filing, the DOJ opened an investigation into the urethanes market but closed it without taking any action.

with collusion, explaining how his opinions were consistent with other evidence presented to the jury. He further explained to the jury how conduct characterized by Dow's expert economist, Professor Elzinga, as competition was in fact examples of cheating on the conspiracy and resultant policing by cartel members. Our damages expert, Dr. James McClave, presented to the jury his statistical analysis showing widespread supra-competitive prices during the class period impacting all or nearly all class members.

Tubach: Plaintiffs typically rely on three main types of evidence in price-fixing cases. First, they rely on evidence of defendants' conduct to show an illegal agreement. When they exist, plea agreements can go a long way toward satisfying this burden. However, plaintiffs' allegations are often broader than the conduct described in the plea agreements, and plaintiffs must then offer additional evidence to support their case. In the absence of a plea agreement, or to supplement one, plaintiffs offer up evidence of defendants' conduct. The more colorful the evidence, the better for plaintiffs. In *Urethanes*, for example, plaintiffs painted defendants' executives as "businessmen behaving like spies," and presented evidence that they had made calls to competitors from gas station pay phones. Plaintiffs also were able to present evidence of an internal whistleblower at Dow.

The second type of evidence consists of pricing information. Plaintiffs use pricing information to demonstrate that defendants made pricing decisions consistent with whatever pricing discussions or agreements plaintiffs claim defendants had. Plaintiffs might show, for example, that several competitors increased prices at exactly the same time shortly after they met.

Finally, plaintiffs generally offer expert evidence to show that they suffered impact and damages as a result of the alleged conspiracy, typically by submitting an economist's testimony that customers paid more for the product at issue than they would have paid absent the alleged conspiracy.

A defendant can employ several strategies in response. Particularly in the absence of a plea agreement, defendants will almost always seek to rebut evidence of an illegal agreement. They may seek to show that any communications between competitors were either part of legitimate interaction, or at the least did not result in any agreement to fix prices. For example, exchange of pricing information would be entirely legitimate if competitors were each other's customers and the pricing information exchange was part of those legitimate sales. It is not unusual for companies to buy from and sell to their competitors. In the *Urethanes* case, for example, Dow and its competitors engaged in "swaps." Joint ventures, when they exist, also can justify limited exchanges of pricing information. Evidence that communications took place in the context of a trade association also can be helpful to defendants seeking to explain that competitor communications are not evidence of an illegal agreement. Alternatively, defendants can introduce affirmative evidence of fierce competition between alleged co-conspirators to cast doubt on plaintiffs' assertion that they were cooperating to fix prices. For example, defendants can argue that they used the pricing information from their competitors to help them undercut the competitors and win more business.

A second strategy defendants can employ is to show that the prices charged had nothing to do with competitor contacts. For example, defendants can tie changes in

prices to economic factors such as changes in underlying costs or demand. A similar approach would be to explain that plaintiffs' evidence reflects common pricing dynamics, not an illegal agreement. Competing gas stations often change their prices in tandem, and such parallel price changes, without more, do not show that prices were set as a result of a conspiracy.

Finally, defendants can show that even if announced prices are similar, there is often considerable negotiation, particularly with large customers, over the prices that the customers actually pay.

Of course, every case has unique features, and defendants will use whatever facts and arguments work best in that case in an effort to defeat plaintiffs' claims of a conspiracy.

Moderator: *Oftentimes in price-fixing conspiracy cases, the United States government has brought charges, which can be used by civil plaintiffs in trial as substantive evidence of the defendant's guilt (although limited to the factual basis articulated in the plea agreement). There were no indictments or plea agreements in the Urethanes matter. How does the lack of criminal charges impact a civil trial of a conspiracy case?*

Goldberg: Setting aside the presence of interstate commerce, which is usually not at issue in cartel cases, the essential elements of a recovery for plaintiffs raising a price-fixing claim are: (1) the existence of a price-fixing conspiracy and the defendant's participation in it; (2) the conspiracy had an effect on the prices paid—called “fact of injury” or “impact”;¹⁰ and (3) the calculation of damages. These essential elements were reflected in questions 1, 2 and 6 of the jury verdict form in the *Urethanes* trial. Section 5 of the Clayton Act, 15 U.S.C § 16, makes a merits determination in a prior criminal or civil proceeding against the defendant as to the same conspiracy under the Sherman Act *prima facie* evidence of the existence of the conspiracy and the defendant's participation in it in the later proceeding. But, that *prima facie* evidence, while being powerful proof as to the first essential element of the subsequent claim, does not address the second or third essential elements—fact of injury and damages. In *Urethanes*, the lack of a prior criminal conviction (or civil judgment) increased the importance for us of putting together the strongest factual case to persuade the jury that there was a conspiracy and Dow's participation in that conspiracy. We marshaled substantial evidence, put on a strong case and were able to convince the jury. The lack of a prior conviction had no effect on proof of the second or third essential elements of our claim.

Tubach: In the absence of criminal charges, plaintiffs must prove a conspiracy from scratch, and defendants stand a much better chance of convincing a jury there was no illegal agreement. The existence of a guilty plea fundamentally changes the case, because it affects the extent to which a defendant realistically can challenge the requirement of an agreement. Section 5(a) of the Clayton Act empowers plaintiffs to use a guilty plea as *prima facie* evidence of the defendant's participation in a conspiracy even if the party cannot claim collateral estoppel. As an initial matter, § 5(a) will be superseded by conventional collateral estoppel analysis because courts have eliminated mutuality

¹⁰ In a price-fixing class action, this “impact” or “fact-of-injury” requirement is modified to require that the impact was felt generally by the class—that all or nearly all class members were impacted by the conspiracy.

requirements for collateral estoppel. *See, e.g., Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 337 (1979). As a result, even when § 5(a) would otherwise apply, private parties generally can obtain estoppel from guilty pleas when the government could do so. If collateral estoppel is found to apply, a plea can preclude a defendant from contesting one or more elements of plaintiffs' claim. In practice, there often is a critical caveat to this analysis: Plaintiffs can obtain collateral estoppel only to the extent their allegations track the content of the plea agreement. To obtain estoppel, they must establish that the guilty plea actually and necessarily decided the identical issue on which they seek estoppel. If the conduct described in the plea and plaintiffs' allegations is not identical, § 5(a) applies, and courts can admit a defendant's plea agreement as non-conclusive, rebuttable evidence of conspiracy for the jury to weigh alongside other evidence.

Section 5(a) and the collateral estoppel doctrine help plaintiffs establish the existence of an illegal agreement, but they often do nothing to help plaintiffs establish that they suffered harm as a result of the conduct they cite in their complaint. A guilty plea therefore tends to sharpen the parties' focus on the "impact" of an alleged conspiracy. Nevertheless, this element of plaintiffs' case typically is contested regardless of whether a defendant has pled guilty, and it was contested in the Urethanes trial.

The existence (or absence) of a guilty plea also affects the likelihood of settlement. Companies that have pleaded guilty rarely proceed to trial. And if they do, defendants that have pleaded guilty face hurdles in terms of how they are perceived by the jury. Defendants that have not pleaded guilty begin on a neutral footing, and as an initial matter likely have greater credibility with the jury.

Moderator: *All of the defendants settled before trial except Dow. Were those settlements revealed to the jury during trial? How did the settlements impact the litigation against the remaining defendant, if at all?*

Goldberg: We settled with all four defendants, other than Dow, prior to trial for a total of \$ 139 million. Those settlements have been distributed to the class. Consistent with pretrial motions *in limine* filed by both class plaintiffs and Dow, neither the fact of settlements nor the amount of settlements was disclosed to the jury. Instead, the Court instructed the jury that the absence of other urethane manufacturers from the trial was of no concern to them. The proof at trial fully (including video deposition testimony of current or former employees of the settled defendants) supported the jury's finding that there was a conspiracy among Dow and the other four producers of urethanes in the United States. After the jury verdict and denial of the post-trial motions, the judge entered a judgment in favor of the class for treble the jury's damages finding, minus the total settlement amount, slightly less than \$ 1.1 billion.

Tubach: Prior to trial, Plaintiffs moved to exclude any reference to or evidence regarding the terms of the settlements with Bayer, BASF, Huntsman and Lyondell, likely fearing that disclosure of the terms would lead jurors to offset their damage award against Dow by the amount already obtained from the settling defendants, or to conclude that those settling defendants were more culpable than Dow. Simultaneously, Dow moved to exclude any reference to or evidence regarding both the terms of the settlements and the very existence of the settlements. Dow's concern was that jurors would be more likely to conclude that plaintiffs' case had merit if they were aware that the other alleged

conspirators had already settled. Both motions were granted by the court two weeks before the start of the trial.

At trial, both sides abided by the court's ruling, seemingly without issue. The other four companies were frequently referred to as (alleged) co-conspirators, with no reference made to the fact that only Dow was defending itself. The closest either side came was when Dow's attorney, in his opening statement, noted that "Dow's the only defendant here. Your verdict will be for or against Dow. There are other companies that are not before you here." Dow made no attempt (in its opening or closing statements) to paint the other parties as uniquely culpable, or to suggest that there was a conspiracy, but that Dow did not join it.

The jury asked no questions regarding the settling defendants, and, based on their verdict, did not appear to discount their damages award to reflect the participation of other parties in the conspiracy.

Moderator: *Before the case went to trial, the court refused to decertify the purchaser class. Dow contends that the trial court erred in not decertifying the class based on the U.S. Supreme Court's ruling in Comcast. Can you please explain the impact of that decision on the Urethanes matter?*

Goldberg: After the jury verdict in *Urethanes*, Dow raised *Comcast* in its post-trial motions, arguing that the testimony of plaintiffs' damages expert, Dr. McClave (the same expert whose opinions were at issue in *Comcast*), was divorced from plaintiffs' price-fixing theory of liability. Judge Lungstrum correctly ruled that *Comcast* was irrelevant to the jury's verdict on two bases: (1) the significant difference in the procedural postures of *Comcast* (addressing class certification) and this case (after trial and a jury verdict); and (2) Dr. McClave's testimony to the jury that prices during the relevant conspiracy period were higher than they would have been absent collusion and that these supra-competitive prices impacted all or nearly all class members "provided the causal link" between the damages estimate and the plaintiffs' price-fixing theory of recovery that was considered missing in *Comcast*.¹¹ *Urethanes* Post-trial Motions Op. at 9. Dow makes similar *Comcast* arguments on appeal to the Tenth Circuit Court of Appeals.

Tubach: The court certified the class on July 28, 2008, but Dow did not move to decertify until January 22, 2013—one day before the start of the jury trial. Their focus was on the purported failings of the work of Plaintiffs' expert econometrician, James McClave's, which had been filed in April 2011. The court found these challenges untimely, coming on the eve of trial, noting that "[r]econsideration of the Court's certification order at that time or even post trial would cause severe prejudice to plaintiffs, who prepared for a long and complex trial at great expense and who might find it much more difficult to assert individual claims at this time." Thus the court rejected the motion to decertify as untimely except with respect to issues based on events occurring at trial

11 Judge Lungstrum also ruled that Dow's motion to decertify the class, which in part relied on its *Comcast* argument, was untimely—having been filed literally on the eve of trial. Judge Lungstrum also ruled that a number of arguments Dow raised in its post-trial motions had been waived, Dow having failed to raise those arguments previously at appropriate times pre-trial. In each case where Judge Lungstrum ruled that Dow's arguments were waived or were untimely, he also rejected the arguments on their merits.

or based on the Supreme Court's *Comcast* opinion, which was handed down two months after the trial, and was addressed in Dow's reply motion in support of decertification.

The court further stated that Dow's arguments for decertification failed on the merits, including the claim that certification was improper because, under Dr. McClave's model, some class members did not suffer damages. The court relied on *Messner v. Northshore University Health System* and *Kohen v. Pacific Inv. Mgmt* in holding that "the presence of a few 'zero-damages' class members" does not "necessarily defeat[] certification." Relying on those decisions, the court distinguished between classes containing members who could not have been injured by defendants' conduct, as opposed to those containing members who were ultimately shown to have suffered no harm. This emphasis on customers who could not have been injured was echoed three months later in the D.C. Circuit's decision in *Rail Freight*.

Regarding *Comcast* (in which McClave's model was found to be insufficient), Dow argued that the Supreme Court's decision "highlights the significance of Dr. McClave's inability to establish causal links between the conduct challenged at trial and injury/damages to Class members." Specifically, McClave could not, according to Dow, separate the effects of the conduct challenged at trial from the effects of other anticompetitive conduct not challenged, nor could he attribute the damages he calculated to the specific anticompetitive conduct alleged by Plaintiffs.

The Court rejected this argument, holding that Dow had failed to challenge this aspect of McClave's opinions before trial, and that McClave's testimony at trial in fact was sufficient to establish the necessary causal linkage. Whereas McClave's reports at the certification stage had assumed that Dow both fixed prices and allocated customers (which latter allegation was subsequently abandoned by Plaintiffs), his opinions at trial based the conclusion of classwide impact only on the allegation of price-fixing.

Moderator: *The Urethanes trial resulted in the largest jury verdict of last year in a Sherman Act case—of \$400 million. How did the plaintiffs prove up those damages to a jury? How did the defense defend against that number?*

Goldberg: Plaintiffs' damages expert, Dr. McClave, presented the jury with his opinions that prices were elevated above competitive levels during the class period from 1999 through 2003 and his calculation of the total amount of those inflated prices on the class. Dr. McClave described to the jury the statistical analysis—a forecasting multiple regression model—he employed to estimate the supra-competitive prices and to calculate the damages. Since, in *Urethanes*, we sought damages beyond the statute of limitations period, Dr. McClave presented a damages number for the full period, 1999–2003, of approximately \$ 1.125 billion; and for the statute of limitations period, November 2000 – 2003, of approximately \$ 496 million. Dr. McClave also presented damages numbers for each of the named plaintiffs and testified that his statistical models showed that the price-fixing conspiracy caused inflated prices across all products, all defendants, both large and small customers, impacting all or nearly all customers. Dow's damages expert, Dr. Keith Ugone, offered technical criticisms of Dr. McClave's statistical modeling, but did not present to the jury an alternative damages number. Dr. McClave responded to each of Dr. Ugone's criticisms of his methodology, showing both that the criticisms were in error and that when properly applied, did not make damages go away but rather served

only to reduce damages. The jury found that damages should be limited to the statute of limitations period and awarded damages of approximately \$ 402 million, approximately 80 percent of Dr. McClave’s damages number for that period.

Tubach: As with virtually all price-fixing cases, plaintiffs used expert testimony to estimate what the prices would have been absent the alleged conspiracy. By comparing those estimates to actual prices, plaintiffs produced an overcharge estimate of \$1.125 billion. Trial Tr. at 2832-34. Expert testimony, however, was not the only reason for plaintiffs’ success. A key factor likely was plaintiffs’ story—full of colorful facts and outlandish behavior. It was one about “businessmen behaving like spies”: using gas station pay phones to call competitors, falsifying business records, meeting in dark hotel hallways, avoiding conference rooms for fear of listening devices, and threatening those who might expose suspicious communications. Trial Tr. at 158-187. Combined with nearly identical price announcements over a five-year period, this suspicious behavior likely helped sell the jury on a large damages figure.

The plaintiffs also deserve credit for embracing many of Dow’s strongest rebuttal arguments. Plaintiffs acknowledged that they were seeking a lot of money in damages. They countered, however, that Dow and its co-conspirators made billions of dollars over the multi-year conspiracy. Plaintiffs also embraced the fact that Dow competed with its co-conspirators, explaining that hearty competition was actually to blame for the conspiracy—the companies didn’t want a price war to undercut their profits. And plaintiffs acknowledged that Dow and its co-conspirators had many legitimate reasons for discussions. But plaintiffs emphasized that in addition to legitimate conversations, the defendants regularly had what plaintiffs described as illicit and elaborately disguised price-fixing discussions.

Dow defended against plaintiffs’ claims by arguing (1) the polyurethane market was an oligopoly and many of the complained-of actions were legitimate consequences of such markets; (2) almost every witness denied knowledge of pricing agreements; (3) announced prices, even if similar, did not always reflect the amount paid by customers; and (4) plaintiffs could not prove the exact conspiracy alleged—for all products, over the entire class period, involving all defendants.

Moderator: *In May of last year, Dow was ordered to pay \$1.2 billion (treble damages). What is the status of the Urethanes case today? What will be the key points on appeal?*

Goldberg: Dow filed a full array of post-trial motions to set aside the verdict and to decertify the class. The district court denied all of Dow’s post-trial motions and entered judgment of three times the jury finding of damages, less the settlements, approximately \$ 1.1 billion. The media reports that the jury verdict in *Urethanes* is the largest jury verdict of 2013 and the largest jury verdict in a price-fixing case in the history of the Sherman Act. Dow posted an agreed-upon bond of \$ 400 million and has appealed to the United States Court of Appeals for the Tenth Circuit. The appeal is pending. Dow has filed its opening brief in the court of appeals, raising issues similar to those it raised in its post-trial motions and rejected by Judge Lungstrum. We filed our response brief on February 14, 2014; and Dow filed its reply brief on March 7, 2014.

Tubach: The *Urethanes* case currently is on appeal before the Tenth Circuit. The trial court judgment—which was reduced slightly to \$1.06 billion to account for prior settlements—currently is stayed pending final resolution of the appeal. In the interim, Dow has posted a \$400 million bond. Doc. 3048. A related proceeding, referred to as the “Direct Action” proceeding, is progressing in the district court. The Direct Action case was brought by a number of entities that opted out of the class action. Although closely related to the class proceedings, the Direct Action raises a handful of additional allegations, including that the conspiracy began in 1994, that defendants violated European Union law, and that additional defendants were involved in the conspiracy. See Doc. 1383; *In re Urethane Antitrust Litig.*, 683 F. Supp. 2d 1214 (D. Kan. 2010). Expert discovery is ongoing.

Among the key issues in the Urethane appeal, three are worth highlighting:

- The adequacy of plaintiffs’ expert modeling. The Tenth Circuit must determine whether plaintiffs’ damages model adequately tracks the alleged conspiracy. Plaintiffs’ model estimated damages caused by price-fixing and allocation of customers and markets. At trial, however, plaintiffs sought to prove only price-fixing. A similar inconsistency doomed plaintiffs’ expert (McClave) in *Comcast*. 133 S. Ct. 1426, 1433 (2013). Relatedly, plaintiffs’ model estimated hundreds of millions of dollars in overcharges for a period (1999–2000) during which the jury found no conspiracy. False positives call into question the validity of the entire model. *In re Rail Freight Fuel Surcharge Antitrust Litig.*, 725 F.3d 244, 252–53 (D.C. Cir. 2013).
- The Rules Enabling Act. Dow argues that it should have had the opportunity to demonstrate in individual proceedings that particular class members could not establish injury and impact. Whether plaintiffs’ models and the inferences drawn therefrom adequately safeguarded Dow’s substantive rights will be central to the appeal. See *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2561 (2011) (discussing the Rules Enabling Act, 28 U.S.C. § 2072(b)).
- Predominance. Plaintiffs’ expert built a model that analyzed impact and damages for roughly one-quarter of the class. From there, he extrapolated his estimates to the remaining three-quarters of the class. Whether this meets the Supreme Court’s requirement that proof of impact be possible in “one stroke,” *Wal-Mart*, 131 S. Ct. at 2550–51, is another key issue on appeal.

LCD REDUX: FOLLOW-ON CLASS ACTION AND DIRECT PURCHASER LITIGATION FROM 2012'S DOJ CRIMINAL PROSECUTIONS

Views from Trial Experts Bruce Simon, Howard Varinsky, and Robert Freitas

Moderated by Aton Arbisser

Edited by Michael J. Kass

I. INTRODUCTION

Last year, the *Competition* journal published a Roundtable discussion of the 2012 eight-week criminal jury trial prosecuted by the San Francisco field office of the Antitrust Division of Department of Justice that resulted in AU Optronics Corporation and individuals being convicted for violating U.S. antitrust laws in connection with a world-wide price fixing scheme involving thin-film transistor liquid crystal display panels (“LCD”). The October 2013 Golden State Institute benefitted from an outstanding panel’s in-depth analysis of two subsequent trials against other alleged conspirators.

Below we reprint a transcript of the panel discussion. **Barkley Court Reporters**, with their fine court reporters in attendance, kindly provided the *Competition* journal with a transcription of the panel discussion. (not sure how to follow the edits)

This discussion is about two LCD trials. The first is a class action lawsuit brought by direct purchasers against Toshiba. In that matter, the jury found for the plaintiffs and awarded an \$87 million verdict against Toshiba.¹ In the second matter, Best Buy (which had opted out of the class actions) brought its own action against two LCD defendants, Toshiba and HannStar.² In this one, Toshiba prevailed, with the jury finding that it did not participate in a price fixing conspiracy. The jury found against HannStar, but significantly limited the damages sought. This panel discussion explored the seemingly contradictory nature of the results in the two trials.

First, **Bruce Simon (Pearson, Simon & Warshaw, LLP)** and renowned jury consultant **Howard Varinsky (Varinsky Associates)** discussed the extensive preparation and strategic considerations that went into the direct purchaser class action they tried against Toshiba Corporation, which resulted in an \$87 million jury verdict. In particular, Bruce and Howard focused on the difficulty inherent in proceeding to trial against Toshiba, a defendant that was the only alleged conspirator was not indicted in the criminal probe and denied fixing prices. They described how they were still able to associate Toshiba with the incriminating “Crystal Meetings” using circumstantial electronic evidence.

Balancing plaintiffs’ counsel’s presentation, **Robert Freitas (Freitas Tseng & Kaufman LLP)** explained the challenges he faced defending HannStar Display Corp. in a direct action brought by a group of Best Buy affiliates, which also named Toshiba as a defendant. In successfully limiting HannStar’s damages to \$7 million, less than 1% of the single damages claimed by the plaintiffs, Bob made various important strategic choices,

1 *In re: TCT-LCD (Flat Panel) Antitrust Litigation*, Case No. MDL 3:07-md-1827 SI (N.D. Cal. June 28, 2012)

2 *Best Buy Co., Inc., et al. v. AU Optronics Corp., et al.*, No. 10-cv-4572 SI (N.D. Cal. Nov. 20, 2013)

including how to apprise the jury of HannStar's guilty plea. Bob discussed that issue and how it was complicated by the fact that the only co-defendant in the case continued to deny any role in the alleged conspiracy. Bob also focused on the complexity of litigating both direct and indirect damage claims, and the role HannStar's experts (including Dennis Carlton, who was also Toshiba's expert in Bruce's class action case) played in convincing the jury to limit the damages awarded. Finally, observations were offered regarding the different perceptions the two juries formed with respect to the relatively sympathetic class representatives in Bruce's trial, contrasted with the HannStar jury's apparent view of the Best Buy plaintiffs.

Our illustrious panel consists of:

- **Aton Arbisser, Moderator:** Aton Arbisser is the Chair of the Litigation Department of Kaye Scholer's Los Angeles office and belongs to the firm's Antitrust and Product Liability groups. As an antitrust lawyer, Aton has won cases at both the trial and appellate levels, in both federal and state court. A frequent lecturer and author, Aton has appeared at many speaking engagements and published numerous articles in the areas of antitrust and class action law. He was recently appointed to the Executive Committee of the Antitrust and Unfair Competition Section of the California State Bar.
- **Bruce Simon:** Bruce Simon has led Pearson, Simon & Warshaw, LLP to national prominence. Mr. Simon specializes in complex cases involving antitrust, consumer fraud and securities. He has served as lead counsel in many business cases with national and global impact. In 2013, Mr. Simon was chosen as one of the Top 100 attorneys in California by the Daily Journal and he received a CLAY award from California Lawyer magazine as one of the attorneys of the year for his work in the *In re TFT-LCD (Flat Panel) Antitrust Litigation* trial and settlements.
- **Howard Varinsky:** Howard Varinsky is recognized as one of the country's preeminent trial consultants. Over the last twenty-five years Varinsky has consulted on virtually every type of litigation, including anti-trust, employment, intellectual property, securities, bad faith, toxic torts, personal injury, and criminal defense and prosecution. A pioneer in the field of trial consulting and witness preparation, Varinsky has developed a proven, proprietary methodology that not only yields quantitative data, but even more importantly, provides vital insight into jury logic—how juries think, feel and react to information. Varinsky's clients, who include many Fortune 500 companies and the law firms that represent them, often credit his contribution as a major factor in developing winning trial strategies.
- **Robert Freitas:** Bob Freitas is a founding partner of Freitas Tseng & Kaufman LLP. He is a versatile trial lawyer and litigator who focuses his practice on antitrust and competition counseling and litigation, intellectual property litigation, representation of policyholders in insurance coverage claims and litigation, and complex litigation for technology companies. Before co-founding Freitas Tseng & Kaufman LLP, Bob worked in the Antitrust, Intellectual Property, and Litigation practices of Orrick, Herrington & Sutcliffe LLP.

II. PANEL DISCUSSION

Moderator: *First Bruce Simon is going to talk to you, give you a little background on the LCD cases generally and talk about liability.*

Bruce has been involved in many of the largest antitrust class actions for 20 or more years. This is certainly one of the largest. Bruce and his co-counsel recovered nearly half a billion dollars in these cases.

He had a very tough task. All of the other alleged conspirators pled guilty. But he went to trial against Toshiba, who had not pled guilty, and he had to prove they were a member of the conspiracy.

After Bruce does that presentation, both background and liability, his jury consultant, Howard Varinski, is going to talk to you about some of the jury research.

Howard is one of the leading jury consultants in the country. He's been doing that for quite a while. He's been involved in many of the highest profile trials: Martha Stewart, Michael Jackson, Dr. Kevorkian; the list goes on and on.

Howard also works on lots of civil cases as well as these criminal matters.

He is a thought leader among jury consultants, has published widely, and has developed proprietary methods that try to figure out how juries think, how juries come to decisions; and he'll tell you how he brought that to bear in this case.

Finally, you're going to hear from Bob Freitas, who represented HannStar in the trial that just recently concluded.

Bob, for many years, was at a large firm here in town representing corporate clients.

Recently he and a couple of other folks founded a new firm where Bob got his name on the door, and you will hear about the stunning victory that he had.

His client had pled guilty. They faced more than three-quarters of a billion dollars of untrebled damages.

And talk about keeping it in the park, the jury came back with a verdict that was in the range of one percent of what was being asked from his client. So great results by all these guys.

You didn't pay to hear me.

Bruce, if you want to take it away.

Simon: *Trials are sociology experiments.*

They are like four-dimensional chess in a way, and you have to put yourself in the middle of a trial, especially if you're lead trial counsel, and try to look at, feel and understand everything that's happening around you spontaneously.

And all your strategic decisions and all that great planning and worrying and getting up at 2:00 in the morning, thinking, "How am I going to deal with this particular point," all those things are compounded.

And a lot of them that you prepare endlessly to respond to and put on in the case end up being not such big deals at trial, and the things that you thought maybe were just going to kind of skate through, end up being big deals.

So that being the case, we are going to try to focus on what went well in our respective trials and things that we could do better.

I am particularly honored that Howard is able to join us.

It is not typical that a plaintiff's trial attorney is going to put up his secret weapon in front of all you, including my defense friends, to tell you a little bit about what our process was for picking a jury and how well it worked and how well it didn't work.

We aren't going to tell you all the secrets, but Howard's going to talk to you about some of the issues he confronted, how he did that in advance of the trial, and how things worked during the trial.

And I have to tell you, Howard and his colleague Paulette, they were just such trusted advisors during this whole case.

And we guessed right most of the time. Sometimes, you know, we didn't guess exactly right, but that's the nature of trials.

I also want to echo what Joe Goldberg said, is that I am up here, but there is a huge team that was involved in this case, and I just don't mean my firm and the people that were my co-counsel.

Obviously my co-counsel was—co-lead trial counsel was Richard Heimann of Lief Cabraser. Also I have to give a shout-out to the government, Peter Huston and Heather Tewksbury, you know, they tried the case before our case.

The entire discovery and coordination effort that went on and try not to get into each other's way to the greatest degree possible was part of what ended up being the trial.

We learned from their trial, which preceded ours, and I think Bob Freitas learned from the trials that preceded his.

Right before we were going to trial—and part of the jury testing you will hear about is we didn't know who we were going to trial with, and we didn't know if we were going to be thrown in with the indirects, the indirect purchasers and the direct purchasers.

I had a few sleepless nights trying to figure out not only who might go first in the presentation of the trial if we were thrown in together, how we would use the 50 hours the judge gave us to try the case, and how we explain the passthrough issue, which is a very important issue, which Bob will talk about in his case.

So all those people basically came together to create the case, and everything they did, when the government would push one way and something would pop out the other way, it could affect the civil case.

When the indirect purchasers came in and said something, it could affect the direct case. It was all interactive all the way through trial and still continues to be.

Judge Illston had five trials involving the LCD conspiracy—the AUO criminal trial preceded ours, our direct purchaser trial, the retrial of one of the AUO defendants, the Best Buy trial that Bob defended, and a trial of one of the AUO defendants who didn't come over for the first trial, who decided to come over and got a defense verdict.

So when you look at this chronologically and holistically, you have to look at all those cases together, and what happened in those cases.

Conviction, plaintiffs' verdict, all the way up to one of the criminal defendants who got a defense verdict. It is a very interesting thing.

You also have to look at it from the standpoint that we were the first in a series of mega-trials, some of which you heard about today, that occurred over the last 18 months.

And in my experience, and I think Aton said 20 years, it is 33 years, and thank you for making me younger than I am, but I have not seen in 33 years so many antitrust price-fixing class action cases tried in an 18-month period, let alone a ten-year period, as have been recently tried.

And I think you could have a whole day talking about what that all means for the law and for us.

So let me tell you a little bit of the LCD case. A lot of you know about it. I am not going to belabor it.

But the LCD case involved the component LCDs, and you all have your computers in front of you, if you took off the front part of your computer there, you would pop out the LCD panel.

And it is basically a sandwich of liquid crystal that is connected to the electronics.

By the way, the electronics are a lot like in DRAM, and also some of the companies that are in LCD were in DRAM, because the memory and electronics that run the panel are so much like DRAM. Those companies had the knowledge to develop these things.

That sandwich, which is the liquid crystal electronics, is surrounded by a module which runs it and allows it to fit in various applications.

The case involved the panels and also involved the finished products, including the panels, and you probably all know what they look like.

This happens to be a slide that Toshiba put up. White & Case did a tremendous job in the case, and they gave me 100 some-odd slides before opening statement.

They ended up using like three or four slides. This was one of them, I believe.

Toshiba Sold Laptops, Monitors, and Flat-Screen TVs



We had to have a little objection about these slides because on the LCD screens, instead of these innocuous places we'd rather be, they had the 49ers and the Giants. I thought that was a bit of pandering to the jury.

Freitas: I thought that was a neat trick.

Simon: We got it taken off.

As you can see, Toshiba, this is what they showed as to what they made. And one of the issues in the case was obviously bringing, wrapping in all the products into one conspiracy that affected everything.

The other obvious thing is—and this is our slide, if you didn't figure that out—is we obviously portrayed Toshiba as being in the middle of a giant conspiracy.



All this information that's on the slide, this was an opening statement slide, so I'll tell you about Samsung in a minute, but all this information in the slide came into evidence.

And one of the biggest things we had to plan and one of the biggest strategic points in this trial is how we are going to play the guilty pleas.

Amazingly, and I think to their credit, White & Case, as I think Bob did in his trial, embraced the guilty pleas and really didn't fight about the fact that there was a giant conspiracy going on here. They just said they weren't involved in it.

If you take a look at this, we put Toshiba in the middle to tell all of you who believe in some sort of ESP from these demonstratives, to tell you Toshiba was in the middle of all these guys who pled guilty, convicted.

Samsung, we weren't allowed to put "amnesty applicant" on the opening statement slide, but during the course of the trial we were able to tell the jury that they had applied to the leniency program.

We weren't allowed to tell them too much. There was a stipulation that was fairly vanilla. By the time we got to closing argument, there was a similar slide and "amnesty applicant" was pasted on Samsung.

If you look at the way Toshiba did it, this is what they presented. They had everybody else, including Bob's client, sitting around a table, shuffling papers, conspiring.

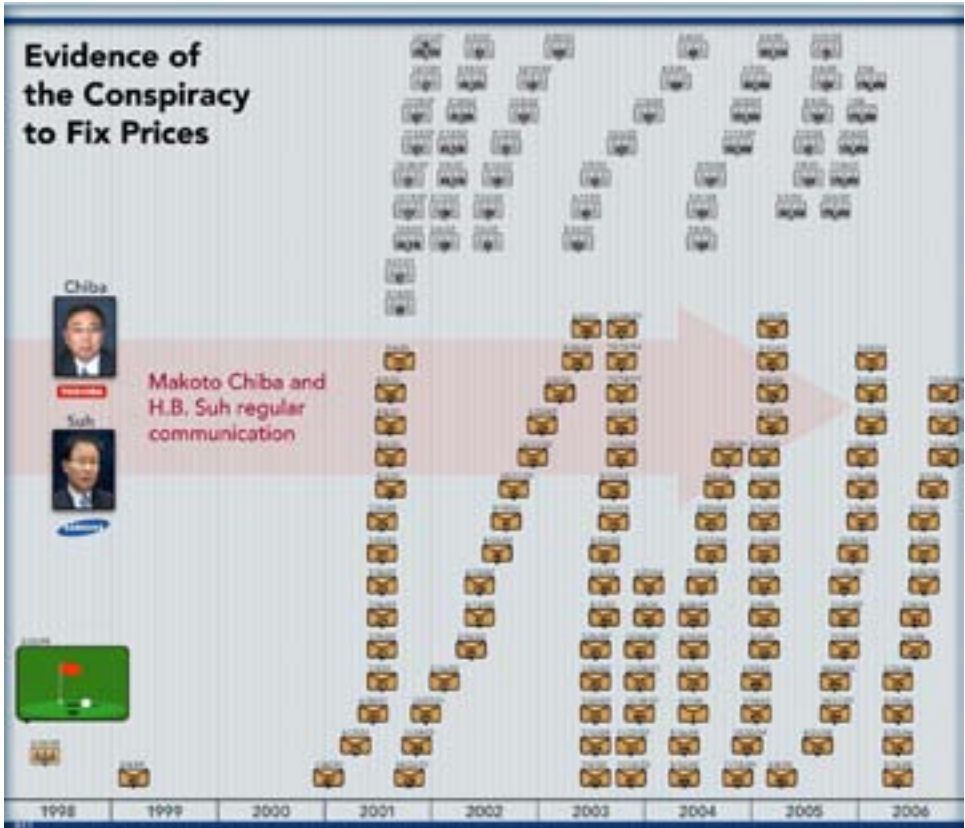


And this is from closing because it does have “amnesty” on there. I suspect it is a closing slide, and of course Toshiba is nowhere to be found. They pretty much tried the whole case with that in mind.

Freitas: Notice who is sitting at the head of the table on this slide. In our trial we asked the White & Case lawyers to change the arrangement, which they did.

Simon: We don’t have time to show you all the slides, but we had them on the golf course with their golf outfits on with their clubs because the first meeting was at a golf course called green meetings.

So that is one of the really big deals in the trial. Here’s what I used in opening, and how you frame things is so important because it was a framework for the trial, and this was a great big board.



This was not used as a slide. It was a board that I left in front of the jury the entire time so they could focus on it.

It gives you the whole period, the time period of the conspiracy and what it attempts to do, and there was [sic] major objections to this.

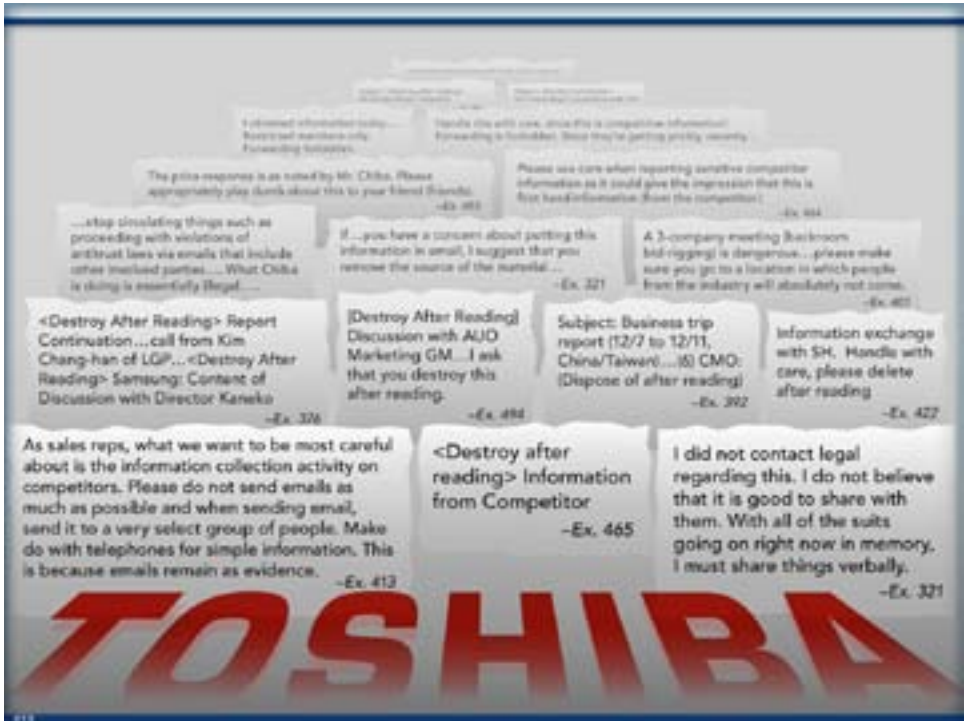
You can see the nice—you got the putting green with the flag there, the first meeting, the green meeting.

But every one of those emails is an email that is a conspiratorial email, many of them stating agreements, many of them talking about not explicitly, but implicitly, that there were agreements.

We have the crystal meetings, which were the notes of the actual meetings for the guys that were sitting at the table.

The question, and the reason the red line goes across the middle and you have the main Toshiba witness there and the Samsung witness, is because we had to bring together Toshiba with the crystal meetings, and we had to visually tell them that, the jury that, and we had to connect the dots.

And we also had this slide, which is my favorite slide to the whole trial, which is all the compendium of destroy after reading and secrecy and all that sort of stuff.



I know Chris Curran would be very mad if I showed you this slide, but I love it, and we did show it to the jury multiple times.

Let me move on and show you what we did, and then I am going to talk about some issues we had and kick it over to Howard.

We had to establish the crystal meetings, and as we got together with our colleagues at Lieff and put ideas together, we came up with internal pairings, because we found information in emails that it appears it could not come from anywhere but the crystal meetings.

2. Pricing review and discussion

NBPC	14.1"
June	255-265
July	255-265

Ex. 52

According to TO Taipei information, the July offer (untranslatable symbol) currently \$266, and they are trying to raise it by (untranslatable symbol)1-3 from the June price.

> checked with Toshiba san, they said they offered \$266
 > to HPQ for 14" XGA July price. Toshiba have no
 > intention to offer \$263 for July as of now. They plan to
 > price up 1 to 3 dollar in July.

6/5/02 6/13/02

Ex. 97 1998 1999 2000 2001 2002 2003 2004 2005 2006

This is one particular slide, which basically shows the crystal meeting, which is above, and it shows the exact amounts and the dates and when they described the prices going up, and right below are almost the exact prices, and it comes from a source that would have known what went on at the crystal meetings.

So that's basically how we tied Toshiba, in our view, to the crystal meetings.

Basically what we had to do and the issues that we had were: How are we going to deal with the fact that Toshiba was not at the crystal meetings? How are we going to present the guilty pleas?

We didn't know whether or not we are going to get into one Toshiba witness that continued to take the Fifth and whether that would get into evidence, which we wanted it to.

We had to deal with the issue of we had a foreign company, Japanese company, but was a brand name in the United States, very well-known, and everybody has probably had a Toshiba TV or something or other, and all these issues had to be tested in advance.

We had the indirect versus direct. How would we handle the passthrough if we tried the case together with the indirects and how do we deal with all those issues?

So we had to do that to begin the trial. We had to constantly reengineer during the trial, and Howard was instrumental in doing that.

And, Howard, I will kick it over to you and talk about how we phased the jury testing so that we did not pollute the pool with those things at the beginning and try to get the best neutral read we could and dealt with these particular issues that we tested.

Varinsky: Those are nice words from both of you. Those high-profile criminal trials are a lot of fun, and there's only a few of us in the country that have learned the dynamics.

Everything is just up in the air in high profile. That's probably one percent of our work, and probably only criminal. Most of our work is obviously complex civil litigation.

This case in particular posed a lot of problems, in that there were so many issues to study.

Normal jury research is either collecting information from groups of jurors, and it is done with the consultant and various groups, asking questions from them. You collect a lot of information.

There's also adversarial focus groups, which we all call mock juries. Neither model fit for this case.

We had a triple jury, a two-day jury, and we had the problem of trying to learn about what I have, and I am not going to read them all, but is 21 separate problems, how do we phase that?

Bruce talked about the crystal meetings. There was no direct evidence, no smoking gun.

We hear that in all kinds of cases after and during jury selection, the jury says, "Oh, yeah, I agree circumstantial is the same as direct. I understand the instruction," and yet when they walk out, you talk to them, "Oh, it was only circumstantial. I couldn't vote on it."

Simon: With respect to Toshiba and the fact that they were distinguishing themselves from the direct evidence.

Varinsky: There's also the problem of the direct versus indirects, didn't know if the indirects were going to be there.

Anything wrong with competitors meeting to discuss confidential information? Competitors need to discuss standardization, prices of fast technology on the market that is more widespread, prices lower.

Were any agreements reached at the crystal meetings? Whether, if agreements were reached, did they violate antitrust laws? And always it is why or why not, tell me more, explain.

Did Toshiba need to attend the crystal meetings to get conspiracy? The locations, whether meetings were in Asia or the United States.

Then had to test the credibility of Toshiba's defenses, understanding the concept of antitrust injury and what evidence was important to you in that regard.

Reaction to expert witnesses, understanding the difference between index products and other products, on and on and on, on the list, treble damages for indirect and direct.

So we had to layer all this in a way such that we got information on every separate issue.

We had that problem, small size, with Toshiba's market share, the fact that Japanese antitrust laws are restricted in the U.S. came into it.

We had the problem with foreign companies, especially Asian companies, because a lot of people have beliefs about Asian business practices that you have to explore. You have to do it.

Simon: One quick war story is that when we did this, and he'll tell you a little bit more how he did it, we phased it and we only brought the indirect case in after we did our own case, just put on the direct purchaser case.

And we had to come up with somebody to play the conglomerate of Fran Scarpulla and Joe Alioto. Joe is probably smiling out there. I am not going to tell you who depicted you, but they did a great imitation of you.

Freitas: The list we were working with was a lot shorter. We had a guilty plea, four and a half years of price-fixing meetings. So our focus was much narrower than what Howard and Bruce had to deal with.

Varinsky: We needed feedback from every one of those issues. How we phased this was by combining that information, collecting, and mock trial adversarial-type juries. So we hybridized it.

First we had a neutral tutorial: me or one of my colleagues, sat down for about an hour and a half and discussed the issues of the case, educated about the case and about what each side was contending.

And then along the way to get feedback, we would stop and say, "What do you think about that? What more do you want to know? Impressions so far?"

So we collected a lot of information even during the neutral tutorial. Here's the hybridization.

That was followed by the crystal meeting issue, which is about five or six or seven or eight of these problems that I had showed you in the last slides needed to get answered.

So we split the presentations into two presentations. Plaintiffs had 45 minutes and the defense had 45 minutes, and we made sure after the plaintiffs' presentation and after the defense presentation to take questions.

It is not the scientific model, but we sure wanted to know what they don't understand. A lot of times in those question periods, they bring up stuff that you would never think of, and you get 15, 20 nods around the room.

We had another segment of witness videos and evaluations.

We had three major witnesses we wanted to test. We played video depo snippets, and then we had discussions about them. There were forms that they filled out in our focus group package.

On day two—it was a two-day focus group—we studied class-wide impact, again, plaintiff and defense arguments with slides, with evidence, they had jury books in front of them the entire time.

And then, again, deliberations, and then questions we had after the deliberation that led to discussions.

Simon: Class-wide impact included the scope of the conspiracy, the products involved, Toshiba-specific defenses that they were only involved in certain products, their products were different from everybody else's products and were not standardized.

Varinsky: Then we had damages. We had overcharge calculations where the directs and indirects were involved.

That's where we layered in the indirects, the passthrough finished product claims. The passthrough is passing through the cost to the consumer, and that was a major issue in our case.

Simon: We had to decide, do we just lay it out there or do we not lay it out there? And we had to—Howard was very helpful in letting us know even if we didn't go to trial with the indirects, whether or not the jury would be thinking about passthrough, even though we didn't tell them about passthrough or they—we had to make the decision whether or not there should be an instruction, "You're not to think about it," in which case you will think about it, or do not tell them anything and hope that it just kind of goes by them.

And the deliberations on that issue were fascinating. I mean, we had some pretty clear indications from the session before we threw the indirects in, and then when we threw the indirects in, I heard some things that I went, "Wow, we have to go to trial with the indirects. It is really going to blow the jury's mind."

Varinsky: Even when they were out there, it was still a problem because, again, those passthrough costs.

Then beginning deliberations. So we would have argumentative presentations.

And then we'd have deliberations, because the dynamic of having pretty argumentative presentations and a jury discussing it that way is a lot different and a lot more realistic to what you get in trial.

You see how they resolve their problems, where just querying them doesn't get that.

Then we went on to—after that we went on to expert witnesses. We tested the expert witnesses, again, there are forms, and we discussed it all.

There's one thing I used on the expert witness eval, which is two pages, but I always ask them the question, "What's the one word that best describes the witness?"

And I go around the room and everybody is together on these, and I have them say the one word, and, my God, that's fascinating every time. That's great.

Simon: I will say one thing we had to contend with is that—I think this is something, a takeaway point for me, is you can either bring the experts live, obviously plaintiffs' experts, in which case the issue about discoverability and being asked about that on examination on the stand, or you can use video.

The video of both plaintiffs and defense do not do them justice, and how they perform on the stand live in realtime is really something hard to, I think, duplicate in a mock trial situation.

Varinsky: One's a deposition, and you are taking that out of context, and the other thing is they were doing something else as an audience and a jury, they behave very differently.

It is very difficult with experts, unless you do a small focus group with just your experts, to see where the holes are, and the jury would have questions and how to make it easier to understand.

And lastly we did the final wrap-up and ask the attorneys to get up and say, "How about if this came in, what if that came in, what would you do for the defense case and the plaintiffs' case?" And this is something we do in every focus group, "What would be your suggestion?"

We have each lawyer stand up, we don't ever say who we are, "Okay. Bob, stand up. You are the plaintiff. The people who voted against him, what would he need to do to get your vote? What kind of evidence would he need to produce?"

Then we test consensus, "How many people agree?" And those start moving. Those are very valuable things to do at the end.

We waited for the Fifth Amendment plea. Caperton Clark pleading the Fifth, we had to save that until the end because it would just poison the deliberations.

We learned that the emails were very important.

And we had to humanize the class reps. We didn't have any at the focus group, and we learned that people wanted to know an awful lot more about them.

Since they were the smaller retailers, we really had to humanize them and get class reps to tell their personal stories about how they were harmed and damaged.

Moderator: Great. Bob, why don't you just contrast the methods that you used in jury research with what Howard did, and then I'll pull your slides up so you can talk about damages.

Freitas: Couple things about that. The first I mentioned is that our range of issues was a lot narrower than what Howard and Bruce were working with.

But also we had another issue addressing what the structure of our jury work might be, and that involved the role we had as one defendant in a big group.

We didn't know who'd be in trial. We didn't know what our relationship would be with the other defendant or defendants that were in trial.

So what we did is we constructed a focus group with a focus on the issues that we thought would matter the most, regardless of what the exact trial contents would be.

We tried to identify the things that would have the biggest bearing on how our damage-focused trial would end up.

We used a jury consultant working with a focus group without any advocacy involved or any lawyer present.

And I have worked with the same consultant before using a model like this, Trial Partners from Los Angeles, and it works very well. They are very good at drawing out the focus group.

We put together a pretty good list of issues, mostly focused on the big picture, but to some extent focused on the plaintiffs we expected to be in trial with to see what we could get not only about our issues and how we should defend, but how the plaintiffs might be received.

Here's the basic overview of what our trial looked like. We had a group of six plaintiffs, Best Buy affiliates.

We had our client, HannStar, which had pleaded guilty, and a group of Toshiba companies that had never been charged. The plaintiffs asked for \$290 million, roughly, in direct purchaser damages and about \$480 million in indirect damages.

Some of the interesting things about the trial configuration have to do with the way we fit in with Toshiba.

You might think that Toshiba would start and end, and all the way in the middle as well, pointing the finger at us and the other conspirators.

And of course, they did some of that, but what we tried to do is take those issues away at the beginning. The very first thing that we told the jury pool, we got to do mini-openings before jury selection, the very first thing we told them—

Simon: Which we did not do, and that was fascinating that you guys got to do that.

Freitas: Yeah, it worked great. We told them right in the beginning that our client had pleaded guilty and that it accepted responsibility and—although what I was hoping for, hoping to get some credit for accepting responsibility right at the start, didn't really happen.

It wasn't too pleasant looking at those faces when I had to say that.

Simon: When we were prepping, Bob said he was looking for love, and you didn't get any love.

Freitas: None. But I think we got it out of the way. So we had a chance to do that right at the beginning.

And then when Chris Curran would stand up and say, “There was a conspiracy, but Toshiba wasn’t a part of it,” we can shrug our shoulders and say, “Yes, there was a conspiracy, and we were part of it.” So we felt that was crucial.

From that point forward, from the beginning when Chris made that point, we worked overall very well with Toshiba, and the overall trial dynamic benefited both of the defendants.

It didn’t turn out to be a situation where they were pointing the finger at us, and we were running from them. In fact, we worked together.

Our presence enabled them to focus more strongly on the liability case. Their presence helped us subliminally, at least showed the jury there were things to be fighting about here. It wasn’t so cut-and-dry.

I think all in all, despite what some might think about how that dynamic would work, I think it was beneficial to the defendants.

I don’t think the plaintiffs were particularly helped in attacking Toshiba by having a plea agreement, because it was easy enough for Toshiba to draw the distinction between the Toshiba companies and HannStar.

Something else that was interesting in the trial dynamic was the role of the plaintiffs. We didn’t think it was very likely that Best Buy would be able to sell itself as a victim.

We thought that we would have a chance at getting a straight-up fight, and I think that turned out to be the case.

I don’t think the jury disrespected or didn’t like Best Buy, but I also think it’s pretty unlikely that Best Buy and its affiliates were looked at the same way that Bruce’s clients were in his class trial.

Simon: And if you don’t mind my interjecting here, that is another takeaway from this, which is fascinating to me, is that some of the insights we got on our deliberations and the damage number being what it was, lower than we asked for, was that they—some of the jurors thought that the class representatives didn’t convey well enough how hurt they were and that their damages were relatively small.

So even though you tried to portray them as victims and thought we were successful in doing that, the size of the damages was at issue in this case. Whereas Best Buy had gigantic damages, and it wasn’t a big issue in your case.

So that’s really fascinating.

Freitas: In both cases benefiting the defendants.

Simon: I think that’s right.

Freitas: So another dynamic in our trial that wasn’t present in Bruce’s was the fact that direct purchaser and indirect purchaser claims were being made.

You would think that's a big disadvantage for the plaintiff because the defendants get to talk about passthrough.

And of course, the second thing I said to the jury was they passed it all on. But we were meticulous in distinguishing between the indirect and direct claims.

It is very difficult to say in retrospect exactly how badly that hurt the plaintiffs.

Should be pretty clear it didn't help them, but it's not crystal clear to us that there was a serious bleed-over from the indirect and the pass-on evidence to the direct claims.

But, nonetheless, we certainly did get to press early and often the theme that the plaintiffs weren't injured.

And of course, what we said about that wasn't limited to pass-on. We also attacked all aspects of the damage model and the damage case. But I think that the verdict shows quite clearly that the jury went with us very strongly on all the damages issues.

They awarded only 7.4 million in direct damages and none in indirect, apparently concluding—although our expert testified that the average pass-on rate was 93 percent, looks like the jury decided that 100 percent of the overcharge was passed on thus no indirect damages.

But clearly the jury accepted the testimony of our principal damage expert, Dennis Carlton, that the overcharge percentage was quite a bit lower than what Doug Bernheim advocated for the plaintiffs.

And that's a connection between the two trials. Dennis Carlton was the defense expert in both cases.

And part of our strategy was based on our sense that Carlton had done well in Bruce's trial.

Simon: I think this is another takeaway from comparing the two cases. Two things on Dennis Carlton.

It's interesting because we took him on pretty hard about how much money he made for giving his testimony, and it was in the millions of dollars that he and his firm, through bonuses and otherwise, made.

In my trials before, that's always been a big deal, to portray somebody as a paid mouthpiece for a particular party. Jury didn't really care too much about that. They just figured all the expert witnesses were kind of paid mouthpieces.

The other thing is that Dennis got a little upset on the stand. He lost his temper, and I forget what the question was, but I think Brendan Glackin from Lief was doing the cross and got under his skin, and he got upset.

And you know what some of the jurors said, they said they liked the fact that he was so passionate about his testimony, which is also counterintuitive to what I would have thought.

So from our case—in Bob’s case you heard about how he attacked the damages, in our case we did a lot of the attacking on the damages, but the one that did draw some blood, which in retrospect what I would do better, would have been not only to go after them on that harder, but also to precondition the jury with our expert better on this point, and that is picking the end date for the damage model.

Which we picked a date that was not the date of the end of the class, because the conspiracy petered out so there was basically no injury toward the latter part of the class period, which is typical, by the way, even though that was a totally rational way to pick the date and it was substantiated in the damage model, we came up with obviously bigger numbers because of the wave of the effect.

And Carlton portrayed it as an arbitrary date that was picked with no economic or scientific basis. And I think the jury kind of got that. So that’s something that was a different approach.

It probably wasn’t the same thing you did in your case, although I think you did attack some of that in your case. That’s a takeaway that I would do better the next time.

Freitas: There was an issue at the end of the conspiracy. The damage model presented by the plaintiffs showed that at least for the large panel portion of the case, that the impact tailed off about eight months before the end of what was identified as the conspiracy period.

We did something different on the compensation of experts. A treaty was made that there would be no presentation by anybody of any evidence of amounts.

Of course, the experts could be portrayed as hired and paid, but there was a treaty excluding the amounts.

Something else that was interesting in the way the trial worked: On the indirect side of the case, we had an expert who did a calculation of the downstream pass-on rate. It was Ted Snyder, the dean of the Yale School of Management.

The plaintiffs had an expert who addressed pass-on, but he did not offer a calculation. So in the trial, we are advocating Snyder’s 93 percent, and the plaintiffs didn’t have a number to push back.

The way they attacked the downstream pass-on issue was to point out how complicated it is calculating the percentage, that there’s no formula, that it is variable, it changes week to week, month to month, store to store.

And of course, all that’s true, but Snyder fielded that cross-examination quite well. And the plaintiffs, because it hadn’t been disclosed this way pretrial, were not allowed to deliver a punch line, “And you can’t calculate it.”

So that was something that was missing in their response to the pass-on rates.

Simon: In our case, it didn’t come in at all. I want to give you a subtlety here, and it is the type of thing that kept me up at night. We had the panels—components and finished products—and we relied on a case, Judge Illston’s case, Royal Printing.

And I won't get into details, but the bottom line is, as a matter of law, 100 percent, as long as you prove control of the pass-on overcharge in the finished products that you are able to claim.

So we actually had an instruction to the effect that we were entitled to 100 percent of what was passed on into the finished products. We tried not to call it pass-on.

I think we called it something else because we didn't even want to mention the word, but the long and short of it is we had a double pass-on problem if we tried the case with the indirects.

We had the components to the finished products and then we had, if we tried it with the indirect purchasers, the fact that a lot of it was passed on to consumers.

And within the context of our trial, the case against Dell and Best Buy was basically tried in our case.

A lot of evidence was put in about how Dell and Best Buy and other large OEMs had so much power that Toshiba had to do what they were doing, and lots of evidence of bilateral meetings, not just these tiny crystal meetings, they had to do it because they were being pounded over the head by these big companies that were crushing them.

There was even testimony to the effect of how dirty and rotten they were and calling meetings on Christmas Eve and making them fly out and then cancel the meetings. Judge Illston let pretty much everything in.

None of that mattered in our case, none of that, "Best Buy, Dell, you are dirty guys who are cheating us, so we cheated you back." None of that really mattered in our case.

Freitas: So Toshiba spun it a little differently, but it played a big role in our case.

In two ways Toshiba's evidence about its interactions with the plaintiffs were important.

The first was in helping us on pass-on because there was a lot of evidence about the efforts by the Best Buy companies to maintain their margins, and that was used by the experts in talking about pass-on and it was tied together quite well.

The other aspect of it was strictly Toshiba. We were not in a position where we would be criticizing the plaintiffs. We had broken the law. We acknowledged it. We pleaded guilty.

But Toshiba was in a different position, and in the context of what was available, they went after the plaintiffs fairly aggressively, and our sense is that some of the blows that they struck really did hit home.

And that probably had some sort of impact on the way the jury saw the case.

One of the important things about Toshiba's defense, I believe in Bruce's case and certainly in ours, is that while they had a lot of communication with competitors, they did not enter into agreements.

They pounded on that theme again and again and again, and ultimately they prevailed in our trial on that basis.

But what they did with some evidence that they got in discovery about the competitive intelligence activities of Best Buy was to show that there were instances in which Best Buy employees communicated with competitors in a way that Toshiba advocated was the same as what Toshiba was being accused of.

Simon: And that came in in our case as well.

Freitas: And they did very well. First of all, taking some of the air out of the emotion about the idea that they were talking with competitors, and also playing the hypocrisy card a bit. I think it was effective.

Simon: Some of the differences between the cases and similarities, they really are fascinating.

In our case, there were two witnesses that didn't appear in Bob's case, Toshiba witnesses. One was a fellow by the name of Chiba, to say it politely, flip-flopped three times from his deposition to trial to his third day of trial testimony.

He basically over Memorial Day weekend last year, his testimony was split in between the Friday testimony—or the Thursday testimony because, I guess, we were dark on Friday, and the following Tuesday testimony, he totally changed his testimony.

An argument was made in closing argument about how he was woodshedded. We actually had a woodshed there and showed how he changed his testimony.

That's one thing. He did not testify in Bob's case. Only the deposition testimony went in, and the trial testimony from our case didn't come in.

Freitas: Right. Interesting story about that. So Mr. Chiba had testified by deposition and in trial.

His trial testimony was not admissible against HannStar because HannStar had not been present. The deposition testimony was admissible.

So what happened was the plaintiffs offered a combination of deposition and trial testimony.

We objected to the trial testimony and Toshiba objected to the trial testimony, saying it would create too much confusion and that it wasn't really different from the deposition testimony.

And what happened was because I think the Court was persuaded that there wasn't a big difference and because there would have been some confusion with the testimony from the same witness against one party and not the other, the trial testimony was held out completely.

Simon: That's a great segue into the other witness who didn't testify, which was one of their experts, a guy by the name of Barry Harris, who I cross-examined.

And we had a big fight in our case about interrogatory responses by Samsung that laid out in detail all the communications, and they were the amnesty applicant. So they laid out everything in gory detail, pages and pages, including conversations with Toshiba, dates, names, places and times.

Those were not allowed into evidence, and there was a big fight about whether we could even refer to them.

We didn't get a chance to even show them to the jury until Dr. Harris alluded to the fact it was one of the documents he relied on in giving his testimony, at which point I argued that the door had been opened.

The judge agreed with me. Even though they didn't go into evidence, I got to flash the Samsung interrogatory responses *ad nauseam* because he basically said that Toshiba hadn't done anything significant that could be deemed to be anticompetitive, and here we had the amnesty applicant basically laying it out in their responses. And he did not show up at your trial as well.

That and the coconspirator exception and the admissibility of documents is another area that was fascinating. It is different in every case.

Early in our trial—it went from the spectrum of getting those Samsung interrogatory responses up on the screen, showing them to the jury, even though they are not in evidence, to starting from the first coconspirator document we wanted to get in against Toshiba not being admitted into evidence, which we had a minor heart attack in our room next door to the court when that happened.

Aaron Sheanin sitting out there got the first coconspirator document in, basically the first document, not everything is coming in, but the second document, she let it in, and everything came in after that, including the Samsung documents.

We lived that roller coaster during the trial.

Freitas: We did not fight on the coconspirator exception. We did not want to spend our efforts there. Toshiba didn't, in our trial, make a fight on that issue.

Couple more things on the overview of our case. We had to figure out what we would do to attack the damage case.

The way the experts put it on, the large panel side, which was 92 percent of the damages, the plaintiffs' experts claimed an overcharge percentage of 18.9 percent. Our expert, Dennis, Carlton, put it at 0.4 percent. So that's a big gap.

And when you have a conspiracy that lasted as long as this one did, or at least allegedly did, and a big group of people involved, meetings, minutes, on and on and on, it is pretty difficult to expect that the 0.4 percent would sell.

But in the context of this case, we were able to sell it. And believe it or not, one of the key parts of our challenge was to attack the variables used in the plaintiffs' expert regression analysis.

So here you can see a slide we used in closing argument addressing three of the variables, which were total industry production figures.

Bernheim Variables:

- Total Industrial Production: Japan
- Total Industrial Production: Korea
- Total Industrial Production: G7 Countries



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What we tried to show is total industry production takes in cigarettes, oil, fish, and women's shoes and all these things, and it doesn't have anything to do with LCD panels. Maybe that would have some impact and maybe not.

But what worked a lot better for us, and by the way, here are the variables that Carlton used, and you can see they are a lot closer to what was really in issue.

LCD Panel Supply / Demand Factors

- » Unit cost of production
- » Unit cost of production from previous period
- » Shipping cost
- » Shipping cost from previous period
- » Number of mobile phones sold worldwide
- » Control for differences due to application/size/resolution/ manufacturer
- » Panel price from previous period
- » Panel price from two periods prior

But the other thing that really made a big difference was in his four variable model, one of the things that Professor Bernheim relied on was the microprocessor producer price index.

And we argued that this had nothing to do with the price of LCD panels.

But, also, there was a very interesting story behind his use of the MP-PPI. That probably played a very big role. Initially he had used this as a cost variable exclusively.

And the basis for his testimony that it was an appropriate cost variable was technical work that had been done by another expert.

Well, that expert had been discredited, and right from the start we went on the offensive about how there wasn't any basis for that and, in fact, that expert was not called by the plaintiffs at trial.

One of the last things I said in closing argument was, "Where's Dr. Fonteccio?" They didn't call him. They didn't bring him.

We, on the other hand, did present our technical expert, who refuted what the plaintiffs' technical expert had said. So there was a mismatch.

That obviously lent a lot of credibility to what we did, and the great job my partner, Jason Angell, did presenting our expert really made a big difference in how the jury might see that.

Simon: It is fascinating to me that the 0.4 came off as credible. Because there's a series of crystal meeting notes, as you know, that went into evidence where the crystal meeting participants acknowledged, as Peter put in so well it his criminal case, that the

price went up five dollars, ten dollars for a total of sixty-five dollars over a certain period, which is far in excess of 0.4 percent.

I would have thought that evidence was proffered to counter that, especially since you were at the meetings—or your client was at the meetings, not you, Bob.

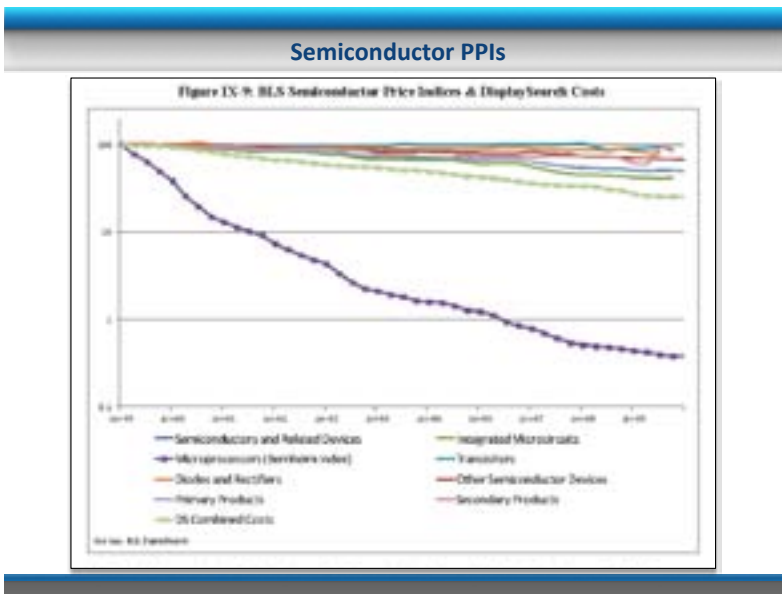
Freitas: We actually used that in a sense as a strength. Because one of the things that the plaintiffs obviously did, is they got Carlton to acknowledge that his overcharge percentage was not statistically different from zero. They tried to portray it as almost nothing.

But one of the ways that he responded was to say, “Wait a minute, this is an average figure. I am not saying there was never any impact. As a matter of fact, my work is consistent with the idea that there were very substantial overcharges for certain products at certain times.”

So he fought back very well on that.

Freitas: Let me say one more thing about this. We attacked the variable—with the shoes and the fish and all that, and with the evidence about that from the technical experts.

But there was one other thing that played a big role in making it possible for us to attack the use of this variable, and this is a slide that Dennis Carlton’s team put together.



As you can imagine, the variable that was used by the plaintiffs’ expert is the outlier, the one that drops way down, the one that could be used to create a very low but-for price, but coupled with the fact that the technical case just didn’t justify singling the

microprocessor index out over the others, that gave us a chance to really fight back, so that the battle was not 0.4 versus 18.9.

We were able to change the terms of the debate and really get inside the black box. So this was very key.

Simon: So let me take a shot at answering the question why we beat Toshiba and why they got off in your case.

You hear about trying it to the empty chair and that whole dynamic. Well, Toshiba was the only one in the courtroom. They were the only ones that the jury saw every day.

Their counsel was front and center in the courtroom and pointing to an empty chair, saying “There’s a bunch of bad guys out there,” even though some of the those bad guy witnesses got on the stand and testified, which gave them at least some presence in the courtroom, I think is one factor in the way the case was tried.

So I think our strategic decision to take out our last remaining defendant and our prayers that we wouldn’t have to try the case together with the indirects, where there might be LG involved, who was at the crystal meetings, was a good strategic decision.

And I think the other thing is that Best Buy decided they were going to go for the gusto and ask for direct and indirect damages, and none of that came in during our case.

Our jury testing, when we watched the deliberations on a closed-screen TV of the deliberations on the indirect versus direct, it confused everybody. They were really confused.

They weren’t sure who they would give the money to. They weren’t sure how they calculated. They weren’t sure what passthrough meant.

Some people were saying, “Yeah, pay all the money to the people who really suffered the harm.”

They didn’t get the fact there was a whole middle of people who were charged that weren’t in the indirects’ case because the indirects’ case was only end users.

They didn’t understand there was a huge gap there that some people would be getting money. It was a morass.

***Moderator:** Let me give Bob the last word on his observations on Toshiba.*

Why do you think they lost to Bruce?

Simon: It’s okay to say I did a good job.

***Moderator:** Maybe Bruce was the variable that was missing in your trial.*

Freitas: Apart from Bruce, probably a couple of things.

First is, it must be the case that the Toshiba lawyers learned from their first experience. They got a chance to try the case, see what works, see what didn't, and I am sure they did a better job with the benefit of that.

But I think Bruce is right, that having us there helped them, and I think it helped them in various ways.

Some you can say real specifically, such as we did a lot of the work on damages that freed them up.

In closing argument, Chris Curran didn't say one word about damages. He was able to go wire to wire on his liability case. Throughout the trial there was an impact like that as well.

Also, I think that having us there probably helped them because it did make it more real that there was a conspiracy and companies were involved and, okay, there's one of them.

Although our client didn't look like a particularly bad actor. It is a smaller company. Its involvement wasn't at the level of a Samsung or some of the others, but still I think it did make it tangible.

And one other thing, in Bruce's trial, when the crystal meetings and all the minutes and all the destroy after reading and all that is taking place, it is going to look one way.

And it is hard in the context of trying liability, damages, dealing with everything throughout the course of the trial, for the Toshiba lawyers to get into the fight about all that.

But in our case, the first three witnesses were cooperating witnesses who had attended the crystal meetings. We took the lead in cross-examining them.

We had a big incentive, and the fact that we were there and able to devote a lot of energy to attacking what those witnesses said, and really we felt turning them more into witnesses for the defense than for the plaintiffs made a difference.

So it was all upside for us in cross-examining them. The fact that we were there with an incentive, going after the details of what went on in the price-fixing meetings, I think that made a big difference overall in the case.

Not sure exactly how much that benefited Toshiba on the liability side, but we were able to downplay the price-fixing in a way that, as a practical matter, "it" was much more difficult for Toshiba to attempt when it was on its own.

JUDGES SPEAK OUT: THE MAKE-OR-BREAK MOMENT OF CERTIFYING A CLASS

*With Judges Marsha Berzon, Virginia Phillips, John Wiley, and Curtis Karnow
Moderated by Penelope Prevolos;¹ Edited by Penelope A. Prevolos and Dominique-Chantale Alepin*

Grant or denial of class certification is often the make-or-break moment for both sides in antitrust, unfair competition and other complex cases. In the past three years, the Supreme Court has issued a series of important class certification decisions, including *Wal-Mart v. Dukes*,² *Amgen v. Connecticut Retirement Plans & Trust Funds*,³ and *Comcast v. Behrend*.⁴ Comcast reversed the decision to certify a class in an antitrust case challenging the defendant's allegedly anticompetitive practices in building its cable network. The *Comcast* decision sparked a sharp dispute between the majority, which held that the plaintiff must prove both classwide impact and the ability to prove damages on a classwide basis at the class certification stage, and the dissent, which argued that individual issues respecting damages do not preclude class certification. This trio of Supreme Court decisions has generated wide-spread commentary—and controversy—regarding the legal standards that plaintiffs and defendants must satisfy, and how the case law will play out in the real world in federal and state courts.

Thus, on October 24, 2013, **Judges Marsha Berzon**,⁵ **Virginia Phillips**,⁶ **John Wiley**⁷ and **Curtis Karnow**⁸ spoke at the 23rd Annual Golden State Antitrust and Unfair Competition Law Institute on the topic of class certification. They discussed their “real world” experience adjudicating class actions after *Walmart*, *Amgen* and *Comcast*, and suggested best practices for plaintiffs and defendants in moving for and opposing class certification.

What follows is an edited version of their remarks.

I. Panel Discussion

Moderator: *In light of Comcast, are we now going to see a requirement in every case that damages can be proven on a class-wide basis?*

Judge Phillips: I think that the answer is yes. If you look at the cases that have come down since *Comcast* was issued, you can see that emphasis on proving damages on a class-wide basis even in areas other than antitrust, primarily in the employment context. There is an increasing focus on the ability of the plaintiff at the certification stage to tether the damages

1 Ms. Prevolos is a partner at Morrison & Foerster LLP in San Francisco, California and a former Chair of the Section.

2 131 S. Ct. 2541 (2011)

3 133 S. Ct. 1184 (2013)

4 133 S. Ct. 1426 (2013)

5 Judge, Ninth Circuit Court of Appeals.

6 Judge, United States District Court, Central District California.

7 Judge of the Superior Court of the State of California.

8 Judge of the Superior Court of the State of California.

analysis to a liability analysis. I expect the issue to be raised by the defense in the context of employment, products liability and other cases during class certification proceedings.

Moderator: *What are best and worst practices for plaintiffs and defendants in approaching the element of predominance after Comcast?*

Judge Karnow: State courts follow class action precedent set by the federal courts but only as a matter of practicality, since there are many more federal than state court class action decisions. But in *Jolly v. Eli Lilly & Co.*,⁹ the California Supreme Court made it clear that California state courts are not required to follow federal law on class certification. So while federal cases are interesting, state judges look at them and state court litigants continue to cite them, if they conflict with other state law, the state court can treat them as advisory. So what Justice Scalia did in *Comcast* isn't necessarily something state court judges will go along with.

In addition, some federal courts have tried to walk away from some of the holdings of *Comcast*. Judge Posner, the Ninth Circuit and the Sixth Circuit have all issued decisions in which they attempt to distinguish *Comcast*. These courts have also discussed more generally how to interpret *Comcast* and have tried to limit its impact. There really are two ways that *Comcast* has been read. The first is the tethering issue—that the damages analysis must have a close relationship with the liability theory. I think it is obvious that this is required. And Judge Posner and some other people have interpreted *Comcast* as not going much beyond this holding. The second interpretation, that the plaintiff must be able to prove damages on a classwide basis, would be a novel interpretation of California law. That requirement would be inconsistent with *Sav-On Drugs v. Superior Court*.¹⁰ In *Sav-On Drugs*, although the opinion did not employ the notion of a “liability class” (state courts generally do not use that term), the court held that individual damages issues did not preclude certification.

In general, state courts tend to be more practical. They focus on whether it makes sense in the long run to certify some issues, even if not all the issues (including damages) are ascertainable on a class-wide basis. The question for state court trial judge is: What will trial look like? In some cases, individual damage issues may not complicate the trial. Thus, individual damages issues may not defeat certification. In fact, in some cases, there are advantages to certifying a class on particular issues including liability, statute of limitations, preemption, etc. There are several items that are more useful to decide on a class-wide basis. In some cases, a trial court judge may certify a class but separate the damages issues to be dealt with by a different process, such as giving it to a referee or sending it back to the agency.

Class certification really comes down to practicality and manageability. I think the most important do's and don'ts that I can suggest in this context are: in class certification motions, plaintiffs especially tend to ignore the damages issues. Many do not want to talk about damages issues at class certification. I think the impact of *Comcast* is that they are going to have to. What's the impact? What's the trial going to look like? How are you going to approach the damages issues in this case? And depending on the outcome of that discussion, damages issues may or may not inhibit certification in the end.

9 44 Cal.3d 1103 (1988)

10 538 P.2d 739 (1975)

Judge Phillips: One of the practical issues that has arisen in federal court is the tension between conducting sufficient discovery on class certification issues and bringing the class certification motion “as early as practical” as the rule requires. For example, in the Central District, the local rule requires that the motion for certification must be brought within ninety days after the filing of the lawsuit. But there is a need, especially after *Comcast*, to develop the evidence sufficiently through discovery to present expert evidence to satisfy a *Daubert* analysis. Performing sufficient discovery in ninety days on these issues would be impractical. Now, several judges in the Central District have their own rule abrogating the local rule and providing relief from the requirement of filing a class certification motion in ninety days. My general practice is to set the deadline for filing the class certification motion at the time of the Rule 16 scheduling conference. At that time, I have a chance to listen to the parties about the discovery needed before filing a well-briefed motion for class certification. I believe that this will be a significant problem confronting both sides. In order to address the emphasis on predominance that’s set out in *Comcast*, significantly more discovery is going to be needed. Thus, class certification motions may be pushed out far past what the local rules currently require.

Moderator: Has the ability to have a trial as to liability on the class level followed by individual damages trials changed following Comcast? Or do courts just need to determine if that procedure would be efficient and consider predominance issues?

Judge Phillips: Actually, I think *Comcast* suggests, and some circuit courts have also held, that liability classes are the right approach. I think, practically, we are going to see more decisions that certify the class as to liability only.

Moderator: What more general advice would you give plaintiffs in thinking about moving for class certifications and defendants in opposing class certification?

Judge Wiley: My advice would be to take advantage of the sophistication of your opposing counsel. For example, in the complex litigation division in Los Angeles, we have only six to eight judges. But we get all the class actions in Los Angeles County now. These cases cover a wide range of types of class actions, and the exposure can be enormous. This means we have many cases to handle. Everyone in this room will be litigating against someone else in this room, and you are all sophisticated lawyers. Exploit that. It helps when the parties have met and conferred and agreed on the key issues that divide them. So work with your opposing counsel and discuss the issues that are really central to the case. Try to agree on the settlement value of the case, and if you can, great. But if you can’t, try to agree on what divides you, on the key issues in the case. By discussing the issues at the heart of the matter, you can avoid needless discovery. In my experience, neither plaintiffs nor defendants are really wild about discovery. It’s expensive and not that fulfilling. In some instances, you may need discovery because a fact issue is central to the case. But that does not happen in the majority of cases.

I encourage the parties to come together and think up creative ways to presenting your issue to the court. Perhaps it’s the case that the procedures contemplated by the Federal Rule or Code of Civil Procedure do not fit with your strategy for resolving the action. The parties should work on measures to crystalize the issues and get them resolved. Be highly rational and highly interactive, and develop a procedure that will help reduce the uncertainty so that both sides look at the judgment, if the case goes the distance, as having the same distribution of probable outcomes. Once everybody agrees on what the case is worth, it should settle in a rational world.

There is a cost-benefits analysis for both sides. For example, either party may start off with a motion for judgment on a question of law, or a motion on proper damage calculations or preemption. And then after both sides agree on what the filing date is, request a case management conference. During that conference, the parties should discuss openly with the judge the discovery needed to fully brief the motion, filing deadlines, and a schedule for oral argument.

Judge Karnow: I have two pieces of advice on this. First, plaintiffs should fess up to whatever the individual issues are. Sometimes plaintiffs feel that the class certification motion is not going to succeed unless all the issues are common. That's just not true. It is an issue of predominance. So coming clean about that and putting together a trial plan on the individual issues assists your case greatly.

Second, consider having a staggered class certification procedure that deals with discovery and motion practice to reduce discovery costs. The parties can file motion papers first and then decide what discovery to take. Then discovery is a function of just what the papers raise rather than massive discovery for fear of what may be coming from the other side. This approach can really reduce the cost of the certification. It does extend the time period to do this, but it is something to think about. Anything you can come up with out of the box that seems to make sense, we will do to reduce costs.

Judge Phillips: I would echo what has already been said. Also, with some frequency, I see motions where it's clear that plaintiff's counsel aren't qualified. That may be surprising, but I see a fair number. It's not just because they have never litigated a class action before. Sometimes the basics are overlooked, including the fact that the motion to certify encompasses class members that were not identified in the complaint. There is a total mismatch between the class alleged in the complaint and the class the motion seeks to certify. In these cases, I encourage counsel to meet and confer and discuss the issues to streamline things a bit further.

Moderator: *How does the Ninth Circuit review class certification orders? What should litigants be thinking about in the district court regarding a possible appeal on class certification issues?*

Judge Berzon: Rule 23(f) permits an interlocutory appeal with regard to class certification by either side, but it is entirely permissive on the part of the court of appeals. Although there is verbiage in a number of decisions that granting an interlocutory appeal is relatively rare, my impression is that we grant them with some frequency.

The Ninth Circuit articulated some standards for granting an interlocutory appeal on a Rule 23(f) motion in 2005 in *Chamberlan v. Ford Motor Company*.¹¹ Those standards are: (1) whether the class certification question is a death knell for either side; (2) whether there is an unsettled and fundamental issue of class certification law; and (3) whether the district court's decision is manifestly unjust. One item to highlight, there are a number of defendants who claim that not granting the Rule 23(f) appeal will cost them a great deal of wasted money and prejudice them in the litigation. But the Ninth Circuit in *Chamberlain* was very skeptical about the proposition that the Ford Motor Company would encounter any huge hardship if their appeal was not heard. So litigants should point to more than

simply the money and time they will lose if they expect the Ninth Circuit to grant their interlocutory appeal.

Practically speaking, the way the Ninth Circuit judges decide which Rule 23(f) interlocutory appeals to grant is that the judges have monthly motions panels during which we review a wide variety of pending motions. We sit for around three days with several hundred motions. Staff attorneys present each motion to us one by one, and we decide whether to grant or deny all motions. When staff attorneys present a Rule 23(f) motion, I take the motion home with me, as it is usually too much to absorb on the spot. At the time the motion is presented to us by the staff attorney, we know nothing about the underlying case except what the parties have briefed and what the staff attorney presents. That is why I view it as important to review the papers separately.

In terms of practical advice for litigants who may consider a 23(f) appeal, first, litigants should make very clear in their 23(f) papers why the applicable standards are met. And while litigating the issue in district court, try to tee up, in particular: (1) whatever evidence there may be that the class certification decision is going to determine the outcome of the case; and (2) a clear and ascertainable separate legal question beyond the usual morass of Rule 23(a) and (b) factors.

***Moderator:** What should counsel for each side focus on when presenting or challenging expert evidence on class certification issues? And how do *Daubert v. Merrell Dow Pharmaceuticals*¹² and *Sargon Enterprises, Inc. v. University of Southern California*¹³ factor into your advice?*

Judge Karnow: I addressed *Sargon* recently in an article published in the ABTL Journal entitled, “*Sargon* and the Science of Reliable Experts,” (Spring 2013). In that article, I tried to think through what the California Supreme Court was trying to do in *Sargon*. My sense is that although we do not quite know what the Court was trying to tell us in *Sargon*, two things are going to happen as a result of *Sargon*.

There are a lot of people on the defense side who have written articles stating that *Sargon* signified a sea change creating a different paradigm. These authors have claimed that, following *Sargon*, all state court judges should act like federal court judges in terms of weighing the admissibility of evidence. But I do not believe that to be the case. The notion that there is a huge division between state and federal judges on what comes in and what stays out is a cartoon version of what actually happens. The implication of *Daubert* and *Sargon* is that state court judges are hopefully going to be spending more time trying to figure out whether or not there really is a basis for the expert’s testimony.

From my perspective, the more difficult issue is not whether to admit this expert evidence at trial, but how to determine whether to admit it during class certification. It is not possible during class certification proceedings to have an eight day Rule 402 hearing as occurred in *Sargon*. Practically speaking, the issue of class certification will be discussed for one to two hours, sometimes much less (15–20 minutes) if you are in law and motion and don’t have a complex judge assigned. So how should we handle these issues during motion practice?

My suggestion is that judges should look to the expert declaration to verify that two

12 509 U.S. 579 (1993)

13 55 Cal. 4th 747 (2012)

things are true: first, that the underlying theories are actually scientific; and second, that the logic that the expert has used to go from the underlying theory to his or her conclusions is clear. Both of those criteria must be satisfied by the declaration. And declarations must carry their own water. The judge should be able to figure out the facts that are being assumed, and how logic and logic alone takes him or her from the assumptions and the scientific theory to the conclusions that the expert reached.

Judge Wiley: I have two follow ups on this topic. First, what is a *Sargon* test exactly? Second, how do both sides take advantage of it?

First, practically speaking, *Sargon* puts expert evidence to the “stink” test. If the experts’ theory really stinks, his or her testimony will not be considered. In *Sargon*, the expert concluded that although the company was a start-up and had not made very much money, if given a chance, it would have made several times its worth (millions upon millions). That was the theory, and the expert cited to a bunch of so-called “methodology” to support that theory.

But the trial judge, aided by, on the defense side, the former dean of the Stanford Law School who was briefing the case, said, “This is simple, and it’s stupid. It stinks, really stinks.” The judge listened to testimony and argument over eight days and concluded that the expert’s conclusions really did not hold water and wrote a lengthy decision on the topic.

Now, superior court judges don’t do that all that often. They do not have time to toss off 30–40 pages on a motion. And it’s pretty simple at the end of the day. If you are opposing an expert, you have to figure out how to explain to the trial judge, “This really stinks. It is just another hired gun coming in to do whatever the client wants, trying to mislead the jury with a bunch of scientific mumbo-jumbo.” *Sargon* is pretty simple. It takes a lot of homework because you need to understand the expert’s testimony perfectly in order to boil it down and say “See, if you put it simply, it’s just dumb.” That can be powerful. Perhaps it is the key issue in the case. Or maybe it is a causation case, and that’s where the parties really disagree. Maybe what the parties really disagree on is which experts are going to get to testify.

Moderator: *Plaintiffs often argue that the California Supreme Court has held that at the class certification stage, the judge should not examine the merits. What is your guidance to state court litigants and how does that differ from class certification proceedings in federal court, where the United States Supreme Court has told judges to do a deep dive into the facts?*

Judge Wiley: When parties come to me in the complex division, I tell them that the complex division affords them the opportunity to develop a process to fit their case. Although the default is to file a class certification motion, that may be the least inventive thing you can do with your case. Although filing a class certification motion may be the right way to go, if there is another issue that is really dividing you, I encourage litigants not to worry about class certification and instead to proceed to the issue where there is the most disagreement. My goal is to make a ruling on that issue and then have the parties appeal it if they want to.

Judge Karnow: With respect to the specific question about getting into the merits on motions for class certification, I am not sure there’s a huge difference between state and federal practice. Judges will try to avoid it but sometimes they cannot. Sometimes the judge must figure out what the merits are before he or she can truly examine whether the class

should be certified. So if you have to look at the merits, you have to do it. In a recent case, I looked at the merits during a decision on a motion for class certification. And in that case, the plaintiff was dissatisfied with my decision and appealed my ruling to the First District. But the First District agreed with my approach. So the bottom line is that whether you are in state or federal court, sometimes you have to address the merits.

Moderator: *Many of us thought that the issue in Comcast was whether the court was required to make Daubert findings. In federal court, what is the role of Daubert at the class certification stage? How should expert testimony be examined? And how should litigants address issues that arise with expert testimony? Are there circumstances where the court should hold an evidentiary hearing?*

Judge Phillips: I frequently see, at a minimum, expert declarations. And on at least one occasion, I held an evidentiary hearing based on expert declarations for both sides. So I would echo what has already been said about making sure that the expert declarations are as detailed as necessary to explain the expert's findings to someone who is not as familiar as counsel with the case and the underlying facts. Litigants should be sure to submit a declaration from an expert and not a declaration from counsel explaining what an expert would testify to if one had been hired. I, and several other judges, have held that type of declaration to be insufficient.

One of the questions that confronts defense counsel is whether to attack on *Daubert* grounds the sufficiency of the evidence of plaintiff's expert declaration, or to submit their own expert declaration in evidence. My advice depends on how strongly you feel about the weakness of what's been submitted by the plaintiff. But generally, I would both attack the sufficiency of plaintiff's expert declaration and submit one from the defense.

I would like to address two more points about *Comcast*. One of the things that struck me in *Comcast* and some of the circuit court discussions on this issue is that there is an assumption that the trial court erred. Some people postulate that because in *Comcast* there was an overlap of the merits discussion and the class certification discussion on predominance, the trial court assumed that it couldn't reach the merits to the extent that it had to in making a ruling on predominance for class certification purposes. I am not sure that the trial court actually made those assumptions. There may have been other reasons why the trial court did not reach the merits. Perhaps those issues had not been presented to the trial court.

Second, I recognize there is a tension between usurping the jury's function on some of these issues and the gatekeeping function of *Daubert* in deciding what evidence is necessary just at the certification stage. But as the Third Circuit pointed out, a showing that common issues predominate is necessary for class certification. While we do not necessarily have to answer whether there is sufficient evidence to prove the particular element of the case for purposes of class certification, the trial court must conclude that common issues predominate.

Judge Berzon: From an appellate perspective, under Rule 23(f), the circuit court can only review issues pertaining to class certification. So we are jurisdictionally bound on an interlocutory appeal to reach the merits only to the extent necessary to decide the class certification question. As Judge Phillips just said, the question with regard to expert evidence or any other evidence is really just whether there is a common question (in the Rule 23(a) context) and whether common issues predominate (in the 23(b) context).

The other major Supreme Court case that was decided last year in the context of class actions was *Amgen v. Connecticut Retirement Plans and Trust Funds*.¹⁴ The Supreme Court's decision was very forceful in holding that trial courts may not directly reach the merits of the case at the class certification stage. Indeed, *Amgen* held that there are circumstances where the ultimate result may be that the plaintiff class loses uniformly, but if the plaintiff will lose uniformly, that is not a reason to deny class certification.

One of the things I have seen is a tendency, even by the plaintiffs, to want more than just a decision on class certification. The plaintiffs do not want to go back to the district court if they are going to lose on the merits. They are looking to the Ninth Circuit to determine whether they are going to lose on the merits. We steadfastly refuse on an interlocutory appeal to do that; the only question we can answer is whether class certification was properly denied. We cannot provide an advisory opinion on whether they are going to lose on the merits.

Moderator: *Let's turn to the subject of class settlements. What do the litigants do right and what do they do wrong at the preliminary settlement approval stage of a class action?*

Judge Karnow: I am one of those judges who has not yet approved a class action settlement the first time around. At the time of final approval, all objections must be heard. So the first stage—when a settlement is presented for preliminary approval—must involve heavy lifting in order to ensure that the settlement will be ready in the final stages. At the preliminary approval stage, I see many problems that need fixing. First, the motion for certification of the settlement class and preliminary approval of the settlement lack transparency. The attorneys have not done a good job explaining what the deal involves, or they are hiding something, advertently or inadvertently. Such hidden items include attorneys' fees and the payout to individual class members. Sometimes, it is impossible to tell how much money will be provided to the class overall. In some instances, when everything is worked out, the defendant gets all the money back and the plaintiffs' attorneys are paid \$20 million. Transparency can be a big problem.

The attorneys must also be transparent to allow the judge to examine the result to determine if it is fair. I call this the “*Kullar*” problem which is named after a case in the First District, *Kullar v. Foot Locker Retail, Inc.*¹⁵ The Court of Appeals held in *Kullar* that the trial judge must make an independent evaluation of the merits of the case and its strengths and weaknesses to figure out whether the result is fair. Judges may not take the attorneys' word that the result is fair and that this is a good deal for the parties. Judges must examine how much work the attorneys did and what evidence both parties have. The judge must have enough information to be able to walk through the same thing the attorneys walk through to be able to figure out if this is a good deal or not.

Judges fulfill an important role when it comes to approving a settlement because by the time of settlement review, there is no adversarial input. And settlement of a class action is a really big deal. Judges must do extra work at this point but must be assisted with information from the attorneys. So that is why transparency is so important.

14 133 S.Ct. 1184 (2013)

15 168 Cal.App.4th 116 (2008)

The second problem that may need fixing is that attorneys think and write in legalese. Many of the materials that are to be presented to the class members are not written in a manner that can be understood by the class. So with these notices, I try to look at them from the perspective of someone in the class. It should be written at a tenth-grade education level and should be understood by those who are not lawyers. Try to give your proposed notice to someone who is fairly smart but not a lawyer and ask them whether they can understand it. Can they figure out how much money they are likely to get? Can they scope this out?

As an example, I recently reviewed a couple of notices out of the Southern District of New York received by my father that were thousands of pages long. At that length, it would take me weeks to go through them to figure out what was involved and why my father was being included as a member of the class. So take your law hat off and give the notice to somebody who is not in the business and see if they can figure out what you wrote.

Judge Phillips: I will start with what people do right. First is an example from a recent case which settled for \$300,000. Now that's quite small, but the attorneys did a great job. The fees were capped at \$75,000, but the plaintiffs' attorneys also submitted their bills so I could review what work they had performed. The parties submitted papers persuading me that most of the class members would qualify. And the defendant agreed to pay above and beyond the \$300,000 (up to \$12,000 in costs). The number of class members turned out to be quite a bit smaller, so they were going to get a pretty fair amount.

What I usually do when I encounter a proposed preliminary settlement that is inadequate in one way or another is deny the motion without prejudice. And sometimes, I will issue a lengthy order pointing to what has and has not been satisfied. I note that there are specified factors that I am supposed to have enough information on so that I can make a reasonable determination. The parties must submit declarations based on personal knowledge to tell me about the strengths and weaknesses of the plaintiff's case; the risks, expense, and likely duration of future litigation; the amount that's offered in settlement; how it's really going to break down to in terms of individual claims as best as can be determined; the extent of the discovery; the parties' stake in the proceedings; the experience and the views of counsel; the reaction of class members to the extent known at that stage; and what claims are being made in the litigation.

Sometimes, the issue I encounter is that the proposed settlement release language releases many claims that are not covered in the litigation. And in many cases, the notice is unduly confusing and the time lines are slanted against giving members enough time to object. There are other big warning signs that can indicate collusion on behalf of the plaintiff and defendant. Perhaps there is no declaration from defense counsel. Or maybe the parties have included a clear sailing provision where the amount that each class member will get is disproportionate to the attorney's fees. Or maybe there is a reversion of funds to the defendants. And one final thing I have to remind parties of is that if it is a nationwide class, they must notify the Attorney General and the Attorneys General of all the states.

Resolution is sometimes difficult as settlement represents the end of the case. Counsel want to be done with the case and it can be tempting for the judge to also quickly approve the settlement because it has been on their docket for quite some time. But I try to address all the factors and ensure that the settlement is fair. Counsel and judges have a fiduciary duty to look out for the silent class members.

Judge Berzon: From the federal appellate perspective, the court of appeals will only review a settlement if there is an objector appealing the approval of the settlement. Something of a professional class of objector lawyers has developed who have their own motives in objecting to settlements. And my observation of what the court of appeals is looking at in these cases is whether the settlement passes the smell test. The smell test often revolves around the fees and around a sense of whether the district court did a careful job of considering the fee amount, whether the fees drive the settlement, and whether what is being provided to the class is a result of the weakness of the case or perhaps something more nefarious.

TRIAL BY SAMPLE:

A POST-GAME, LOCKER ROOM CHAT EXPLORING THE MCADAMS V. MONIER TRIAL: A ROUNDTABLE

With Trial Counsel Jeffrey Cereghino and William Stern

Moderated by Kimberly Kralowec; Edited by Asim Bhansali

The case of *McAdams v. Monier* went to trial in 2012 as one of the few class action cases under either the Unfair Competition Law or Consumers Legal Remedies Act to reach trial in the past few years. Following an eight-week trial, the jury found for plaintiffs, but returned a damages verdict of \$7.4 million rather than the \$250 million that the plaintiff sought. The trial court subsequently entered judgment for the defendant despite the verdict, finding the methodology used by plaintiff's expert to be speculative.

This judgment came after a decade of litigation. Following an original filing in 2003, the case reached the Court of Appeal on certification issues. The Court of Appeal reversed the trial court's decision not to certify the class, but the defendant appealed to the California Supreme Court. Following its decision in *Tobacco II*, the California Supreme Court remanded this case to the Court of Appeal to review in view of that decision. The Court of Appeal again decided that class certification was appropriate, and a trial followed.

What follows is a roundtable discussion among trial counsel for plaintiff, **Jeffrey Cereghino** of **Ram, Olson, Cereghino & Kopczynski**, and trial counsel for the defendant, **William Stern**, of **Morrison & Foerster**. This written roundtable forum has been edited by **Asim Bhansali** of **Keker & Van Nest LLP**. The original roundtable was presented at the 2013 Golden State Institute and moderated by **Kimberly Kralowec** of **The Kralowec Law Group**.

Below are more specifics about our illustrious panelists:

- **Jeffrey B. Cereghino** is a Partner at Ram, Olson, Cereghino & Kopczynski, LLP, located in San Francisco, California. His practice area primarily focuses upon complex litigation and class actions. He represents consumers in class action matters as well as property owners in complex construction and product liability actions. He has been or is a class counsel on numerous cases.
- **William Stern** is a partner in Morrison & Foerster's Litigation Department, resident in the firm's San Francisco office. He specializes in the defense of consumer class actions in a number of industries. Mr. Stern is the author of *BUSINESS & PROFESSIONS CODE SECTION 17200 PRACTICE* (West Pub/TRG Press 2013) and the principal author of the 2004 voter initiative Proposition 64, which amended California's unfair competition law (Cal. Bus. & Prof. Code § 17200 *et seq.*). William Stern is recommended as a leading lawyer by *Legal 500 US 2013*, *Best Lawyers In America 2012* and *Super Lawyers 2012*.
- **Kimberly A. Kralowec** is the principal of The Kralowec Law Group in San Francisco, California. Ms. Kralowec handles class action litigation in the areas of antitrust, wage and hour, and consumer fraud. She served as lead appellate counsel for the class in *Brinker Restaurant Corp. v. Superior Court*, 53 Cal.4th 1004 (2012), and received a 2013 CLAY Award in recognition of her work.

Since 2003, Ms. Kralowec has been the author of *The UCL Practitioner* (<http://www.uclpractitioner.com>), a weblog on the UCL, the CLRA, and class action practice in California and the Ninth Circuit.

Moderator: *Can you describe, at a high level, the key considerations in deciding whether or not to try a plaintiffs' class action under the UCL or CLRA, or both?*

Cereghino: I can actually answer that in the context of *McAdams*. From the plaintiff's perspective, every case begins with a liability assessment. In *McAdams*, we knew the product was defective; we had clear evidence the defendant knew the product's failure mechanism; and we had irrefutable evidence the defendant concealed material facts from everyone. Under those circumstances, we considered trial our only option, because we did not believe the class or the Court would accept any of the settlement offers. So the key consideration in trying the case was it was our only option.

That said, trial was where we wanted to be, even though we knew the defense team was very capable and committed. After nine years of litigation, two appeals, two summary judgment motions, a decertification motion, countless other motions and assorted skirmishes, we were finally in a courtroom. Two unanimous favorable appellate decisions helped frame our case, and gave us a solid roadmap to structure the trial. The trick was getting to court to follow that map.

In terms of whether to proceed at trial under the UCL or CLRA, choosing one or the other was really never on the table in *McAdams*. Both statutes offer unique remedies to the class, and electing one over the other would have deprived the class. Plus the evidence presentation was substantially identical between our UCL and CLRA case, so there was no efficiency benefit in choosing one or the other.

Moderator: *What are the circumstances under which you would advise a defendant to take a class to trial in California court, assuming a class is certified, in some form?*

Stern: A defendant does not get to decide. A defendant either settles or goes to trial.

In this case, we could not settle. We faced a determined and veteran group of trial lawyers. They were confident, they had made a sizable commitment and personal investment, and they were not afraid to "roll the dice." But their settlement demand was aggressive, and was pretty much our "worst case scenario" after trial. That made the decision to go to trial easy.

The overwhelming majority of defendants settle once a class is certified, many of them at a premium above their true value. Economists and risk managers will tell you that all litigation entails risks. But what sets class actions apart from other litigation is the asymmetric nature of the risk. Any litigant can lose, but losing for a class action defendant is far worse than for the plaintiff. Why? The whole purpose of class actions is to aggregate claims. That means that a mistake gets amplified. For example, Mr. *McAdams*' individual claim of \$4,000 was amplified by 125,000 similarly situated claimants—to a half billion dollars.

So, once a class is certified, "the defendant will be under great pressure to settle even if the merits of the case are slight." *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1298-99 (7th Cir.1995). This is especially true if the company is publicly traded. It also explains why there are very few jury trials in class action cases and few lawyers, even among experienced

counsel, who have tried a class action to verdict.

Moderator: *Can you describe the McAdams case from a plaintiff's perspective, including the "proviso" about exposure that the Court of Appeal required?*

Cereghino: *McAdams* began with a homeowner who noticed his red roof tiles were eroding to bare concrete. He had purchased the product directly from the defendant, and had relied upon their advertising that included language such as "permanent color," lifetime roof and the like. He contacted the defendant and inquired about what was happening to the roof tiles. He was essentially told that he could pay for a roof re-coat. He ultimately made contact with a large group of homeowners with similar problems, who received the same response.

The case was filed in 2003. Discovery revealed the defendant, Monier, knew the tiles would erode, and never told anyone, not even internally, except for two senior executives. So there was a common issue, a common omission to the entire class. The trial court was not persuaded and denied class certification.

We appealed and, the Court of Appeal reversed the trial court by unanimous decision. The class was certified. Among the issues argued by Monier was the absence of a common representation and reliance. The Court of Appeal—the Third District—recognized that building products are typically marketed indirectly, through roofers, contractors and builders. That marketing paradigm helped fashion their opinion.

Monier appealed to state Supreme Court, which swept this case into the Tobacco II net, such that it was remanded after the decision in *Tobacco II*. After vigorous oral argument on remand from the Supreme Court, the Court of Appeal again unanimously ordered the class certified.

However, this time, the Court added the "proviso." The proviso set out class membership criteria. Class members had to be exposed to a statement "along the lines of, permanent color, life-time, or maintenance-free." *McAdams v. Monier, Inc.*, 182 Cal. App. 4th 174 (2010). From our perspective, the Court again recognized the indirect way building products are marketed and thus articulated a broad definition of the class.

Interpreting the "proviso" was the primary issue that framed this case, and how we collectively approached the trial.

Moderator: *Was losing class certification a win in disguise for the defendant?*

Stern: It did not seem that way when the decision came out. We moved twice to decertify. Prior to trial we moved to decertify and lost. So, at that time, we certainly didn't think it was a blessing in disguise. We had filed a simultaneous motion for summary judgment but we felt that decertification was the more likely result, if we were going to notch a win short of trial. However, we faced a Court of Appeal decision that had reversed the earlier denial of class certification, and ordered the class certified on remand. It would have taken a brave (or defiant) judge to order the class decertified in light of that published appellate ruling.

After plaintiff rested, we moved again to decertify. And yes, in hindsight, I suppose that

is a blessing in disguise. It now means that the Third District could affirm on the separate ground that, quite apart from the merits ruling, and in light of the evidence presented by plaintiff, the case should have been decertified and can be affirmed on that basis.

***Moderator:** Can you provide additional background key issues from the defensive perspective?*

Stern: The key to unlocking the case for the defendant, and probably for both sides, was the “proviso.” It was perhaps the only “silver lining” in what was otherwise a defiantly pro-plaintiff class certification decision by the appellate court. The problem is, what did the Court of Appeal mean? The parties and the judge wrestled with that enigma every day, through every witness and every argument.

On the one hand, if it meant (as defendant contended) that every class member had to prove he or she was “exposed” to an actionable representation and was damaged “as a result,” that is incompatible with a class action. Indeed, plaintiff argued exactly that. Plaintiff argued that this cannot have been what the Court of Appeal meant: why would the appellate court reverse and order a class to be certified on remand, only to erect a standard that is impossible to satisfy?

We felt this was a false dilemma. The “proviso” wasn’t inherently impossible to prove. In fact, the appellate court gave examples of *how* it could be proven, e.g., a uniform brochure or advertisement that every homeowner would have seen. The problem for plaintiff was that there was no such evidence. Therein lay the problem. Plaintiff had to find another way to prove “exposure” and classwide reliance and injury.

***Moderator:** Can you briefly explain what happened in the trial phase, from the plaintiff’s perspective, including the evidence used to prove exposure as required by the class certification proviso?*

Cereghino: We initially proposed a bifurcated trial plan, which the trial court declined to adopt. The case was in Placer County. The assigned judge elected to bring in a retired judge from Southern California, because of the limited civil trial capacity in Placer County and the defense trial estimate of six months. The trial lasted about seven weeks. The defense’s original four month estimate for their case in chief ultimately became four days.

Plaintiff’s witnesses consisted of the class representative, the sample group of sixteen, several other class members, four former defendant employees, and five experts. The primary evidence to prove exposure came from the sample group. Each witness was randomly selected. Their home was inspected to ensure they had the product. Then their deposition was taken. The statistician was only used to validate the mathematics. It was up to the jury to decide, for each sample witness, whether that witness met the proviso. Once that determination was made, then it was statistics 101 to determine the number of class members represented statistically by that witness.

***Moderator:** Can you describe how class certification, including the proviso, was presented to the jury?*

Cereghino: There is truly a finite number of ways to determine class membership. The defense contended that each potential class member needed to testify at trial. Given the potential class size of over 120,000 (and trial counsel’s life expectancy), we didn’t see ourselves trying this case for the next twenty years. The trial court agreed. So that leaves either a bifurcated trial, with a liability phase and a damages phase or process, or using statistical methodologies. Because the trial court rejected bifurcation, we were left with

using statistical methodologies.

The first step in any statistical sampling is determining the potential class size. In this case, no senior Monier executive knew how much product was sold during the class period, and records were very limited. The next problem was identifying the product on potential class members' roofs. Monier sold two different products during the class period, and another manufacturer had a similar tile profile. So any random survey, without actually confirming the product was on a participant's home was fraught with error. We ultimately randomly sampled 22 potential class members, inspecting their homes to ensure they had the product, and then deposing them so the defense had full access to cross-examination, unlike blind survey methodologies. Then the 16 who we believed were class members testified, and the jury made the final call.

Moderator: *What was the key to the defendant being able to undo the jury verdict?*

Stern: The plaintiff's entire case, stem to stern, was built on statistics. At trial, we wound up fighting a "phantom" adversary, a fictional plaintiff who was a compilation of the elements of many—exposure (liability) drawn from one homeowner, reliance from another, damages from a third—but who resembled no actual, flesh-and-blood homeowner. Plaintiff hired a formidable expert, a retired professor of statistics at CalTech. But this expert admitted his assignment was merely to "size" the class, i.e., he was retained to investigate "exposure of homeowners to statements about Monier tile roofs of a certain kind."

Class membership is one thing; proof of liability is something else altogether. There was no evidence of a classwide statement for purposes of establishing liability—that was not even on the expert's radar. Nor could he mass-produce through statistics a classwide case of reliance, materiality, or absence of the statute of limitations.

Ultimately, the trial court in its post-verdict ruling accepted the arguments we made at the *Kelly*/Evidence Code § 402 hearing: (i) The process used to recruit sampled homeowners was slanted, and raised concerns about bias; (ii) there was an extremely small sample, which meant that errors were distorted; and (iii) "The particular methodology Plaintiff designed for this case is inconsistent with long-established principles regarding the use of surveys and statistics and is without any legal authority."

Moderator: *Was this just a case of an inappropriate methodology, or is the proof of the kind required by the Court of Appeal's proviso inherently impossible?*

Stern: As I said, the "proviso" was not inherently impossible to prove. The Court of Appeal suggested that it could be proven, for example, by a uniform brochure or advertisement that every homeowner would have seen. But when discovery showed that this didn't happen, plaintiff had to find another method. He had to invent evidence. And to do that, he turned to statistical extrapolations. It was bad evidence—really just hocus pocus.

Moderator: *Did Sargon Enterprises, Inc. v. University of Southern California, 55 Cal.4th 747 (2012) have an effect on how this case ultimately turned out?*

Stern: The result would have been the same without *Sargon*. *Sargon* was handed down while we were still in trial. But while the court cited *Sargon* in its post-trial ruling, *Sargon* broke no new ground as far as our issues were concerned. It merely confirmed that the court has a "gatekeeper" function when it comes to scientific evidence.

Cereghino: I agree with Will, that it really did not impact this case.

Moderator: *Regardless of whether you agree with the trial court's decision, is there anything plaintiffs might have done with the survey that would have improved its chances on review?*

Cereghino: As I indicated above, we really had no viable choice but to proceed with statistical sampling, in view of the decision not to bifurcate liability and damages. One can always argue that more putative class members should have been sampled, but frankly doubling the size would not have foreclosed defense arguments, and merely moved the confidence intervals slightly higher.

Moderator: *Do you think the proviso could have been avoided altogether by presenting class certification arguments in a different way?*

Cereghino: Our case was essentially an omission case, with a single material omission made to the entire class. Regardless of that predominating common question, we faced the typical difficulties in trying any product class case: class membership and liability, class damages, and defenses such as statute of limitations or product misuse to name a few.

That said, this case began as a clear omissions case as I indicated. Thus, given the ruling in *Tobacco II*, I don't think any certification argument could have avoided the proviso. The appellate court made the proviso very broad, which in our view was a clear recognition of trying to apply the CRLA and UCL as legislatively intended, in a scenario where class members had the product but exposure was naturally limited to mostly third party statements (even where those third-party statements repeated the defendant's marketing statements).

Moderator: *How would this case have proceeded differently in federal court?*

Stern: In all likelihood, it probably would never have gone to trial. Plaintiff's statistical evidence in this case went far beyond what any federal court had ever allowed, even before *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011). Here, plaintiff was planning to prove everything—class size, class membership, liability, reliance, causation, materiality, damages, and absence of a limitations bar—through statistical sampling. Most federal courts would have denied class certification, or entered summary judgment long before trial, or would have weeded this out in the pretrial conference or a *Daubert* hearing.

Moderator: *Do you have any predictions for appeal?*

Stern: The losing party following a lengthy jury trial always has an uphill battle arguing for reversal. So, plaintiff has his work cut out, especially given that the Court of Appeal could affirm on the ground that the trial court should have decertified the class. A wild card could be how the California Supreme Court decides *Duran v. U.S. Bank N.A.*, Case No. S200923, a case that tests the extent to which statistical sampling may be used to prove liability in a wage-and-hour class action. The California Supreme Court is slated to decide *Duran* by June 2014.

Cereghino: I think the *Duran* decision will have a significant impact. I also believe the Court of Appeal will give the jury verdict substantial weight, and it will recognize a liability verdict is not dependent on whether a statistician testifies.

Moderator: *Moving away from McAdams for the last question, what are the top two UCL, CLRA and class action cases or issues to watch for 2014?*

Stern: That is easy. The first is arbitration, and the extent to which the California Supreme Court will follow the United State Supreme Court's decision in *Concepcion* and start enforcing consumer arbitration agreements. The case that will test this is *Sanchez v. Valencia Holding Co.*, No. S199119 (review granted, March 12, 2012). In the employment area, the comparable case is *Iskanian v. CLS Transportation of Los Angeles, LLC*, No. S204032 (review granted, Sept. 19, 2012).

The second, of course, is *Duran*, which we discussed above, the state-court counterpart to *Wal-Mart v. Dukes*. *Duran* will test the extent to which statistical evidence can be used to prove liability in a class action case in California state court.

Cereghino: I agree with Will that *Duran* is a key case to watch. My second case to watch would be this one.

THE SUPREME COURT IN *BOROUGH OF DURYEY V. GUARNIERI* SIGNALS A RETREAT FROM *PRE*'S BROAD DEFERENCE TO THE RIGHT TO PETITION

By Chris O'Connell¹

I. INTRODUCTION

This spring marks the twenty-first anniversary of the U.S. Supreme Court's decision in *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc.* ("*PRE*"),² a seminal case determining when one can sue one's competitor without antitrust scrutiny. The *PRE* Court, faced with an allegation that an anticompetitive lawsuit violated the Sherman Act,³ posited that a lawsuit is a petition to the judicial branch of government, protected by the First Amendment's Petition Clause.⁴ Because of this constitutional protection, the *PRE* Court held that only in narrow circumstances could a lawsuit against one's competitors be exposed to antitrust scrutiny.

Two decades later, the Court in its most recent right to petition case, *Borough of Duryea v. Guarnieri*,⁵ cast doubt on this critical First Amendment rationale. In *Borough of Duryea*, the Court limited the right of public employees to sue their employers in light of the substantial competing public interests that had to be balanced against those fostered by the Petition Clause.⁶ Furthermore, *PRE*'s own author, Justice Thomas, declared in an opinion concurring in the judgment: "I seriously doubt that lawsuits are 'petitions' within the original meaning of the Petition Clause of the First Amendment."⁷ While this does not necessarily portend the death knell for *PRE*'s First Amendment immunity for competitor litigation, it does demonstrate the evolving views of the justices on the scope of the Petition Clause, which invites a reappraisal of *PRE*'s basic holdings and approach. This article concludes that *Borough of Duryea* represents a rejection of an absolute deference to the right to petition and that its more nuanced approach to that right necessitates a recalibration of *PRE*'s broad First Amendment immunity for firms that sue competitors.

1 Chris O'Connell is a former newspaper journalist who became a lawyer in 2011 and entered private practice in San Francisco. He wishes to thank Cheryl Lee Johnson for her encouragement and feedback regarding this article. This article appeared originally in the Fall 2013 issue of *Icarus*, the journal of the Media and Technology Committee of the ABA's Antitrust Section.

2 508 U.S. 49 (1993).

3 Section 1 of the Sherman Act provides in part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . ." 15 U.S.C. § 1. Section 2 of the Act provides in part: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . ." 15 U.S.C. § 2.

4 "Congress shall make no law . . . abridging . . . the right of the people . . . to petition the Government for a redress of grievances." U.S. CONST. amend. I.

5 131 S. Ct. 2488, 2501 (2011).

6 *Id.* at 2497-2500.

7 *Id.* at 2501 (Thomas, J., concurring in the judgment).

II. THE PATH TO *PRE*

PRE was the latest in a line of cases in which the Supreme Court considered the protection of the Petition Clause for business conduct that otherwise might violate the antitrust laws.⁸ The cases covered petitioning to all branches of the government (legislative,⁹ executive,¹⁰ and judicial¹¹), at all levels of government (federal,¹² state,¹³ and local¹⁴). The principle that emerged from this line of cases was that a competitor—even a monopolist—could engage in anticompetitive activities with the intent to eliminate competition, without violating the Sherman Act as long as those activities constituted petitioning of the government under the First Amendment. This defense to antitrust liability came to be known as “*Noerr* immunity,” or “*Noerr-Pennington* immunity,” after the first cases to articulate the doctrine.¹⁵

The doctrine was originally developed in cases addressing petitioning to the legislative and executive branches of government. The Supreme Court reasoned that because the government has the authority to restrain or eliminate competition,¹⁶ the people must be free to urge the legislative and executive branches to enact restraints of trade.¹⁷ This principle applied even when those petitioning the government, with anticompetitive intent, sought anticompetitive legislation or action.¹⁸ A related rationale derived from the government’s separation of powers. The Court cautioned against judicial branch intrusion

8 At the outset, it should be noted that the Supreme Court has not stated definitively whether this doctrine is grounded wholly in the Petition Clause or partly in a limiting construction of the Sherman Act. See, e.g., Fed. Trade Comm’n, *Enforcement Perspectives on the Noerr-Pennington Doctrine 6* (2006), available at <http://www.ftc.gov/reports/P013518enfperspectNoerr-Penningtondoctrine.pdf> (“Although the Court has not provided a consistent source for the doctrine, it appears to be rooted in a construction of the Sherman Act to avoid conflict with the constitutional right to petition the government for redress of grievances and the principle of effective government decision-making.”). This article presumes that the better view is that the Petition Clause is essential to the Court’s doctrine of immunity; without it, there would be no justification for shielding firms from the antitrust laws.

9 *E. R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 135–38 (1961) (*Noerr*).

10 *Id.*; see also *United Mine Workers v. Pennington*, 381 U.S. 657, 669–70 (1965) (*Pennington*); *Cal. Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508, 510 (1972).

11 *Cal. Motor Transp.*, 404 U.S. at 510.

12 *Id.*; *Pennington*, 381 U.S. at 669–70.

13 *Noerr*, 365 U.S. at 135–138; *Cal. Motor Transp.*, 404 U.S. at 510–11.

14 *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492 (1988); *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365 (1991).

15 *Noerr*, 365 U.S. at 135–38; *Pennington*, 381 U.S. at 669–70.

16 *Noerr*, 365 U.S. at 136 (citing *United States v. Rock Royal Coop.*, 307 U.S. 533 (1939), and *Parker v. Brown*, 317 U.S. 341 (1943)).

17 *Id.*

18 *Id.* at 139 (“[T]he right of the people to inform their representatives in government of their desires with respect to the passage or enforcement of laws cannot be properly made to depend upon their intent in doing so.”); *Pennington*, 381 U.S. at 670 (“*Noerr* shields from the Sherman Act a concerted effort to influence public officials regardless of intent or purpose.”).

into the decision-making processes of the legislative and executive branches.¹⁹ The Court ultimately declared that lawsuits, too, were First Amendment petitions to the government—the judicial branch itself—and were similarly entitled to immunity from antitrust scrutiny.²⁰

Noerr immunity was not absolute, however. The Court developed a corresponding exception, known as the “sham” exception, which recognized that some ostensible petitioning fell outside of First Amendment protection.²¹ In *Noerr*, the Court’s initial conception of “a mere sham” focused on conduct that could be deemed separate from attempts to influence legislative or executive officials—that is, conduct that was “nothing more than an attempt to interfere directly with the business relationships of a competitor.”²² In later cases, the Court perceived the potential for sham within the petitioning process itself. A classic formulation of this kind of sham recognized the “use [of] the governmental process—as opposed to the *outcome* of that process—as an anticompetitive weapon.”²³ The first case in which a complaint adequately pleaded a sham involved this kind of bad-faith petitioning: The antitrust defendants allegedly filed multiple administrative or judicial proceedings against competitors, “with or without probable cause and regardless of the merits of the cases.”²⁴ In short, the sham exception to *Noerr* immunity recognizes that a

19 *Noerr*, 365 U.S. at 136 (“[U]nder our form of government the question whether a law of that kind [resulting in trade restraints or monopoly] should pass, or if passed be enforced, is the responsibility of the appropriate legislative or executive branch of government so long as the law itself does not violate some provision of the Constitution.”).

20 *Cal. Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508, 510 (1972) (“Certainly the right to petition extends to all departments of the Government. The right of access to the courts is indeed but one aspect of the right of petition.”). The Court and commentators, however, recognized that petitioning of the courts is subject to more formalized rules than is petitioning of legislative and executive officials. *Id.* at 512–13; *see also* 1 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 203e (3d ed. 2006) (“As compared with the legislative process, improper behavior in the adjudicatory or judicial context is more readily identified as improper and more widely regarded as reprehensible. . . . Indeed, there are well developed and highly elaborated definitions of what is or is not proper behavior by litigating parties.”).

21 *Noerr*, 365 U.S. at 144. There also is a “misrepresentation” exception to *Noerr* immunity, applicable when a party, instead of being indifferent to the outcome of a governmental process, actually seeks and obtains governmental action, but does so through the use of misrepresentations to an adjudicatory body. *See, e.g., In re Union Oil Co.*, 138 F.T.C. 1, 25 (2004) (“Although Supreme Court law remains unsettled, the weight of lower court authority, spanning more than thirty years, has recognized that misrepresentations may preclude application of *Noerr-Pennington* in less political arenas than the legislative lobbying at issue in *Noerr* itself.”). *See also* AREEDA & HOVENKAMP, *supra* note 20, at ¶ 203f (“[T]he policy is more important than the underlying labels, and in most cases it makes little difference whether we say that the provision of false information is unprotected by *Noerr* to begin with or that it falls into the ‘sham’ exception to *Noerr*.”) (citations omitted).

22 *Noerr*, 365 U.S. at 144. The challenged conduct in *Noerr* was a publicity campaign intended to influence the passage of anticompetitive legislation.

23 *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 380 (1991) (emphasis in original). *See also* AREEDA & HOVENKAMP, *supra* note 20, at ¶ 204a (“The injury to the rival springs directly from the antitrust defendant’s action rather than from a government decision.”).

24 *Cal. Motor Transp.*, 404 U.S. at 512 (“[T]he allegations are not that the conspirators sought ‘to influence public officials,’ but that they sought to bar their competitors from meaningful access to adjudicatory tribunals and so to usurp that decisionmaking process.”).

fairly narrow interest in competition might trump the right to petition where governmental proceedings are clearly being abused in order to suppress competition.²⁵

In *PRE*, the Supreme Court addressed the sham exception in the context of competitor-versus-competitor litigation. The central question was the relevance of a litigant's intent when its lawsuit against a competitor is challenged as a sham—that is, “whether litigation may be sham merely because a subjective expectation of success does not motivate the litigant.”²⁶ The Court decided that anticompetitive intent alone was insufficient to support a finding of sham litigation; even further, a litigant's intent was irrelevant unless its lawsuit was first shown to be “objectively baseless.”²⁷

In *PRE*, eight motion picture studios filed a copyright infringement lawsuit against a resort hotel operator (“PRE”) that rented movie videos to guests to watch in their rooms.²⁸ The studios contended that PRE's rentals infringed their copyrights on the movies.²⁹ PRE denied infringement and counterclaimed under the Sherman Act, alleging that the studios' lawsuit “was a mere sham that cloaked underlying acts of monopolization and conspiracy to restrain trade.”³⁰ At summary judgment, the movie studios lost their copyright action when the court ruled that movie rentals for in-room viewing did not constitute public performance of a copyrighted work in violation of the Copyright Act.³¹ The U.S. Court of Appeals for the Ninth Circuit affirmed.³²

On remand regarding PRE's antitrust counterclaims, the movie studios moved for summary judgment, invoking *Noerr* immunity for their copyright suit.³³ PRE argued that *Noerr* immunity was inapplicable because the studios “did not honestly believe that the infringement claim was meritorious” and their suit thus had been a sham.³⁴ This placed the studios' intent squarely at issue, and PRE sought further discovery on why the studios had sued.³⁵ The district court rejected PRE's argument, finding that the studios' lawsuit “was clearly a legitimate effort and therefore not a sham.”³⁶ The court saw both subjective

25 See ROBERT H. BORK, *THE ANTITRUST PARADOX* 159 (“Misuse of courts and governmental agencies is a particularly effective means of delaying or stifling competition. We are here speaking of legal processes undertaken without regard to the merit of the claim advanced, in order to harm an actual or potential business rival.”). See also Gary Myers, *Antitrust and First Amendment Implications of Professional Real Estate Investors*, 51 WASHINGTON & LEE L. REV. 1199, 1201 (1994) (“It is well established that litigation and other forms of petitioning activity can be part of a firm's anticompetitive strategy.”); Susan A. Creighton et al., *Cheap Exclusion*, 72 ANTITRUST L.J. 975, 992–93 (2005).

26 *PRE*, 508 U.S. 49, 57.

27 *Id.* at 51.

28 *Id.* at 51–52.

29 *Id.* at 52.

30 *Id.*

31 *Id.* at 53.

32 *Columbia Pictures Indus., Inc. v. Prof'l Real Estate Investors, Inc.*, 866 F.2d 278 (9th Cir. 1989).

33 *Columbia Pictures Indus., Inc. v. Prof'l Real Estate Investors, Inc.*, 944 F.2d 1525, 1527 (9th Cir. 1991).

34 *Id.* at 1530.

35 *Id.* at 1527.

36 *PRE*, 508 U.S. at 53.

good faith and objective merit in the studios' suit: "It was clear from the manner in which the case was presented that [Columbia was] seeking and expecting a favorable judgment," and "[T]he case was far from easy to resolve. . . . I find that there was probable cause for bringing the action"37 The court denied PRE's request for further discovery on the studios' intent.³⁸

The Court of Appeals affirmed, setting forth a two-part test for sham litigation that separated the objective and subjective elements.³⁹ The court required antitrust plaintiffs to show "(1) that the suit is baseless—a legal question [citation omitted]; and (2) that the suit was brought as part of an anticompetitive plan external to the underlying litigation—a question of fact."⁴⁰ The court agreed that PRE could not show that the movie studios' copyright suit was objectively baseless (the first prong), and so concluded that the district court was correct in denying further discovery on the studios' intent (the second prong).⁴¹ In an assertion the Supreme Court subsequently adopted, the court said: "[A] suit brought with probable cause does not fall within the sham exception to the *Noerr-Pennington* doctrine."⁴²

The Supreme Court affirmed.⁴³ In an opinion by Justice Thomas, the Court first reiterated that a lawsuit is subject to *Noerr* immunity for petitioning activity, citing *California Motor Transport*.⁴⁴ The Court then surveyed its precedents and found that a plaintiff's subjective intent had never been the sole criterion for determining whether litigation amounted to a sham.⁴⁵ To the contrary, the Court said, "the sham exception

37 *Columbia Pictures Indus.*, 944 F.2d at 1528.

38 *Id.*

39 *Id.* at 1532.

40 *Id.*

41 *Id.* at 1532-33.

42 *Id.* at 1532; see also *PRE*, 508 U.S. 49, 54. This represented a narrower reading of the sham exception than the Supreme Court's *California Motor Transport* decision, which held that proceedings brought "with or without probable cause" could be deemed shams. *Cal. Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508, 512 (1972); see also *AREEDA & HOVENKAMP*, *supra* note 20, at ¶ 205c ("In *California Motor* itself, the Supreme Court held that a sham claim was stated by allegations of repetitive suits brought 'with or without probable cause,[]' and this was true even though the trial court had found that 21 out of 40 proceedings initiated by the antitrust defendants had 'resulted in action favorable to the defendants.[]'") (citations omitted)). The Ninth Circuit subsequently distinguished *PRE* from *California Motor Transport* by noting that *PRE* involved one lawsuit, whereas *California Motor Transport* involved multiple proceedings. *USS-POSCO Indus. v. Contra Costa County Bldg. & Constr. Trades Council*, 31 F.3d 800, 810 (9th Cir. 1994).

43 *PRE*, 508 U.S. 49.

44 *Id.* at 57-58.

45 *Id.* at 57-60.

contains an indispensable objective component.”⁴⁶ The Court then set forth its own two-part test for determining when a lawsuit would be deemed a sham and thus exposed to antitrust scrutiny:

First, the lawsuit must be objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits. . . . Only if challenged litigation is objectively meritless may a court examine the litigant’s subjective motivation. Under this second part of our definition of sham, the court should focus on whether the baseless lawsuit conceals ‘an attempt to interfere *directly* with the business relationships of a competitor’ (emphasis added), through the ‘use [of] the governmental *process*—as opposed to the *outcome* of that process—as an anticompetitive weapon’ (emphasis in original).⁴⁷

The Court, drawing on the tort of wrongful civil proceedings, defined objectively baseless as lacking in probable cause to sue,⁴⁸ and emphasized that even if a plaintiff loses a lawsuit (as the movie studios did), the plaintiff should be found to have had probable cause if its belief in the chance of success was objectively reasonable.⁴⁹

To support this test for sham litigation, the Supreme Court relied on “fidelity to precedent.”⁵⁰ The Court omitted discussion of the Petition Clause itself (perhaps because previous *Noerr* opinions had done the same).⁵¹ The Court also omitted any extended consideration of the public interest that could be harmed by this kind of petitioning—*i.e.*, litigation’s potential to harm economic competition and consumer welfare. In other words, *PRE* did not engage in the balancing of the public interests served by the Petition Clause with those served by the antitrust laws, such as it did in *Borough of Duryea v. Guarnieri*, the recent case interpreting the right to petition. The Court’s broad interpretation of the

46 *Id.* at 58. This assertion seemed to have merit, but the Court undermined its credibility with a related statement: “Our original formulation of antitrust petitioning immunity required that unprotected activity lack objective reasonableness.” *Id.* at 57 (citing *Noerr*, 365 U.S. at 138, 143). In fact, *Noerr* said nothing about a sham lacking objective reasonableness; *Noerr* instead described a sham as activity “ostensibly directed toward influencing governmental action” that was “a mere sham to cover what is actually nothing more than an attempt to interfere directly with the business relationships of a competitor” 365 U.S. at 144. *Noerr*’s concern thus was with defendants engaging in non-petitioning activities and trying to invoke the protection of petitioning activities; the concern was not about the objective reasonableness of real petitioning efforts.

47 *Id.* at 60-61 (citations omitted). The Court observed that a plaintiff meeting this two-part test still would have to prove an antitrust violation. *Id.* at 61.

48 *Id.* at 62-63.

49 *Id.* at 60 n.5.

50 *Id.* at 60.

51 *PRE* mentioned the right to petition once in general terms (“Those who petition government for redress are generally immune from antitrust liability”), *id.* at 56, and once in reviewing the *Noerr* decision and its legislative and executive context (“Nor did we ‘impute to Congress an intent to invade’ the First Amendment right to petition.”), *id.* at 56 (citing *Noerr*, 365 U.S. 127, 138). *PRE* thus protected a firm’s First Amendment right to litigate without quoting the relevant clause of the First Amendment or otherwise discussing its history or purpose. By contrast, the majority opinion in *Borough of Duryea v. Guarnieri* signaled its intent to explore the public interests that animate the Petition Clause from its opening statement: “Among other rights essential to freedom, the First Amendment protects ‘the right of the people . . . to petition the government for a redress of grievances.’ U.S. Const., Amdt. 1.” 131 S. Ct. 2488, 2491 (2011).

constitutional right to litigate in *PRE* is difficult to reconcile with the Court's narrower interpretation in *Borough of Duryea*.⁵²

PRE came under criticism as overprotective of antitrust defendants, starting with Justice Stevens' opinion concurring in the judgment.⁵³ While he agreed that the movie studios' lawsuit was not a sham,⁵⁴ Justice Stevens found the Court's new rule unnecessarily broad: "I would not . . . use this easy case as a vehicle for announcing a rule that may govern the decision of difficult cases, some of which may involve abuse of the judicial process."⁵⁵ Justice Stevens preferred to leave federal courts freer to perform their traditional role under the Sherman Act of distinguishing between legitimate and illegitimate conduct, with a litigant's intent having more relevance.⁵⁶

The label "sham" is appropriately applied to a case, or series of cases, in which the plaintiff is indifferent to the outcome of the litigation itself, but has nevertheless sought to impose collateral harm on the defendant by, for example, impairing his credit, abusing the discovery process, or interfering with his access to governmental agencies. It might also apply to a plaintiff who had some reason to expect success on the merits but, because of its tremendous cost, would not bother to achieve that result without the benefit of collateral injuries imposed on its competitor by the legal process alone.⁵⁷

Some commentators agreed that a firm's intent to inflict "collateral harm" on a competitor through litigation should have greater relevance when the competitor alleges the litigation is a sham:

In many cases one can preserve the objective nature of the query without going

52 *PRE*'s protection of lawsuits as part of the right to petition is even harder to reconcile with Justice Thomas' view in *Borough of Duryea*: "I seriously doubt that lawsuits are petitions within the original meaning of the Petition Clause." 131 S. Ct. 2488, 2501 (Thomas, J., concurring in the judgment).

53 *PRE* at 67-76 (Stevens, J., joined by O'Connor, J., concurring in the judgment). See also, e.g., Gary Myers, *Antitrust and First Amendment Implications of Professional Real Estate Investors*, 51 WASHINGTON & LEE L. REV. 1199, 1226 ("This definition of unreasonableness is overly narrow because it unnecessarily permits the use of litigation as an anticompetitive tool."); *Litigation as a Predatory Strategy: Hearing Before the Subcomm. on Intellectual Property, Competition, and the Internet of the H. Comm. on the Judiciary*, 112th Cong. 21 (2012) (statement of Marina Lao, Professor of Law, Seton Hall University School of Law) ("In the absence of a meaningful doctrinal limit to the expansive *Noerr* immunity principle, there are greater risks that dominant firms could bring actions against smaller competitors that they would not have rationally brought, in order to impose heavy costs on a small rival in the hope of excluding it from the market, diminishing its ability to compete on the merits, or deterring entry by other firms.").

54 *Id.* at 69 ("Access to the courts is far too precious a right for us to infer wrongdoing from nothing more than using the judicial process to seek a competitive advantage in a doubtful case.").

55 *Id.* at 76. Justice Stevens also questioned one of the Court's rationales for its rule: conflicting appellate decisions on sham litigation: "To an unnecessary degree . . . the Court has set up a straw man to justify its elaboration of a two-part test describing all potential shams." *Id.* at 69.

56 On this point, Justice Stevens quoted at length from Judge Posner's opinion in *Grip-Pak v. Ill. Tool Works, Inc.*, 694 F.2d 466, 476 (7th Cir. 1982), including this passage: "[W]e are not prepared to rule that the difficulty of distinguishing lawful from unlawful purpose in litigation between competitors is so acute that such litigation can never be considered an actionable restraint of trade, provided it has some, though perhaps only threadbare, basis in law. . . . The difficulty of determining the true purpose is great, but no more so than in many other areas of antitrust law."

57 *PRE* at 68-69 (Stevens, concurring in the judgment).

as far as the Court did and requiring an objectively baseless suit. The objective query would then be presumably whether, objectively considered, the value of the antitrust defendant's lawsuit was the anticipated judicial decision or the anticipated consequences upon rivals without regard to the merits of the case.⁵⁸

III. REVISITING THE RIGHT TO PETITION

In *Borough of Duryea v. Guarnieri*, the Supreme Court interpreted the First Amendment right to petition in another context: a public employee's lawsuit against his employer.⁵⁹ In this case, the Court left an employee unprotected by the Petition Clause against retaliation by an employer in light of the history and purpose of the right to petition and the "substantial government interests"⁶⁰ that would be harmed by "[u]nrestrained" petitioning⁶¹ by public employees. This approach differed from the Court's approach in *PRE*, where a firm's right to sue competitors was protected with scant analysis of the competing public interests served by the Petition Clause and our antitrust laws.

Perhaps the most striking aspect of *Borough of Duryea* was the view expressed by Justices Scalia and Thomas that litigation may not even be entitled to First Amendment protections. In a dissenting and concurring opinion, Justice Scalia declared: "The Court has never actually *held* that a lawsuit is a constitutionally protected 'Petition,' nor does today's opinion hold that. . . . I find the proposition that a lawsuit is a constitutionally protected 'Petition' quite doubtful."⁶² In a separate opinion concurring in the judgment, Justice Thomas agreed. "For the reasons set forth by JUSTICE SCALIA, I seriously doubt that lawsuits are 'petitions' within the original meaning of the Petition Clause of the First Amendment. . . . Unreasoned statements to the contrary in this Court's prior decisions do not convince me otherwise."⁶³ This view appears to contradict the rationale for the *PRE* opinion of two decades ago, which Justice Thomas authored and Justice Scalia joined.

The majority opinion in *Borough of Duryea* was less willing to exclude lawsuits from the right to petition (which would have overruled both *California Motor Transport* and *PRE*). However, the majority's analysis contained important observations about the scope of the right to petition.

58 AREEDA & HOVENKAMP, *supra* note 20, at ¶ 205b. The reality is that one's view of the *PRE* test depends on the danger that one is most concerned about: the possible suppression of parties' rights to seek a judicial vindication of their rights, or the potential of a commercial plaintiff to suppress competition with a predatory lawsuit. Regardless of one's view, the point is that a constitutional doctrine should be grounded in adequate constitutional analysis that gives due regard to all statutory rights after balancing their respective weight and the public's interests. In that regard, this article considers *Borough of Duryea* to be far better reasoned than *PRE*.

59 *Borough of Duryea v. Guarnieri*, 131 S. Ct. 2488, 2501 (2011).

60 *Id.* at 2495.

61 *Id.* at 2496.

62 *Id.* at 2503 (emphasis in original).

63 *Id.* at 2501.

A. The Case

In *Borough of Duryea*, the Supreme Court applied the “public concern” test for public employee speech rights⁶⁴ to a public employee’s right to sue his employer. In doing so, the Court necessarily explored and explained the purpose of the First Amendment’s Petition Clause. While the Court confined the application of its conclusions to the public employment context, these conclusions nevertheless have significant implications for the proper application of the Petition Clause in other areas of law, including antitrust.

In *Borough of Duryea*, after a town council fired its police chief (Guarnieri),⁶⁵ the chief responded by filing a union grievance. The grievance went to arbitration, and the arbitrator ordered Chief Guarnieri reinstated. The town council then passed several measures instructing Guarnieri in the performance of his duties (including directives that the borough’s police car was for official business only and that the borough’s municipal building was smoke-free). Guarnieri responded by filing another union grievance, which resulted in some of the directives being revised or withdrawn. Guarnieri then sued the borough, the council, and individual council members in federal court under 42 U.S.C. § 1983.⁶⁶ In his lawsuit, Guarnieri contended that his initial union grievance over his termination had been a petition protected by the First Amendment, and that the council had retaliated against him by issuing the directives instructing him in his duties. Guarnieri later amended his lawsuit to add another allegation of retaliation by the council, this time for his filing of the lawsuit itself. He alleged that the council had denied a request that he made for overtime compensation because of his lawsuit, which also was a protected petition.

At trial, the district judge instructed the jury that Guarnieri’s union grievance and lawsuit were protected activities under the Constitution, and that the defendants could be found liable if there was a sufficient connection between those protected activities and the alleged retaliation against him. The jury found for Guarnieri and awarded him compensatory damages, punitive damages, and attorneys’ fees totaling more than \$142,000. The U.S. Court of Appeals for the Third Circuit affirmed on the question of liability,⁶⁷ quoting from an earlier circuit case: “[A] public employee who has petitioned the government through a formal mechanism such as the filing of a lawsuit or grievance is protected under the Petition Clause from retaliation for that activity, even if the petition concerns a matter of solely private concern.”⁶⁸ The court rejected the defendants’ argument that Guarnieri’s petitions were not protected by the First Amendment because they did

64 *Pickering v. Bd. of Ed. of Twp. High Sch. Dist. 205, Will County, Ill.*, 391 U.S. 563, 568 (1968); *Connick v. Myers*, 461 U.S. 138, 142 (1983).

65 The factual and procedural history in this and the following paragraph is taken from *Borough of Duryea*, 131 S. Ct. at 2492-93. (The opinion does not discuss the reasons for Guarnieri’s termination, but notes that he was reinstated after a disciplinary suspension.)

66 The statute provides in part: “Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress”

67 The appeals court found the evidence insufficient to support an award of punitive damages.

68 *Borough of Duryea*, 131 S. Ct. at 2493 (quoting *Borough of Duryea v. Guarnieri*, 364 Fed. Appx. 749, 753 (3rd Cir. 2010)) (in turn quoting *Foraker v. Chaffinch*, 501 F.3d 231, 236 (3rd Cir. 2007)).

not address matters of public concern (the test applied in some other circuits to Petition Clause claims by public employees). The Third Circuit said that only if a public employee's petition were a "sham" would it be unprotected under the First Amendment.

The Supreme Court reversed, framing the issue as follows: "This case concerns the extent of the protection, if any, that the Petition Clause grants public employees in routine disputes with government employers."⁶⁹ Writing for a seven-member majority, Justice Kennedy looked to the Court's doctrine on public employee speech rights and applied it to public employee petitioning rights. The Court held that when a public employee sues his or her employer on a matter of private concern, the public entity may retaliate against the employee without violating his or her First Amendment right to petition.⁷⁰ If the public employee sues the employer "as a citizen" on a matter of public concern, retaliation by the employer will violate the employee's right to petition only when the employee's First Amendment interest outweighs the government's interest in effective and efficient management.⁷¹ The Court concluded: "The right of a public employee under the Petition Clause is a right to participate as a citizen, through petitioning activity, in the democratic process. It is not a right to transform everyday employment disputes into matters for constitutional litigation in the federal courts."⁷²

As with its limit on public employee speech rights, the Court justified its limit on public employee petitioning rights in part by emphasizing the potential for these petitions to harm a substantial public interest: "the efficient and effective operation of government."⁷³ Public employees, the Court said, could "use petitions to frustrate progress towards the ends they have been hired to achieve."⁷⁴ Public employees also could "use the courts to pursue personal vendettas or to harass members of the general public," and consequently undermine public confidence in the government entity.⁷⁵ Further, the Court cautioned, such petitions could lead to an improper role for the federal courts: "Unrestrained application of the Petition Clause in the context of government employment would subject a wide range of government operations to invasive judicial superintendence. . . . This would raise serious federalism and separation-of-powers concerns."⁷⁶

The Court also grounded its rule in "the historic and fundamental principles" underlying the Petition Clause.⁷⁷ Some petitions, the Court said, merit greater First

69 *Id.* at 2491.

70 *Id.* at 2500. The Court emphasized that government employees often have statutory and regulatory protections against "improper retaliation or discipline" and added: "The Petition Clause is not an instrument for public employees to circumvent these legislative enactments when pursuing claims based on ordinary workplace grievances." *Id.* at 2497.

71 *Id.* at 2501.

72 *Id.*

73 *Id.* at 2495.

74 *Id.*

75 *Id.* at 2496.

76 *Id.* This echoed the Court's concern in *Noerr*, in the antitrust context, about the judicial branch intruding in the domain of the legislative and executive branches. Of course, when a court evaluates whether the lawsuit before it is a sham, separation of powers is not a concern.

77 *Id.* at 2498.

Amendment concern than others. “In analogous cases under the Speech Clause, this Court has noted the ‘Constitution’s special concern with threats to the right of citizens to participate in political affairs,’ even though it is likely that, in this and any other age, most speech concerns purely private matters. . . . Petitions to the government assume an added dimension when they seek to advance political, social, or other ideas of interest to the community as a whole.”⁷⁸ The Court based this conclusion on the rich history of English and American petitioning, including Magna Carta, the Petition of Right of 1628, the Declaration of Right of 1689, and the Declaration of Independence, and its central preoccupation with freedom and governance.⁷⁹ “The right to petition is in some sense the source of other fundamental rights, for petitions have provided a vital means for citizens to request recognition of new rights and to assert existing rights against the sovereign.”⁸⁰

Given the historical importance of petitions on matters of public concern as opposed to private concerns, and given the inherent potential of public employee lawsuits to interfere with government operations, the Supreme Court in *Guarnieri* established limitations on a public employee’s right to sue his or her employer and thus exercise the right to petition. However, the Court reserved discussion of the First Amendment right to litigate outside of the public employment context. It suggested its ruling might be limited to similar scenarios, observing that in this case:

[r]estraints are justified by the consensual nature of the employment relationship and by the unique nature of the government’s interest. . . . Although retaliation by a government employer for a public employee’s exercise of the right of access to the courts may implicate the protections of the Petition Clause, this case provides no necessity to consider the correct application of the Petition Clause beyond that context.⁸¹

Similarly, the Court reserved discussion of whether petitions on matters of private concern might receive more protection in other areas of law. “The Petition Clause undoubtedly does have force and application in the context of a personal grievance addressed to the government. . . . Outside the public employment context, constitutional protection for petitions does not necessarily turn on whether those petitions relate to a matter of public concern.”⁸²

B. The New View of Two Justices

In an opinion concurring in part and dissenting in part,⁸³ Justice Scalia set forth a significantly different view of the protections of the Petition Clause. Historically, he argued, the people had petitioned the legislative and executive branches of government, not the judicial branch.⁸⁴ Thus, he challenged the majority’s premise that a lawsuit is a petition to

78 *Id.* (citation omitted).

79 *Id.* at 2499–2500.

80 *Id.* at 2500.

81 *Id.* at 2494..

82 *Id.* at 2498.

83 *Id.* at 2502–07.

84 *Id.* at 2503–04.

the judicial branch within the protection of the First Amendment.⁸⁵ Of particular interest to the antitrust field, Justice Scalia contended that *California Motor Transport* contained only “pure dictum” regarding First Amendment protection of lawsuits.⁸⁶ “The Court has never actually *held* that a lawsuit is a constitutionally protected ‘Petition,’ nor does today’s opinion hold that. . . . I find the proposition that a lawsuit is a constitutionally protected ‘Petition’ quite doubtful.”⁸⁷

While disagreeing with the majority’s broader application of the right to petition, Justice Scalia proffered a broader view of the kinds of petitions that merit First Amendment protection. He took issue with the majority’s distinction between petitions on matters of public concern and those on matters of private concern, pointing to the private nature of most historical petitioning.⁸⁸

We have decided innumerable cases establishing constitutional rights with respect to litigation, and until today not a one of them has so much as hinted that litigation of public concern enjoys more of those rights than litigation of private concern. . . . [T]here is no basis for believing that the Petition Clause gives special protection to public petitions.⁸⁹

In his own opinion concurring in the judgment,⁹⁰ Justice Thomas agreed with Justice Scalia regarding the constitutional status of lawsuits. His opinion opened with this statement: “For the reasons set forth by JUSTICE SCALIA, I seriously doubt that lawsuits are ‘petitions’ within the original meaning of the Petition Clause of the First Amendment. . . . Unreasoned statements to the contrary in this Court’s prior decisions do not convince me otherwise.”⁹¹ Justice Thomas did not, however, mention any unreasoned statements in his *PRE* opinion, which not only assumed the existence of constitutional protection for litigation but also strengthened it.

85 *Id.* at 2502–04.

86 *Id.* at 2503.

87 *Id.* (emphasis in original). Justice Scalia also asserted: “The fact that the Court never affirmed a First Amendment right to litigate until its unsupported dictum in 1972—after having heard almost 200 years’ worth of lawsuits, untold numbers of which might have been affected by a First Amendment right to litigate—should give rise to a strong suspicion that no such right exists.” *Id.* at 2504. However, Justice Scalia conceded that the question of Petition Clause protection of lawsuits was not before the Court: “[T]he parties have not litigated the issue, and so I agree we should leave its resolution to another day.” *Id.*

88 *Id.* at 2504–05.

89 *Id.* at 2505–06. On the question before the Court, Justice Scalia said: “[W]e should hold that the Petition Clause protects public employees against retaliation for filing petitions unless those petitions are addressed to the government in its capacity as the petitioners’ employer, rather than its capacity as their sovereign.” *Id.* at 2056. This would have withheld First Amendment protection from Guarnieri’s union grievance, but would have extended First Amendment protection to his federal lawsuit.

90 *Id.* at 2501–02. On the question before the Court, Justice Thomas also endorsed Justice Scalia’s framework on public employee petitioning rights, but favored adding a further restriction: “Even where a public employee petitions the government in its capacity as sovereign, I would balance the employee’s right to petition the sovereign against the government’s interest as an employer in the effective and efficient management of its internal affairs.” *Id.* at 2502.

91 *Id.* at 2501.

IV. SHAM LITIGATION AFTER *BOROUGH OF DURYEA*

Borough of Duryea analyzed the right to petition in a way the Supreme Court has yet to do in the antitrust context. Several points are worth consideration.

A. The Right to Petition

In the *Noerr* line of cases, the Supreme Court offered little analysis of the history or purpose of the Petition Clause in reaching its results. By contrast, in *Borough of Duryea*, the Court analyzed the interests and principles informing the right to petition at length. In doing so, it concluded that petitions on “political, social, or other ideas of interest to the community as a whole” lie at the core of the people’s right to petition their government.⁹² This became one of the Court’s justifications for limiting Petition Clause protection of public employees who sue their employers. That is, if a public employee’s lawsuit addresses a matter of private concern, the employee is not protected by the First Amendment against employer discipline or retaliation.

This reading of the Petition Clause necessarily raises the question of whether *PRE*’s strong protection of petitions to the government on matters of purely private concern—*i.e.*, commercial lawsuits—remains justified. After *Borough of Duryea*, the question becomes what degree of First Amendment protection a firm should receive when it sues a competitor on a matter of private concern, given that public employees receive no First Amendment protection when they sue their employers on matters of private concern (and possibly no protection even when they sue on matters of public concern). The Supreme Court expressly left this question open outside the public employment context.⁹³

Over the years, the Court has offered some insight regarding the importance of petitioning on commercial matters.⁹⁴ However, *Borough of Duryea* made clear that “the ‘Constitution’s special concern’” protected by the Petition Clause derived from concerns

92 *Id.* at 2498.

93 Other questions about the Petition Clause remain unanswered in the antitrust context. For example, while *Borough of Duryea* addressed an individual’s right to sue under the Petition Clause, the Supreme Court has yet to undertake a meaningful analysis of a commercial entity’s right to sue. That is, the Court has yet to explain why the language of the First Amendment—*i.e.*, the right of “the people” to petition government—applies to commercial entities. *But cf. Citizens United v. Fed. Election Comm’n*, 130 S. Ct. 876, 899 (2010); *First Nat’l Bank of Boston v. Bellotti*, 435 U.S. 765 (1978) (extending First Amendment protection to corporate speech). Another point is that commercial speech receives less First Amendment protection than individual speech. *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n*, 447 U.S. 557, 566 (1980). Just as it looked to its doctrine on free speech for guidance on individual petitioning in *Borough of Duryea*, the Court could look to its doctrine on commercial speech for guidance on commercial petitioning in the antitrust context.

94 *See, e.g., Noerr*, 365 U.S. 127, 139 (“A construction of the Sherman Act that would disqualify people from taking a public position on matters in which they are financially interested would . . . deprive the people of their right to petition in the very instances in which that right may be of the most importance to them.”); *Cal. Motor Transp.*, 404 U.S. 508, 510–511 (“We conclude that it would be destructive of rights of association and of petition to hold that groups with common interests may not, without violating the antitrust laws, use the channels and procedures of state and federal agencies and courts to advocate their causes and points of view respecting resolution of their business and economic interests vis-à-vis their competitors.”).

for preservation of the right to petition on political affairs.⁹⁵ Just as *Noerr* stated that “[t]he proscriptions of the [Sherman] Act, tailored as they are for the business world, are not at all appropriate for application in the political arena,”⁹⁶ it seems reasonable to inquire whether the freedom of the Petition Clause, tailored as it is for the political world, is appropriate for or should be accorded the same weight in its application in the business arena.

B. The Public Interest

In *Borough of Duryea*, the Supreme Court contemplated the tension between an individual’s right to petition and the public’s interest in effective government. The Court resolved this tension by imposing a limit on the individual right to petition: “In light of the government’s interests in the public employment context, it would be surprising if Petition Clause claims by public employees were not limited as necessary to protect the employer’s functions and responsibilities.”⁹⁷ The potential for harm to the public interest, then, was another justification for limiting a public employee’s right to petition (along with the purpose of the Petition Clause itself, as discussed above).

By contrast, the *PRE* opinion focused on a competitor’s right to litigate and omitted any real evaluation or weighing of that right as against the important public interests served by the nation’s antitrust laws.⁹⁸ Clearly, the antitrust laws foster and further fundamental interests in free enterprise and consumer welfare that are critical public interests: “Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms.”⁹⁹

After *Borough of Duryea*, a proper analysis of the right to sue a competitor should take into account the importance of this public interest. There, the Supreme Court limited the right to petition based upon the public’s interest in efficient government operation. In a hierarchy of public interests, one could readily conclude that the public interests in freely operating markets, which the legislature chose to enshrine in the antitrust laws, would be given greater weight than the unlegislated interests in efficient government recognized in *Borough of Duryea*.¹⁰⁰ Similarly, one could argue that the potential for public harm from antitrust violations eclipses any that could arise from public employee grievances, given the broader impact of anticompetitive conduct on the populace as a whole.

95 *Borough of Duryea*, 131 S. Ct. at 2498 (citation omitted).

96 *Noerr*, 365 U.S. 127, 141.

97 *Borough of Duryea*, 131 S. Ct. at 2497.

98 After its initial citation of the Sherman Act, the *PRE* opinion made no further mention of the Act or its purposes.

99 *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972).

100 *Cf. L. A. County Metro. Transp. Auth. v. Alameda Produce Mkt., LLC*, 52 Cal. 4th 1100, 1113-14 (2011) (“Our role as a court is not to ‘sit in judgment of the Legislature’s wisdom in balancing such competing public policies.’ Instead, ‘due respect for the power of the Legislature and for the separation of powers’ requires us to ‘follow the public policy choices actually discernible from the Legislature’s statutory enactments.’”) (internal citations omitted); *Planning & Conservation League v. Dep’t of Fish & Game*, 55 Cal. App. 4th 479, 494 (1997) (“Exemptions cannot be judicially created” in the absence of an explicit statutory exemption).

While commercial litigation may serve to enforce, not frustrate, the public interest in lawful competition—for example, by vindicating a copyright or patent—the same could be said for according public employees the right to petition to uphold legislated labor principles. But often commercial litigation can hinder and impede the public’s interest in free competition and is pursued by the litigant for purely personal gain and profit. Why this litigation should be uncritically accorded the protection of the right of petition and insulated from the antitrust laws, particularly when some of the justices have tethered that right to vindication of public interests, seems particularly hard to justify after *Borough of Duryea*.

The Supreme Court has long recognized the broad reach of the Sherman Act: “That Congress wanted to go to the utmost extent of its Constitutional power in restraining trust and monopoly agreements . . . admit[s] of little, if any, doubt.”¹⁰¹ The Court, as a general rule, has long exercised restraint when considering constitutional challenges to statutes.¹⁰² If the Court does perceive “a constitutional flaw in a statute,” then “the touchstone for any decision about remedy is legislative intent, for a court cannot ‘use its remedial powers to circumvent the intent of the legislature.’”¹⁰³ Nevertheless, that is arguably what the Court did in the *PRE* case on the strength of its interpretation of the right to petition in purely private matters. In antitrust enforcement, Congress has directed the courts to determine where conduct is unduly restricting competition.¹⁰⁴ But restricting a court by judicial fiat to a technical judgment of a lawsuit’s objective merit prevents the kind of contextual inquiry that Congress made central to antitrust enforcement, and does so on the dubious justification of the right to petition.

V. CONCLUSION

Litigation has long been recognized as an effective tool to suppress competition. “Predation by abuse of governmental procedures, including administrative and judicial processes, presents an increasingly dangerous threat to competition. . . . As a technique for predation, sham litigation is theoretically the most promising.”¹⁰⁵ The challenge is to devise a fair framework that respects firms’ right to petition the judicial branch “in the very instances in which that right may be of the most importance to them,”¹⁰⁶ while recognizing the potential for the “use [of] the governmental *process*—as opposed to the *outcome* of that process—as an anticompetitive weapon.”¹⁰⁷ The *PRE* opinion skewed this

101 *United States v. S.E. Underwriters*, 322 U.S. 533, 558 (1944).

102 *Cf. Regan v. Time, Inc.*, 468 U.S. 641, 652 (1984) (plurality opinion) (“A ruling of unconstitutionality frustrates the intent of the elected representatives of the people.”).

103 *Ayotte v. Planned Parenthood of N. New England*, 546 U.S. 320, 328, 330 (2006) (citations omitted).

104 Congress not only expressed the public interest in economic competition in the antitrust laws, but also entrusted the federal courts with deciding what is lawful and unlawful competition under those laws. The concern expressed in *PRE* was that judges would arbitrarily detect sham litigation; however, Congress has directed judges to “discern and draw” that “difficult line.” *Cal. Motor Transp.*, 404 U.S. 508, 513. And of course, judges certainly are capable of determining when the judicial process is being abused. See BORK, *supra* note 25, at 357-58 (“Judges . . . have far more experience with and understanding of litigation than of economics and business behavior. They are far less likely to make mistakes about the former.”).

105 BORK, *supra* note 25, at 347.

106 *Noerr*, 365 U.S. 127, 139.

107 *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 380 (1991) (emphasis in original).

balance, giving great weight to the First Amendment right to litigate without adequate constitutional justification and without recognition of the important public interest served by our antitrust laws that might be harmed. *Borough of Duryea* represents a better reasoned and better balanced doctrine that would be more faithful to the First Amendment's purpose and to the letter and spirit of our antitrust laws.

NOERR-PENNINGTON: SAFEGUARDING THE FIRST AMENDMENT RIGHT TO PETITION THE GOVERNMENT

Stuart N. Senator & Gregory M. Sergi¹

I. Introduction

The right to petition the government is guaranteed in the First Amendment: “Congress shall make no law . . . abridging the freedom . . . to petition the Government for a redress of grievances.”² The *Noerr-Pennington* doctrine³ exists to safeguard that right by conferring immunity on a wide variety of petitioning activities—including petitioning of the legislative, executive, and judicial branches—from subsequent legal liability.⁴ While the *Noerr-Pennington* doctrine originated with immunity from claims under the Sherman Act, it extends much more broadly to confer immunity from many other legal claims premised on conduct involving protected petitioning activities.⁵

The scope of the *Noerr-Pennington* doctrine arises in a wide range of cases. For example, the issue has arisen recently with respect to cases involving: efforts to lobby local zoning

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2 U.S. CONST. amend. I.

3 The doctrine is named after two Supreme Court cases: *E. R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961) (“*Noerr*”); *United Mine Workers of Am. v. Pennington*, 381 U.S. 657 (1965) (“*Pennington*”).

4 See, e.g., *City of Colum. v. Omni Outdoor Adver., Inc.*, 499 U.S. 365, 379 (1991) (“it is obviously peculiar in a democracy, and perhaps in derogation of the constitutional right ‘to petition the Government for a redress of grievances,’ U.S. Const., Amtd. 1, to establish a category of lawful state action that citizens are not permitted to urge”); *Vibo Corp. v. Conway*, 669 F.3d 675, 683–84 (6th Cir. 2012) (explaining that *Noerr-Pennington* protects the constitutional right to petition the government embodied in the Petition Clause of the First Amendment); *Mercatus Grp., LLC v. Lake Forest Hosp.*, 641 F.3d 834, 846 (7th Cir. 2011) (“*Noerr-Pennington* was crafted to protect the freedom to petition guaranteed under the First Amendment.”).

5 See, e.g., *New West, L.P. v. City of Joliet*, 491 F.3d 717, 722 (7th Cir. 2007) (“*Noerr-Pennington* has been extended beyond the antitrust laws, where it originated, and is today understood as an application of the first amendment’s speech and petitioning clauses.”); *Manistee Town Ctr. v. City of Glendale*, 227 F.3d 1090, 1092 (9th Cir. 2000) (“The immunity is no longer limited to the antitrust context; we have held that *Noerr-Pennington* immunity applies to claims under 42 U.S.C. § 1983 that are based on the petitioning of public authorities.”); *In re Innovatio IP Ventures, LLC Patent Litig.*, 921 F. Supp. 2d 903, 911 (N.D. Ill. 2013) (“[T]he Seventh Circuit has applied the [*Noerr-Pennington*] doctrine broadly, including to RICO claims. . . . [B]ecause the doctrine derives from a constitutional source, other regional circuit courts have held that it must also extend to state law statutory and common law claims.”) (collecting cases); *Rondigo, LLC v. Twp. of Richmond*, 2012 WL 1021726, at *5, 8 (E.D. Mich. Mar. 27, 2012) (applying *Noerr-Pennington* to Section 1983 and defamation claims).

boards;⁶ litigation over patents and copyrights;⁷ litigation in foreign jurisdictions;⁸ “serial” litigation;⁹ pre-suit demand letters;¹⁰ citizen petitions submitted to the U.S. Food and Drug Administration (“FDA”);¹¹ proceedings before the U.S. Commodity Futures Trading Commission (“CFTC”);¹² and challenges to the Master Settlement Agreement ending advertising litigation against tobacco companies.¹³ These recent cases present a number of recurring issues regarding the application of *Noerr-Pennington*.

One recurring issue is whether petitioning activity involves a “legislative” body or an “adjudicative” body. This is a critical question because the scope of *Noerr-Pennington* immunity differs for petitioning in the political arena compared to petitioning judicial bodies.¹⁴ Another frequent issue is how courts should apply the “sham” petitioning exception, particularly the criteria relevant to determine whether prior petitioning was “objectively baseless.”¹⁵ Relatedly, a question of practical importance is whether the determination on objective baselessness can (and should) in most circumstances be made on the pleadings or at another early stage in the litigation.¹⁶

In light of the purpose of the *Noerr-Pennington* doctrine, we provide the following suggestions:

(1) Because there is a significant difference in the scope of *Noerr-Pennington* immunity for legislative petitioning versus adjudicatory petitioning, greater clarity is necessary on how to identify what is legislative versus adjudicatory, particularly in light of the increasing role of administrative agencies that often perform both functions.

6 See, e.g., *Mercatus*, 641 F.3d at 841-42.

7 See, e.g., *Intellectual Ventures I LLC v. Capital One Fin. Corp.*, 2013 WL 6682981, at *7 (E.D. Va. Dec. 18, 2013); *Surface Supplied, Inc. v. Kirby Morgan Dive Sys. Inc.*, 2013 WL 5496961, at *5 (N.D. Cal. Oct. 3, 2013); *Reg'l Multiple Listing Serv. of Minn., Inc. v. Am. Home Realty Network, Inc.*, ___ F. Supp. 2d ___, 2013 WL 3367132, at *12 (D. Minn. July 5, 2013); *In re AndroGel Antitrust Litig.*, 888 F. Supp. 2d 1336, 1343-44 (N.D. Ga. 2012); *Adobe Sys. Inc. v. Coffee Cup Partners, Inc.*, 2012 WL 3877783, at *8-9 (N.D. Cal. Sept. 6, 2012).

8 See *Luxpro Corp. v. Apple Inc.*, 2011 WL 1086027, at *4-5 (N.D. Cal. Mar. 24, 2011).

9 See *Waugh Chapel S., LLC v. United Food & Commercial Workers Union Local 27*, 728 F.3d 354, 362-65 (4th Cir. 2013).

10 See, e.g., *Rock River Commc'ns, Inc. v. Universal Music Grp., Inc.*, ___ F.3d ___, 2014 WL 223689, at *6-8 (9th Cir. Jan. 22, 2014); *OG Int'l, Ltd. v. Ubisoft Entm't*, 2012 WL 4809174, at *2-3 (N.D. Cal. Oct. 9, 2012).

11 See, e.g., *In re Skelaxin (Metaxalone) Antitrust Litig.*, 2013 WL 2181185, at *20-22 (E.D. Tenn. May 20, 2013); *In re Prograf Antitrust Litig.*, 2012 WL 293850, at *5 (D. Mass. Feb. 1, 2012); *In re Flonase Antitrust Litig.*, 795 F. Supp. 2d 300, 309-16 (E.D. Pa. 2011).

12 See *U.S. Futures Exch. LLC v. Bd. of Trade of City of Chi.*, 2012 WL 3155150, at *3-4 (N.D. Ill. Aug. 3, 2012).

13 See *Vibo*, 669 F.3d at 683-86.

14 See *infra* § II.A.

15 See *infra* § III.A.

16 See *infra* § IV.

(2) The two-part inquiry (objective and subjective) set forth in *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc.* (“PREP”)¹⁷ demarcates a narrow exception to *Noerr-Pennington* immunity based upon “sham” petitioning in the context of litigation. That exception should continue to be construed narrowly so as to avoid intrusion upon or chilling bona fide petitioning, including petitioning that may be unlikely to succeed but advances “‘good faith argument[s] for the extension, modification, or reversal of existing law.’”¹⁸

(3) Courts should continue to hold plaintiffs to the pleading standard of requiring specific facts that would show “objective baselessness” before allowing a claim based on alleged sham petitioning to proceed. When appropriate, courts should dismiss claims challenging petitioning activities subject to *Noerr-Pennington* immunity at the pleading stage, including in instances where the public or judicially noticeable record shows that the conduct at issue does not fall within the sham exception. If a more factual determination is necessary, courts should attempt to phase discovery such that the record necessary to evaluate summary judgment is created early in the litigation.

The remainder of this article explores these three issues in more detail.

II. Adjudicatory Versus Legislative Petitioning

A. The Scope of *Noerr-Pennington* Immunity for Adjudicatory Compared to Legislative Petitioning

The *Noerr-Pennington* doctrine arose in the context of providing immunity for legislative petitioning from antitrust liability. In *Noerr*, the Supreme Court held petitioning efforts by a group of railroads to influence legislation adverse to their competitors in the trucking industry were immune from liability under the Sherman Act. The Court explained that “the whole concept of representation depends upon the ability of the people to make their wishes known to their representatives.”¹⁹ Thus, the Sherman Act does not punish “political activity” by which “the people . . . freely inform the government of their wishes.”²⁰ The Court reached that conclusion despite the fact that the railroads’ “sole purpose . . . was to destroy the truckers as competitors” and their efforts were conducted in an unethical and deceptive manner.²¹

Four years later in *Pennington*, the Court held a union’s efforts to petition the executive branch—specifically the Secretary of Labor—for a favorable minimum wage determination were immune from antitrust liability.²² Notably, the Secretary of Labor granted the union’s minimum wage request. The Court therefore held that regardless of the union’s intent, the

17 508 U.S. 49, 60–61 (1993).

18 *Id.* at 65 (quoting FED. R. CIV. P. 11).

19 *Noerr*, 365 U.S. at 137.

20 *Id.*

21 *Id.* at 138–45.

22 *Pennington*, 381 U.S. at 670.

plaintiff could not recover damages for injury it suffered by what was ultimately an act of the Secretary of Labor.²³

Adjudicatory petitioning. The Supreme Court first applied *Noerr-Pennington* immunity to petitioning administrative agencies and courts in *California Motor Transport Co. v. Trucking Unlimited*.²⁴ The defendants instituted state and federal proceedings to defeat plaintiffs' applications to acquire certain operating rights. The Court held that the principles of *Noerr* and *Pennington* applied to petitioning of administrative agencies and courts: "Certainly the right to petition extends to all departments of the Government. The right of access to the courts is indeed but one aspect of the right of petition."²⁵ But, the Court also held that immunity from the antitrust laws may not apply where "a pattern of baseless, repetitive claims may emerge which leads the factfinder to conclude that the administrative and judicial process have been abused" by "effectively barring [an adversary] from access to the agencies and courts."²⁶

Most recently, in *PREI* the Court articulated the contours of a specific two-part definition of "sham" petitioning *in the context of litigation*:

1. "First, the lawsuit must be objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits."²⁷ ("**Objective Component**")
2. "Only if challenged litigation is objectively meritless may a court examine the litigant's subjective motivation. Under this second part of our definition of sham, the court should focus on whether the baseless lawsuit conceals 'an attempt to interfere *directly* with the business relationships of a competitor,' through the 'use [of] the governmental *process*—as opposed to the *outcome* of that process—as an anticompetitive weapon."²⁸ ("**Subjective Component**")

Significantly, the issue under the Subjective Component is *not* whether the defendant had an anticompetitive intent. A market participant is entitled to use the adjudicatory process to try to achieve an anticompetitive result or otherwise harm a competitor. Indeed, it is the nature of litigation that the plaintiff intends to gain an advantage over the defendant. Rather, the Subjective Component asks whether the party knew or reasonably should have known at the time that its litigation was objectively unreasonable.

The Court noted in *PREI* that it "need not decide . . . whether and, if so, to what extent *Noerr* permits the imposition of antitrust liability for a litigant's fraud or other misrepresentations."²⁹ While some courts put fraud and misrepresentations into a separate

23 *Id.* at 671.

24 404 U.S. 508, 510 (1972).

25 *Id.*

26 *Id.* at 513.

27 *PREI*, 508 U.S. at 60.

28 *Id.* at 60-61 (quoting *Noerr*, 365 U.S. at 144; *Omni Outdoor*, 499 U.S. at 380) (emphasis in original).

29 *Id.* at 61 n.6.

analytic category under *Noerr-Pennington*,³⁰ it can be useful to think of fraud or misrepresentations as one way of satisfying the objectively baselessness requirement. As one district court stated, “it is apparent that any misrepresentation exception to the doctrine should be limited to

30 See, e.g., *Mercatus*, 641 F.3d at 843-44 (describing a “fraud exception” that applies “if the misrepresentation (1) was intentionally made, with knowledge of its falsity; and (2) was material, in the sense that it actually altered the outcome of the proceeding”); *Baltimore Scrap Corp. v. David J. Joseph Co.*, 237 F.3d 394, 401-02 (4th Cir. 2001) (“If a fraud exception to *Noerr-Pennington* does exist, it extends only to the type of fraud that deprives litigation of its legitimacy.”).

misrepresentations respecting the substance of the claim that show that the party's litigation position had no objective basis, i.e., that it was not 'objectively genuine.'"³¹

Legislative petitioning. While the “sham” exception to *Noerr-Pennington* for adjudicatory petitioning is exceedingly narrow as defined by *PREI*, it is even more narrow, if it exists at all, in the legislative context.³² In *City of Columbia v. Omni Outdoor Advertising*,³³ the Court stated that the “sham” exception would apply where a defendant’s “activities are ‘not genuinely aimed at procuring favorable government action’ *at all*.”³⁴ On the other hand, it is *not* a “sham” where a defendant “genuinely seeks to achieve his governmental result, but does so *through improper means*.”³⁵ This articulation significantly limits the scope of any possible “sham” exception for legislative petitioning because it “will indeed be a rare case to find a petitioner that has no genuine interest ‘at all’ in procuring governmental action, even though its principal purpose and expectation may be to injure its rivals directly through the petitioning process.”³⁶ Areeda states that “it is difficult” to identify what would qualify as “sham” in the legislative context: “least difficult for judicial processes, more difficult for administrative adjudication, much more difficult for executive or administrative action generally, and *most difficult for legislative processes where it is virtually impossible to identify the sham*.”³⁷

In the context of legislative petitioning, courts have specifically rejected application of *PREI*'s “sham” exception for adjudicatory petitioning.³⁸ As the Ninth Circuit explained, “it would seem quite pointless to ask whether [a] lobbying effort was ‘objectively baseless.’ To decide objective baselessness, we would need objective standards, of which there are few, if any, in the political realm of legislation, against which to measure the defendant’s conduct.”³⁹ Thus, the Ninth Circuit held:

The sham exception is more easily applied to litigation, however, than it is to lobbying before executive or legislative bodies. . . . We decline to apply the [*PREI*] standard here. . . . Defendants petitioned county officials not to enter a lease,

31 See *Thomas v. Hous. Auth. of Cnty. of L.A.*, 2006 WL 5670938, at *9 n.49 (C.D. Cal. Feb. 28, 2006).

32 *Kottle v. Nw. Kidney Ctrs.*, 146 F.3d 1056, 1061 (9th Cir. 1998) (“[T]he scope of the sham exception to the *Noerr-Pennington* doctrine depends on the branch of government involved. *If it is the legislature, the sham exception is extraordinarily narrow*. But if it is the judicial branch, this circuit recognizes three categories of anticompetitive behavior that can amount to a sham and, therefore, outside the protection of the *Noerr-Pennington* doctrine.”) (emphasis added).

33 499 U.S. 365 (1991).

34 *Id.* at 380 (quoting *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 500 n.4) (emphasis added).

35 See *id.* (quoting *Allied Tube*, 486 U.S. at 508 n.10) (emphasis in original).

36 ABA, Section of Antitrust Law, *THE NOERR-PENNINGTON DOCTRINE* 61 (1994); see also Shubha Ghosh & Darren Bush, *Predatory Conduct and Predatory Legislation: Exclusionary Tactics in Airline Markets*, 45 HOUS. L. REV. 343, 365–66 (2008) (“The sham exception is an impossible one to meet, and no reported case has found antitrust liability for engaging in what is essentially a political, rather than a market, process.”).

37 I Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 204, at 262 (2013) (emphasis added) (“Areeda”).

38 See, e.g., *Manistee*, 227 F.3d at 1094; *Kottle*, 146 F.3d at 1061 (“It is obvious that [the ways] in which litigation might be a sham do not necessarily extend beyond the litigation context.”).

39 *Kottle*, 146 F.3d at 1061.

and attempted to energize members of the public to do the same. There are no enforceable standards by which either of the two prongs of the [PREI] test can be applied. *The exception simply does not fit.*⁴⁰

Indeed, the standards embodied in the PREI definition of “sham” that can be applied practicably to the institution of legal proceedings do not—and should not—apply to legislative petitioning.⁴¹ The question therefore remains whether there is any sham exception to *Noerr-Pennington* immunity in the context of legislative petitioning. While the Ninth Circuit stated that “the sham exception is extraordinary narrow”⁴² in the context of legislative petitioning, no circuit court appears to have expressly applied such an exception or explained what exactly it would be.

In the legislative context, the courts have also specifically rejected application of the exception to *Noerr-Pennington* immunity for fraud or misrepresentations that applies in the adjudicatory context: “[m]isrepresentations, condoned in the political arena, are not immunized when used in the adjudicatory process.”⁴³ As the Seventh Circuit recently held, there simply is no fraud exception to *Noerr-Pennington* “outside of adjudicative proceedings.”⁴⁴

B. What is “Legislative” and What is “Adjudicatory”?

In light of the difference in the scope of *Noerr-Pennington* immunity in the context of legislative versus adjudicatory petitioning (if there is even any exception, however narrow, in the context of legislative petitioning), and to avoid chilling of the fundamental constitutional right that undergirds *Noerr-Pennington* immunity, it is essential that actors know, *ex ante*, how *Noerr-Pennington* applies to specific petitioning conduct.⁴⁵ Yet “the line between legislation and adjudication is not always easy to draw.”⁴⁶ One district court recently lamented: “*Noerr-Pennington* immunity has existed since the 1960s, but since that time there has been some disparate application of the rule due in part to confusion over

40 *Manistee*, 227 F.3d at 1094 (emphasis added).

41 *See id.*; *Areeda*, ¶ 204, at 248 (“*First*, one lobbies for new legislation or rule making when existing law does *not* provide for the right being sought. *Second*, and more important, the range of legislative requests can be potentially infinite in variety. Legislative bodies have passed manifestly silly laws, and they are likely to do so again. Certainly one could not develop an ‘objective test’ whether the legislation or rule sought was manifestly unreasonable, for the First Amendment petitioning right is not limited to reasonable requests.”)

42 *Kottle*, 146 F.3d at 1061.

43 *See Cal. Motor*, 404 U.S. at 513; *see also Allied Tube*, 486 U.S. at 499–500 (“A publicity campaign directed at the general public, seeking legislation or executive action, enjoys antitrust immunity even when the campaign employs unethical and deceptive methods.”).

44 *Mercatus*, 641 F.3d at 844; *id.* at 838–39 (“Even if we assume that the Hospital made material misrepresentations during and relating to the [board] proceedings concerning *Mercatus*’ physician center, such misrepresentations are legally irrelevant because those meetings were inherently political in nature.”).

45 *See id.* at 847 (stating that the risk of stifling “the legitimate exercise of” the core right to petition the government “grows when, as may often be the case, a layperson is uncertain whether the governmental action at issue is adjudicatory or legislative”).

46 *Id.* at 845 (quoting *Mercatus Grp. LLC v. Lake Forest Hosp.*, 695 F. Supp. 2d 811, 819 (N.D. Ill. 2010)).

where to draw the line between adjudicative and legislative activity.”⁴⁷

The principal line-drawing difficulty arises most often in the context of proceedings before administrative agencies, which at different times act in different capacities, and sometimes simultaneously act in both legislative and adjudicative capacities.⁴⁸ The Seventh Circuit recently grappled with this problem and set forth a comprehensive set of factors to draw the line between legislative and adjudicatory.⁴⁹ Those factors include:

Whether the particular body has legislative power;

Whether the governmental actions at issue were matters of discretionary authority or instead were guided by more definite standards susceptible to judicial review;

The formality of the fact-finding processes (*e.g.*, whether evidence is subject to strict rules of relevance and admissibility, and whether there is a formal record of decision);

Whether testimony at the proceedings was under oath;⁵⁰

Whether the fact-finding process is subject to political influences; and

Whether the proceedings involve or permit *ex parte* communications.

The courts sometimes single out the factor of whether the governmental action at issue was discretionary as having particularly great weight⁵¹ because “[o]nly when administrative officials must follow rules is it meaningful to ask whether a petition before an agency was ‘objectively baseless.’”⁵²

In *Mercatus*, the Seventh Circuit held that proceedings before a village board on plaintiff’s proposed physician center were “legislative.” The court noted the following in support of that determination: the board “generally acts in a policymaking capacity,” the board is “ill-equipped to conduct adjudicative proceedings,” the board “conducts the vast majority of its business through relatively informal public meetings,” both the plaintiff and defendant “engaged in *ex parte* lobbying of individual Board members,” “[n]one of the evidence the Board considered was subject to strict rules of admissibility or any recognizable evidentiary rules,” “one Board member . . . contacted independent think tanks for guidance,” “[m]embers of the general public were allowed to voice their opinions,” and “[n]one of the testimony before the Board was given under oath or on penalty of perjury.”⁵³ Furthermore, the Seventh Circuit emphasized that the Board’s decision on “developmental approval was

47 *U.S. Futures*, 2012 WL 3155150, at *3.

48 *See Mercatus*, 641 F.3d at 844.

49 *See id.* at 845–46; *see also Metro Cable Co. v. CATV of Rockford, Inc.*, 516 F.2d 220, 228 (7th Cir. 1975) (noting the city council had been delegated legislative powers of the state, it need not “compile an evidentiary record through formal proceedings,” “[i]t is free to base its actions on information and arguments that come to it from any source,” and “[i]ts members are subject to lobbying and other forms of *ex parte* influences”).

50 The Supreme Court “has treated as significant whether any testimony at the proceeding in question was given under oath or affirmation, under penalty of perjury.” *Mercatus*, 641 F.3d at 845 (citing *Allied Tube*, 486 U.S. at 504).

51 *See id.* at 846 (collecting cases).

52 *Kottle*, 146 F.3d at 1062.

53 *See Mercatus*, 641 F.3d at 847–48.

not guided by enforceable, definite standards subject to review.”⁵⁴

Applying the factors discussed above, a district court recently found that proceedings of the CFTC regarding approval of an application to launch an exchange were legislative for purposes of *Noerr-Pennington*.⁵⁵ The court noted that the CFTC has both adjudicatory and legislative power, but held that the CFTC was acting in its legislative capacity because there was no complaint filed, the matter was not assigned to an administrative law judge, the fact-finding process was highly informal, evidence was not taken on the record and no rules of evidence applied, testimony was not given under oath, “the fact-finding process was subject to considerable lobbying and other *ex parte* influences,” and the CFTC’s decision was “more a matter of discretionary authority than a decision guided by definite standards susceptible to judicial review.”⁵⁶

One particular circumstance in which the question of whether petitioning is legislative or adjudicative has often arisen relates to the filing of citizen petitions to the FDA. A few courts recently found the citizen petition process to be “adjudicatory” in nature,⁵⁷ but these courts have not grappled with the various factors that courts have typically relied on to distinguish legislative from adjudicatory proceedings. For example, these courts did not consider the nature of the fact-finding process for citizen petitions, whether the process is subject to *ex parte* communications, and the extent of discretion the FDA has in deciding on citizen petitions.

Perhaps most significant is that the courts do not appear to have sufficiently considered the discretionary nature of the FDA’s ruling on citizen petitions. In *U.S. Futures*, the district court found the petitioning to be legislative even though there were statutory guidelines, because those guidelines were broad and generalized so as to confer substantial discretion on the agency that was not readily susceptible to judicial review.⁵⁸ Whether the FDA’s discretion with respect to citizen petitions is similar deserves closer scrutiny. One court, for example, explained:

[T]he citizen petition process resembles lobbying to some extent. A petitioner can urge the FDA to exercise its administrative discretion by issuing, amending, or revoking a regulation or order; or by taking or refraining from an action. . . .
[T]o the extent a citizen petition urges the FDA to exercise administrative

54 *Id.*

55 *U.S. Futures Exch.*, 2012 WL 3155150, at *3-4.

56 *See id.*

57 *See In re Skelaxin*, 2013 WL 2181185, at *20-22 (to the extent it is relevant, the authors represent one of the defendants in *Skelaxin*); *In re Wellbutrin XL Antitrust Litig.*, 2012 WL 1657734, at *4 n.4 (E.D. Pa. May 11, 2012) (noting the question of whether the citizen petition process is legislative or adjudicatory had not been raised); *In re Prograf*, 2012 WL 293850, at *5 (holding “the FDA citizen petition process contains sufficient indicia of an adjudicatory proceeding to warrant application of the sham exception in this case”); *In re Flonase*, 795 F. Supp. 2d at 309-10 (assuming that the *PREI* two-part “sham” litigation test applied to “petitions to administrative agencies”).

58 *See U.S. Futures Exch.*, 2012 WL 3155150, at *4 (“While 7 U.S.C. §§ 7(b) and 7(d) lay out eight application factors and eighteen core principles, respectively, for the CFTC to apply in considering DCM applications, these rules are extremely general in nature. The sheer numerosity of considerations points to a high level of discretion and flexibility, and insusceptibility to meaningful judicial review.”).

discretion, the process more closely resembles traditional legislative or executive lobbying. In this context, courts must exercise great caution, if not abstain from interfering with the process entirely.⁵⁹

Along the same lines, a recent law review article states that the FDA's citizen petition process "is unlikely to receive judicial review because the FDA's refusal to grant the requested relief is within the discretion to choose which issues to pursue."⁶⁰

Because *Noerr-Pennington* safeguards a constitutional right, the courts should be extremely cautious in expanding the exceptions to immunity by increasing the scope of activities within the "adjudicative" context.⁶¹

III. Applying the Narrow "Sham" Exception for Adjudicatory Proceedings

A. Principles of the "Objectively Baseless" Determination

"The sham exception is narrow, and. . . the party attempting to invoke the exception bears a heavy burden of demonstrating that the lawsuit is objectively *meritless*."⁶² This section sets forth three principles of the "objectively baseless" determination that courts should apply in assessing claims based on alleged "sham" petitioning: (1) litigation that is warranted by existing law or embodies a good faith attempt for the extension, modification, or reversal of existing law is not objectively baseless; (2) the objectively baseless determination should in most circumstances be resolved as a question of law; and (3) that determination typically should be made solely on the record in the litigation at issue.

First, "[a] winning lawsuit is by definition a reasonable effort at petitioning for redress and therefore not a sham."⁶³ But even where a party loses the underlying litigation, courts should be mindful to avoid "the understandable temptation to engage in *post hoc* reasoning by concluding that an ultimately unsuccessful action must have been unreasonable or without foundation."⁶⁴

The Court in *PREI* analogized the Objective Component to the concept of "probable cause, as understood and applied in the common law tort of wrongful civil proceedings" (frequently called malicious prosecution) and to Federal Rule of Civil Procedure 11, which "requires the plaintiff to prove that the defendant lacked probable cause to institute

59 *Aventis Pharma S.A. v. Amphastar Pharm., Inc.*, 2009 WL 8727693, at *11 (C.D. Cal. Feb. 17, 2009).

60 See M. Avery et al., *The Antitrust Implications of Filing "Sham" Citizen Petitions with the FDA*, 65 HASTINGS L.J. 113, 123 (2013); see also M. Sean Royall & Joshua Lipton, *The Complexities of Litigating Generic Drug Exclusion Claims in the Antitrust Class Action Context*, 24 ANTITRUST 22, 23 (2010) ("[B]ecause a citizen petition can be more akin to legislative or executive lobbying than to an adjudicatory process, such petitions are arguably entitled to even broader *Noerr-Pennington* doctrine immunity than applies to court proceedings.").

61 Cf. *Mercatus*, 641 F.3d at 846 ("the application of the sham exception might inadvertently stifle the legitimate exercise of this core right").

62 *CBS Interactive Inc. v. Nat'l Football League Players Ass'n, Inc.*, 259 F.R.D. 398, 413 (D. Minn. 2009) (internal quotation marks omitted).

63 *PREI*, 508 U.S. at 60 n.5.

64 *Id.* (internal quotation marks omitted).

an unsuccessful civil lawsuit and that the defendant pressed the action for an improper, malicious purpose.”⁶⁵ “Probable cause to institute civil proceedings requires no more than a ‘reasonable belief that there is a chance that a claim may be held valid upon adjudication.’”⁶⁶ Probable cause to institute legal proceedings therefore exists where the legal position is “arguably ‘warranted by existing law’ or at the very least [is] based on an objectively ‘good faith’ argument for the extension, modification, or reversal of existing law.”⁶⁷

In *PREI*, the Court held that the defendant “plainly had probable cause to sue” where the relevant law was unsettled.⁶⁸ More recently, the district court in *CBS Interactive* considered a claim based on alleged sham litigation where the defendant’s argument in the underlying litigation was arguably foreclosed by existing circuit precedent.⁶⁹ The court granted a motion to dismiss that claim because it found the defendant’s legal position was based at least on a “good faith argument for the extension, modification, or reversal of existing law,” it was also supported by “some legal commentators” who argued the existing circuit precedent “was wrongly decided,” and the defendant had argued that the relevant facts were “sufficiently distinguishable” from the circuit precedent “to warrant a different result.”⁷⁰ The court further buttressed its conclusion by explaining that a party “should not be exposed to antitrust liability for making [such an] argument, which would have a chilling effect on the right to petition.”⁷¹

In another recent decision, the court in *In re Androgel Antitrust Litigation*⁷² granted summary judgment for the defendants with respect to claims that prior patent litigations were sham.⁷³ The court held that the defendants’ legal positions on issues such as the applicability of a patent certificate of correction and the “on-sale bar” doctrine were not objectively baseless based, in part, on subsequent case law supporting the defendants’ position.⁷⁴ In granting summary judgment, the court repeatedly emphasized that litigation is not objectively baseless when a legal argument is a “stretch [but does] not exceed the pale of an aggressive attempt to extend the existing law.”⁷⁵ The court also concluded that evidence that arguably undermines or discredits the position of the defendants’ experts in the underlying litigation does not establish that the litigation was objectively baseless

65 *Id.* at 61-62, 65; *see also CBS Interactive*, 259 F.R.D. at 413 (“The analogy to the Rule 11 standard is supported by the Eighth Circuit’s explanation that the litigation must be ‘so clearly baseless as to amount to an abuse of process.’”) (quoting *Razorback Ready Mix Concrete Co. v. Weaver*, 761 F.2d 484, 487 (8th Cir. 1985)).

66 *PREI*, 508 U.S. at 62-63 (quoting *Hubbard v. Beatty & Hyde, Inc.*, 343 Mass. 258, 262 (1961)) (alterations omitted).

67 *Id.* at 65 (citing FED. R. CIV. P. 11).

68 *See id.*

69 *See* 259 F.R.D. at 414.

70 *See id.* at 413-14.

71 *Id.* at 414.

72 888 F. Supp. 2d 1336 (N.D. Ga. 2012).

73 *Id.* at 1357 (the authors’ firm represents one of the defendants in the *Androgel* litigation).

74 *See id.* at 1347, 1354.

75 *See id.* at 1347 (quoting *In re Terazosin Hydrochloride Antitrust Litig.*, 335 F. Supp. 2d 1336, 1360-61 (S.D. Fla. 2004)).

because “by pointing out mild inconsistency or confusion in [the expert’s] testimony[,] the Plaintiffs have not established that no reasonable litigant would believe there was a chance [the expert’s] testimony would be credited.”⁷⁶

Some commentators have criticized courts for applying too strict a test for an antitrust plaintiff’s satisfying the Objective Component because a strict test means that few sham litigation claims will succeed.⁷⁷ But it is properly the rare situation in which the Objective Component is satisfied, because *Noerr Pennington* immunity is meant to protect an essential constitutional right and “only the exceptional lawsuit or other use of government machinery is objectively unreasonable in its inception or abusive in its pursuit.”⁷⁸ Moreover, there does not appear to be widespread damage from improper conduct going un-remedied. Indeed, the requirements of the sham exception “are most likely to be met only where the frivolous claim could not have done much harm anyway.”⁷⁹ And there remain other “doctrines of tort liability, statutory fees or judicial sanctions” to deal with improper litigation.⁸⁰

Second, the determination of whether prior litigation was “objectively baseless” should in most circumstances initially be a question of law for the court to resolve. The Court explained in *PREI* that “[w]here . . . there is no dispute over the predicate facts of the underlying legal proceeding, a court may decide probable cause as a matter of law.”⁸¹ Indeed, “[o]nly someone with legal training can rationally determine whether the pleading of a particular legal theory is justified by or a reasonable extension of existing law.”⁸² A jury cannot practicably determine whether a reasonable litigant had probable cause to institute litigation; a jury cannot properly assess whether a good faith basis existed to assert novel legal claims; and a jury’s determination is likely, albeit improperly, to be influenced by evidence of anticompetitive intent—which, as noted, is immaterial to not just the Objective Component but also the Subjective Component of the “sham” petitioning exception to *Noerr-Pennington* immunity.

While there have been instances where the Objective Component has been submitted to a jury,⁸³ it is only the rare case—perhaps where the issue is whether the underlying claim was allegedly based on perjured testimony or other false evidence—in which a jury is in a better position than the court to assess whether prior litigation was “objectively baseless.” In those rare circumstances involving disputed, material facts on the question of objective baselessness, a court should consider submitting the disputed factual issues to a jury and then making the ultimate determination with respect to objective baselessness upon the

76 *Id.* at 1351.

77 *See, e.g.,* Karen Roche, *Deference or Destruction? Reining in the Noerr-Pennington and State Action Doctrines*, 45 LOY. L.A. L. REV. 1295, 1321 (2012).

78 Areeda, ¶ 207, at 318.

79 *Id.*, ¶ 205, at 266.

80 *See Intellectual Ventures*, 2013 WL 6682981, at *8.

81 *PREI*, 508 U.S. at 63. *See also Regional Multiple Listing Serv. of Minn. V. Am. Home Realty Network, Inc.*, ___ F. Supp. 2d ___, 2013 WL 3367132, at *12 (D. Minn. July 5, 2013) (“Whether a petitioning activity is objectively baseless for *Noerr-Pennington* purposes may be decided as a question of law.”).

82 Areeda, ¶ 207, at 325.

83 *See, e.g., La. Wholesale Drug*, 2009 WL 2708110, at *1 (S.D.N.Y. Aug. 28, 2009) (stating that the jury concluded that the defendant’s citizen petition filed with the FDA “was not ‘objectively baseless’”).

facts that the jury finds. This is an approach used in some jurisdictions and endorsed by the Restatement of Torts with respect to claims for malicious prosecution.⁸⁴

Third, in attempting to prove objective baselessness, the plaintiff should not be able to engage in wholesale re-litigation of the underlying case, or introduce new arguments or evidence that were not presented in the underlying litigation. Instead, the default rule should be that the objective baselessness determination be made based on “the record made in the [underlying] proceedings.”⁸⁵ This is particularly true where the record from the underlying litigation goes beyond the pleading stage to include discovery, summary judgment motions, or merits-based decisions by the court.

The most relevant evidence on the issue of objective baselessness will generally be the claims asserted in the underlying litigation, the legal arguments put forth in support of and in opposition to those claims, the evidence developed with respect to those claims, and any decisions by the court overseeing that litigation. Where that record provides no reason to conclude that the litigation was frivolous, the inquiry into whether litigation was “sham” should generally be brought to an end. And, needless to say, the fact that the underlying litigation failed, even decisively or at the pleading stage, should not be enough to plead or prove objective baselessness. The courts should look with skepticism on claims of objective baselessness that are principally supported by arguments never made and evidence never presented in the underlying litigation.

84 See, e.g., *Forgie-Buccioni v. Hannaford Bros., Inc.*, 413 F.3d 175, 182 (1st Cir. 2005) (“Whether probable cause exists is a mixed question of law and fact [with respect to malicious prosecution under New Hampshire law]; that is, the court must submit conflicting evidence proffered on the issue of probable cause to the jury and then determine, based upon the facts the jury found, the ultimate issue of whether probable cause exists.”); *Heron v. Revere Copper & Brass, Inc.*, 494 F.2d 705, 707 (8th Cir. 1974) (“Unlike other tort actions the rule in malicious prosecution cases appears to be that the court determines the reasonableness of conduct. This rule is almost universally accepted in the cases.”); RESTATEMENT (SECOND) OF TORTS § 681B (1977) (stating that the court determines whether “the defendant had probable cause for his action” and the function of the jury is to determine “the circumstances under which the proceedings were initiated in so far as may be necessary to enable the court to determine whether the defendant had probable cause for initiating them”).

85 *Androgl*, 888 F. Supp. 2d at 1344 (quoting *iLOR, LLC v. Google, Inc.*, 631 F.3d 1372, 1380 (Fed. Cir. 2011)).

B. Serial Litigation

The Supreme Court's decision in *PREI* did not discuss how the two-part definition of the "sham" exception applies to the type of repetitive conduct at issue in *California Motor*. The right to petition is not deserving of less protection on the basis that a party frequently exercises that right. But some courts have interpreted *California Motor* and *PREI* as applying to different situations: according to these courts, *PREI* "provides a strict two-step analysis to assess whether a single action constitutes sham petitioning;" whereas *California Motor* "deals with the case where the defendant is accused of bringing a whole series of legal proceedings."⁸⁶ However, even if the test for sham litigation in the context of a series of legal proceedings should differ from the test in the context of a single underlying lawsuit, the test in the context of a series of legal proceedings should incorporate the essence of the Objective Component and the Subjective Component of *PREI* because the policies behind those components are equally applicable regardless of whether a series of legal proceedings has been instituted.

The Fourth Circuit recently addressed the issue of serial litigation in *Waugh Chapel S., LLC v. United Food & Commercial Workers Union Local 27*.⁸⁷ Following *California Motor*, the Fourth Circuit stated that in the context of a series of legal proceedings instituted by the defendant, the court "should conduct a holistic evaluation of whether 'the administrative and judicial processes have been abused.' The pattern of the legal proceedings, not their individual merits, centers this analysis . . ."⁸⁸ "Of course, the subjective motive of the litigant and the objective merits of the suits are relevant, but other signs of bad-faith litigation . . . may also be probative of an abuse of the adjudicatory process."⁸⁹ The Fourth Circuit held that summary judgment for the defendants should have been denied because the evidence showed "the vast majority of the legal challenges failed demonstrably,"⁹⁰ plus there was additional indicia of bad-faith litigation, including a perverse attempt that would have enjoined the plaintiff's agreement to engage in environmental remediation and the fact that the defendant withdrew ten of the fourteen suits at issue "under suspicious circumstances."⁹¹

This sort of "holistic" approach is dangerously vague, and lacks the clear standards that are necessary to avoid chilling the constitutionally protected right to petition. Moreover, in some circumstances, such as where a patent holder is protecting its intellectual property rights from multiple different competitors, there will of necessity be multiple lawsuits filed, raising common issues, and no inference of baselessness or improper intent should be permitted

86 *USS-POSCO Indus. v. Contra Costa Cnty. Bldg. & Const. Trades Council*, 31 F.3d 800, 810-11 (9th Cir. 1994); see also *Primetime 24 Joint Venture v. Nat'l Broad. Co.*, 219 F.3d 92, 101 (2d Cir. 2000).

87 728 F.3d 354 (4th Cir. 2013).

88 *Id.* at 364 (quoting *Cal. Motor*, 404 U.S. at 513).

89 *Id.* at 364.

90 See *id.* The Fourth Circuit stated that "no particular win-loss percentage [applies] to secure the protection of the First Amendment" but "a one-out-of-fourteen batting average at least suggests 'a policy of starting legal proceedings without regard to the merits and for the purpose of [violating the law.]" *Id.* at 365 (quoting *USS-POSCO*, 31 F.3d at 811) (emphasis added). In another recent case, a district court noted that "[i]f a defendant prevails in more than half of its lawsuits, it is unlikely that the lawsuits are meritless." See *Luxpro*, 2011 WL 1086027, at *5.

91 *Waugh Chapel*, 728 F.3d at 365.

from either the number of lawsuits or the plaintiff's "batting average."⁹² It is also true that where the series of lawsuits at issue is spread out among different defendants, the worry that a competitor is being improperly overwhelmed by litigation will be more attenuated. Even in the context of what is alleged to be serial litigation, the touchstone to any exception to *Noerr-Pennington* immunity must be that the litigation was objectively baseless when instituted and the defendant instituted the litigation knowing that it was baseless.

IV. Early Disposition of “Sham” Claims

“[T]here has been a strong impulse to identify and dispose of the invalid sham claim as early as possible in the antitrust suit.”⁹³ This impulse is evident in many decisions disposing of antitrust claims based on sham petitioning on motions to dismiss, as well as decisions recognizing that such claims, even if not subject to dismissal on the pleadings, are often appropriately disposed of through early summary judgment before (or after limited) discovery. Adjudication of claims based on sham petitioning as early as possible is justified not just by the general public interest in resolution of litigation in a speedy and efficient manner, but also by the specific importance of avoiding extensive discovery and protracted litigation that can unnecessarily deter the essential First Amendment right to petition the government.

A. Motions to Dismiss

In light of the purpose of the *Noerr-Pennington* doctrine, the courts should rigorously enforce the pleading standard requiring specific facts that would show “objective baselessness.” Many courts have emphasized the importance of holding plaintiffs to this pleading standard for claims based on alleged sham petitioning. The Ninth Circuit, for example, explained that “[w]hen ‘a plaintiff seeks damages . . . for conduct which is prima facie protected by the First Amendment, the danger that the mere pendency of the action will chill the exercise of First Amendment rights requires more specific allegations than would otherwise be required.’”⁹⁴ Similarly, in *GMA Cover*, the court held that “because an improper application of the sham exception could chill the exercise of [First Amendment] rights,” a plaintiff “must comply with Rule 9(b) by pleading with particularity ‘the ‘who, what, where, when and how’ of the misconduct,’ as well as plead ‘allegations regarding the specific activities which bring

92 See *Kaiser Found. Health Plan, Inc. v. Abbott Labs.*, 552 F.3d 1033, 1047 (2009) (with respect to the fact that Abbott filed 17 patent infringement lawsuits, the court noted that the volume of Abbott's suits was dependent on the number of companies attempting to market products in competition with Abbott's product, “a matter over which Abbott had no control.”); *Twin City Bakery Workers & Welfare Fund v. Astra Aktiebolag*, 207 F. Supp. 2d 221, 224 n.2 (S.D.N.Y. 2002) (a brand name drug company's filing 12 patent infringement lawsuits against generic-drug applicants could not be considered “serial” litigation because “the lawsuits complained of . . . are simply individual actions against each of the ten . . . applicants. It would be unreasonable to expect defendants to initiate litigation against only some of the generic-drug applicants they claim are infringing their patents.”).

93 Areeda, ¶ 207, at 319.

94 See *Kottle*, 146 F.3d at 1063 (quoting *Franchise Realty Interstate Corp. v. San Francisco Local Joint Exec. Bd. of Culinary Workers*, 542 F.2d 1076, 1083 (9th Cir. 1976)); *Darba Enters., Inc. v. Amica Mut. Ins. Co.*, 2012 WL 3096709, at *3 (D. Nev. July 30, 2012) (“Allegations of greater than ordinary particularity are required where, as here, there is a potential for a chilling effect of the fundamental First Amendment right to petition.”).

the defendant's conduct into one of the *Noerr-Pennington* exceptions.”⁹⁵ Numerous other courts likewise have carefully examined the factual allegations supporting the plaintiff's claim that the defendant engaged in sham petitioning.⁹⁶

Many antitrust claims based on sham petitioning are dismissed on the pleadings for failure to make specific factual allegations explaining why the underlying litigation was allegedly a sham.⁹⁷ In *Intellectual Ventures I LLC v. Capital One Financial Corp.*,⁹⁸ for example, the court granted a motion to dismiss claims based on alleged sham litigation that failed to allege “any specific litigation history to support that claim” and failed to “identify any particular patents [the defendant had] attempted or threatened to enforce that have expired, been cancelled or adjudicated to be invalid.”⁹⁹ Of course, some such claims survive motions to dismiss, such as in *Regional Multiple Listing Service v. American Home Realty Network, Inc.*,¹⁰⁰ where the plaintiff provided detailed factual allegations in support of its claim of sham litigation (e.g., the defendant asserted a copyright infringement claim even though it “did not design and does not own” the relevant software; and that the defendant did not take or obtain the necessary written assignments for the photographs over which it was claiming copyrights).¹⁰¹

Before accepting that sham petitioning may have occurred, courts should take judicial notice of the decisions and the record from the underlying litigation. *Twin City Bakery Workers & Welfare Fund v. Astra Aktiebolag*,¹⁰² illustrates why this is useful. The amended complaint in that case broadly alleged that twelve patent infringement suits were baseless based on the fact that the court in those suits had “declared invalid all asserted claims of two

95 *GMA Cover Corp. v. Saab Barracuda LLC*, 2012 WL 642739, at *11 (E.D. Mich. Feb. 8, 2012) (quoting *Meridian Project Sys. v. Hardin Constr. Co.*, 404 F. Supp. 2d 1214, 1221 (E.D. Cal. 2005)), report and recommendation adopted, 2012 WL 639528 (E.D. Mich. Feb. 28, 2012).

96 See, e.g., *Dish Network, LLC v. Fun Dish Inc.*, 2010 WL 5230861 (N.D. Ohio July 30, 2010) (“When pleading the sham exception to the *Noerr-Pennington* Doctrine, courts have required more specific allegations.”), report and recommendation adopted as modified, 2010 WL 5230860 (N.D. Ohio Dec. 16, 2010); *Letica Corp. v. Sweetheart Cup Co.*, 790 F. Supp. 702, 705 (E.D. Mich. 1992) (“When pleading the sham exception to the *Noerr-Pennington* doctrine, courts have required more specific allegations The courts have recognized such a need because the mere pendency of such actions may chill the exercise of first amendment rights. This is particularly true when the pending action involves antitrust violations because such actions involve long, drawn out discovery processes and great expense.”) (internal citations omitted).

97 See, e.g., *Surface Supplied, Inc. v. Kirby Morgan Dive Sys. Inc.*, 2013 WL 5496961, at *5 (N.D. Cal. Oct. 3, 2013) (dismissing sham litigation claim for failure “to plead any facts showing th[e] lawsuits to be ‘objectively baseless’”); *OG Int’l*, 2012 WL 4809174, at *2-3 (dismissing intentional interference, trade libel, and unfair competition claims against Ubisoft that were based on letters Ubisoft sent to OG’s customers threatening litigation if the customers distributed OG’s products for failure to sufficiently allege the letters were “objectively baseless”); *Adobe*, 2012 WL 3877783, at *9 (dismissing sham litigation counter-claim because, among other reasons, Coffee Cup failed to allege the “requisite improper subjective intent,” i.e., that “Adobe had brought the lawsuit with the intent of [injuring Coffee Cup’s business by requiring it to incur costs in defending the suit] or of interfering with its business in any other particular manner”).

98 2013 WL 6682981 (E.D. Va. Dec. 18, 2013).

99 *Id.* at *7.

100 ___ F. Supp. 2d ___, 2013 WL 3367132 (D. Minn. July 5, 2013).

101 *Id.* at *12.

102 207 F. Supp. 2d 221 (S.D.N.Y. 2002).

of the six patents . . . as well as parts of a third patent.”¹⁰³ The court stated that “even on a motion to dismiss, [it] may take cognizance not only of those orders of [the judge overseeing the underlying litigations] expressly referenced in the Amended Complaint but also of her other orders and related public records in the case before her.”¹⁰⁴ And these materials showed that the amended complaint told only part of the story. The judicially-noticed materials revealed that the judge in the underlying case allowed “claims of infringement of four of the six asserted patents to proceed beyond summary judgment, and two of the four to proceed through trial”¹⁰⁵ The court in the antitrust case held that those facts “preclude[d] any contention that defendants’ litigation is so baseless as not to warrant *Noerr-Pennington* immunity,” and thus dismissed the claims with prejudice.¹⁰⁶

B. Summary Judgment

If claims are permitted to survive a motion to dismiss, courts should endeavor to phase discovery and summary judgment motions strategically such that potentially dispositive issues can be addressed early and efficiently.¹⁰⁷ Courts should address the question of objective baselessness through early summary judgment either before discovery or after only limited discovery.

It is often possible for the court in the antitrust case legitimately to conclude, as a matter of law based solely on the record in the underlying litigation, that the objective baselessness test cannot be satisfied.¹⁰⁸ As noted, courts should always consider whether such a conclusion can be reached before any inquiry into the Subjective Component of the *PREI* two-part test. Indeed, the Supreme Court held in *PREI* that it was proper to refuse the plaintiff’s “request for further discovery on the economic circumstances of the underlying copyright litigation,” *i.e.*, on issues relevant to the Subjective Component, because a plaintiff cannot “pierce . . . *Noerr* immunity without proof that [a defendant’s action] was objectively baseless or frivolous.”¹⁰⁹ Thus, the Court instructed that a plaintiff must “disprove the challenged lawsuit’s *legal* viability before the court will entertain evidence of the suit’s *economic* viability.”¹¹⁰

103 *Id.* at 223.

104 *Id.* at 224.

105 *Id.*

106 *See id.* at 224–25.

107 *See* Federal Judicial Center, *MANUAL FOR COMPLEX LITIGATION* § 30.1, at 519–20 (2004) (“Effective management of antitrust litigation requires identifying, clarifying, and narrowing pivotal factual and legal issues as soon as practicable. . . . Defining the issues at an early stage may enable the court to structure the litigation so as to limit the scope and volume discovery, reduce cost and delay, facilitate the prospect of settlement, and improve the trial.”).

108 *Areeda*, ¶ 207, at 327 (“[N]o discovery is necessary to determine whether filed litigation is objectively reasonable under the existing law And since the criterion for determining legal unreasonableness is objective, nothing is gained by inquiring into the defendant’s state of mind.”).

109 *PREI*, 508 U.S. at 65; *see also* *Areeda*, ¶ 205, at 273 (“Because subjective intent became irrelevant once Columbia’s infringement suit was found non-baseless, the refusal below to allow discovery on that intent was correct.”).

110 *PREI*, 508 U.S. at 61 (emphasis in original).

THE IRRELEVANCE OF THE FIRST AMENDMENT TO THE MODERN REGULATION OF THE INTERNET

Richard Epstein¹

I. INTRODUCTION

One of the most vexing challenges to any legal system is to answer this question: Should established legal principles be modified with the advent of new technologies that in turn require the creation of new property rights? The trivial answer is simply “yes.” It is a commonplace observation that the creation of new property rights regimes is often dependent upon the creation of new technologies. For example, no one was in a position to ask who owned the electromagnetic spectrum—at least at invisible frequencies—until the technology became available to exploit it. But once communications through the spectrum became possible, someone had to organize it, lest physical interference in the use of frequencies render it useless for all concerned. Does this new generation of regulation pose a problem for the protection of speech under the First Amendment? Does it, for that matter, pose any difficulties under conventional conceptions of the antitrust law? After all, any exclusive system of property rights in the spectrum necessarily blocks the speech rights of all individuals except for that favored owner.

The answer to these and similar questions does not depend on the novelty of, for example, spectrum, for the same answer could also be made with respect to land. As Pierre-Joseph Proudhon famously observed, “property is theft”² because its creation limits the rights of non-owners to access land as they could have before it was reduced to private ownership. Whether Proudhon’s observation is false, it does not carry the weight that he sought to attach to it with either land or the electromagnetic spectrum. In both instances, if you leave property in a commons, no individual is in a position to exploit it. Allow the first possessor to make exclusive use of it, and, for example, agriculture and manufacturing become possible. Other individuals can reduce other parcels of land to private possession, and the persons who start out without property can acquire wealth by labor or land by purchase.

The key observation in this article is that identical arguments carry against any claim that individual efforts to reduce the spectrum to private ownership necessarily violate other individuals’ free speech rights. The organization of the spectrum, for example, creates a coherent set of property rights that allows more speech to be heard over time than under any alternative arrangement. Any limitation of speech in the individual case is more than offset by the overall social gains. The First Amendment does not let any and every person speak as he pleases wherever he pleases. Instead, all claims for freedom of speech have to be

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2 PIERRE-JOSEPH PROUDHON, *WHAT IS PROPERTY?* 13 (Donald R. Kelley & Bonnie G. Smith eds. & trans., Cambridge Univ. Press 1994) (1840).

embedded within a system of property rights that gives some individuals exclusive control over key resources. For example, under the law of copyright, it is not a violation of your free speech rights for me to enjoy your publication of an infringing copy of my book.³

To be sure, there have always been some well-defined exceptions to the exclusive use of one's own property. For example, people can enter the land of another in order to save their own lives. More relevant here, the law of copyright recognizes the privilege of "fair use," whereby others can quote short passages from works that they wish to criticize, lest all criticism be stopped. Property rights, be they physical or intellectual, are not absolute, and their exercise is of course subject to conventional antitrust limitations on the creation or exploitation of monopoly power.

The same is true of rights to speech. Although it is a presumptive violation of the right of free speech to impose restrictions on the use you may make of your own telephone or printing press, it is not a violation of your rights to free speech for me to say that you cannot enter my house to use my telephone or printing press against my will.⁴ By the same token, all speakers in a given industry cannot collude to raise prices and divide territories.⁵

In all cases, freedom of speech must always be embedded in some larger system of property rights for it to be coherent. People do not have the right to trespass on the lands of others in order to voice their messages. Indeed, the one case that hinted at this approach, *PruneYard Shopping Center v. Robins*,⁶ applied only to the distinctive setting of shopping centers, which are analogous to traditional public forums like streets and parks. The approach has never been applied, for example, to residential apartment complexes.⁷ There are too many alternative ways for speakers to reach their intended audiences without having to commandeer the property of others. Likewise, newer technologies create tensions between property and speech rights, but in the end these tensions are generally amenable to the same solution: Establish the basic systems of property rights correctly, and any concerns with the protection of speech take care of themselves, by the general protections against the use of force (and the threat of force), misrepresentation (and concealment), and monopoly. But if that property rights system falters, no invocation of the First Amendment is able to restore balance to the overall system.

In order to illustrate these problems, I shall look at the following questions. The first asks whether the First Amendment trumps the law of trade secrets. The second asks whether the First Amendment limits website owners from restricting unauthorized entry by other users. The third asks whether the First Amendment restricts the application of the principles of rate regulation and antitrust to new technologies in the common carrier

3 See, e.g., *Harper & Row v. Nation Enterprises*, 471 U.S. 539 (1985) (discussing 17 U.S.C. § 107).

4 As with copyright, it is easy to imagine rare occasions of necessity, but the cases are likely to be few and far between where I could claim (at least in the pre-cell phone age) the legal privilege to use your telephone to protect my own life, or the lives of third persons. See, e.g., *Soldano v. O'Daniels*, 190 Cal. Rptr. 310 (Cal. App. 1983).

5 *Associated Press v. United States*, 326 U.S. 1 (1945), discussed *infra* at n.37.

6 447 U.S. 74 (1980). For my views, see Richard A. Epstein, *Takings, Exclusivity and Speech: The Legacy of PruneYard v. Robins*, 64 U. CHI. L. REV. 21 (1997).

7 See, e.g., *Golden Gateway Center v. Golden Gateway Tenants Ass'n*, 29 P.3d 797 (Cal. 2001) (denying a tenants association "the right to distribute its newsletter in a privately owned apartment complex").

setting. In all these settings, the answer is the same. If one understands how property and speech fit together as a matter of first principle, nothing in the Constitution requires that the First Amendment trump, limit, or restrict the outcomes in any of these three scenarios. There is less novelty here than meets the eye. Technology becomes a diversion that does not alter the guiding principle.

II. TRADE SECRETS

In most situations, there is little conflict between the First Amendment and the law of trade secrets. In business, one who steals a trade secret has every incentive to keep his theft secret. The value of a trade secret lies in the extent to which the use of particular information necessarily supplies some competitive advantage to the person who holds the information over those without it. The benefit of that trade secret can be confined to its owner, or the secret can be licensed to other individuals subject to conditions of confidentiality, on an exclusive or nonexclusive basis. But in both cases the value of the secret lies in the ability to restrict the class of individuals who use it. Nobody has any incentive to let the world in on a good idea for free. Indeed, in typical commercial settings, the last thing that the thief of any trade secret wants to do is announce his success publicly to the rest of the world, and thus lose the value of what he has stolen.

But this iron logic of trade secrets does not apply when the theft of a trade secret occurs not for private profit, but rather for political ends advanced by disclosing the trade secret publicly. Two famous instances of this behavior occurred over a decade ago, in *Ford Motor Co. v. Lane* and in *DVD Copy Control Ass'n, Inc. v. Bunner*.

In *Ford Motor Co. v. Lane*,⁸ the Ford Motor Company sought to enjoin the publication of key business plans that had been leaked by a Ford employee to Lane, who published that information on his own website. The subsidiary issue was whether an injunction of that speech violated the First Amendment prohibition on prior restraint given that the defendant knew he had received the information from an unauthorized source.

The district court took a wooden approach to First Amendment law by applying the normal First Amendment prohibition on prior restraint to the stolen material, which resulted in a denial of the injunctive relief sought. I regard that outcome as a serious categorical error. It is of course the case that injunctions should not be issued to restrain the publication of defamatory speech. In that area, prior restraint carries the serious risk of suppressing vital speech critical of either a key government official or public figure. The safer course is to let the speech be published, so long as the aggrieved party retains the ability to sue for a damages remedy in cases of defamatory harm.

The situation is, however, wholly different with the illegal disclosure of trade secrets, whose value is lost with public disclosure, and for which a damage award is a weak substitute for injunctive relief that preserves the exclusive right of use. Nor does the unauthorized publication of technical specifications for a new product, a customer list, or a litigation strategy rate First Amendment protection, when none of these could be pried

8 67 F. Supp. 2d 745 (E.D. Mich. 1999).

out of their owner by legal process.⁹ In this respect, the proper analogy is to the bad faith purchaser of stolen goods, who nowhere gains rights superior to those of the original thief under private law.¹⁰ And once the owner of a trade secret can enjoin its publication as of right by those who have come unlawfully into its possession, it follows that any third person who receives that trade secret should be subject to the same relief if he knows that the information in question has been purloined from its owner. In this context, the law of freedom of speech should never confer some special immunity on the press for tort liability that would not be granted to any other bad faith recipient of stolen property whose value is diminished or destroyed. Never encourage a senseless cat-and-mouse game by adopting a consciously inferior set of remedies that allow the holder of a trade secret to use any and all measures of self-help to protect that secret,¹¹ while denying a call for legal assistance when some outsider, or worse, employee turned thief, has taken the information and handed it over to a third party, who to a moral certainty knows of its illegal acquisition from the intermediate party.¹²

The same analysis also applies to the well-known case of *DVD Copy Control Ass'n, Inc. v. Bunner*,¹³ on which I coauthored an amicus brief supporting the DVD Copy Control Association (DVCCA).¹⁴ One major concern of copyright holders is that their material will be pirated by persons who have not paid for its creation. In order to forestall that threat, members of the DVCCA encoded their copyrighted material under a Content Scrambling System (“CSS”) in order to deny access to it from those who had not purchased the appropriate key. As is commonly the case, this encryption system can be reverse-engineered, allowing an unauthorized person to make the key needed to unlock the content. In this instance, Jon Johansen was able to reverse-engineer the protected software and develop a decryption program called deCSS that used confidential elements of CSS to allow users to play pirated DVDs. He did so even though he knew that the software that he had acquired contained a licensing agreement that specifically prohibited that practice.

If these prohibitions against reverse-engineering can be ignored with impunity, it is only a matter of time before someone cracks the code, thereby allowing everyone to gain

9 Compare *United States v. Alvarez*, 132 S. Ct. 2537, 2547–48 (2012) (plurality op.) (rejecting the view that all fraudulent speech receives First Amendment protection when striking down a statute that subjects a person to criminal sanctions for lying about receiving military medals).

10 See Saul Levmore, *Variety and Uniformity in the Treatment of the Good Faith Purchaser*, 16 J. LEGAL STUD. 43, 46 (1987).

11 The phrase is used in *Intel Corp. v. Hamidi*, 114 Cal. Rptr. 2d 244 (Cal. App. 2001): “We conceive of no public benefit from this wasteful cat-and-mouse game which justifies depriving Intel of an injunction. *Id.* at 249.

12 See Pamela Samuelson, *Principles for Resolving Conflicts Between Trade Secrets and the First Amendment*, 58 HASTINGS L.J. 777, 777 (2007) (defending injunctive relief in trade secret cases); Andrew Beckerman-Rodau, *Prior Restraints and Intellectual Property: The Clash Between Intellectual Property and the First Amendment from an Economic Perspective*, 12 FORDHAM INTEL. PROP. MEDIA & ENT. L.J. 1, 67 (2001) (same); Richard A. Epstein, *Privacy, Publication, and the First Amendment: The Dangers of First Amendment Exceptionalism*, 52 STAN. L. REV. 1003, 1035—46 (2000) (same, given the valuation difficulties in these cases).

13 75 P.3d 1 (Cal. 2003).

14 Amicus Brief of Microsoft Corporation, et al., *DVD Copy Control Ass'n, Inc. v. Bunner*, 75 P.3d 1 (Cal. 1993) (No. S102588), available at https://w2.eff.org/IP/Video/DVCCA_case/20020718_bunner_ms_amicus_brief.pdf.

access to pirated content without paying a fee. Nor is it sufficient to enforce this prohibition only against the first buyer of the copyrighted material. That prohibition must also be enforced against any third party, such as *Bunner*, who takes and discloses that information with knowledge that it had been stolen. Thus, First Amendment issues disappear from view just as they did in *Ford Motor Co. v. Lane*. *Bunner* does not limit the ability of others to speak their own minds. It merely blocks efforts to transfer the plaintiff's property for free. To be sure, once the information has been made public, it is fair to ask whether an injunction helps limit its further spread.¹⁵ But that genuine concern is no argument for denying a plaintiff an injunction that may slow the spread of pirated material, even if it cannot staunch the flow altogether. This First Amendment claim should fail because it upsets the basic framework of intellectual property rights.

III. UNAUTHORIZED TRESPASS

Unauthorized trespasses into computer networks should be treated like the theft of trade secrets: once again, exclusive property rights should trump any novel First Amendment claim, notwithstanding judicial decisions to the contrary.

The earlier discussion of the *PruneYard* case shows how this tension between speech and trespass should play out in the case of land. That same issue also arose in the celebrated case of *Intel Co. v. Hamidi*,¹⁶ for which I also prepared an amicus brief, this time in support of Intel's effort to enjoin Hamidi's trespass into its private computer network. At issue was whether Intel could enjoin Hamidi, a former employee it had fired, from making unauthorized use of Intel's servers to email Intel's employees. The messages were highly inflammatory, but Intel's claim was for trespass to its equipment, not for defamation. In framing its claim this way Intel achieved two things. First, it narrowed the issue so that it was not asking the court to enjoin any messages that Hamidi sent to Intel employees from non-Intel servers. Second, it relieved itself of the duty to prove the messages were defamatory.

Intel sought relief under the trespass to chattels doctrine, which in effect makes it impermissible for any person to use force to either take or dispossess another person of his chattels.¹⁷ By a narrow four-to-three vote, the California Supreme Court denied the injunction on the grounds that there was no physical damage to Intel's computers. That conclusion may make some sense in those cases where the self-help measures give perfect protection to the property owner, as is the case when, to use the example provided by the Restatement of Torts, the defendant's conduct consists of pulling the ears of someone else's dog without harming it.¹⁸ The implicit subtext is that the owner can get the dog out of harm's way.

But the Internet is not a dog, let alone a conventional chattel. In this instance, the self-help remedy is decidedly imperfect, as Hamidi was able on several occasions to skirt those software defenses with mass mailings that roiled Intel's employees. Hamidi also

15 See, e.g., *DVD Copy Control Ass'n v. Bunner*, 10 Cal. Rptr. 3d 185, 192-96 (Cal. App. 2004).

16 71 P.3d 296 (Cal. 2003).

17 RESTATEMENT (SECOND) OF TORTS §§ 217—18.

18 RESTATEMENT (SECOND) OF TORTS § 218 cmt. e illus. 2.

had full knowledge that his actions were unauthorized. Once again, the law of remedies contains no principle that should deny a simple injunction against the performance of an admittedly unlawful act, when the parallel remedy is routinely available, for example, in cases of trespass to land. Nor is there any First Amendment argument on behalf of Hamidi that justifies his trespass in this case, any more than the First Amendment would justify using someone else's office lobby to speak to his or her employees. Indeed, in this case, the free speech issue cuts *in favor of* Intel because, as the dissenters in that case argued, Intel and its employees had to receive Hamidi's unwanted messages from his unauthorized use of Intel's facilities.¹⁹

The Internet is, as I argued in the amicus brief,²⁰ a complex institution that contains key elements of common and private property in cyberspace. Its organization is parallel to that governing the use of open access highways and private homes in ordinary physical space. There is no risk that strong trespass remedies designed to protect houses beside the highway will limit the traffic along the public road, and the same conclusion holds here.

The right to prevent trespasses applies with equal force to efforts to scrape information from someone else's website, which is yet another form of unauthorized activity that should receive no First Amendment protection. Anyone who wishes to acquire this information can do so efficiently through the standard voluntary protocols commonly used to expedite complete and accurate data transfers.²¹ Indeed in most cases, a firm that posts its information publicly on its website should not be understood to make it available by scraping to its competitors. The recent Federal Trade Commission (FTC) investigation of Google's practice of "scraping" information off rival websites to use in building its search results demonstrates that rival websites have property rights in their own compilations of publicly available information.²² In this setting, Google faces a strong parity constraint because its competitors can scrape information from Google's website if Google can scrape information from theirs. Scraping has been attacked on various grounds, including trespass to chattels, where the claim has drawn blood precisely because the technique can impose physical damage, induce inferior performance on the scraped system,²³ and even lead to lost advertisement revenue when unique visitors do not enter through an advertisement portal. The disposition of this issue in the FTC's investigation of Google resulted not just in a TKO for the FTC but in an affirmation of property rights in developing and presenting information online. The Report's brief discussion says it all:

The Commission considered whether this conduct could have diminished the incentive of Google's rivals to invest in bringing new and innovative content

19 See *Hamidi*, 71 P.3d at 318 (Brown, J. dissenting).

20 Amicus Brief of California Employment Law Council, et al., *Intel Corp. v. Hamidi*, 71 P.3d 296 (Cal. 2003) (No. S103781), 2002 CA S. Ct. Briefs LEXIS 39. The claim was explicitly criticized by Judge Werdegar. *Hamidi*, 71 P.3d at 309—11. For my extended reply, see Richard A. Epstein, *Intel v. Hamidi: The Role of Self-Help in Cyberspace*, 1 J. LAW, ECON. & POL. 147 (2005).

21 See *EF Cultural Travel BV v. Zefer Corp.*, 318 F.3d 58, 64 (1st Cir. 2003) (allowing injunction against scrapers in cases involving "misuse of confidential information").

22 See *Feist Publications, Inc. v. Rural Telephone Service Co., Inc.*, 499 U.S. 340, 344–51, 358–59, 361–62 (1991) (factual compilations may often be copyrighted, but not the information in white pages which lacks even the smidgen of the required originality).

23 See e.g., *eBay, Inc. v. Bidder's Edge, Inc.*, 100 F. Supp. 2d 1058, 1066 (N.D. Cal. 2000).

and services to the Internet in the future or reduced Google's own incentive to innovate in the relevant markets, and if so whether this conduct was actionable as an unfair method of competition within the meaning of Section 5 of the FTC Act, 15 U.S.C. § 45. Chairman Leibowitz, Commissioner Brill and Commissioner Ramirez found the record evidence to support strong concerns about Google's conduct in this regard, and Google has committed to refrain from this conduct in the future.²⁴

It is worth noting in this context that Google did not seek to protect that practice, in part because it would object strongly if the tables were turned. The creation of these property rights does not offend the basic principle that the legal system affords no protection to simple ideas, any more than it does to the laws of nature.²⁵ So long as the basic property rights system fits these requirements, the First Amendment does not impose any additional constraints in this area.

IV. MISAPPROPRIATION

A similar analysis applies to the common law tort of misappropriation, where once again the proper principles of dispute do not implicate the First Amendment. The origins of the modern misappropriation tort lie in the 1918 United States Supreme Court decision in *International News Service v. Associated Press*,²⁶ which introduced the tort of misappropriation of information to deal with conflicts between direct competitors. INS engaged for a time in collecting information off the AP's bulletin boards in New York for use in INS newspapers on the Pacific Coast. At no point in the case did INS argue that it had a First Amendment right to use information that the AP had collected from its own sources. In affirming the lower court decision to enjoin INS from copying AP's news stories, Justice Pitney cautioned: "It is to be observed that the view we adopt does not result in giving to complainant the right to monopolize either the gathering or the distribution of the news, or, without complying with the copyright act, to prevent the reproduction of its news articles, but only postpones participation by complainant's competitor in the processes of distribution and reproduction of news that it has not gathered, and only to the extent necessary to prevent that competitor from reaping the fruits of complainant's efforts and expenditure, to the partial exclusion of complainant."²⁷ Thus, the remedy afforded in Justice Mahlon Pitney's opinion was shaped so as not to prevent anyone else from obtaining and disseminating the underlying public facts by independent effort. Rather, it only prevented the freeloading in *information gathering* that would make it less desirable for AP to generate the information in the first place.

One of the great achievements of the *INS* decision was its temporal limitation. The protection disappeared a day later, with the next day's news cycle. Consequently, the

24 In the Matter of Google Inc., Statement of the Federal Trade Commission Regarding Google's Search Practices, at 3 n.2 FTC File No. 111-0163 (Jan. 3, 2013), available at <http://www.ftc.gov/os/2013/01/130103googlesearchstntofcomm.pdf>.

25 See *Laboratory Corp. of America Holdings v. Metabolite Laboratories, Inc.*, 548 U.S. 124, 126 (2006) (approving limits on the patenting of laws of nature or abstract ideas by analogy of the limits of copyright protection for "ideas").

26 248 U.S. 215 (1918).

27 *Id.* at 241.

protection applies when it is needed most, but it is promptly and automatically lifted when the wide circulation of the information from multiple public sources renders this form of protection ineffective. If one sums private and public value over the full news cycle, this division of entitlements maximizes the total value of the information to all players at all times—a neat achievement that responds to the need to limit the temporal dimension of the property right far more dramatically than for either inventions or writings. Correspondingly, it also shows how crafting the scope of the property right in question protects short-term production without impairing long-term access to valuable information, all without invoking the First Amendment. Indeed, one could imagine the First Amendment being used in such a way as to hinder the useful result achieved in *INS*: if *INS* were to claim a First Amendment right to reuse information acquired by others, that misguided claim would start to resemble *Harper & Row v. Nation Enterprises*,²⁸ which rejected the parallel First Amendment claim in the copyright context.

Similar business practices in related contexts also maximize the value of information, thereby serving First Amendment values, without explicitly invoking the First Amendment. It is commonplace today, for example, for radio talk shows to get leads from written articles. But, since these outlets do little investigative reporting of their own, there is no way that the print media can rely reciprocally on the broadcast media for leads, let alone detailed information on which they could profitably rely. Accordingly, the usual mode of implicit compensation, which helps both sides, is for the radio talk-show host to thank the written source for starting the story. On the one side, that practice gives recognition for work done that could expand readership. On the other, it also lends credibility to the talk-show host, so that this wide-open public system is largely self-enforcing, and continues on indefinitely without complaint from either side.

V. COMMON CARRIERS AND ANTITRUST REGULATION

As noted earlier, no well-articulated system of property rights blocks the use of both common carrier regulation and antitrust laws to prevent the acquisition or exercise of monopoly power. Here too the institutional risk is that overblown First Amendment claims can hinder the sensible development of these bodies of law in cases involving misappropriation, theft of trade secrets, trespass, or scraping, as for example with net neutrality laws.²⁹ The seminal discussion is found in Sir Matthew Hale's *De Portibus Maris*, or Concerning the Gates to the Sea, which examined just these questions under the heading of businesses that were "affected with the public interest."³⁰ Hale concluded that

28 471 U.S. 539 (1985).

29 Under net neutrality telecommunications, cable companies are obliged "to route traffic without regard to the source or content of the packets of data that move across the Internet, the application with which those packets are associated, or the sender's willingness to pay." Christopher S. Yoo, *Network Neutrality or Internet Innovation*, 1 (University of Pennsylvania Law School, Institute for Law and Economics, Research Paper No. 10-06, April 2010). The Federal Communications Commission has promulgated net neutrality rules in what is known as its Open Internet Order. See *In the Matter of Preserving the Open Internet Broadband and Industry Practices*, FCC 10-21 (Federal Communications Commission Dec. 23, 2010), http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-10-201A1_Rcd.pdf (last visited Sept. 14, 2013).

30 Matthew Hale, *De Portibus Maris*, in 1 A COLLECTION OF TRACTS RELATIVE TO THE LAW OF ENGLAND 77-78 (Francis Hargrave ed., 1787).

special rules were required for those firms that acquired either a legal or a natural monopoly over a particular commodity in a particular area, so that only one firm can operate. His view, still valid today, was that such firms must serve all customers on reasonable and nondiscriminatory terms. The motivation behind that limitation was to make sure that the firm did not reap monopoly profits. Implementing this program is not easy, for it must at the very least allow for differentiation among customers for whom the cost of service is different. This principle led to the system of rate regulation that applied after the Civil War to railroads and public utilities.

The doctrine developed in cases involving rate regulation for railroads has special relevance for the Internet. Railroads and the Internet are both networks, which means at the very least that no party who controls access to either can refuse to deal with customers without cause. But the quid pro quo for the duty to deal was and is the requirement that the common carrier or public utility receive over the long haul a rate of return on its investment that would allow it to attract and retain capital.³¹

What is relevant, however, is how these basic principles carry over to today's key issue of net neutrality, which refers to the extent to which the firms who own the "pipes" through which data is transmitted are duty-bound to supply equal service to any and all users of the system. The analysis contains an added layer of complexity whenever the owner of the pipes seeks to send its own messages across its own networks. So how best to handle these situations?

Not by invoking the First Amendment. The reason why that amendment is irrelevant is that the scope of a common carrier duty is not enlarged when it is involved with the transmission of ideas rather than the shipment of goods. Today's telecommunications carrier may incorrectly argue that it is being forced to carry speech with which it disagrees under net neutrality, for which it might invoke Justice Robert Jackson's famous pronouncement in *West Virginia v. Barnette*,³² in the flag salute cases, where public schools sought to compel students to salute the flag or recite the pledge of allegiance: "If there is any fixed star in our constitutional constellation, it is that no official, high or petty, can prescribe what shall be orthodox in politics, nationalism, religion, or other matters of opinion or force citizens to confess by word or act their faith therein."³³ But the carrier's use of that analogy is hopeless. For years railroads have been required to carry cartons of books even if they disagree with their content. No one assumes that the carrier endorses the positions represented in the information that is shipped on its network. The same is true with respect to the modern set of internet connections, which do not "force citizens," or for that matter corporations, to confess by word or act their faith in anything. It is equally vacuous to argue that imposing general rules of carriage in some way limits the freedom of speech of the persons who use the network.

It follows, therefore, that the standard rules of the game should apply to today's common carriers as applied to those historically, which require setting reasonable

31 I ignore here the complex calculations needed to determine reasonable rates of return in public utility pricing . For a convenient discussion of permissible methodologies, see *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

32 319 U.S. 624 (1943).

33 *Id.* at 642.

and nondiscriminatory terms for their use of their monopoly power.³⁴ The modern embodiment of that ancient principle is a more cautious version of the modern principle of “net neutrality.” But in dealing with ordinary common carriers, nothing in the restrained account of the nondiscrimination principle prevents the carrier from charging premium rates for more rapid service, so that same flexibility given to FedEx or UPS, or for that matter, the U.S. Post Office, should be allowed here as a regulatory matter (if not a First Amendment one). Whenever different packets of information have different value, it would be absurd to force valuable information to wait in the queue as reams of spam-like material sashay across the pipes. To avoid just that risk, it should be made perfectly clear that any carrier should be allowed to use tiered pricing to allow for sorting of content by importance, which is done by the content provider in response to a pricing schedule, thus eliminating the risk of selective approval that can raise First Amendment issues.

In this situation, moreover, it does not matter whether the carrier itself wishes to push its own content through the pipes because there is no way that it can give its own content preferential treatment. To be sure, the fee paid just goes from one pocket to another. But that does not matter, because the key point is that by taking the spots at the head of the queue, the common carrier forfeits the revenues for premium services that it could collect from others, so that its opportunity cost becomes the proper estimate of the social value of its own information.³⁵ The First Amendment adds nothing to the protection of speech, but only clouds the application of the older common law duties of common carriers that developed outside the speech area.

If rate regulation fails, what about the use of antitrust laws? Here it is necessary to stress the now-familiar theme that the First Amendment does not aid in finding the correct analysis. Historically, the United States Supreme Court has long allowed antitrust regulation of conduct with only an incidental impact on speech.³⁶ Thus, the 1945 Supreme

34 See *United States of America v. Terminal Railroad Ass'n of St. Louis et al.*, 224 U.S. 383, 392-400, 404-05, 411-12 (1912) (terminal company that gained control of every railroad bridge across the Mississippi could be forced to grant access to all carriers on reasonable and non-discriminatory terms).

35 It remains an open question whether tiered pricing should be subject to a total revenue constraint similar to that in old public utility regulation. The Federal Trade Commission's Maureen K. Ohlhausen noted that “[t]echnology industries are notoriously fast-paced, particularly industries involving the Internet.” In the Matter of Google Inc., Statement of Commissioner Maureen Ohlhausen of the Federal Trade Commission Regarding Google's Search Practices, FTC File No. 111-0163, at 1, available at <http://www.ftc.gov/os/2013/01/130103googlesearchohlhausentmt.pdf>. The persistent rapid decline in rates owing to technological improvements makes setting maximum rates completely otiose. At this point, an obligation to take all comers under tiered pricing is the most that can be expected. More aggressive rate regulation in this industry leads to a dead end.

36 See, e.g., *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969) (upholding injunction prohibiting newspaper publishers from entering into joint operating agreement); *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978) (striking down under the antitrust laws a professional association's ethical ban on competitive bidding for engineering services); *American Society of Mechanical Eng'rs v. Hydrolevel Corp.*, 456 U.S. 556 (1982) (inaccurate professional association report on safety issues violated the antitrust laws when used to undermine a competitor's product); *Federal Trade Comm'n v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 430-32 (1990) (bar association's boycott of case assignments involving indigent defendants violated the antitrust laws even though the boycott involved expression); see also e.g., *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.*, 472 U.S. 749, 758 n.5 (1985) (exchange of pricing and production information by competitors can be proscribed under the antitrust laws).

Court decision in *Associated Press v. United States*³⁷ held that a cooperative agreement of newspapers was not immune from prosecution under the Sherman Act just because the defendants were involved in the transmission of news information and opinion, which receives the highest protection under the First Amendment. That decision is correct because it is never clear whether the AP's members are entitled to invoke the First Amendment to keep the information private, or whether the INS subscribers should invoke that reverse trump card to gain access to information they need. Neither argument has any traction. The proper analysis just notes that cartels tend to reduce output, raise prices, and result in a loss of social welfare that may be remedied by either damages or injunctive relief against participants in the collusive behavior.

That same approach carries over to modern technologies as well. Thus, in *United States v. Microsoft*,³⁸ the question was whether Microsoft abused its monopoly power when it sought to leverage the control of its operating system into control over the market for key applications, most notably web browsers. The monopolization charge raised under Section 2 of the Sherman Act echoed the basic theme associated with the common carrier cases. Microsoft was placing entry barriers against other suppliers of particular competitive applications. That charge could not be answered by Bill Gates' famous, if uninformed, remark that Microsoft had no more duty to accommodate Netscape on its operating system than Coke had a duty to make room for Pepsi bottles in its cartons³⁹ simply because Microsoft had become a common carrier in a way that Coke has not. Given that connections could be established at a zero price point, a material difference from other "common carriers," the only point of contention was the scope of the interconnection obligations fashioned on remand by Judge Colleen Kollar-Kotelly.⁴⁰

To elaborate, Coke and Pepsi are not network industries, which the Internet surely is, so the duties of common carriers could apply to Microsoft to the extent that its operating system enjoyed a monopoly position. Normally the antitrust law cannot be used to regulate a market for a zero-priced good because, as with telecommunications, the regulator has to set specific nonzero rates. But that administrative action is not needed for Microsoft when all interconnections should be done at zero price. The key point here is that the Microsoft settlement ultimately reduced itself to forcing interconnection obligations on Microsoft on reasonable terms, which was the right course generally, though it was arguably bungled on remand.⁴¹ But again note that the problem goes away when multiple hubs obviate both the antitrust and the common carrier obligations, a result that furthers First Amendment values of diversity without relying on the First Amendment.

37 326 U.S. 1 (1945).

38 253 F.3d 34 (D.C. Cir. 2001). For my account, see Richard A. Epstein, *ANTITRUST CONSENT DECREES IN THEORY AND PRACTICE: WHY LESS IS MORE*, ch. 4 (AEI Press 2007); Richard A. Epstein, *Monopolization Follies: The Dangers of Structural Remedies under Section 2 of the Sherman Act*, 76 *ANTITRUST L.J.* 205, 231–37 (2009).

39 See, e.g., *U.S. v. Microsoft—It's a Battle over Metaphors*, C.S. MONITOR (n.d.), <http://www.csmonitor.com/1998/0522/052298.us.us.5.html/%28page%29/2> (last visited Sept. 14, 2013).

40 See *Open Law: The Microsoft Case*, BERKMAN CENTER FOR INTERNET & SOCIETY, <http://cyber.law.harvard.edu/msdoj/>.

41 See William H. Page & Seldon J. Childers, *Measuring Compliance with Compulsory Licensing Remedies in the American Microsoft Case*, 76 *ANTITRUST L.J.* 239 (2009).

A related analysis explains why the antitrust claim against Google did not gain much traction either. As in *Microsoft*, the charges against Google were for monopolization, only in this instance by the use of algorithms that gave Google entries higher places on the search queue than those entries from its competitors. But this opening gambit is where the difficulties begin. Most critically, the higher ranking that Google gives its own entries is not an undivided bad. It may have some negative effect on consumer search costs, but by the same token, even if that were true, several powerful ripostes eventually carried the day. First, its competitors often exhibited the same pattern of search results. Second, the actual Google rankings did not seem off base in comparison with those supplied by others, so allegations of consumer harm were difficult to sustain. Third, users are able in part to detect and correct those ranking errors. Fourth, even if there were some preference, it does not follow that such results are bad for users. With search engines, there are the same trade-offs as with patents. Cutting Google, as the generator of the system, a bit of slack has the additional benefit of inducing a somewhat more rapid deployment of new technologies. In the end, the exhaustive FTC search concluded that the game was not worth the candle.⁴² And for what it is worth, no invocation of the First Amendment could, or should, alter the outcome of the case—whenever Google, Microsoft, or any high technology company acquires market power.

VI. CONCLUSION: BEWARE OF NOVEL FIRST AMENDMENT CLAIMS

This very rapid tour of modern communications law reveals an established truth. It is always necessary to ask how traditional legal doctrines carry over to the novel institutions and practices of a new technological age. The answer is that the older principles may need a bit of tweaking here and there; but in general, if they were sound in their inception, they will do quite well in a new context.⁴³ That result applies in this case whether we look at the novel forms of misappropriation that are generated on the Internet or the principles of common carrier or antitrust regulation of these same technologies. Physical invasions and the misappropriation of information still remain issues, but these can be handled by standard tools of analysis within customary frameworks.

Once that is done, a further proposition becomes clear. Virtually all of these new situations involve the control and dissemination of information, which clearly bring the First Amendment into play. But strangely enough, not for long. The complications about stealing information from websites do not differ all that much from the theft of information from old-style bulletin boards. The antitrust and common carrier rules are driven more by issues of monopoly and its regulation than by the First Amendment, which plays no more role here than it does in cases of rate regulation of common carriers that carry cartons of books to their destination. Plus ça change, plus c'est la même chose: The more things change, the more they remain the same.⁴⁴

42 See *In the Matter of Google, Inc.*, *supra*, Statement of the Federal Trade Commission Regarding Google's Search Practices at 2-3.

43 See Richard A. Epstein, *The Static Conception of Common Law*, 9 J. LEGAL STUD. 253 (1980).

44 *Wiktionary*, http://en.wiktionary.org/wiki/plus_%C3%A7a_change,_plus_c%27est_la_m%C3%Aame_chose (last visited Sept. 14, 2013).

FIRST AMENDMENT PROTECTION FOR SEARCH ENGINE SEARCH RESULTS¹

By Eugene Volokh² and Donald M. Falk³

I. INTRODUCTION

Once, the leading sources to which people turned for useful information were newspapers, guidebooks, and encyclopedias. Today, these sources also include search engine results, which people use (along with other sources) to learn about news, local institutions, products, services, and many other matters. Then and now, the First Amendment has protected all these forms of speech from government attempts to regulate what they present or how they present it. And this First Amendment protection has applied even when the regulations were motivated by a concern about what some people see as “fairness.”

Google, Microsoft’s Bing, Yahoo! Search, and other search engines are speakers. First, they sometimes convey information that the search engine company has itself prepared or compiled (such as information about places appearing in Google Places). Second, they direct users to material created by others, by referencing the titles of Web pages that the search engines judge to be most responsive to the query, coupled with short excerpts from each page. Such reporting about others’ speech is itself constitutionally protected speech.

Third, and most valuably, search engines select and sort the results in a way that is aimed at giving users what the search engine companies see as the most helpful and useful information. (That is how each search engine company tries to keep users coming back to it rather than to its competitors.) This selection and sorting is a mix of science and art: It uses sophisticated computerized algorithms, but those algorithms themselves inherently incorporate the search engine company engineers’ judgments about what material users are most likely to find responsive to their queries.

In this respect, each search engine’s editorial judgment is much like many other familiar editorial judgments:

newspapers’ daily judgments about which wire service stories to run, and whether they are to go “above the fold”;

newspapers’ periodic judgments about which op-ed columnists, lifestyle columnists, business columnists, or consumer product columnists are worth carrying regularly, and where their columns are to be placed;

1 This article grew out of a white paper commissioned by Google, but the views within it should not necessarily be ascribed to Google. This article appeared originally in the Fall 2013 issue of *Icarus*, the journal of the Media and Technology Committee of the ABA’s Antitrust Section.

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guidebooks' judgments about which local attractions, museums, stores, and restaurants to mention, and how prominently to mention them;

the judgment of sites such as DrudgeReport.com about which stories to link to, and in what order to list them.

All these speakers must decide: Out of the thousands of possible items that could be included, which to include, and how to arrange those that are included? Such editorial judgments may differ in certain ways. For example, a newspaper also includes the materials that its editors have selected and arranged, while the speech of Drudge Report.com or a search engine consists almost entirely of the selected and arranged links to others' material. But the judgments are all, at their core, editorial judgments about what users are likely to find interesting and valuable. And all these exercises of editorial judgment are fully protected by the First Amendment.

That is so even when a newspaper simply makes the judgment to cover some particular subject matter. For instance, when many newspapers published TV listings, they were free to choose to do so without regard to whether this choice undermined the market for *TV Guide*. Likewise, search engines are free to include and highlight their own listings of (for example) local review pages even though Yelp might prefer that the search engines instead rank Yelp's information higher. And this First Amendment protection is even more clearly present when a speaker, such as Google, makes not just the one include-or-not editorial judgment, but rather many judgments about how to design the algorithms that produce and rank search results that—in Google's opinion—are likely to be most useful to users.

Of course, search engines produce and deliver their speech through a different technology than that traditionally used for newspapers and books. The information has become much easier for readers to access, much more customized to the user's interests, and much easier for readers to act on. The speech is thus now even more valuable to customers than it was before. But the freedom to distribute, select, and arrange such speech remains the same.

We will discuss this in detail below, both as to the First Amendment generally (Part III) and as to the intersection of First Amendment law and antitrust law (Part IV). We focus in this submission on Google search results for which no payment has been made to Google, because they have been the subject of recent debates; we do not discuss, for instance, the ads that Google often displays at the top or on the right-hand side of the search results page.

II. ACCUSATIONS AND FACTS

The accusations by certain competitors against Google and the facts bearing on those accusations have been covered in Google's previous filings, and will not be repeated here. Briefly, the heart of the accusations is that Google somehow prioritizes its own thematic search results over results originating from specialized competitors. Whether this is so is a contested question, which turns, among other things, on disputes about what would constitute "neutral" judgments and what would be a departure from those judgments. Yet even if it is assumed that Google engages or plans to engage in such prioritizing, that

prioritizing would constitute the legitimate exercise of Google's First Amendment right to decide how to present information in its speech to its users.

III. THE FIRST AMENDMENT FULLY PROTECTS SEARCH ENGINE RESULTS

Two federal court decisions have held that search results, including the choices of what to include in those results, are fully protected by the First Amendment. *Search King, Inc. v. Google Technology, Inc.* concluded that Google's rankings of pages were "subjective result[s]" that constituted "constitutionally protected opinions" "entitled to full constitutional protection." No. 02-1457, 2003 U.S. Dist. LEXIS 27193, at *12, 2003 WL 21464568, at *4 (W.D. Okla. May 27, 2003) (internal citations and quotation marks omitted). Likewise, *Langdon v. Google, Inc.*, refused to order Google and Microsoft to prominently list plaintiff's site in their search results, reasoning: "The First Amendment guarantees an individual the right to free speech, 'a term necessarily comprising the decision of both what to say and what not to say.' . . . [T]he injunctive relief sought by Plaintiff contravenes Defendants' First Amendment rights." 474 F. Supp. 2d 622, 629-30 (D. Del. 2007) (citing *Riley v. Nat'l Fed'n of the Blind of N.C., Inc.*, 487 U.S. 781, 796-97 (1988), *Miami Herald Publ'g Co. v. Tornillo*, 418 U.S. 241, 256 (1974), and other cases). Just as newspapers cannot be forced to print either editorial content or advertising, the court held, so search engines cannot be forced to include links that they wish to exclude. *Id.* at 630.

And Supreme Court precedents compel the conclusion reached by these two courts, for eight related reasons. First, Internet speech is fully constitutionally protected. Second, choices about how to select and arrange the material in one's speech product are likewise fully protected. Third, this full protection remains when the choices are implemented with the help of computerized algorithms. Fourth, facts and opinions embodied in search results are fully protected whether they are on nonpolitical subjects or political ones. Fifth, interactive media are fully protected. Sixth, the aggregation of links to material authored by others is fully protected. Seventh, none of this constitutional protection is lost on the theory that search engine output is somehow "functional" and thus not sufficiently expressive. And, eighth, Google has never waived its rights to choose how to select and arrange its material.

A. The First Amendment Fully Protects Internet Speech

To begin with, the First Amendment protects communications delivered over the Internet as much as it protects traditional print communications. *Reno v. ACLU*, 521 U.S. 844 (1997). The Supreme Court's First Amendment precedents "provide no basis for qualifying the level of First Amendment scrutiny that should be applied to this medium [the Internet]." *Id.* at 870.

B. The First Amendment Fully Protects Editorial Choices About What to Include or Exclude in One's Speech Product

Just as the First Amendment fully protects Internet speech, it also fully protects Internet speakers' editorial judgments about selection and arrangement of content. As the Supreme Court held in *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, 258 (1974),

the freedom to speak necessarily includes the right to choose what to include in one's speech and what to exclude. And the Court later reinforced that principle: "Since *all* speech inherently involves choices of what to say and what to leave unsaid,' *Pacific Gas & Electric Co. v. Public Utilities Commission of California*, 475 U.S. 1, 11 (1986) (plurality opinion) (emphasis in original), one important manifestation of the principle of free speech is that one who chooses to speak may also decide 'what not to say,' *id.* at 16." *Hurley v. Irish-Am. Gay, Lesbian & Bisexual Grp. of Boston*, 515 U.S. 557, 573 (1995).

A speaker is thus entitled to choose to present only the speech that "in [its] eyes comports with what merits" inclusion. *Id.* at 574. And this right to choose what to include and what to exclude logically covers the right of the speaker to choose what to include on its front page, or in any particular place on that page. The government may not tell the Huffington Post or the Drudge Report how to rank the news stories or opinion articles to which they link. Likewise, it may not do so for other speakers, such as search engines.

And this is true even when the government argues that a speaker's choices are unfair to others. "A responsible press is an undoubtedly desirable goal, but press responsibility is not mandated by the Constitution and like many other virtues it cannot be legislated." *Miami Herald*, 418 U.S. at 256. The "point" of the rule that speakers may choose what to include and what to exclude "is simply the point of all speech protection, which is to shield just those choices of content that in someone's eyes are misguided, or even hurtful." *Hurley*, 515 U.S. at 574.

The Court has also made clear that this right to choose what to include and what to exclude in one's speech is not "restricted to the press, being enjoyed by business corporations generally and by ordinary people engaged in unsophisticated expression as well as by professional publishers." *Hurley*, 515 U.S. at 574, 575-76 (applying *Miami Herald* to protect the rights of a parade organizer). "The concerns that caused [the Court] to invalidate the compelled access rule in [*Miami Herald*] apply to appellant [a utility company sending material to its customers] as well as to the institutional press." *Pac. Gas & Elec. Co.*, 475 U.S. at 11 (plurality opinion), 21-26 (Marshall, J., concurring in the judgment) (not noting any disagreement with the majority on this matter). And this in turn is just a special case of the broader principle that First Amendment rights extend equally to the institutional press and to other speakers. *See, e.g., Citizens United v. FEC*, 558 U.S. 310, 351-52, 130 S. Ct. 876, 905 (2010) ("We have consistently rejected the proposition that the institutional press has any constitutional privilege beyond that of other speakers.") (quotation marks and internal citations omitted); *First Nat'l Bank of Boston v. Bellotti*, 435 U.S. 765, 782 n.18 (1978) (rejecting the "suggestion that communication by corporate members of the institutional press is entitled to greater constitutional protection than the same communication by [non-institutional-press businesses]"); *Lovell v. City of Griffin*, 303 U.S. 444, 452 (1938) (stating that the freedom of the press "embraces pamphlets and leaflets" as well as "newspapers and periodicals," and indeed "comprehends every sort of publication which affords a vehicle of information and opinion"). Google, Microsoft's Bing, Yahoo! Search, and other search engine companies are rightly seen as media enterprises, much as the New York Times Company or CNN are media enterprises. And in any event, the First Amendment fully protects speech by all speakers, whether they are media enterprises or not.

C. That Search Engine Results Are Created with the Help of Computerized Algorithms Does Not Rob Them of First Amendment Protection

Search engine selection decisions are indeed the result not just of individual editorial choices, but also of the computerized algorithms that search engine employees have created to implement these choices. That is necessary given the sheer volume of information that search engines must process, and given the variety of queries that users can input. Such automation is necessary for users to get free, convenient, quick, and comprehensive access to speech—both the speech of the search engines expressing their decisions about how to rank and organize content, and the speech of the sites referenced by the search engines’ speech.

Such automation does not reduce the First Amendment protection afforded to search engine results, for three related reasons. First, the computer algorithms that produce search engine output are written by humans. Humans are the ones who decide how the algorithm should predict the likely usefulness of a Web page to the user. These human editorial judgments are responsible for producing the speech displayed by a search engine. For instance, Google’s ground-breaking use of the volume of links from other sites as a criterion for ranking search results was itself the result of Google engineers’ editorial judgment that inbound links provided a sound and quantifiable measure of a site’s value. Search engine results are thus the speech of the corporation, much as the speech created or selected by corporate newspaper employees is the speech of the newspaper corporation.

Second, the First Amendment value of speech also stems from the value of the speech to listeners or readers. *See, e.g., First Nat’l Bank of Boston v. Bellotti*, 435 U.S. 765 (1978); *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council*, 425 U.S. 748 (1976); *Lamont v. Postmaster Gen.*, 381 U.S. 301, 307–08 (1965) (Brennan, J., concurring). As we mentioned, the automation process only increases the value of the speech to readers beyond what purely manual decision-making can provide. Finally, the objections to Google’s placement of its thematic search results arise precisely because Google employees are said to have made a conscious choice to include those results in a particular place.

D. The First Amendment Fully Protects Facts and Opinions on Nonpolitical Subjects

Much of the speech distributed by search engines responds to searches on political, religious, or scientific topics. And if the government asserts the power to constrain Google’s ordering of search results, that power would logically extend to search results for political queries (e.g., “the best book about Mitt Romney” or “is global warming happening”) as much as for other queries. The First Amendment clearly forbids such use of government authority. *See, e.g., Police Dep’t of Chicago v. Mosley*, 408 U.S. 92, 96 (1972) (holding that the government acting as regulator may not prefer some ideas over others).

But even query results that relate to less elevated matters remain fully constitutionally protected, because the First Amendment protects even speech that is not closely linked to political or religious debates. As the Court pointed out just two years ago:

Most of what we say to one another lacks “religious, political, scientific, educational, journalistic, historical, or artistic value” (let alone serious value), but it is still sheltered from government regulation. Even “[w]holly neutral utilities . . . come under the protection of free speech as fully as do Keats’ poems or Donne’s sermons.”

United States v. Stevens, 559 U.S. 460, 479–80, 130 S. Ct. 1577, 1591 (2010) (emphasis and ellipsis in original) (quoting *Cohen v. California*, 403 U.S. 15, 25 (1971) (internal quotation marks omitted)).

And the First Amendment also protects the collection and communication of facts as much as it protects opinions, including facts that are not ideologically laden—such as names of crime victims in three-sentence crime reports, names of accused juvenile offenders, lists of bestselling books, lists of tenants who had been evicted by local landlords, information in a mushroom encyclopedia, recipes in a cookbook, and computer program source code. See, respectively, *Florida Star v. B.J.F.*, 491 U.S. 524 (1989); *Okla. Publ’g Co. v. District Court*, 430 U.S. 308 (1977); *Blatty v. N.Y. Times Co.*, 42 Cal. 3d 1033 (1986); *U.D. Registry, Inc. v. California*, 34 Cal. App. 4th 107, 111 (1995); *Winter v. G.P. Putnam’s Sons*, 938 F.2d 1033, 1037 (9th Cir. 1991); *Universal City Studios, Inc. v. Corley*, 273 F.3d 429, 447 (2d Cir. 2001) (dictum); *Junger v. Daley*, 209 F.3d 481, 485 (6th Cir. 2000). As the Supreme Court has held, “information is speech,” *Sorrell v. IMS Health, Inc.*, 131 S. Ct. 2653, 2667 (2011),⁴ and “[the] general rule, that the speaker has the right to tailor the speech [by choosing what to say and what to leave unsaid], applies not only to expressions of value, opinion, or endorsement, but equally to statements of fact the speaker would rather avoid,” *Hurley v. Irish-American Gay, Lesbian & Bisexual Group of Boston*, 515 U.S. 557, 573 (1995). Any theory that search results lack full First Amendment protection because they are “mere facts” thus lacks support.

Of course, search engine results are in reality not simply facts: They are collections of facts that are organized and sorted using the judgment embodied in the engines’ algorithms, and those judgments and algorithms represent the search engine companies’ opinions about what should be presented to users. See, e.g., *Search King, Inc. v. Google Tech., Inc.*, No. 02-1457, 2003 U.S. Dist. LEXIS 27193, at *12, 2003 WL 21464568, at *4 (W.D. Okla. May 27, 2003) (concluding that Google’s rankings of pages were “constitutionally protected opinions”). But even to the extent that search engine results could be treated as primarily consisting of facts rather than opinions, they remain fully constitutionally protected.

E. The First Amendment Fully Protects Interactive Media

Search engine output is in many ways more interactive than traditional print—users get different results depending on the particular queries they enter, as well as on the user’s location, the user’s search history, and other factors. But the First Amendment protects interactive media as well as noninteractive ones, and new media as well as the centuries-

⁴ In *Sorrell* there was an argument that the speech was subject to the somewhat lower protection offered for commercial advertising, because the speech itself was used as part of an advertising transaction. This is not so for Google’s speech discussed here, and it was not so in the other cases mentioned in this paragraph. But *Sorrell*’s broader point remains applicable: Whether or not speech is commercial advertising, the protection given to factual speech is the same as that given to ideas.

old ones. See *Brown v. Entertainment Merchs. Ass'n*, 131 S. Ct. 2729, 2738 (2011) (holding that even violent video games are constitutionally protected, despite their interactivity). Indeed, the fact that interactive search engine outputs are more personalized than a traditional book or newspaper simply makes them especially valuable to readers.

F. The First Amendment Fully Protects Aggregation of Materials Authored by Others

Search engines are also fully constitutionally protected in showing short excerpts from selected other sites, rather than creating content themselves. The First Amendment protects the decisions to include or exclude others' content, based on the speakers' exercise of their judgment, as much as it protects the authoring of the content in the first place. As the Supreme Court made clear in deciding that a parade organizer is protected by the First Amendment—even though the parade simply consists of others' floats:

First Amendment protection [does not] require a speaker to generate, as an original matter, each item featured in the communication. . . . [T]he presentation of an edited compilation of speech generated by other persons is a staple of most newspapers' opinion pages, which, of course, fall squarely within the core of First Amendment security, *Miami Herald Pub. Co. v. Tornillo*, as does even the simple selection of a paid noncommercial advertisement for inclusion in a daily paper, see *New York Times v. Sullivan*.

Hurley v. Irish-Am. Gay, Lesbian & Bisexual Grp., 515 U.S. 557, 570 (1995). And that was so even when the parade was highly unselective, allowing nearly all applicants to march. *Id.* at 569–70. Search engines are vastly more selective, with the first page of the output containing only a tiny fraction—though, in the search engine companies' views, the most useful fraction—of all the potentially relevant Web pages. Search engines' selectivity is much more comparable to the selectivity of newspaper op-ed pages, which choose to feature only a small fraction of potential columns. Thus, even though the search engine does not generate the content that is linked to by its results, the judgments and opinions about how to rank and present those results are fully protected by the First Amendment.

So what is true for parades and newspaper op-ed pages is at least as true for search engine output. When search engines select and arrange others' materials, and add the all-important ordering that causes some materials to be displayed first and others last, they are engaging in fully protected First Amendment expression—“[t]he presentation of an edited compilation of speech generated by other persons.” *Id.* at 570.

G. The Rules Governing Speech That Is Acted on Mechanically Are Inapplicable Here

Some contents of a Web page may be acted on mechanically, with no user judgment, and may therefore be more subject to regulation in some circumstances. Thus, for instance, if a Web page contains a virus, courts and legislatures may be able to impose liability on the producer of the page.⁵ The same would be true if the page knowingly

5 We do not say that such liability is currently the law, or that it would be a good legal rule to have; we only say that such liability likely would not violate the First Amendment.

displays a link that, when clicked on, triggers such a virus. Analogous examples with paper publications are rare, but one can imagine some: If some of the chemicals used in a fashion magazine's "scratch and sniff" perfume insert prove poisonous to some readers, that might lead to liability.

This conclusion might also support the results in the aeronautical charts cases, in which people were allowed to recover damages against manufacturers who provided factually erroneous aeronautical charts. See, e.g., *Brocklesby v. United States*, 767 F.2d 1288, 1294-95 (9th Cir. 1985). As we noted above, even purely factual information—such as that given in an encyclopedia of mushrooms—is constitutionally protected. But as a federal appellate court explained in distinguishing aeronautical charts from the mushroom encyclopedia, “[a]eronautical charts are highly technical tools” akin to compasses, which are “like a physical ‘product’” rather than like speech. *Winter v. G.P. Putnam’s Sons*, 938 F.2d 1033, 1036 (9th Cir. 1991).

People use aeronautical charts not by considering whether to follow the charts’ advice, contemplating using a different chart, or deciding which of the charts’ many recommendations should be accepted. Chart users just apply the information given in the charts. Charts are authoritative, especially in an environment where quick decisions are necessary and lives are at stake.

But search engines’ speech about goods and services, which people read and evaluate at leisure and often with skepticism, is not “a physical ‘product’” akin to a compass. Rather, like the mushroom encyclopedia, the information output by a search engine “is pure . . . expression,” *id.*, and restrictions on the format and distribution of such information implicate the First Amendment, *id.* at 1037.

H. Google Has Never Surrendered the Right—Which All Speakers Possess—to Choose What Information It Presents and How It Presents It

Finally, some of Google’s critics assert that any speech by Google that prefers Google’s thematic search results is misleading. Customers, the argument goes, have allegedly come to expect that Google will choose search results based solely on supposedly “neutral” computer algorithms, with no preference for Google’s thematic search results. But the critics cannot point to any such guarantees to customers, because Google makes no such guarantees. Google has never given up its right as a speaker to select what information it presents and how it presents it.

And the First Amendment does not let the government hold a speaker liable on the theory that the speaker’s alleged biases deny readers the balanced presentation that they supposedly expect. That the *New York Times* has spoken of publishing “all the news that’s fit to print” cannot justify holding the newspaper liable for slighting some stories that the government or a third party may feel are even more important than what the *Times* chooses to print.

The precedents bear this out. That the *Times* bestseller list is said to be “based on computer-processed sales figures from about 2,000 bookstores in every region of the United States” cannot justify a lawsuit objecting to the *Times*’ supposedly misleading

exclusion of one book, on the theory that the *Times* represented the list as an “objective, unbiased and accurate compilation of actual sales.” *Blatty v. N.Y. Times Co.*, 42 Cal. 3d 1033, 1046 n.2 (1986). And an information technology advisor’s describing its “analysis [as] being ‘fact-based and knowledge-centric,’ ‘built on objectivity,’ and founded on a methodology it says ensures the ‘ultimate objectivity’” cannot justify a lawsuit objecting to a particular ranking as being supposedly contrary to the publisher’s assurance of objectivity and therefore misleading. *ZL Techs., Inc. v. Gartner, Inc.*, 709 F. Supp. 2d 789, 797-98 (N.D. Cal. 2010). Even such express assertions of an objective foundation, the *ZL Technologies* court held, “are insufficient to transform the tenor of the rankings . . . from opinion to fact,” *id.* at 798, and thus to diminish the speaker’s right to exercise its judgment in crafting such rankings. This is so even when the rankings are allegedly biased by the speaker’s economic incentives, *id.* at 801 n.4.

It is clearer still that the government may not demand that a search engine live up to some hypothetical and undefined expectations of abstract objectivity. Reasonable users understand that determining which of the billions of Internet pages are the most useful responses to any particular query necessarily involves a great deal of subjective judgment, and that search engine companies might well conclude that material produced by themselves will be especially useful and thus merits being prominently displayed. And reasonable users would not expect that Google would lock itself into a set of ranking and display criteria used at any particular time—indeed, given the rapid innovation that has characterized the Internet generally and search engines specifically, change in algorithm design should and would be expected.

If users do find Google’s results to be unreliably skewed, Google will be punished by the marketplace, as frustrated users shift to other easily available search engines.⁶ Users’

6 Google’s rivals are naturally promoting what they say is the superior quality of their search technology, both as to its selection decisions and as to the arrangement of results on the page—that is to say, their own supposedly superior editorial judgment—in order to persuade users to switch. See, e.g., Tim Addington, *Bing Will Take Market Share from Google*, B & T (Australia), Nov. 15, 2011, <http://www.bandt.com.au/news/latest-news/bing-will-take-market-share-from-google/> (quoting “Stefan Weiz, senior director of Bing search,” as saying, “I think we are going to take share away in certain areas because we are going to have a better experience and they are going to maintain share in certain areas because they have a good experience”); Dr. Jan Pedersen, Chief Scientist for Core Search at Bing, *Bing Search Quality Insights: Whole Page Relevance*, Mar. 5, 2012, http://www.bing.com/blogs/site_blogs/b/search/archive/2012/03/05/bing-search-quality-insights-whole-page-relevance.aspx (promoting the result selection and arrangement technology of Microsoft’s Bing as supposedly being better for users); UKTeam, *Bing Announces Significant Improvements to Instant Answer and News Searches*, Apr. 26, 2011, http://www.bing.com/blogs/site_blogs/b/uk/archive/2011/04/26/bing-announces-significant-improvements-to-instant-answer-and-news-searches.aspx (discussing changes in Microsoft’s Bing search, and closing with “The search improvements are a result of customer feedback and research, and closely follow news that Bing has gained a greater market share in the UK. With more and more room to grow we look forward to further developments in the future and will continue to keep you all updated. We hope you enjoy the new features!”); Dave Copeland, *Is Microsoft Driving at Google with Bing Maps Improvements & Patent?*, Jan. 5, 2012, READWRITEWEB, <http://readwrite.com/2012/01/05/is-microsoft-driving-at-google-with-bing-maps-impr/> (“Microsoft announced enhancements to its Bing Maps, including a change to the algorithm that allows the service to process directions requests twice as fast and help drivers avoid traffic. Those changes, along with a newly-awarded patent for a feature that allows Bing Maps to route pedestrians away from unsafe neighborhoods, suggest Microsoft is driving to surpass Google Maps, which has dominated the space since surpassing MapQuest in site traffic and queries in 2008.”).

appreciation of the usefulness of Google’s search results is what brought so many users to Google in the first place. If users start doubting the usefulness of Google’s results, the users will switch to another search engine. But the First Amendment denies government the power to police the “fairness” of search engine speech, just like the First Amendment denies government the power to police the fairness of newspaper speech.⁷

IV. THE FIRST AMENDMENT PROTECTS SEARCH ENGINE RESULTS AGAINST ANTITRUST LAW

Businesses that engage in speech, like other businesses, are covered by antitrust law when it comes to restrictions on their nonspeech business practices, such as the licensing of content. *Associated Press v. United States*, 326 U.S. 1 (1945). But antitrust law itself, like other laws, is limited by the First Amendment, and may not be used to control what speakers say or how they say it.

A clear example of this comes in the *Noerr/Pennington* line of cases. Antitrust law generally prohibits organizations from unreasonably restraining competition. But when organizations try to restrain trade by speaking to legislators and to the public, and urging the listeners to enact anticompetitive regulations, such speech is immunized from liability. A contrary conclusion, the Court has held, would “invade” the protection offered by the First Amendment. *E.R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); see also *United Mine Workers v. Pennington*, 381 U.S. 657 (1965). Indeed, the Supreme Court took the view that it should interpret the antitrust laws to avoid any interpretation that would even “raise important constitutional questions.” *Noerr*, 365 U.S. at 138; see also *FTC v. Superior Court Trial Lawyers Ass’n*, 493 U.S. 411, 424 (1990) (noting the *Noerr* Court’s interpretation of the Sherman Act “in the light of the First Amendment[]”).

Likewise, antitrust law cannot be used to require a speaker to include certain material in its speech product. *Associated Press v. United States*, the 1945 Supreme Court case that held that the press may generally be covered by antitrust law, stressed that the lower court’s decree “does not compel AP or its members to permit publication of anything which their ‘reason’ tells them should not be published,” 326 U.S. at 20 n.18. And the Court has since made clear, in *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, 256 (1974), that the First Amendment bars orders that a newspaper “print that which it would not otherwise print,” even when those orders apply antitrust law:

[B]eginning with *Associated Press, supra*, the Court has expressed sensitivity as to whether a restriction or requirement constituted the compulsion exerted by government on a newspaper to print that which it would not otherwise print. The clear implication has been that any such a compulsion to publish that which “‘reason’ tells them should not be published” is unconstitutional.

To be sure, it is constitutionally permissible to stop a newspaper from “forcing advertisers to boycott a competing” media outlet, when the newspaper refuses

7 For a particularly effective—and amusing—illustration of the analogy between calls for regulating search and what would be clearly unconstitutional calls for regulating news, see Danny Sullivan, SEARCH ENGINE LAND, July 15, 2010, <http://searchengineland.com/regulating-the-new-york-times-46521>.

advertisements from advertisers who deal with the competitor. *Lorain Journal Co. v. United States*, 342 U.S. 143, 152, 155 (1951). But the newspaper in *Lorain Journal Co.* was not excluding advertisements because of their content, in the exercise of some editorial judgment that its own editorial content was better than the proposed advertisements. Rather, it was excluding advertisements solely because the advertisers—whatever the content of their ads—were also advertising on a competing radio station. *The Lorain Journal Co.* rule thus does not authorize restrictions on a speaker’s editorial judgment about what content is more valuable to its readers. See also *Superior Court Trial Lawyers Ass’n*, 493 U.S. 411 (stressing that a boycott violated antitrust law not because of the defendants’ speech or lobbying, but because of the “concerted refusal” to engage in commercial transactions); *Nat’l Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 697 (1978) (stressing that an injunction against a professional association’s adoption of a ban on competitive bidding was constitutional because the ban was implemented in reaction to a Sherman Act violation that consisted of an “agreement among competitors to refuse to discuss prices with potential customers until after negotiations have resulted in the initial selection of an engineer,” *id.* at 692).

Search engines’ decisions about where to display certain search results do not involve any such illegal agreements, or attempts to force advertisers to boycott the search engines’ competitors. Instead, search engines’ selection and arrangement decisions reflect editorial judgments about what to say and how to say it, which are protected by the First Amendment. As the Tenth Circuit made clear in *Jefferson Cnty. Sch. Dist. No. R-1 v. Moody’s Investor Servs.*, 175 F.3d 848, 860 (10th Cir. 1999), cases such as *Lorain Journal*, *Superior Court Trial Lawyers Ass’n*, and *National Society of Professional Engineers* “do not suggest that merely engaging in protected speech may constitute an antitrust violation.” “[T]he First Amendment does not allow antitrust claims to be predicated solely on protected speech.” *Id.* Likewise, the Ninth Circuit has concluded that even a newspaper that was plausibly alleged to have a “substantial monopoly” could not be ordered to run a movie advertisement that it wanted to exclude, because “[a]ppellant has not convinced us that the courts or any other governmental agency should dictate the contents of a newspaper.” *Assocs. & Aldrich Co. v. Times Mirror Co.*, 440 F.2d 133, 135 (9th Cir. 1971). And the Tennessee Supreme Court similarly stated that “[n]ewspaper publishers may refuse to publish whatever advertisements they do not desire to publish and this is true even though the newspaper in question may enjoy a virtual monopoly in the area of its publication.” *Newspaper Printing Corp. v. Galbreath*, 580 S.W. 2d 777, 779 (Tenn. 1979).

This principle that even generally applicable economic regulations may not be used to require a speaker to include certain material in its speech product is not confined to antitrust law; it is equally visible, for example, in the labor law cases. Labor law, like antitrust law, is aimed at protecting against misuse of economic power. And labor law, like antitrust law, may usually be lawfully applied to most business decisions by newspapers and other speakers. Yet the Court has stressed “the full freedom and liberty of” a speaker “to publish the news as it desires it published or enforce policies of its own choosing with respect to the editing and rewriting of news for publication.” *Associated Press v. NLRB*, 301 U.S. 103, 133 (1937).

Likewise, federal appellate courts have reaffirmed that “the First Amendment erects a barrier against government interference with a newspaper’s exercise of editorial control over its content.” *McDermott v. Ampersand Publ’g, LLC*, 593 F.3d 950, 959 (9th

Cir. 2010). The NLRB, for instance, is not allowed to force newspapers to yield editorial control to union members, keep publishing an employee's column, or keep an employee as part of the publisher's editorial writing staff. *See, respectively, id.; Passaic Daily News v. NLRB*, 736 F.2d 1543, 1558 (D.C. Cir. 1984); *Wichita Eagle & Beacon Publ'g. Co., Inc. v. NLRB*, 480 F.2d 52, 56 (10th Cir. 1973) (holding that the NLRB's ruling blocking the transfer of an employee from the editorial writing department "infringe[s] upon the newspaper's freedom to determine the content of its editorial voice in an atmosphere of free discussion and exchange of ideas"). "The Supreme Court has implied consistently that newspapers have absolute discretion to determine the contents of their newspapers." *Passaic Daily News*, 736 F.2d at 1557. "Implementation of a remedy that requires governmental coercion gives rise to a confrontation with the First Amendment." *Id.* at 1558. The First Amendment bars the government from controlling what speakers say and how they say it, even when the government's motivation is to correct a perceived unfair use of economic power.

And, as discussed above, these principles apply equally to all speakers, whether they create newspapers or other speech. Indeed, the *Miami Herald v. Tornillo* principle has been applied even to parades, including ones that have far more viewers than other parades are likely to have. Even when "the size and success of [a] parade makes it an enviable vehicle for the dissemination of [a speaker's] views," that sort of influence on the parade's part cannot justify ordering the parade to include floats that the organizers want to exclude. *Hurley v. Irish-Am. Gay, Lesbian & Bisexual Grp.*, 515 U.S. 557, 577-78 (1995).

Moreover, the one case in which the Court did uphold a law that required speakers to include certain kinds of speech, *Turner Broadcasting System, Inc. v. FCC*, 512 U.S. 622 (1994), relied on the fact that the speakers in that case—who were cable system operators—were physically able to "prevent . . . subscribers from obtaining access to programming [the operator] chooses to exclude." *Id.* at 656. The Court stressed that its decision to uphold the must-carry law did not stem simply from a judgment that a cable company had market power. The Court made clear that its analysis would not apply to newspapers, "no matter how secure [their] local monopoly," because such a newspaper "does not possess the power to obstruct readers' access to other competing publications." *Id.* Instead of focusing on market share, the Court focused on the physical power of the cable operator to block speakers: "A cable operator, unlike speakers in other media, can . . . silence the voice of competing speakers with a mere flick of the switch." *Id.*

Search engine operators, no matter what their alleged market shares may be, lack any such physical power because of how the Internet works. In 1994, each home usually had access only to one cable provider. But each home has access, with just a click of the mouse, to Google, Microsoft's Bing, Yahoo! Search, and other general-purpose search engines, as well as to almost limitless other means of finding content on the Internet, including specialized search engines, social networks, and mobile apps.

As the later *Hurley* case explained, *Turner* also rests on the fact that cable system operators were seen at the time as merely "a conduit" for others' speech that viewers did not perceive as edited or compiled into a coherent item by the cable operator. *Hurley*, 515 U.S. at 575; *Turner*, 512 U.S. at 629 ("the cable system functions, in essence, as a conduit for the speech of others, transmitting it on a continuous and unedited basis to subscribers"). But the *Turner* approach does not apply where the speaker is compiling and

editing a speech product of its own—such as a single page that contains text selected and presented in a way that “in the [speaker’s] eyes comports with what merits” inclusion. *Hurley*, 515 U.S. at 574 (stating this as to parades).

As *Hurley* held, the *Turner* “conduit” metaphor is “not apt” where the inclusion of some item of speech “would likely be perceived as having resulted from the [speaker’s] customary determination . . . that [the] message [of any component of the speech] was worthy of presentation.” *Id.* at 575. That is precisely the perception that users are likely to have when viewing search engine results: Users assume that each link was judged by the search engine as “worthy of presentation,” because the very point of using a search engine is to narrow down the billions of Web pages into those that the engine views as worth presenting.

In such a situation, whether it involves a parade, a newspaper, or a page of results displayed by a search engine, the First Amendment fully protects the speaker’s “autonomy to control [its] own speech.” *Id.* For search engine output, as for the contents of a parade or of a newspaper, “[t]he choice of material . . . and the decisions made as to limitations on the size and content . . . —whether fair or unfair—constitute the exercise of editorial control and judgment” upon which the State cannot intrude. *Id.* at 575 (quoting *Tornillo*, and explaining why *Turner* is inapplicable).

V. CONCLUSION

Google, Microsoft’s Bing, and Yahoo! Search exercise editorial judgment about what constitutes useful information and convey that information—which is to say, they speak—to their users. In this respect, they are analogous to newspapers and book publishers that convey a wide range of information from news stories and selected columns by outside contributors to stock listings, movie listings, bestseller lists, and restaurant guides. And all of these speakers are shielded by the First Amendment, which blocks the government from dictating what is presented by the speakers or the manner in which it is presented.

DOES THE FIRST AMENDMENT IMMUNIZE GOOGLE'S SEARCH ENGINE SEARCH RESULTS FROM GOVERNMENT ANTITRUST SCRUTINY?

Paula Lauren Gibson¹

I. INTRODUCTION

For several years now, Google has faced allegations from various fronts of purported violations of the antitrust laws in regards to its manipulation of its vertical shopping search engine results.² Vertical shopping competitors³ have filed complaints with the FTC and the State Attorneys General.⁴ Those complaints alleged, among other things, that Google violated the antitrust laws⁵ by giving itself preferential treatment in the search results of its own properties through the manual manipulation of its search engine algorithm in order to demote the offerings of rivals, notwithstanding in some cases the alleged superior content of the rival pages.⁶

This article will address only one issue: Whether Google vertical shopping search engine results are “opinions” and, as such, would be protected by the First Amendment

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- 1 The author is a Deputy Attorney General for the State of California in the Antitrust Law Section. The views and opinions expressed in this page are strictly those of the author and are not the views or opinions of the Office of the California Attorney General, the American Bar Association, or the State Bar of California. Annette Goode-Parker, Sr. Legal Analyst, provided invaluable assistance in the research and writing of this article. This article appeared originally in the Fall 2013 issue of *Icarus*, the journal of the Media and Technology Committee of the ABA's Antitrust Section.
 - 2 This article distinguishes between vertical shopping search engine results and organic search engine results. “*Organic search results* are listings on search engine results pages that appear because of their relevance to the search terms, as opposed to their being advertisements.” *Organic Search*, WIKIPEDIA (Sept. 14, 2013), available at http://en.wikipedia.org/wiki/Organic_search; A *vertical search engine*, as distinct from a general web search engine, focuses on a specific segment of online content. *Id.*, *Vertical Search*, available at http://en.wikipedia.org/wiki/Vertical_search. This distinction could be a basis for determining the relevant market for establishing monopoly power.
 - 3 Google's 10-K for the year ending December 31, 2012 describes these vertical shopping engines as “competitors.” See Google, Inc., Annual Report (Form 10-K), at 8 (Jan. 29, 2013) (“Our business is characterized by rapid change and converging, as well as new and disruptive, technologies. We face formidable competition in every aspect of our business, particularly from companies that seek to connect people with information on the web and provide them with relevant advertising. We face competition from: Vertical search engines and e-commerce websites, such as Kayak (travel queries), Monster.com (job queries), WebMD (for health queries), and Amazon.com and eBay (e-commerce)”), available at <http://www.sec.gov/Archives/edgar/data/1288776/000119312513028362/d452134d10k.htm>.
 - 4 Google's competitors have also filed complaints with the European Commission, which are not discussed herein due to this paper's focus upon the First Amendment of the U.S. Constitution.
 - 5 Whether this conduct violates the antitrust laws has been the subject of great debate. Indeed, the Federal Trade Commission determined that ranking system's benefits to consumers outweigh any harm suffered by rivals and declined to take formal action against Google under Section 5 of the FTC Act. In the Matter of Google, Inc., Statement of the Federal Trade Commission Regarding Google's Search Practices, FTC No. 111-0163 (Jan. 3, 2013), available at <http://ftc.gov/os/2013/01/130103googlesearchstntofcomm.pdf>.
 - 6 See <http://www.fairsearch.org/> for a complete discussion of these competitors' positions and concerns.

of the U.S. Constitution⁷ and/or its state counterparts⁸ from any regulation based on alleged violations of the antitrust laws?⁹

To do so, this article will first examine whether computerized search engine results are the equivalent of speech and whether such speech amounts to being an opinion. Next, this article will examine whether, if such speech amounts to being an opinion, whether it is entitled to First Amendment protection from government action, in particular, enforcement of the antitrust laws. Through its examination of various cases, including two in which Google asserted a First Amendment defense against private parties, this article will explore the applicable factors and applicable level of constitutional scrutiny assuming that some level of First Amendment protection applies. Ultimately, this article will conclude that a First Amendment defense is likely not available to Google should a government enforcer bring an action on the ground that Google's search engine's mode of operation violates the antitrust laws.

II. SEARCH ENGINE RESULTS DERIVED FROM COMPUTER CODE ARE SPEECH

Search engine results are formulated through the use of algorithms. An *algorithm* is a computer code that provides a step-by-step procedure for calculation or data processing.¹⁰ It is as much a language as English with a structure and a vocabulary that can be used to carry out complex functions or express complex thoughts. Even though algorithms use the language of computer code, and ultimately carry out their functions on a computer via the use of binary code with ones and zeros, such code may still be regarded as "speech" for constitutional purposes.¹¹ In *Universal City Studios Inc. v. Corley* ("Corley"), the United States Court of Appeals for the Second Circuit drew an analogy between computer code and musical compositions or mathematical equations, indicating that the obscurity or difficulty of understanding what is written does not make "computer code . . . distinguishable from

7 "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances." U.S. CONST., amend. I, available at http://www.law.cornell.edu/constitution/first_amendment.

8 For California's version of the First Amendment, see CAL. CONST., art. I, § 2, available at www.leginfo.ca.gov/cons/article_1.

9 Outside of the antitrust enforcement context, search engines often enjoy special protections from liability as a statutory matter. For example, Section 230 (c) (1) of the Communications Decency Act, 47 U.S.C. § 230 (c) (1), provides that "no provider . . . of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider." According to the Ninth Circuit, "the touchstone of section 230(c) is that providers of interactive computer services are immune from liability for content created by third parties." However, in *Fair Hous. Council of San Fernando Valley v. Roommates.com, LLC*, 521 F.3d 1157 (9th Cir. 2008), the United States Court of Appeals for the Ninth Circuit noted: "[O]rdinary search engines do not use unlawful criteria to limit the scope of searches conducted on them, nor are they designed to achieve illegal ends—as Roommate's search function is alleged to do here. Therefore, such search engines play no part in the 'development' of any unlawful searches." *Id.* at 1167. This article will not address those special exemptions, whether such exemptions are valid, or whether such exemptions should be imported in some fashion into the antitrust context.

10 *Algorithm*, WIKIPEDIA (Sept. 14, 2013), available at <http://en.wikipedia.org/wiki/Algorithm>.

11 *Universal City Studios Inc. v. Corley*, 273 F.3d 429, 446 (2nd Cir. 2001) ("Corley").

conventional speech for First Amendment purposes.”¹² In that case, the court found that computer code, which instructed the computer to perform certain functions which were “capable of being understood and assessed by human beings,” qualified as speech for First Amendment purposes.¹³

In turn, *Corley* was one of several federal decisions¹⁴ relied upon by the California Supreme Court in *DVD Copy Control Association, Inc. v. Bunner*¹⁵ to determine that computer code qualified as speech protected by the First Amendment. In *Bunner*, Andrew Bunner was accused of misappropriation of trade secrets under California’s Uniform Trade Secrets Act. Bunner posted on his website the hacked code for DVD CCA’s “content scramble system” also known as “CSS.” Once Bunner was enjoined from further distribution of the broken code, he appealed, claiming the injunction violated his First Amendment free speech rights. Ultimately, though the California Supreme Court found that the dissemination of computer code was speech, it also found that the First Amendment does not prohibit courts from enjoining speech to protect a legitimate property right, in this case, DVD CCA’s encryption code, which was a trade secret. Therefore, the First Amendment did not stand in the way of enjoining Bunner from distribution of the computer code.¹⁶

III. SINCE SEARCH ENGINE RESULTS ARE SPEECH, ARE THEY ALSO OPINIONS?

Based on these cases, this article views computer code as being equivalent to speech for First Amendment purposes. That being said, being “speech” does not automatically qualify such code for First Amendment protection. For instance, it is understood that falsely yelling “fire” in a crowded theatre might be speech, but not protected speech.¹⁷ Therefore, the next question for consideration is what type of speech would be a vertical shopping search engine result: Is a vertical shopping search engine result an opinion or something else? In an April 2012 paper commissioned by Google, with the caveat that “the views within it should not necessarily be ascribed to Google,” UCLA Professor

12 *Id.*

13 *Id.*

14 See, e.g., *Junger v. Daley*, 209 F.3d 481, 485 (6th Cir. 2000) (regarding export of encryption software: “Because computer source code is an expressive means for the exchange of information and ideas about computer programming, we hold that it is protected by the First Amendment”); *Universal City Studios, Inc. v. Reimerdes*, 111 F. Supp. 2d 294, 326 (S.D.N.Y. 2000), *aff’d* 273 F.3d 429 (2d Cir. 2001) (“*Reimerdes*”) (regarding decryption software – “It cannot seriously be argued that any form of computer code may be regulated without reference to First Amendment doctrine. The path from idea to human language to source code to object code is a continuum.”); *United States v. Elcom, Ltd.*, 203 F. Supp. 2d 1111, 1126 (N.D. Cal. 2002) (anti-trafficking provisions of the Digital Millennium Copyright Act—“Computer software is expression that is protected by the copyright laws and is therefore ‘speech’ at some level”); see also *Bernstein v. U.S. Dept. of State*, 922 F. Supp. 1426, 1436 (N.D. Cal. 1996) (First Amendment extends to source code); *Karn v. U.S. Dept. of State*, 925 F. Supp. 1, 10 (D.D.C. 1996) (assuming First Amendment extends to source code).

15 *DVD Copy Control Ass’n, Inc. v. Bunner*, 31 Cal. 4th 864 (2003) (“*Bunner*”).

16 *Id.* at 877–85.

17 See, e.g., *Schenck v. United States*, 249 U.S. 47, 52 (1919) (“The most stringent protection of free speech would not protect a man in falsely shouting fire in a theatre and causing a panic.”).

Eugene Volokh made the case for Google's search engine's results being treated as a judgment or opinion for First Amendment purposes. He stated:

Search engines' selectivity is much more comparable to the selectivity of newspaper op-ed pages, which choose to feature only a small fraction of potential columns. Thus, even though the search engine does not generate the content that is linked to by its results, the judgments and opinions about how to rank and present those results are fully protected by the First Amendment.¹⁸

The "opinion" is thus, according to Professor Volokh, Google's decision as where to place results and how to rank those results.¹⁹ Therefore, it is argued that an antitrust action directed at decision-making conduct involving such "opinions" would be barred by the First Amendment.

Google rivals, on the other hand, make three primary contentions as to why that argument is not so: First, Google's decisions or manipulations are intended to foreclose competition as to vertical shopping results; second, manual manipulation of the algorithmic results places Google's own results ahead of the placement of rivals' results that Google's own algorithm otherwise determined to be superior, thus giving Google a competitive advantage; and third, Google just simply intends to destroy vertical shopping competitors who seek to tap into Google's approximate "235 million active users across . . . Google properties"²⁰ as potential customers of Google's competition.

The difference between Google's and its competitors' viewpoints as to the operation of Google's search engine is whether the algorithm's determination is just an *ad hoc* editorial judgment based upon objective criteria or instead consists of manipulated results that are falsely represented to be objective and are used in an anticompetitive manner. In other words, are these vertical shopping search engine results opinions or factual commercial statements (that are, in fact, false or manipulated according to Google's competitors)?

A. The Search Engine Process for Formulating "Opinions"

To answer this question, it is necessary to discuss the search engine process. Google contends that its "search technologies sort through an ever-growing amount of information to deliver relevant and useful search results in response to user queries."²¹ Put another way, search engines provide "answers" by crawling and indexing websites, calculating relevancy and serving the results to user queries. To do this, an Internet web page crawling device, also known as a "bot," seeks out words on web pages from which an index is created. The Internet user uses keywords to search the index for directions to the relevant websites.

18 Eugene Volokh, First Amendment Protection for Search Engine Search Results, at 15 (April 20, 2012) ("*Volokh*"), <http://www.volokh.com/wp-content/uploads/2012/05/SearchEngineFirstAmendment.pdf>.

19 "When search engines select and arrange others' materials, and add the all-important ordering that causes some materials to be displayed first and others last, they are engaging in fully protected First Amendment expression—"[t]he presentation of an edited compilation of speech generated by other persons." *Volokh, supra* at note 18, at 15-16 (Citations omitted).

20 Google 10-K, *supra* note 3, at 3.

21 Google 10-K, *supra* note 3, at 4.

In Google's own words, its engineers "write programs and formulas"—an algorithm—which is "designed to deliver the best results possible"²² in response to user queries. The algorithm is a constantly evolving document. Google claims its "algorithms rely on more than 200 unique signals or 'clues' that make it possible for Google to guess what any user might really be looking for. These signals include things like the terms on websites, the freshness of content, your region, and PageRank."²³ To keep results "relevant," Google fights spam²⁴ "24/7 mainly through an automatic process but sometimes by manual manipulation."²⁵ Google has long maintained that any changes it makes by manipulation of the original algorithm search results are intended to give the consumer a better experience, not to preserve its own market share.²⁶ So does this process amount to an opinion or to commercial statements of fact or simply to statements of fact? The answer can make a critical difference as to the degree of First Amendment protection.

1. Opinion or Statements of Fact

The meaning of "opinion" has continuously evolved since its common law definition. Speech that appears to convey a fact, I think the sky is grey, is treated as conveying an opinion.²⁷ Justice Powell's opinion for the Court in *Gertz v. Robert Welch, Inc.*²⁸ ("Gertz") is, in turn, the lead case for the proposition that statements appearing to be false are still protected under the First Amendment if they qualify as an opinion.²⁹ In that case, the plaintiff, Gertz, was a lawyer who filed a defamation suit against the John Birch Society, which was legally known as Robert Welch, Inc., claiming defamation based upon a society publication which contained many "serious inaccuracies" about him. Accepting that the statements were false but qualified as the opinion of the John Birch Society, Justice Powell's consideration of the case started with what he called "common ground," that is:

22 Google, How Search Works—The Story, <http://www.google.com/insidesearch/howsearchworks/thestory/> (last visited Sept. 14, 2013).

23 See <http://www.google.com/insidesearch/howsearchworks/algorithms.html> (last visited Sept. 14, 2013). PageRank is a Google algorithm which ranks the importance of a page as a function of the number of incoming links to that page. See PageRank, WIKIPEDIA (Sept. 14, 2013), available at en.wikipedia.org/wiki/PageRank#Description. The greater the number of incoming links to a page, the more important the page and thus the higher the ranking in the search results.

24 See <http://www.google.com/insidesearch/howsearchworks/thestory/index.html> (last visited Sept. 14, 2013); see also <http://www.google.com/insidesearch/howsearchworks/fighting-spam.html> (last visited Sept. 14, 2013).

25 See *supra* note 24.

26 *F.T.C. Still Expects to Resolve Google Antitrust Inquiry by Year's End*, NEW YORK TIMES BITS BLOG (Sept. 19, 2012), available at <http://bits.blogs.nytimes.com/2012/09/19/f-t-c-still-expects-to-resolve-google-antitrust-inquiry-by-years-end/?src=rechp>.

27 For a detailed discussion of "opinion" jurisprudence, see Robert D. Sack, Protection of Opinion under the First Amendment: Reflections on Alfred Hill, "Defamation and Privacy under the First Amendment", 100 COLUMBIA L. REV. 294 (2000), available at <http://www.jstor.org/stable/1123560>.

28 418 U.S. 323 (1974).

29 See, e.g., *Cianci v. N.T. Publ'g Co.*, 639 F.2d 54, 61 (2nd Cir. 1980). This passage "has become the opening salvo in all arguments for protection from defamation actions on the ground of opinion, even though the case did not remotely concern the question."

Under the First Amendment there is no such thing as a false idea. However pernicious an opinion may seem, we depend for its correction not on the conscience of judges and juries but on the competition of other ideas. But there is no constitutional value in false statements of fact. Neither the intentional lie nor the careless error materially advances society's interest in "uninhibited, robust, and wide-open" debate on public issues.³⁰

Justice Powell stated in his opinion that: "The First Amendment requires that we protect some falsehood in order to protect speech that matters".³¹ His opinion held that "so long as they do not impose liability without fault, the States may define for themselves the appropriate standard of liability for a publisher or broadcaster of defamatory falsehood injurious to a private individual."³² "Because the jury was allowed to impose liability without fault and was permitted to presume damages without proof of injury, a new trial is necessary."³³

Gertz was interpreted in a very expansive manner in treating *all* false statements of fact as amounting to nothing more than opinion, and hence being protected under the First Amendment. For example, in *Blatty v. New York Times Co.*,³⁴ the California Supreme Court found that "First Amendment limitations are applicable to all claims, of whatever label, whose gravamen is the alleged injurious falsehood of a statement."

However, sixteen years later, in *Milkovich v. Lorain Journal Co.*,³⁵ the Court would find that cases after *Gertz* misconstrued its holding, requiring clarification that not all false statements of fact could be labeled as opinions. *Milkovich* involved the issue of whether a high school wrestling coach could sue a local newspaper and one of its reporters for defamation for accusing him of having committed perjury. Although the lower court granted summary judgment, the Court reversed, noting that the dispositive question was whether the challenged statements could be reasonably interpreted to state a fact.³⁶

The *Milkovich* Court stated the "false idea—pernicious opinion" much quoted passage from *Gertz* was not intended to create a "wholesale exemption for anything that might be labeled 'opinion.'" The Court described the categorical rule adopted by lower courts as a product of "mistaken reliance on the *Gertz* dictum."³⁷ Instead the Court indicated that, read in context, "the fair meaning of the passage is to equate the word 'opinion' in the second sentence with the word 'idea' in the first sentence."³⁸ The relevant sentence from *Gertz*, quoted above, should have been read as: "Under the First Amendment there is no such thing as a false idea. However pernicious an *idea* may seem, we depend for its

30 *Gertz*, 418 U.S. at 339-340.

31 *Id.* at 347.

32 *Id.*

33 *Id.* at 352.

34 *Blatty v. N.Y. Times Co.*, 42 Cal. 3d 1033 (1986) ("*Blatty*").

35 *Milkovich v. Lorain Journal Co.*, 497 U.S. 1 (1990) ("*Milkovich*").

36 *Id.*

37 *Id.* at 17-18.

38 *Id.* at 18.

correction not on the conscience of judges and juries but on the competition of other ideas.” The Court saw the quote as “a reiteration of Justice Holmes” classic “marketplace of ideas” concept presented in his dissenting opinion in *Abrams v. United States*.³⁹ The Court saw the “marketplace of ideas” origin of this passage as pointing “strongly to the view that the ‘opinions’ held to be constitutionally protected were the sort of thing that could be corrected by discussion.”⁴⁰ Thus, the Court distinguished between false ideas or opinions, such as “rhetorical hyperbole” and “imaginative expression,” and false or deceptive statements of fact.⁴¹

This correction has important implications for the issue of Google’s search engine being protected under the First Amendment as set out in the prescient dissent of California Supreme Court Justice Grodin in *Blatty*, which preceded *Milkovich*:

Suppose that the New York Times, after conducting its normal survey of representative bookstores throughout the country, found that Blatty’s novel was, indeed, the top selling book for a particular week based on its own statistics. Suppose further that, despite this information, the Times purposefully substituted one of its own publications for Blatty’s book at the top of its best seller list in order to enhance its own book’s sales, and entirely omitted Blatty’s book from the list If a plaintiff can prove that a media defendant knowingly published a false statement for the purpose of inflicting financial injury on him personally, I do not believe that the free speech provisions of either the state or federal Constitution would be offended if the defendant were held liable in damages for such conduct, even if it were not obvious on the face of the publication who the defendant was intending to injure.⁴²

The accusations against Google contend that it has done just that: favored its own inferior search results over those of competitors in a manner that is deceptive. Moreover, these search results are not like the kinds of opinions or ideas discussed in *Milkovich* that could be corrected in the court of public opinion. *Milkovich*, taken in conjunction with this dissent in *Blatty*, would thus suggest such a result is not protected opinion. However, the fact that vertical shopping search engine results are not opinions, and thus automatically protected under the First Amendment, does not mean that they are free to be regulated under the First Amendment. The next step is to determine what *kind* of speech are vertical shopping search engine results: commercial speech or ordinary statements of fact.

2. Commercial Statements of Fact or Ordinary Statements of Fact

This article now turns to the next step of determining whether vertical shopping search engine results are commercial speech. The test for identifying commercial speech

39 *Id.* (citing *Abrams v. United States*, 250 U.S. 616, 630 (1919)).

40 *Id.* (citing *Cianci v. N.T. Publ'g Co.*, 639 F.2d 54, 62 n.10 (2nd Cir. 1980)).

41 *Id.* at 20–21 (distinguishing between statements that can be reasonably interpreted as being ones of fact versus those that can be interpreted to be statements of “imaginative expression” or “rhetorical hyperbole”).

42 *Blatty*, 42 Cal.3d at 1049.

is whether the expression at issue proposes a commercial transaction.⁴³ There may be a distinction, however, between speech that is part of a commercial transaction, as that appears possibly to involve private matters more beyond the purview of the First Amendment, and speech that proposes a transaction as that appears likely to involve more public matters such as advertising that can trigger enhanced First Amendment scrutiny. This distinction is most noticeable in the case of *Dun & Bradstreet, Inc. v. Grove*⁴⁴ (“*Dun & Bradstreet I*”) and *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.* (“*Dun & Bradstreet II*”).⁴⁵

Dun & Bradstreet I involved a publisher of credit reports that confidentially analyzed plaintiff, among many other companies, from time to time at the request of suppliers and creditors.⁴⁶ Even though the publisher erred in reporting that there was an unpaid judgment against plaintiff as opposed to plaintiff’s predecessor corporation (though an error that the publisher retracted), the trial court issued a judgment notwithstanding a jury verdict of libel in favor of the publisher, noting that such an innocent error was not libel under First Amendment law.⁴⁷ On appeal, the United States Court of Appeal for the Third Circuit reversed, finding that such confidential factual reports on matters of private concern did not trigger enhanced First Amendment protections applicable to matters of public concern or matters involving an opinion.⁴⁸ Though the United States Supreme Court denied certiorari,⁴⁹ Justice Douglas, who dissented, proposed that any false statement, private or public, commercial or not commercial, on matters of fact could not be proscribed under the First Amendment as being libelous.⁵⁰

Dun & Bradstreet II involved the same publisher of credit reports who was sued again for defamation, this time for a false, though quickly corrected, report that the plaintiff had filed for voluntary bankruptcy.⁵¹ The Vermont Supreme Court reversed a trial verdict in favor of plaintiff in drawing a media versus non-media distinction.⁵² The United States Supreme Court affirmed the Vermont Supreme Court *but* on different grounds.⁵³

In particular, Justice Powell, the author of *Gertz*, who was writing for a majority of the Court, found that the credit report involved matters of private concern and, as such, enjoyed a less stringent measure of First Amendment protection.⁵⁴ Interestingly, the Court analogized this situation to other circumstances in which the flow of information

43 *Va. Pharmacy Bd. v. Va. Consumer Council*, 425 U.S. 748, 762 (1976).

44 404 U.S. 898 (1971).

45 472 U.S. 749 (1985).

46 *Id.* at 898.

47 *Id.* at 898-99.

48 *Id.* at 899.

49 *Id.* at 898.

50 *Id.* at 898-906 (Douglas, J., dissenting).

51 *Dun & Bradstreet II*, 472 U.S. at 750-51.

52 *Id.* at 752-53.

53 *Id.* at 753.

54 *Id.* at 758-62 & n.5.

was regulated without offending the First Amendment, including the exchange of price and production information among competitors.⁵⁵

In noting that that speech did have some degree of First Amendment protection, the *Dun & Bradstreet II* Court cited a particular statement in its earlier opinion of *Connick v. Myers*⁵⁶ that speech on matters of private concern cannot be suppressed altogether unless it “falls within one of the narrow and well-defined classes of expression which carries so little social value, such as obscenity, that the State can prohibit and punish such expression by all persons within its jurisdiction.”⁵⁷ This suggests that, absent a complete ban on private communications as part of commercial transactions, only rational basis scrutiny would apply under the First Amendment.⁵⁸ However, *Dun & Bradstreet II* stressed the private and confidential nature of these credit reports, distinguishing the situation in which the flow of such information, even if that information were economic or commercial, was public.⁵⁹

As with *Dun & Bradstreet I*, there was a dissent.⁶⁰ The dissent argued that libel actions should not be allowed on any matters of public or private concern under the First Amendment.⁶¹ However, the dissent recognized that, even under First Amendment jurisprudence, there is a strong cognizable state interest in protecting consumers and regulating commercial transactions where such speech is concerned that could justify appropriate regulation.⁶²

Accordingly, what may flow from *Dun & Bradstreet I* and *Dun & Bradstreet II* is that proposing a commercial transaction may enjoy a higher standard of protection under the First Amendment than the commercial transaction itself, especially if that transaction is not public. In this regard, Google’s alleged market manipulation seem to be a hybrid between involving a commercial transaction and proposing one since it uses the search results (a commercial transaction) both to sell its own products and sell its search results. Google summarizes its search engine queries into three basis categories:⁶³ “Action

55 *Id.* at 758 n.5 (citing *Ohralik v. Ohio State Bar Ass’n*, 436 U.S. 447, 456 (1978)).

56 461 U.S. 138 (1983).

57 *Id.* at 147 (cited in *Dun & Bradstreet II*, 472 U.S. at 760).

58 *See, e.g., United States v. Alvarez*, 132 S. Ct. 2537, 2552 (2013) (Breyer, J., concurring, joined by Kagan, J.) (noting that there are three levels of scrutiny under the First Amendment: strict (with near-automatic condemnation), rational (with implicitly near-automatic approval), and intermediate (with a proportionality analysis)); *Glickman v. Wileman Bros. & Elliot, Inc.*, 521 U.S. 457, 473–75 & n.16 (1997) (applying rational-basis scrutiny to First Amendment challenge to compelled assessments of fruit growers, manufacturers, and handlers for generic advertising).

59 *Dun & Bradstreet II*, 404 U.S. at 762 & n.8.

60 *Id.* at 774 (Brennan, J., dissenting on behalf of himself and three other justices).

61 *Id.* at 778–95 (dissenting op.). Interestingly, the dissent pointed out that it could be argued that the speech set out in these credit reports should be entitled to even greater protection than commercial advertising. *Id.* at 791–92.

62 *Id.* at 795 (citing *Ohralik*, 436 U.S. at 460).

63 Search Quality Rating Guidelines, Version 1.0, November 2, 2012, at 9, http://static.googleusercontent.com/external_content/untrusted_dlcp/www.google.com/en/us/intl/en_us/insidesearch/howsearchworks/assets/searchqualityevaluatorguidelines.pdf (last visited Sept. 14, 2013).

intent;”⁶⁴ “Information intent;”⁶⁵ and “Navigation intent.”⁶⁶ Competitor allegations have implicated all three types of searches: competing vertical shopping site for purchases of goods have been ranked lower or blocked;⁶⁷ competitor product or service reviews have been hijacked;⁶⁸ and searches have been claimed to redirect searches from an offering company to Google’s own products.

However, Google does not present its opinions as such but rather as facts derived from predetermined algorithm private sources. Google’s own policies make various statements that would lead a user to believe that search results are not opinions but rather factual statements based on private sources. For example, such policies claim that “Google’s index merely reflects that the page exists on the wider web, and not that Google endorses it”;⁶⁹ or that, “There is very little that we remove from search results on a discretionary basis. Aside from spam, the main cases where we might take action are certain types of sensitive information and adult spam.”⁷⁰ That being said, there still remains one perhaps critical difference between the credit reports at issue in *Dun & Bradstreet I* and *Dun & Bradstreet II* and Google’s vertical shopping search engine results. While those results are available only to the individual who requests them, the search engine itself and its algorithm operate via the medium of the Internet, which is open to the public.

This suggests on balance that Google’s vertical shopping search engine results could fall in the commercial transaction bucket, like credit reports, and as such could enjoy only a rational basis level of protection under the First Amendment. But that is far from being established.

3. False Commercial Speech or True Commercial Speech

Even if Google’s hybrid speech could be treated as commercial speech, it would still be subject to rational basis protection (if any at all) under the First Amendment if it were being regulated only as to its falsity. In this respect, allegations continue to be made that Google’s vertical shopping search engine results are in effect “false” because they are manually manipulated in contrast to Google’s representations, and such “false” speech or advertising alone may remove any First Amendment protection that even commercial

64 Users want to accomplish a goal or engage in an activity, such as download software, play a game online, send flowers, find entertaining videos, etc. These are “do” queries: users want to do something.

65 Users want to find information. These are “know” queries: users want to know something.

66 Users want to navigate to a website or webpage. These are “go” queries: users want to go to a specific page.

67 Adam Raff and Shivaun Raff, *How Google’s Universal Search Mechanism Threatens Competition and Innovation on the Internet* (February 23, 2010), available at http://www.foundem.co.uk/Foundem_Preferencing_Data_and_Arguments.pdf.

68 James Temple, *Google Places draws complaints from Yelp, others*, S.F. CHRON. (July 29, 2011), available at <http://www.sfgate.com/business/article/Google-Places-draws-complaints-from-Yelp-others-2352896.php>.

69 Remove information from Google, <https://support.google.com/websearch/troubleshooter/3111061> (last visited Sept. 14, 2013).

70 Removal Policies, <https://support.google.com/websearch/answer/2744324?hl=en> (last visited Sept. 14, 2013).

speech might otherwise enjoy.⁷¹ Indeed, for almost eighty years, the notion that false or misleading advertising has an anticompetitive effect, and as such can and should be regulated, has prevailed.⁷² This is not to say, of course, that false speech outside the economic or commercial realm is not entitled to First Amendment protection since the absence of such protection would give the government too broad a “censorial power.”⁷³

IV. OTHER FACTORS TO CONSIDER REGARDING WHETHER VERTICAL SHOPPING SEARCH ENGINE RESULTS ARE PROTECTED

Consequently, this article finds in the first instance that the nature of Google’s vertical shopping search engine results at best would elicit rational basis protection under the First Amendment because, while it is speech, it is not an opinion; it is not commercial speech; and even if it were commercial speech, it could be regulated for its falsity or deception. However, the nature of the regulation proposed here, namely an application of the antitrust laws, would also support an application of rational basis scrutiny under the First Amendment as a general matter. It is to this point that this article turns.

A. Appropriate Level of Scrutiny of Any Enforcement Action

Conceding that the Google algorithm is speech, the appropriate level of scrutiny or evaluation for antitrust regulation of that speech (or any speech) must still be determined.⁷⁴ Courts have three levels of scrutiny or review that are used to weigh the government’s interest against the infringement of a constitutional right such as the First Amendment: (1) *strict* – “suspect legal restrictions . . . must [be subjected] to the most rigid scrutiny;”⁷⁵ (2) *intermediate* – “content neutral” and “narrowly tailored to serve a significant governmental interest;”⁷⁶ or (3) *rational basis* – a reasonable means to an end that may be legitimately pursued by the government.⁷⁷ This latter test requires that the

71 *Va. Pharmacy Bd.*, 425 U.S. at 773 (“What is at issue is whether a State may completely suppress the dissemination of *concededly truthful information* about entirely lawful activity, fearful of that information’s effect upon its disseminators and its recipients. Reserving other questions, we conclude that the answer to this one is in the negative.” (emphasis added)). From this quote, it would appear that untruthful information can be suppressed without running afoul of the First Amendment.

72 *See e.g., FTC v. Algoma Lumber Co.*, 291 U.S. 67, 79–80 (1934) (finding a false advertisement to be unfair competition).

73 *United States v. Alvarez*, 132 S. Ct. 2537, 2547–48 (2012) (plurality op.) (distinguishing false speech involving fraudulent economically related speech from lying about receiving military medals or asserting that all false speech is outside the purview of the First Amendment); *see id.* at 2554–55 (Breyer, J., concurring, joined by Kagan, J.) (noting that statutes prohibiting false statements have additional limitations that do not make the simple telling of a lie by itself actionable and contrasting those statutes with the one before the Court as lacking those limitations).

74 *Id.*

75 *See e.g., Korematsu v. United States*, 323 U.S. 214, 216 (1944).

76 *See, e.g., Madsen v. Women’s Health Center*, 512 U.S. 753, 762–764 (1994).

77 *See, e.g., United States v. Carolene Products Co.*, 304 U.S. 144, 154 (1938); *see also, e.g., Alvarez*, 132 S. Ct. at 2552 (Breyer, J., joined by Kagan, J., concurring).

governmental action only be “rationally related” to a “legitimate” government interest.⁷⁸ As it turns out, at best rational basis applies simply because the antitrust laws are viewed as having only an incidental impact on speech in their regulation of commercial transactions.

Strict scrutiny can apply as a conceptual matter only where pure, non-commercial speech is concerned. Pure speech has never been definitively defined, but the cases suggest that such speech either “editorializes on any subject, cultural, philosophical, or political,” reports upon “newsworthy facts” or makes “generalized observations even about commercial matters” and is different from commercial speech.⁷⁹ At best, it would appear that Google’s vertical shopping results are commercial speech, as discussed above.⁸⁰ Antitrust regulation typically would not tread on the kind of pure speech involved here. Therefore, strict scrutiny should not apply.

However where commercial speech is involved, an argument can now be made that the form of scrutiny is a higher form of intermediate, heightened level of scrutiny, even if not strict scrutiny. For instance, in *Sorrell v. IMS Health Inc.*,⁸¹ the Court was faced with a law which on its face contained “content-and speaker-based restrictions on the sale, disclosure, and use of prescriber-identifying information.”⁸² That law was aimed at pharmaceutical marketers, and did not apply to other non-commercial purveyors of that same information. The Court acknowledged that “restrictions on protected expression are distinct from restrictions on economic activity or, more generally, on non-expressive conduct.”⁸³

The Court further noted, in what turns out to be an important distinction, that “the First Amendment does not prevent restrictions directed at commerce or conduct from imposing incidental burdens on speech,” and as an example, noted that “antitrust laws can prohibit agreements in restraint of trade.”⁸⁴ Ultimately, the Court in *Sorrell* found that Vermont’s law imposed a burden based on the content of speech and the identity of the speaker such that “heightened judicial scrutiny” is warranted.⁸⁵ Although some commentators have seen *Sorrell* as an expansion of First Amendment protections to the mere dissemination of information via software,⁸⁶ it is unlikely that this case has any impact at all on antitrust enforcement given that it expressly distinguished said enforcement as not falling within the scope of the First Amendment. The goal of

78 *Id.*

79 *Va. Pharmacy Bd.*, 425 U.S. at 760-761.

80 *Id.*

81 131 S. Ct. 2653 (2011).

82 *Id.* at 2663.

83 *Id.* at 2665.

84 *Id.* (citing *Giboney v. Empire Storage & Ice Co.*, 336 U.S. 490, 502 (1949)). The citation to *Giboney* is important because picketers in *Giboney* were attempting peacefully to publicize truthful facts about a labor dispute as a means to force a manufacturer to agree to stop selling ice to nonunion peddlers. The Court held in *Giboney* that a course of conduct that is illegal can still be thwarted even if the conduct was in part initiated, evidenced, or carried out by means of language, spoken, written, or printed. 336 U.S. at 502.

85 131 S. Ct. at 2664.

86 See, e.g., Andrew Tutt, *Software Speech*, 65 STAN. L. REV. ONLINE 73 (November 15, 2012), available at: <http://www.stanfordlawreview.org/online/software-speech>.

antitrust regulation is unrelated to the suppression of expression on the basis of neither source nor content.⁸⁷

Indeed, numerous cases have found and proscribed restraints of trade in various First Amendment contexts in spite of speech being involved in one capacity or another: *Associated Press v. United States*⁸⁸ (preventing members from selling news to nonmembers, and also making it difficult for nonmembers to join were restraints of trade); *Lorain Journal Co. v. United States*⁸⁹ (antitrust laws violated by a newspaper publisher's refusal to publish advertisements from businesses that also placed advertisements with competing radio station); *Citizen Publishing Co. v. United States*⁹⁰ (upholding injunction prohibiting newspaper publishers from engaging in joint operating agreement); *National Society of Professional Engineers v. United States*⁹¹ (professional association's ban on competitive bidding for engineering services violated the antitrust laws even though one means of carrying out the ban was through the publication of an ethical code); *American Society of Mechanical Engineers v. Hydrolevel Corp.*⁹² (professional association violated the antitrust laws through the issuance of an inaccurate safety report used to undermine a competitor's product); *Federal Trade Commission v. Superior Court Trial Lawyers Ass'n*⁹³ (an attorneys' association's boycott of assignments to cases involving indigent defendants violated the antitrust laws even though the boycott had an expressive component); and *Wilk v. American Medical Ass'n*⁹⁴ (a medical association's boycott of chiropractors violated the antitrust laws even though one means of enforcing the boycott was through the association's code of ethics). And, as set out in the debates of the Court between the majority and the dissent in such opinions as *Dun & Bradstreet II*, antitrust regulation is viewed as generally not offending the First Amendment. This suggests that, at best, only rational basis review applies where the application of the First Amendment laws, absent viewpoint discrimination,⁹⁵ which is not an issue here.

87 See *R.A.V. v. St. Paul*, 505 U.S. 377, 389 (1992) (“[W]ords can in some circumstances violate laws directed not against speech but against conduct.”).

88 326 U.S. 1, 6-7, 19-20 (1945).

89 342 U.S. 143, 155-56 (1951).

90 394 U.S. 131, 135 (1969).

91 435 U.S. 679, 694-95, 697 (1978).

92 456 U.S. 556, 569-72 (1982).

93 493 U.S. 411, 430-32 (1990).

94 895 F.2d 352, 357-58, 371 (7th Cir. 1990).

95 See, e.g., *R.A.V.*, 505 U.S. at 384-89 (listing examples for the proposition that, even if speech is outside the purview of the First Amendment altogether, such as obscenity, or can be heavily regulated without running afoul of the First Amendment, such as regulating price advertising in one industry but not another, the Government cannot engage in viewpoint discrimination). But the proscription against viewpoint discrimination does not apply where the viewpoint in question has associated with the particular harms that the Government seeks to redress. See, e.g., *Virginia v. Black*, 538 U.S. 343, 361-63 (2003) (distinguishing *R.A.V.* and addressing a statute proscribing cross-burning with the intent to intimidate).

B. Though a First Amendment Defense Must Be Examined on a Case-by-Case Basis Where High-Technology Is Concerned, the Allegation of False or Deceptive Speech Means that the Result Does Not Change

Where the First Amendment is concerned, it is not just a matter of examining the applicable level of scrutiny as a general matter. First Amendment jurisprudence is in a constant state of flux insofar as such high-technology issues as computer code or the operation of the Internet is concerned. Courts have been reluctant to generally answer “categorically” what violates the First Amendment. Instead, courts have taken, as described by the Second Circuit in *Name.Space, Inc. v. Network Solutions, Inc.*,⁹⁶ “an ‘evolutionary’ or ‘as-applied’ approach to the task of tailoring familiar constitutional rules to novel technological circumstances, favoring ‘narrow’ holdings that would permit the law to mature on a ‘case-by-case’” basis.”⁹⁷ Thus, the constitutional questions presented in regard to any violation of the antitrust/consumer protection laws must be examined as applied to the specific facts of any case where the high-technology industry is concerned.

But here, competitors claim that the Google algorithm search result is manually manipulated in such a way as to be false. And, as the Court has stated: “[T]here is no constitutional value in false statements of fact. Neither the intentional lie nor the careless error materially advances society’s interest in ‘uninhibited, robust, and wide-open’ debate on public issues.”⁹⁸ It would not seem that the nature of the high-technology industry should or would somehow cause society to have to revisit that truism. The analysis, however, cannot end here.

In Professor Volokh’s paper supporting Google,⁹⁹ he contends: “[t]wo federal court decisions have held that search results, including the choices of what to include in those results, are fully protected by the First Amendment.” The two cases cited, *Search King v. Google Technology*¹⁰⁰ (which is unpublished) and *Langdon v. Google, Inc.* each purport to address this First Amendment as a defense issue,¹⁰¹ although neither case involves government law enforcement. However, these cases serve to highlight only how, at best, the examination of First Amendment issues should occur on a case-by-case basis.

In *Search King*, the plaintiff alleged tortious interference with contract. Google admitted that it demoted Search King’s, and a related entity’s, PR Ad Network (“PRAN”) page ranks after Google learned that PRAN was profiting by selling ad space

96 202 F.3d 573, 584 n.11 (2d Cir. 2000).

97 *Id.*

98 *E.g., Gertz*, 418 U.S. at 340.

99 *Volokh, supra* note 18, at 6-7.

100 *Search King, Inc. v. Google Tech., Inc.*, No. 02-1457, 2003 U.S. Dist. LEXIS 27193, 2003 WL 21464568, (W.D. Okla. Jan. 13, 2003).

101 In another case, *Kinderstart.com, LLC v. Google, Inc.*, Case No. 06-2057 2007 U.S. Dist. LEXIS 22648, 2007-1 Trade Cas. (CCH) P75,643 (N.D. Ca. March 16, 2007), the plaintiff asserted that Google violated the plaintiff’s First Amendment rights.

on web sites ranked highly by Google's PageRank system.¹⁰² Defendants argued that the plaintiff could not state a claim for violation of his right to free speech under either the United States or Delaware Constitution because they were not state actors.

The district court rejected this claim in drawing an analogy to *Jefferson County School District No. R-1 v. Moody's Investor's Services, Inc.*¹⁰³ In *Jefferson School District*, Moody's published an article regarding the bonds in its "Rating News," an electronically distributed information service sent to subscribers and news services. Moody's stated that although it had not been asked to rate the bonds, it intended to assign a rating to the issue subsequent to the sale. Moody's then discussed the bonds and the school district's financial condition, concluding that "[t]he outlook on the district's general obligation debt is negative, reflecting the district's ongoing financial pressures due in part to the state's past underfunding of the school finance act as well as other legal uncertainties and fiscal constraints." That negative report was then repeated in the *The Dow Jones Capital Market Reports*.

The court in *Search King* made the following analogy to the claims in *Jefferson County School District* in dismissing the plaintiff's claims:

Like the review in Jefferson County, a PageRank is an opinion—an opinion of the significance of a particular web site as it corresponds to a search query. Other search engines express different opinions, as each search engine's method of determining relative significance is unique . . . the PageRanks do not contain provably false factual connotations. *While Google's decision to intentionally deviate from its mathematical algorithm in decreasing SearchKing's PageRank may raise questions about the "truth" of the PageRank system*, there is no conceivable way to prove that the relative significance assigned to a given web site is false. A statement of relative significance, as represented by the PageRank, is inherently subjective in nature. Accordingly, the Court concludes that Google's PageRanks are entitled to First Amendment protection.¹⁰⁴

Since no government actors were involved, it would appear that consideration of the First Amendment issue was not necessary to the determination of the case. But what is interesting is the Court's nod to the "truth" of the PageRank system.

The dicta from the dissent in *Blatty*,¹⁰⁵ coupled with the case-by-case determination requirement from First Amendment jurisprudence, would suggest a different outcome in light of *Milkovich*¹⁰⁶ if government enforcers were to bring a case based on their uncovering actual misrepresentations involved with the advertisement of Google's vertical shopping search engine results. The actual falsity of the page ranking, as shown by evidence, might indeed remove the ranking from the protection of the First Amendment notwithstanding *Search King*.

102 *Search King*, 2003 U.S. Dist. LEXIS 27193, 2003 WL 21464568.

103 175 F.3d 848 (10th Cir. 1999).

104 *Search King*, supra n.97 (emphasis added).

105 See supra note 52.

106 See supra note 53.

The second case is *Langdon v. Google, Inc.*¹⁰⁷ In that case, the pro se plaintiff alleged that his First Amendment freedoms were violated by Google's refusal to place web advertisements for plaintiff's two sites, which were critical of North Carolina officials, as well as a separate site critical of the Chinese government. As a defense, Google asserted that to "compel it to speak in a manner deemed appropriate by Plaintiff and to prevent Google from speaking in ways that Plaintiff dislikes" would contravene the First Amendment.

While the *pro se* plaintiff did not brief this issue, the district court did address the issue anyway in detail, citing three newspaper cases for the proposition that "the injunctive relief sought by Plaintiff contravenes Defendants' First Amendment rights." One of those cases, *The Miami Herald Publishing Co. v. Tornillo*,¹⁰⁸ involved a decision by the United States Supreme Court declaring unconstitutional Florida's "right of reply" statute that had granted a political candidate a right to equal space to answer criticism and attacks on his record by a newspaper, and made it a misdemeanor for the newspaper to fail to comply. That statute was declared unconstitutional by the *Tornillo* Court as a content-based violation of the First Amendment's right of freedom of the *press* rather than speech.

Another case, *Sinn v. The Daily Nebraskan*,¹⁰⁹ involved a decision from the United States Court of Appeals for the Eighth Circuit and, as it addressed the editorial discretion of a state university publication, also involved freedom of the press rather than freedom of speech. The last, *Associates & Aldrich Co. v. Times Mirror Co.*,¹¹⁰ an old case from the United States Court of Appeals of the Ninth Circuit—that predated even *Gertz* let alone *Milkovich*—involved a movie producer's objection to changes being made to his advertising copy pursuant to the Los Angeles Times' censorship code. As noted by the court, the movie producers' First Amendment rights were not implicated, since the *Times* was not a government actor.

Langdon thus has very limited precedential value even if one were not to factor in the lack of government actors or the presence of a *pro se* plaintiff who did not even brief the issue in question.

V. CONCLUSION

While the computer code involved in Google's search engine processes and results constitutes speech, those results do not qualify as an opinion and it can be questioned as to whether they even qualify as commercial speech. If they do not qualify as commercial speech, or if they did, but could be shown to be false, then their regulation under the antitrust laws would involve only rational basis review.

In fact, the application of the antitrust laws has generally been upheld under the First Amendment, as the application of those laws is viewed as having only an incidental impact on speech. This also suggests that, at most, absent viewpoint discrimination, only rational basis would apply.

107 *Langdon v. Google, Inc.*, 474 F. Supp. 2d 622 (D. Del. 2007).

108 *The Miami Herald Publ'g Co. v. Tornillo*, 418 U.S. 241 (1974).

109 *Sinn v. The Daily Nebraskan*, 829 F.2d 662 (8th Cir. 1987).

110 *Assoc. & Aldrich Co. v. Times Mirror Co.*, 440 F.2d 133 (9th Cir. 1971).

And, while the courts have shown solicitude for applying a case-by-case analysis where the First Amendment and high-technology is concerned, it is hard to imagine how such an analysis would yield a different result here if (as Google's competitors alleged) Google's vertical shopping search engine results were false or deceptive.

It is true, of course, that Google's algorithm is a constantly evolving program and has continued to change since the time of publication of the various Google cases. As a result, not only is it the case that those cases—in which Google was victorious—do not have any precedential value as to any government enforcement case that may be brought, but it also remains true that any case brought against Google has to be judged on its own facts, especially where high technology is involved.

DO FIRST AMENDMENT PRINCIPLES LIMIT THE ANTITRUST AGENCIES' ABILITY TO PROHIBIT ENFORCEMENT OF STANDARDS-ESSENTIAL PATENTS?

By David L. Meyer¹ and Fabien Thayamballi²

Recent antitrust enforcement actions have called attention to the potential that application of the antitrust laws, like all governmental action, is limited by the constraints of the First Amendment. This is not a new development. The half-century old *Noerr-Pennington* doctrine reflects, at least in part, limitations placed on the reach of the antitrust laws by the First Amendment right of petition. Recent developments at the interface between antitrust and patent enforcement have brought renewed attention to the potential for antitrust enforcement to run afoul of constitutional limits.

The issue is starkly illustrated by dueling comments issued by commissioners of the Federal Trade Commission (“FTC”) addressing recent agency settlements that limited the defendants’ ability to enforce their standards-essential patents in the courts by seeking injunctive relief. The commissioners disagreed on the proper application of *Noerr-Pennington* immunity, which shields genuine attempts to influence governmental action from antitrust liability irrespective of their effects on competition. In each case, the FTC opined that the owner of patents essential to the practice of industry standards could be subjected to liability for seeking injunctions against parties that were prepared to enter patent licenses, contrary to the owners’ prior commitments to license those patents on Fair, Reasonable, and Non-Discriminatory (“FRAND”) terms. Commissioner Maureen Ohlhausen dissented in both cases, arguing that “the *Noerr-Pennington* doctrine precludes Section 5 liability for conduct grounded in the legitimate pursuit of an injunction or any threats incidental to it.”³ The FTC majority’s response to that objection was that enforcing Section 5 does not offend the First Amendment when it merely “requires those making promises to keep them.”⁴

Antitrust law is often invoked to regulate activities that could be regarded as within a class protected by the First Amendment. At least in some sense price fixing

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3 *In the Matter of Motorola Mobility LLC and Google, Inc.*, Dissenting Statement of Commissioner Maureen K. Ohlhausen at 1, FTC File No. 121-0120 (Jan. 3, 2013) (“*Google* dissent”); see also *In the Matter of Robert Bosch GmbH*, Statement of Commissioner Maureen K. Ohlhausen at 1-2, FTC File No. 121-0081, (Nov. 26, 2012) at 1-2, available at <http://www.ftc.gov/sites/default/files/documents/cases/2012/11/121126boschohlhausenstatement.pdf>.

4 *In the Matter of Motorola Mobility LLC and Google, Inc.*, Statement of the Federal Trade Commission at 4-5, FTC File No. 121-0120 (Jan. 3, 2013) (“*Google* decision”) (citation omitted); see also *In the Matter of Robert Bosch GmbH*, Statement of the Federal Trade Commission, at 2-3, FTC File No. 121-0081 (Nov. 26, 2012) at 2-3.

and other agreements in restraint of trade entail both “association” and “speech.” However, since early in the last century, antitrust jurisprudence has paid little attention to First Amendment limitations, with the exception of *Noerr-Pennington* immunity and the occasional limits on the remedial powers of courts to regulate ongoing behavior by entities, like newspapers, for which expression is their stock in trade. If expressive conduct causes competitive harm that brings it into conflict with the antitrust laws, the conduct generally has not been treated as protected by the First Amendment. No court has suggested that the Constitution gives cartellists the privilege to utter “I agree” without consequence.

This article examines how First Amendment principles can affect the application of the antitrust laws by first summarizing how courts have previously viewed the interaction between antitrust law and the First Amendment, then setting out the background behind the controversy over standards-essential patents and FRAND commitments, and finally evaluating the dueling positions articulated by the commissioners in these recent FTC matters against the principles courts have applied when assessing whether law enforcement implicates First Amendment concerns.

I. FIRST AMENDMENT LIMITS ON ANTITRUST LIABILITY

The antitrust laws prohibit many activities involving speech, association, and petitioning, yet the First Amendment is seldom a successful defense to liability. One commentator characterizes antitrust law as “almost wholly untouched by the First Amendment.”⁵ There are two major exceptions to this principle: certain politically motivated boycotts receive constitutional protection, as do genuine attempts to petition the government. This state of affairs arises from the interaction of several basic First Amendment principles.

The Supreme Court recognizes certain “narrowly limited classes of speech, the prevention and punishment of which have never been thought to raise any Constitutional problem.”⁶ As a general matter, these categories involve speech viewed as having minimal social value, but which society has a strong interest in regulating. Examples of such exceptions include obscenity, “fighting words,” threats, and (until fairly recently) libel.⁷ The Court finds support for excluding these categories from First Amendment protection both in the historical context of the Constitution as well as its own assessment of costs and benefits of the conduct from the perspective of First Amendment principles.⁸

It is well-established that price fixing and other types of “contract[s], combination[s] . . . , or conspirac[ies], in restraint of trade or commerce”⁹ are treated as unprotected

5 Frederick Schauer, *The Boundaries of the First Amendment: A Preliminary Exploration of Constitutional Salience*, 117 HARV. L. REV. 1765, 1781-82 (2004).

6 *Chaplinsky v. State of New Hampshire*, 315 U.S. 568, 571-72 (1942); see also *United States v. Stevens*, 559 U.S. 460, 468-69 (2010).

7 See *Stevens*, 559 U.S. at 468-69.

8 *Stevens*, 559 U.S. at 469-72.

9 15 U.S.C. § 1 (Sherman Act § 1).

speech.¹⁰ Cartelists certainly fix prices by exchanging information aloud or in writing. And any resulting prosecution will inevitably punish the cartelists, at least in part, for the content of their communications, which must yield a meeting of the minds to violate antitrust laws.¹¹ Yet price fixing is so clearly outside the purview of the First Amendment that it serves as the Supreme Court's paradigmatic example of why one cannot take seriously the expressive characteristics of communications that cause competitive or other harm that society has seen fit to condemn as unlawful. For example, when declining to extend First Amendment protection to an economic boycott, the Supreme Court noted that "[t]he most blatant, naked price-fixing agreement is a product of communication, but that is surely not a reason for viewing it with special solicitude."¹²

The reasons why price fixing falls so clearly outside the protective scope of the First Amendment are instructive. Arguably, such conduct falls within several classes of unprotected speech. First, "[o]ffers to engage in illegal transactions are categorically excluded from First Amendment protection."¹³ As a result, the "long established criminal proscriptions" against conspiracy and solicitation pass constitutional muster because the speech involved has no social value whether or not it is part of a commercial exchange.¹⁴ In the antitrust arena, communications that amount to price fixing are themselves an integral step in the illegal act, and under this branch of First Amendment analysis can be proscribed without further judicial scrutiny.

Second, even if price fixing were not itself illegal, it surely could be framed as an incitement to "imminent lawless action"—namely, the course of illegally coordinated pricing that the agreement portends.¹⁵ Communications giving rise to an anticompetitive agreement go beyond "the abstract advocacy of illegality,"¹⁶ and are instead intended to or in fact do produce illegal restraints on competition. As is the case with conspiracy and solicitation, the social value of such incitement can be understood as clearly outweighed by society's interest in preventing illegal anticompetitive restraints.

Third, price fixing could fall under the exception for "speech or writing used as an integral part of conduct" in violation of a valid statute.¹⁷ The precise contours of this category are unclear and perhaps analytically unsatisfying.¹⁸ Nevertheless, the Court frequently alludes to this principle when the First Amendment and the antitrust laws

10 See, e.g., *Sorrell v. IMS Health, Inc.*, 131 S. Ct. 2653, 2665 (2011) (citing *Giboney v. Empire Storage & Ice Co.*, 336 U.S. 490, 502 (1949)).

11 See, e.g., *In re Processed Egg Products Antitrust Litig.*, 902 F. Supp. 2d 704, 710 (E.D. Pa. 2012).

12 *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 431 (1990).

13 See e.g., *United States v. Williams*, 553 U.S. 285, 297 (2008) (citations omitted).

14 *Id.* at 298.

15 See *Brandenburg v. Ohio*, 395 U.S. 444, 447 (1969) (discussing the exception for incitement to "imminent lawless action"). "Incitement" may be a subset of "offers to engage in illegal transactions." See *Williams*, 553 U.S. at 297.

16 See *Williams*, 553 U.S. at 298–99 (citations omitted) (discussing the difference between a proposal or request to engage in illegal activity and the abstract advocacy of illegal activity).

17 *Giboney v. Empire Storage & Ice Co.*, 336 U.S. 490, 498 (1949); see also *Stevens*, 559 U.S. at 467–68.

18 See Eugene Volokh, *Speech as Conduct: Generally Applicable Laws, Illegal Courses of Conduct, "Situation-Altering Utterances," and the Uncharted Zones*, 90 CORNELL L. REV. 1277, 1314–1326 (2005).

intersect.¹⁹ The overarching lesson is that speech in furtherance of—or that comprises a necessary link in establishing—anticompetitive conduct merits little or no First Amendment protection.²⁰

Other First Amendment principles operate, in some circumstances, to shield from liability certain forms of expressive conduct that would otherwise violate the antitrust laws but that might be thought outside the scope of the First Amendment under the principles set out above.²¹ Three examples chart the scope of First Amendment protection for conduct that causes, or leads indirectly to, potential competitive harm. First, in *NAACP v. Claiborne Hardware Co.*,²² the Supreme Court held that boycotts motivated by political principles, rather than by parochial economic interests, enjoy a constitutional shield against the antitrust laws even if they cause economic harm. The conduct at issue was a nonviolent boycott organized to protest racial discrimination, which the Court deemed “essential political speech lying at the core of the First Amendment.”²³ The Court subsequently narrowed the potential reach of its holding in *FTC v. Superior Court Trial Lawyers Ass’n*,²⁴ where it withheld First Amendment protection from a boycott of new indigent criminal defense appointments by trial lawyers, reasoning that the boycott sought a fee increase for those same lawyers and thus was economically motivated.²⁵

Second, the *Noerr-Pennington* doctrine²⁶ protects genuine attempts to seek governmental action.²⁷ One foundation for that doctrine is the canon of constitutional avoidance, under which the Court interprets federal laws on the assumption that Congress did not intend to create a potential conflict with the First Amendment right of petition.²⁸

19 See, e.g., *Superior Court Trial Lawyers Ass’n*, 493 U.S. at 428 n.12 (citing *Giboney*); *NAACP v. Claiborne Hardware Co.*, 458 U.S. 886, 912 (1982) (same); *Nat’l Soc. of Prof’l Engineers v. United States*, 435 U.S. 679, 697 (1978) (same); *Giboney*, 336 U.S. at 501-02.

20 One commentator suggests that the communication of prices should be analyzed under the Court’s “commercial speech” precedents. See Stephen G. Thompson, *Antitrust, the First Amendment, and the Communication of Price Information*, 56 *TEMPLE L.Q.* 939 (1983). It is clear, however, that the regulation of price fixing would not still run afoul of the relevant test, which protects only speech that “concern[s] lawful activity.” See *id.* at 974-75.

21 There is immense doctrinal complexity in the application of the First Amendment to conduct having both a propensity to cause societal harm and some social value related to free expression. For example, reasonable and content-neutral “restrictions on the time, place, or manner of protected speech” are upheld under certain circumstances even when they may limit the speaker’s practical opportunities to communicate. See *Ward v. Rock Against Racism*, 491 U.S. 781, 791 (1989).

22 458 U.S. 886 (1982).

23 *Id.* (quoting *Henry v. First Nat. Bank of Clarksdale*, 595 F.2d 291, 303 (5th Cir. 1979)).

24 493 U.S. 411 (1990).

25 *Id.* at 426. The Court has suggested that the distinction between political and economic boycotts derives from the test for regulations of expressive conduct articulated in *United States v. O’Brien*, 391 U.S. 367 (1968). See *Superior Court Trial Lawyers Ass’n*, 493 U.S. at 429-31; *Claiborne Hardware Co.*, 458 U.S. at 911-13.

26 *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

27 *Prof’l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*, 508 U.S. 49, 56-57 (1993).

28 David McGowan and Mark A. Lemley, *Antitrust Immunity: State Action and Federalism, Petitioning and the First Amendment*, 17 *HARV. J.L. & PUB. POL’Y* 293, 298 (1994).

Under the doctrine, genuine attempts to petition the government for redress are immune from antitrust liability, even if the petitioning activity seeks an anticompetitive outcome or itself causes incidental anticompetitive harm. *Noerr* itself concerned lobbying for anticompetitive legislation, and the doctrine has been extended to cover efforts to seek relief from courts and administrative agencies as well.²⁹

The doctrine does not, however, protect petitioning activity that is a “mere sham to cover what is actually nothing more than an attempt to interfere directly with the business relationships of a competitor.”³⁰ Stated another way, if the objective is only to cause harm to the marketplace by virtue of the petitioner’s own conduct, rather than through the government action ostensibly being sought, *Noerr-Pennington* is not a shield to liability. In the litigation context, the “sham” exception denies immunity only to lawsuits that are both “objectively baseless” and subjectively intended to wield “the governmental process” as an anticompetitive weapon.³¹

The United States Supreme Court has also recognized the possibility in the *Noerr-Pennington* context of an exception for “fraud or other misrepresentations” before adjudicatory bodies.³² This is important because there is a related, third doctrine relevant to the interface between antitrust liability and expressive conduct that has particular application in the field of patent enforcement, namely the *Walker Process* doctrine. In *Walker Process Equipment, Inc. v. Food Machinery and Chemical Corp.*,³³ the case that spawned the doctrine, the defendant in a patent infringement suit filed an antitrust counterclaim asserting that the patent holder had obtained its patent by fraud. The Supreme Court held that proof of fraud on the Patent and Trademark Office (“PTO”) would strip the patent holder of its limited “exemption from the antitrust laws.”³⁴ Similarly, an “assignee who maintains and enforces the patent with knowledge of the patent’s infirmity” could also be liable.³⁵ The Court remanded the case for the alleged infringer to clarify the asserted antitrust violation and establish the required elements.³⁶

Although both the acquisition and the enforcement of a patent are forms of “petitioning,” *Walker Process* did not mention *Noerr-Pennington* immunity at all, and the resulting doctrine has survived and flourished despite the explicit expansion of *Noerr* immunity to the adjudicative setting. Indeed, the United States Court of Appeals for the Federal Circuit has interpreted *Walker Process* as carving out an exception to *Noerr-Pennington* when a patent owner seeks to enforce a patent that was procured by fraud on the PTO.³⁷ And the Supreme Court in turn has not foreclosed the possibility that

29 *Prof'l Real Estate Investors*, 508 U.S. at 56-57 (citing *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508 (1972)).

30 *Noerr Motor Freight*, 365 U.S. at 144.

31 *Prof'l Real Estate Investors*, 508 U.S. at 60-61.

32 *Id.* at 61 n.6.

33 382 U.S. 172 (1965).

34 *Id.* at 176-77.

35 *Id.* at 172 n.5.

36 *Id.* at 177-78.

37 See, e.g., *In re Indep. Serv. Organizations Antitrust Litig.*, 203 F.3d 1322, 1326-28 (Fed. Cir. 2000).

this exception could be read broadly as a prohibition on “unethical conduct” before adjudicatory bodies notwithstanding *Noerr*.³⁸

These and other contexts in which courts consider—implicitly or explicitly—the limits on antitrust enforcement posed by the First Amendment are subjects that could be discussed at length.³⁹ In the balance of this article, we explore whether the First Amendment is properly viewed as limiting the ability of the antitrust agencies or courts to restrict a patent holder’s ability to seek injunctive relief that—absent some extrinsic course of conduct implicating antitrust principles—would be available under the patent laws. As we have foreshadowed in our discussion above, we conclude that depending on the nature of the underlying antitrust claim, First Amendment jurisprudence need not bar courts or antitrust agencies from prohibiting the seeking of injunctive relief.

II. THE FIRST AMENDMENT AND THE ENFORCEMENT OF STANDARDS-ESSENTIAL PATENTS

As laid out in the introduction, the *Noerr-Pennington* doctrine has been invoked in recent decisions of the Federal Trade Commission concerning the enforcement of standards-essential patents (“SEPs”).⁴⁰ Before turning to our analysis, a bit of background is in order.

SEPs are patents on technologies that have been incorporated into an industry standard. Even if there may be multiple competing technologies capable of meeting a particular need, once an industry standard embeds a single patented technology, and the standard gains substantial traction in the marketplace, industry participants may have little practical choice but to use that technology. These industry participants thus can be “held up” by the patent holder who has through the standard-setting process acquired market power.⁴¹

Standard-setting organizations (“SSOs”) often have rules designed to address the problem of patent hold-up involving SEPs, including rules requiring participants in the standard-setting process to disclose their relevant patents or to commit that they will license their patent to all users if their technology wins inclusion in the standard.⁴² A common formulation of these rules involves the patent owner’s commitment to license the SEP on terms that are “reasonable and nondiscriminatory” (“RAND”) or “fair, reasonable, and nondiscriminatory” (“FRAND”).⁴³

38 *Prof'l Real Estate Investors*, 508 U.S. at 61 n.6.

39 The *Noerr-Pennington* doctrine itself has been the subject of extensive commentary and debate. See, e.g., McGowan, *supra* note 28.

40 Glenn G. Lammi, *FTC's Standards-Essential Patent Settlement: The Real "Elephant" in the Room?*, FORBES: WASHINGTON LEGAL FOUNDATION (Jan. 8, 2013), <http://www.forbes.com/sites/wlf/2013/01/08/ftcs-standards-essential-patent-settlement-the-real-elephant-in-the-room/> (last visited Sept. 21, 2013).

41 Daryl Lim, *Misconduct in Standard Setting: The Case for Patent Misuse*, 51 IDEA 559, 559, 561-64 (2011); Janice M. Mueller, *Patent Misuse Through the Capture of Industry Standards*, 17 BERKELEY TECH. L.J. 623, 623, 631-35 (2002).

42 Mueller, *supra* note 41, at 635-36; *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 313 (3d Cir. 2007).

43 Mueller, *supra* note 41, at 635-36.

In January 2013, the FTC and Google reached a settlement regarding SEPs that Google had acquired through its purchase of Motorola Mobility.⁴⁴ Motorola had made commitments to SSOs to license its SEPs on FRAND terms, but, according to the FTC, Motorola later refused to grant licenses to its rivals and sought injunctions against their infringing products.⁴⁵ The FTC concluded that Google's continued pursuit of injunctions against willing licensees violated Section 5 of the FTC Act.⁴⁶

Commissioner Maureen Ohlhausen dissented from the decision to impose antitrust liability on Google, arguing among other things that “the *Noerr-Pennington* doctrine precludes Section 5 liability for conduct grounded in the legitimate pursuit of an injunction.”⁴⁷ In response, the other commissioners noted that Motorola had willingly given up the right to seek injunctive relief when it made its FRAND commitments.⁴⁸ These opposing views mirrored those expressed in a prior FTC settlement that forbade Robert Bosch GmbH from seeking injunctions to enforce its FRAND-encumbered patents.⁴⁹

This debate within the FTC spans only a few pages of text, but it raises potentially difficult questions. An SEP owner who seeks to enjoin sale of infringing products is certainly “petitioning” the courts within the meaning of the *Noerr-Pennington* doctrine—it is asking the court to issue an order that would in turn affect marketplace competition. And although *Noerr-Pennington* immunity arose in the context of Sherman Act liability, there is no doubt that the FTC Act is similarly constrained by the doctrine.⁵⁰ But there is a deeper question—akin to that raised in the price-fixing context—whether the application of the FTC Act to prohibit an injunctive suit is punishing (or regulating) the petitioning or instead merely seeking redress for some underlying misconduct that threatens harm to competition. That is the question we explore below.

The first section that follows will examine whether the FTC could identify a source of antitrust liability independent of the SEP owner's lawsuit in order to avoid infringing upon the right of petition and ultimately on the First Amendment itself. Second, we will consider whether the SEP owner's FRAND commitment operates as a waiver of its First Amendment rights, obviating the need for *Noerr-Pennington* analysis or for any other First Amendment concern. The third section investigates whether established exceptions to the *Noerr-Pennington* doctrine might apply to allow the antitrust laws to reach the attempted enforcement of FRAND-encumbered patents. Finally, we consider, against the backdrop of our discussion of general principles involving antitrust and the

44 Lammi, *supra* note 40.

45 Steve Lohr, *On Google, F.T.C. Sets Rules of War Over Patents*, N.Y. TIMES (Jan. 4, 2013), http://www.nytimes.com/2013/01/05/technology/in-google-patent-case-ftc-set-rules-of-engagement-for-battles.html?_r=0 (last visited Sept. 21, 2013).

46 *Id.*; Lammi, *supra* note 40.

47 Google dissent, *supra*, at 3.

48 Google decision, *supra*, at 4-5.

49 Bosch dissent, *supra*, at 1-2; Bosch decision, *supra*, at 2-3.

50 Indeed, the *Noerr-Pennington* doctrine's First Amendment roots have been cited as a basis for applying the doctrine in numerous contexts other than antitrust law. See *In re Innovatio IP Ventures, LLC Patent Litig.*, 921 F. Supp. 2d 903, 912-13 (N.D. Ill. 2013) (collecting cases).

First Amendment, whether there is even greater latitude for application of limitations on expressive conduct and/or petitioning in the context of *remedying* antitrust violations than there is for imposing liability in the first place.

A. What Is The Antitrust Theory?

We first consider whether the FTC's enforcement actions sought to impose antitrust liability on the owners of FRAND-encumbered patents *because* they have petitioned the courts for relief or instead on some basis other than petitioning.⁵¹ We conclude that, assuming the correctness of the factual and legal premises behind the FTC's theory in these cases, the FTC's case is much less about seeking from a court an order enforcing a patent, and much more about the pattern of conduct that preceded that effort.

The apparent premise of the FTC's theory is that an SEP owner can violate the antitrust laws when it procures market power through a standards-setting process in which it either (a) acts improperly or (b) accepts limitations on the enforcement of its patent in exchange for obtaining the inclusion of its technology in the standard and then subsequently releases itself from those limitations. In either circumstance, the basis of liability would appear to have no more to do with the SEP owner's subsequent exercise of its patent rights in court than would a price-fixer's liability stem from its efforts to enforce the agreed upon prices in a judicial or other forum. To be sure, the SEP owner must go to court in order to exercise its power to exclude competitors, and this exercise of power may constitute petitioning, but liability arguably attaches not to that petitioning activity but to the SEP owner's prior acts that gave it market power.⁵² The SEP owner's attempt to enforce its patent may well provide evidence of its prior antitrust violation, and it may be a necessary step in creating the injury arising from the violation, but these features do not constitute the violation itself and thus would not trigger the application of the *Noerr-Pennington* doctrine.⁵³ We examine this point further as it relates to each of the FTC's two apparent theories of liability.

Deceptive Conduct in the SSO Process. Consider first the case where the SEP owner gets its patent included in the standard through some form of alleged misconduct in the standards-setting process. This in essence was the theory in one of the leading antitrust cases in this field: *Rambus Inc. v. FTC*.⁵⁴ In *Rambus*, the SEP owner allegedly deceived the SSO by failing to disclose its patents before the SSO incorporated the patented technologies into industry standards. The United States Court of Appeals for

51 In its *Google* decision, the FTC identified Google's continued pursuit of injunctions as one element of its "unfair" conduct under Section 5 of the FTC Act. See *Google* decision, *supra*, at 1. This section does not explore that aspect of the decision.

52 Although the *Noerr-Pennington* doctrine immunizes deceptive practices before legislative bodies, it does not tolerate the deception of administrative agencies or courts, and it certainly does not apply to private organizations like SSOs. See *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 501 (1988); *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 308 (3d Cir. 2007).

53 Cf. *Prof'l Real Estate Investors*, 508 U.S. at 75 (Stevens, J., concurring in the judgment) (citing cases for the proposition that "a manufacturer's successful action enforcing resale price maintenance agreements, restrictive provisions in a license to use a patent or a trademark, or an equipment lease, may evidence, or even constitute, violations of the antitrust laws").

54 522 F.3d 456 (D.C. Cir. 2008).

the D.C. Circuit held that the FTC had failed to demonstrate a violation of Section 2 of the Sherman Act, reasoning that the SEP owner had not inflicted “anticompetitive harm” because the FTC failed to adduce evidence that the SSO would have selected an alternative technology absent the alleged deception. Had such a showing been made, however, there is no reason to think that the *Noerr-Pennington* doctrine or any other aspect of First Amendment jurisprudence would have precluded liability for efforts to distort the actions of a private SSO⁵⁵ just as those doctrines would not preclude liability for price fixing.⁵⁶

Failure to Live Up to RAND/FRAND Commitments. A different situation is presented by cases involving no misconduct by the SEP owner during the standards-setting process, but instead involving subsequent actions by the SEP owner that are alleged to be inconsistent with the RAND or FRAND commitments it or its predecessor made in the course of the process. In *Broadcom Corp. v. Qualcomm, Inc.*, the Third Circuit held that “(1) in a consensus-oriented private standard-setting environment, (2) a patent holder’s intentionally false promise to license essential proprietary technology on FRAND terms, (3) coupled with an S[SO]’s reliance on that promise when including the technology in a standard, and (4) the patent holder’s subsequent breach of that promise, is actionable anticompetitive conduct.”⁵⁷

Some variant of this basic thesis, minus any allegation that the RAND promise was “intentionally false” when made, appears to undergird much of the FTC’s recent enforcement activity in this area. The core of the concern appears to be that the patent was included in the standard only because of the promise, that the promise acts as a limitation on the exercise of market power—perhaps substituting for the constraint posed by real competition—and that the SEP owner’s removal of that constraint is wrongful and enhances the owner’s effective market power. In any such case there may be difficult questions relating to the proper interpretation of the RAND or FRAND commitment, including whether it should be interpreted as a promise only about royalty rate levels or also as a commitment never to seek an injunction (such as when the potential licensee believes the SEP owner’s demand for royalties exceeds a RAND or FRAND level). But whatever the proper interpretation in a given case, there would seem a credible position that antitrust liability is predicated on the alleged *breach of the prior commitment*—which on this theory operates to remove a constraint on the exercise of market power—rather than the exercise of First Amendment rights. Accordingly, as with price fixing itself, the First Amendment would impose no limitation if the FTC’s theory of liability in this field were to be viewed through such a lens.

55 See *Allied Tube*, 486 U.S. at 501; *Broadcom*, 501 F.3d at 308.

56 Indeed, deceptive conduct has been perceived as being outside the protection of the First Amendment, at least where economical matters are involved. See *United States v. Alvarez*, 132 S. Ct. 2537, 2547-48 (2012) (plurality op.); *id.* at 2554-55 (Breyer, J., concurring, joined by Kagan, J.).

57 *Broadcom*, 501 F.3d at 314. In *Broadcom*, the alleged violation was that the SEP owner breached its commitment by licensing its technology on non-FRAND terms, rather than by seeking injunctions against willing licensees. The case thus did not explicitly raise any “petitioning” issue though *Noerr* cases were discussed as part of the *Broadcom* court’s reasoning behind this holding. See *id.* at 308, 313.

B. Is There Waiver Of The Right To Petition?

To the extent the operative theory of potential antitrust liability imposes liability directly upon petitioning conduct, there is a different obstacle to the application of the First Amendment that was not directly discussed previously, namely waiver. In *Google/Motorola* and *Bosch*, the commissioners in the FTC majority argued that the SEP owners could not assert *Noerr-Pennington* immunity because they had voluntarily given up their right to seek injunctions when they made their FRAND commitments.⁵⁸ There appears to be a sound basis for this view. Certain constitutional rights can be waived if the waiver was voluntary, knowing, and intelligent,⁵⁹ and the First Amendment right of petition is one of them.⁶⁰ To the extent a FRAND commitment is properly interpreted to preclude the seeking of an injunction, a sophisticated, well-lawyered patent owner in negotiations with an SSO should recognize the limitations to which it has agreed, making waiver a powerful argument in this context.⁶¹

There may, however, be significant room for disagreement on whether a FRAND commitment in fact constitutes a promise *never* to seek an injunction, including in circumstances where the prospective licensee refuses to pay the royalty demanded by the SEP owner that is later proven to be consistent with FRAND terms. Imagine an SEP owner who extends identical FRAND terms to all potential licensees of its patent. A potential licensee might practice the patented technology but reject the SEP owner's price, proposing instead a lower price that the owner is not willing to accept. When there is a dispute over the terms of a potential license, the propriety of seeking an injunction depends on how one interprets the FRAND commitment. A permissive interpretation would simply require the SEP owner to *offer* licenses on FRAND terms to all who wish to use the patented technology. If a potential licensee rejects the terms of the license and

58 *Google* decision, *supra*, at 4-5; *Bosch* decision, *supra*, at 2-3.

59 *See Overmyer Co. v. Frick Co.*, 405 U.S. 174, 185-86 (1972) (discussing constitutional due process rights as well as constitutional rights pertaining to criminal procedure).

60 *See, e.g., Leonard v. Clark*, 12 F.3d 885, 889-90 (9th Cir. 1993) (citing *Overmyer*, 405 U.S. at 185-86). In *Leonard*, the Portland firefighters' union sought the invalidation of a provision of its collective bargaining agreement with the city. The union claimed that the provision, which shifted any increased payroll costs resulting from union-endorsed legislation back onto the union, violated its First Amendment right of petition. Avoiding the issue of whether the provision actually infringed upon the union's petitioning rights, the Ninth Circuit held that the union had waived any such rights when it signed the collective bargaining agreement. The fact that the union was advised by counsel and had explicitly objected to the provision during negotiations with the city reinforced the court's conclusion that the waiver was knowing, voluntary, and intelligent. *See Leonard*, 12 F.3d at 889-90. Also of relevance is *Cohen v. Cowles Media Co.*, in which the Supreme Court found that a promissory estoppel action based on a promise made to keep a source confidential did not violate the First Amendment, reasoning from cases, including those involving antitrust, that hold that the media is not exempt from generally applicable laws. 501 U.S. 663, 665, 669 (1991).

61 *Cf. Apple, Inc. v. Motorola Mobility, Inc.*, 886 F. Supp. 2d 1061, 1078 (W.D. Wis. 2012) (holding that *Noerr-Pennington* immunity did not bar a breach of contract claim against a patent holder in part because the patent holder had "waived some of its petitioning rights through contract"). However, the court in *Apple* did not consider whether the patent holder's declaration to SSOs that it would license SEPs on FRAND terms waived its *Noerr-Pennington* immunity with respect to the antitrust claims. As the case concerned essentially the same facts as the FTC's *Google* investigation, Commissioner Ohlhausen cited it in her dissent. *See Google* dissent, *supra*, at 1.

nevertheless uses the technology, the owner can seek an injunction without violating its FRAND commitment

A more restrictive reading of the FRAND commitment, however, would suggest that the SEP owner promises not to seek injunctions so long as the infringer offers to pay a royalty that is *arguably* FRAND and subject to potential retroactive upward adjustment following an adjudication of the FRAND issue. Under this view the infringer would be deemed a willing licensee, and the SEP owner's only recourse would be to sue for royalties so that a court may determine the appropriate terms for a license.

Two of the cases cited by the FTC majority in *Bosch* appear to favor the latter interpretation. In *Microsoft Corp. v. Motorola, Inc.*,⁶² the United States Court of Appeals for the Ninth Circuit discussed the scope of an SEP owner's RAND commitment in the course of upholding a preliminary injunction against the enforcement of a patent injunction the SEP owner had obtained in German court. It suggested that "[w]hatever the appropriate method of determining the RAND licensing rate, it could well be that retrospective payment at the rate ultimately determined and a determination of the future rate, not an injunction banning sales while that rate is determined, is the only remedy consistent with the contractual commitment to license users of ITU standard-essential patents."⁶³

When sitting by designation in *Apple, Inc. v. Motorola, Inc.*,⁶⁴ Judge Posner took an even more forceful position:

Motorola counters that Apple's refusal to negotiate with it after rejecting its initial offer of a 2.25 percent royalty warrants injunctive relief; by opting not to take a license *ex ante*, it argues, Apple should lose the FRAND safe harbor. But Apple's refusal to negotiate for a license . . . was not a defense to a claim by Motorola for a FRAND royalty. If Apple said no to 2.25 percent, it ran the risk of being ordered by a court to pay an equal or even higher royalty rate, but that is not the same thing as Motorola's being excused from no longer having to comply with its FRAND obligations. Motorola agreed to license its standards-essential patents on FRAND terms as a *quid pro quo* for their being declared essential to the standard. . . . It does not claim to have conditioned agreement on prospective licensees' making counteroffers in license negotiations.⁶⁵

The FTC's citation to these cases indicates that it interprets the FRAND commitment as a promise not merely to offer licenses on FRAND terms, but also to forgo injunctive relief entirely. In essence, the FRAND commitment itself is a license, with the FRAND terms to be determined later through negotiation or litigation.⁶⁶

62 696 F.3d 872 (9th Cir. 2012).

63 *Id.* at 885.

64 869 F. Supp. 2d 901 (N.D. Ill. 2012).

65 *Id.* at 914.

66 *Cf.* Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 CAL. L. REV. 1889, 1924–25 (2002) (discussing the possibility of treating a FRAND commitment as the grant of an "implied license"). Of course, if one views the FRAND commitment as an implied license, and as a result the SEP owner has no hope of obtaining an injunction, then the danger that the SEP owner will acquire market power appears to be greatly reduced.

Even if a FRAND commitment is properly viewed as a promise to forgo injunctive relief, the *Google/Motorola* case presents a twist that may complicate the waiver analysis. Although Motorola may have waived its right of petition when it entered its FRAND commitment, arguably Google's only action was its acquisition of Motorola along with its SEPs. But as Google was Motorola's successor and thus charged with knowledge that its SEPs were encumbered by a FRAND commitment, this step likely was sufficient to waive any First Amendment rights Google had with respect to the enforcement of those patents.⁶⁷

C. Potential Application Of Exceptions To *Noerr-Pennington* Immunity

If the SEP owner has preserved its First Amendment rights, and the theory of the antitrust violation is the SEP owner's attempt to seek an injunction rather than some previous misconduct, antitrust regulators may avoid the *Noerr-Pennington* doctrine only if the SEP owner's petitioning activity falls within one of the doctrine's exceptions. Two exceptions are relevant here: (1) the exception for "sham" litigation articulated in *Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*,⁶⁸ and (2) the "fraud" exception, which has its origins in *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*⁶⁹

For litigation to be a "sham," it must be both "objectively meritless" and subjectively intended as a means of wielding "the governmental *process*—as opposed to the *outcome* of that process—as an anticompetitive weapon."⁷⁰ The enforcement of FRAND-encumbered patents would not meet these criteria where there is a reasonable basis to dispute the applicability of the FRAND commitment, perhaps in many circumstances including the situation where a potential licensee refuses the SEP owner's terms.⁷¹ Moreover, typically one would think the SEP owner is not merely attempting to burden its rivals through the litigation "process"—but instead is genuinely seeking a favorable judicial "outcome." Only if the court issues an injunction can the SEP owner exclude its rivals.

The Supreme Court has, however, left open the possibility of other exceptions to *Noerr-Pennington* immunity. In its decision articulating the two-part test for "sham"

67 See 6 AM. JUR. 2D *Assignments* § 128 (2001) ("Assumption of the liabilities may be implied from the acceptance of the benefits under the contract. For example, when an assignee takes over a going business, his or her intention to assume the obligations of the contract relating to the business may be found from his or her acquiescence in the terms of the contract.").

68 508 U.S. 49 (1993).

69 382 U.S. 172 (1965).

70 *Prof'l Real Estate Investors*, 508 U.S. at 60-61.

71 In addition, one recent district court decision held that because the question of how to resolve RAND licensing disputes is "muddled," the owner of a RAND-encumbered patent could maintain plausible infringement claims and therefore was not subject to antitrust liability under the "sham" exception to *Noerr-Pennington*. See *In re Innovatio IP Ventures, LLC Patent Litig.*, 921 F. Supp. 2d 903, 914-17 (N.D. Ill. 2013). The court recognized, however, that RAND commitments have been held to preclude injunctive relief; consequently, its determination that the "sham" exception did not apply relied heavily on the fact that the SEP owner could plausibly sue for damages (*i.e.*, a RAND royalty). *Id.* at 916-17. If the principles laid down by the FTC in *Google/Motorola* and *Bosch* and by the Ninth Circuit and Northern District of Illinois in the *Motorola* cases are widely adopted, it will become more difficult for SEP owners to contend that seeking an injunction is not objectively and subjectively baseless.

litigation, the Court noted that “unethical conduct in the setting of the adjudicatory process often results in sanctions” but concluded that it “need not decide here whether and, if so, to what extent *Noerr* permits the imposition of antitrust liability for a litigant’s fraud or other misrepresentations.”⁷² Significantly, the Court cited *Walker Process*, which establishes the principle that the enforcement or attempted enforcement of patents obtained by fraud may constitute a Sherman Act, Section Two violation.⁷³

Even a broad “fraud” exception, however, may not apply to efforts to enforce FRAND-encumbered patents. What is the fraud? If the patent was procured properly, *Walker Process* itself does not apply. And the court is certainly not being defrauded: its injunction will presumably not issue until after the licensee seeks to avoid an injunction by invoking the FRAND encumbrance. In some cases there may be facts suggesting that the SEP owner who allegedly breaches its FRAND commitment misled the SSO, but it has not misled the PTO or the court from which it seeks an injunction.

Even if one extended *Walker Process* to apply to conduct directed at the SSO—perhaps on the theory that the market power being exercised was procured improperly—it is not obvious that the SEP owner has deceived the SSO in a manner that amounts to fraud, at least in the circumstance where there is no allegation that the patent holder lied about the existence of its patent. Every contracting party leads its counterparty to believe that it will perform, but a breach of contract is not normally treated as fraudulent. Thus, if a contract is interpreted as a promise to perform or pay damages, neither party is deceived as to the possibility of non-performance. A party’s failure to perform generally amounts to fraud only where a party enters a contract *with no intention* of performing, and a plaintiff alleging fraud must prove that state of mind.⁷⁴

D. First Amendment Limits in the Remedial Context

The First Amendment has implications for antitrust remedies as well as antitrust liability. A court order enjoining the SEP owner from enforcing its FRAND-encumbered patents at least superficially resembles a prior restraint on the right of petition. Nevertheless, in this context, the First Amendment is likely to impose only minimal (if any) restrictions on the expansive powers of courts (and agencies) to remedy antitrust violations.

In *Nat’l Soc. of Prof’l Engineers v. United States*,⁷⁵ the Supreme Court addressed a district court order that prohibited a trade association of civil engineers from “adopting any official opinion, policy statement, or guideline stating or implying that competitive bidding is unethical.”⁷⁶ The society claimed that the order was a prior restraint on speech

72 *Prof’l Real Estate Investors*, 508 U.S. at 61 n.6.

73 *Id.*

74 37 AM. JUR. 2D *Fraud and Deceit* § 90 (2001).

75 435 U.S. 679 (1978).

76 *Id.* at 696-97.

and association and thereby violated its First Amendment rights.⁷⁷ The Court disagreed, concluding that the injunction could legitimately curtail rights that would otherwise have been constitutionally protected in order to remedy the antitrust violations.⁷⁸ If the engineering society feared that the injunction covered “legitimate paths of expression,” it had the burden of bringing its claims to the district court’s attention and moving to modify the decree.⁷⁹

It is well-established that in the course of remedying proven antitrust violations, courts may enter orders prohibiting conduct that would not violate the antitrust laws.⁸⁰ When market power is acquired through improper means, a court would typically act within its remedial powers if it sought to excise the ill-gotten power entirely. If that power arises from an industry standard, and the inclusion of the SEP in the standard is a bell that cannot readily be unrung, one conceivable remedial option would be to prohibit *any* enforcement of the patent in question. If that would be a permissible remedy—an issue on which we express no opinion—the less draconian approach of regulating how the patent may be enforced (*i.e.*, via a request for injunction as opposed to only money damages) would appear to be unobjectionable. Not surprisingly, perhaps, courts have upheld consent orders that require SEP owners to cease and desist from efforts to enforce FRAND-encumbered patents.⁸¹

III. CONCLUSION

Although the *Noerr-Pennington* doctrine—and First Amendment principles more broadly—can be a powerful shield against antitrust liability for petitioning or other expressive conduct, the proper application of the antitrust laws typically will turn on proof of anticompetitive harm to competition, not solely on the defendant’s constitutionally protected conduct. Determining whether a particular application of the law nonetheless threatens to infringe protected speech or petitioning requires a rigorous assessment of the antitrust theory and the nature of the expressive conduct in question.

77 *Id.* at 697 & n.25. The engineering society also argued that the injunction barred lobbying activities in violation of the *Noerr-Pennington* doctrine, but the Court found that the injunction did not prohibit such activity. *Id.* at 699 n.27.

78 *Id.* at 697-98. Although the Court’s language suggests that an antitrust remedy could impinge on otherwise valid First Amendment rights, it cites an example (price fixing) and a case (*Giboney*) that concern categories of speech unprotected by the First Amendment.

79 *Id.* at 698-99.

80 *See, e.g., Nat’l Soc. of Prof’l Engineers*, 435 U.S. at 697-98; *United States v. Paramount Pictures*, 334 U.S. 131, 148 (1948); *see also New York v. Microsoft*, 224 F. Supp. 2d 76, 108, 110 (D.D.C. 2002) (agreeing with the principle that the remedy for an antitrust violation may address otherwise lawful conduct based on a discussion of Supreme Court cases but interpreting these cases as requiring that the conduct in question must be closely related to, or be the same class or type as, the anticompetitive conduct in question).

81 *Broadcom Corp.*, 501 F.3d at 311.

THE MARKET-PARTICIPANT EXCEPTION TO STATE-ACTION IMMUNITY FROM ANTITRUST LIABILITY

Jarod M. Bona and Luke A. Wake¹

I. INTRODUCTION

“The heart of our national economy has long been faith in the value of competition,”² and as the United States Supreme Court put it, those “fundamental national values of free enterprise and economic competition” are embodied in federal antitrust laws.³ Antitrust enforcers and “private attorneys’ general”⁴ work within this system to support competition by challenging anticompetitive conduct.

But a significant category of potentially-anticompetitive conduct often escapes antitrust scrutiny: state and local commercial activity. Governmental entities can, and do, enter the marketplace as competitors, and may have even stronger incentives than profit-maximizing firms to harm competition.⁵ Indeed, state and local entities have built-in advantages that may allow them to successfully monopolize, or otherwise injure competition. For example, a local entity could utilize a statutory monopoly on certain utilities to tie those monopolistic services to other products or services from a competitive market. Or, a governmental entity could use the power to tax to raise sufficient revenue to offer a product or service below cost for sufficient time to exclude other competitors from a market.

The reason that state and local anticompetitive conduct often avoids antitrust scrutiny is because the courts have applied a state-action immunity since the early 1940s.⁶ This doctrine exempts some government conduct—described more fully below—from federal antitrust law. Because monopoly is so profitable, an enterprising government could decide to solve its fiscal woes by entering a market and taking monopoly prices from consumers. And without a commercial-conduct exception to state-action immunity, governmental actors could get away with it.

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2 *National Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 695 (1978).

3 *Federal Trade Commission v. Phoebe Putney Health Sys.*, 133 S.Ct. 1003, 1010 (2013).

4 See generally Carl W. Hittinger and Jarod M. Bona, *The Diminishing Role of the Private Attorney General in Antitrust and Securities Class Action Cases Aided by the Supreme Court*, 4 J. BUS. & TECH. L. 167 (2009).

5 David E.M. Sappington & J. Gregory Sidak, *Competition Law for State-Owned Enterprises*, 71 ANTITRUST L. J. 479, 480 (2003). See generally Eleanor Fox and Deborah Healey, “When the State Harms Competition—The Role for Competition Law” (May 2013). *University of New South Wales Faculty of Law Research Series 2013*, also available at <http://ssrn.com/abstract=2248059> (surveying thirty-two jurisdictions and analyzing antitrust and competition laws that condemn governmental anticompetitive-conduct).

6 *Parker v. Brown*, 317 U.S. 341, 351 (1943).

Last term, the U.S. Supreme Court, in *Federal Trade Commission v. Phoebe Putney Health System, Inc.*, addressed the state-action immunity doctrine, but left open the following circuit-splitting question: Is there a market-participant exception to state-action immunity from the antitrust laws?⁷ In this article, we contend that state and local entities that engage in commercial conduct should abide by the same antitrust laws as their private-market competitors.⁸

II. What is state-action immunity?

In 1943, the U.S. Supreme Court held in *Parker v. Brown* that the federal antitrust laws do not apply to certain state conduct.⁹ This decision developed into what is now referred to as “state-action immunity,” even though it is more aptly described as an exemption.¹⁰ The *Parker* Court upheld the obviously-anticompetitive California Agricultural Act, which the Supreme Court later characterized as a “state-supervised” market-sharing scheme.¹¹ Importantly, the decision was grounded in statutory interpretation, but the doctrine has evolved such that federalism and state-sovereignty rationales control the doctrine’s scope and development.¹² Like all antitrust exemptions, the state-action-immunity exemption is disfavored, and only recognized “when it is clear that the challenged anticompetitive conduct is undertaken pursuant to a regulatory scheme that ‘is the State’s own.’”¹³

To determine whether to apply immunity in a traditional case, the Supreme Court adheres to a form of the test developed in *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.*¹⁴ First, the party seeking exemption must prove that the challenged restraint is “clearly articulated and affirmatively expressed as state policy,” and second,

7 133 S.Ct. at 1011 n.4.

8 The authors filed an amicus brief in *Federal Trade Commission v. Phoebe Putney Health Systems, Inc.* on behalf of the National Federation of Independent Business urging that the Supreme Court adopt this exception in that case.

9 317 U.S. 341, 351 (1943). For a more complete statement of the state-action immunity doctrine and its development, see Jarod M. Bona, *The Antitrust Implications of Licensed Occupations Choosing Their Own Exclusive Jurisdiction*, 5 UST. J.L. & PUB. POL’Y 28, 36-44 (2011).

10 See *South Carolina State Bd. of Dentistry v. Federal Trade Commission*, 455 F.3d 436, 444-46 (4th Cir. 2006).

11 *Federal Trade Comm’n v. Ticor Title Ins. Co.*, 504 U.S. 621, 632 (1992).

12 See William J. Martin, *State Action Antitrust Immunity for Municipally Supervised Parties*, 72 U. CHI. L. REV. 1079, 1082 (2005); see also *Ticor Title Ins.*, 504 U.S. at 633 (noting that the *Parker* “decision was grounded in principles of federalism”).

13 *Phoebe Putney*, 133 S.Ct. at 1010 (quoting *Ticor Title Ins.*, 504 U.S. at 635).

14 445 U.S. 97, 105 (1980).

the policy must be “actively supervised” by the State itself.¹⁵ Certain parties, like municipalities, need not prove “active supervision.”¹⁶

In the 1985 decision of *Town of Hallie v. City of Eau Claire* the Court lowered the bar for satisfying the first prong—“clear articulation and affirmative expression of state policy”—by holding that that it is satisfied where the governmental actor shows that their anticompetitive conduct is a *foreseeable* result of state legislation.¹⁷ The Court in *Phoebe Putney*, however, recently restored some teeth to the test when it expanded *Community Communications Company v. Boulder*¹⁸ to hold that grants of general corporate power to government entities is not a sufficient articulation and expression of state-sovereign policy to invoke an exemption from the antitrust laws.¹⁹

III. STATE-ACTION IMMUNITY SHOULD NOT APPLY TO MARKET-PARTICIPANT CONDUCT BY GOVERNMENTAL ENTITIES.

A. The History of the State-Action Immunity Doctrine Supports Applying the Antitrust Laws to State and Local Commercial Activity.

1. *Union Pacific Railroad and Parker.*

The Supreme Court issued its *Parker* decision—the genesis of the state-action exemption—in the wake of an important case decided just two years before: In *Union Pacific Railroad Company v. United States*, the Court applied the Elkins Act—a federal competition statute regulating interstate commerce carriers—to certain rebates and concessions by Kansas City, Kansas, in its capacity as a commercial participant.²⁰ The Court rejected the city’s attempt to entangle its market conduct with its “municipal interests,” and explained that “the promotion of civic advancement may not be used as a cloak to screen the granting of discriminatory advantages to shippers.”²¹ In other words, Kansas City had to follow federal competition laws, just like every other market player.

15 *Id.*

16 *See* Bona, *supra* note 9 at 39–51 (discussing which parties are subject to the “active supervision” requirement); *see also* *North Carolina State Bd. of Dental Examiners v. Federal Trade Commission*, 717 F.3d 359, 368 (4th Cir. 2013) (holding that “state agencies ‘in which a decisive coalition (usually a majority) is made up of participants in the regulated market,’ who are chosen by and accountable to their fellow market participants, are private actors and must meet both *Midcal* prongs”), cert. granted March 3, 2014.

17 471 U.S. 34, 41–42 (1985).

18 455 U.S. 40 (1982) (holding that Colorado’s Home Rule Amendment, which allowed municipalities to govern their local affairs, did not satisfy the clear-articulation test).

19 *Phoebe Putney*, 133 S.Ct. at 1012–13. The Court explained that “[g]rants of general corporate power that allow substate governmental entities to participate in a competitive marketplace should be, can be, and typically are used in ways that raise no federal antitrust concerns.” *Id.* at 1012.

20 313 U.S. 450, 470–71 (1941). The Supreme Court in *City of Lafayette, Louisiana v. Louisiana Power & Light Co.*, 435 U.S. 389 described the Elkins Act as “a statute which essentially is an antitrust provision serving the same purposes as the anti-price-discrimination provisions of the Robinson-Patman Act.” 435 U.S. 389, 401 n.19 (1978).

21 313 U.S. at 464–65.

Two years later, when the Court in *Parker* held for the first time that the federal antitrust laws do not—as a matter of statutory interpretation—apply to the state “as sovereign,” it expressly distinguished a government entity acting as a market participant: “[W]e have no question of the state or its municipality becoming a participant in a private agreement or combination by others for restraint of trade.”²² Indeed, many years later, the Court in *City of Columbia v. Omni Outdoor Advertising* acknowledged this limitation by finding that *Parker* distinguished “States in their governmental capacities as sovereign regulators” from their capacity “as a commercial participant in a given market.”²³ Thus, from the doctrine’s origins, the Court never contemplated that states and municipalities could use state-action immunity as a shield when they were engaged as actual participants in a market.

2. *City of Lafayette*.

Years after *Parker*, in *City of Lafayette*, the Court addressed policy issues related to a market-participant exception to state-action immunity when it rejected a broad antitrust exclusion for local governments.²⁴ This case involved antitrust counterclaims against Louisiana cities that owned and operated electric-utility systems, both inside and outside city limits.²⁵ The Court referred back to the case preceding *Parker*—*Union Pacific*—and explained that “it has not been regarded as anomalous to require compliance by municipalities with the substantive standards of other federal laws which impose such sanctions upon ‘persons.’”²⁶

Significantly, the Court rejected the argument that the intent of the antitrust laws is to protect the public *only* from private abuses and not from municipal activity.²⁷ The Court explained that “[e]very business enterprise, public or private, operates its business in furtherance of its own goals.”²⁸ Even though municipally-owned utilities may have public goals, “the economic choices made by public corporations in the conduct of their business affairs . . . are not inherently more likely to comport with the broader interests of national economic well-being than are those of private corporations”²⁹ Indeed, the counterclaim’s allegations “illustrate the impact which local governments, acting as providers of services, may have on other individuals and business enterprises with which they inter-relate as purchasers, suppliers, and sometimes, as here, competitors.”³⁰ Finally, the Court expressed worry that when a massive number of local government units—62,437 in 1972—“act as owners and providers of services” without antitrust restrictions, there is the “potential of serious distortion of the rational and efficient allocation of

22 317 U.S. at 351-52.

23 499 U.S. 365, 374-75 (1991).

24 435 U.S. at 403.

25 *Id.* at 391.

26 *Id.* at 400.

27 *Id.* at 403.

28 *Id.*

29 *Id.*

30 *Id.*

resources, and the efficiency of free markets which the regime of competition embodied in the antitrust laws is thought to engender.”³¹

Notably, the Court’s concern about freeing municipal activity from antitrust scrutiny arose from municipal commercial conduct not local regulatory activity. The Court did not want to exempt public entities that “inter-relate” with a market ‘as purchasers, suppliers, and . . . competitors’ from the federal competition regime.”³²

Chief Justice Warren E. Burger, concurring, went even further by arguing that the case should simply turn on the fact that the cities were engaging in commercial activity: There is “nothing in *Parker v Brown* . . . or its progeny, which suggests that a proprietary enterprise with the inherent capacity for economically disruptive anticompetitive effects should be exempt from the Sherman Act merely because it is organized under state law as a municipality.”³³ The Chief Justice expressed his belief that immunizing municipal commercial activity from the antitrust laws “would inject a wholly arbitrary variable into a ‘fundamental national economic policy.’”³⁴ Moreover, he recognized the crucial distinction in the existing doctrine “between a State’s entrepreneurial personality and a sovereign’s decision . . . to replace competition with regulation.”³⁵ “[T]he running of a business enterprise is not an integral operation in the area of traditional government functions.”³⁶

3. *Jefferson County Pharmaceutical Association.*

Five years later—in a case that doesn’t receive enough attention in this area—the Court in *Jefferson County Pharmaceutical Association, Inc. v. Abbott Laboratories* held that federal antitrust law applied to “state purchases for the purpose of competing against private enterprise.”³⁷ There, an association of pharmacists and pharmacies sued, among other defendants, public hospitals and medical centers with pharmacies for violating the price-discrimination prohibitions³⁸ of the Robinson-Patman Act.³⁹ The public defendants sought dismissal by arguing that their purchases were exempt from the federal antitrust laws.⁴⁰

The facts did not concern state purchases for “traditional government functions”—only “state purchases for the purpose of competing with private enterprise”—so this case was an opportunity for the Supreme Court to specifically address whether federal antitrust law applies to a state actor participating in a commercial market.⁴¹

31 *Id.* at 408.

32 *Id.* at 403.

33 *Id.* at 418 (Burger, C.J. concurring).

34 *Id.* at 419.

35 *Id.* at 422.

36 *Id.* at 424.

37 460 U.S. 150, 154 (1983).

38 15 U.S.C. § 13.

39 *Jefferson County*, 460 U.S. at 152.

40 *Id.* at 153.

41 *Id.* at 154.

Distinguishing traditional state activity—or activity of a sovereign—from state commercial activity, the Court explained that “the retail sale of pharmaceutical drugs is not ‘indisputably’ an attribute of state sovereignty.”⁴² And “it is too late in the day to suggest that Congress cannot regulate states under its Commerce Clause powers when they are engaged in proprietary activities.”⁴³

From a policy perspective, the Court also explained that antitrust review of government market-participant conduct is important because public entities often have certain advantages in the commercial markets.⁴⁴ For example, relevant to the Robinson-Patman Act, “retail competition from state agencies can be more invidious than that from chain-stores, the particular targets” of the Act.⁴⁵ Even though consumers may benefit from lower costs through economies of scale and volume purchases, “to the extent that lower prices are attributable to lower overhead, resulting from federal grants, state subsidies, free public services, and freedom from taxation, state agencies merely redistribute the burden of costs from the actual consumers to the citizens at large.”⁴⁶ The Court thus concluded that an “exemption from the Robinson-Patman Act could give state agencies a significant *additional* advantage in certain commercial markets, perhaps enough to eliminate marginal or small private competitors.”⁴⁷

Jefferson County addressed whether state commercial conduct is subject to the Robinson-Patman Act, which is statutorily separate from the Sherman Acts. It therefore does not strictly control the question of whether the market-participant exception applies to state-action immunity from Sherman Act claims. But the policy issues underlying their respective applications to state and local entities is the same: Does applying the particular antitrust act implicate federalism concerns because the activity is state-sovereign activity? If the challenged activity is not part of a traditional government—it is instead commercial activity—then “it is too late in the day to suggest that Congress cannot regulate states under its Commerce Clause powers when they are engaging in proprietary activities.”⁴⁸

4. *Omni Outdoor Advertising.*

The *Phoebe Putney* Court acknowledged that it left “open the possibility of a market participant exception”⁴⁹ in its 1991 decision of *Columbia v. Omni Outdoor Advertising, Inc.*⁵⁰ In *Omni* the lower court held that certain language in *Parker* suggested a conspiracy exception to the general rule of state action immunity.⁵¹ But the Supreme Court disagreed, explaining that the disputed language instead suggested a commercial-

42 *Id.* at 154 n.6.

43 *Id.*

44 *Id.* at 158 n.17.

45 *Id.*

46 *Id.*

47 *Id.* (emphasis in original).

48 *Id.*

49 133 S.Ct. at 1010 n.4.

50 499 U.S. 365, 374–75, 379 (1991).

51 *Id.* at 374–75.

participant exception to state-action immunity, not a *conspiracy exception*.⁵² More specifically, the Court explained that the “rationale of *Parker* was that, in light of our national commitment to federalism, the general language of the Sherman Act should not be interpreted to prohibit anticompetitive actions by the States in their governmental capacities as sovereign *regulators*.”⁵³

According to the *Omni* Court, *Parker* was distinguishing a commercial-participant scenario, not a public-private conspiracy when it stated that in its case there is “no question of a state or its municipality becoming a participant in a private agreement or combination by others for restraint of trade[.]”⁵⁴ Indeed, the Court in *Omni* supported this conclusion based in part upon *Parker*’s citation of *Union Pacific*, which, as noted above, involved a federal competition statute’s application to “certain rebates and concessions made by Kansas City, Kansas, in its capacity as the owner and operator of a wholesale produce market that was integrated with railroad facilities.”⁵⁵

5. *Phoebe Putney*.

In its 2013 *Phoebe Putney* decision, the Supreme Court had the opportunity to clarify once and for all that state and local entities are subject to antitrust laws when acting as active market-participants.⁵⁶ The case arose when a hospital authority, Phoebe Putney, sought to acquire Palmyra Park Hospital—its only competitor in a six-county geographic market in rural Georgia.⁵⁷ The two hospitals together, in fact, accounted for over 85 percent of the acute care in the geographic market.⁵⁸ The FTC sought to enjoin the transaction, claiming that it would substantially lessen competition.⁵⁹ The merging hospitals asserted state-action immunity, which the trial court accepted and the Eleventh Circuit affirmed.⁶⁰

Ultimately, the Supreme Court held that a state’s grant of general corporate powers to government entities does not protect them from the antitrust laws.⁶¹ More specifically, to invoke the exemption, the entity must show that the state itself affirmatively contemplated that the entity’s conduct would displace competition. While clarifying what must be shown for a governmental entity to invoke *Parker* immunity, the court expressly declined to address the still open question of whether there is, indeed, a

52 *Id.*

53 *Id.* at 374 (emphasis added).

54 317 U.S. at 351-52.

55 *Id.* at 375.

56 133 S.Ct. 1003. The authors urged to the Supreme Court via amicus brief to apply the market-participant exception to the case. See Brief of National Federation of Independent Business as Amicus Curiae in Support of the Petition, *Federal Trade Commission v. Phoebe Putney Health System, Inc. et al.*, No. 11-1160 (2013).

57 133 S.Ct. at 1008-09.

58 *Id.*

59 *Id.*

60 *Id.*

61 *Id.* at 1011-12.

“market-participant” exception to state-action immunity.⁶² But the Court did suggest that in most cases the antitrust laws should apply when local or state actors engage in anticompetitive conduct as market-participants in so far as it acknowledged that when a state grants some entity—public or private—the general power to act, “it does so against the backdrop of federal antitrust law.”⁶³

6. A Circuit Split.

Phoebe Putney did not resolve the current split on the market-participant exception issue among the circuits. Some circuits recognize the exception.⁶⁴ Others do not, pending a more affirmative statement from the Supreme Court.⁶⁵

G. Applying the Antitrust Laws to State and Local Commercial Activity Is Consistent with Federal Antitrust Policy and Federalism.

The state-action immunity doctrine attempts to balance the sometimes conflicting principles of federalism and federal antitrust policy.⁶⁶ The purpose of the doctrine is “grounded in principles of federalism”⁶⁷ to respect “the States in their governmental capacities as sovereign regulators.”⁶⁸ Market-participant conduct, however, is not an “integral operation in an area of traditional government functions.”⁶⁹ Thus, this conduct does not fit within the doctrine’s purpose to protect state-sovereign activity from federal interference.

By contrast, immunizing state and local market-participant conduct from antitrust scrutiny could negatively affect federal antitrust policy. First, with a free pass from antitrust regulation, state and local entities have a financial incentive to participate in commercial markets in anti-competitive ways because such conduct is very profitable. It may not take an enterprising municipality long to try to solve its fiscal woes by entering a market and

62 *Id.* at 1010 n.4.

63 *Id.* at 1013.

64 See, e.g., *VIBO Corp. v. Conway*, 669 F.3d 675, 687 (6th Cir. 2012) (“[I]f a state acts as a ‘commercial participant in a given market,’ action taken in a market capacity is not protected.”); *A.D. Bedell Wholesale Co., Inc.*, 263 F.3d 239, 265 n.55 (3d Cir. 2001) (declining to apply market-participant exception to state-action immunity because states did not enter the tobacco market as a buyer or seller); *Genentech, Inc. v. Eli Lilly and Co.*, 998 F.2d 931, 948 (Fed. Cir. 1993) (“To warrant *Parker* immunity the anticompetitive acts must be taken in the state’s ‘sovereign capacity,’ and not as a market participant in competition with commercial enterprise.”), *abrogated* on another issue by *Wilton v. Seven Falls Co.*, 515 U.S. 277, 289 (1995).

65 See, e.g., *Paragould Cablevision, Inc. v. City of Paragould, Arkansas*, 930 F.2d 1310, 1312-13 (8th Cir. 1991) (citing *Omni* and remarking that “the market participant exception is merely a suggestion and is not a rule of law”); *Automated Salvage Transport, Inc. v. Wheelabrator Env'tl. Sys., Inc.*, 155 F.3d 59, 81 (2d Cir. 1998) (concurring with Eighth Circuit on exception).

66 See Einer Richard Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 667, 670 (1991) (explaining that there “is no principled way for courts to reconcile [these] truly conflicting interests”).

67 *Ticor Title*, 504 U.S. at 633.

68 *Omni*, 499 U.S. at 374; *Parker*, 317 U.S. at 352.

69 *Lafayette*, 435 U.S. at 424; see also *Jefferson County*, 460 U.S. at 154 n.6 (“The retail sale of pharmaceutical drugs is not ‘indisputably’ an attribute of state sovereignty.”).

taking monopoly fees from consumers. Second, if the government entity's anticompetitive harm extends beyond its electorate, political correction may not occur as the voters are unlikely to care about harm (particularly the diffused harm of anticompetitive conduct) beyond their borders.⁷⁰ The costs will fall on those without a vote.

So the federalism concerns are minimal, but the negative effect of immunizing state commercial conduct is substantial. This balance must be considered in the context of the Commerce Clause and interstate commerce.⁷¹

1. Federalism and Antitrust Policy.

In wrestling with the interplay between principles of federalism and the goals of antitrust law, the *Parker* Court explained that the Sherman Act “makes no mention of the state . . . and gives no hint that it was intended to restrain state action or official action directed by a state.”⁷² Thus, the decision implicitly invoked a form of the cannon of avoidance in narrowly construing the Sherman Act to foreclose potential federalism concerns, or at least in seeking to preserve a presumption against displacing traditional state powers.⁷³ Such a presumption is consistent with the principle underpinnings of our federalist system, which holds that—while granting the federal government power to regulate the national economy under the Commerce Clause—the states are generally allowed to maintain their traditional police powers to regulate matters of health, morals and the public good under the Tenth Amendment.⁷⁴

70 See F.T.C. Office of Policy Planning, *Report of the State Action Task Force*, September 2003, p.41–42 (expressing concern that “out-of-state citizens adversely affected by spillovers typically have no participation rights and effectively are disenfranchised on the issue.”).

71 *United States v. California*, 297 U.S. 175, 184 (1936) (“The sovereign power of the states is necessarily diminished to the extent of the grants of power to the federal government in the Constitution.”).

72 317 U.S. 341, 351 (1943).

73 Christopher Madsen, *Unfettered Federalism: The State of State Action Immunity to Federal Antitrust Actions in the Eighth Circuit After Paragould Cablevision v. City of Paragould.*, 37 S.D. L. Rev. 155, 158–59 (1992) (“Parker advocated federalism, concluding that the sovereign power of the individual states to act on their own behalf is of higher import than requiring states to serve the will of the federal government.”).

74 317 U.S. at 351 (“In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state’s control over its officers and agents is not lightly to be attributed to Congress.”); see also Casey L. Westover, *Structural Interpretation and the New Federalism: Finding the Proper Balance Between State Sovereignty and Federal Supremacy*, 88 MARQ. L. REV. 693, 696–97, 705 (2005) (explaining that “[t]he principles or themes derived from the Constitution can help give meaning to ambiguous constitutional texts or answer questions not directly addressed by the text[.]” and explaining “Structural analysis is commonplace in the Supreme Court’s separation of powers jurisprudence.”).

Congress, of course, has the power to regulate anticompetitive conduct in the same manner that it regulates other forms of economic conduct.⁷⁵ For that matter, federal law unremarkably governs state and local government actors in many contexts—from environmental regulations imposed on municipalities, to federal wage and hour laws applicable to state and local governments when acting in the capacity of an employer.⁷⁶ Indeed, it is clear that Congress maintains the power to apply federal-statutory schemes indiscriminately to state and local governments in the same manner it regulates private citizens engaged in such conduct.⁷⁷ This is because the Supremacy Clause

75 The Commerce Clause provides simply that the federal government maintains the power to regulate “commerce among the several states.” U.S. CONST. Art. I, Sec. 8, Cl. 3. While there is tremendous support for the proposition that this grant of authority was originally intended to authorize only limited economic regulation—*i.e.* regulation of economic conduct where goods or services actually cross state lines—the New Deal era courts radically expanded the federal commerce power in *Wickard v. Filburn*, 317 U.S. 111 (1942); Craig L. Jackson, *The Limiting Principle Strategy and Challenges to the New Deal Commerce Clause*, 15 U. Pa. J. Const. L. 11, 15 (2012) (“The new-New Deal Commerce Clause interpretation essentially expanded the close and substantial relation test used in some of the earlier cases by broadly allowing regulation of all activity having a substantial effect on interstate commerce.”). Following *Wickard* the federal courts interpreted the commerce power so broadly that many questioned whether there were *any* limits on federal power until *United States v. Lopez* in 1995, and *United States v. Morrison* in 2000, when the Court—for the first time since the New Deal era—struck down federal laws regulating purely intrastate conduct. See *e.g.*, *The Right Results All the Wrong Reasons: An Historical and Functional Analysis of the Commerce Clause*, 53 Vand. L. Rev. 271, 283-84 (2000) (noting that until *Lopez*, there was no “case law prevent[ing] the expansive nationalization of criminal law.”). *Lopez* and *Morrison* made clear that the conduct must actually impact interstate commerce in some non-attenuated way in order to fall within the purview of the federal commerce power. *United States v. Morrison*, 529 U.S. 598, 608 (2000). But for whatever halting step the Supreme Court might have taken toward restraining federal powers in *Lopez* and *Morrison*, the Court’s decision in *Gonzales v. Raich* made clear that federal regulation will be upheld so long as there is some rational connection to interstate commerce. 545 U.S. 1 (2005). As recently demonstrated in *Nat’l Fed’n of Indep. Bus. v. Sebelius*, some federal enactments reach too far to be upheld under the Commerce Power. 132 S. Ct. 2566, 2587, 183 L. Ed. 2d 450 (2012). Nonetheless, the *Raich* standard has been understood as an exceedingly low bar for the federal government to meet. *San Luis & Delta-Mendota Water Auth. v. Salazar*, 638 F.3d 1163, 1177 (9th Cir. 2011) *cert. denied*, 132 S. Ct. 498, 181 L. Ed. 2d 388 (U.S. 2011) (emphasizing that *Raich* requires courts to uphold federal regulation of local conduct where the restriction is part of a “comprehensive regulatory scheme” having a “substantial relation to commerce.”).

76 *E.g.*, *Los Angeles Cnty. Flood Control Dist. v. Natural Res. Def. Council, Inc.*, 133 S. Ct. 710, 184 L. Ed. 2d 547 (2013) (noting that “the Clean Water Act (CWA) and its implementing regulations require certain [municipal actors] ... to obtain a National Pollutant Discharge Elimination System (NPDES) permit before discharging storm water into navigable waters.”); *Christensen v. Harris Cnty.*, 529 U.S. 576 (2000) (concerning application of the Fair Labor Standards Act to local government employees).

77 *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 554, 105 S. Ct. 1005, 1019, 83 L. Ed. 2d 1016 (1985) (noting that under the FLSA local government “faces nothing more than the same minimum-wage and overtime obligations that hundreds of thousands of other employers[.]” and explaining that “the fundamental limitation that the constitutional scheme imposes on the Commerce Clause to protect the ‘States as States’ is one of process rather than one of result. Any substantive restraint on the exercise of Commerce Clause powers must find its justification in the procedural nature of this basic limitation, and it must be tailored to compensate for possible failings in the national political process rather than to dictate a “sacred province of state autonomy.”).

enables Congress to govern over the states with the understanding that states retain the prerogative to act freely, consistent with the dictates of the Tenth and Fourteenth Amendments.⁷⁸

Nonetheless, the Tenth Amendment still imposes meaningful limitations on federal regulatory powers when it comes to enactments that infringe on state sovereignty.⁷⁹ For example, in *New York v. United States* and *Printz v. United States*, the Supreme Court held that the federal government could not affirmatively compel states to set-up or enforce regulatory programs.⁸⁰ Likewise, in *NFIB*, the Court held that the federal government could not coercively condition the continued receipt of federal funds on a requirement to radically expand Medicaid coverage, or to enact new regulatory programs—at least where the states were already reliant upon such funds.⁸¹

The Supremacy Clause does, however, provide that federal law trumps state law to the extent they stand in conflict.⁸² This is why states cannot nullify federal enactments.⁸³ But the general rule is that states are presumed to retain the sovereign prerogative to adopt regulatory restrictions in the absence of clear congressional intent to displace state regulatory powers.⁸⁴ This presumption against preemption is intended to preserve traditional sovereign powers, except to the extent federal law conflicts.⁸⁵ Thus, the federal preemption doctrine is premised in the same foundational principle upon which *Parker* stands—*i.e.* the idea that Congress should not be presumed to have abrogated the prerogative of state and local officials to adopt regulatory enactments pursuant to their traditional police powers.

78 *Garcia* abandoned the notion that the Court can or should seek to determine whether the federal statute invades upon the traditional sovereign powers, rejecting the very notion that courts may “employ freestanding conceptions of state sovereignty when measuring congressional authority under the Commerce Clause.” *Id.* at 550; see also Walter Wheeler Cook, *What is the Police Power?*, 7 Colum. L. Rev. 322 (1907) (defining the police power as “the unclassified, residuary power of government vested by the United States Constitution in the respective states[.]” and positing that the state retains all powers unless the power has been exclusively vested with the national government, or denied by a constitutional provision protecting “individual liberty, e.g. due process of law.”).

79 *Printz v. United States*, 521 U.S. 898, 919–20 (1997) (“[T]he Framers rejected the concept of a central government that would act upon and through the States, and instead designed a system in which the State and Federal Governments would exercise concurrent authority...”).

80 *New York v. United States*, 505 U.S. 144 (1992); *Printz*, 521 U.S. 898.

81 *Nat’l Fed’n of Indep. Bus.*, 132 S. Ct. at 2602–03.

82 U.S. CONST. Art. VI Cl. 2.

83 Timothy Sandefur, *State Standing to Challenge Ultra Vires Federal Action: The Health Care Cases and Beyond*, 23 U. Fla. J.L. & Pub. Pol’y 311, 322–24 (2012) (repudiating the notion that states may nullify federal enactments because the Constitution vested supreme sovereignty in the federal government under the theory that “the nation constituted the aggregate of the people as a single community...”).

84 In the absence of express preemption, courts look to see whether Congress has implicitly preempted state action “with the assumption that the historic police powers of the States [are] not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.” *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

85 *Santa Fe Elevator Corp.*, 331 U.S. at 230.

2. Federalism, State-Sovereignty, and the Proper Role of Government.

The federalist system seeks to protect individual rights by disseminating political power between competing sovereign entities.⁸⁶ The fear was that a centralized government might grow despotic if vested with too many powers.⁸⁷ Indeed, Madison envisioned the federalist system as preserving the state's traditional sovereign powers, subject only to the few narrowly-defined "enumerated powers" granted to the federal government.⁸⁸ Of course, during the New Deal era, the Roosevelt Administration radically expanded federal power at the same time that state and local governments were increasing traditional conceptions of the police power.⁸⁹ In a matter of decades the judicial mindset reset from a preoccupation with protecting the natural rights of individuals to a reflexively-statist presumption that favored regulations impinging upon individual liberties.⁹⁰

In any event, the bedrock principles of the federalist system—both as originally conceived and as applied in practice today—have everything to do with controlling

86 *Bond v. United States*, 131 S. Ct. 2355, 2364 (2011) ("The federal system rests on what might at first seem a counterintuitive insight, that 'freedom is enhanced by the creation of two governments, not one.' The Framers concluded that allocation of powers between the National Government and the States enhances freedom, first by protecting the integrity of the governments themselves, and second by protecting the people, from whom all governmental powers are derived.") (citing *Alden v. Maine*, 527 U.S. 706, 758 (1999); *New York v. United States*, 505 U.S. 144, 181 (1992) ("State sovereignty is not just an end in itself: Rather, federalism secures to citizens the liberties that derive from the diffusion of sovereign power.") (internal quotation marks omitted); see also Patrick M. Garry, *A One-Sided Federalism Revolution: The Unaddressed Constitutional Compromise on Federalism and Individual Rights*, 36 Seton Hall L. Rev. 851, 852 (2006) ("[W]hereas the Bill of Rights protections were limited to its identified freedoms, federalism had a much broader scope: built into the very structure of America's constitutional democracy, federalism would protect individual liberty as a whole, in every aspect in which it could be threatened by a distant central government.").

87 James Madison argued that federalism would prevent the United States government from growing too powerful "to allay concerns that the United States Constitution created a centralized government." Mark Tushnet, *Federalism and Liberalism*, 4 Cardozo J. Int'l & Comp. L. 329, 335 (1996) (explaining that federalism is an institutional mechanism designed to "retard the drift toward centralization.").

88 The Federalist No. 45, at 313 (James Madison) (Jacob E. Cooke ed., 1961).

89 Norman Redlich & David R. Lurie, *Federalism: A Surrogate for What Really Matters*, 23 Ohio N.U. L. Rev. 1273, 1274 (1997) ("The 'New Deal Constitutional Revolution' had a fairly precise starting point—the Spring of 1937 when the Supreme Court, in a dramatic turnabout (the 'switch in time that saved nine'), retreated from its 'Lochner-era' rejection of governmental regulation and upheld broad-based federal, as well as state, regulation of economic activity, thereby averting the constitutional crisis that developed as the nation attempted to cope with the Great Depression and that came to a head when President Roosevelt launched his court-packing plan."). See generally David E. Bernstein, *REHABILITATING LOCHNER: DEFENDING INDIVIDUAL RIGHTS AGAINST PROGRESSIVE REFORM* (University of Chicago Press 2011).

90 Kurt T. Lash, *The Constitutional Convention of 1937: The Original Meaning of the New Jurisprudential Deal*, 70 *FORDHAM L. REV.* 459, 462–63 (2001) (noting that "[t]he New Deal justices appointed by Roosevelt brought to the Court a simple mandate--they were to put an end to the 'tortured construction' of the Constitution that prevented the enactment of New Deal legislation[,] and explaining that the Court accomplished this end by "declar[ing] that judicial interference with the political process henceforth required... some clear textual justification.").

and diffusing political power.⁹¹ Political power might be defined as the (presumptively legitimate) capacity to use force to control the actions of others.⁹² Indeed, the debate between the Federalists and the Anti-Federalists was largely focused on what system would best restrain the federal government from abrogating, or infringing upon, the right of individuals to exercise their natural liberties and to control their properties.⁹³

The exercise of sovereign political power, however, is different from other actions government might take.⁹⁴ When the government engages in economic conduct, it is acting as an independent actor in the same manner that ordinary individuals might.⁹⁵ For example, when operating as an employer, or engaged in a business enterprise, the government is carrying out activities that normal citizens might pursue. Thus, in these circumstances, the State, or her political subdivisions, is not acting in a traditional-sovereign capacity.⁹⁶ This conduct is different in kind from when the State invokes its sovereign prerogative to use force to control the actions of others. Strictly speaking, these

91 Edward L. Rubin & Malcolm Feeley, *Federalism: Some Notes on A National Neurosis*, 41 UCLA L. REV. 903, 911 (1994) (explaining that federalism is not so much about decentralization, as it is about structuring our national political order in a manner that preserves areas of jurisdiction for the states).

92 “Power is one of the key concepts in the great Western tradition of thought about political phenomena. It is at the same time a concept at which, in spite of its long history, there is, on analytical levels, a notable lack of agreement both about its specific definition, and about many features of the conceptual context in which it should be placed. There is however, a core complex of its meanings, having to do with the capacity of persons or collectivities ‘to get things done’ effectively, in particular when their goals are obstructed by some kind of human resistance or opposition. The problem of coping with resistance then leads into the question of the role of coercive measures, including the use of physical force, and the relation of coercion to the voluntary and consensual aspects of political systems.” Talcott Parsons, *On the Concept of Political Power*, PROCEEDINGS OF THE AMERICAN PHILOSOPHICAL SOCIETY, VOL. 107, No. 3, 232 (Nov. 8, 1963).

93 “One of the central themes in the Antifederalists’ arguments was resort to a putative rule of construction providing that all rights not expressly reserved by the people to themselves in forming a government were deemed surrendered to the control of that government. Federalists quickly cohered around two related defenses of the omission of a bill of rights. First, they argued that a bill of rights would be unnecessary because rights would be sufficiently protected by the enumerated federal powers scheme envisioned by the proposed Constitution. Second, they argued that inclusion of a bill of rights could be affirmatively dangerous because it might provide a basis for inferring the existence of additional federal powers beyond those specifically enumerated in the Constitution.” Ryan C. Williams, *The Ninth Amendment As A Rule of Construction*, 111 COLUM. L. REV. 498, 511 (2011).

94 See Johnny Hutchinson, *What A Difference A Contract Makes: Protecting Taxpayers from Changes in the Tax Code*, 57 Case W. Res. L. Rev. 483, 492-93 (2007) (observing that government may not craft regulation to “‘eliminate an obligation that arose under one of the Government’s contractual relationships.’” but explaining that when government acts “‘as a sovereign’” it may not be held liable for nullifying a contract with a regulatory enactment).

95 See e.g., *United States v. Winstar Corp.*, 518 U.S. 839, 896 (1996) (“The sovereign acts doctrine thus balances the Government’s need for freedom to legislate with its obligation to honor its contracts by asking whether the sovereign act is properly attributable to the Government as contractor. If the answer is no, the Government’s defense to liability depends on the answer to the further question, whether that act would otherwise release the Government from liability under ordinary principles of contract law.”).

96 See e.g., *Conner Bros. Const. Co., Inc. v. Geren*, 550 F.3d 1368, 1371 (Fed. Cir. 2008) (explaining that courts must distinguish between actions undertaken in the state’s role as a sovereign—i.e. those “resulting from its public and general acts as a sovereign”—and actions on equal footing with other private actors).

traditional sovereign powers were understood as the State's exclusive prerogative to use force to control others.⁹⁷

As such, the State does not act within its sovereign prerogative when engaged in economic conduct.⁹⁸ It cannot be that the government is truly exercising sovereign powers when acting in the same manner as its private citizens. Thus, restricting the prerogative of state and local governments to engage in economic conduct does not abrogate sovereign power. Therefore, the federalism concerns underpinning the *Parker* immunity doctrine are not in play when the State acts as an ordinary market-participant on equal-footing with private citizens.⁹⁹

Moreover, to the extent the State acts to advance its own pecuniary interests to the detriment of its citizens, it may exceed its natural charter to govern in the public interest.¹⁰⁰ Indeed, the revolutionary generation believed that the State owed fiduciary-like duties to her citizens on the theory that the citizens had vested political power in the government for the limited purpose of protecting natural rights.¹⁰¹ Thus the contemplated market-participant exception to the *Parker* immunity doctrine is both consistent with the principles of federalism and the classical liberal conception of the proper role of government.

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- 97 “The concept that a monopoly on legitimate force is necessary for government to function may sound heretical in a country steeped in stories of our own revolutionary founding, but it is the fundamental organizing principle of any political entity, including a democracy like the United States. Max Weber’s famous definition states: ‘A compulsory political association with continuous organization . . . will be called a ‘state’ if and in so far as its administrative staff successfully upholds a claim to the monopoly of the legitimate use of physical force in the enforcement of its order.’” Joshua Horwitz & Casey Anderson, *Taking Gun Rights Seriously: The Insurrectionist Idea and Its Consequences*, 1 Alb. Gov’t L. Rev. 496, 504 (2008) (citing Max Weber, *The Theory of Social and Economic Organization* 154 (Talcot Parsons ed., A.M. Henderson & Talcott Parsons, trans., The Free Press 1968) (1947)).
- 98 *New Energy Co. of Indiana v. Lumbach*, 486 U.S. 269, 277 (1988) (explaining that the market participant doctrine, to the Dormant Commerce Clause, “differentiates between a State’s acting in its distinctive governmental capacity, and a State’s acting in more general capacity of market-participant; only the former is subject to the limitations of the negative commerce clause.”) (citing *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806–10 (1976)).
- 99 *See California State Bd. of Optometry v. F.T.C.*, 910 F.2d 976, 980 (D.C. Cir. 1990) (“Although a State may be a “person” for purposes of the antitrust laws, it is equally clear, under the ‘state action’ doctrine enunciated in *Parker v. Brown*, . . . that when a State acts in a sovereign rather than a proprietary capacity, it is exempt from the antitrust laws even though those actions may restrain trade. . . . Thus, properly framed, the question before us is not simply whether a State is a person under section 5(a)(2) of the Act, but whether a State acting in its sovereign capacity is subject to the Act.”) (emphasis added).
- 100 *See Timothy Sandefur, In Defense of Substantive Due Process, or the Promise of Lawful Rule*, 35 Harv. J.L. & Pub. Pol’y 283 (2012) (“*In Politics*, Aristotle distinguished between governments aimed for the benefit of the ruled and those that aim at the ruler’s benefit.”).
- 101 *See Chisolm v. Georgia*, 2 U.S. 419 (2 Dall.), 468 (1793) (“The rights of individuals and the justice due to them, are as dear and precious as those of States. Indeed the latter are founded upon the former; and the great end and object of them must be to secure and support the rights of individuals, or else vain is Government.”); *Yick Wo v. Hopkins*, 118 U.S. 356, 370 (1886) (“[I]n our system, while sovereign powers are delegated to the agencies of government, sovereignty itself remains with the people by whom and for whom all government exists and acts.”); *see also* Evan Fox-Decent, *The Fiduciary Nature of State Legal Authority*, 31 Queen’s L.J. 259, 260–61 (2005).

Without the shield of state-sovereignty and federalism, the federal policy of applying antitrust law to commercial conduct throughout the economy should control. As the Supreme Court in *United States v. Topco Associates* explained, the federal antitrust laws are the “Magna Carta of free enterprise,” and “are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms.”¹⁰² Thus, anticompetitive state and local commercial conduct, like private conduct, must, absent constitutional protection, yield to the federal policy of free competition—as embodied in our federal antitrust laws.

C. The Market-Participant Exception Is Within the Expertise of the Federal Courts to Administer.

1. Any Exception to the *Parker* Immunity Rule Must Be Principled and Manageable.

Laws do not enforce themselves. Federal courts translate the federal antitrust laws to specific factual scenarios. The translation is not always perfect and antitrust—with its often complex economic foundation—is among the more difficult subjects to apply.¹⁰³ Indeed, with respect to antitrust actions against governmental entities, the Supreme Court has expressed caution about federal courts becoming arbiters of state administrative law.¹⁰⁴

That fear does not present itself with the market-participant exception because it does not require federal courts to make substantive determinations of state-agency law. In fact, federal courts need not analyze what state law permits; they need only determine what the state or its subdivision is doing. The significant question is whether the government entity is competing in a market. This is an evidence-analyzing role that is well within the purview of the federal courts, and does not encroach on the state’s ability to develop its own administrative law as it sees fit.

But there is another—coincidental—factor that will substantially ease the administrability of the market-participant exception: Under the Dormant Commerce Clause doctrine, there is already a developed standard for distinguishing between when the state is acting in a truly sovereign capacity and when it is acting as an ordinary commercial actor. Courts applying a market-participant exception to state-action immunity can look to this jurisprudence for guidance. These cases recognize a “market-participant exception” to the Dormant Commerce Clause on the theory that the constitutional prohibition against state-enacted protectionist regimes has no application when the state is acting as a private commercial actor.

102 405 U.S. 596, 610 (1972).

103 See generally Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984).

104 See *Omni*, 499 U.S. at 372; *Town of Hallie*, 471 U.S. at 44 n.7.

2. The Market-Participant Exception to the Dormant-Commerce-Clause.

The Commerce Clause authorizes the federal government to “regulate Commerce . . . among the several States.”¹⁰⁵ “This affirmative grant of power does not explicitly control the states, but it ‘has long been understood to have a ‘negative’ implication that denies the States the power to unjustifiably discriminate against, or burden, the flow of interstate of commerce.”¹⁰⁶ Thus, the so-called “Dormant Commerce Clause” is rooted in the idea that the Commerce Clause made the United States a single economic union by vesting Congress with the exclusive power to regulate the national economy.¹⁰⁷

Of course, the Dormant Commerce Clause is understood to leave room for the states to address local issues.¹⁰⁸ But when a state, or its political subdivisions, regulates in a manner that facially discriminates against out-of-state business, or seeks to regulate out-of-state conduct, the restriction is virtually always a violation. In other cases—where the regulation merely has a discriminatory effect—reviewing courts will uphold the challenged regulation “unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits.”¹⁰⁹ But a governmental entity can defend against a Dormant Commerce Clause challenge by invoking a categorical defense: the market-participant exception.¹¹⁰ To do so, the local or state government must demonstrate that the challenged discriminatory measure is undertaken to further an essentially private-economic function.¹¹¹

In other words, the constitutional restrictions, implicit in the Dormant Commerce Clause, apply only against the State when it acts in a regulatory capacity.¹¹² By contrast, when a governmental unit acts like an ordinary economic actor—for example, as a speculator or purchaser of commodities, or as an employer—the constitutional

105 U.S. Const., art. I, Sec. 8, cl. 3.

106 *Rocky Mt. Farmers Union*, 12-15131, 2013 WL 5227091 (citing *Or. Waste Sys., Inc. v. Dep’t of Env’tl. Quality of State of Or.*, 511 U.S. 93, 98, 114 S.Ct. 1345, 128 L.Ed.2d 13 (1994)).

107 *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 537-38 (1949).

108 *Grant-Hall v. Cavalry Portfolio Servs., LLC*, 856 F. Supp. 2d 929, 937 (N.D. Ill. 2012) (“The law has had to respect a cross-purpose as well, for the Framers’ distrust of economic Balkanization was limited by their federalism favoring a degree of local autonomy.”).

109 *Pike*, 397 U.S. at 142.

110 *SSC Corp. v. Town of Smithtown*, 66 F.3d 502, 510 (2d Cir. 1995) (“At the threshold of its Commerce Clause analysis, the Supreme Court has drawn an important distinction between “regulation” of, and ‘participation’ in, a market.”).

111 *Id.* (explaining that when acting as a market participant, the State “enters the open market as a buyer or seller on the same footing as private parties...”)

112 “Because the power conferred by the Constitution is the power to ‘regulate,’ the strictures of the dormant Commerce Clause are not activated unless a state action may be characterized as a ‘regulation.’” *Id.*

restrictions don't apply.¹¹³ Thus, our Dormant Commerce Clause jurisprudence endeavors to distinguish between sovereign action and economic conduct.¹¹⁴

The distinction comes down to the question of whether the challenged conduct is undertaken in the government's role as an arbitrator over the local economy, or as an active participant in the economy.¹¹⁵ State government is only subject to constitutional scrutiny to the extent it is utilizing its sovereign powers to stack the deck to favor local economic interests.¹¹⁶ This understanding of the Dormant Commerce Clause recognizes that government acts in a sovereign capacity whenever it acts as a referee—*i.e.* as an arbitrator setting the rules of the game for competing economic actors.¹¹⁷

Dormant Commerce Clause jurisprudence says that state and local governments must act in an even-handed manner when setting the ground rules for in-state and out-of-state economic actors.¹¹⁸ State and local governments can regulate economic conduct, but only in so far as they act as geographically-impartial referees.¹¹⁹ But when the government steps out of its role as a referee and into the game as an economic actor in its own right, it is no longer acting in a sovereign capacity.¹²⁰ Courts recognize that governmental units (or quasi-governmental entities) sometimes act as independent economic actors.¹²¹

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- 113 See *e.g.*, *Reeves, Inc. v. Stake*, 447 U.S. 429, 440 (1980) (“South Dakota, as a seller of cement, unquestionably fits the “market participant” label...”); *White v. Massachusetts Council of Const. Employers, Inc.*, 460 U.S. 204, 214–15 (1983) (“Insofar as the city expended only its own funds in entering into construction contracts for public projects, it was a market participant and entitled to be treated as such...”).
- 114 *Reeves, Inc.*, 447 U.S. 429, 436 (1980) (affirming the fundamental importance of this “basic distinction.”).
- 115 Lawrence Tribe, *American Constitutional Law* 336 (1978) (“the commerce clause was directed, as an historical matter, only at regulatory and taxing actions taken by states in their sovereign capacity”).
- 116 *Reeves, Inc.*, 447 U.S. at 436.
- 117 See *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 95 (1984) (refusing to apply the market participant exception because the State of Alaska was not merely entering the market for timber, but was further imposing a condition on the right of other economic actors to participate in the market).
- 118 *E.g.*, *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 196 (1994) (holding unconstitutional a local regulation that had the effect of “neutraliz[ing] advantages belonging to the place of origin” of a commercial good) (citing *Baldwin v. G.A.F. Seeing, Inc.*, 249 U.S. 511, 527 (1935)); *Hunt v. Washington State Apple Advertising Com’n*, 423 U.S. 333 (1977) (invalidating a North Carolina statute that operated to strip market advantages from Washington apple-growers).
- 119 “Following this logic, the Supreme Court has consistently recognized facial discrimination where a statute or regulation distinguished between in-state and out-of-state products and no nondiscriminatory reason for the distinction was shown.” *Rocky Mountain Farmers Union*, 730 F.3d 1070, 1089.
- 120 See *S.-Cent. Timber Dev., Inc.*, 467 U.S. 82, 97 (1984) (“The limit of the market-participant doctrine must be that it allows a State to impose burdens on commerce within the market in which it is a participant, but allows it to go no further.”).
- 121 See *e.g.*, *White*, 460 U.S. at 208 (affirming the principle that state and local governments are exempt from Dormant Commerce Clause review when acting as market participants).

Indeed, when government begins providing services, or trading in articles of commerce, it is an active participant in the market rather than a pure sovereign.¹²²

A philosophical complication is the fact that government might advance public interest when providing products or services in a market. This does not, however, change the reality that when acting as a market participant the government is also advancing its selfish interests.¹²³ The government's own interests, admittedly, are often coextensive with the public interest that it seeks to advance in endeavoring to provide products or services.¹²⁴ In this light, the line between government's role as an arbitrating-referee and a market-participant is somewhat blurred. Nonetheless, Dormant Commerce Clause jurisprudence distinguishes between conduct undertaken in the state's sovereign capacity and conduct undertaken in its capacity as a market-participant because only the sovereign is setting rules—backed by force—governing the conduct of other economic actors.¹²⁵ This is significant for constitutional purposes because the Commerce Clause speaks directly only to the power of the federal government to regulate economic conduct, and thus its negative implication can only be understood as a constraint on the power of state government to regulate economic conduct.¹²⁶

122 See *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806 (1976) (“The common thread of all [dormant Commerce Clause] cases is that the State interfered with the natural functioning of the interstate market either through prohibition or through burdensome regulation. By contrast, Maryland has not sought to prohibit the flow of hulks, or to regulate the conditions under which it may occur. Instead, it has entered into the market itself to bid up their price.”).

123 As Francis Fukuyama explains, liberal governmental institutions, and constitutional regimes, aim to control the interests of individual political actors by guarding against despotism and cronyism; however, he explains that governmental institutions have a tendency to advance their own interests, which may be coextensive with select interest groups in a democratic system. Francis Fukuyama, *THE ORIGINS OF POLITICAL ORDER*, 403, 457 (Farrar, Straus and Giroux, 2011).

124 It is important to recognize that the government's institutional interests may somewhat diverge from the interests of civil society. For example, an administrative agency might be created to administer a program, or to enforce a regulatory regime. In a sense the agency is advancing the public interest, at least the interests of that portion of the electorate who stand to benefit from that program or regime. But, in reality, the agency will respond to shifting external political pressures, and inevitable internal forces. Although the agency might owe a fiduciary-like duty to serve the public interest in administering or enforcing this statute, the reality is that the agency develops its own institutional interests that will often direct the actions of the agency in practice. An enforcement officer, for example, has incentives to bring enforcement actions—not necessarily because they are in the public interest, but because the enforcement officer must demonstrate productivity, or must satisfy top-down orders. See Nathan A. Sales & Jonathan H. Adler, *The Rest is Silence: Chevron Deference, Agency Jurisdiction, and Statutory Silences*, 2009 U. ILL. REV. 1497, 1504 (2009) (discussing the phenomena of agencies taking self-aggrandizing positions, and noting that “[a]gencies might focus on matters that advance their own institutional interests, as distinct from the interests Congress tasked them with serving.”); see also Damien M. Schiff, Luke A. Wake, *Leveling the Playing Field in David v. Goliath: Remedies to Agency Overreach*, 17 TEX. REV. L. & POL. 97, 102 (2012) (discussing perverse incentives for agencies to take aggressive positions).

125 “The limit of the market-participant doctrine must be that it allows a State to impose burdens on commerce within the market in which it is a participant, but allows it to go no further. The State may not impose conditions, whether by statute, regulation, or contract, that have a substantial regulatory effect outside that particular market.” *S-Cent. Timber Dev., Inc.*, 467 U.S. at 97.

126 “Our cases make clear that if a State is acting as a market participant, rather than as a market regulator, the dormant Commerce Clause places no limitation on its activities.” *Id.* at 93 (holding that Alaska was acting in a regulatory capacity in imposing conditions down-stream on timber processors).

3. Courts Should Tailor the Market-Participant Test to Antitrust Law.

It is a luxury of a market-participant exception to state-action immunity that the Dormant Commerce Clause jurisprudence has already established a principled framework for distinguishing between sovereign-state action and ordinary economic conduct. Of course, courts can customize the test to fit more precisely within the antitrust framework, such that it might develop its own nuances for antitrust law, distinct from Dormant Commerce Clause rules.¹²⁷

Along these lines, courts might look to Professor Joseph Sax' proposed test from the takings doctrine to delineate "the distinction between the role of government as [a] participant and the government as [a] mediator in the process of competition among economic claims."¹²⁸ Sax sought to distinguish between an appropriate exercise of police powers and a self-interested abuse of power requiring compensation under the Takings Clause. Observing that government often plays two functions—one as a "mediator in the process of competition among economic claims" and the other as an "enterprise[] operat[or]"—he noted that, in its capacity as an enterprise operator, "government must acquire economic resources, which by one means or another must be obtained from the citizenry."¹²⁹ And further, "in the performance of this enterprise capacity, government is very much like those who function in the private sector of the economy, and indeed is in its resource-acquiring job a competitor with private enterprises: it is a consumer of land, machines, clothing, and the like."¹³⁰ Thus, he suggested that government effects a taking when it wields its regulatory powers in a manner that disadvantages private economic actors for the purpose of advancing a public enterprise.¹³¹

While the federal courts have never explicitly embraced the notion that government incurs a duty to compensate landowners when using its police powers to advance a public enterprise, some state courts have invoked Sax's theory with regard state constitutional claims.¹³² For example, the Minnesota Supreme Court held that a local government had to compensate landowners when it enacted zoning restrictions to inhibit property development near a public airport—reasoning that the restrictions operated to further

127 The Court noted in *S-Cent. Timber*, "[t]he precise contours of the market-participant doctrine have yet to be established... [considering that] the doctrine [had previously] been applied in only in three cases" in the Supreme Court. 467 U.S. at 93. So even in the Commerce Clause context, there is still room for fleshing out the contours of the test.

128 Joseph L. Sax, *Takings and the Police Power*, 74 Yale L.J. 36, 62 (1964).

129 Sax, *Takings and the Police Power*, 74 Yale L.J. at 62.

130 *Id.* at 62.

131 However, it should be noted that Sax later repudiated this line of analysis in a subsequent article, on the ground that it was too generous to property owners. R.S. Radford, Luke A. Wake, *Deciphering and Extrapolating: Searching for Sense in Penn Central*, 38 Ecology L.Q. 731, 748 (2011); see Joseph L. Sax, *Takings, Private Property and Public Rights*, 81 Yale L.J. 149, 150, n.5 (1971).

132 See Radford & Wake, 38 Ecology L.Q. 731, 746-48 (discussing application Sax' theory in the context of state takings claims).

the economic interests of the airport authority to the disadvantage of near-by private property owners.¹³³

Similarly, an antitrust market-participant exception might distinguish between government acting in the role of a disinterested mediator of economic life, and government adopting regulatory measures in its capacity as a self-interested economic actor. On this view, one could invoke the antitrust market-participant exception in a case alleging that a public authority has violated antitrust law by seeking to use regulatory powers, or the power of eminent domain, to affirmatively displace competition. For example, one might invoke the exception to challenge a municipal redevelopment plan that eliminates all private parking garages near a new public arena where the displacement was initiated—at least in part—to undermine competition with a new public parking garage.¹³⁴ Thus, the market-participant exception could apply even to regulatory conduct that doubles as anticompetitive commercial conduct. Should the antitrust market-participant test develop in this manner, it could conceivably cover a wider range of governmental conduct than the Dormant Commerce Clause test does.

4. Applying the Market-Participant Exception in Practice.

Although the market-participant test might sound conceptually difficult, it is typically straightforward in practice.¹³⁵ In most instances, the question of whether the government is acting in its regulatory-capacity, or as a commercial participant is not controversial. The more difficult issue is how far does the market-participant exception reach with regard to anticompetitive regulatory conduct designed to help a public enterprise gain or maintain monopoly power in the market.¹³⁶

133 *McShane v. City of Faribault*, 292 N.W.2d 253 (Minn. 1980); *DeCook v. Rochester Int'l Airport Joint Zoning Bd.*, 796 N.W.2d 299 (Minn. 2011) (finding airport authority effected a taking in zoning restrictions that furthered the economic interests of the airport authority).

134 A similar claim was raised in *Commonwealth v. Susquehanna Area Reg'l Airport Auth.*, 423 F.Supp. 472 (M.D. Pa. 2006), wherein a property owner challenged an airport authority's use of eminent domain on the ground that the authority sought to use "eminent domain for an improper purpose, to wit: to eliminate its only competitor for airport parking services and to gain leverage in an ongoing dispute with a local school district." The defendant succeeded in this case in convincing the Court that it should still be entitled to *Parker* immunity because the exercise of eminent domain powers is inherently governmental—as opposed to a market action. This district court decision did not contemplate the argument raised in this article that an exercise of governmental powers might still be within the scope of the market-participant exception in so far as it advances the pecuniary interests of the public actor. See Elhauge, *supra* note 66, *The Scope of Antitrust Process*, 104 Harv. L. Rev. at 696 (*Parker* immunity should only apply where "a financially disinterested and politically accountable actor controls and makes a substantive decision in favor of the terms of the restraint.").

135 See e.g., *Koontz v. St. Johns River Mgmt. Dist.*, 133 S. Ct. 2586 (2013) (noting that in some cases "teasing out" a doctrinal test is "more difficult in theory than in practice.").

136 The Supreme Court has stated that the market participant exception must be defined narrowly for the purposes of the dormant Commerce Clause because otherwise the exception would "swallow[] up the rule that States may not impose substantial burdens on interstate commerce..." *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. at 98. This is because the market participant doctrine serves an exception to a general rule in the dormant Commerce Clause context. By contrast, in the context of antitrust law, a market participant rule would serve as a limiting principle to the *Parker* immunity doctrine, which is itself disfavored. *Phoebe Putney*, 133 S.Ct. at 1010. Thus, to promote the goals of antitrust law—i.e. discouraging anticompetitive conduct.—there is good reason to define "market participant" more broadly than under the dormant Commerce Clause.

The straight-forward case would be one in which the alleged antitrust violation arises from simple administration of some public program—as opposed to a regulatory regime. For example, in *Union Pacific*, the Court held that Kansas City breached the Elkins Act because the City conspired to offer businesses incentives to relocate their operations to a new development owned and operated by the City.¹³⁷ Had the program been challenged under the Dormant Commerce Clause, the City may have invoked the market-participant defense because it was not regulating anything—only encouraging merchants to voluntarily move into a the City’s new development.¹³⁸ Although the project served some public goals—new tax revenue for the City—a Court would most likely recognize that the City was acting as a market-participant because it was promoting its own enterprise.¹³⁹

The more difficult applications would arise where a plaintiff challenges anticompetitive government actions that both promote a public enterprise and regulate private conduct in some way. Suppose, for example, that a regional transit agreement among municipalities required each to enact ordinances requiring taxi-cab drivers, or other pay-as-you-go transportation vendors, to set up fixed rates for their services above a set rate.¹⁴⁰ At that point, the municipalities would be regulating private conduct, and would therefore no longer enjoy the benefit of a market-participant exception to the Dormant Commerce Clause.¹⁴¹ But the municipalities, although their actions are regulatory, are also fixing prices in markets in which they compete—local transportation. Thus, the market-participant exception should apply, even though the challenged conduct has a regulatory component.¹⁴²

IV. CONCLUSION

The Supreme Court in *Phoebe Putney* officially left open the question whether the market-participant exception applies to the state-action exemption from antitrust

137 313 U.S. 450, 470–471.

138 To be sure, the court recognized that the city was acting legitimately in a proprietary capacity, before going on to question whether in doing so it violated the Elkins Act. *Id.*

139 The Supreme Court noted that the plan was pursued because the City saw legitimate public benefits. *Id.* at 452–61.

140 There is currently a split in authority between the Federal Circuits on the issue of whether economic protectionism is in itself sufficient to satisfy rational basis scrutiny. Compare *Merrifield v. Lockyer*, 547 F.3d 978 (9th Cir. 2008) (“economic protectionism for its own sake, regardless of its relation to the common good, cannot be said to be in furtherance of a legitimate governmental interest”) with *Powers v. Harris*, 379 F.3d 1208, 1218, (10th Cir. 2004) (upholding a regulation under rational basis review because it advanced the state’s interest in “protecting the intrastate funeral industry”). This raises a corollary question as to whether government can satisfy rational basis review where the regulation is designed solely to insulate a public enterprise from private competition. Moreover, there may be ground to invoke a heightened form of scrutiny where there is a substantial likelihood that the regulation was adopted to advance the pecuniary interests of the local or state government—to the detriment of its citizens. Intermediate scrutiny might be more appropriate in order to deter self-interested regulatory conduct, on the assumption that such conduct cannot enjoy the same presumption of legitimacy. Indeed, if government is allowed to enact regulation to protect its economic interests from competition, there is great potential for abuse of the sovereign powers for which it has been entrusted for the benefit of the citizens.

141 *S-Cent. Timber Dev., Inc.*, 467 U.S. at 97.

142 See Elhauge, *supra* note 66, *The Scope of Antitrust Process*, 104 Harv. L. Rev. at 696.

liability.¹⁴³ And two federal circuits want to wait for the Supreme Court to officially rule that it does before making that the law in their territories.¹⁴⁴ But the federalism foundations behind the exemption, combined with federal antitrust policy, the ability of the federal courts to actually administer the exception, and the ready-made body of doctrine gifted from the Dormant Commerce Clause strongly support the market-participant exception. Thus, courts and litigants should continue to seek to apply it until the Supreme Court is ready to bless it.

143 133 S.Ct. at 1011 n.4.

144 See, e.g., *Paragould Cablevision*, 930 F.2d at 1312-13 (Eighth Circuit); *Automated Salvage*, 155 F.3d at 81 (Second Circuit).

THE MISAPPLICATION OF *MATSUSHITA*'S HEIGHTENED SUMMARY JUDGMENT STANDARD

By Ara Jabagchourian*

I. Introduction

The courts have long recognized that horizontal collusion in the marketplace creates a significant risk of harm to competition. Anticompetitive conduct in the form of price collusion, market division, bid-rigging, or output restriction is treated under the per se rule because of the likelihood such conduct will result in higher prices or diminished product quality. Despite these harmful consequences on the economy and consumer welfare, proof of collusion under antitrust law faces a number of hurdles. Some of those hurdles have been created by appellate decisions that have wrongly interpreted *Matsushita* as raising the standard to prove that an economically sensible and anticompetitive conspiracy took place.

Courts have held that direct evidence alone, such as admissions by a defendant or a document, may establish an agreement.¹ Without either a confession or a Federal Bureau of Investigation hidden camera videotaping a meeting where the rivals agree to set prices or divide the market, however, plaintiffs must rely on circumstantial evidence to prove an agreement.² Courts have recognized that “[o]nly rarely will there be direct evidence of an express agreement” in a conspiracy case,³ and have found that circumstantial evidence of informal and even tacit understandings may suffice to establish a violation of Section 1.⁴ A reliance on circumstantial evidence complicates the question of how much circumstantial evidence and of what nature is necessary to overcome a defendant’s motion for summary judgment.

The core tension that arises in attempting to answer that question exists between the economic theory of interdependence or conscious parallelism in an oligopolistic market and the standards set forth under federal procedural law. For instance, does Rule 56 of the Federal Rules of Civil Procedure allow a judge to grant summary judgment when the antitrust theory is implausible, even though it is supported by circumstantial facts, or does Rule 56 merely require raising a genuine issue of material fact through

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1 Courts have reasoned that, because direct evidence typically does not require inferences, it may suffice to prove an agreement. See, e.g., *In re High Fructose Corn Syrup Antitrust Litigation*, 295 F.3d 651, 654 (7th Cir. 2002)(Posner, J.) [hereinafter *In re High Fructose Corn Syrup*]; *In re Baby Food Antitrust Litigation*, 166 F.3d 112, 118 (3d Cir. 1999) [hereafter *Baby Food*].

2 *In re Text Messaging Antitrust Litigation*, 630 F.3d 622, 628 (7th Cir. 2010) (Posner, J.) (citing numerous cases), cert. denied, 131 S. Ct. 2165 (2011)[hereinafter *In re Text Messaging*].

3 *Local Union No. 189, Amalgamated Meat Cutters v. Jewel Tea Co.*, 381 U.S. 676, 720 (1965); see also ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS (7th ed. 2012) at 6 & n. 36 [hereinafter *Antitrust Law Developments* (7th ed.)].

4 *American Tobacco Co. v. United States*, 328 U.S. 781, 810 (1946). See also *Antitrust Law Development* (7th ed.) at 3–4.

circumstantial evidence and thus the plausibility issue is reserved for argument before the jury? Or is this a false dichotomy, requiring a third alternative?

Courts have addressed these questions by developing rules for the types of evidence required to prove collusion. Under these rules, circumstantial evidence of parallel conduct, such as closely timed price increases, cannot alone prove an agreement.⁵ “‘Conscious parallelism’ describes ‘the process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions.’”⁶ As Areeda and Hovenkamp explain, when “[e]ach firm’s pricing decision is *interdependent* with that of its rivals[,] each knows that its choice will affect the others, who are likely to respond, and that their responses will affect the profitability of each actor’s initial choice.”⁷ Thus, “because of their mutual awareness, oligopolists’ decisions may be *interdependent although arrived at independently*.”⁸

Therefore, “a plaintiff must prove more than that the defendants acted in parallel; it must prove that they did so pursuant to an agreement.”⁹ To prove an agreement, “a plaintiff must show additional circumstances—often referred to as ‘plus factors’ – which, when viewed in conjunction with the parallel conduct, would permit a fact-finder to infer a conspiracy.”¹⁰ “Evidence of [] plus factors tends to ensure that courts punish ‘concerted action’—an actual agreement—instead of the ‘unilateral, independent conduct of competitors.’”¹¹

Those “plus factors” must “tend[] to exclude the possibility of independent action by the [parties].”¹² “That is, there must be . . . circumstantial evidence that reasonably tends to prove that [the parties] had a conscious commitment to a common scheme.”¹³

5 *Theatre Enterprises v. Paramount Film Distributing Corp.*, 346 U.S. 537, 541 (1954).

6 *In re Publication Paper Antitrust Litigation*, 690 F. 3d 51, 62 (2d Cir. 2012)[hereinafter *In re Publication Paper*], quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993).

7 Phillip Areeda and Herbert Hovenkamp, *Antitrust Law* §1410b (2012) (emphasis in original).

8 *Id.* § 1429 (emphasis supplied). For example, then-Judge Breyer explained that individual decisions to follow a price leader do not constitute an unlawful agreement on price, “even when each firm rests its own decision on its belief that its competitors will do the same.” *Clamp-All Corp. v. Cast Iron Soil Pipe Institute*, 851 F.2d 478, 483 (1st Cir. 1988). He pointed out this “is not because such pricing is desirable (it is not), but because it is close to impossible to devise a judicially enforceable remedy for “interdependent” pricing. How does one order a firm to set its prices *without regard* to the likely reactions of its competitors?” *Id.*

9 *Antitrust Law Development* (7th ed.) at 9, citing *Theatre Enterprises v. Paramount Film Distributing Corp.*, 346 U.S. 537 (1954).

10 *In re Publication Paper*, 690 F.3d at 62.

11 *In re Flat Glass Antitrust Litigation*, 385 F.3d 350, 360 (3d Cir. 2004) [hereinafter *In re Flat Glass*].

12 *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 768 (1984) [hereinafter *Monsanto*]. See also *American Tobacco*, 328 U.S. at 810 (defining agreement as “a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement”).

13 *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 768 (1984) [hereinafter *Monsanto*]. See also *American Tobacco*, 328 U.S. at 810 (defining agreement as “a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement”).

Courts and commentators agree “[t]here is no finite set of [plus factors]; no exhaustive list exists.”¹⁴ Nonetheless, Areeda and Hovenkamp assert, the Supreme Court’s decision in *Bell Atlantic Corp. v. Twombly*¹⁵ “made clear that if proof of agreement rests on the existence of plus factors, at least a sufficient number of them must be pled to raise an inference of conspiracy.”¹⁶

Thus, when determining whether to grant a defendant’s motion for summary judgment, courts evaluate plaintiff’s alleged “plus factors” to determine whether they “tend to exclude” the possibility of independent action by the alleged conspirator. This test already inserts a judge into the typical province of the jury: evaluating the inferences that should be drawn from circumstantial evidence.

In *Matsushita*, the Supreme Court added another task for the district court judge: evaluating whether plaintiff’s collusion claim is plausible. The Court framed the issue this way: “if the factual context renders respondents’ claim implausible – if the claim is one that simply makes no economic sense – respondents must come forward with more persuasive evidence to support their claim than would otherwise be necessary.”¹⁷

This article seeks to explore how courts have applied – or misapplied – *Matsushita*’s mandate. Two circuits in particular – the third and the eighth – have misapplied *Matsushita*’s standard to limit the inferences that can be drawn when an economically sensible and manifestly anticompetitive conspiracy is alleged. A proper understanding of *Matsushita* has become even more important now that the Supreme Court has required that for an antitrust claim to survive a motion to dismiss, a plaintiff must present “only enough facts to state a claim to relief that is *plausible* on its face (emphasis supplied)” in order to survive a motion to dismiss.¹⁸ This article will discuss how other courts and a leading antitrust commentator have criticized the misuse of *Matsushita*. Secondarily, the article will touch upon the “tend to exclude” analysis and how such an analysis may be too stringently applied in the summary judgment phase, especially when courts apply *Matsushita*’s heightened standard to economically sensible conspiracies. Finally, the article will assess the ramifications associated with imposing a heightened standard to prove economically sensible and anticompetitive conspiracies.

II. Rule 56, *Matsushita* and the Implausible Conspiracy

Under Federal Rules of Civil Procedure 56 (“Rule 56”), courts may grant summary judgment only if “there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.”¹⁹ There is a genuine dispute about a material fact “if the evidence is such that a reasonable jury could return a verdict for the nonmoving

14 *In re Flat Glass*, 385 F. 3d at 360. See also Areeda & Hovenkamp, *Antitrust Law* § 1434a, n. 1 (2012).

15 550 U.S. 544 (2007).

16 Areeda & Hovenkamp, *Antitrust Law* § 1434a.

17 *Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

18 *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007). Commentators have construed *Twombly* as “extend[ing] *Matsushita*’s plausibility screen backwards to the pleading stage.” Gavil, et al., *ANTITRUST LAW IN PERSPECTIVE* at 280.

19 Fed.R.Civ.Proc. 56.

party.”²⁰ In the context of an antitrust claim, a genuine dispute as to a material fact may be about the plausibility of allegedly anticompetitive behavior,²¹ whether that conduct had an anticompetitive effect,²² or whether there is a causal relation between the behavior and injury.²³ For the most part, prior to 1986, antitrust cases were treated no differently in regards to analysis under Rule 56 than any other case.²⁴

Matsushita Electric Ind. Co., Ltd. v. Zenith Radio Corp. laid the groundwork for a heightened standard for a particular type of antitrust case in the summary judgment context.²⁵ The core issue in the case was centered on the proper summary judgment analysis regarding a predatory pricing conspiracy. The case was brought by two American consumer electronics (primarily televisions) companies against 21 Japanese based consumer electronics manufacturers.²⁶ The plaintiffs brought forth several conspiracy claims under Section 1 of the Sherman Act as well as monopolization claims under Section 2 of the Sherman Act and Section 2 under the Robinson-Patman Act.²⁷ The plaintiffs’ key allegation was that the defendants had entered into a conspiracy for over 20 years to cut prices on electronics in the United States to drive out the American manufacturers.²⁸ The District Court granted summary judgment for defendants, reasoning that the evidence of “the alleged price-cutting conspiracy did not rebut the more plausible inference that petitioners were cutting prices to compete in the American market and not to monopolize it.”²⁹

The Court of Appeals for the Third Circuit reversed.³⁰ Based on the oligopolistic market structure, coordinated agreements through Japan’s Ministry of International Trade and Industry, as well as other factors, the “Court of Appeal concluded that a reasonable factfinder could find a conspiracy to depress prices in the American market . . .”³¹

The Supreme Court took up a limited review on the issue of whether the Court of Appeal applied the proper standards in evaluating the District Court’s decision on

20 *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

21 *Norfolk Monument Co. v. Woodlawn Memorial Gardens, Inc.*, 394 U.S. 700 (1969).

22 *White Motor Co. v. United States*, 372 U.S. 253, 83 S. Ct. 696 (1963).

23 54 Am. Jur. 2d Monopolies and Restraints of Trade § 488.

24 *Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464, 473 (1962)(hereinafter *Poller*) (in reversing a grant of summary judgment, the Supreme Court held that “summary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles, proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot. It is only when witnesses are present and subject to cross-examination that their credibility and the weight to be given their testimony can be appraised.”)

25 *Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

26 *Id.* at 577.

27 *Id.* at 578.

28 *Ibid.*

29 *Id.* at 579.

30 *Id.* at 580.

31 *Id.* at 581.

summary judgment.³² The Court framed the issue this way: “if the factual context renders respondents’ claim implausible—if the claim is one that simply makes no economic sense—respondents must come forward with more persuasive evidence to support their claim than would otherwise be necessary.”³³

In taking on the issue, the *Matsushita* Court acknowledged that on summary judgment, the inferences should be drawn in favor of the non-moving party.³⁴ However, the Court pointed out that “antitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case.”³⁵ The basis of the statement is two-fold. First, as referenced above, the theory must make economic sense.³⁶ If it does not, then the respondents must put forth more persuasive evidence than normally required in a Section 1 case that makes economic sense. Second, under Section 1 of the Sherman Act, an agreement to conspire can arise explicitly or tacitly. Likewise, proving that an agreement exists can be shown through either direct or circumstantial evidence. In most situations, the evidence is purely circumstantial. Where conduct is as consistent with permissible competition as with an illegal conspiracy, the conduct “standing alone,” will not support an inference of antitrust conspiracy.³⁷ Thus, in a circumstantial case, the plaintiff must present evidence “that tends to exclude the possibility” that the alleged conspirators acted independently.³⁸ This is to increase the likelihood that the conduct was actually pursuant to an agreement rather than merely conscious parallelism.

The Court then turned to the allegation in the case, a “predatory pricing conspiracy.”³⁹ The Court explored the academic literature regarding predatory pricing by a single firm. It delved into then-Professor Robert Bork’s analysis of predatory pricing.⁴⁰ As discussed in his book, *The Antitrust Paradox*, Bork maintained that for a rational business to enter into a predatory pricing scheme, it must believe that the losses it incurs in selling below cost will be exceeded by monopoly profits to be gained in the future.⁴¹ As a consequence of the nature of a predatory pricing scheme, “the success of such schemes is inherently uncertain.”⁴² This is because the short-run loss is definite, but the long-term gain depends on the ability to keep out competitors.⁴³ To supplement Bork’s thoughts, the Court relied on then-Professor Easterbrook’s observation that “[t]he success of any predatory scheme depends on *maintaining* monopoly power for long enough both to recoup the predator’s

32 *Id.* at 582.

33 *Id.* at 583.

34 *Id.* at 587–588.

35 *Id.* at 588.

36 *Id.* at 587.

37 *Ibid.*; citing *Monsanto Co. v. Spray-Rite Services Corp.*, 465 U.S. 752, 764 (1984).

38 *Ibid.*; citing *Monsanto*, 465 U.S. at 764.

39 *Matsushita Elect. Industrial Co.*, 475 U.S. at 588–595.

40 *Id.* at 589.

41 *Id.* at 589, citing Robert Bork, *The Antitrust Paradox*, p.145 (1978). The Court also cited to John S. McGee, *Predatory Pricing Revisited*, 23 J. Law & Econ. 289, 295–297 (1980).

42 *Id.* at 589. See also *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993)

43 *Ibid.*

losses and to harvest some additional gain.”⁴⁴ Citing Easterbrook, the Court pointed out that “[a]bsent some assurance that the hoped-for monopoly will materialize, and that it can be sustained for a significant period of time, [t]he predator must make a substantial investment with no assurance that it will pay off.”⁴⁵

Based on these observations, the Court concluded there is a consensus “that predatory pricing schemes are rarely tried, and even more rarely successful.”⁴⁶ The Court then explained that plaintiff’s allegations in *Matsushita* were even more unlikely than predatory pricing by a single firm, because having a large number of firms conspiring to charge below-cost pricing “is incalculably more difficult to execute than an analogous plan undertaken by a single predator.”⁴⁷ If done jointly, conspirators must allocate losses to be sustained and must allocate any gains “realized from its success.”⁴⁸ All of this must be done under the risk that any of the co-conspirators and the plaintiffs could cheat—the classic “prisoner’s dilemma.” If the supply of all of the consumer electronics sold at the predatory price does not satisfy the market demand for those products, then the petitioners and the cheating co-conspirators can continue to sell at the “real” market price.⁴⁹

The Court went further in supporting its holding that the predatory pricing conspiracy was unlikely to occur. It noted that although the conspiracy was allegedly operating over two decades, the petitioners were far from their goal of monopolizing the relevant markets.⁵⁰ Rather, the two American companies held the two largest shares of the retail television market.⁵¹ In addition, the combined market share of these two companies in the relevant market was 40%, which did not appreciably decline during the 1970s.⁵² Finally, despite the fact that petitioners’ market share rose rapidly from under 20% to 50% of the relevant market, the Court believed that this was insufficient to constitute monopoly power.⁵³

The Court concluded that based on its holding in *Monsanto*, factfinders should not be permitted “to infer conspiracies when such inferences are implausible, because the effect of such practices is often to deter procompetitive conduct.”⁵⁴ Since cutting prices in order to increase business is the essence of competition, mistaken inferences can be “especially

44 *Matsushita*, 475 U.S. at 588.

45 *Ibid.*, quoting Frank Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. Chi. L. Rev. 263, 268 (1981).

46 *Matsushita*, 475 U.S. at 589. The Court cites other commentators, including Phillip Areeda, Donald Turner, Roland H. Koller, and John S. McGee.

47 *Id.* at 590.

48 *Ibid.*

49 *Ibid.*

50 *Id.* at 591.

51 *Ibid.*

52 *Ibid.*

53 *Ibid.*

54 *Ibid.* at 593; citing *Monsanto*, 465 U.S. at 762-764.

costly, because they chill the very conduct the antitrust laws are designed to protect.”⁵⁵ Furthermore, “predatory pricing conspiracies [are] self-detering: unlike most other conduct that violates the antitrust laws, failed predatory pricing schemes are costly to the conspirators.”⁵⁶ The Court therefore held that “there is little reason to be concerned that by granting summary judgment in cases where the evidence of conspiracy is speculative or ambiguous, courts will encourage such conspiracies.”⁵⁷

III. The Application of *Matsushita* to Plausible Conspiracies

Commentators almost universally have deemed the predatory pricing conspiracy alleged in *Matsushita* improbable, and the Court noted that the potential for price cutting to be procompetitive, not anticompetitive, conduct provided an additional justification for requiring greater evidence than usual to survive a defendant’s summary judgment motion. Nonetheless, some circuits have applied the *Matsushita* standard in matters where the alleged conspiracy was economically sensible and, if implemented, would be clearly anticompetitive.⁵⁸ A careful look will be taken at two cases that have followed this path.

A. *Blomkest* and Conscious Parallelism

The Eighth Circuit Court of Appeals explicitly stated that it applied the standards set forth in *Matsushita* “broadly” in *Blomkest Fertilizer, Inc. v. Potash of Saskatchewan*.⁵⁹ *Blomkest* was an *en banc* review of a grant of summary judgment to defendant related to an alleged price fixing conspiracy in the potash market.⁶⁰ An agreement to form an antitrust conspiracy under Section 1 can be established either by direct evidence or by inference.⁶¹ The claim brought forth by the plaintiffs was based on a theory of conscious parallelism, supported by circumstantial, rather than direct, evidence of a conspiracy.⁶²

In order to establish an agreement under Section 1 from conscious parallelism, that is requiring an inference that an illegal agreement to conspire exists, the plaintiff must establish the existence of “plus factors.”⁶³ A plus factor means “the additional facts or factors required to be proved as a prerequisite to finding that parallel [price]

55 *Id.* at 594. “[W]e must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition.” *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983).

56 *Id.* at 595; citing Easterbrook, *The Limits of Antitrust*, 63 Texas L. Rev. 1, 26 (1984).

57 *Ibid.*

58 Herbert Hovenkamp argues that this trend exists in the Supreme Court, citing to both *Matsushita* and *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007). Hovenkamp, *The Federal Trade Commission and the Sherman Act*, Fla. L. Rev., Vol. 62, 1, 10 (2010).

59 *Blomkest Fertilizer, Inc. v. Potash of Saskatchewan*, 203 F.3d 1028, 1032 (8th Cir. 2000).

60 *Id.* at 1031.

61 *American Tobacco*, 328 U.S. at 809-810.

62 “Conscious parallelism” is the process “not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests.” *Blomkest*, 203 F.3d at 1032; quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993).

63 *Blomkest*, 203 F.3d at 1033; citing *Baby Food*, 166 F.3d at 122.

action amounts to a conspiracy.”⁶⁴ Examples of “plus factors” include: high level of communications by competitors,⁶⁵ actions against economic self-interest,⁶⁶ motivation to enter into a price fixing conspiracy,⁶⁷ a pattern of uniform conduct,⁶⁸ and no economic justification for the conduct.⁶⁹ There is no finite set of plus factors.⁷⁰ “Although our caselaw has identified some specific plus factors . . . any showing by [a plaintiff] that tend[s] to exclude the possibility of independent action can qualify as a plus factor.”⁷¹ Furthermore, such plus factors should be not be viewed in a vacuum, but rather *in toto* against the entire backdrop in which the conduct took place.⁷² Ultimately, the plus factor requirement exists to assist courts in distinguishing between independent conduct and an agreement.

The *Blomkest* court began its analysis on the wrong foot. First of all, a conspiracy to raise price in an industry that has had historically low prices is economically sensible. Second, if such a conspiracy to raise prices was implemented, then there would be anticompetitive impact on consumers in the form of higher prices. The application of *Matsushita’s* heightened standard requires the factual context of the claim to be implausible.⁷³ If, and only if, the claim is economically implausible, then more persuasive evidence to support the claim is necessary.⁷⁴ As a result of the *Blomkest* court mistakenly asserting *Matsushita’s* heightened standard to an economically sensible conspiracy, it also was overly skeptical of the “plus factor” evidence put forth by the claimant.

The *Blomkest* court delved into an analysis of the alleged plus factors.⁷⁵ The first plus factor reviewed was the alleged interfirm communications. The court began by stating that plaintiffs’ evidence was “far too ambiguous to support” an inference of conspiracy⁷⁶. Plaintiffs put forth evidence of three dozen price verifications between the competitors’ employees, “including high-level sales employees of different companies” over a seven year period.⁷⁷ These communications involved the verification of prices the companies had already charged.⁷⁸ The plaintiffs’ class argued that “large and parallel price increases” combined with “simultaneous price verifications” created a conspiracy inference

64 *Ibid.*, quoting *Baby Food*, 166 F.3d at 122.

65 *In re Plywood Antitrust Litigation*, 655 F.2d 627, 633-34 (5th Cir. 1981).

66 *Petruzzi’s IGA Supermarkets, Inc. v. Darling-Delaware Co.*, 998 F.2d 1224, 1243-45 (3d. Cir. 1993).

67 *Id.* at 1242; *Baby Food*, 166 F.3d at 122.

68 *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939).

69 *American Tobacco*, 328 U.S. 781.

70 *In re Flat Glass*, 385 F.3d 350, 360 (3rd Cir. 2004)

71 *Williamson Oil Co. v. Phillip Morris USA*, 346 F.3d 1287, 1301 (11th Cir. 2003).

72 *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 699 (1962).

73 *Matsushita*, 475 U.S. at 587.

74 *Ibid.*

75 *Blomkest*, 203 F.3d at 1033-1038.

76 *Ibid.*

77 *Ibid.*

78 *Ibid.*

sufficient to survive summary judgment.”⁷⁹ Plaintiffs also pointed out that, when the alleged conspiracy began, the price was at historic lows and the producers were losing millions of dollars.⁸⁰ Then, one producer of potash had a sudden and dramatic increase in the price of potash in one day.⁸¹ A week later, the remaining potash producers all increased their prices accordingly.⁸²

The *Blomkest* court held that these facts were not sufficient to overcome defendant’s summary judgment motion.⁸³ The court concluded that, because the price verifications only dealt with past prices, not future prices, such communications had no “impact on price increases.”⁸⁴ “[T]o survive summary judgment, there must be evidence that the exchanges of information had an impact on pricing decisions.”⁸⁵ The court concluded that there “is no evidence here that price increases resulted from any price verification” and therefore could not support a conspiracy for the setting of a broad market price.⁸⁶

The court went further in its analysis by assuming that the price verification evidence was relevant in establishing a tacit agreement between the competitors.⁸⁷ In this case, the United States potash companies complained to the United States Department of Commerce that the Canadian producers were dumping potash well-below market value.⁸⁸ The Department of Commerce made a preliminary determination that they were in fact dumping and required expensive bonds for all imports.⁸⁹ The Canadian industry leader hired new management and began the process of privatization from the Canadian government.⁹⁰ Once privatized, the industry leader significantly reduced production output.⁹¹ Further, the potash producers reached a Suspension Agreement with the Department of Commerce that set price floors for potash.⁹² With these facts, the court posited that “it would have been ridiculous for the remaining companies not to also

79 *Id.* at 1034.

80 *Id.* at 1033-1034.

81 *Id.* at 1034.

82 *Ibid.*

83 *Ibid.*

84 *Ibid.*

85 *Ibid.*; quoting *Baby Food*, 166 F.3d at 125.

86 *Ibid.*

87 *Ibid.*

88 *Ibid.*

89 *Ibid.*

90 *Ibid.*

91 *Ibid.*

92 *Ibid.*

raise their prices in parallel fashion.”⁹³ The court deemed any evidence that exchanges of information had an impact on pricing decisions to be purely speculative.⁹⁴

The second “plus factor” the *Blomkest* court assessed was action taken against self-interest. Plaintiffs argued that the uniform participation of the Suspension Agreement was against some of the participants’ self-interest.⁹⁵ This is because those producers with low dumping margins could have undercut other producers’ prices and gained market share while still maintaining prices at profitable levels.⁹⁶ The court however found that the Department of Commerce’s investigation was unpredictable and participation in the Suspension Agreement reduced uncertainty.⁹⁷ The low tariff producers would also have to “post substantial bonds which would have caused considerable capital drain.”⁹⁸ The Suspension Agreement provided certainty and a higher price in the United States potash market, all of which benefited the defendants.⁹⁹ The court ultimately concluded that plaintiffs failed to raise a genuine issue of material fact to overcome the summary judgment motion.

Since the *Blomkest* court believed it was required to apply Matsushita’s heightened standard, it required more evidence to support the claim of a conspiracy. By being overly skeptical about the evidence put forth by the claimant, the court made judgments about the alleged conspirators’ business justifications. By doing so, the court necessarily weighed the evidence of the parties to determine liability as a matter of law. Additionally, the practical impact such a heightened standard places on the antitrust practitioner is also daunting. As Judge John R. Gibson stated in his dissent in *Blomkest*:

Because conspirators cannot be relied upon either to confess or to preserve signed agreements memorializing their conspiracies, the court’s requirement for direct evidence will substantially eliminate antitrust conspiracy as a ground for recovery in our circuit.¹⁰⁰

93 *Ibid.* The author notes that it would have been quite rational to not raise prices in parallel fashion of a fungible commodity such as potash in order to garner the competitive advantage associated with lower prices which would have driven up the price-cutter’s (or non-price-follower’s) market share. This is especially true if the underlying costs associated with the production of potash had not changed. The court’s analysis did take a serious look to see if the market participants met the minimum market price set by agreement with the Department of Commerce, or whether they exceeded it. Such a fact would also have been relevant in determining whether there was in fact a horizontal agreement to raise prices. This argument was raised and rejected by the court. *Blomkest*, 203 F.3d at 1037. See also *Blomkest*, 203 F.3d at 1039 (J. Gibson dissenting) (citing to evidence of an internal memorandum from one of the potash companies’ president of sales which indicated that the industry would not be able to end the price war without “joint action”).

94 *Id.* at 1035.

95 *Id.* at 1037.

96 *Ibid.*

97 *Ibid.*

98 *Ibid.*

99 *Ibid.*

100 *Blomkest*, 203 F.3d at 1039 (J. Gibson dissenting).

This was just the type of case that the *Poller* court warned about in making such assessments at the summary judgment stage and the usurpation of the role of the jury.¹⁰¹ At the end, the jury may have believed the alleged conspirators' justifications for the behavior, but those decisions are to be left to the jury.

B. *In re Baby Food and Information Exchange*

In *Baby Food*, the Third Circuit Court of Appeals dealt with an allegation of price fixing in the baby food market.¹⁰² The core allegation was that the three defendants, in a highly concentrated market, exchanged information with each other regarding future price increases before announcing such increases to the public.¹⁰³ As in *Blomkest*, the *Baby Food* court set forth the law related to both direct evidence and circumstantial evidence related to agreements in Section 1 cases.¹⁰⁴ Additionally, the court noted that it is well established that price-fixing cases are deemed to be a *per se* violation of Section 1.¹⁰⁵ “However, when the evidence consists of mere exchanges of information the presumption vanishes.”¹⁰⁶ Information exchanges are not deemed illegal *per se* because there are some instances where information exchanges “increase economic efficiency,” causing markets to be more competitive.¹⁰⁷ Given this, the court held that a “rule of reason” analysis was warranted in this case.¹⁰⁸

The court apparently did not take into account that information exchanges may be circumstantial evidence from which a conspiracy may be inferred. Contacts that involve the sharing of competitively sensitive information are evidence of an agreement to share that information. That agreement may be challenged as a stand-alone unreasonable restraint of trade, subject to analysis under the rule of reason.¹⁰⁹ In addition, however, the exchange of competitively sensitive information may be circumstantial evidence that, in combination with other evidence, supports an inference of an agreement to fix prices.¹¹⁰

In this case, the court first rejected plaintiff's claim that there was direct evidence of a price-fixing conspiracy.¹¹¹ The basis for this denial was that “the evidence evinces only

101 *Poller*, 368 U.S. at 473.

102 *Baby Food*, 166 F.3d 112 (3rd Cir. 1999).

103 *Baby Food*, 166 F.3d at 117.

104 *Id.* at 117-118, 121.

105 *Id.* at 118. *Per se* violation are the type of restraints that are themselves considered unreasonable because of “their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable.” *Northern Pacific Railway v. United States*, 356 U.S. 1, 5 (1958).

106 *Baby Food*, 166 F.3d at 118; citing *United States v. United States Gypsum Co.*, 438 U.S. 422, 441 n. 16 (1978).

107 *Ibid.*; quoting *Gypsum*, at 441 n. 16.

108 *Ibid.*

109 Gavil et al., ANTITRUST LAW IN PERSPECTIVE, at 297.

110 Gavil et al., ANTITRUST LAW IN PERSPECTIVE, at 297 (two categories of information exchange include “cases in which the agreement to share information is itself challenged as a stand-alone unreasonable restraint of trade,” and “cases in which the express information sharing agreement provides a basis for inferring an illicit agreement to fix prices”).

111 *Id.* at 119-121.

an exchange of information among the defendants.”¹¹² This statement is astounding in the context of the direct evidence that was presented to the court. The direct evidence cited by the plaintiffs in the case was multi-faceted. They relied on deposition testimony of a former Heinz salesman and a former Heinz district manager. These two individuals testified that they shared future price information with Beech-Nut and Gerber before any public announcements were made, that they learned about when their competitors were going to make price changes before it was announced to the public, and that these exchanges occurred between sales representatives on a regular basis.¹¹³ Two Presidents of Beech-Nut testified at their respective depositions that it was company policy for sales representatives to obtain and report pricing information of their competitors.¹¹⁴

There was also a “competitive price change and activity report” sent to Gerber’s Regional Manager from Gerber’s New York Division Manager with an attached unsigned report from Beech-Nut regarding an upcoming price increase.¹¹⁵ Gerber admitted having the document nearly a month before Beech-Nut’s announcement.¹¹⁶ Beech-Nut obtained advance notice of Gerber’s price and had that information in a memorandum labeled “HIGHLY CONFIDENTIAL” at least one week before Gerber announced the price increase.¹¹⁷ An internal Beech-Nut email set forth a detailed discussion between Beech-Nut’s District manager and an employee of Gerber which stated that Beech-Nut would not be taking “a price increase at this time.”¹¹⁸ A handwritten note on the Gerber e-mail printout stated “Keep me advised on any price increases by competition! We will be in a world of hurt if Heinz/BeechNut does not increase.”¹¹⁹

In addition, there was evidence of an internal Heinz communication discussing how the retailers only wanted to stock Gerber and only one other baby food brand and this two-tier stocking structure in retail was becoming the trend. In that same communication, it was noted that the Heinz area manager told a retailer that it would “make every effort to secure a majority base of distribution.”¹²⁰ But the Heinz area manager, in his correspondence to his superior also said that “[h]owever, with our ‘truce’ in effect, I knew our hands were tied.”¹²¹

The court then turned to the circumstantial evidence in weighing the conspiracy claim supported by circumstantial evidence. First, the court pointed out that if the plaintiffs establish conscious parallel pricing and supplemented the evidence with “plus

112 *Ibid.*

113 *Id.* at 118-119.

114 *Id.* at 119.

115 *Ibid.*

116 *Ibid.*

117 *Ibid.*

118 *Id.* at 120.

119 *Ibid.*

120 *Ibid.*

121 *Ibid.*

factors,” a rebuttable presumption of conspiracy arises.¹²² Plaintiffs’ evidence consisted of statistical analysis by an expert, much of the evidence supported their direct evidence case, and a statement in Beech-Nut’s Long Term Plan stated “Gerber will accept the price leadership of Beech-Nut and will accept price increases as a means of improving profitability.”¹²³

Second, the court set forth the Rule 56 standard for summary judgment. It explained that summary judgment is granted when “there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.”¹²⁴ The court notes that “in the context of an antitrust case, the nonmoving party’s burden ‘is no different than any other case.’”¹²⁵ Summary judgment should be granted only when “after drawing all reasonable inferences from the underlying facts in the light most favorable to the nonmoving party, the court concludes that there is no genuine issue of material fact to be resolved at trial.”¹²⁶ However, the court stated that “reasonable inferences in the context of an antitrust case . . . [are] somewhat different from cases in other branches of the law.”¹²⁷ “The acceptable inferences which we can draw from circumstantial evidence vary with the plausibility of the plaintiffs’ theory and the danger associated with such inferences.”¹²⁸

With that framework, the court began to discount each piece of evidence brought forth by the plaintiffs. It should be first noted that the court never decided the issue of plausibility of the plaintiff’s theory. The court held that the information exchanges between the companies were with lower level employees, which was not sufficient to support a claim because the employees had no pricing authority.¹²⁹ Furthermore, despite setting forth a document indicating that there was a “truce” amongst the competitors, the court believed that competition was still fierce between the market participants and the term was ambiguous.¹³⁰ The court also noted that the plaintiffs were not able to show parallel pricing behavior, but rather only demonstrated that Gerber, Heinz and Beech-Nut made similar pricing decisions 15.5% of the time during the period of the alleged conspiracy.¹³¹ The court ultimately held that the evidence established that defendants acted independently of one another in their marketing activities.¹³²

Just as in *Blomkest*, the *Baby Food* court started its analysis incorrectly. The theory brought forth by plaintiffs was an economically sensible price fixing conspiracy in a

122 *Id.* at 122; citing *Todorov v. DCH Healthcare Authority*, 921 F.2d 1438, 1456 n. 30 (11th Cir. 1991).

123 *Id.* at 123.

124 Fed.R.Civ.P. 56(c).

125 *Id.* at 124; quoting *Apple BMW, Inc. v. BMW of North America, Inc.*, 974 F.2d 1358, 1363 (3d. Cir. 1992).

126 *Ibid.*; quoting *Petruzzi’s*, 998 F.2d at 1232.

127 *Ibid.*

128 *Ibid.*; citing *Petruzzi’s*, 998 F.2d at 1232.

129 *Id.* at 125.

130 *Id.* at 126-127.

131 *Id.* at 128.

132 *Id.* at 135-136, 137-138.

highly concentrated market. By assuming that *Matsushita's* heightened standard applied, the court overly scrutinized evidence brought forth by the plaintiff. This required the court to interpret what “truce” meant and whether the information exchanges actually correlated with actual price moves in the market. Again, at the end of the day, the jury may have sided with the baby food manufacturers, but that decision is to be made by a jury, and not through summary judgment.

IV. Recognizing the Limits Of *Matsushita*

Despite application of the heightened standard to traditional horizontal conspiracy cases such as *Blomkest*, *Baby Food* and others,¹³³ many circuit courts have limited its application to only cases where the underlying theory is implausible. In fact, several cases have recognized the misapplication of *Matsushita* to typical horizontal collusion cases such as price-fixing.

A. Judge Posner and Economically Sensible Conspiracies

One such case was *In re High Fructose Corn Syrup Antitrust Litigation*.¹³⁴ In reviewing the grant of summary judgment in an alleged price-fixing case between manufacturers of high fructose corn syrup, Chief Judge Richard Posner looked at the law related to proving a Section 1 case based on circumstantial evidence.¹³⁵ The court stated that in order to provide sufficient evidence in order to overcome summary judgment on a Section 1 case, the plaintiff “must present evidence that would enable a reasonable jury to reject the hypothesis that the defendants foreswore price competition without actually agreeing to do so.”¹³⁶

The court then indicated that “[m]ore evidence is required the less plausible the charge of collusive conduct.”¹³⁷ The court acknowledged that the basis for this proposition is that in *Matsushita*, the underlying claim of conspiratorial predatory pricing “was implausible for a variety of reasons.”¹³⁸ However, the court distinguished the case before it from *Matsushita*.

But the charge in this case involves no implausibility. The charge is of a garden-variety price-fixing conspiracy orchestrated by a firm, ADM, conceded to have fixed process on related products (lysine and citric acid) during a period overlapping the period of the alleged conspiracy to fix the prices of HFCS.¹³⁹

133 See also *Williamson Oil Co. v. Philip Morris USA, R.J.*, 346 F.3d 1287, 1300-1301 (11th Cir., 2003) (wholesalers alleging price-fixing by tobacco companies scrutinized under heightened summary judgment standard); *Clamp-All Corp. v. Cast Iron Soil Pipe Institute*, 851 F.2d 478, 484 (1st Cir. 1988) (upholding summary judgment based on alleged restraint of trade related to standard-setting activities); *Apex Oil Co. v. DiMauro*, 822 F.2d 246; 253-54 (2d. Cir. 1987) (finding insufficient evidence to support conspiracy claim related to heating oil futures).

134 *In re High Fructose Corn Syrup Antitrust Litigation*, 295 F.3d 651 (7th Cir. 2002).

135 *Id.* at 661-666.

136 *Id.* at 661; citing *Matsushita*, 475 U.S. at 588.

137 *Ibid.*

138 *Ibid.*

139 *Ibid.*

The court then stated that the proper analysis is whether the evidence before it, taken as a whole, is sufficient to defeat summary judgment.¹⁴⁰

Furthermore, the court explored the distinction made between a direct evidence case and a circumstantial case. The court indicated that such distinctions, as set out in *Baby Food* was not only confusing, but also “entirely superfluous.”¹⁴¹ As explained by the court, direct evidence is “tantamount to an acknowledgment of guilt” where circumstantial evidence “is everything else including ambiguous statements.”¹⁴² Circumstantial cases are “not to be disregarded because of their ambiguity; most cases are constructed out of a tissue of such statements and other circumstantial evidence, since an outright confession will ordinarily obviate the need for trial.”¹⁴³ Ultimately, the grant of summary judgment was reversed and the matter was remanded so it could be heard before a jury for trial.¹⁴⁴

In an earlier matter, Chief Judge Posner looked at a horizontal action by both manufacturers and wholesalers to deny retailers discounts on brand named drugs.¹⁴⁵ In reviewing a judgment as a matter of law at the close of plaintiff’s case-in-chief on liability, the court of appeal looked to the economic evidence brought forth to support their theory. Citing *Matsushita*, the court noted that the standard required of the plaintiff is that economic evidence be presented to demonstrate “that the hypothesis of collusive action was more plausible than that of individual action.”¹⁴⁶ What was key here, in contrast to *Blomkest* and *Baby Food*, was that this standard did not require plaintiff to “exclude all possibility that the manufacturers’ price discrimination was unilateral rather than collusive.”¹⁴⁷ The court held that requiring the plaintiff to meet such a burden would mandate that it exceed the burden of preponderance of the evidence and even reasonable doubt for criminal matters. The burden to have to eliminate every possibility of unilateral conduct would require plaintiff to meet the burden of “100 percent certainty, since any lesser degree of certitude would leave a possibility that the defendant was innocent.”¹⁴⁸ Based on the appellate court’s analysis, the matter was vacated and remanded in part, sending the matter back to the trial court.¹⁴⁹

140 *Ibid*

141 *Id.* at 661-662.

142 *Id.* at 662.

143 *Ibid.*

144 *Id.* at 666.

145 *In re Brand Name Prescription Drugs Antitrust Litigation*, 186 F.3d 781 (7th Cir. 1999).

146 *Id.* at 787; citing *Matsushita*, 475 U.S. at 587-588; *City of Tuscaloosa v. Harcross Chemicals, Inc.*, 158 F.3d 548, 571-72 (11th Cir. 1998).

147 *Ibid.*

148 *Ibid.*

149 *Id.* at 790.

B. *In re Flat Glass* and The Varying Inference

Another case that was critical of the use of *Matsushita's* heightened standard in economically sensible Section 1 cases was *In re Flat Glass Antitrust Litigation*.¹⁵⁰ This case involved an action brought by purchasers of flat and automotive replacement glass alleging price-fixing in these products.¹⁵¹ The court framed the issue of the case right from the start.

This case addresses the recurring question of what quantity and quality of evidence suffices to create a genuine issue of material fact as to one particular element of a claim under Section 1 of the Sherman Act: whether a defendant entered into an unlawful agreement.¹⁵²

The court launched into a discussion regarding restraints of trade that are deemed *per se* unreasonable. The court indicated that a *per se* case is one that is “‘manifestly anticompetitive’ or ‘would always or almost always tend to restrict competition.’”¹⁵³ Given that effects of certain conduct lack any legitimate business justification, *per se* restraints are “‘conclusively presumed to be unreasonable restraint[s] [on] competition.’”¹⁵⁴ If the conduct is *per se* illegal, plaintiff only has to show the existence of a conspiracy and that the conduct was a proximate cause of the injury.¹⁵⁵

The court then indicated that the same summary judgment principles apply when faced with whether a plaintiff has offered sufficient proof of an agreement as it would in other contexts. This includes the principle that “‘the court must ‘view the facts and any reasonable inferences drawn therefrom in the light most favorable to the party opposing summary judgment.’”¹⁵⁶ However, as set out by the Supreme Court in *Monsanto*, the court acknowledged that there are certain limits regarding permissible inferences from ambiguous evidence in antitrust cases.¹⁵⁷

In the *Petruzzi* case, the Third Circuit explored “‘exactly what inferences are circumscribed in a section 1 case.’”¹⁵⁸ There, the court identified “‘two important circumstances underlying the [Supreme] Court’s decision in *Matsushita*.’”¹⁵⁹ The two factors were (1) the conspiracy was implausible; and (2) if held illegal, it “‘would have the effect of deterring significant procompetitive conduct.’”¹⁶⁰ Thus, the court held

150 *In re Flat Glass Antitrust Litigation*, 385 F.3d 350 (3d Cir. 2004).

151 *Id.* at 353.

152 *Id.* at 352.

153 *Id.* at 356; quoting *Rossi v. Standard Roofing, Inc.*, 156 F.3d 452, 461 (3d Cir. 1998).

154 *Ibid.*; quoting *Rossi*, 156 F.3d at 461.

155 *Ibid.*; citing *InterVest Inc. v. Bloomberg L.P.*, 340 F.3d 144, 159 (3d Cir. 2003)

156 *Id.* at 357; quoting *InterVest*, 340 F.3d at 160.

157 *Ibid.*

158 *Ibid.*, citing *Petruzzi's*, 998 F.2d 1224 (3d. Cir. 1993)

159 *Ibid.*; *Petruzzi's*, 998 F.2d at 1232.

160 *Petruzzi's*, 998 F.2d at 1232; quoting *In re Petroleum Prods. Antitrust Litig.*, 906 F.2d 432, 439 (9th Cir. 1990).

that acceptable inferences to be drawn from a circumstantial evidence “vary with the plausibility of the plaintiffs’ theory and the dangers associated with such an inference.”¹⁶¹

The *In re Flat Glass* court then conducted a quick review of a couple of cases. As it regarded *Matsushita*, the court noted that courts and commentators regard predatory pricing as a “relatively speculative phenomenon, particularly when its success requires collusion among multiple firms.”¹⁶² Furthermore, the court noted that inferences arising from firms engaged in predatory pricing scheme are generally weak because the conduct “largely mirrors how firms in a competitive market act: by cutting prices.”¹⁶³

In contrast, the court noted that the conspiracy alleged in *Petruzzi’s* was “not implausible,” but “rather it made ‘perfect economic sense.’”¹⁶⁴ Given this, “more liberal inferences from the evidence should be permitted than in *Matsushita* because the attendant dangers from drawing inferences recognized in *Matsushita* are not present.”¹⁶⁵

The *In re Flat Glass* court then turned its attention to not only other circuit decisions, but also decisions rendered in its very own, the Third Circuit. The court noted that “despite the absence of the *Matsushita* Court’s concerns, this Court and others have been cautious in accepting inferences from circumstantial evidence in cases involving allegations of horizontal price-fixing among oligopolists.”¹⁶⁶ The court believed that the reason why the courts were so circumspect in those cases was because of the theory of “interdependence.”¹⁶⁷

The court explained the theory of interdependence in terms of comparing a concentrated market to what economists have called a “perfect market.” In a perfect market, defined as having numerous firms in the market, one’s price and output decisions would be “so diffuse” that competitors would not take notice of the change.¹⁶⁸ On the other hand, in a highly concentrated market, a single firm’s price or output decisions “will have a noticeable impact on the market and its rivals.”¹⁶⁹ Given that an oligopolist’s behavior will be noticed by its rivals, “any rational decision must take into account the anticipated reaction of the other [] firms.”¹⁷⁰ Under the theory of interdependence, rivals

161 *Flat Glass*, 385 F.3d at 357; quoting *Petruzzi’s*, 998 F.2d at 1232.

162 *Id.* at 358, citing *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226-27 (1993).

163 *Ibid.*; citing *Matsushita*, 475 U.S. at 594.

164 *Ibid.*; quoting *Petruzzi’s*; 998 F.2d at 1232.

165 *Ibid.*; quoting *Petruzzi’s*, 998 F.2d at 1232.

166 *Ibid.*; citing *Williamson Oil Co. v. Philip Morris USA, R.J.*, 346 F.3d 1287, 1300-01 (11th Cir. 2003); *Blomkest*, 203 F.3d at 1042-43; *Baby Food Antitrust*, 166 F.3d at 121-22; *Clamp-all Corp. v. Cast Iron Soil Pipe Institute*, 851 F.2d 478, 484 (1st Cir. 1988); *Apex Oil Co. v. DiMauro*, 822 F.2d 246, 253-54 (2d Cir. 1987).

167 *Id.* at 359.

168 *Ibid.*; quoting Philip Areeda & Herbert Hovenkamp, *Antitrust Law*, ¶ 1429, at 206 (2nd ed. 2000).

169 *Ibid.*; quoting Areeda & Hovenkamp, *Antitrust Law*, ¶ 1429 at 206.

170 *Ibid.*; quoting Areeda & Hovenkamp, *Antitrust Law*, ¶ 1429 at 207.

in a concentrated market can maintain supracompetitive price levels “without engaging in any overt concerted action.”¹⁷¹

Given that oligopolists may maintain prices of their goods at supracompetitive levels in a “conscious parallel” fashion, the Sherman Act does not prohibit it.¹⁷² The reason for this is two-fold and arises out of the line of scholarship in the field.¹⁷³ First interdependent behavior is not an “agreement” under the Sherman Act.¹⁷⁴ Second, “judicial remedies are incapable of addressing the anticompetitive effects of conscious parallel pricing.”¹⁷⁵

Based on this, where there is a claim of collusion based on conscious parallel behavior, certain “plus factors” must be shown.¹⁷⁶ The purpose of having such plus factors is to punish concerted action which is based on an actual agreement rather than unilateral conduct of rivals.¹⁷⁷ Ultimately, the court went through an analysis and upheld the district court’s grant of summary judgment as it related to automotive replacement glass, but reversed the grant of summary judgment as it related to price-fixing of flat glass.¹⁷⁸

C. *In re Publication Paper* and the “Tends To Exclude” Standard

In a recent case out of the Second Circuit, the court was faced with a review of summary judgment granted to several manufacturers of various grades of paper used in publications.¹⁷⁹ In this matter, a certified class of direct purchasers of publication paper claimed that two foreign based manufacturers had conspired to fix prices on three occasions and reduce supply of publication paper.¹⁸⁰ The district court granted summary judgment to the defendants, holding that there was no direct evidence of an agreement and that plaintiffs’ evidence did not “exclude the possibility” of independent action.¹⁸¹

The court began its analysis setting forth the rules and function of summary judgment. First the court noted that summary judgment is to be “affirm[ed] only” when construing the evidence in the light most favorable to the non-moving party “there is no genuine dispute as to any material fact.”¹⁸² “By avoiding wasteful trials and preventing lengthy litigation that may have a chilling effect on pro-competitive market forces, summary

171 *Ibid.*

172 *Id.* at 359-360.

173 *Id.* at 360.

174 *Ibid.*; citing Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 Harv.L.Rev. 655, 663-65 (1962).

175 *Ibid.*; citing Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 Harv.L.Rev. at 669-71, Areeda, *Antitrust Law*, *supra*, ¶¶ 1432d5-1432f, at 232-36.

176 *Ibid.*

177 *Ibid.*

178 *Id.* at 378.

179 *In re Publication Paper*, 690 F.3d at 55.

180 *Ibid.*

181 *Id.* at 60.

182 *Id.* at 61, quoting Fed.R.Civ.P. 56(a).

judgment serves a vital function in the area of antitrust law.”¹⁸³ However, “summary judgment is not a substitute for trial.”¹⁸⁴ Where the evidence allows for competing permissible inferences regarding whether plaintiff is entitled to relief, “the question of what weight should be assigned to [those] inferences remains within the province of the fact-finder at a trial.”¹⁸⁵

The reviewing court next turned its attention to the district court’s application of *Matsushita* in granting summary judgment. While citing extensively to *Matsushita*, the district court acknowledged that while “the evidence as a whole arguably could support an inference of illegal collusive behavior,” [it concluded] that plaintiffs ‘failed to offer sufficient evidence to dispel the possibility’ that [an alleged conspirator] acted independently.”¹⁸⁶

The reviewing court turned its attention to the *Matsushita*’s requirement that the moving party demonstrate evidence that “tends to exclude the possibility” that the alleged coconspirators acted independently.¹⁸⁷ The Court noted that although *Matsushita* limits the range of permissible inferences that can be drawn from ambiguous evidence, “the range of inferences that may be draw[n] from such evidence depends on the plausibility of the plaintiff’s theory.”¹⁸⁸ “[W]hen the conspiracy is economically sensible for the alleged conspirators to undertake” and the conduct cannot be deemed procompetitive, “broader inferences are permitted, and the ‘tends to exclude’ standard is more easily satisfied.”¹⁸⁹

The appellate court questioned the district court’s requirement that plaintiffs “exclude” or “dispel” the possibility that the defendants acted independently. “Requiring a plaintiff to ‘exclude’ or ‘dispel’ the possibility of independent action places too heavy a burden on the plaintiff.”¹⁹⁰ Quoting Professors Areeda and Hovenkamp, the court noted that:

It is important not to be misled by *Matsushita*’s statement . . . that the plaintiff’s evidence, if it is to prevail, must “tend . . . to exclude the possibility that the alleged conspirators acted independently.” The Court surely did not mean that the plaintiff must disprove all nonconspiratorial explanations for the defendants’ conduct. Not only did the court use the word “tend,” but the context made clear that the Court was simply requiring sufficient evidence to allow a reasonable fact finder to infer that the conspiratorial explanation is more likely than not.¹⁹¹

183 *Ibid.*; quoting *Tops Mkts., Inc. v. Quality Mkts., Inc.*, 142 F.3d 90, 95 (2d Cir. 1998).

184 *Ibid.*; citing *Apex Oil Co. v. DiMauro*, 822 F.2d 246, 252 (2d Cir. 1987).

185 *Ibid.*; quoting *Apex Oil*, 822 F.2d at 253.

186 *Id.* at 62; quoting *Publication Paper*, 2010 WL 5253364, at *9, *13.

187 *Id.* at 62–64.

188 *Id.* at 63, citing *Matsushita*, 475 U.S. at 588; *Monsanto*, 465 U.S. at 764; *Apex Oil*, 822 F.2d at 253.

189 *Ibid.*; citing *Flat Glass*, 385 F.3d at 358.

190 *Ibid.*

191 *Ibid.*; quoting Phillip E. Areeda & Herbert Hovenkamp, *Fundamentals of Antitrust Law*, §14.03(b) at 14–25 (4th ed. 2011)

The court further held that “the standards established in *Matsushita* do not apply at all when a plaintiff has produced *unambiguous* evidence of an agreement to fix prices.”¹⁹² The court noted that the Third, Ninth and Eleventh Circuits have also held that summary judgment is generally not appropriate where a plaintiff has produced direct evidence of an agreement to fix prices.¹⁹³

Based on the evidence, the court vacated and remanded in part and affirmed in part the ruling on summary judgment. As it related to the one defendant that was remanded back to the district court, the appellate court held that “[i]n sum, unlike *Matsushita*, the record in this case presents strong, if not irrefutable, evidence of a conspiracy in a context where the conspiracy’s goals were aligned with the conspirators’ economic interests.”¹⁹⁴

D. Hovenkamp and The Unfortunate Misinterpretation

Herbert Hovenkamp, one of the preeminent scholars in the field of antitrust law, has stated that the application of a heightened standard “is the result of an unfortunate misinterpretation of *Matsushita*.”¹⁹⁵ In his article reviewing Judge Richard Posner’s book, *Antitrust Law*, Hovenkamp looks to the approach and application the judge has taken in regards to *Matsushita*.¹⁹⁶ He pointed out that despite the work done by Phillip Areeda in the mid-1980s regarding a more behavioral approach to the problem of non-explicit collusive behavior, the courts have “not moved far from the traditional position requiring a . . . common law ‘agreement.’”¹⁹⁷

Hovenkamp believes that this continued trend requiring a showing of more traditional common law agreement in establishing an unlawful agreement under Section 1 has arisen out of a misinterpretation of *Matsushita*.¹⁹⁸ Even though *Matsushita* was a case regarding the “quantum and quality of evidence of collusion” in relation to summary judgment, some courts have interpreted this case as “requiring a certain quantum of evidence of verbal agreement before summary judgment can be avoided.”¹⁹⁹ However, *Matsushita* only required that the evidence be of such type to support collusion as a likely explanation of the conduct.²⁰⁰ Just as the cases discussed above, Hovenkamp believes that *Matsushita*’s heightened standard should not be applied to horizontal collusion cases such as price-fixing and market division.

192 *Ibid.* (emphasis in the original).

193 *Id.* at 63–64; citing *Williamson Oil Co., Inc. v. Philip Morris USA*, 346 F.3d 1287, 1300 (11th Cir. 2003); *Petruzzi’s*, 998 F.2d at 1233; *In re Coordinated Pretrial Proceedings in Petroleum Prods Antitrust Litig.*, 906 F.2d 432, 441 (9th Cir. 1990).

194 *Id.* at 65.

195 Herbert Hovenkamp, *The Rationalization of Antitrust*, 116 Harv. L. Rev. 917, 925 (2003).

196 *Id.* at 925–926.

197 *Id.* at 925.

198 *Ibid.*

199 *Ibid.*

200 *Ibid.*; citing, *Matsushita*, 475 U.S. at 587–88.

V. Ramifications Resulting From The Heightened Standard

Herbert Hovenkamp euphemistically stated that the heightened standard arose out of an “unfortunate misinterpretation.” By shining a light on this understatement, it can be said that the application of the heightened standard to traditional horizontal collusion cases is an injustice on many levels. From a legal interpretative standpoint, to read *Matsushita* “broadly,” as done in *Blomkest*, is to divorce the basis of the heightened standard from its application. *Matsushita* clearly set out that the heightened test is to be applied only (1) where the theory is implausible and (2) where prohibiting the conduct may stifle procompetitive behavior.

Applying a heightened standard to traditional economically sensible horizontal cases further undermines the division between the role of the judge and the role of the jury in antitrust matters. By improperly applying *Matsushita* to what the Supreme Court has identified as “the supreme evil of antitrust,”²⁰¹ the judge now places herself in the shoes of the jury. Application of the heightened standard in alleged economically sensible conspiracies requires a judge to assess the qualitative weight (and possibly the credibility) of the evidence, where such judgments are to be reserved for jury of the parties’ peers. The application of a heightened standard in economically sensible conspiracies not only undermines and circumvents Rule 56 of the Federal Rules of Civil Procedure, it also circumvents the Seventh Amendment of the United States Constitution.

On an evidentiary level, the burden shifting that has been applied in some cases at the summary judgment level required the judge to improperly weigh credibility. The “plus factors” test is used to establish a *prima facie* case when there is parallel pricing, which helps prove a likelihood that the parallel pricing was as a result of a conspiracy.²⁰² Part of this burden is to provide evidence “‘that tends to exclude the possibility’ that the alleged conspirators acted independently.”²⁰³ A significant problem arises when the courts entertain the alleged conspirators’ reasons or rationalizations for the conduct as being procompetitive or innocuous. For instance, in *Blomkest*, the court relied on the defendants “point[ing] out” evidence.²⁰⁴ Based on this the *Blomkest* court held that the “class has thus failed to carry its burden to rebut the producers’s (sic) independent business justification for their actions.”²⁰⁵ Although defendants are clearly entitled to put forth evidence of procompetitive justifications for their conduct, summary judgment requires that the court look to the evidence in the light most favorable to the non-moving party, drawing all reasonable inferences in its favor.

Where *Matsushita* is misapplied by requiring greater scrutiny on the “tends to exclude” standard, much more credence is provided to moving party’s business justifications for the conduct at the summary judgment stage. Alleged conspirators can be counted on to raise all sorts of business justifications to explain their conduct, some real and some imagined. These may include the “belief” that costs would rise or the anticipation that competitors

201 *Verizon Communs. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408 (2004).

202 *Blomkest*, 203 F.3d at 1043.

203 *Matsushita*, 475 U.S. at 588, quoting *Monsanto*, 465 U.S. at 764.

204 *Blomkest*, 203 F.3d at 1037.

205 *Ibid.*; citing *Laurel Sand & Gravel, Inc. v. CSX Transp. Inc.*, 924 F.2d 539, 543 (4th Cir. 1991).

were going to raise their prices. Obviously, contemporaneous documents immediately preceding such conduct would have more weight to a fact finder than an after-the-fact statement made at a deposition. However, both pieces of evidence, under a summary judgment analysis would need to be evaluated equally—meaning without weighing its credibility. By requiring a heightened standard related to the “tends to exclude” standard and by allowing an evaluation at summary judgment of the alleged conspirators’ business justification, plaintiff has lost the ability it would have at trial to challenge the veracity of such evidence. Therefore, under a summary judgment analysis, allowing the business justification to shift the burden back to the plaintiff will result in an unduly large number of summary judgments being granted.

The fact of the matter is that most cases regarding antitrust conspiracies are based on circumstantial evidence. Although there are some cases that arise out of an entity that seeks leniency or amnesty through the Department of Justice’s Corporate Leniency Policy, absent a confession and cooperation of one of the competitors, the government, competitor or the consumer must look to piece together evidence of an unlawful agreement on top of the conspirators’ conduct.²⁰⁶ Such is the case in many traditional fraud cases that are based on a conspiracy.

Since the issue of conscious parallelism by definition arises in oligopolistic markets, it is likely that the companies in these markets are well counseled in the laws of direct evidence. Rather than creating a smoking gun email or written memorandum, conspirators hold meetings where people only communicate verbally. Leaving no trail is the marching order, and given the high penalties and possible jail time, destruction of evidence is not implausible.

From an impact level, requiring a heightened standard may have reduced the minimal deterrent effect the antitrust laws have in the business world.²⁰⁷ Treble damages and criminal penalties²⁰⁸ are available in antitrust cases not only to punish anyone violating the Sherman Act, but to serve as a deterrent to prospective conduct.²⁰⁹ If the hurdle to the application of such penalties is heightened, the limited deterrent force of such punishments is further diminished.

206 U.S. DEP’T OF JUSTICE, CORPROATE LENIENCY POLICY, 4 Trade Reg. Rep. (CCH) ¶ 13, 113, ¶ A (August 10, 1993).

207 See John S. Thompson and David L. Kaserman, *After the Fall: Stock Price Movements and the Deterrent Effect of Antitrust Enforcement*, Review of Industrial Organization, Vol. 19, 329-334 (2001); see also Alla Golub, Joshua Detre, and John M. Connor, *The Profitability of Price Fixing: Have Stronger Antitrust Sanctions Deterred?*, International Industrial Organization Conference 3, Atlanta, Georgia, April 8-9, 2005, also found at <http://ssrn.com/abstract=1188515>.

208 15 U.S.C. §1 (“any combination or conspiracy hereby declared illegal shall be deemed guilty of a felony, and on conviction thereof, shall be punished by fine not exceeding \$100,000,000 if a corporation, or if any other person, \$1,000,000, or by imprisonment not exceeding 10 years.”)

209 Joseph C. Gallo, Kenneth G. Dau-Schmidt, Joseph L. Craycraft and Charles J. Parker, *Criminal Penalties Under the Sherman Act: A Study of Law and Economics*, Research in Law and Economics, Vol. 16, 25, 59 (1994) (concluding that “to date the level of criminal penalties imposed has not, by itself, provided adequate deterrence against antitrust offenses.”)

VI. Conclusion

The heightened standard in *Matsushita* was established as a method to cull out an implausible predatory pricing conspiracy prior to trial. This heightened standard unfortunately bled into the analysis applied to more traditional antitrust conspiracies, such as price-fixing or bid-rigging. These economically sensible antitrust conspiracies have long been recognized as conduct that is: (1) detrimental to competition, (2) not implausible, and (3) not a deterrent to pro-competitive conduct when enforced under the law. Going forward, the hope is that courts will recognize the distinction between an implausible Section 1 theory which requires a heightened standard, from the economically sensible conspiracy cases. By making this distinction from the onset, the courts will better serve the parties by clearly setting forth the standards and burdens they face in having to establish or defend a Section 1 case. Furthermore, by separating the type of Section 1 case and its associated standard, courts will be more apt to follow the strictures of Rule 56 in not having to entertain evidence that may be less than credible at the summary judgment stage, allowing the parties to have their evidence evaluated by a jury when warranted under the law.

REGULATION OF COMPANIES' DATA SECURITY PRACTICES UNDER THE FTC ACT AND CALIFORNIA UNFAIR COMPETITION LAW

By Kathryn F. Russo¹

I. Introduction

News of data breaches dominates the headlines. Technology is advancing at a dizzying speed. Companies are collecting more sensitive personal information about consumers than ever before while hackers are devising new strategies to access this information.

In the context of this data-driven world, it is no surprise that companies' data security practices are coming under increasingly strict scrutiny. The Bureau of Justice Statistics estimates that approximately 7 percent of all U.S. residents age 16 or older were victims of identity theft in 2012.² Both the Federal Trade Commission and the California Attorney General have made it a priority to pursue enforcement actions against companies that do not have reasonable data security practices.

For over a decade the FTC has used its authority under Section 5 of the Federal Trade Commission Act³ to enforce the prohibition against unfair and deceptive acts or practices in the field of data security. In evaluating whether a company's data security practices are unfair, the FTC uses a reasonableness standard and considers each company's data security practices on a case-by-case basis. The majority of the FTC's data security enforcement actions have resulted in settlements. However, for the first time, the FTC is facing a challenge to its authority to regulate companies' data security practices.

Companies also face challenges to their data security programs under California law. The California Attorney General has made clear that investigating breaches of personal information is an enforcement priority. Further, companies that experience data breach incidents face the additional burden of private lawsuits. Even though litigants bringing data security lawsuits have faced hurdles establishing constitutional standing under Article III and have had difficulty establishing a quantifiable harm, companies have chosen to settle these cases for significant sums.

Companies that store, transmit, and use consumer information would be well advised to reassess their data security practices to reduce the likelihood of data breaches and to avoid costly regulatory and private litigations that may arise following a breach.

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2 See Bureau of Justice Statistics, *Victims of Identity Theft*, 2012 (Dec. 2013), available at <http://www.bjs.gov/content/pub/pdf/vit12.pdf>.

3 15 U.S.C. § 45(a)(1).

II. The FTC's Enforcement of Reasonable Data Security Practices

A. The FTC Evaluates Reasonableness of Data Security Practices on a Case-By-Case Basis

Pursuant to Section 5 of the FTC Act, Congress delegated broad authority to the FTC to protect consumers from unfair and deceptive trade practices.⁴ Under Section 5 of the FTC Act, an act or practice is unfair if the act or practice (1) “causes or is likely to cause substantial injury to consumers,” (2) “which is not reasonably avoidable by consumers themselves,” and (3) “not outweighed by countervailing benefits to consumers or to competition.”⁵ The FTC assesses these three factors whenever it examines whether a particular practice is “unfair.”⁶

In the context of evaluating a company's data security practices, the FTC has held that a company's failure to implement reasonable data security practices can be considered an unfair practice under this three-part standard.⁷ First, the FTC has stated that failing to reasonably protect consumers' personal and financial information can cause significant injury to consumers.⁸ Such failures increase the likelihood of unauthorized charges to consumers' financial accounts and put consumers at an increased risk of identity theft. Second, the FTC has stated that consumers cannot reasonably avoid such harms because the consumer has no way of independently knowing whether the company has unreasonable security practices and turning over confidential financial and personal information is generally required of a consumer to complete a transaction with a company.⁹ Third, the FTC has stated that where a company employs unreasonable data security practices and does not implement low cost technologies that reduce the risk of data breaches, harm to consumers caused by a company's unreasonable data security practices is not outweighed by the countervailing benefits to consumers or to competition.¹⁰ Although a hacker may devise a way to breach even the most expensive state-of-the-art data security measure, requiring onerous data security measures could raise costs to businesses therefore making them less competitive and ultimately harming consumers. Therefore, this factor is flexible and allows the FTC to determine whether a company's data security measures employed are sufficient, given the particular situation.

Accordingly, the FTC uses its authority under Section 5 of the FTC Act to evaluate a company's data security practices on a case-by-case basis, considering the unique

4 15 U.S.C. § 45(a)(1).

5 15 U.S.C. § 45(n); *FTC v. Neovi, Inc.*, 604 F.3d 1150, 1153 (9th Cir. 2010).

6 FTC Policy Statement on Unfairness, *appended to Int'l Harvester Co.*, 104 F.T.C. 949, 1070 (1984), available at <http://www.ftc.gov/ftc-policy-statement-on-unfairness>. Of course, to the extent that a company has made an explicit promise to protect consumers' personal and financial information and then fails to protect that information, such action constitutes a misrepresentation that can be challenged under the FTC Act's prohibition against “deceptive acts or practices.”

7 *See In the Matter of LabMD, Inc.*, Order Denying Respondent LabMD's Motion To Dismiss (January 16, 2014) (“LabMD Order”).

8 *See* LabMD Order at 18-19.

9 *See Id.* at 19.

10 *Id.*

characteristics of the business, and current security threats and technology. In a recent statement before Congress, the Commission emphasized that “[i]n the data security context, the FTC conducts its investigations with a focus on reasonableness – a company’s data security measures must be reasonable in light of the sensitivity and volume of consumer information it holds, the size and complexity of its data operations, and the cost of available tools to improve security and reduce vulnerabilities.”¹¹ In considering whether a company’s data security practices are reasonable, the Commission “examines such factors as whether the risks at issue were well known or reasonably foreseeable, the costs and benefits of implementing various protections, and the tools that are currently available and used in the marketplace.”¹² Further, the Commission stated that “it does not require perfect security; that reasonable and appropriate security is a continuous process of assessing and addressing risks; that there is no one-size-fits-all data security program; and that the mere fact that a breach occurred does not mean that a company has violated the law.”¹³

The FTC has undertaken efforts to provide guidance to companies in developing reasonable data security programs. The FTC publically publishes its complaints and consent decrees related to its data security enforcement actions.¹⁴ Additionally, the FTC holds workshops on issues that affect consumer data. Its recent workshops include a workshop on the Internet of Things,¹⁵ a workshop on mobile security issues,¹⁶ and a program on child identity theft.¹⁷ Further, the Commission published a business guide on data security with the goal of helping companies develop reasonable data security programs.¹⁸ Companies should review the consent decrees, workshops, and other guidance published by the FTC to help assess whether their data security program is reasonable.

B. The FTC is Pursuing Data Security Enforcement Actions Under the Unfairness Prong

For over a decade, the FTC has used its authority under Section 5 of the FTC Act to enforce the prohibition against unfair and deceptive acts or practices in the field of

11 Prepared Statement of the Federal Trade Commission, “Protecting Consumer Information: Can Data Breaches Be Prevented?” before the Committee on Energy and Commerce, February 5, 2014, (“2014 Commission Testimony”), available at http://www.ftc.gov/system/files/documents/public_statements/prepared-statement-federal-trade-commission-protecting-consumer-information-can-data-breaches-be/140205databreaches.pdf.

12 2014 Commission Testimony at 4.

13 *Id.*

14 See <http://business.ftc.gov/legal-resources/8/35>.

15 FTC Workshop, *Internet of Things: Privacy & Security in a Connected World* (Nov. 19, 2013), available at <http://www.ftc.gov/bcp/workshops/internet-of-things/>.

16 FTC Workshop, *Mobile Security: Potential Threats and Solutions* (June 4, 2013), available at <http://www.ftc.gov/bcp/workshops/mobile-security/>.

17 FTC Workshop, *Stolen Futures: A Forum on Child Identity Theft* (July 12, 2011), available at <http://www.ftc.gov/news-events/events-calendar/2011/07/stolen-futures-forum-child-identity-theft>.

18 See *Protecting Personal Information: A Guide for Business*, available at <http://www.business.ftc.gov/documents/bus69-protecting-personal-information-guide-business>.

consumer privacy and data security. Initially, the FTC focused its enforcement efforts on companies' "deceptive" data security practices.¹⁹ In 2005, the Commission began pursuing enforcement actions against companies engaging in "unfair" data security practices.²⁰

Companies should expect and be prepared for the FTC to continue to aggressively pursue actions against companies for engaging in unfair data security practices. Recently, the Commission released a report stating that the Commission has "redoubled its efforts to protect consumer privacy, including through law enforcement. . . ." ²¹ Further, at the beginning of this year, the Commission marked its 50th data security settlement.²² Over 20 of these settlements included allegations that a company's failure to reasonably safeguard consumer data was an unfair practice.²³

Companies should be aware that the majority of the Commission's data security investigations have resulted in consent decrees. In the context of data security actions, the Commission's consent decrees typically require a company to establish, implement, and maintain a comprehensive information security program and to obtain, on a biannual basis, an assessment and report from a third party professional regarding the company's data security safeguards for a period of time ranging from 10 to 20 years.²⁴ However, recently two companies have challenged the FTC's authority to regulate companies' data security practices as described below.

C. Two Companies Have Challenged the FTC's Authority to Regulate Data Security Practices

Although the majority of the Commission's data security investigations have resulted in consent decrees, recently, two companies, LabMD Inc. and Wyndham Worldwide Corporation and three of its subsidiaries, are challenging the FTC's authority to regulate data security practices of businesses.²⁵ Both LabMD and Wyndham argue that the FTC lacks authority to regulate companies' data security practices under Section 5 of the FTC

19 See LabMD Order at 9.

20 *Id.*

21 FTC Report, *Protecting Consumer Privacy in an Era of Rapid Change, Recommendations for Businesses and Policymakers*, (March 2012), available at <http://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-report-protecting-consumer-privacy-era-rapid-change-recommendations/120326privacyreport.pdf>.

22 Commission Statement Marking the FTC's 50th Data Security Settlement, (January 31, 2014), available at <http://www.ftc.gov/system/files/documents/cases/140131gmrstatement.pdf>.

23 2014 Commission Testimony at 3-4.

24 See, e.g., *Dave & Busters, Inc.*, No. C-4291 (F.T.C. May 20, 2010), available at <http://www.ftc.gov/sites/default/files/documents/cases/2010/06/100608davebustersdo.pdf>; *BJ's Wholesale Club, Inc.*, No. C-4148 (F.T.C. Sept. 20, 2005), available at <http://www.ftc.gov/sites/default/files/documents/cases/2005/09/092305do0423160.pdf>; *DSW Inc.*, No. C-4157 (F.T.C. March 7, 2006), available at <http://www.ftc.gov/sites/default/files/documents/cases/2006/03/0523096c4157dswdecisionandorder.pdf>.

25 *Federal Trade Commission v. Wyndham Worldwide Corporation, et al.*, Motion to Dismiss by Defendant Wyndham Hotels & Resorts LLC (D. Ariz. Aug. 27, 2012) ("Wyndham Motion to Dismiss"); *In the Matter of LabMD, Inc.*, Respondent LabMD, Inc.'s Motion to Dismiss Complaint With Prejudice and to Stay Administrative Proceedings (Nov. 12, 2013) ("LabMD Motion to Dismiss").

Act, and that the FTC has failed to provide fair notice of what constitutes reasonable data security standards.²⁶ As discussed below, the Commission issued an order in the LabMD case affirming its authority under the FTC Act to regulate and enforce data security practices of businesses.²⁷ Wyndham’s motion to dismiss the FTC’s complaint is pending in the United States District Court for the District of New Jersey following oral argument.

Specifically, in the LabMD case, the FTC filed an administrative complaint against LabMD, alleging that it “engaged in a number of practices that, taken together, failed to provide reasonable and appropriate security for personal information on its computer networks.”²⁸ LabMD is a clinical laboratory that conducts tests on specimen samples from patients and reports the test results to patients’ health care providers.²⁹ In conducting such tests, LabMD obtains a variety of types of sensitive personal information about patients.³⁰ The FTC alleges that as a result of LabMD’s security failures, a file containing the personal information of approximately 9,300 patients was shared to a public file-sharing network, Limewire.³¹ LabMD filed a motion to dismiss the FTC’s complaint, arguing, among other things, that the FTC lacks authority to regulate companies’ data security practices under Section 5 of the FTC Act and that the FTC has failed to provide fair notice of what constitutes reasonable data security standards.³²

On January 16, 2014, the Commission issued an order denying LabMD’s motion to dismiss and held, among other things, that the FTC Act’s prohibition of “unfair . . . acts or practices” applies to a company’s failure to implement reasonable and appropriate data security measures.³³ In support of its holding, the Commission references Congress’ intent to delegate broad authority to the Commission to proscribe activities that qualify as “unfair acts or practices,” as well as the Commission’s long history of applying the three “unfairness” factors to prohibit a wide range of unfair acts and practices.³⁴ The Commission also rejected LabMD’s due process arguments that the Commission must first adopt regulations before bringing enforcement actions in the field of data security.³⁵ In support of its holding, the FTC reasoned that the three-part statutory standard governing whether an act or practice is unfair provides fair notice of what conduct is prohibited. The FTC also highlighted the fact that companies are subject to tort liability for violating uncodified standards of care on a regular basis.³⁶

26 See Wyndham Motion to Dismiss; LabMD Motion to Dismiss.

27 See LabMD Order.

28 *In the Matter of LabMD, Inc.*, Complaint, ¶ 10 (August 28, 2013) (“LabMD Complaint”).

29 *Id.* ¶3.

30 *Id.* ¶6.

31 *Id.* ¶17-19.

32 See LabMD Motion to Dismiss.

33 LabMD Order at 2.

34 *Id.* at 3-6.

35 *Id.* at 2.

36 *Id.* at 17.

Additionally, in its case against Wyndham, the FTC alleges that Wyndham’s “failure to maintain reasonable security” allowed intruders to obtain unauthorized access to Wyndham’s computer networks and such security failures resulted in “more than \$10.6 million in fraud loss, and the export of hundreds of thousands of consumers’ payment card account information to a domain registered in Russia.”³⁷ In the complaint, the FTC identifies ten data security failures that it alleges unreasonably and unnecessarily exposed consumers’ personal data to unauthorized access and theft.³⁸ Wyndham filed a motion to dismiss the FTC’s complaint arguing, among other things, that the FTC lacks authority to regulate data security under Section 5 of the FTC Act, and that the FTC failed to provide fair notice of what constitutes reasonable data security standards.³⁹ Currently, Wyndham’s motion to dismiss the FTC’s complaint is pending in the United States District Court for the District of New Jersey following oral argument. This will be the first time a court decides whether the FTC has authority to regulate data security practices of companies pursuant to Section 5 of the FTC Act.

Over time the FTC’s authority to enforce companies’ data security practices will be fully fleshed out. In the interim, companies should pay attention to the guidance provided by the FTC, discussed above, regarding reasonable data security practices in order to prevent data breaches and avoid costly regulatory enforcement actions.

III. The California Attorney General and Data Security Enforcement Actions

A. The UCL and Data Security

Pursuant to California’s unfair competition law, any “unlawful, unfair or fraudulent business act or practice” is prohibited.⁴⁰ The California Supreme Court has affirmed that an act or practice may be independently actionable as ‘unfair,’ even if the act or practice is “not specifically proscribed by some other law.”⁴¹ In the context of consumer cases, there is a three-way split among the courts as to what definition of “unfair” should be applied.⁴²

First, some courts apply the definition of unfair set forth in the California Supreme Court’s *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.*⁴³ decision. In *Cel-Tech*, the California Supreme Court stated that in competitor cases “unfair” should apply to “conduct that threatens an incipient violation of an antitrust law, or violates the policy or spirit of one of those laws because its effects are comparable to or the same as a violation of the law, or otherwise significantly threatens or harms competition.”⁴⁴

37 *Federal Trade Commission v. Wyndham Worldwide Corporation, et al.*, First Amended Complaint for Injunctive and Other Equitable Relief, ¶ 2, (D. Ariz. Aug. 9, 2012) (“Wyndham Complaint”).

38 Wyndham Complaint ¶ 24(a)-(j).

39 See Wyndham Motion to Dismiss.

40 Cal. Bus. & Prof. Code § 17200 et seq.

41 *Cel-Tech Comm’ns, Inc., v. Los Angeles Cellular Tele. Co.*, 20 Cal. 4th 163, 180 (1999).

42 See *Durell v. Sharp Healthcare*, 183 Cal. App. 4th 1350, 1364 (2010); *Morgan v. AT&T Wireless Servs. Inc.*, 177 Cal. App. 4th 1235, 1254-55 (2009); *Klein v. Chevron U.S.A., Inc.*, 202 Cal. App. 4th 1342, 1376 (2012).

43 *Cel-Tech*, 20 Cal. 4th 163.

44 *Cel-Tech*, 20 Cal. 4th at 187.

Second, some courts apply the accepted definition of unfair business practice in place before the *Cel-Tech* decision, which is that “an ‘unfair’ business practice occurs when that practice ‘offends an established public policy or when the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers.’”⁴⁵ Typically, a broad balancing test is used to determine whether a practice is unfair under this definition. Third, some California courts of appeal have applied the Federal Trade Commission’s three-prong definition of unfair as described above.⁴⁶

As discussed above, the FTC has interpreted its three-prong unfairness test, which is generally regarded as the most restrictive of the three possible tests for unfairness under the UCL,⁴⁷ as covering lax data security practices that result in breaches. Since even the most restrictive test under the UCL has been interpreted to cover unreasonable data security practices that result in breaches, the question regarding which unfairness test should be applied would likely not change the outcome. Under any of these tests, unreasonable data security practices likely expose companies to potential liability under the UCL. Therefore, companies should take care to ensure that their data security practices would not be deemed unfair under any of the three standards. Additionally, companies should be aware that the California Customer Records Act requires a business that owns or licenses personal information about a California resident to “implement and maintain reasonable security procedures and practices appropriate to the nature of the information, to protect the personal information from unauthorized access, destruction, use, modification, or disclosure.”⁴⁸ Although there have not been many actions brought alleging violations of this statutory provision, companies should make sure that they are maintaining reasonable and appropriate security procedures as a precautionary measure.

B. The Attorney General Has Made Investigating Data Breaches An Enforcement Priority

The California Attorney General has made clear that investigating breaches of personal information is an enforcement priority. In July 2012, the California Attorney General announced the creation of the Privacy Enforcement and Protection Unit in the Department of Justice, which focuses on “protecting consumer and individual privacy through civil prosecution of state and federal privacy laws.”⁴⁹ The Data Breach Report released by the California Attorney General in July 2013, found that “[m]ore than 2.5 million Californians were put at risk by data breaches in 2012” and “[m]ore than 1.4 million Californians would not have been put at risk, and 28 percent of the data breaches would not have required

45 *State Farm Fire & Cas. Co. v. Superior Court*, 45 Cal. App. 4th 1093, 1104 (1996).

46 *See Klein v. Chevron U.S.A., Inc.*, 202 Cal. App. 4th at 1376.

47 *See* David L. Belt, *Should the FTC’s Current Criteria for Determining “Unfair Acts or Practices” Be Applied to State “Little FTC Acts”?*, 10-11, *The Antitrust Source*, (Feb. 2010).

48 California Civil Code § 1798.81.5(b).

49 *See* Press Release, *Attorney General Kamala D. Harris Announces Privacy Enforcement and Protection Unit* (July 19, 2012), available at <https://oag.ca.gov/news/press-releases/attorney-general-kamala-d-harris-announces-privacy-enforcement-and-protection>.

notification, if the data had been encrypted.”⁵⁰ The California Attorney General’s Office has stated that it “will make it an enforcement priority to investigate breaches involving unencrypted personal information, and encourage [their] allied law enforcement agencies to similarly prioritize these investigations.”⁵¹ Further the Attorney General’s data breach report states, “[c]ompanies and agencies have legal and moral obligations to protect personal information with reasonable and appropriate safeguards.”⁵²

Companies that store, transmit, and use consumer information about Californians should reassess their data security programs to make sure they include reasonable and appropriate safeguards for personal information. Recently, on January 24, 2014, the California Attorney General’s office filed a complaint in state court against the Kaiser Foundation Health Plan, Inc. alleging Kaiser violated California’s unfair competition law.⁵³ Specifically, the complaint alleges that Kaiser violated the UCL by publicly posting and displaying the Social Security numbers of more than 20,000 Californians on an unencrypted hard drive, in violation of California Civil Code section 1798.85, and delayed notification of security breach in violation of California Civil Code section 1798.82.⁵⁴ The California Attorney General’s action against Kaiser highlights the growing trend of state attorneys general increasing their role in protecting consumers’ data privacy and security. Companies should expect more data security enforcement actions to come and should take care to ensure their data security practices do not run afoul of California law.

IV. Private Data Security Actions

In addition to state and federal regulatory enforcement actions, companies that experience data breach incidents may face the additional burden of private lawsuits. The data breach class actions brought to date usually arise from an unauthorized third party gaining access to a company’s stored data and involve claims that the company failed to properly secure such data. Litigants bringing data breach lawsuits have faced hurdles establishing constitutional standing under Article III and have had difficulty establishing a quantifiable harm. Even in the face of these difficulties, plaintiffs have still brought data breach cases against companies that result in settlement due to the enormous cost of litigation.⁵⁵

Practitioners and companies should take note of the Ninth Circuit’s decision in *Krottner v. Starbucks Corp.* in which the court held that “Plaintiffs–Appellants, whose personal information has been stolen but not misused, have suffered an injury sufficient

50 Data Breach Report 2012, p. iii, Kamala D. Harris, Attorney General, California Department of Justice (“Data Breach Report”), available at http://oag.ca.gov/sites/all/files/agweb/pdfs/privacy/2012data_breach_rpt.pdf.

51 Data Breach Report at iv., 14.

52 *Id.* at 14.

53 *The People of the State of California v. Kaiser Foundation Health Plan, Inc.*, Case No. RG14711370, Cal. Sup. Ct., Alameda Co. (January 24, 2014).

54 *Id.*

55 See *Johansson-Dohrmann v. CBR Sys.*, 2013 U.S. Dist. LEXIS 103863 (S.D. Cal. 2013); *In re TD Ameritrade Account Holder Litig.*, 2011 U.S. Dist. LEXIS 103222 (N.D. Cal. 2011).

to confer standing under Article III, Section 2 of the U.S. Constitution.”⁵⁶ A recent class action lawsuit, *In re Sony Gaming Networks & Customer Data Sec. Breach Litigation*,⁵⁷ arising out of criminal intrusion into a computer network system, cited *Krottner* and held that defendants had established Article III standing because plaintiffs sufficiently alleged a loss of money or property as a result defendants’ alleged unfair business practices. The court stated, “...where sensitive personal data, such as names, addresses, social security numbers and credit card numbers are improperly disclosed or disseminated into the public, increasing the risk of future harm, injury-in-fact has been recognized.”⁵⁸ Further, the court held that “even though Sony alleges no harm has yet occurred, in certain circumstances, ... future harm may be regarded as a cognizable loss sufficient to satisfy Article III’s injury-in-fact requirement.”⁵⁹

Following the *Krottner* and *Sony* decisions, the U.S. Supreme Court held in a non-data security related case, *Clapper v. Amnesty Int’l USA*,⁶⁰ that plaintiffs “lack Article III standing because they cannot demonstrate that the future injury they purportedly fear is certainly impending and because they cannot manufacture standing by incurring costs in anticipation of non-imminent harm.”⁶¹ Although *Clapper* is not a data security case, the reasoning behind the decision is likely to be used to argue that plaintiffs alleging future harm resulting from data breaches is not sufficient for purposes of Article III standing.

Indeed, the Supreme Court’s recent decision in *Clapper* was raised to challenge plaintiffs’ Article III standing in the *Sony* case.⁶² In light of the *Clapper* decision, the District Court reconsidered its prior ruling that plaintiffs’ had sufficiently alleged that their sensitive personal information was wrongfully disseminated, increasing the risk of future harm, regardless of whether actual harm had occurred.⁶³ After reconsidering its prior ruling, the District Court rejected Sony’s argument that *Clapper* tightened the “injury-in-fact” analysis set forth by the Ninth Circuit in *Krottner*.⁶⁴ Instead the District Court found that “although the Supreme Court’s word choice in *Clapper* differed from the Ninth Circuit’s word choice in *Krottner*, stating that the harm must be ‘certainly impending,’ rather than ‘real and immediate,’ the Supreme Court’s decision in *Clapper* did not set forth a new Article III framework, nor did the Supreme Court’s decision overrule previous precedent requirement that the harm be ‘real and immediate.’”⁶⁵ The District Court stated, “the Supreme Court’s decision in *Clapper* simply reiterated an

56 *Krottner v. Starbucks Corp.*, 628 F.3d 1139, 1140 (9th Cir. 2010).

57 *In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 903 F. Supp. 2d 942 (S.D. Cal. 2012).

58 *Sony*, 903 F. Supp. 2d at 958.

59 *Id.*

60 *Clapper v. Amnesty Int’l USA*, 133 S. Ct. 1138 (2013).

61 *Id.* at 1155.

62 See *In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 2014 U.S. Dist. LEXIS 7353 (S.D. Cal. Jan. 21, 2014).

63 *Id.* at 22.

64 *Id.* at 25.

65 *Id.*

already well-established framework for assessing whether a plaintiff had sufficiently alleged an ‘injury-in-fact’ for purposes of establishing Article III standing.”⁶⁶

Although plaintiffs in *Sony* have survived defendants’ motion to dismiss, the question remains as to whether plaintiffs can establish the required quantifiable harm to succeed. Even if such lawsuits are ultimately untenable, the cost of litigation represents a real threat to businesses that store, use, and transmit consumer information.

V. Conclusion

With both the FTC and the California Attorney General declaring it a priority to pursue data security enforcement actions, companies can expect to see more enforcement actions in the near future. Companies should take a proactive approach and assess whether their data security practices are reasonable and appropriate given their unique circumstances. Companies should make use of the resources provided by the FTC and the California Attorney General’s office to assist them in protecting themselves against costly regulatory and private actions.

66 *Id.* at 25-26.

UPDATE ON CALIFORNIA STATE ANTITRUST AND UNFAIR COMPETITION LAW AND FEDERAL AND STATE PROCEDURAL LAW

By Thomas A. Papageorge and Thomas Greene*

Editor's Note: Every year, at the October Golden State Institute, Tom Papageorge and Tom Greene provide an extensive overview of recent developments in, respectively, state antitrust substantive law and relevant federal procedural law. Their outlines are thorough and well-done. The Committee receives numerous requests for copies of their fine work. In order to provide their outlines to as many of our members as possible, The Editors of Competition have decided to publish their work herein. Please note that, while the authors have done their best to annotate this outline, this Update reflects new cases and developments as of October 2013. Furthermore, these are a selection of developments that may be particular important to members of the Section. Please consult other references for all of the developments that may be important to your practice.

I. CALIFORNIA DEVELOPMENTS: SUBSTANTIVE LAW

A. Cartwright Act (Business and Professions Code § 16720 et seq.)

1. California Supreme Court Will Decide Cartwright Act Applicability to “Pay-for-Delay” Patent Settlements

In re Cipro Cases I & II, 200 Cal.App.4th 442 (2011), (review granted, 137 Cal. Rtr.3d 248, February 12, 2012)

The California Supreme Court will join the U.S. Supreme Court in the high-stakes debate over “reverse payment” or “pay-for-delay” patent settlements and decide the proper standard for determining when such settlements violate the Cartwright Act. At issue is the confluence of, and potential conflict between, federal patent rights and antitrust principles of competition.

The lengthy coordinated class action matter in *In re Cipro Cases I & II* involves plaintiffs’ antitrust claims concerning ciprofloxacin (branded as “Cipro”), an antibiotic patented by Bayer Corporation. Plaintiffs alleged that Bayer and several generic drug manufacturers violated the Cartwright Act, the Unfair Competition Law, and common law monopolization principles by entering into a patent infringement settlement in which Bayer agreed to make payments (ultimately totaling \$398 million) in exchange for the generic manufacturers’ agreement not to manufacture the generic version of Cipro until the patent expired—an arrangement characterized by the plaintiffs as “pay-for-delay” monopolization and by the defendants as legitimate “reverse payments” to settle *bona fide* patent litigation.

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The trial court granted defendants' summary judgment motion, ruling the settlements were neither illegal per se under the Cartwright Act nor unreasonable under the rule of reason, and finding no triable issue as to whether the agreements produced "anticompetitive effects beyond the exclusionary scope of the patent itself."

The Fourth District Court of Appeal affirmed summary judgment for defendants (*id.* at 478), adopting defendants' proposed legal standard, derived from the Second Circuit Court of Appeals opinion in *In re Tamoxifen Citrate Antitrust Litigation* (2d Cir. 2006) 466 F.3d 187, which held that "in the absence of any plausible allegation that a patent infringement lawsuit [is] baseless or that the Settlement Agreement otherwise restrained competition beyond the scope of the . . . patent," the plaintiff's antitrust complaint fails to state a claim on which relief can be granted. (*Id.* at 221.)

Reviewing the *Tamoxifen* rule and similar holdings, the Fourth District held those principles properly govern this issue under the Cartwright Act. Since "the Cipro agreements did not restrain competition outside the exclusionary zone of the . . . patent, we cannot view the Cipro agreements as lacking any redeeming virtue . . . Accordingly, we conclude they are not unlawful per se." (200 Cal.App.4th at 467.) And under the rule of reason, the court found reverse payment agreements to be consistent with federal and state policies favoring dispute resolution and are a "natural byproduct of patent litigation" under current federal law, such that prohibiting them would "harm competition by reducing the incentive to challenge patents by reducing the challenger's settlement options." (*Id.* at 469-470.) Thus, unless such patent settlements "restrain competition beyond the exclusionary scope of the [underlying] patents, they do not violate the Cartwright Act." (*Id.* at 470.)

Triable issues would be presented if the patent enforcement action were objectively baseless, or if the patent were procured by fraud, but neither issue could be properly pleaded in the Cipro matter. Federal law preempted the sham litigation claim here because it "necessarily depends on resolution of a substantial question of federal patent law" (the validity of certain "inequitable conduct" by Bayer in securing its patent). (*Id.* at 473.)

Summarizing the court's version of the *Tamoxifen* rule, "[w]e conclude that unless a patent was procured by fraud, or a suit for its enforcement was objectively baseless, a settlement of the enforcement suit does not violate the Cartwright Act if the settlement restrains competition only within the scope of the patent." (*Id.* at 467.)

Status update: The California Supreme Court granted Plaintiffs' petition for review on February 15, 2012 (137 Cal.Rptr.3d 24), and extensive *amici* participation was anticipated. However, briefing was stayed in September of 2012, pending the U.S. Supreme Court's consideration of these issues in *FTC v. Actavis, Inc.*, ___ U.S. ___ (2013), 133 S.Ct. 2223, which held that the FTC's section 5 unfair competition allegations in the AndroGel reverse payment matter were not forestalled by patent law principles. The Supreme Court remanded the matter for trial under rule of reason principles.

Further proceedings in *In re Cipro Cases I & II* are currently stayed pending trial court approval of a proposed settlement with defendant Bayer.

2. Ninth Circuit Confirms Broad Extraterritorial Scope of Cartwright Act

At&T Mobility v. AU Optronics Corp., 707 F.3D 1106 (9th Cir.2013)

Because California has a valid interest in protecting competition within its borders, the Ninth Circuit has held that an antitrust price-fixing conspiracy arranged in California is subject to the Cartwright Act and UCL even if all the sales of the price-fixed products occur in other states.

As part of the global LCD panel antitrust litigation, plaintiffs (AT&T-related companies) sued LCD panel manufacturers under the Cartwright Act and UCL, alleging a conspiracy to fix prices for LCD screens used in AT&T phones, all of which phones were sold outside of California. Focusing on the loci of those sales, the U.S. District Court twice dismissed plaintiffs' California claims, ruling that the California antitrust laws cannot apply to price-fixed sales occurring exclusively in other states.

The Ninth Circuit reversed. The district court's analysis incorrectly focused on just one aspect of the conspiracy (the phone sales) and erroneously ignored other aspects of the conspiracy, including that the formation of the conspiracy had occurred, at least in part, in California. "The district court's conclusion ignores conduct that may give rise to a cause of action under the Cartwright Act . . . A reading of the plain text of the Cartwright Act reveals that the district court's place-of-purchase focus severely truncates the scope of the anticompetitive conduct that the Act proscribes." (*Id.* at 1110.)

Rejecting the defendants' due process objections, the court found "perpetration of anticompetitive activities within California 'creat[es] state interests' in applying California law to that conduct." (*Id.* at 1112.) The Ninth Circuit cited the California Supreme Court's statement of Cartwright Act goals in *Clayworth v. Pfizer, Inc.*, 49 Cal.4th 758 (2010), and found that "[a]pplying California law to anticompetitive conduct undertaken within California advances the Cartwright Act's overarching goals of maximizing effective deterrence of antitrust violations, enforcing the state's antitrust laws against those violations that do occur, and ensuring disgorgement of any ill-gotten proceeds." (*Id.*) A conspiracy occurring in California can undermine these interests even if the resulting sales occur elsewhere.

The court also concluded that this analysis governs UCL claims: "We focus on Plaintiffs' claims under the California Cartwright Act . . . but the principles articulated herein apply equally to Plaintiffs' claims under California's Unfair Competition Law . . . The UCL provides a cause of action for harms caused by 'any unlawful, unfair or fraudulent business act or practice.' Because a violation of the Cartwright is, by definition actionable under the UCL, we do not belabor our analysis in this case with respect to Plaintiffs' UCL claims." (*Id.* at 1107, n. 1)

3. Federal Natural Gas Act Does Not Preempt Certain State Antitrust Enforcement Actions

***In Re Western States Natural Gas Antitrust Litigation*, 715 F.3d 716 (9th Cir.2013)**

The Ninth Circuit has determined that the federal Natural Gas Act does not preempt state antitrust claims when plaintiffs' alleged damages result from retail purchases not subject to federal law.

Natural gas company defendants were sued by commercial and industrial consumers of natural gas on allegations that the defendants colluded to submit false information to publishers of two major natural gas price indices (*Gas Daily* and *Inside FERC*) in order to manipulate market prices during the 2000–2002 energy crisis. Consolidated as an MDL matter in Nevada federal court, this lengthy litigation ultimately resulted in the district court dismissing the state law claims as preempted by the Natural Gas Act, which gives the federal government authority over wholesale natural gas sales and transportation, but reserves to the states jurisdiction over sales to end-use consumers. Recognizing that the published index prices were used to set rates in both wholesale transactions governed by federal law, and in retail transactions subject to state law, the district court concluded that section 5(a) of the Natural Gas Act, which gives the Federal Energy Regulatory Commission (FERC) jurisdiction over practices that affect wholesale rates, preempted state law from being used to regulate alleged index price manipulation that would have affected both wholesale and retail rates in the same way.

In April 2013, the Ninth Circuit reversed, concluding that section 5(a) does not preempt state antitrust claims “arising out of false price reporting and other anticompetitive behavior associated with nonjurisdictional sales.” Noting that a prior Ninth Circuit opinion involving some of the same transactions at issue in *Western States* had already concluded that “the removal of certain transactions from FERC’s jurisdiction meant that claims arising out of those transactions were not preempted by the NGA” (id. at 731), the *Western States* court concluded that “federal preemption doctrines do not preclude state law claims arising out of transactions outside of FERC’s jurisdiction.”

Defendants filed a cert petition in August 2013 and in December 2013 the Supreme Court invited the Solicitor General’s office to file a brief expressing the views of the United States.

B. Unfair Practices Act (Business and Professions Code § 17000 et seq.)

1. Sales Below Cost and Loss Leader Allegations Dismissed in Medical Labs Case

***Rheumatology Diagnostics Laboratory, Inc. v. Aetna, Inc., et al.*, (N.D.Cal.2013) 2013 U.S.Dist. LEXIS 89208; 2013-1 Trade Cas. (CCH) ¶ 78,442**

Illustrating the challenges facing antitrust plaintiffs in the post-*Twombly* era, the U.S. District Court for the Northern District of California has dismissed plaintiffs’ Unfair Practices Act allegations of sales below cost (§ 17043) and loss leader sales (§ 17044)

as part of a dismissal of the entirety of an antitrust suit involving medical laboratory billing practices.

Plaintiffs, medical diagnostic laboratories in California engaged in the “commercial reference laboratory business,” sued three health insurers and the largest competing laboratory, Quest Diagnostics, Inc., for conspiring to exclude plaintiffs from the diagnostic testing market through a series of contracts making it difficult or impossible for plaintiffs to participate in the insurers’ preferred networks. Plaintiffs also sued Quest for attempted monopolization and violations of the UPA, including sales under cost and loss leaders, undertaken to harm competitors and competition in the California marketplace.

In addition to dismissing the balance of the complaint (with leave to amend) based largely on *Twombly* “plausibility” analysis, the district court dismissed the plaintiffs’ UPA claims against Quest. Plaintiffs had alleged that Quest engaged in loss-leader pricing on certain capitated contracts in exchange for more lucrative fee-for-service business, but the district court found the allegations “too conclusory to state a plausible UPA claim.” (*Id.* at LEXIS 45.) The court concluded that the plaintiffs failed to adequately allege “Quest’s sales prices, costs, or cost of doing business” and plaintiffs’ generalized allegations of pricing “below cost” were insufficient to survive demurrer. (*Id.* at LEXIS 46.)

C. Covenants Not to Compete (Business and Professions Code § 16600 et seq.)

1. Section 16600 Does Not Abrogate Officer’s Duty of Loyalty During His Employment

***Angelica Textile Services, Inc. v. Park*, 220 Cal.App.4th 495 (2013) (review denied, Jan. 29, 2014)**

Although our non-competition-covenant principles permit an employee wide latitude to seek other employment, California law does not authorize a current employee (while still employed) to transfer his loyalty to a competitor, the Fourth District Court of Appeal has ruled.

Plaintiff Angelica Textile Services, a large-scale laundry business serving San Diego hospitals, sued defendant Emerald (a new competitor) and Park, a former Angelica employee now working for Emerald, alleging violations of California’s Uniform Trade Secrets Act (UTSA), unfair competition, and various contract breaches and business torts. The trial judge dismissed all the non-UTSA theories, and at trial the jury found none of the information at issue was a trade secret within the meaning of UTSA, resulting in judgment for defendants. Plaintiff Angelica then appealed the dismissal of the non-UTSA claims.

The Fourth District reinstated the non-trade-secret claims. Considering plaintiff’s claims implicating California policy on covenants not to compete, the appellate court confirmed that section 16600 “has consistently been interpreted as invalidating any employment agreement that unreasonably interferes with an employee’s ability to compete with an employer *after* his employment ends. However, the statute does not

affect limitations on an employee’s conduct or duties *while* employed.” (*Id.* at 509; emphasis original.)

The court noted: “While California law does permit an employee to seek other employment and even to make some ‘preparations to compete’ before resigning, California law does not authorize an employee to transfer his loyalty to a competitor. During the term of employment, an employer is entitled to its employees’ ‘undivided loyalty.’” (*Id.*)

This has particular force where the employee in question is a corporate officer. As such an officer, “Park owed the corporation a fairly broad duty of loyalty . . . which demands of a corporate officer or director . . . the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation, but also to refrain from doing anything that would work injury to the corporation” (*Id.* at 510.) During his employment at Angelica, Park had assisted Emerald by disparaging Angelica to a local bank, and by granting contractual cancellation rights to Angelica customers in violation of Angelica’s policies. Angelica’s claim that Park breached the non-competition clause of his contract by these actions was not defeated by section 16600 principles and could go forward.

D. Consumer Legal Remedies Act (Civil Code § 1750 et seq.)

1. FTC Holder in Due Course Rule Applies and Permits CLRA Claim Against Lender

***Lafferty v. Wells Fargo Bank*, 213 Cal.App.4th 545 (2013)**

The Third Appellate District has held that the FTC Holder in Due Course Rule (16 C.F.R. 433.2) allowed the purchaser of a motorhome to assert all claims it had against the RV dealership also against the lending institution to which the buyer’s loan had been assigned.

Plaintiff spouses (the Laffertys) sued a motorhome manufacturer, the RV dealer, and Wells Fargo Bank, to whom the purchase contract was assigned, for warranty breach and violations of the CLRA and other state consumer protection statutes relating to a “lemon” motor home plaintiffs had purchased. Plaintiffs appealed the trial court’s order granting Wells Fargo’s demurrer to the CLRA and related claims, and the Third Circuit reversed as regards to those claims. “[W]e decline to depart from the clear language required by the Holder Rule In short, the Holder Rule allows the Laffertys to assert the same ‘claims and defenses’ against Wells Fargo that they might otherwise have had against [the dealer].” (*Id.* at 563.) However, “the Holder Rule limits the Laffertys to recovering no more than what they have paid under the installment contract.” (*Id.* at 556.)

2. Auto Club’s Billing Policy Not Subject to CLRA/UCL Class Action Challenge

***Thompson v. Automobile Club of Southern California*, 217 Cal.App.4th 719 (2013)**

Plaintiffs sought certification for a class action alleging CLRA and UCL violations by defendant Auto Club regarding its membership renewal billing practices. The Auto Club provided a grace period after membership expiration, but the putative representative

plaintiff objected to receiving less than a full year's membership when he took advantage of the grace period to renew without a \$20 processing fee.

The Fourth Appellate District held the trial court did not abuse its discretion when it refused to certify a class under the CLRA and UCL. The appellate court found insoluble problems with the ascertainability of the class and the predominance of common questions of law and fact due to differences among putative class members regarding receipt of membership services during the delinquency period, disclosure of the renewal policy, and economic benefits or detriments from differing renewal choices. "The predominance of these individual issues makes the class action mechanism unmanageable in this case." (*Id.* at 732.)

Other recent CLRA opinions:

Flores v. West Covina Auto Group, 212 Cal.App.4th 895 (2013) *review granted, deferred pending review in Iskanian v. CLS Transportation of Los Angeles*, 15 Cal.Rptr.3d 651 (2013). Depublished pending Supreme Court review of *Iskanian* (see discussion, *infra*), the Second District's opinion held that the Federal Arbitration Act preempted the California Consumer Legal Remedies Act's prohibition against class waivers in an automobile sales contract governed in part by federal law.

Chapman v. Skype Inc., 220 Cal.App.4th 217 (2013); 2013 Cal.App. LEXIS 794. The Second Appellate District held that CLRA claims against VOIP provider Skype included adequate allegations of the requisite CLRA elements to avoid demurrer. (See discussion, *infra*).

E. Unfair Competition Law (Business and Professions Code § 17200 et seq.)

1. California Supreme Court: All Equitable Exceptions Apply to UCL Statute of Limitations

***Aryeh v. Canon Business Solutions, Inc.*, 55 Cal.4th 1185 (2013)**

The California Supreme Court has clarified the governing principles of the statute of limitations in Unfair Competition Law cases, holding that "the text and legislative history of the UCL leave UCL claims as subject to the common law rules of accrual as any other cause of action." (*Id.* at 1185.)

Plaintiff Aryeh leased a photocopier from defendant Canon and sued when he discovered service practices that allegedly resulted in overcharges under the lease. Defendant's demurrer on statute of limitations grounds was sustained and plaintiff appealed, claiming his on-going leasing contracts with Canon justified the application of the "continuous accrual" equitable exception to the usual four-year statute of limitations period of the UCL. A divided Second District Court of Appeal upheld the order of dismissal, and the California Supreme Court granted review.

The Supreme Court reversed and reinstated plaintiff's claim. After a detailed review of the historical development of various equitable exceptions to the usual limitations

principles, the Supreme Court held that the “last element” principle—the cause of action does not fully accrue until the last necessary element takes place—governs the UCL.

As a result, all the common law exceptions to the “last element” principle apply to relevant UCL factual situations as with any other statutory scheme: “Accordingly, we conclude the UCL is governed by common law accrual rules to the same extent as any other statute. That a cause of action is labeled a UCL claim is not dispositive; instead, ‘the nature of the right sued upon’ [citation] and the circumstances attending its invocation control the point of accrual. The common law last element accrual rule is the default [citation] while exceptions to that rule apply precisely to the extent the preconditions for their application are met, as would be true under any other statute. We disapprove *Snapp and Associates Ins. Svs. Inc. v. Robertson*, 96 Cal.App.4th 884 (2002) and *Salenga v. Mitsubishi Motors Credit of America, Inc.*, 183 Cal.App.4th 986 (2010) to the extent they hold otherwise.” (55 Cal.4th at 1194.)

In the *Aryeh* case facts, the equitable exception for “continuous accrual” was applicable where Canon was alleged to have engaged in a recurring breach of a contractual obligation, so that “each alleged breach must be treated as triggering a new statute of limitations.” (*Id.* at 1200.) Thus, “continuous accrual principles prevent Aryeh’s complaint from being dismissed at the demurrer stage on statute of limitations grounds.” (*Id.* at 1185.) And depending on the factual circumstances, the other equitable exceptions to the “last element” doctrine, including delayed discovery, equitable tolling, fraudulent concealment, and continuing violations, may apply if their factual preconditions are met. (*Id.* at 1194.)

2. Applying *Aryeh*, Third District Holds Fraudulent Concealment Doctrine Applies to UCL

***Fuller v. First Franklin Financial Corp.*, 216 Cal.App.4th 955 (2013)**

Following the Supreme Court’s guidance in *Aryeh v. Canon Business Solutions, Inc.* (*supra*), the Third District has held the doctrine of fraudulent concealment applies to an action against a loan broker and lender, extending plaintiff borrowers’ time for filing their UCL claim.

Plaintiffs sued defendants (a mortgage lender and its agents) for deceptive and fraudulent practices in connection with home loans which defendants allegedly manipulated to obtain illegal kickbacks. Plaintiffs did not discover key misrepresentations of loan terms concealed by the defendants until more than four years after the loans were made. When they sued on UCL and other theories, the trial court sustained defendants’ demurrers on statute of limitations grounds.

Taking plaintiffs’ facts as true for demurrer purposes, the court found the plaintiffs “had sufficiently alleged delayed discovery of facts that defendants had purposely withheld from them . . . ,” which was sufficient to invoke the fraudulent concealment equitable exception applicable to UCL statute of limitations matters after *Aryeh*. (*Id.* at 959). “The allegations establish with adequate specificity nondisclosures and misrepresentations . . . and the absence of any circumstances to trigger plaintiffs’ reasonable inquiry in to available facts revealing the true nature of the loans.” (*Id.* at 966.) The court reversed the judgments of dismissal with directions to overrule the demurrers. (*Id.* at 959.)

3. Scorecard: UCL Preemption or Bar Arising From Federal or State Regulatory Schemes

The California and federal courts continue to wrestle with the multi-faceted issue of the applicability of the Unfair Competition Law to specific business practices and contexts where other regulatory schemes are involved. Claims of federal preemption, or preclusion or bar by state regulatory schemes, have recently produced a number of important results.

a. Holdings [final or provisional] of no preemption of or bar to UCL action:

Rose v. Bank of America, N.A., 57 Cal.4th 390 (2013)

In an opinion widely viewed as a significant expansion of UCL private actions in federal regulatory contexts,¹ the California Supreme Court has held that the elimination by Congress of a private right of action under the federal Truth in Savings Act (TISA, 12 U.S.C. § 4301 *et seq.*) did not preclude the filing of a UCL claim predicated on TISA violations.

Plaintiffs filed a putative class action under the UCL alleging that defendant Bank of America had engaged in an unlawful and unfair business practice of failing to adequately notify customers of account fee increases. Since Congress had amended TISA in 1996 to sunset that law's private right of action, defendant Bank of America argued on demurrer that Congress had intended to bar all private actions alleging TISA violations. The trial court sustained the demurrer and the Second District affirmed, concluding that the UCL could not be used now to redress TISA violations.

A unanimous California Supreme Court reversed. "May a claim of unlawful business practice under California's unfair competition law be based on violations of a federal statute, after Congress has repealed a provision of that statute authorizing civil actions for damages? We hold that it may, when Congress has also made it plain that state laws consistent with the federal statute are not superseded." (*Id.* at 393.) The Court found TISA's savings clause determinative: "By leaving TISA's savings clause in place, Congress explicitly approved the enforcement of state laws 'relating to the disclosure of yields payable or terms for accounts' . . . The UCL is such a state law." (*Id.* at 395.)

The Supreme Court emphasized that "by borrowing requirements from other statutes, the UCL does not serve as a mere enforcement mechanism. It provides its own distinct and limited equitable remedies for unlawful business practices, using other laws only to define what is 'unlawful,'" reflecting "the Legislature's intent to discourage business practices that confer unfair advantages in the marketplace . . ." (*Id.* at 397.) Because the UCL is meant "to provide remedies cumulative to those established by other laws, absent express provision to the contrary (Bus. & Prof. Code, § 17205)," a UCL

1 See *e.g.*, thecomplexlitigator.com/in-rose-v-bank-of-america-california (Aug. 1, 2013) ("The UCL still has teeth in the view of the California Supreme Court, it would seem.")

action is “only barred if a statute expressly prohibits such an action or expressly permits the conduct in question.” (*Id.* at 398–399.)

***People ex rel. Harris v. Pac Anchor Transportation, Inc.*, 195 Cal.App.4th 765 (2011) (review granted, 2011 Cal. LEXIS 9188, Aug. 31, 2011)**

The Second District held a UCL case filed by the attorney general for improper classification of employees as independent contractors was not preempted by the Federal Aviation Administration Authorization Act (49 U.S.C. § 14501 *et seq.*), as it was not related to rates, routes, or services. The California Supreme Court granted review on August 31, 2011, and briefing was still continuing in August of 2013.

b. Holdings [final or provisional] of preemption of or bar to UCL action:

***Simpson v. Kroger Corporation*, 219 Cal.App.4th 1352 (2013)**

Plaintiffs appealed the trial court’s dismissal with prejudice (on preemption grounds) of their UCL challenge, based on California’s Milk and Milk Products Act (MMPA) (Food & Agr. Code § 32501 *et seq.*) and other theories, to defendant Kroger’s labeling of its dairy products combining butter with canola oil or olive oil. The Second District held California’s MMPA is preempted to the extent its provisions are inconsistent with the terms of the federal Food, Drug and Cosmetic Act (21 U.S.C. § 301), as they are here. While plaintiff’s cause of action based on California’s Sherman Food, Drug and Cosmetic Law (Health & Safety Code § 109875 *et seq.*) was not preempted, it nonetheless also failed because the court found as a matter of law that plaintiff failed to demonstrate that a reasonable consumer would be misled by the product labels.

***Rodriguez v. RWA Trucking Company, Inc.*, 219 Cal.App.4th 692 (2013) (review granted, 162 Cal.Rptr.3d 250, Dec. 11, 2013)**

Plaintiffs, independent-contractor truck drivers, sued the defendant trucking company under the UCL for selling auto liability insurance improperly and for charging unlawfully for workers’ compensation insurance. After trial judgment for plaintiffs, the Second Appellate District found that the auto liability insurance UCL claim under the California Insurance Code was preempted by the Truth-in-Leasing regulations of the federal Motor Carrier Act (49 U.S.C. § 14101 *et seq.*; 49 C.F.R. § 376 *et seq.*), but held that the workers compensation UCL cause of action for Labor Code violations was not preempted by the Federal Aviation Administration Authorization Act of 1994 (49 U.S.C. § 14501 *et seq.*).

***Parks v. MBNA America Bank*, 54 Cal.4th 376 (2012)**

Reversing the Fourth Appellate District, which had found no necessary preemption, the California Supreme Court held that the National Banking Act of 1864 (13 Stat. 99) (NBA) preempted a UCL class action against defendant MBNA America Bank for alleged failure to provide certain convenience-check disclosures required by Civil Code section 1748.9. “We conclude that the NBA preempts Civil Code section 1748.9 because the state law stands as an obstacle to the broad grant of power given by the NBA to national banks to conduct the business of banking.” (*Id.* at 380.) The Civil Code provisions “exceed any requirements in federal law” (*Id.* at 387), and are not part of the

“general legal backdrop to Congress’ enactment of federal banking legislation.” (*Id.* at 390.)

4. Scorecard: Arbitration and Unconscionability in Consumer Contracts after *Concepcion*

The U.S. Supreme Court’s decision in *AT&T Mobility, LLC v. Concepcion*, ___ U.S. ___, 131 S.Ct. 1740 (2011), upholding the preemptive effect of the Federal Arbitration Act (9 U.S.C. § 1 et seq.) on inconsistent state principles, stands as a bar to UCL or FAL actions challenging unfair business practices or false advertising by businesses using contracts with mandatory arbitration clauses. The full scope of the *Concepcion* principle, and its impact on California arbitration and unconscionability principles, continues to be the subject of extensive litigation. The following is a survey of some of the more prominent unfair competition matters raising these issues of mandatory arbitration and contract unconscionability after *Concepcion*:

a. Arbitration Clauses Upheld:

***Iskanian v. CLS Transportation*, 206 Cal.App.4th 949 (2012) (review granted, 2012 Cal. LEXIS 8925, September 19, 2012)**

Disagreeing with a division in its own district, the Second Appellate District (Division Two) held that the California Supreme Court’s opinion in *Gentry v. Superior Court*, 42 Cal.4th 443 (2007), holding that the statutory right to receive overtime pay was unwaivable and thus not subject to a mandatory class arbitration waiver, was no longer valid after *Concepcion* (cf. *Brown v. Ralph’s Grocery Co.*, 197 Cal.App.4th 489 (2011) (2nd DCA, Div. 5); *Kinecta Alternative Financial Services, Inc. v. Superior Court*, 205 Cal.App.4th 506 (2012) (2nd DCA, Div. 3) (assuming *Gentry* remains valid). Based on this analysis, the court ruled that the arbitration requirement in a trucking company’s contract must be enforced. (206 Cal.App.4th at 954.)

In light of the conflicts on this issue among three divisions within the Second District and others, the California Supreme Court granted review on *Iskanian* on September 19, 2012. The Supreme Court’s guidance on the fate of *Broughton-Cruz* and *Gentry* in the aftermath of *Concepcion* is clearly needed. The landscape of consumer contracts in California will likely be altered significantly by the Court’s opinion, whatever its substantive conclusions may be.

***Kilgore v. KeyBank*, 78 F.3d 1052 (9th Cir. 2013)**

In the original opinion expressing remorse about the result, a three-judge Ninth Circuit panel held that *AT&T Mobility, Inc. v. Concepcion* mandated the conclusion that the Federal Arbitration Act (9 U.S.C. § 1 et seq.) preempts the California Supreme Court’s rulings in *Broughton v. Cigna Healthplans*, 21 Cal.4th 1066 (1999) and *Cruz v. Pacificare Health Systems, Inc.*, 30 Cal.4th 303 (2003) that UCL and Consumer Legal Remedies Act (CLRA) actions seeking injunctive relief on behalf of the public cannot be the subject of arbitration. “Although the *Broughton-Cruz* rule may be based upon the sound public policy judgment of the California legislature, we are not free to ignore *Concepcion*’s holding that state public policy cannot trump the FAA when that policy prohibits the arbitration of a ‘particular type of claim’. . . . Therefore we hold that the conflicting [*Broughton-Cruz*] rule is displaced by the FAA.” (673 F.3d at 963.)

The panel then found that the arbitration clause at issue was not procedurally unconscionable, based on its clear disclosure and 60-day opt-out period, and thus was enforceable. (*Id.* at 964.) However, the panel took pains to note that *Concepcion* “did not overthrow the common law contract defense of unconscionability whenever an arbitration clause is involved. Rather, [*Concepcion*] reaffirmed that the savings clause preserves generally applicable contract defenses such as unconscionability, so long as those doctrines are not ‘applied in a fashion that disfavors arbitration.’” (*Id.* at 963, quoting *Concepcion*.)

On September 21, 2012, the Ninth Circuit’s judges ordered rehearing *en banc*, and on April 11, 2013, the court filed this *en banc* opinion. The larger panel reversed the district court’s denial of defendant’s motion to compel arbitration. However, the court did not hold that *Concepcion* abrogates the *Broughton-Cruz* rule, but rather held that the rule only applies to requests for public injunctions and is thus inapplicable because plaintiffs here sought private injunctive relief. Since KeyBank had withdrawn completely from the business at issue, “the injunctive relief sought, thus, for all practical purposes relates only to past harms suffered by members of the putative class.” Thus, [e]ven assuming the continued viability of the *Broughton-Cruz* rule, Plaintiffs’ claims do not fall within its purview” and plaintiffs’ challenge to the mandatory arbitration clause fails. (*Id.* at 1060).

b. Arbitration Clauses Rejected:

***Natalini v. Import Motors*, 213 Cal.App.4th 587 (2013) (review granted, 155 Cal. Rptr. 3d 831, May 1, 2013)**

The First Appellate District sided with the *Sanchez* and *Goodridge* courts (*see infra*) and found that an arbitration clause in an industry-standard motor vehicle installment sales contract was unconscionable and thus unenforceable notwithstanding *Concepcion*. “We conclude that the arbitration provision in the present case is substantively unconscionable because it is designed in several ways to systematically favor the car dealer.” (*Id.* at 596.) Further, “both aspects of procedural unconscionability [oppression and surprise] are present in this case.” (*Id.*) Thus the contract’s arbitration clause was unconscionable and unenforceable. The California Supreme Court granted review on May 1, 2013, adding this matter to the series of cases in queue including *Sanchez* and *Iskanian* (*infra*).

***Sanchez v. Valencia*, 201 Cal. App. 4th 74 (2012) (review granted, 139 Cal. Rptr.3d 2, March 21, 2012)**

Division One of the Second District Court of Appeal had held an arbitration clause in the defendant’s standard auto purchase contract to be unconscionable under general California contract principles, notwithstanding the *Concepcion* issue of the class action waiver in the contract. The panel held: “The [arbitration] provision is adhesive— involving oppression and surprise—and contains harsh one-sided terms that favor the car dealer to the detriment of the buyer We cannot sever all of the offending language. Thus, regardless of the validity of the class action waiver, the trial court properly declined to compel arbitration.” (*Id.* at 80.)

The California Supreme Court granted review on March 21, 2012. The *Sanchez* opinion relied in part on *Broughton* and thus its fate may depend on the California

Supreme Court's conclusion on the survival of its *Broughton-Cruz* rule in this review and the *Iskanian* review (discussed *supra*) presently underway.

Other recent arbitration/unconscionability opinions:

Vasquez v. Greene Motors, Inc., 214 Cal.App.4th 1172 (2013) (*review granted*, 156 Cal. Rptr.3d 260, June 26, 2013). The First Appellate District disagreed with its sister panel in *Natalini*, *supra*, and held the arbitration clause in the standard vehicle sales contract not unconscionable and thus enforceable.

Vargas v. SAI Monrovia B, Inc., 216 Cal.App.4th 1269 (2013) (*review granted*, 2013 Cal. LEXIS 6925, Aug. 21, 2013). The same Second District panel that decided *Sanchez*, *supra*, again found that the usual arbitration clause used by most car dealerships in California is unconscionable and thus unenforceable.

Goodridge v. KDF Automotive, 209 Cal.App.4th 325 (2012). The Fourth District held the auto purchase contract to be unconscionable in the requisite procedural and substantive dimensions and is thus unenforceable.

Compton v. Superior Court (American Mgmt. Services, LLC), 214 Cal.App.4th 873 (2013) (*review granted*, 157 Cal.Rptr.3d 570, June 12, 2013). The Second District found the arbitration clause in an employment contract to be so one-side as to be unconscionable and unenforceable, notwithstanding *Concepcion*.

c. Scorecard: Standing, Injury, and Reliance Pleadings after *Tobacco II* and *Kwikset*

***Chapman v. Skype Inc.*, 220 Cal.App.4th 217 (2013)**

Plaintiff Chapman, a customer of VOIP provider Skype, sought to certify a UCL and FAL class action against Skype based on allegations of misrepresentations of the terms of Skype's "Unlimited" use plan. Applying the standing principles of *Tobacco II* and *Kwikset*, the Second Appellate District found that plaintiff's UCL, FAL, and CLRA allegations were improperly dismissed because she adequately alleged the tendency or likelihood of deception and adequately pled actual reliance on the misrepresentations at issue. Both the likelihood of misleading a reasonable consumer and the materiality of the misrepresentations in influencing plaintiff's purchase were sufficiently alleged and "cannot be decided as a question of law on this record." (*Id.* at Cal. App. LEXIS 794, at 18.)

Other recent standing/reliance/injury opinions:

Schwartz v. Provident Life and Accident Ins. Co., 216 Cal.App.4th 607 (2013). The First District held that an insured lacked standing to sue defendant disability insurers for alleged deceptive practices based on plaintiff's claim that some insureds – but not plaintiff – were wrongfully denied benefits. Actuarial evidence of alleged higher premiums did not constitute the requisite showing of individual harm required after Proposition 64.

Faulkinbury v. Boyd and Associates, Inc., 216 Cal.App.4th 220 (2013). The Fourth Circuit, pursuant to directions from the California Supreme Court, reconsidered its prior order denying class certification to plaintiff security guards in their UCL action alleging Labor Code and UCL violations relating to off-duty meal breaks and overtime pay, and

directed the trial court to certify all three classes proposed by plaintiffs in light of the Supreme Court's *Brinker* standards.

5. Antitrust Uses of Unfair Competition Law Addressed

***Law Offices of Matthew Higbee v. Expungement Assistance Services*, 214 Cal. App.4th 544 (2013)**

The Fourth Appellate District has held that the trial court erred in sustaining a defendant's demurrer in a UCL competitor-versus-competitor suit in which the plaintiff law office contended that it lost profits because of the unlawful conduct of the defendant with which plaintiff had no direct business dealings. Reversing the trial court's order, the appellate court concluded: "Bearing in mind the UCL was originally conceived to protect business competitors . . . and also that the deterrence of unfair competition is an important goal of the UCL . . . we conclude that the lack of direct dealings between two business competitors is not fatal to UCL standing, provided the plaintiff competitor has suffered injury in fact and lost money or property . . ." (*Id.* at 547.) Further, the alleged added expenses and lost profits resulting from decreased market share could constitute the requisite injury in a competitor-on-competitor antitrust action under the UCL. (*Id.* at 561.)

***AT&T Mobility v. AU Optronics Corp.*, 707 F.3d 1106 (9th Cir.2013)**

The Ninth Circuit concluded that its extraterritoriality analysis focusing on all aspects of an antitrust conspiracy including its place of origin (see discussion, *supra*), also governs UCL claims: "We focus on Plaintiffs' claims under the California Cartwright Act . . . but the principles articulated herein apply equally to Plaintiffs' claims under California's Unfair Competition Law . . . The UCL provides a cause of action for harms caused by 'any unlawful, unfair or fraudulent business act or practice.' Because a violation of the Cartwright is, by definition actionable under the UCL, we do not labor our analysis in this case with respect to Plaintiffs' UCL claims." (*Id.* at 1107, n. 1)

6. Supreme Court Resolves *Moradi-Shalal* Controversy (But Prolongs Uncertainty on the "Unfairness" Legal Standard in UCL Consumer Cases)

***Zhang v. Superior Court (California Capital Insurance)*, 57 Cal.4th 354 (2013)**

In an opinion with multiple impacts, the California Supreme Court has held that its opinion in *Moradi-Shalal v. Fireman's Fund Insurance Companies*, 46 Cal.3d 287 (1988), does not prevent an insured from filing a UCL action against an insurer alleging false advertising and bad faith claims handling, notwithstanding that those practices are also addressed in California's Unfair Insurance Practices Act (UIPA) (Ins. Code § 790 et seq.).

Plaintiff owner of a commercial building bought insurance from the defendant insurance company, and after a fire damaged the building, there was a lengthy dispute about defendant's obligation to pay under the policy. Plaintiff sued alleging breach of contract and related theories and also alleging a UCL violation consisting of false advertising and bad faith in honoring claims. The trial court sustained defendant's demurrer, ruling that the principle of *Moradi-Shalal*, which limits remedies for California's UIPA, foreclosed plaintiff's UCL cause of action on these insurance practices. The Fourth Appellate District reversed, holding *Moradi-Shalal* did not bar the action.

The Supreme Court affirmed. “We hold that *Moradi-Shalal* does not preclude first party UCL actions based on grounds independent from section 790.03, even when the insurer’s conduct also violates section 790.03. We have made it clear that while a plaintiff may not use the UCL to ‘plead around’ an absolute bar to relief, the UIPA does not immunize insurers from UCL liability for conduct that violates other laws in addition to the UIPA.” (57 Cal.4th at 369, disapproving *Textron Financial Corp. v. National Union Fire Insurance Co.* 118 Cal.App.4th 1061 (2004))

On the topic of UCL “unfairness” doctrine, in its now superseded opinion in *Rose v. Bank of America*, 200 Cal.App.4th 1441 (2011) ([review granted](#), 139 Cal.Rptr.3d 1), the Second Appellate District accurately noted that “[o]ur Supreme Court has not announced a definitive test for unfair business practices in consumer cases.” This unfortunate state of affairs continues in 2013, as the California Supreme Court in *Zhang* passed over an important opportunity to provide essential guidance on which of the four (or more) differing theories of UCL “unfairness” should be used to analyze such allegations in consumer—as opposed to antitrust—cases.

While providing an important result for insurance litigation in California, the *Zhang* opinion prolonged rather than resolved the continuing uncertainty over the correct legal standard to apply in UCL “unfairness” cases involving consumers. The Court noted:

The standard for determining what business acts or practices are “unfair” in consumer actions under the UCL is currently unsettled. (See *Aleksick v. 7-Eleven, Inc.* (2012) 205 Cal.App.4th 1176, 1192 [public policy that is predicate for action must be tethered to specific constitutional, statutory or regulatory provisions]; *Ticconi v. Blue Shield of California Life & Health Ins. Co.* (2008) 160 Cal.App.4th 528, 53 [applying balancing test, but also examining whether practice offends established public policy or is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers]; *Camacho v. Automobile Club of Southern California* (2006) 142 Cal.App.4th 1394, 1403 [consumer injury must be substantial, and neither outweighed by countervailing benefits nor avoidable by consumers]; *Progressive West Ins. Co. v. Superior Court* (2005) 135 Cal.App.4th 263, 285 [37 Cal. Rptr. 3d 434] [impact of the act or practice on victim is balanced against reasons, justifications and motives of the alleged wrongdoer].) The parties here do not address this question, nor do we. (57 Cal.4th at 380, n.9.)

As an example of the continuing analytical problems arising from this doctrinal uncertainty, in *Aspiras v. Wells Fargo Bank, N.A.*, 219 Cal.App.4th 948 (2013), the Fourth District rejected plaintiffs’ UCL claims against defendant for unfair and unlawful mortgage foreclosure practices and in doing so applied the “tethering” analysis of *Cel-Tech* to a consumer case without acknowledging or distinguishing between competitor/antitrust “unfairness” and “unfairness” in consumer contexts. (*Cf. Cel-Tech Communications, Inc.*, *supra*, 20 Cal.4th at 186-187.)

F. False Advertising Law (Business and Professions Code § 17500 et seq.)

1. Ninth Circuit: Price Misrepresentations “Matter,” Conferring *Kwikset* Standing

***Hinojos v. Kohl’s Corp.*, 718 F.3d 1098 (9th Cir.2013)**

The Ninth Circuit has concluded that the broader Proposition 64 standing principles enunciated by the California Supreme Court in *Kwikset* are not limited to the *Kwikset* context of misrepresentations regarding where merchandise is manufactured.

In *Hinojos v. Kohl’s Corp.*, plaintiffs brought a false advertising and UCL class action against defendant retailer Kohl’s for engaging in multiple continuing misrepresentations about “sale” pricing and reductions from “original” prices. The Ninth Circuit, relying on the California Supreme Court’s analysis in *Kwikset Corp. v. Superior Court*, 51 Cal.4th 310 (2011), rejected defendant’s contention that the *Kwikset* standing principle only governs place-of-origin matters. The court concluded “*Kwikset* cannot be . . . limited” to its facts of manufacturing origin claims. Where there are allegations of “misrepresentations that induced [plaintiff] to buy products he would not ordinarily have purchased . . . but for the misrepresentation, he has standing to sue under the UCL and FAL because he has suffered economic injury.” (*Id.* at 1107, n. 8.)

The court described the wrongful economic motivations behind phony-sales ploys and the consumer harm that results. Echoing the widely-quoted phrase of the *Kwikset* Court (“Simply stated, labels matter.”), the Ninth Circuit concluded that “a product’s ‘regular’ or ‘original’ price matters.” (*Id.* at 1105.) Plaintiffs had properly pleaded sufficient Proposition 64 “actual injury” to establish standing under the FAL and UCL. (*Id.*)

2. First Appellate District Confirms Principal-Agent Liability in False Advertising Matters

***People v. JTH Tax, Inc.*, 212 Cal.App.4th 1219 (2013)**

With specific reference to the false advertising law and the Unfair Competition Law, the First District Court of Appeal has affirmed that “the California Supreme Court has held that ‘section 17500 incorporates the concept of principal-agent liability’” (*Id.* at 1242.)

The California Attorney General sued JTH Tax (parent company of the Liberty Tax franchised system of tax preparers) for false advertising and related deceptive business practices. Defendant JTH attempted to avoid liability by disclaiming responsibility for the deceptive conduct of its franchisees. Defendant cited *People v. Toomey*, 157 Cal.App.3d 1 (1984), for the proposition that there is no vicarious liability under the UCL or false advertising law, and *Emery v. Visa International Service Assn.*, 95 Cal.App.4th 952 (2002), for the claim that California courts refuse to impose vicarious liability in UCL and false advertising cases when the relationship between the alleged principal and agent is remote.

The First District rejected those propositions. Since violations of the UCL “‘include any . . . unfair, deceptive, untrue or misleading advertising and any act prohibited by [section 17500],’ [the Supreme Court’s opinion in] *Ford Dealers* establishes that ‘persons can be found liable for misleading advertising and unfair business practices under normal

agency theory.’ To the extent that *Toomey*, supra, 157 Cal.App.3d 1, or *Emery*, supra, 95 Cal.App.4th 952, hold otherwise . . . these cases are mistaken.” (212 Cal.App.4th at 1242.)

The court also concluded that California civil liability for the acts of a corporation’s agents turns on the *right* of control, as well as the *actual* control, of those acts by the principal. Speaking in a franchising context, the court found that in California “[t]he general rule is where a franchise agreement gives the franchisor the right of complete or substantial control over the franchisee, an agency relationship exists. (2 Witkin, *Summary of Cal. Law* (9th ed. 1987) Agency and Employment, § 6, pp. 24–25). . . ‘The significant test of an agency relationship is the principal’s right to control the activities of the agent. [Citations.] It is not essential that the right of control be exercised or that there be actual supervision of the work of the agent; the existence of the right establishes the relationship.’” (212 Cal.App.4th at 1242.)

II. CALIFORNIA AND FEDERAL DEVELOPMENTS: PROCEDURAL LAW

A. Jurisdiction

1. U.S. Supreme Court Enforces Limits on “All Purpose” or “General” Jurisdiction

***Daimler AG v. Bauman*, __ U.S. __, 134 S.Ct. 746, 187 L.Ed.2d 624 (January 14, 2014)**

Bauman was an action brought on behalf of employees of MB Argentina, an Argentine subsidiary of Mercedes-Benz. The gravamen of the case was an allegation that MB Argentina collaborated with local security forces to detain and torture MB employees during that country’s “Dirty War” between 1976 and 1983. The action was filed in the U.S. District Court for the Northern District of California alleging wrongful death and intentional infliction of mental distress under California and Argentine law. The question on appeal was whether Daimler AG, the owner of Mercedes, had sufficient contacts with the California forum to allow review of the Argentine employees’ claims in the face of a Due Process challenge.

California is an important market for Mercedes-Benz, representing \$2 billion in revenue and 10% of all U.S. sales. Mercedes also had multiple California-based facilities, including a regional office in Costa Mesa, a Vehicle Preparation Center in Carson, and a Classic Center in Irvine. (*Bauman*, 187 L.Ed.2d at 631.)

However, writing for a near-unanimous Court, Justice Ginsberg concluded that, while the contacts with California were substantial, they did not give rise to “general jurisdiction,” as articulated in *Goodyear Dunlop Tires Operations S.A v. Brown*, 546 U.S. __, 131 S.Ct. 2846 (2011).² Reprising principles announced in *Goodyear*, the Court concluded that general jurisdiction, that is, jurisdiction not based on activities of alleged wrong-doing in the forum state, required more than substantial business activity in the forum state, but a showing that the defendant was “at home” in the forum state. A

2 *Goodyear* was discussed in the 2011 Developments program.

corporation is typically “at home” where it is incorporated or has its principal place of business. (*Bauman*, 187 L.Ed.2d at 639-641)

Justice Sotomayor agreed with the result but rejected Ginsberg’s analysis, arguing that for large, multi-national companies, substantial local activity should be enough to confer general jurisdiction on a forum state. (*Id.* at 643 *et seq.*)

2. In a Post-*McIntyre* Decision, the Third District Court of Appeal Concludes Canadian Company had Insufficient Contacts with California Forum

***Bombardier Recreational Prods., Inc. v. Dow Chemical Canada ULC*, 216 Cal. App.4th 157 (2013)**

In light of the U.S. Supreme Court’s splintered decision on special jurisdiction in *J. McIntyre Machinery Ltd. v. Nicastro*, ___ U.S. ___, 131 S.Ct. 2780 (2011)³, *Bombardier* provides a useful primer on special jurisdiction from the perspective of a California intermediate appellate court.

Bombardier arose from a cross-complaint for indemnity against Dow Chemical Canada for a fuel tank and fuel tank filler neck it manufactured that was implicated in a fire in a Sea-Doo watercraft built by Bombardier. Dow Canada had never had an agent for service of process in California, never manufactured any products in California, never had any employees, officers or other facilities in California, and never advertised or sold products in California or to customers in California. (*Bombardier*, 216 Cal.App.4th at 595.) Bombardier did not dispute these facts, but nonetheless argued that jurisdiction was proper because Dow had known that “Bombardier would incorporate its fuel tanks and fuel tank filler necks in personal watercraft it intended to sell in the United States, including California.” (*Ibid.*)

Both parties to the litigation invoked the *McIntyre* decision to support their respective claims. After reviewing the decision, the Third District Court of Appeal concluded that while “[s]ix justices of the United States Supreme Court now hold mere foreseeability that a product may enter a foreign state is insufficient to establish minimum contacts with the a forum state...the high court has not agreed on exactly what more besides foreseeability must be shown.” (*Bombardier*, 216 Cal.App.4th at 602.)

Given the limited usefulness of the *McIntyre* decision to guide its analysis, the court fell back on existing California law, albeit colored by the *McIntyre* precedent, writing:

We thus rely on the California Supreme Court’s most recent description of the purposeful availment requirement as our guide to resolving this case, understood in light of *J. McIntyre’s* holdings that mere foreseeability is insufficient to establish minimum contacts, and that the existence of jurisdiction is determined based on an individualized assessment of the facts. “The purposeful availment inquiry... focuses on the defendant’s intentionality [Citation.] This prong is only satisfied when the defendant purposefully and voluntarily directs [its] activities toward the forum so that [it] should expect, by virtue of the benefit it receives, to be subject

3 *McIntyre* was also discussed in the 2011 Developments program.

to the court's jurisdiction based on'[its] contact with the forum. (*Pavlovich, supra*, 29 Cal.4th at p. 269, quoting *U.S. v. Swiss American, Ltd.*) 274 F.3d 610, 623-624 (1st Cir. 2001.)

Applying California precedents, the Third District concludes that there were insufficient contacts between Dow Canada and California to support jurisdiction in a California court. (*Bombardier*, 2126 Cal.App.4th at 602.)

B. Class Actions

1. U.S. Supreme Court Denies Class Certification Because Damage Model Did Not Distinguish Between the Theory of Harm Adopted by the Trial Court and Plaintiffs' Alternate Theories

***Comcast Corp. v. Behrend*, __U.S.__, 133 S.Ct. 1426 (November 26, 2012)**

An ideologically divided U.S. Supreme Court concluded that plaintiffs in a putative class action against a national cable services provider failed to meet the requirements of Rule 23(b)(3) because plaintiffs' damage model did not distinguish among the effects of plaintiffs various theories of harm.

The basic allegation in the case was that defendant Comcast traded service areas with its competitors, resulting in high market shares for Comcast in some markets. The focus of this case was the effect of this "clustering" tactic in the Philadelphia area, where nine different trades resulted in an increase in Comcast's share from 23.9% to 69.5%.

Plaintiffs asserted four distinct theories of harm. At the certification stage, only one of these theories was accepted by the trial court. The issue that the Court focused on was the fact that the plaintiffs' economic expert had not distinguished the effects of the accepted theory of harm from the three rejected theories of harm.

Because the damage modeling did not map to the accepted theory of harm, and only that theory of harm, Justice Scalia, writing for a majority consisting of Chief Justice Roberts and Justices Kennedy, Thomas and Alito, opined that ". . . respondents' model falls far short of establishing that damages are capable of measurement on a classwide basis. Without presenting another methodology, respondents cannot show Rule 23(b)(3) predominance: Questions of individual damage calculations will inevitably overwhelm questions common to the class." (*Comcast*, 133 S.Ct. at 1432.)

This drew a stinging dissent from Justices Ginsburg and Breyer, joined by Justices Sotomayor and Kagan. First, the dissent argued that the majority had changed the question presented in mid-process, making the briefing largely irrelevant to the modified question presented. Second, the dissent scored the majority for misapprehending the actual modeling done by the plaintiffs' expert. Finally, the dissenters argued that this decision was "good for this case and this case only." (*Id.* at 1438.)

There are perhaps three takeaways from this decision. First, and most important, damage modeling must match the theory of harm. Given modern econometrics and regression techniques, this probably means a relatively simple adjustment for plaintiffs. Second, a pregnant footnote suggests that modeling must show effects in each area in which a restraint is alleged to have restrained trade. (*Id.* at 1435, n. 6.) The level of detail

suggested by this footnote may have long-term effects on class litigation of antitrust cases. Third, the Court reiterates that lower courts must inquire into merits issues if necessary to decide class certification issues. (*Id.* at 1432.)

2. Comcast Appears to Have Had Limited Impact on California Courts

***Leyva v. Medline Industries, Inc.*, 716 F.3d 510 (9th Cir. 2013)**

***Gaudin v. Saxon Mortgage Services, Inc.*, 2013 U.S. LEXIS 110727 (N.D. Cal., August 5, 2013)**

***Barbosa v. Cargill Meat Solutions Corp.*, 2013 U.S. LEXIS 93194 (E.D.Cal., July 2, 2013)**

Leyva was a class action brought on behalf of hourly workers who were allegedly denied overtime pay, and subjected to waiting time penalties. The Ninth Circuit concluded that *Comcast* was not apposite because, “unlike in *Comcast*, if putative class members prove Medline’s liability, damages will be calculated based on the wages each employee lost due to Medline’s unlawful practices.” (*Leyva*, 716 F.3d at 514.)

Gaudin was a class action challenge to the alleged failure of a financial institution to reform home mortgages consistent with post-financial crisis reforms. In response to defendant’s invocation of *Comcast*, the court simply distinguished the case, noting that “Plaintiff proposes no calculations that would assess damages on the basis of dismissed or abandoned theories of liability.” (*Gaudin*, 2013 U.S. Dist. LEXIS 110727 at *30.)

Barbosa is another wage and hour case, but reviewed in the context of settlement approval. In a footnote, the court observes that plaintiffs argued that in this case, “unlike *Behrend*, there is no damages model that improperly measures a broader pool of damages that conflict with a more narrowly defined class.” On this basis, the court concludes *Behrend* does not bar the settlement. (*Barbosa*, 2013 U.S. Dist. LEXIS 93149 at *27, n. 2.)

3. Two U.S. Supreme Court Decisions Enforce Letter of Arbitration Agreements

***Oxford Health Plans v. Sutter* __ U.S. __, 133 S.Ct. 2064 (2013)**

***American Express v. Italian Colors Restaurant* __ U.S. __, 133 S.Ct. 2304 (2013)**

In two important cases, the Supreme Court applies contract principles to the determination of the scope and effect of contractual arbitration agreements. Although the two cases are largely defense wins, the cases underscore the need for clarity in drafting arbitration agreements.

In *Oxford Health*, a physician had signed an arbitration agreement with a health insurer. He filed a class action several years later on behalf of himself and a class of other physicians asserting that Oxford had not paid claims fully and promptly. Defendant moved to compel arbitration, and the court referred the matter to arbitration. The agreement between Dr. Sutter and Oxford Health precluded “any civil action,” and required that all disputes were subject to “final and binding arbitration.” The parties agreed that the arbitrator could decide whether the agreement provided for class arbitration. Reviewing

the language of the agreement, the arbitrator concluded that “any civil action” included a class action, so class arbitration was authorized.

Oxford filed a motion under § 10(a)(4) of the Federal Arbitration Act, asserting that the arbitrator had exceeded his authority. Writing for a unanimous Court, Justice Kagan noted that, “[u]nder the FAA, the courts may vacate an arbitrator’s decision “only in very unusual circumstances.” [citation omitted]. (*Oxford Health*, 133 S.Ct. at 2068.) Those circumstances were not found here. Distinguishing a case relied on by Oxford, *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.* 559 U.S. 662 (2010), the Court found that:

In *Stoldt-Nielsen*, the arbitrators did not construe the parties’ contract, and did not identify any agreement authorizing class proceedings. So in setting aside the arbitrators’ decision, we found not that they had misinterpreted the contract, but had abandoned their interpretive role. Here, the arbitrator did construe the contract (focusing, per usual, on its language), and did find an agreement to permit class arbitration. So to overturn his decision, we would have to rely on a finding that he misapprehended the parties’ intent. But § 10(a)(4) bars that course. (*Oxford Health*, 133 S.Ct. at 2069.)

In *American Express*, an ideologically split court determined that the language of an arbitration agreement trumped consumer interests in an efficient remedy. Writing for the conservative majority, Justice Scalia concluded that merchants who signed an arbitration agreement with American Express could not escape its prohibitions against seeking judicial remedies for alleged antitrust violations. According to Justice Scalia: “No contrary congressional command requires us to reject the waiver of class arbitration here. Respondents argue that requiring them to litigate their claims individually—as they contracted to do—would contravene the policies of the antitrust laws. But the antitrust laws do not guarantee an affordable procedural path to vindication of every claim.” (*American Express*, 133 S.Ct. at 2309.)

A dissent authored by Justice Kagan, joined by Justices Ginsburg and Breyer,⁴ summarized the effects of the majority’s opinion as follows:

Here is the nutshell version of this case. . . The owner of a small restaurant (Italian Colors) thinks that American Express (Amex) has used its monopoly power to force merchants to accept a form of contract violating the antitrust laws. The restaurateur wants to challenge the allegedly unlawful provision (imposing a tying arrangement), but the same contract’s arbitration clause prevents him from doing so. That term imposes a variety of procedural bars that make pursuit of the antitrust claim a fool’s errand. So if the arbitration clause is enforceable, Amex has insulated itself from antitrust liability—even if it has in fact violated the law. The monopolist gets to use its monopoly power to insist on a contract effectively depriving its victims of all legal recourse. (*American Express*, 133 S.Ct. at 2313.)

This is a sweeping win for American Express. Given the majority’s apotheosis of freedom of contract principles over consumer protection concerns, this case suggests that companies should review their strategic use of arbitration agreements. In light of *Oxford*, these agreements must be drafted with care, but the pay-off can be substantial.

4 Justice Sotomayor did not participate in this decision.

4. U.S. Supreme Court Decides that an Attorney General’s Enforcement Action Is Not a “Mass Action” Within the Meaning of CAFA

***Mississippi ex rel. Hood v. AU Optronics*, ___ U.S. ___, 134 S.Ct. 736, 187 L.Ed.2d 654, 2014 U.S. LEXIS 645 (January 14, 2014)**

Mississippi Attorney General Jim Hood brought an enforcement action in state court against an alleged price-fixer under his state’s antitrust and consumer protection statutes. Hood sought, among other forms of relief, restitution for Mississippi citizens who had purchased allegedly price-fixed liquid crystal displays or LCD-containing products. Hood, as a representative of his state, was the only named plaintiff.

On the basis of defendant’s argument that since the number of citizens who might receive restitution was numerous, his case was characterized a “mass action” within the meaning of the Class Action Fairness Act (28 U.S.C. §1332(d)(1)(B)), and removed to federal court.

Justice Sotomayor, writing for a unanimous Court, concluded that the plain text of the statute did not support the conclusion that a state enforcement action brought by a single plaintiff was subject to CAFA.

According to the Court, since the “mass action” definition in the statute spoke in terms of 100 or more “plaintiffs”, it did not cover real parties in interest, like citizens who bought LCDs. The Court tested its conclusion by asking what a trial court would have to do in order to determine the real parties in interest in such cases, and found that exercise “surpassingly difficult.” By contrast, if “plaintiff” meant plaintiff—a party in a legal action—the statute evinces a “straightforward, easy to administer rule under which a court would examine whether the plaintiffs have pleaded in good faith the requisite amount.” (*AU Optronics*, 187 L.Ed.2d at 666.)

Since California has laws analogous to those employed by General Hood, this decision has important California implications. Strategically, it guarantees that enforcement actions such as those under the UCL brought by California’s attorney general, California DA’s and some city attorneys will stay in state court, even if such actions seek restitution for thousands (or millions) of citizens.

5. U.S. Supreme Court Holds that Class Plaintiff Cannot Stipulate to Damages of Less than \$5 million to Avoid CAFA

***Standard Fire Ins. Co. v. Knowles*, ___ U.S. ___, 133 S.Ct. 1345 (2013)**

Plaintiff filed a class action in state court in Arkansas challenging a standard provision in a widely sold insurance product. Plaintiff averred that potentially “thousands” of people could be affected by the suit. But apparently in order to avoid the \$5 million trigger for the Class Action Fairness Act, plaintiff agreed to limit his damage claims to less than \$5 million.

Justice Breyer, writing for a unanimous court, rejected this tactic. The Court noted that “a plaintiff who files a class action cannot legally bind members of the proposed class

before the class is certified.” (*Standard Fire*, 133 S.Ct. at 1349.) Therefore, the proposed stipulation did not bind anyone but the named plaintiff.

The Court concluded that:

We do not agree that CAFA forbids federal courts to consider, for purposes of determining the amount in controversy, the very real possibility that a nonbinding, amount-limiting, stipulation may not survive the class certification process. This potential outcome does not result in the creation of a new case not now before the federal court. To hold otherwise would, for CAFA jurisdictional purposes, treat a nonbinding stipulation as if it were binding, exalt form over substance, and run counter to CAFA’s primary objective: ensuring “Federal court consideration of interstate cases of national importance. [citation omitted].

(*Id.* at 1350.)

6. Ninth Circuit Rewards Facially Inconsistent Pleadings in CAFA decision

***Visendi v. Bank of America*, 733 F.3d 863 (9th Cir. 2013)**

Plaintiffs were over 100 individuals allegedly injured by various financial firms through deceptive mortgage lending and securitization practices. Plaintiffs’ action was initially filed in state court. Upon removal, defendant successfully argued that plaintiffs’ action was a “mass action” within the meaning of CAFA because it was a civil action containing “monetary relief claims of 100 or more persons proposed to be tried jointly on the grounds that the plaintiffs’ claims involve common questions of law or fact.” (28 U.S.C. § 1332(d)(11)(B)(i).) Once before the U.S. District Court, however, defendants challenged the joinder of plaintiffs because their claims had no common elements. Although the district court characterized this sequence of filings as “gamesmanship and bad faith,” (*Visendi*, 733 F.3d at 868.), the Ninth Circuit ultimately agreed with defendants.

The Ninth Circuit reasoned that jurisdiction to transfer the case from state court to federal court was proper because a mass action under CAFA is one in which a joint action is “*proposed* to be tried jointly on the ground that the plaintiffs’ claims involve common questions of law or fact.” This predicate for jurisdiction was supplied by plaintiffs’ complaint. (*Visendi*, 733 F.3d at 868.)

Once before the district court, according to the Ninth Circuit, it was proper for the trial court to determine whether the complaint met the two-part requirement for permissive joinder under Fed.R.Civ.P. 20(a), specifically that (1) the plaintiffs assert a right . . . arising from the same transaction and occurrence, and (2) some question of law or fact is common to all plaintiffs. Concluding that individual plaintiffs had disparate claims arising from different transactions, the court concluded that the requirements of Rule 20 were not met, (*Id.* at 870.), and ordered remand with instructions for the trial court to dismiss all plaintiffs except the lead plaintiff, Carla Visendi. (*Id.* at 871.)

7. Ninth Circuit Reverses Class Action Settlement Because Incentive Awards to Class Representatives Contingent on Support of Settlement

***Radcliffe v. Experian Information Solutions, Inc.*, 715 F.3d 1157 (9th Cir. 2013)**

Radcliffe involved the settlement of a class action against credit rating agencies that issued negative credit reports after debts were discharged or settled. Class representatives were to receive incentive payments, which are ordinarily allowed, but in this case the incentive payments were contingent on support for the settlement. The court concluded that such payments, “corrupt the settlement by undermining the adequacy of the class representatives and class counsel.” (*Radcliffe*, 715 F.3d at 1164.) Because of this problem, the Ninth Circuit held that approval by the district court of the settlement was an abuse of discretion and the case remanded for further proceedings consistent with the opinion. (*Id.* at 1168.)

C. Discovery

1. Southern District Orders Cost-Shifting for Overbroad E-Discovery Request

***Connecticut Gen. Life Ins. Co. v. Earl Scheib, Inc.*, 2013 U.S. Dist. LEXIS 16234 (S.D.Cal., February 6, 2013)**

Plaintiff claimed \$119,515.49 in damages. However, in discovery, plaintiff sought an estimated 219 gigabytes of electronically stored information. Defendant estimated that the costs of responding to this request would be \$121,000, not counting attorney review time.

Applying an earlier Northern District decision, *OpenTV v. Liberate Technologies*, 219 F.R.D. 309, 318 (N.D.Cal. 2003), the court decided that cost-shifting was appropriate. It concluded that “if plaintiff believes that this information is important to its case, then plaintiff can perform its own cost-benefit analysis and determine whether it wants to fund the discovery.” (*Connecticut General*, 2013 U.S. Dist. LEXIS 16234 at *10.)

2. Antitrust Division Opens Door to Use of Predictive Coding

Last year, the Southern District of New York issued the first decision approving the use of predictive coding in a litigated case, *Da Silva Moore v. Publicis Groupe S.A.* 2012 U.S. Dist. LEXIS 58742 (S.D.N.Y., Feb. 24, 2012). Soon after this decision, the *Wall Street Journal* reported that the Antitrust Division was already giving parties the opportunity to use predictive coding strategies to produce documents in selected matters, saving as much as 50% on the costs of production. (J. Palazzola, *Software: The Attorney Who Is Always on the Job*, Wall St. J., May 6, 2013, at <http://online.wsj.com/news/articles/SB10001424127887324582004578460860324234712>.)

In a major speech a few days later, Deputy Assistant Attorney General Renatta Hesse reported:

Another innovation we have been testing over the past several years to help streamline our process is allowing parties to use predictive coding in their document productions. When it works well, predictive coding reduces the

document review and production burden on parties while still providing the division with the documents it needs to fairly and fully analyze transactions and conduct. Of course, for predictive coding to work for the division, we require a high degree of cooperation and transparency about the implementation and structure of the predictive coding process. That being said, we have allowed parties to use predictive coding in some matters already.

(Renatta Hesse, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, IP, Antitrust and Looking Back on the Last Four Years, Address at the Global Competition Review (February 8, 2013), at <http://www.justice.gov/atr/public/speeches/292573.pdf>.)

Given the dramatically lower cost of predictive coding, this is a significant development for those practicing before or against the Antitrust Division.

3. California Legislature Amends CCP to Clarify When Waiver Occurs After Receipt of Discovery Response

AB 1183 (Jones), codified at Cal. Civ. Proc. §§ 2030.300, 2031.310 & 2033.290

Pre-existing law provided 45 days from the receipt of a response to interrogatories, a demand for documents or requests for admissions within which to move to compel a further response. In the event that no motion to compel is filed within that period, the receiving party is deemed to have waived any right to compel any further response.

This legislation keeps the 45-day rule of repose, but the trigger is receipt of “a *verified* response or supplemental *verified* response.” This language is added to CCP provisions relating to specific discovery tools:

Civ. Proc. § 2030.300(c) (Interrogatories)

Civ. Proc. § 2031.310(c) (Demands for Inspection)

Civ. Proc. § 2033.290(c) (Requests for Admissions)

D. Expert Opinion

1. Post-Sargon Decisions Illuminate Gatekeeper Role of State Judges

Sargon Enterprises, Inc. v. University of Southern California, 55 Cal.4th 747 (2012)
Garrett v. Howmedica Osteonics Corp., 214 Cal.App.4th 173 (2nd DCA, 2013)
Corenbaum v. Lampkin, 215 Cal.App.4th 1308 (2nd DCA, 2013)

In its 2012 *Sargon* decision, the California Supreme Court reinvigorated the role of state judges as gatekeepers for expert testimony. Relying on the text of both sections 801 and 802 of the California Evidence Code, the *Sargon* court clarified and strengthened the power of state judges to exclude expert testimony or opinion that does not meet minimum standards of reliability. *Sargon* is not a decision adopting federal *Daubert* jurisprudence; indeed, the Court explicitly notes that its decision neither alters California’s “general

acceptance” test nor its rejection of *Daubert* in *People v. Leahy*, 8 Cal.4th 587 (1994). (*Sargon*, 55 Cal.4th at 772, n.6.) Rather, the Court concluded:

Thus, under Evidence Code sections 801, subdivision (b) and 802, the trial court acts as a gatekeeper to exclude expert opinion testimony that is (1) based on matter of a type on which an expert may not reasonably rely, (2) based on reasons unsupported by the material on which the expert relies, or (3) speculative. Other provisions of law, including decisional law, may also provide reasons for excluding expert opinion testimony.

(*Id.* at 771-72.)

The Court warned that California trial courts “must also be cautious in excluding expert testimony” and that “[t]he goal of trial court gatekeeping is simply to exclude ‘clearly invalid and unreliable’ expert opinion [citation omitted]. (*Id.* at 772.) Applying its new rule to the facts before it, the Court sustained exclusion of a plaintiff’s expert’s lost profits analysis because of its Herculean assumption that plaintiff’s small company would grow into a world leader in a short time.

Subsequent DCA opinions begin to illuminate what this new standard means in state trial courts. Perhaps the most important takeaway is that the gate can swing both ways under *Sargon*. In *Howmedica Ostionics*, the Second DCA reversed a trial court decision excluding an expert affidavit in a product liability case. There, plaintiff’s expert, a metallurgist, averred that part of a replacement femur included titanium pieces, rather than much stronger chrome molybdenum steel parts, resulting in failure of the femur-replacement within two years of implantation. The trial court excluded the expert’s affidavit in a response to a summary judgment motion because the expert (i) did not name the specific tests he employed to determine the strength of the materials in the limb, and (ii) did not identify the ASTM hardness standard that the softer pieces of the limb did not meet.

The Court of Appeal quoted the expert’s report in which he said that he used “visual examination, optical microscopic examination, x-ray radiography, fluorescent dye penetrant examination, scanning electronic, microscopy, and such destructive testing as hardness testing, micro hardness testing, microstructural analysis, and chemical analysis.” *Howmedica Ostionics*, 214 Cal.App. 4th at 187.) The DCA determined that the expert’s “failure to more particularly describe the results of that testing do not in any manner indicate that his conclusions are speculative, conjectural or lack a reasonable basis.” (*Ibid.*) This conclusion was buttressed by the requirement that a court must “liberally construe the evidence submitted in opposition” to a summary judgment motion. (*Id.* at 189.)

On the other hand, the same DCA sustained exclusion of proffered expert opinion in *Lampkin*. In this personal injury case, the issue was the use of the undiscounted costs of medical care. The court concluded that, “evidence of the full amounts billed for [plaintiffs’], medical care was not relevant to the amount of their damages for past medical expenses, future medical expenses, and it was not offered in evidence for any other purpose.” (*Lampkin*, 215 Cal.App.4th at 1333.) Since the evidence was not properly admissible, the expert opinion using this evidence was properly excluded under *Sargon*.

Sargon and its progeny give new powers to state judges to exclude expert opinion that is either speculative or contrary to public policy. At the same time, it seeks to preserve the role of juries in assessing testimony, including expert testimony, in most cases. The line between what is properly before a jury and what is not is still being determined, but these cases represent an important development for practitioners before state courts.

E. California Supreme Court Revamps Parol Evidence Rule

***Riverisland Cold Storage v. Fresno-Madera Prod. Credit Assn.*, 55 Cal.4th 1169 (2013)**

This decision revamps California's historic approach to the use of parol evidence with respect to fraud claims. Indeed, *Riverisland* rejects a 78-year-old decision that substantially limited the use of extrinsic evidence to support fraud allegations in a contract dispute, *Bank of Am. Assn. v. Pendergrass* (1935) 4 Cal.2d 258.

The essential facts in *Riverisland* were that a couple fell behind on loans totaling over \$775,000 on two ranches. The lender agreed to hold off on foreclosure if the couple (1) made specified payments, and (2) pledged several additional properties as collateral. The couple failed to make all of the required payments and the lender recorded a notice of default on *all* of the pledged properties.

Eventually, the couple repaid their loans and foreclosure proceedings ceased. The couple then sued the lender for fraud, asserting that the lender's vice-president had assured them that (1) the lender would extend their loan for two years in exchange for the additional collateral, and (2) *only* the original *two* properties would be foreclosed upon in the event of default.

California's parol evidence rule is codified in Code of Civil Procedure section 1856. This establishes the familiar rule that the terms of a written contract cannot be trumped by extrinsic evidence. However, subsection (f) provides a broad exception to this general rule with respect to issues of formation (as opposed to the terms of a contract). This subsection provides that: "Evidence to prove that the instrument is void or voidable for mistake, fraud, duress, undue influence, illegality, alteration, lack of consideration, or another invalidating cause is admissible. The evidence does not contradict the terms of an effective integration, because it shows that the purported instrument has no legal effect." (Code of Civ.Proc. § 1856(f).)

Although the language of subsection (f) is broad, the *Pendergrass* court required evidence that "must tend to establish some independent fact or representation, some fraud in the procurement of the instrument or some breach of confidence concerning its use, and not a promise directly at variance with the promise of the writing." (*Pendergrass*, 4 Cal.2d at 263 (emphasis added).)

This judicial gloss was both hard to apply and arguably protected fraudulent practices from review. (*Riverisland*, 55 Cal.4th at 1177.) Indeed, in overturning the *Pendergrass* rule, the Court, quoting Corbin on Contracts, wrote that:

The best reason for allowing fraud...to be proven extrinsically is the obvious one: [i]f there was fraud it is unlikely that it was bargained over or will be recited in the document. To bar extrinsic evidence would be to make the parol evidence rule a shield to protect misconduct or mistake.

(*Ibid.* (citation omitted).)

With the *Pendergrass* rule out of the way, the Court decided that extrinsic evidence could be used to prove fraud, but underscored that:

... the intent element of promissory fraud entails more than proof of an unkept promise or mere failure of performance. We note also that promissory fraud, like all forms of fraud, requires a showing of justifiable reliance on the defendant's misrepresentation.

(*Id.* at 1183.)

This decision harmonizes California law with the law of most other jurisdictions, the Restatement of Contracts and the text of the Code of Civil Procedure. For California businesses and law firms, this means that negotiators have to be far more careful with oral statements. For us, this new rule opens up either a new avenue of potential liability or a new vulnerability to discuss with clients. This is a major decision that warrants special review.

F. New Rules and Regulations

1. FTC Clarifies H-S-R Reporting Requirements for Pharmaceuticals and Increases Reporting Threshold to \$75.9 Million

Federal Trade Commission, Premerger Notification, Reporting and Waiting Period Requirements, 78 Fed.Reg. 68705 (November 15, 2013) (to be codified at 16 C.F.R. Part 801)

Federal Trade Commission, Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 79 Fed.Reg. 3814 (January 23, 2014)

The Federal Trade Commission, with the concurrence of the Antitrust Division, has amended the regulations for the Hart-Scott-Rodino Act to clarify reporting requirements for pharmaceuticals. The problem addressed by the new rule is when should transfer of some—but not all—rights in a patented pharmaceutical be reportable under the Act. Under the amended rule, a reporting obligation exists if there is an acquisition of “all commercially significant rights” in a patented pharmaceutical. “The rule clarifies that, in the pharmaceutical industry, a patent licensing arrangement constitutes an asset acquisition if it transfers all commercially significant rights to the patent in a particular therapeutic area or specific indication within a therapeutic area.” (78 Fed.Reg. at 68707.) The notice specifically states that the new rule “ensures that transactions in which the licensor retains only the right to manufacture exclusively for the licensee...will be reported if the relevant HSR statutory threshold are met. (*Ibid.* at 68708.)

On January 17, 2014, the FTC announced that the H-S-R reporting threshold under Section 7A(a)(2)(B)(i) of the Clayton Act will be increased from \$70.9 million to \$75.9 million for 2014. This new threshold will become effective on February 24, 2014.

2. HIPPA Regulations Impose Privacy Requirements on Additional Entities, Including Law Firms.

Department of Health and Human Services, Modifications to the HIPPA Privacy, Security, Enforcement and Breach Notification Rules, 78 Fed.Reg.5566 (January 25, 2013)

The Department of Health and Human Services issued new rules in January imposing additional requirements on businesses, including law firms, that handle confidential health records. Major changes include:

- Makes “business associates” of already covered entities directly liable for compliance with privacy requirements under the Health Insurance Portability and Accountability Act (HIPPA)
- Strengthens limitations on the use and disclosure of protected health information
- Requires specified notice of breaches of protected health information
- Imposes penalties for violation of the new rule

The Notice of Final Rule is 138 pages long, with detailed standards for properly and legally managing protected health information. If your client or firm handles such information, this is a must-read rule.

3. U.S. International Trade Commission Amends its Procedural Rules

Rules of General Application and Adjudication and Enforcement, 78 Fed.Reg. 23474 (April 19, 2013)

The International Trade Commission has issued new rules regulating its adjudicatory procedures. Major changes include:

- Content of a complaint. (19 C.F.R. §210.12.)
- Default and types of relief available. (19 C.F.R. §210.15.)
- Limitation of depositions to no more than five fact depositions per respondent but no more than twenty fact depositions. (19 C.F.R. §210.28.)
- Limitations of written interrogatories that any party may serve upon any other party to not more than 175 interrogatories, including subparts. (19 C.F.R. §210.29.)
- Initial determinations by the ALJ. (19 C.F.R. § 210.42.)
- Commission action. (19 C.F.R. §210.50.)

4. Amendments to the Federal Rules

In mid-2013, the Supreme Court transmitted proposed changes in the Federal Rules of Procedure, the Federal Rules of Evidence and the Federal Rules of Evidence to Congress. These amendments became effective on December 1, 2013 because Congress did not disapprove or alter them. Relevant changes follow:

a. Federal Rules of Civil Procedure

Rule 37, relating to disclosures and cooperation in discovery, and Rule 45, relating to subpoenas are both amended.

The changes in Rule 45 are the more important. Key elements include:

In an effort to streamline the rule, all of the compliance provisions are combined into a new subsection Rule 45(c).

Rule 45(c)(2)(A) now provides for production “within 100 miles of where the person [subject to the subpoena] resides, is employed or regularly transacts business in person.”

The Committee Note makes clear that a subpoena is not required for depositions of parties, party officers, directors or managing agents.

The new rule disapproves a line of cases starting with *In re Vioxx Prod. Liab. Lit.*, 438 F.Supp.2d 664. (E.D.La. 2006) (requiring an officer of a defendant corporation, who lived and worked in New Jersey, to testify in New Orleans even though he was not served within Louisiana under Rule 45(b)(2)). New Rule 45(c)(1) now specifies that a subpoena may command any person to testify, but only within the limits that apply to all witnesses.

Rule 37(b)(1) receives a conforming amendment providing that:

If a deposition-related motion is transferred to the court where the action is pending, and the court orders a deponent to be sworn or to answer a question and the deponent fails to obey, the failure may be treated as contempt in either the court where the discovery is taken or the court where the action is pending.

b. Federal Rules of Evidence

Rule 803(10), relating to the hearsay exception for a certification of the absence of a public record, is amended to take into account the Supreme Court’s decision in *Melendez-Diaz v. Massachusetts* 557 U.S. 305 (2009). *Melendez-Diaz* held that the introduction of a certificate of lack of a public record in a criminal case was “testimonial,” thus requiring a live witness in order to avoid a Confrontation Clause challenge. The amended rule provides a notice-and-demand process that cures this problem. The new rule requires a prosecutor who intends to use a certificate to notify the defense at least 14 days before trial of the proposed use of a certificate from a custodian in lieu of live testimony, and requires the defense to object 7 days before trial. If the defense does not timely object under this procedure, the *Melendez-Diaz* live testimony requirement is waived.

c. Federal Rules of Appellate Procedure

In a victory for good writing, Federal Rule of Appellate Procedure 28 is amended to create a new “statement of the case,” bringing together in a single section a statement of facts and a procedural history. Amended Rule 28(a)(6) requires “a concise statement of the case setting out the facts relevant to the issues submitted for review, describing the relevant procedural history, and identifying the rulings presented for review, with appropriate references to the record.” An Advisory Committee Note will indicate that subheadings may be used.

5. Amendments to the California Rules of Court

The Judicial Council adopted amendments to the California Rules of Court concerning electronic filing in a series of amendments to Rules 2.250 – 2.259. Key changes include:

Rule 2.251(b) allows parties to agree to electronic service of documents.

Rule 2.253(b) gives courts broad authority to order electronic service in:

- Specific cases
- Cases assigned to a specific department or courthouse
- Broad categories of cases, including all civil cases or all complex cases

Rule 2.259 makes clear that “documents received electronically before midnight on a court day are deemed filed on that day, and documents received after midnight are deemed filed on the next court day.”

These amendments became effective on July 1, 2013.

G. Other Developments

1. Ninth Circuit Begins Audio and Video Streaming of Arguments

Starting in mid-December 2013, the Ninth Circuit began video streaming *en banc* arguments from its San Francisco courthouse. Jonny Bonner, “Live Internet Streaming Coming to the 9th Circuit,” Courthouse News Service (December 3, 2013), at <http://www.courthousenews.com/2013/12/03/63396.htm>. This was the first time a federal appellate court used its technology to deliver live video of its proceedings over the Internet. (The Ninth Circuit has made available video streams of *en banc* arguments at its various courthouses since 2010.) *En banc* cases streamed during December 2013 can be found at: http://www.ca9.uscourts.gov/content/view.php?pk_id=0000000710.

On January 2, 2014, the court announced that it would provide live audio streaming of *all* of its proceedings. Internet users can listen to proceedings online by visiting <http://www.ca9.uscourts.gov/>, and clicking on links listed under “Live Oral Arguments.”

Digital audio and video files of prior arguments are available at <http://www/ca9.uscourts.gov/media/>

2. Federal Judicial Center Issues Benchbook for Federal Trial Judges

Federal Judicial Center, *Benchbook for U.S. District Court Judges* (6th ed. 2013) at [http://www.fjc.gov/public/pdf.nsf/lookup/Benchbook-US-District-Judges-6TH-FJC-MAR-2013-Public.pdf/\\$file/Benchbook-US-District-Judges-6TH-FJC-MAR-2013-Public.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/Benchbook-US-District-Judges-6TH-FJC-MAR-2013-Public.pdf/$file/Benchbook-US-District-Judges-6TH-FJC-MAR-2013-Public.pdf).

On the theory that it is useful to read what your judge is reading, you may wish to review the most recent edition of the Federal Judicial Center’s *Benchbook for U.S. District Court Judges*. This new edition contains a detailed discussion of effective management of

Brady material in federal criminal cases as well as best practices for pre-trial proceedings, among other topics. This is available as a free download from the Federal Judicial Center.

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