



# competition

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

Chair's Column  
Thomas N. Dahdoun

Editor's Column  
Heather S. Tewksbury

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*Recent Developments in  
Competition and Antitrust Law*

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Law Section of the State Bar of California

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## CHAIR'S COLUMN

Thomas N. Dahdouh<sup>1</sup>  
Federal Trade Commission  
San Francisco, CA

With thanks to the authors, editors and other contributors, our Section is pleased to present you with another edition of *Competition*. A variety of articles and viewpoints are provided on important antitrust and unfair competition law topics. Our editor-in-chief, **Heather Tewksbury**, for whom special thanks is due, provides an overview of this edition in her Editor's Column below.

In addition to publications, our Section promotes education via professional programs. Our flagship program is the **Golden State Institute (GSI)**, a daylong conference followed by an evening event honoring the Antitrust Lawyer of the Year. **This year's GSI will be held on Thursday, October 29, 2015, at the historic Julia Morgan Ballroom in San Francisco, California.**

Expect a top-notch program with leading plaintiff and defense practitioners, government enforcers, and state and federal judges serving as speakers and panelists. A highlight will be an insightful conversation with the **Chief Justice of the California Supreme Court Tani Cantil-Sakauye**.

Following the panels, we will honor **Craig Corbitt** as our **2015 Antitrust Lawyer of the Year**. Craig Corbitt has been an antitrust litigator for over 35 years. He has been centrally involved in dozens of the most significant civil antitrust cases in the United States during his career. He has represented class plaintiffs in the **LCD Flat Panel, Natural Gas, De Beers, Microsoft, Smokeless Tobacco, and Brand Name Prescription Drugs** cases among many others. Craig Corbitt is a former Chair of the California State Bar Antitrust and Unfair Competition Law Section, and is a Member of the Advisory Board of the American Antitrust Institute. We congratulate Craig.

Please join us for GSI 2015 and the award dinner honoring Craig on October 29th. It will be a special event, from start to finish. More information will be available in Section email updates and on the website, <http://antitrust.calbar.ca.gov/Antitrust/LawyeroftheYear.aspx>

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

## EDITOR'S NOTE

Heather S. Tewksbury

Wilmer Cutler Pickering Hale & Dorr LLP

Palo Alto, CA

Recent Developments in Unfair Competition –  
From groundbreaking legal issues to blockbuster trials.

This issue of *Competition* not only provides a survey of developments in Antitrust and Unfair Competition law from the past year, but also focuses on discrete issues arising out of the blockbuster trials and litigation of 2014.

Starting the issue off is a comprehensive discussion by **Tom Greene** and **Tom Papa-george** on several key developments in California substantive law and federal and state procedural law relating to competition issues. The Section's Chair, **Tom Dahdouh**, follows up with a focused discussion on finding the best test to evaluate exclusionary conduct under Section 2 of the Sherman Act. Also, **Cheryl Johnson** and **Kathleen Tuttle** reprise the keynote address given at the premier West Coast antitrust event, the Golden State Antitrust Institute, by the **Honorable Kathryn Mickle Werdegar**, Justice of the California Supreme Court.

Last year's GSI also offered a series of roundtable discussions on the groundbreaking verdicts and legal issues of 2014. This issue reprises those roundtables and also provides a focused discussion on key substantive legal issues arising out of that litigation.

- In 2012, Bazaarvoice, a leading provider of product ratings and review software and services, finalized its acquisition of its rival, PowerReviews. The U.S. Department of Justice opened an investigation into that acquisition, which eventually led to a three week trial before Northern District Judge William H. Orrick, and a victory for the government. **Karen Silverman**, Managing Partner of Latham & Watkins San Francisco office, moderates a discussion between **Peter Huston**, lead trial counsel for the government, **Boris Feldman**, co-lead trial counsel for defendant Bazaarvoice, and **Arthur Burke**, a litigation partner with Davis Polk.
  - In a companion article, **Gregory Werden**, Senior Economic Counsel in the Antitrust Division of the U.S. Department of Justice, discusses the use of customer testimony on future anticompetitive effects in Clayton Act merger trials.
- Also in 2012, St. Luke's Health System acquired Saltzer Medical Group. After a four week trial in district court in Idaho, Judge Lynn Winnmill, held that the acquisition violated the Clayton Act and other state laws. **Paul Riehle**, partner and practice group co-chair at Sedgwick and Vice Chair of GSI, moderates a panel discussion with the FTC's lead trial lawyer, **Thomas Greene**, and lead defense counsel, **Jack Bierig**.
  - Relatedly, **Ari Bassar**, weighs in with an article on the vitality of the divestiture remedy ordered by the court and the potential burden the merging

parties bear to proffer evidence of the pro-competitive effects of the challenged transaction.

- Observers at GSI also experienced a lively discussion about litigation surrounding the antitrust exemption in the Major League Baseball matter. This issue offers opposing viewpoints in two exceptional articles:
  - **John Cooper** and **Racheal Turner** argue that the federal courts, including the Supreme Court, must defer to Congress's determination in the Curt Flood Act that baseball should generally continue to be exempt from the antitrust laws, and explains that only Congress can change the exemption.
  - **Phil Gregory** and **Don Polden** offer a different view. Their article discusses several reasons why the Supreme Court can and should abrogate the exemption and clearly define the scope of the nation's competition policies and antitrust laws on the business of baseball.
- A new and fascinating panel discussion at last year's GSI related to privacy and the question of whether enforcement agencies and private litigation can ensure online information will remain safe and private. **Niall Lynch**, partner at Latham & Watkins, moderated a discussion between **Laura Berger**, an attorney in the Division of Privacy and Identity Protection at the FTC, **Adam Miller**, supervising Deputy Attorney General for the Privacy Enforcement and Protection Unit of the California Attorney General's office, **Ara Jabaghourian**, partner at Cotchett, Pitre & McCarthy, and **Jim Snell**, partner at Perkins Coie.
  - In a companion article, **Matthew George**, explores some of the key claims and legal issues that have emerged in recent lawsuits brought over consumer privacy issues.
  - **Joseph Tiffany**, **Connie Wolfe**, and **Allen Briskin**, discuss recent treatment by Californian courts of the California Confidentiality of Medication Information Act.
  - In an article that analyzes traditional litigation behind data breaches and public enforcement, **Evan Wooten** explores what states and the federal government have done in response to high profile data breaches and important developments in the case law.

The issue concludes with a discussion by **Stephen McIntyre** and past Section Chair, **Ken O'Rourke**, on the issue of the statute of limitations and the continuing violations doctrine. The authors argue that the exception to the Clayton Act's Statute of Limitations swallows the rule.

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# CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW AND FEDERAL AND STATE PROCEDURAL LAW DEVELOPMENTS

By Thomas Greene and Thomas A. Papageorge<sup>1</sup>

## I. INTRODUCTION

This article provides a selection of litigation developments that may be of particular importance to members of the Antitrust and Unfair Competition Section. The first part of this article presents cases that reflect recent California substantive law developments related to the Cartwright Act, covenants not to compete, the Consumer Legal Remedies Act, the Unfair Competition Law, and false advertising law. The second part of this article provides federal and California procedural law developments in the areas of forum, the Foreign Trade Antitrust Improvements Act, discovery, class actions, evidence, settlements, appeals, patent law, ethics, and developments abroad. This latter part also provides a selection of relevant new rules and other notable developments. Please consult other references for all of the developments that may be important to your practice.

## II. CALIFORNIA DEVELOPMENTS: SUBSTANTIVE LAW

### A. Cartwright Act<sup>2</sup>

There were some notable Cartwright Act developments in 2014. First, in a pending case, 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. Second, the California Attorney General reached a \$3.75 million settlement with eBay over an anticompetitive “no-poach” agreement with Intuit. Third, the Second District discussed continuing the per se status of resale price maintenance under the Cartwright Act. Fourth, the failure to exhaust judicial remedies dooms doctor’s Cartwright Act and Unfair Competition Law (“UCL”) claims. Finally, a California district court finds that a challenge to the Internet Corporation for Assigned Names and Numbers (“ICANN”) naming authority fails to sufficiently plead antitrust conspiracy.

#### 1. *In re Cipro Cases I & II*<sup>3</sup>

The California Supreme Court will decide the standard for Cartwright Act applicability to “pay-for-delay” patent settlements in *In re Cipro Cases I and II*. At issue

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1 Thomas Greene is special litigation counsel with the Bureau of Competition, Federal Trade Commission. Thomas A. Papageorge is the head of the Consumer Protection Unit, San Diego District Attorney’s Office. The views expressed in this article are the authors’ alone and do not necessarily reflect the views of the Federal Trade Commission or the San Diego District Attorney’s Office.

2 CAL. BUS. & PROF. CODE § 16720 *et seq.*

3 200 Cal. App. 4th 442 (2011), *petition for review granted*, 269 P.3d 653 (Cal. 2012).

are the interaction between federal patent rights and antitrust principles of competition, and the rule of reason/per se distinction in such matters.

The lengthy coordinated class action matter 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. This arrangement is characterized by the plaintiffs as "pay-for-delay" monopolization and by the defendants as legitimate "reverse payments" to settle bona fide patent litigation.<sup>4</sup>

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. It also found no triable issue as to whether the agreements produced "anticompetitive effects on competition beyond the exclusionary scope of the . . . patent itself."<sup>5</sup>

The California Fourth Appellate District affirmed summary judgment for defendants,<sup>6</sup> adopting defendants' proposed legal standard, derived from *In re Tamoxifen Citrate Antitrust Litigation*,<sup>7</sup> in which the Second Circuit 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.<sup>8</sup>

Reviewing the *Tamoxifen* rule and similar holdings, the Fourth Appellate 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."<sup>9</sup> And under the rule of reason, the court found reverse payment agreements to be consistent with federal and state policies favoring dispute resolution and a "natural byproduct of patent litigation" under then-current federal law.

Summarizing the court's version of the *Tamoxifen* rule, the court "conclude[d] 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."<sup>10</sup>

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4 See 200 Cal. App. 4th at 454 n.2.

5 *Id.* at 455.

6 *Id.* at 478.

7 466 F.3d 187 (2d Cir. 2006).

8 *Id.* at 221.

9 200 Cal. App. 4th at 467.

10 *Id.*

The California Supreme Court granted plaintiffs’ petition for review on February 15, 2012,<sup>11</sup> and extensive amici participation followed. Briefing was stayed in September 2012 pending the United States Supreme Court’s consideration of these issues in *FTC v. Actavis, Inc.*,<sup>12</sup> which ultimately held that the Federal Trade Commission Act’s § 5 unfair competition allegations in the AndroGel reverse payment matter were not forestalled by federal patent law principles.

In November 2013, plaintiffs and defendant Bayer reached a settlement of Bayer’s portion of the matter, agreeing to a settlement pool of \$74 million.<sup>13</sup> The covered class was consistent with the 2004 formulation eliminating those purchasers of Cipro who had paid only a flat co-payment amount.<sup>14</sup> On October 1, 2014, the supreme court dismissed the settling Bayer defendants from the pending review.<sup>15</sup>

Deputy Attorney General Cheryl Johnson reports that the supplemental round of briefing addressing the impact of the *Actavis* opinion has now been completed, with all parties and numerous amici curiae briefing the matter. The California Attorney General has asserted that the per se standard should govern the Cartwright Act claim and has also argued for application of the non-competition covenant principles of Business and Professions Code section 16600 *et seq.*<sup>16</sup> The court has not yet set oral argument in the matter.

## 2. *California v. eBay, Inc.*<sup>17</sup>

On August 29, 2014, in *California v. eBay, Inc.*, San Jose U.S. District Court Judge Edward J. Davila signed an order approving the settlement of the California Attorney General’s Cartwright Act and UCL action against eBay alleging an anticompetitive “no-poach, no-hire” personnel agreement between eBay and Intuit.

In November 2012, the Attorney General’s Antitrust Section filed its Cartwright Act and UCL complaint against online giant eBay, naming fellow high-tech firm Intuit as a co-conspirator. The suit alleged that from 2006 to 2009 senior executives at both companies entered into a “no-poach, no-hire” agreement that neither company would hire the other’s employees, thus blocking the career progress of their employees and depriving the marketplace of the benefits of competition for qualified high-tech personnel.<sup>18</sup> The U.S. Department of Justice filed parallel charges under the Sherman Act.<sup>19</sup>

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11 *In re Cipro Cases I & II*, 269 P.3d 653 (Cal. 2012).

12 133 S. Ct. 2223 (2013).

13 Order, *In re Cipro Cases I & II*, JCCP Nos. 4154 & 4220 (Sup. Ct. Nov. 18, 2013).

14 See *Frequently Asked Questions*, CIPRO SETTLEMENT, <https://ciprossettlement.com/mainpage/FrequentlyAskedQuestions.aspx> (last visited Jan. 27, 2015); see also *In re Cipro Cases I & II*, 121 Cal. App. 4th 402 (2004).

15 *In re Cipro Cases I & II*, 334 P.3d 687 (Cal. 2014).

16 Brief of the Cal. Attorney General, *In re Cipro Cases I and II*, No. S198616, 2014 WL 1765268 (Cal. Ct. App. Mar. 19, 2014).

17 No. 12-cv-05874, 2014 WL 4273888 (N.D. Cal. Aug. 29, 2014).

18 In 2010 and 2013 Intuit entered into consent-decree settlements with both the U.S. and California authorities. Stipulation, *United States v. Adobe Sys., Inc.*, No. 10-cv-01629 (D.D.C. Sept. 24, 2010); Stipulation, *California v. Intuit, Inc.*, No. 13-cv-02933 (N.D. Cal. June 26, 2013).

19 Complaint, *United States v. eBay, Inc.*, 12-cv-05869 (N.D. Cal. Nov. 16, 2012).

Defendant eBay's motions to dismiss both actions were resolved in related decisions on September 27, 2013. Judge Davila denied eBay's motion to dismiss the U.S. action, finding the Department of Justice had adequately pleaded a Sherman Act section 1 market division case. Judge Davila dismissed California's complaint with leave to amend, and California filed its amended complaint in October 2013.<sup>20</sup> Before further motions could be heard, the U.S. and California agencies filed motions for approval of separate settlements with eBay.

The California settlement approved by Judge Davila includes injunctive relief barring eBay from entering into similar agreements and prohibiting the enforcement of the existing provisions.<sup>21</sup> The judgment calls for \$2.375 million in restitution payments to natural persons, with any unclaimed portion used to fund *cy pres* beneficiaries, including a charitable organization that supports employment mobility, and \$1.375 million to the State of California, including \$250,000 in civil penalties. Significantly, the court approved \$300,000 of that amount as payment for the harm the anticompetitive conduct caused to the state's economy, reportedly the first time a state antitrust settlement has explicitly recovered additional funds for general harm to the economy.

### 3. *Alsheikh v. Superior Court*<sup>22</sup>

In an unpublished (noncitable) opinion, *Alsheikh v. Superior Court*, a panel of the Second Appellate District recently discussed its assessment of the continuing per se illegality of vertical price fixing under California's Cartwright Act, notwithstanding the United States Supreme Court's *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*<sup>23</sup> opinion.

Plaintiff Sylvia Ingoglia sued bakery company Sara Lee and others alleging she was denied wage and hour benefits, and asserting that if she were an independent contractor, as defendants claimed, defendants violated the Cartwright Act and the UCL by imposing resale prices on her, a practice unlawful per se under the California Supreme Court's standard for such conduct in *Mailand v. Burckle*.<sup>24</sup> Defendants countered that *Mailand* should no longer be controlling after the United States Supreme Court's abandonment of the per se rule in *Leegin*. The Second Appellate District ultimately found plaintiff's pleadings inadequate and remanded with leave to amend.

However, in describing the legal standard to be applied by the trial court on remand, the Second Appellate District added: "Had the distribution agreements . . . operated in such a way as to 'limit[] the distributor's freedom to sell the supplier's product at a price independently selected by the distributor . . .', then a Cartwright Act violation might be stated. We also note that if there were vertical price fixing, that would, under *Mailand v. Burckle*, . . . be a per se violation under the Cartwright Act, notwithstanding a change of

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20 *United States v. eBay, Inc.*, 968 F. Supp. 2d 1030 (N.D. Cal. 2013); *California v. eBay, Inc.*, No. 12-cv-05874, 2013 WL 5423774 (N.D. Cal. Sept. 27, 2013).

21 *eBay, Inc.*, 2014 WL 4273888.

22 No. B249822, 2013 WL 5530508 (Cal. App. 2d Dist. Oct. 7, 2013).

23 551 U.S. 887 (2007).

24 20 Cal. 3d 367 (1978).

law under the Sherman Antitrust Act . . . . We are bound to follow the law set forth by our supreme court applying state law.”<sup>25</sup>

California enforcement authorities have consistently signaled their ongoing application of the *Mailand v. Burckle* precedent. This unpublished opinion suggests that state appellate courts will continue to apply the per se standard, absent contrary instructions from the California Supreme Court.

#### **4. *Lin v. Dignity Health-Methodist Hospital of Sacramento*<sup>26</sup>**

In *Lin v. Dignity Health-Methodist Hospital of Sacramento*, plaintiff Dr. Lin, a cardiologist with privileges at the defendant hospital, was discharged from the hospital after a patient’s death and the resulting administrative hearing, which found that the plaintiff engaged in practices endangering patients. Dr. Lin refused to participate in the hospital’s administrative hearing, believing it to be a sham, and instead filed suit in federal court alleging violations of the Cartwright Act, the UCL, and federal and state anti-discrimination statutes. The defendant filed a motion to dismiss and an anti-strategic lawsuit against public participation (“SLAPP”) motion, seeking to strike the plaintiff’s complaint as a SLAPP suit that sought to interfere with the defendant’s “protected act” (the hearing process) without a reasonable prospect of success.

U.S. District Court Judge Kimberly Mueller granted the motions to dismiss and strike. Regarding the Cartwright Act and UCL claims, Judge Mueller concluded that the plaintiff’s failure to exhaust the available administrative and judicial remedies (including a writ of mandamus if the hospital’s hearing was defective) doomed her suit. “In light of plaintiff’s failure to exhaust her judicial remedies, she has not shown a reasonable probability she can succeed on her claims for violations of California Business and Professions Code §§ 16720 and 17200. . . .”<sup>27</sup> Judge Mueller found that, as a result, both the motion to dismiss and the anti-SLAPP motion to strike were in order.

#### **5. *Name.Space, Inc. v. Internet Corporation for Assigned Names & Numbers*<sup>28</sup>**

In *Name.Space, Inc.*, the plaintiff owns and operates alternative “generic top level domain” names (“gTLDs”, which are equivalents of “.com” and “.net”) and hoped to register them for widespread use under the authority of the Internet Corporation for Assigned Names and Numbers, the entity assigned the exclusive authority over such domain names by the U.S. Department of Commerce. When ICANN conducted two “Application Rounds” in 2000 and 2012 to permit applicants to obtain new Internet domain names, the plaintiff applied unsuccessfully, and then sued in federal court. The plaintiff claimed that ICANN had engaged in a number of unlawful acts, including restraints of trade and monopolization in violation of the Sherman Act, the Cartwright Act, and the UCL.

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25 *Alsheikh*, 2013 WL 5530508, at \*3 (citing *Kuhnert v. Mission Fin. Serv. Corp.*, 110 Cal. App. 4th 242, 263 (2003); *Mailand*, 20 Cal. 3d 367; *Leegin*, 551 U.S. 887; *Auto Equity Sales, Inc. v. Superior Court*, 57 Cal. 2d 450, 455 (1962)).

26 No. S-14-0666, 2014 WL 3401451 (E.D. Cal. July 10, 2014).

27 *Lin*, 2014 WL 3401451, at \*6.

28 No. 12-cv-8676, 2013 WL 2151478 (C.D. Cal. Mar. 4, 2013).

U.S. District Court Judge Percy Anderson granted ICANN’s motion to dismiss. The (unreported) court order addressed the pleading requirements under the terms of *Bell Atlantic Corp. v. Twombly*<sup>29</sup> for both the Sherman Act and Cartwright Act claims. Finding that “[t]he analysis under California’s law mirrors the analysis under federal law,”<sup>30</sup> Judge Anderson found the plaintiff had not met the *Twombly* standard since it had “not alleged sufficient facts explaining who it believes participated in the conspiracy, and what the alleged co-conspirators actually agreed to do in violation of the antitrust laws.”<sup>31</sup>

## **B. Covenants Not to Compete<sup>32</sup>**

In a development regarding covenants not to compete, the First Appellate District determined that standards for noncompetition provisions apply differently to property orders in marital dissolutions.

### **1. *In re Marriage of Greaux and Mermin*<sup>33</sup>**

The First Appellate District, addressing an apparent issue of first impression for the district, has determined that the standards for covenants not to compete found in Business and Professions section 16600 *et seq.* apply differently where a family court determines that such orders are necessary for an equal division of marital property, such as a jointly-owned business.

The Court stated that California’s “settled public policy in favor of open competition,”<sup>34</sup> which voids most covenants not to compete, must be balanced against “the family court’s authority to issue *any orders*—and specifically a noncompetition order—to achieve an equal division of marital property.”<sup>35</sup>

Analogizing to business sales and goodwill evaluations, the court concluded: “[I]f an ongoing marital business is being awarded to one spouse, and if the value of that business includes goodwill, a family court should have the power . . . to issue a noncompetition order so that the value of that asset is preserved, just as a noncompetition clause in a business purchase and sale agreement is designed to protect the value of the asset purchased.”<sup>36</sup>

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29 550 U.S. 544 (2007).

30 *Name.Space*, 2013 WL 2151478, at \*6 (quoting *Cnty. of Tuolumne v. Sonora Cmty. Hosp.*, 236 F.3d 1148, 1160 (9th Cir. 2001)) (internal quotation marks omitted).

31 *Id.* at \*7.

32 CAL. BUS. & PROF. CODE § 16600 *et seq.*

33 223 Cal. App. 4th 1242 (2014).

34 *Id.* at 1248 (internal quotation marks omitted).

35 *Id.* at 1250.

36 *Id.* at 1251 (citing similar decisions from other states).

### C. Consumer Legal Remedies Act<sup>37</sup>

There have been a few notable developments related to the Consumer Legal Remedies Act (“CLRA”). First, the California Supreme Court held that taxability issues must be resolved through the Board of Equalization process, not through a UCL/CLRA lawsuit. Second, a California federal district court decided that CLRA claims for computer monitor defects are limited by the *Daugherty* doctrine. Finally, another California federal district court decided that claims of failure to disclose auto defects satisfy the *Daugherty* standard and may proceed.

#### 1. *Loeffler v. Target Corporation*<sup>38</sup>

Providing a lengthy discourse on California’s tax regulatory process, the California Supreme Court has held that a private lawsuit brought under the CLRA and the UCL challenging the sales tax representations of retailer Target was improper. It held that an issue involving taxability can only be properly addressed by the State Board of Equalization through its administrative process.

Chain retailer Target operates food counters in its stores that offer take-out coffee. Target routinely charged its take-out customers an additional sum represented as the sales tax on the coffee purchases, when, in fact, to-go coffee orders are exempt from sales tax. Private plaintiffs filed an action and sought class certification for their allegations that Target’s practice was unlawful and fraudulent under the UCL and an unlawful misrepresentation of Target’s authority to collect taxes in violation of the CLRA.

The trial court sustained Target’s demurrer and the Fourth Appellate District affirmed, holding that permitting superior court litigation of the CLRA/UCL claims would be inconsistent with the state constitution’s provision barring any “legal or equitable process . . . to prevent or enjoin the collection of any tax” except in the manner specified by the California Legislature in the Revenue and Taxation Code, which parallels article XIII, section 32 of the California Constitution.<sup>39</sup>

The California Supreme Court affirmed, by a four-three majority, on somewhat different grounds: “[W]e conclude that permitting plaintiffs to use the UCL or CLRA to challenge Target’s collection of a sales tax reimbursement on the ground that the sale was not taxable is inconsistent with the tax code provisions relating to the sales tax, particularly in light of the primary role assigned to the Board [of Equalization] with regard to the resolution of sales tax issues . . . . When a consumer claim such as plaintiffs’ is dependent upon the resolution of the taxability question, a UCL or CLRA lawsuit . . . is inconsistent with the method established by the Legislature as the exclusive means for ascertaining whether a transaction is subject to the sales tax.”<sup>40</sup>

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37 CAL. CIV. CODE § 1750 *et seq.*

38 No. S173972, 58 Cal. 4th 1081 (May 1, 2014).

39 *Id.* at 1108.

40 *Id.* at 1123–24.

A detailed dissent by Justice Liu (joined by Justices Werdegar and Moore) concludes: “[T]his is not really a tax case. This is a case about the reach of consumer protection statutes that prohibit unfair business practices, including misrepresentations by a retailer as to what its customers are actually paying for.”<sup>41</sup> Justice Liu further commented that none of the majority opinion’s reasoning “speaks to whether a retailer may represent to its customers that it is collecting sales tax on a transaction when the transaction is not actually subject to sales tax.”<sup>42</sup>

## 2. *Rasmussen v. Apple, Inc.*<sup>43</sup>

Plaintiff consumer Rasmussen sought certification of a class action against computer maker Apple under the CLRA and UCL, alleging that Apple failed to disclose a known defect that caused permanent dimming of the monitor screens on its all-in-one computers. Apple moved to dismiss for failure to state a claim.

U.S. District Court Judge Edward Chen expressed reservations about the limitations on consumer rights inherent in present California law, but concluded that the CLRA warranty claim did not sufficiently state an actionable failure to disclose in light of the *Daugherty v. American Honda Motor Company*<sup>44</sup> precedents. Interpreting the CLRA claim under *Daugherty* and its progeny, Judge Chen held that when a CLRA claim is based on a manufacturer’s failure to inform customers of a latent defect (manifesting itself outside the warranty period), the manufacturer generally has a duty to disclose that defect only when it involves a safety issue, absent affirmative misrepresentations. Here the defect did not implicate safety concerns, so under *Daugherty* no CLRA duty was breached. While the statements plaintiffs asserted – misrepresentations of durability or quality – only “constitute[d] inactionable puffery.”<sup>45</sup>

## 3. *Aguilar v. General Motors LLC*<sup>46</sup>

Illustrating the type of CLRA claim that meets the *Daugherty* standard for failures to disclose defects, U.S. District Court Judge Lawrence O’Neill held that the plaintiffs’ class action lawsuit against General Motors for failing to disclose known steering defects validly pleaded a breach of the CLRA duty to disclose.

Judge O’Neill reviewed the *Daugherty* standard, as interpreted by the Ninth Circuit, and ruled: “Because GM had knowledge of the steering defect, the steering defect constituted material [safety-related] information, and GM did not disclose the defect, the Court DENIES GM’s motion to dismiss Aguilar’s duty to disclose claims under the CLRA and UCL.”<sup>47</sup>

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41 *Id.* at 1135.

42 *Id.* at 1137.

43 27 F. Supp. 3d 1027 (N.D. Cal. 2014).

44 144 Cal. App. 4th 824 (2006).

45 27 F. Supp. 3d at 1042.

46 No. 1:13-cv-00437, 2013 WL 5670888 (E.D. Cal. Oct. 16, 2013).

47 *Id.* at \*6.

#### 4. *Chapman v. Skype, Inc.*<sup>48</sup>

In *Chapman v. Skype*, the Second Appellate District held that plaintiffs' CLRA claims against voice over Internet protocol ("VoIP") provider Skype included adequate allegations of the requisite CLRA elements based on deceptive advertising to avoid demurrer.

#### D. Unfair Competition Law<sup>49</sup>

In notable Unfair Competition Law developments, the California Supreme Court held that statistical extrapolation in UCL class action cases must satisfy appropriate statistical standards and due process concerns. California and federal courts also continue to wrestle with the multi-faceted issue of the applicability of the UCL to specific business practices and contexts where other regulatory schemes are involved. As a result, there have been a number of important UCL cases addressing claims of federal preemption, preclusion, or bar by state regulatory schemes. For example, the California Supreme Court held that the Attorney General's UCL labor classification case was not preempted by the Federal Aviation Administration Authorization Act ("FAAAA"). The Ninth Circuit also found that there was no Food, Drug, and Cosmetic Act ("FDCA") preemption of UCL/false advertising law ("FAL") in a mislabeling case.

There have also been notable developments related to arbitration and unconscionability in consumer contracts after *AT&T Mobility, LLC v. Concepcion*.<sup>50</sup> The United States Supreme Court's decision in *Concepcion*, upholding the preemptive effect of the Federal Arbitration Act ("FAA")<sup>51</sup> 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. While the California Supreme Court has given broad scope to the FAA's preemptive effect, in cases such as *Iskanian v. CLS Transportation*,<sup>52</sup> the interface between arbitration and unconscionability principles continues to be the subject of extensive litigation. The cases provided below are a survey of some of the more prominent unfair competition matters addressing the principles of arbitration and unconscionability after *Concepcion*.

The California Supreme Court currently has at least ten *Concepcion*-related appellate cases pending. Six of those cases deal with the single issue of the unconscionability of the arbitration and class waiver clause in the standard auto sales contract used by nearly all California car dealerships for the past decade. The leading case of this group is *Sanchez v. Valencia*,<sup>53</sup> which has been pending before the court since March 21, 2012. The California Supreme Court's resolution of the interface between the FAA and unconscionability principles will determine the fates of all these matters.

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48 220 Cal. App. 4th 217 (2013).

49 CAL. BUS. & PROF. CODE § 17200 *et seq.*

50 131 S. Ct. 1740 (2011).

51 9 U.S.C. § 1 *et seq.*

52 59 Cal. 4th 348 (2014).

53 201 Cal. App. 4th 74 (2012).

This section also provides recent examples of the continuing challenge of interpreting the complaint pleading and certification requirements for class actions and other private actions under the UCL and FAL. In the wake of the financial system crisis of 2007-2009 and the resulting collapse of real property values, a massive wave of foreclosure actions brought widespread allegations of lender abuse through the use of so-called “dual tracking” practices. In such practices, lenders offered to help homeowners with mortgage assistance while at the same time aggressively pursuing foreclosure, often unbeknownst to the homeowners. Numerous lawsuits and class actions alleging UCL and FAL violations in these and similar practices are now entering the appellate phase.

Finally, an Attorney General loan modification case clarifies UCL liability proof issues and remedy standards.

## 1. Statistical Sampling and Class Certification

In *Duran v. U.S. Bank National Association*,<sup>54</sup> plaintiffs, employees of defendant U.S. Bank, brought suit under the UCL and obtained certification of a class on the basis of overtime-misclassification allegations. The trial judge permitted extensive use of surveys and statistical sampling of the class members and extrapolations from that sampling in both the liability and damages phases of the case.

On appeal from the trial court’s judgment for plaintiffs, the First Appellate District reversed, finding due process violations regarding the methodology of the statistical sampling (which had margins of error up to 43%) and abuse of discretion in denying defendant’s second motion to decertify after evidence appeared that individual issues predominated in the case.

The California Supreme Court affirmed the reversal and the decertification of the class. While recognizing that many courts permit statistical methods to play a role in appropriate cases in determining liability or damages, the court emphasized that proper statistical standards must be followed to avoid due process concerns. “If sampling is used to estimate the extent of a party’s liability, care must be taken to ensure that the methodology produces reliable results. With input from the parties’ experts, the court must determine that a chosen sample size is statistically appropriate and capable of producing valid results within a reasonable margin of error.”<sup>55</sup>

The court also emphasized the importance of protecting the defendant’s right to put on affirmative defenses: “[A]ny class action trial plan, including those involving statistical methods of proof, must allow the defendant to litigate its affirmative defenses . . . . If statistical methods are ultimately incompatible with the nature of the plaintiffs’ claims or the defendant’s defenses, resort to statistical proof may not be appropriate.”<sup>56</sup>

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54 59 Cal. 4th 1 (2014).

55 *Id.* at 42.

56 *Id.* at 40.

## 2. No Preemption of or Bar to UCL Action

In *People ex rel. Harris v. Pac Anchor Transportation, Inc.*,<sup>57</sup> the California Attorney General filed a UCL case against the defendant trucking company for alleged improper classification of employees as independent contractors. The trial court held the FAAAA<sup>58</sup> preempted the UCL in this case. The Second Appellate District reversed, finding the People’s action was not related to the truck carrier’s prices, routes, or services. The California Supreme Court granted review on August 31, 2011, and affirmed the finding of no preemption.

The supreme court held that the FAAAA does not preempt the UCL, either facially or as applied to this labor classification case. The UCL does not conflict with Congress’s regulatory purpose in this field: “The FAAAA embodies Congress’s concerns about the regulation of motor carriers with respect to the transportation of property; a UCL action that is based on an alleged general violation of labor and employment laws does not implicate these concerns.”<sup>59</sup>

The application of the UCL and the state labor standards to the practices at issue here also does not materially affect “price, route, or service” within the meaning of the FAAAA. As applied here, “even though the People’s UCL action may have some indirect effect on defendants’ prices or services, that effect is ‘too tenuous, remote, [and] peripheral . . . to have pre-emptive effect.’”<sup>60</sup>

In *Lilly v. ConAgra Foods, Inc.*,<sup>61</sup> the Ninth Circuit Court of Appeals held that the federal FDCA does not preempt a claim of mislabeling of the sodium content of sunflower seeds under California’s UCL and FAL. The Ninth Circuit determined that the UCL and FAL, and the related state laws at issue, collectively impose no greater labeling requirements than those imposed by the federal FDCA, which expressly disavows preemption of state laws consistent with the labeling requirements of the FDCA Act.

In *Dilts v. Penske Logistics, LLC*,<sup>62</sup> the Ninth Circuit Court of Appeals held that California’s meal and rest-break laws, which plaintiffs, a class of the defendant’s employees, sought to enforce in a UCL action, were not preempted by the FAAAA. “The FAAAA does not preempt California’s meal and rest break laws as applied to Defendants [motor carriers], because those state laws [the state labor laws and the UCL] are not ‘related to’ Defendants’ prices, routes, or services.”<sup>63</sup>

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57 59 Cal. 4th 772 (2014).

58 49 U.S.C. § 14501.

59 59 Cal. 4th at 783.

60 *Id.* at 786 (alteration in original) (citing *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 390 (1992)) (internal quotation marks omitted).

61 743 F.3d 662 (9th Cir. 2014).

62 769 F.3d 637 (9th Cir. 2014).

63 *Id.* at 650.

In *Allergan, Inc. v. Athena Cosmetics, Inc.*,<sup>64</sup> the Federal Circuit Court of Appeals affirmed U.S. District Court Judge James Selna’s grant of summary judgment in favor of plaintiff Allergan, which brought an action against its competitor, Athena, alleging Athena was unlawfully selling unapproved drugs in violation of the UCL. The appellate court agreed with the plaintiff that “the FDCA does not impliedly preempt its UCL claim. . . . The fact that the California Health Code parallels certain FDCA provisions does mean that it does not implicate an historic state power.”<sup>65</sup> However, the court reversed the portion of the injunctive order that applied beyond California.

In *Hawaii ex rel. Louie v. HSBC Bank Nevada, N.A.*,<sup>66</sup> a case brought under Hawaii’s very similar versions of the California UCL and CLRA, the Ninth Circuit Court of Appeals held that actions brought by the Hawaii Attorney General against six credit card issuers alleging credit card “cramming” were not preempted by the National Bank Act,<sup>67</sup> and were not removable under the Class Action Fairness Act.<sup>68</sup>

### 3. Preemption of or Bar to UCL Action

In *Solus Industrial Innovations, LLC v. Superior Court*,<sup>69</sup> the Orange County District Attorney’s Office brought a UCL enforcement action seeking to enforce Cal/OSHA workplace standards in a case where the defendant manufacturer installed a residential water heater in an industrial facility, leading to an explosion that killed two workers. The Fourth Appellate District ruled that application of the California Labor Code and the UCL to this conduct was preempted by federal Occupational Safety and Health (“OSH”) Act standards, because the federal OSH Act law expressly preempts any state law workplace safety enforcement mechanism that has not been specifically incorporated in the workplace safety plan submitted to and approved by the U.S. Secretary of Labor.<sup>70</sup> Since UCL enforcement was not adequately incorporated into California’s 1973 application for its own state standard, the federal OSH Act preempts the UCL action here. The California Supreme Court has granted review of this opinion.<sup>71</sup>

In *Piñon v. Bank of America, NA (In re Late Fees & Over-Limit Fee Litigation)*,<sup>72</sup> the Ninth Circuit Court of Appeals held that the district court properly dismissed a UCL challenge to defendant banks’ late fees and over-limit charges under the unlawful practice prong of California Business and Professions section 17200 *et seq.* The challenged fees were permissible under the National Bank Act,<sup>73</sup> and the Depository Institutions

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64 738 F.3d 1350 (Fed. Cir. 2013).

65 *Id.* at 1355.

66 761 F.3d 1027 (9th Cir. 2014).

67 12 U.S.C. § 1 *et seq.*

68 28 U.S.C. § 1332(d).

69 178 Cal. Rptr. 3d 122 (Cal. Ct. App. 2014) (previously published at 229 Cal. App. 4th 1291), *review granted*, No. S222314, 2015 WL 177288 (Cal. Jan. 14, 2015).

70 *See* 29 U.S.C. § 651(b)(3).

71 2015 WL 177288.

72 741 F.3d 1022 (9th Cir. 2014).

73 12 U.S.C. §§ 85–86.

Deregulation and Monetary Control Act (“DIDMCA”).<sup>74</sup> “Because constitutional due process jurisprudence does not prevent enforcement of excessive penalty clauses in private contracts, and the fees were permissible under the National Bank Act and the DIDMCA, the district court did not err in dismissing the complaint.”<sup>75</sup> Certiorari was subsequently denied by *Pinon v. Bank of America, NA*.<sup>76</sup>

#### 4. Arbitration Clauses Upheld

In *Iskanian v. CLS Transportation Los Angeles, LLC*,<sup>77</sup> the California Supreme Court held that *Concepcion*<sup>78</sup> abrogated *Gentry v. Superior Court*,<sup>79</sup> but that it did not bar labor code private attorney general actions.

Sounding the death knell for the doctrine of non-waivable labor law rights in *Gentry*, the California Supreme Court has held that *Concepcion* impliedly overruled *Gentry*, and thus mandatory arbitration provisions must be enforced even when they require arbitration of wage and hour issues protected by California’s labor laws. The supreme court concluded: “[A] state’s refusal to enforce [this arbitration] waiver on grounds of public policy or unconscionability is preempted by the FAA. . . . [O]ur holding to the contrary in *Gentry* . . . has been abrogated by recent United States Supreme Court precedent.”<sup>80</sup> The court further noted: “*Concepcion* held that the FAA does prevent states from mandating or promoting procedures incompatible with arbitration. The *Gentry* rule runs afoul of this latter principle. We thus conclude in light of *Concepcion* that the FAA preempts the *Gentry* rule.”<sup>81</sup>

However, the supreme court ruled that an arbitration agreement requiring the employee to give up the right to bring representative actions under the Labor Code Private Attorneys General Act of 2004 (“PAGA”) is against public policy and unenforceable. The Supreme Court distinguished between FAA-protected arbitration requirements and acts to force employees to waive rights provided by the California Legislature to bring private attorney general cases enforcing state labor laws. “[T]he rule against PAGA waivers does not frustrate the FAA’s objectives because . . . the FAA aims to ensure an efficient forum for the resolution of *private* disputes, whereas a PAGA action is a dispute between an employer and the state Agency.”<sup>82</sup>

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74 12 U.S.C. § 1831d(a).

75 741 F.3d at 1028.

76 134 S. Ct. 2878 (2014).

77 59 Cal. 4th 348 (2014).

78 131 S. Ct. 1740 (2011).

79 42 Cal. 4th 443 (2007).

80 59 Cal. 4th at 360.

81 *Id.* at 366.

82 *Id.* at 384.

“[T]he FAA’s goal of promoting arbitration as a means of private dispute resolution does not preclude [the state] Legislature from deputizing employees to prosecute Labor Code violations on the state’s behalf [under PAGA].”<sup>83</sup> Thus, the court “conclude[d] that California’s public policy prohibiting waiver of PAGA claims, whose sole purpose is to vindicate the Agency’s interest in enforcing the Labor Code, does not interfere with the FAA’s goal of promoting arbitration as a forum for private dispute resolution.”<sup>84</sup>

In *Ferguson v. Corinthian Colleges, Inc.*,<sup>85</sup> the Ninth Circuit Court of Appeals held that *Concepcion* abrogates California’s *Broughton-Cruz* rule. College students had filed and sought to certify a class action against defendant, a for-profit college, alleging UCL, FAL, CLRA, and contract law violations involving false statements of employment prospects and other misrepresentations. In light of *Concepcion*, the Ninth Circuit concluded that the FAA preempted California’s *Broughton-Cruz* rule that claims for injunctive relief could not be arbitrated.

The Ninth Circuit analyzed the policies of the *Broughton-Cruz* rule and found them to be in unavoidable conflict with the FAA principles of *Concepcion*. “Of particular significance to this case is the Court’s statement [in *Concepcion*] that ‘[w]hen state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA.’”<sup>86</sup> That analysis resolved this case because, “[b]y exempting from arbitration claims for public injunctive relief under the CLRA, UCL and FAL, the *Broughton-Cruz* rule similarly prohibits outright arbitration of a particular type of claim.”<sup>87</sup>

In *Sanchez v. CarMax Auto Superstores California, LLC*,<sup>88</sup> the Second Appellate District held that an arbitration agreement was not substantively unconscionable because of limitations on discovery, where those limitations were equally applicable to all parties and the plaintiff failed to demonstrate that the limitations would keep him from obtaining necessary evidence. Additional requirements regarding written awards, confidentiality, and consolidation of claims of multiple employees were also held not unconscionable. The court concluded: “We disagree with the trial court’s conclusion that the arbitration agreement and the [dispute resolution rules and procedures] ‘are permeated with unconscionability.’ None of the provisions addressed by the trial court’s decision is substantively unconscionable. We therefore do not need to determine whether the court abused its discretion in declining to sever unconscionable provisions.”<sup>89</sup>

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83 *Id.* at 360.

84 *Id.* at 388-89.

85 733 F.3d 928 (9th Cir. 2013).

86 *Id.* at 934 (second alteration in original) (citing *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1747 (2011)).

87 *Id.*

88 224 Cal. App. 4th 398 (2014).

89 *Id.* at 408-09.

In *Vasquez v. Greene Motors, Inc.*,<sup>90</sup> the First Appellate District disagreed with its sister panel in *Natalini v. Import Motors, Inc.*,<sup>91</sup> and held the arbitration clause in the standard vehicle sales contract not unconscionable. Thus, the arbitration clause was enforceable.

In *McGill v. Citibank, N.A.*,<sup>92</sup> the Fourth Appellate District followed the Ninth Circuit in *Ferguson v. Corinthian Colleges, Inc.*,<sup>93</sup> and held that the FAA preempts California's *Broughton-Cruz* rule purporting to limit the arbitration of UCL, FAL, and CLRA injunction actions brought for the public's benefit.

## 5. Arbitration Clauses Rejected

Post-*Concepcion* California and federal decisions have held that a lack of bilaterality, sufficient to constitute unconscionability, remains a defense under the FAA and state law.<sup>94</sup> Even after *Iskanian v. CLS Transportation Los Angeles, LLC*<sup>95</sup> ended the *Gentry* labor-law waiver rule, principles of unconscionability stemming from *Armendariz v. Foundation Health Psychcare Services*<sup>96</sup> continue to be the basis of unconscionability findings resulting in refusals to enforce mandatory arbitration.

In *Sanchez v. Valencia Holding Co.*,<sup>97</sup> the Second Appellate District 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 California Supreme Court granted review on March 21, 2012.

In *Natalini v. Import Motors, Inc.*,<sup>98</sup> the First Appellate District Court agreed with the *Sanchez v. Valencia* court and found that an arbitration clause in the industry-standard motor vehicle installment sales contract was unconscionable and thus unenforceable, notwithstanding *Concepcion*. The California Supreme Court granted review on May 1, 2013, adding this case to the *Sanchez v. Valencia* queue.

In *Imburgia v. DIRECTV, Inc.*,<sup>99</sup> the Second Appellate District Court ruled that the trial court correctly found the class-wide arbitration waiver in the agreement between defendant DIRECTV and its customers to be unenforceable under the UCL and CLRA where the contract specifically provided that the waiver was subject to "the law of [the

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90 214 Cal. App. 4th 1172 (2013), *review granted*, 302 P.3d 573 (Cal. 2013).

91 213 Cal. App. 4th 587 (2013), *review granted*, 299 P.3d 700 (Cal. 2013).

92 232 Cal. App. 4th 753 (2014).

93 733 F.3d 928 (9th Cir. 2013).

94 *See, e.g., Sonic-Calabasas A, Inc. v. Moreno*, 57 Cal. 4th 1109 (2013), *cert. denied*, 134 S. Ct. 2724 (2014).

95 59 Cal. 4th 348 (2014).

96 24 Cal. 4th 83(2000).

97 201 Cal. App. 4th 74 (2011), *review granted*, 272 P.3d 976 (Cal. 2012).

98 213 Cal. App. 4th 587 (2013), *review granted*, 299 P.3d 700 (Cal. 2013).

99 225 Cal. App. 4th 338 (2014).

consumer's] state.”<sup>100</sup> This language was reasonably interpreted to mean that California law banning such waivers would be enforced, even when the arbitration waiver would have been enforceable under the preemption principles of *Concepcion*.<sup>101</sup>

In *Sabia v. Orange County Metro Realty, Inc.*,<sup>102</sup> ruling in the context of a contract for foreclosure relief services, the Second Appellate District held that the arbitration clause in that contract was unconscionable and unenforceable because it was substantively one-sided and lacking in mutuality (clients were prohibited from court relief but the business was not), and because it was procedurally unconscionable having been presented in English to Spanish-speaking customers with signatures obtained in an adhesive manner. The supreme court granted review on September 24, 2014, in another *Sanchez v. Valencia* deferral.

In *Chavarria v. Ralphs Grocery Co.*,<sup>103</sup> the Ninth Circuit Court of Appeals held that the arbitration term in Ralphs' employment application was both substantively and procedurally unconscionable, and upheld the district court's denial of enforcement. On the continuing viability of unconscionability as a defense in arbitration matters, the appellate court concluded: “The Supreme Court's holding that the FAA preempts state laws having a ‘disproportionate impact’ on arbitration cannot be read to immunize all arbitration agreements from invalidation no matter how unconscionable they may be, so long as they invoke the shield of arbitration.”<sup>104</sup>

In *Nguyen v. Barnes & Noble, Inc.*,<sup>105</sup> in a deceptive business practices and false advertising suit, the Ninth Circuit Court of Appeals upheld the trial court's denial of enforcement of the defendant's arbitration term. The appellate court found that consumers purchasing the computer equipment online had neither actual nor constructive notice of the defendant's Terms of Use that included the arbitration term. Therefore, there was no mutual assent to that provision and it could not be enforced.

In *Knutson v. Sirius XM Radio Inc.*,<sup>106</sup> the Ninth Circuit Court of Appeals held that defendant Sirius XM Radio failed to meet its burden of proving the existence of an arbitration agreement with plaintiff purchaser of a new truck equipped with the defendant's radio receiver. The court of appeals found that there was inadequate proof of mutual assent to the arbitration provision in the contract terms at issue, and the provision was thus unenforceable.

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100 *Id.* at 346-47.

101 *Id.* at 343-46.

102 227 Cal. App. 4th 11 (2014), *review granted*, 334 P.3d 685 (Cal. 2014).

103 733 F.3d 916 (9th Cir. 2013).

104 *Id.* at 927.

105 763 F.3d 1171 (9th Cir. 2014).

106 771 F.3d 559 (9th Cir. 2014).

## 6. Standing, Injury, and Reliance Pleadings

In *Jones v. Farmers Insurance Exchange*,<sup>107</sup> the plaintiff, seeking to represent a putative class of employees of defendant insurance company, brought a UCL action against defendant for alleged wage and hour violations. The trial court denied certification, and the employee appealed.

The Second Appellate District remanded with instructions, finding that plaintiff had sufficiently shown that common issues predominated and that a class action was the superior method of resolving the dispute, but had failed to show he was an adequate class representative and had failed to establish prejudice from any error in the trial court's striking of his amended class certification motion. The plaintiff was given leave to amend to name a suitable representative.

In *Boorstein v. CBS Interactive, Inc.*,<sup>108</sup> plaintiff Boorstein appealed from a dismissal entered after the trial court sustained defendant's demurrer to causes of action for violations of Civil Code section 1798.83 *et seq.* (the Shine the Light or "STL" Law) and the UCL. The Second Appellate District affirmed, agreeing with the trial court that the plaintiff inadequately pleaded and proved standing to pursue causes of action under either the STL or the UCL.

The STL, a disclosure statute designed to "shine the light" on businesses' information-sharing practices, provides various civil remedies, as does the UCL. However, the STL requires that a plaintiff have made or have attempted to make a disclosure request. The court found that, "because it is undisputed that the plaintiff has not alleged, and cannot allege" that he did so, the STL cause of action was properly dismissed.<sup>109</sup> Furthermore, since the UCL claim was derivative of the STL claim, the plaintiff could not adequately plead actual injury cognizable in a private UCL action.

## 7. Foreclosure-Related "Dual Tracking" Cases

In *Rufini v. CitiMortgage, Inc.*,<sup>110</sup> the First Appellate District ruled that the trial court erred in granting defendant bank's demurrer to the UCL cause of action here. The borrower was not required to allege a predicate act involving a violation of some other statute in order to maintain the UCL claim. The court found that the plaintiff sufficiently alleged actual injury and damages, as is required for standing to bring a private UCL claim.

In *Lueras v. BAC Home Loans Servicing, LP*,<sup>111</sup> although sustaining the trial court's demurrer regarding several other causes of action, the Fourth Appellate District reversed the trial court's grant of demurrer regarding the borrower's UCL action, finding that the borrower sufficiently alleged fraudulent and/or unfair practices in violation of the UCL.

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107 221 Cal. App. 4th 986 (2013).

108 222 Cal. App. 4th 456 (2013).

109 *Id.* at 463-64.

110 227 Cal. App. 4th 299 (2014).

111 221 Cal. App. 4th 49 (2013).

In *Alvarez v. BAC Home Loans Servicing, LP*,<sup>112</sup> the plaintiff homeowners brought action under the UCL and other theories against mortgage lender defendants for “fraud and unfair business practices in the origination of [their] residential mortgage loans, and negligence in the subsequent servicing of the loans, including negligent review of [their] applications for loan modification.”<sup>113</sup> The trial court sustained the defendants’ demurrer without leave to amend, and homeowners appealed.

The First Appellate District, in the published portion of the opinion, struggled with the “poorly drafted” complaint, but agreed that “potentially meritorious claims can be distilled from the allegations,” including a UCL cause of action.<sup>114</sup> Of particular note, the appellate court held that the bank defendants owed homeowners a duty to exercise reasonable care in the review of their loan modification applications once they had agreed to consider them.

## 8. UCL Liability Proof Issues and Remedy Standards

In *People ex. rel. Harris v. Sarpas*,<sup>115</sup> the California Attorney General’s Office sued defendants Sarpas and Nazarzi, partners doing business as “US Homeowners Assistance (USHA).”<sup>116</sup> USHA, a boiler room operation, was cold-calling vulnerable homeowners in jeopardy of losing their homes to entice them to enter into \$1,000-\$4,500 agreements for “home loan modifications” and claiming a “97 percent success rate” in obtaining such modifications.<sup>117</sup> However, “[n]o credible evidence was presented at trial that USHA ever obtained a loan modification, or did anything of value, for any customer.”<sup>118</sup> After trial, defendants appealed the joint and several judgment against them, which enjoined their practices and ordered payments of up to \$2.047 million in restitution and in excess of \$2 million in civil penalties.

The Fourth Appellate District upheld the entire judgment, remanding only one penalty calculation. The court first held that “individualized proof of harm was unnecessary, . . . the law was settled that restitution and civil penalties under the UCL and FAL could be ordered against them without individualized proof of harm.”<sup>119</sup>

The appellate court further ruled that: (1) restitution can be ordered paid even if the defendants were not paid directly by victims; (2) the ordered civil penalties were appropriate here and the burden is on defendants to demonstrate inability to pay as partial mitigation; (3) the evidence of involvement of the part owner and the office manager was sufficient to support the imposition of penalties and restitution; and (4) no due process violation resulted from the defendants’ inability to cross-examine the additional victim/witnesses who did not testify at trial.

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112 228 Cal. App. 4th 941 (2014).

113 *Id.* at 943-44.

114 *Id.* at 944.

115 225 Cal. App. 4th 1539 (2014).

116 *Id.* at 1543.

117 *Id.* at 1545.

118 *Id.* at 1546.

119 *Id.* at 1548-49.

## E. FALSE ADVERTISING LAW<sup>120</sup>

In notable false advertising law developments, California appellate courts decided that: California has specific jurisdiction over an out-of-state drug manufacturer in a products liability/UCL/FAL class action suit; a restaurant owner's challenge to Yelp's statements was not subject to an Anti-SLAPP motion; and a trier of fact determines tendency or capacity to deceive in FAL suits.

### 1. *Bristol-Myers Squibb Co. v. Superior Court*<sup>121</sup>

The First Appellate District has ruled that a class of prescription drug users may bring a products liability and UCL/FAL action against a non-resident drug manufacturer, and that this class may include hundreds of *non-resident* co-plaintiffs making the same allegations.

Plaintiffs, including many non-residents (the real parties in interest or "RPI" in this case), were purchasers of defendant Bristol-Myers Squibb's ("BMS's") heart disease medication, Plavix, who had suffered adverse side effects. These plaintiffs sought to sue non-resident BMS on products liability, UCL, and FAL theories in a California court. The defendant sought a writ of mandate after the trial court denied its motion to quash the summons. The First Appellate District denied the writ.

After a thoroughgoing review of contemporary principles of general and specific jurisdiction, the First Appellate District concluded that the RPI plaintiffs had met the California Supreme Court's contemporary standards for the specific jurisdiction doctrine, found in *Vons Companies, Inc. v. Seabest Foods, Inc.*,<sup>122</sup> including minimum contacts, relatedness, and balance of convenience. "Thus, given BMS's substantial, continual contacts with California, including its extensive sales of Plavix here, the presence of dozens (not one or two) of resident plaintiffs who allege precisely the same wrongdoing by BMS and McKesson (also a Cal. resident) as is alleged by the RPI, as well as the interstate nature of BMS's business and its nationwide sales of Plavix are even more significant in determining whether the RPI's claims are sufficiently connected to BMS's California activity so that assertion of specific jurisdiction satisfies the traditional conception of fair play and substantial justice."<sup>123</sup>

The court stated: "In short, we hold that the RPI have sustained their burden of showing sufficient contacts with California and the relatedness of these contacts to the claims at issue so as to satisfy the traditional test for specific jurisdiction under the United States and California Supreme Court cases discussed at length in this opinion."<sup>124</sup>

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120 CAL. BUS. & PROF. CODE § 17500 *et seq.*

121 228 Cal. App. 4th 605 (2014), *review granted*, 337 P.3d 1158 (Cal. 2014).

122 14 Cal. 4th 434 (1996).

123 228 Cal. App. 4th at 637.

124 *Id.* at 637-38.

On November 19, 2014, the California Supreme Court granted review in this matter, and, as a result, at least some portions of this sweeping analysis will now be evaluated by the California high court.

## **2. *Demetriades v. Yelp, Inc.***<sup>125</sup>

The Second Appellate District held that a restaurant operator’s UCL/FAL action challenge to the truth of Yelp’s statements about its filtering process was within the commercial speech exemption of the anti-SLAPP statute since Yelp’s statements were intended to reach third parties to induce them to engage in a commercial transaction by patronizing its website. Thus, it was error to grant Yelp’s motion to strike.

## **3. *Chapman v. Skype Inc.***<sup>126</sup>

The Second Appellate District found that, in cases under the Business and Professions Code section 17500, determining whether a statement has the tendency or capacity to deceive is a question of fact to be resolved by the trier of fact. The court stated that this issue can be decided on demurrer “only if the facts alleged in the complaint, and facts judicially noticed, compel the conclusion as a matter of law that consumers are not likely to be deceived.”<sup>127</sup>

### **III. CALIFORNIA AND FEDERAL DEVELOPMENTS: PROCEDURAL LAW FORUM**

In forum developments, the United States Supreme Court narrowed the *Younger* abstention doctrine in *Sprint Communications, Inc. v. Jacobs*,<sup>128</sup> and determined procedures for enforcing forum-selection clauses in *Atlantic Marine Construction Co. v. U.S. District Court*.<sup>129</sup>

## **1. *Sprint Communications, Inc. v. Jacobs***<sup>130</sup>

This case arose from a battle between Sprint, a national telecommunications company, and Windstream, the former Iowa Telecom. For years, Sprint paid access fees to Windstream for long distance calls placed by Sprint customers to Iowa. Relying on provisions of the Telecommunications Act of 1996 preempting intrastate regulation of VoIP communications, Sprint stopped paying fees for such calls. In response, Windstream threatened to discontinue all services to Sprint customers in Iowa.

Sprint responded by filing a complaint against Windstream with the Iowa Utilities Board (“IUB”) seeking an order directing that the local phone company continue to provide services to Sprint customers. Windstream withdrew its threat, but the IUB

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125 228 Cal. App. 4th 294 (2014).

126 220 Cal. App. 4th 217 (2013).

127 *Id.* at 226-27.

128 134 S. Ct. 584 (2013).

129 134 S. Ct. 568 (2013).

130 134 S. Ct. 584.

retained the matter to determine the underlying legal issues. Sprint responded with a two-front attack on Iowa regulators. First, it filed a petition in Iowa state court seeking a declaration that the IUB was preempted by federal law from imposing access fees on VoIP traffic. Second, Sprint filed a federal action against IUB board members in their official capacities in federal district court seeking a declaration that any local access fees on VoIP traffic were preempted and requesting an injunction against the IUB proceeding.

The IUB sought a remand from the district court based on the *Younger*<sup>131</sup> abstention doctrine, which was granted based on the lower court's reading of the Supreme Court's decision in *Middlesex County Ethics Committee v. Garden State Bar Association*.<sup>132</sup> The Eighth Circuit Court of Appeals affirmed this decision.<sup>133</sup>

Invoking one of its earliest cases, Justice Ginsberg, writing for a unanimous Court, opined that:

Federal courts, it was early and famously said, have “no more right to decline the exercise of jurisdiction which is given, than to usurp that which is not given.” Jurisdiction existing, this Court has cautioned, a federal court’s “obligation” to hear and decide a case is “virtually unflagging.”<sup>134</sup>

Justice Ginsberg underscored that *Younger* abstention is “exceptional,” and limited to “state criminal prosecutions,” “civil enforcement proceedings,” and “civil proceedings involving certain orders that are uniquely in furtherance of the state courts’ ability to perform their judicial functions.”<sup>135</sup>

She rejected the Eighth Circuit’s characterization of *Middlesex* as requiring *Younger* abstention whenever “[t]here is (1) ‘an ongoing state judicial proceeding, which (2) implicates important state interests, and (3) . . . provide[s] an adequate opportunity to raise [federal] challenges.’”<sup>136</sup> According to Justice Ginsberg, this misapprehended *Middlesex* because it ignored the fact that the case arose from an ethics prosecution by a state bar that was “akin to a criminal proceeding.”<sup>137</sup> Slamming the door on the use of *Middlesex* as a springboard for a broad application of *Younger* abstention, she concluded that:

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131 *Younger v. Harris*, 401 U.S. 37 (1971).

132 457 U.S. 423 (1982).

133 *Sprint Commc’ns. Co. v. Jacobs*, 690 F.3d 864 (2012).

134 134 S. Ct. at 590-91 (citations omitted).

135 *Id.* at 588 (citing *New Orleans Pub. Serv., Inc. v. Council of New Orleans*, 491 U.S. 350, 367-68 (1989)) (internal quotation marks omitted).

136 *Id.* at 593 (citation omitted) (second and third alteration in original).

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

Divorced from their quasi-criminal context, the three *Middlesex* conditions would extend *Younger* to virtually all parallel state and federal proceedings, at least where a party could identify a plausibly important interest. That result is irreconcilable with our dominant instruction that, even in the presence of parallel state proceedings, abstention from the exercise of federal jurisdiction is the “exception, not the rule.”<sup>138</sup>

Ultimately, according to the Court, “*Younger* extends to the three ‘exceptional circumstances’ identified in [*New Orleans Public Service, Inc.*], but no further.”<sup>139</sup>

## 2. *Atlantic Marine Construction Co. v. U.S. District Court*<sup>140</sup>

Appellant, Atlantic Marine, a Virginia contractor, entered into a subcontract with a Texas company, J-Crew Management, to assist in the construction of a childcare center at Fort Hood, located in western Texas. Despite the locus of the work in Texas, the contract contained a forum-selection clause requiring that any disputes over the contract “shall be litigated in the Circuit Court for the City of Norfolk, Virginia, or the United States District Court for the Eastern District of Virginia, Norfolk Division.”<sup>141</sup>

Following a dispute over payment, J-Crew Management sued Appellant. Ignoring the forum-selection clause, it filed suit in the U.S. District Court for the Western District of Texas. Both the district court and the Fifth Circuit Court of Appeals concluded that the case could proceed in Texas. The Supreme Court reversed.

Writing for a unanimous court, Justice Alito first concluded that the appropriate way to handle such situations is with the doctrine of *forum non conveniens*, codified in 18 U.S.C. § 1404(a). Section 1404(a) provides for change of venue—for “the convenience of parties and witnesses, in the interests of justice, a district court may transfer any civil action to any other district or division where it might have been brought or to any district or division to which all parties have consented.”<sup>142</sup>

Both the doctrine of *forum non conveniens* and § 1404(a) rely on a broad balancing of public and private interests to determine an appropriate venue. However, this test was adjusted to fit a forum-selection clause, specifically:

- Contrary to the allocation of burden employed by the trial court, Justice Alito concluded that “the party defying the forum-selection clause . . . bears the burden of establishing that transfer to the forum for which the parties bargained is unwarranted.”<sup>143</sup>

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138 *Id.* (citations omitted).

139 *Id.* at 594.

140 134 S. Ct. 568 (2013).

141 *Id.* at 575 (citation omitted) (internal quotation marks omitted).

142 *Id.* at 579 (internal quotation mark omitted). The Court rejected use of either 28 U.S.C. §1406(a) or Federal Rule of Civil Procedure 12(b)(3) because use of either provision requires a determination that the venue selected is “wrong” or “improper.” Here the Texas venue may have been proper, but the parties had agreed to another, proper venue in Virginia. *Id.* at 577-79.

143 *Id.* at 581.

- Private interests in using an alternate forum—including convenience of parties and witnesses—do not count, because “[w]hen parties agree to a forum-selection clause, they waive the right to challenge the preselected forum as inconvenient or less convenient for themselves or their witnesses, or for their pursuit of the litigation.”<sup>144</sup>
- Only public interests—not found in this case—can be considered in doing the analysis, and “[o]nly under *extraordinary circumstances* unrelated to the convenience of the parties should a § 1404(a) motion be denied.”<sup>145</sup>
- When a party “flouts” a forum-selection cause, the transfer back to the preselected forum will not bring with it the choice-of-law rules from the forum chosen by the party ignoring the forum-selection clause.<sup>146</sup>
- When parties select a non-federal forum, the doctrine of *forum non conveniens* applies and “courts should evaluate a forum-selection clause pointing to a nonfederal forum in the same way that they evaluate a forum-selection clause pointing to a federal forum.”<sup>147</sup>

Between sophisticated parties, this analysis makes sense, although clients may need to be counseled on the importance of looking for forum-selection clauses in standard contracts. However, in contracts with consumers or unsophisticated small businesses, the Court’s strong endorsement of forum-selection clauses may lead to untoward results. For this reason, apparently, the Court leaves open the possibility that a forum selection clause could be *contractually* invalid.<sup>148</sup>

#### IV. FOREIGN TRADE ANTITRUST IMPROVEMENTS ACT

In Foreign Trade Antitrust Improvement Act (“FTAIA”) developments, the Ninth Circuit Court of Appeals, in *United States v. Hui Hsiung*,<sup>149</sup> decided that the FTAIA does not bar criminal price-fixing convictions, and affirmed a penalty based on gross gains of conspiracy. In a revised FTAIA decision, *Motorola Mobility LLC v. AU Optronics Corp.*,<sup>150</sup> the Seventh Circuit Court of Appeals precluded damage claims by foreign subsidiaries but protected federal enforcement actions.

##### 1. *United States v. Hui Hsiung*<sup>151</sup>

Addressing “complicated issues of first impression regarding the reach of the Sherman Act in a globalized economy,” the Ninth Circuit provides guidance on the FTAIA and

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144 *Id.* at 582.

145 *Id.* at 581 (emphasis added).

146 *Id.* at 582.

147 *Id.* at 580 (citation omitted).

148 *Id.* at 581 n.5 (“Our analysis presupposes a contractually valid forum-selection clause.”).

149 758 F.3d 1074 (9th Cir. 2014).

150 No. 14-8003, 2014 U.S. App. LEXIS 22408 (7th Cir. Nov. 26, 2014).

151 758 F.3d 1074.

other issues in a criminal antitrust case.<sup>152</sup> The appeal arose from criminal prosecutions of two individuals and a company for participation in an international price-fixing conspiracy in the sale of Thin-Film-Transistor Liquid-Crystal Displays (“TFT-LCDs”). The individual defendants, Hui Hsiung and Hsuan Bin Chen, were sentenced to thirty-six months in federal prison and fined \$200,000 each; the corporate defendant, AU Optronics (“AUO”), was fined \$500 million and sentenced to three years of probation with detailed conditions.

The court initially addressed venue, rejecting the defendants’ argument that the standard of proof is beyond a reasonable doubt. The court noted succinctly that “[t]he defendants’ position . . . has no support in the law.”<sup>153</sup> Turning to the record, the court concluded that evidence of meetings to negotiate prices for TFT-LCDs with Hewlett Packard and Apple in the Northern District and the presence of an AU Optronics sales office in the district was “sufficient to establish by a preponderance of the evidence that overt acts in furtherance of the conspiracy occurred in the Northern District.”<sup>154</sup>

The court swept aside claims that the Sherman Act does not apply to foreign conduct and that the *per se* rule does not apply to foreign price-fixing.<sup>155</sup>

Turning to the FTAIA, the court parsed the language of the Act, distinguishing between “import trade” and “trade or commerce (other than import trade or import commerce) with foreign nations.”<sup>156</sup> Cutting through the less than transparent prose of the FTAIA, the court writes:

Although the statute is a web of words, it boils down to two principles. First the Sherman Act applies to “import trade or import commerce” with foreign nations. Put differently, the FTAIA does not alter the Sherman Act’s coverage of import trade; import trade is excluded from the FTAIA altogether. Second, under the FTAIA, the Sherman Act does not apply to nonimport trade or commerce with foreign nations, unless the domestic effects exception is met. For the Sherman Act to apply to nonimport trade or commerce with foreign nations, the conduct at issue must have a “direct, substantial, and reasonably foreseeable effect—(A) on trade or commerce which is not trade or commerce with foreign nations . . . .”<sup>157</sup>

The court focused initially on whether the commerce involved is “import trade,” which is not affected by the FTAIA. Quoting with approval the Seventh Circuit’s decision in *Minn-Chem, Inc. v. Agrium, Inc.*,<sup>158</sup> the court writes, “transactions that are directly between the [U.S.] plaintiff purchasers and the defendant cartel members *are*

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152 *Id.* at 1078.

153 *Id.* at 1081.

154 *Id.*

155 *Id.* at 1080–87.

156 *Id.* at 1086.

157 *Id.* (citing 15 U.S.C. § 6a).

158 683 F.3d 845 (7th Cir. 2012).

the import commerce of the United States.”<sup>159</sup> Reviewing the trial record, the court found abundant evidence that the commerce at issue was import commerce based on evidence that:

- i. AUO imported over one million price-fixed panels per month into the United States.
- ii. Conspirators earned over \$600 million from imports into the United States.
- iii. AUO executives negotiated with U.S. buyers in the United States in order to sell products at price-fixed prices.

Addressing a defense argument that AUO was not technically an “importer,” the court stated that the defense “misses the point” because “[t]he panels were sold into the United States, falling squarely within the scope of the Sherman Act.”<sup>160</sup>

The Ninth Circuit amended its original opinion on January 10, 2015.<sup>161</sup> Although the original version of the opinion did not decide whether the trade alleged had “direct, substantial, and reasonably foreseeable” effects on domestic U.S. commerce, the court nonetheless provided some guidance, albeit arguably in the form of dicta.<sup>162</sup> The amended decision concludes that “[t]he constellation of events that surrounded the conspiracy leads to one conclusion—the impact on the United States market was direct and followed as ‘an immediate consequence’ of the price-fixing.”<sup>163</sup> As it did in the original opinion, the court rejects the assertion of prosecutors that the FTAIA is an affirmative defense, so, presumably, the burden of proof is on defendants.<sup>164</sup>

Referring to the Seventh Circuit’s *Motorola Mobility* decision, discussed *infra*, the Ninth Circuit’s amended decision states: “Ultimately the private antitrust claim failed because of the indirect-purchaser doctrine of *Illinois Brick Co. v. Illinois*, but, as the court explained, ‘[i]f price fixing by the component manufacturers had the requisite statutory effect on cellphone prices in the United States, the Act would not block the Department of Justice from seeking criminal or injunctive remedies.’”<sup>165</sup> Thus, the Ninth Circuit finds support in *Motorola Mobility* for its own conclusion.

However, this formulation suggests that the reason that Motorola failed to secure consideration of its subsidiaries’ claims was the direct-purchaser rule of *Illinois Brick*, not the jurisdictional provisions of the FTAIA. Such a formulation provides a firmer basis for distinguishing between enforcement actions by the Antitrust Division and actions by private plaintiffs with indirect purchaser claims, disallowed under federal law (but not California law).

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159 758 F.3d at 1090 (alteration in original) (quoting *Minn-Chem*, 683 F.3d at 855) (internal quotation marks omitted).

160 *Id.* at 1091.

161 *United States v. Hui Hsiung*, No. 12-10492, 2015 U.S. App. LEXIS 1590 (9th Cir. Jan. 30, 2015).

162 758 F.3d at 1092.

163 *Hui Hsiung*, 2015 U.S. App. LEXIS 1590, at \*51.

164 *Id.* at \*44.

165 *Id.* at \*53-54 (alteration in original) (citations omitted).

The court concludes its opinion by clearing up issues with the Alternate Fine Statute.<sup>166</sup> It concludes: “[T]he statute unambiguously permits a ‘gross gains’ calculation based on the gain attributable to the entire conspiracy.”<sup>167</sup> The court also rejects the defendants’ argument that the \$500 million fine against AUO should be reduced by the amounts already paid by its co-conspirators, writing: “No statutory authority or precedent supports AUO’s interpretation of the Alternate Fine Statute as requiring joint and several liability and imposing a ‘one recovery’ rule.”<sup>168</sup>

This is one of the most significant antitrust decisions of the year, and merits special review.

## 2. *Motorola Mobility LLC v. AU Optronics Corp.*<sup>169</sup>

This decision arose from a private case brought by Motorola Mobility against AU Optronics. Motorola averred that it “purchased over \$5 billion worth of LCD panels from cartel members.”<sup>170</sup> In an earlier decision, Judge Posner disputed this claim, writing that only 1% of the \$5 billion figure represented purchases by Motorola; the rest were purchases through subsidiaries.<sup>171</sup>

This directly implicated the domestic effects exception of the FTAIA, which allows antitrust actions to proceed if, though they may involve transactions by foreign companies, the challenged conduct has a “direct, substantial, and reasonably foreseeable effect” on the United States.<sup>172</sup> While Judge Posner concedes that there was “doubtless *some* effect” on Motorola, it was not a “direct effect.”<sup>173</sup> Judge Posner assumes that the brunt of the injury was borne by Motorola’s subsidiaries that should not, in his view, be able to take advantage of federal courts. In addition, Judge Posner wrote that the FTAIA also requires that Motorola itself be subject to an antitrust action because of the challenged conduct.<sup>174</sup> The effect of his decision was to reduce Motorola’s potential claim by 99%.

After noting that prices of “many products exported to the United States are elevated to some extent by price fixing,” Judge Posner concluded that his decision was nonetheless appropriate because “[t]he Supreme Court has warned that rampant extraterritorial application of U.S. law ‘creates a serious risk of interference with a foreign nation’s ability independently to regulate its own commercial affairs.’”<sup>175</sup>

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166 18 U.S.C. § 3571(d).

167 *Hui Hsiung*, 2015 U.S. App. LEXIS 1590, at \*56; *see also* 758 F.3d at 1095.

168 *Hui Hsiung*, 2015 U.S. App. LEXIS 1590, at \*58; *see also* 758 F.3d at 1096.

169 No. 14-8003, 2014 U.S. App. LEXIS 22408 (7th Cir. Nov. 26, 2014).

170 *Id.* at \*6.

171 *Motorola Mobility LLC v. AU Optronics Corp.*, 746 F.3d 842, 843 (7th Cir. 2014).

172 *See* 15 U.S.C. § 6a.

173 746 F.3d at 844.

174 *Id.* at 845.

175 *Id.* at 846 (quoting *F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 165 (2004)).

Judge Posner's narrow interpretation of the domestic effects prong of the FTAIA drew immediate and strong reactions. The U.S. Department of Justice and the Federal Trade Commission filed an amicus brief asking the court to reverse itself. But criticism was not limited to federal agencies, the New York Times scored the opinion as representing a "cramped view of antitrust laws" that could "tear a gaping hole in American antitrust law."<sup>176</sup>

Subsequently, the Judge Posner decision was vacated and the case set for rehearing.<sup>177</sup>

The most recent decision of the Seventh Circuit provides support for the observation that even judges read the papers. Decided in November 2014, the court's latest opinion, also written by Judge Posner, disallows claims brought by Motorola for purchases by its foreign subsidiaries, but vindicates the ability of federal authorities to enforce federal antitrust laws even if the effects of offshore price-fixing flow through foreign firms to American consumers.<sup>178</sup> Judge Posner squares this circle by finding that federal authorities will respect foreign nations, while private plaintiffs will not, citing an on-line journal.<sup>179</sup>

The court's analysis of Motorola's private claims is virtually identical to its earlier decision, but with an expanded argument that the Supreme Court's decision in *Illinois Brick Co. v. Illinois*,<sup>180</sup> would be nullified if Motorola were allowed to proceed on claims for purchases made by foreign subsidiaries.<sup>181</sup> As in its prior decision, this opinion reduced Motorola's claims by over \$4.9 billion.

This decision is a major win for defendants in damage actions in the Seventh Circuit, and will be widely cited in other jurisdictions. But this decision underscores the need for either congressional action or Supreme Court review of the scope of the FTAIA.

## V. DISCOVERY

In discovery developments, three federal circuit courts rejected broad work-product claims against expert discovery. The Federal District Court for the District of Nevada rejected the use of predictive coding without an agreement with the adverse party. Finally, California's Second Appellate District clarified responsibilities of third parties in responding to state subpoenas for electronically stored information ("ESI").

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176 Editorial Board, *A Cramped View of Antitrust Laws, The Motorola Mobility Ruling and Foreign Cartels*, N.Y. TIMES, July 16, 2014, at A18.

177 *Motorola Mobility LLC v. AU Optronics Corp.*, No. 14-8003, 2014 U.S. App. LEXIS 12704 (7th Cir. July 1, 2014).

178 *Motorola Mobility LLC v. AU Optronics Corp.*, No. 14-8003, 2014 U.S. App. LEXIS 22408, at \*25-32 (7th Cir. Nov. 26, 2014).

179 *Id.* at \*30 (quoting Robert E. Connolly, *Repeal the FTAIA! (Or At Least Consider It as Coextensive with Hartford Fire)*, CPI ANTITRUST CHRON. (Sept. 2014), <https://www.competitionpolicyinternational.com/file/view/7249>).

180 431 U.S. 720 (1977).

181 *Motorola*, 2014 U.S. App. LEXIS 22408, at \*18.

1. *Republic of Ecuador v. Hinchee*<sup>182</sup>

*Carrion v. For the Issuance of a Subpoena Under 28 U.S.C. §1782(a) (In re Republic of Ecuador)*<sup>183</sup>

*Republic of Ecuador v. Mackay*<sup>184</sup>

These three cases proceed from the same general fact pattern. Chevron was sued in Ecuador for pollution that allegedly injured the environment and its local workers in Ecuador. The action spilled into the U.S. court system because Ecuador requested U.S. federal courts to order discovery of specific information in support of a foreign arbitration. In all three cases, the demand was for information from Chevron’s testifying experts, including communications (and notes of communications) with non-attorneys. The non-attorneys at issue included other experts for Chevron and Chevron employees.

Chevron sought to cloak these communications in a broad reading of 2010 Amendments to Federal Rule of Civil Procedure 26(b), related to expert discovery. Summing up Chevron’s claims, the Tenth Circuit wrote:

Chevron argues that the 2010 revisions to the Federal Rules caused a sea change in the discoverability of documents held by experts. It argues that the Rule 26(b)(3)(A)’s “by or for another party or its representative” language protects trial preparation materials prepared by or provided to a testifying expert. Further, it argues that the amendment to Rule 26(a)(2)(b)(ii)’s reporting standard was intended to make clear that reporting [consulting] experts are protected by the work-product doctrine. Finally, it argues that the two limited protections of Rules 26(b)(4)(B) and (C) are not the exclusive protections for expert materials but merely “*examples* of the broader protection provided by Rule 26(b)(3)(A).”<sup>185</sup>

The Tenth Circuit reviewed the history of the 2010 Amendments, focusing on the concern of the drafters that attorney work product was jeopardized by broad interpretations of the 1993 Amendments to Rule 26.<sup>186</sup> The 2010 Amendments, according to the court, protected core work product—impressions and judgments—but not every piece of information the attorney helped the expert to see or review. Therefore, “the revisions appear to alter only the outcome of cases either allowing discovery of draft reports or attorney-expert communications”<sup>187</sup>

In *Hinchee*, similar arguments were addressed by the Eleventh Circuit. After another exegesis of the history of the 2010 amendments, the court found that:

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182 741 F.3d 1185 (11th Cir. 2013).

183 735 F.3d 1179 (10th Cir. 2013).

184 742 F.3d 860 (9th Cir. 2014).

185 *Carrion*, 735 F.3d at 1183 (citations omitted).

186 *Id.* at 1186; *see, e.g., Elm Grove Coal Co. v. Dir., O.W.C.P.*, 480 F.3d 278, 303 (4th Cir. 2007) (finding work-product materials given to expert discoverable).

187 735 F.3d at 1186 (citing FED. R. CIV. P. 26).

None of this suggests the drafters' intent to confer work-product status on the notes of a testifying expert or on a testifying expert's communications with other experts. Rather, the 2010 Amendments to Rule 26(a)(2)(B) were intended to protect the opinion work-product of attorneys in the context of expert discovery. As the 2010 Advisory Committee put it: "[t]he refocus of disclosure on 'facts or data' is meant to limit disclosure to material of a factual nature by excluding *theories or mental impressions of counsel*." At the same time, the term "facts or data" should "be interpreted broadly to require disclosure of any material considered by the expert from whatever source, that contains factual ingredients." . . . In other words, the term "facts or data" includes all materials considered by a testifying expert, except the core opinion work-product of attorneys.<sup>188</sup>

In *Mackay*, the Ninth Circuit came to the same conclusions as its sister circuits.<sup>189</sup> The Ninth Circuit concluded:

[T]he Committee sought to balance the competing policy considerations, including the need to provide an adversary with sufficient information to engage in meaningful cross-examination and prepare a rebuttal, on the one hand, and the need to protect the attorney's zone of privacy to efficiently prepare a case for trial without incurring the undue expense of engaging multiple experts, on the other. There is no indication that the Committee intended to expand Rule 26(b)(3)'s protection for trial preparation materials to encompass all materials furnished to or provided by testifying experts, which would unfairly hamper an adverse party's ability to prepare for cross-examination and rebuttal. We accordingly reject Chevron's argument.<sup>190</sup>

These three cases take a restrictive, but pragmatic, approach to the 2010 Amendments concerning expert discovery. One important implication is that many litigators—on both sides of the aisle—will find this balance of interests unhelpful. In such instances, a stipulation on expert discovery makes very good sense.

## 2. *Progressive Casualty Insurance Co. v. Delaney*<sup>191</sup>

In a contentious piece of litigation in Nevada, parties agreed in 2013 to an e-discovery protocol that relied on key word searches. After this approach yielded approximately two million e-documents, the producing party unilaterally applied predictive coding (also known as technology-assisted review) to the results of the word searches. The demanding party objected, partly because (i) this was a major (and unilateral) change in a carefully negotiated discovery agreement, and (ii) the responding party failed to disclose the underlying seed sets of documents and other important information needed to assess the quality of the predictive coding review.

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188 *Republic of Ecuador v. Hinchee*, 741 F.3d 1185, 1194-95 (11th Cir. 2013) (citations omitted).

189 *See also Apple Inc. v. Amazon.com, Inc.*, No. 11-1327, 2013 U.S. Dist. LEXIS 47124 (N.D. Cal. Apr. 1, 2013) (consulting experts must be prepared to testify at depositions on assistance provided to testifying expert).

190 *Republic of Ecuador v. Mackay*, 742 F.3d 860, 870-71 (9th Cir. 2014).

191 No. 11-cv-00678, 2014 U.S. Dist. LEXIS 69166 (D. Nev. May 19, 2014).

In a thoughtful opinion, the district court concluded that, while it would have authorized the use of predictive coding as part of an agreement with the adverse party, unilateral use of this technology—particularly without revealing how the searches were made—was unacceptable.<sup>192</sup>

Of particular practical interest, the court relied on an online white paper prepared by the responding party’s e-discovery vendor, Equivio, to make the point that predictive coding is highly sensitive to the seed sets selected by the “expert” lawyer guiding discovery, as well as other systemic issues. This paper<sup>193</sup> is a smart, short guide to major issues associated with the use of this powerful technology.

### 3. *Vasquez v. California School of Culinary Arts, Inc. (Sallie Mae, Inc.)*<sup>194</sup>

This case arose from a class action by 1,034 former students of a culinary academy who alleged that the academy had misrepresented their post-graduation job prospects in order to obtain large tuition payments financed by student loans. Sallie Mae, Inc., the real party in interest in this appeal, services many of the former students’ loans. Plaintiffs subpoenaed electronically stored loan records from Sallie Mae pertaining to 746 plaintiffs. Plaintiffs sought forty-four specific fields of information from these files and specified that Sally Mae’s response be “on digital data disk(s) in a reasonably useful form.”<sup>195</sup>

California’s Electronic Discovery Act, enacted in 2009 and amended in 2012, creates a structure for such disputes. Under the Act,

- A subpoena may require production of “electronically stored information.”<sup>196</sup>
- The party serving the subpoena can “specify the form or forms in which each type of information is to be produced.”<sup>197</sup>
- If necessary, the responding party, at the reasonable expense of the demanding party, shall “through detection devices, translate any data compilations included in the subpoena into a reasonably useable form.”<sup>198</sup>
- A responding party can object to a subpoena for ESI because the demanded records are “not reasonably accessible because of undue burden or expense” to produce, but the objecting party bears the burden of establishing inaccessibility.<sup>199</sup>

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192 *Id.* at \*25-31.

193 *Top 10 Best Practices in Predictive Coding*, EQUIVIO, [http://www.equivio.com/resource\\_download.php?ID=75&utm\\_source=Equivio+update%3A+Epiq+adopts+Zoom%2C+Clustering+in+Zoom%2C+Case+Order+on+Relevance...&utm\\_campaign=Equivio+update+August+22&utm\\_medium=email](http://www.equivio.com/resource_download.php?ID=75&utm_source=Equivio+update%3A+Epiq+adopts+Zoom%2C+Clustering+in+Zoom%2C+Case+Order+on+Relevance...&utm_campaign=Equivio+update+August+22&utm_medium=email) (last visited Feb. 1, 2015).

194 230 Cal. App. 4th 35 (2014).

195 *Id.* at 38.

196 CAL. CIV. PROC. § 1985.8(a)(1).

197 *Id.* § 1985.8(b).

198 *Id.* § 1985.8(g).

199 *Id.* § 1985.8(d).

- Even if collecting the records is burdensome, the trial court can nonetheless order production, but may limit the scope of discovery or impose conditions, including “allocation of the expense of discovery.”<sup>200</sup>

In response to plaintiffs’ subpoena, Sallie Mae’s attorney objected that the lender had “no obligation to do research on the loans . . . and to prepare a spread sheet.”<sup>201</sup> Plaintiffs repeatedly offered to pay for the reasonable costs of Sallie Mae’s work, but Sallie Mae refused to supply a cost estimate.

Sallie Mae then moved to quash plaintiffs’ subpoena on various grounds, including relevance and burden. It asserted that it had no duty to do anything other than produce existing documents and records.<sup>202</sup> Plaintiffs responded based on the Electronic Discovery Act and prevailed, leading to an award of fees and costs to plaintiffs. Sallie Mae appealed.

The Second Appellate District reviewed the plain text of the California Electronic Discovery Act, finding that California law required Sallie Mae to respond. The court also relied on federal precedent, noting in particular that in *Gonzales v. Google, Inc.*,<sup>203</sup> non-party Google was required under federal discovery rules to produce information that it could extract from its databases, even if the information was not ordinarily kept in the form specified. Sallie Mae was directed to produce the requested information and pay plaintiffs their reasonable costs and fees for opposing Sallie Mae’s motion to quash.

This case is useful for at least two reasons. First, it clarifies the obligations of third parties in responding to subpoenas for ESI under California law. Second, given the paucity of state court precedent for the California Electronic Discovery Act, the Second Appellate District’s reliance on federal precedent suggests that federal decisions will be useful in addressing e-discovery issues in state courts.

## VI. CLASS ACTIONS

In class action developments, the Supreme Court overturned the Tenth Circuit on the Class Action Fairness Act (“CAFA”) pleading standard in a decision that can potentially have broader implications.

### *1. Dart Cherokee Basin Operating Co. v. Owens*<sup>204</sup>

This started as a simple correction of a procedural decision under the Class Action Fairness Act, but may have broader implications in the future. The core of the case is the language of CAFA that says that a defendant seeking to remove a case from a state court to a federal forum must file a notice of removal in the federal court “containing a short and plain statement of the grounds for removal.”<sup>205</sup> Notwithstanding this language, the trial court decided that actual proof of the amount in controversy was required in the notice.

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200 *Id.* § 1985.8(f)

201 *Vasquez*, 230 Cal. App. 4th at 38 (internal quotation mark omitted).

202 *Id.* at 39.

203 234 F.R.D. 674 (N.D. Cal. 2006).

204 135 S. Ct. 547 (U.S. 2014).

205 28 U.S.C. § 1446(a).

Defendant Dart petitioned the Tenth Circuit for permission to appeal relying on 28 U.S.C. § 1453(c)(1), which provides that a court of appeal “*may* accept an appeal from an order of a district court granting or denying a motion to remand.”<sup>206</sup> An equally divided Tenth Circuit declined to exercise this discretionary authority.<sup>207</sup>

The Supreme Court granted certiorari on the CAFA pleading issue. However, during briefing, amicus Public Citizen, Inc. noted that since review by the Tenth Circuit was discretionary, the only possible appellate question before the Court was whether the Tenth Circuit had abused its discretion by denying Dart permission to appeal the trial court’s decision.<sup>208</sup> This put the majority in a box. On the one hand, they had a simple statutory interpretation issue they wanted to resolve. On the other, the Tenth Circuit had not reviewed the substantive CAFA issue and its simple denial of a discretionary appeal was only reviewable under the abuse of discretion standard.

The majority, led by Justice Ginsburg, solved this problem by asserting that the Tenth Circuit must have agreed with the trial court or it would have granted discretionary review. Starting from this assumption, the majority proceeded through the text and legislative history of CAFA, concluding that the statute means what it says: a “short and plain statement” is all that is required in the initial removal notice.

The opinion could have ended there, but it did not. In a stinging dissent authored by Justice Scalia and joined by Justices across the spectrum of the Court (Justices Kennedy, Kagan, and Thomas<sup>209</sup>), he argued that the majority only got to the CAFA issue by imputing a decision on the merits to the Tenth Circuit, a decision which, Scalia noted, could have been for “countless other permissible reasons.”<sup>210</sup> The dissent argued that, “[o]nce we found that the issue presented differed from the issue we granted certiorari to review, the responsible course would have been to confess error and to dismiss the case as improvidently granted.”<sup>211</sup>

The upshot of all this is that an apparently simple correction of a straightforward problem of statutory interpretation under CAFA has potentially made a hash of the abuse of discretion standard of review. There are a couple of possibilities moving forward. The most likely is that the Supreme Court will walk back any dilution of the abuse of discretion standard, confining this case to its unique, if contentious, facts. The other alternative is that *Dart* may become a tool to require courts of appeals to exercise appellate jurisdiction over CAFA decisions. This latter alternative is unlikely, but certainly possible given the drive-by approach of the majority to this traditionally deferential standard of review.

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206 *Dart*, 135 S. Ct. at 552 (emphasis added) (quoting 28 U.S.C. § 1453(c)(1)) (internal quotation mark omitted).

207 *Id.*

208 *Id.* at 555.

209 Justice Thomas also wrote separately to disassociate himself from one sentence in the dissent of the four Justices and made the additional point that the Court did not have jurisdiction “to review even the Court of Appeals’ denial of permission to appeal” on the grounds that such decisions were not “cases” within the meaning of 28 U. S. C. § 1254. *Id.* at 562.

210 *Id.* at 559.

211 *Id.* at 558-59.

## VII. EVIDENCE

In evidence developments, a district court judge in Nevada provided a tutorial on the authentication of web materials, including websites, emails, text message, and YouTube videos.

### 4. *Randazza v. Cox*<sup>212</sup>

This was an ugly case involving a pro per defendant and a lawyer plaintiff who was chastised for failing to authenticate evidence properly. The basic allegation was that defendant Cox had harassed the plaintiff, a lawyer, with the intention of extorting money from the lawyer and his immediate family.<sup>213</sup> This allegation was packaged into allegations of cybersquatting under 15 U.S.C. § 1125(d) and various other common law violations.

This decision was triggered by competing summary judgment motions. Citing *Orr v. Bank of America*,<sup>214</sup> the court noted that “unauthenticated documents cannot be considered in a motion for summary judgment.” The court also commented that summary judgment “requires consideration of the same caliber of evidence that would be admitted at trial.”<sup>215</sup> Against this background, a clearly frustrated district court judge addressed numerous problems with the web evidence offered by the two sides. Briefly, the judge concluded:

- **Websites:** “[W]ebsite print-outs [are] sufficiently authenticated where the proponent declared that they were true and correct copies of pages on the internet and the print-outs included their webpage URL, address and the dates printed.”<sup>216</sup>
- **Letters, Emails, and Text Messages:** Documents (and e-documents) can be “authenticated by personal knowledge ‘by a witness who wrote it, signed it, used it, or saw others do so.’”<sup>217</sup> In addition, “circumstantial evidence—like an email’s context, email address or previous correspondence between the parties—may help authenticate an email.”<sup>218</sup> Using these tools, the trial judge let some evidence in, but rejected one e-mail string because it had an unexplained gap and a text message screen shot because it did not have “circumstantial indicia of authenticity.” Among other problems with the text messages was a lack of information on the sending and receiving phones.<sup>219</sup>

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212 No. 2:12-cv-2040-JAD-PAL, 2014 U.S. Dist. LEXIS 49762 (D. Nev. Apr. 10, 2014).

213 *Id.* at \*2-3.

214 285 F.3d 764, 773 (9th Cir. 2002).

215 *Randazza*, 2014 U.S. Dist. LEXIS 49762, at \*5 (citations omitted).

216 *Id.* at \*7-8 (citing *Haines v. Home Depot U.S.A., Inc.*, No. 1:10-cv-017863-SK, 2012 Dist. LEXIS 47967 (E.D. Cal. Apr. 4, 2012)).

217 *Id.* at \*8-9 (citing *Orr v. Bank of America*, 285 F.3d at 774 n.8).

218 *Id.* at \*9; see also FED. R. EVID. 901(b)(4) (“distinctive characteristics of the item together with all circumstances”); FED. R. EVID. 902(7) (“sign, tag or label . . . indicating origin, ownership, or control”).

219 *Randazza*, 2014 U.S. Dist. LEXIS 49762, at \*9.

- **YouTube Video:** Citing *United States v. Hassan*,<sup>220</sup> the court opined that “videos from the online video network are self-authenticating as a certified domestic record of a regular[ly] conducted activity if their proponent satisfies the requirements of the business-records hearsay exception.”<sup>221</sup> While the video was supported by a declaration from the plaintiff, an affidavit from YouTube was required in order to verify that “the page had been maintained as a business record in the course of regularly conducted activities.”<sup>222</sup>

If one needs to authenticate web materials for summary judgment or trial, this decision provides a nice overview of the latest cases.

## VIII. SETTLEMENTS

In settlement developments, the Second Circuit overturned a trial judge’s rejection of a Securities and Exchange Commission (“SEC”) consent decree as an abuse of discretion, reaffirming the deference standard. In addition, both a district court and an appellate court, while not necessarily starting a trend, rejected putative class settlements after close scrutiny, finding the settlement deals to be inadequate.

### 1. *SEC v. Citigroup Global Markets, Inc.*<sup>223</sup>

U.S. District Court Judge Jed Rakoff has gained renown for not approving settlements between the SEC and financial services firms because they do not contain an admission of guilt or admissions of facts supporting the agency’s complaints.

The Second Circuit dusts off Judge Rakoff’s rationales for disapproving the SEC’s settlement in a sharply written decision. Specifically:

- i. “[T]here is no basis in the law for the district court to require an admission of liability as a condition for approving a settlement between the parties.”<sup>224</sup>
- ii. “It is an abuse of discretion to require, as the district court did here, that the S.E.C. establish the ‘truth’ of the allegations against a settling party as a condition for approving the consent decrees. Trials are primarily about the truth. Consent decrees are primarily about pragmatism.”<sup>225</sup>
- iii. “It is not within the district court’s purview to demand ‘cold, hard, solid facts, established either by admissions or by trials.’”<sup>226</sup>

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220 742 F.3d 104, 132–33 (4th Cir. 2014).

221 *Randazza*, 2014 U.S. Dist. LEXIS 49762, at \*12.

222 *Id.* at \*13.

223 752 F.3d 285 (2d Cir. 2014).

224 *Citigroup*, 752 F.3d at 293.

225 *Id.* at 295 (citation omitted).

226 *Id.* (citation omitted).

- iv. “The job of determining whether the proposed S.E.C. consent decree best serves the public interest, however, rests squarely with the S.E.C., and its decision merits significant deference . . . .”<sup>227</sup>

In evaluating a proposed consent decree, a trial court “should at a minimum, assess (1) the basic legality of the decree; (2) whether the terms of the decree, including its enforcement mechanism, are clear; (3) whether the consent decree reflects a resolution of the actual claims in the complaint; and (4) whether the consent decree is tainted by improper collusion or corruption of some kind.”<sup>228</sup>

The appellate court omitted “adequacy” as an appropriate metric for reviewing a public settlement, concluding that the trial court appeared to borrow this standard from review of class action settlements. In class action settlements, but not in public settlements, parties’ rights are extinguished by the settlement, which makes a review for adequacy appropriate, indeed essential.<sup>229</sup>

This decision clears away underbrush about necessary elements in a public settlement. In doing so, the Second Circuit reaffirms the division of labor between federal judges and federal prosecutors, opining that: “federal judges—who have no constituency—have a duty to respect legitimate policy choices made by those who do.”<sup>230</sup>

## 2. *Eubank v. Pella Corp.*<sup>231</sup>

### *In re High-Tech Employee Antitrust Litigation*<sup>232</sup>

Two court decisions do not necessarily represent a new trend. Nonetheless, in two significant decisions, two different courts peered deeply into the structure, mechanisms and dollars achieved in settlement, and found both deals inadequate.

In *Eubank*, the appellate court rejected what it characterized as a “scandalous settlement.” According to the court, the settlement was chock-a-block with procedural and substantive “red flags,” including:

1. The initial lead class representative was the father-in-law of the lead counsel for the class;
2. The lead class counsel was being investigated for ethical breaches by the Illinois Bar (and was ultimately disbarred for thirty months), so he had a strong interest in securing a settlement before his ethics case was resolved;
3. The lead counsel was to receive fees up front, including \$2 million before the notice concerning the settlement was sent to the class;

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227 *Id.* at 297.

228 *Id.* at 294-95 (citations omitted); *see also SEC v. Randolph*, 736 F.2d 525, 529 (9th Cir. 1984).

229 *See Citigroup*, 752 F.3d at 294-95.

230 *Id.* at 296 (citations omitted).

231 753 F.3d 718 (7th Cir. 2014).

232 No. 11-CV-02509-LHK, 2014 U.S. Dist. LEXIS 110064 (N.D. Cal. Aug. 8, 2014).

4. Claim forms were complicated, discouraging claims. Specifically, forms were more than twelve pages long and required “a slew of arcane data.”<sup>233</sup>

“In sum,” the court wrote, “almost every danger sign in a class action settlement that our court and other courts have warned district judges to be on the lookout for was present in this case.”<sup>234</sup>

This case is interesting for at least two reasons. First, it contains an encyclopedic overview of what can go wrong with a class settlement. Second, its searching examination of a restrictive claims process may implicate other cases in which claims-form formalities discourage claims.

Closer to home, in *High-Tech*, Northern District Court Judge Lucy Koh, sitting in San Jose, rejected settlements Apple, Adobe, Intel, and Google reached a month before trial.

A prior set of settlements with smaller firms (by comparison to Apple and Intel) had generated a settlement fund of \$20 million; these firms represented approximately 5% of the employee class.<sup>235</sup> However, according to the court, just to be as good as the settlement with the smaller, early settlers, a settlement with the remaining large defendants would have to “total at least \$380 million.”<sup>236</sup> But the actual proposed settlement for these firms was \$324.5 million, with 25% of that figure available for attorneys’ fees.

The court found the mismatch between the early settlements and the later settlement “particularly troubling in light of changes in the procedural posture of the case between the two settlements,” notably class certification and denial of summary judgment.<sup>237</sup>

Plaintiffs pointed to various weaknesses in their cases, each of which Judge Koh dissected and found wanting. She concluded: “The Court recognizes that Plaintiffs face substantial risks if they proceed to trial. Nonetheless, the Court cannot in light of the evidence above, conclude that the instant settlement is within the range of reasonableness, particularly compared to the settlements with the Settled Defendants . . . .”<sup>238</sup>

Judge Koh’s decision generated a writ from defendants. Argument is scheduled for March 13, 2015 in the Ninth Circuit’s Browning Courthouse in San Francisco.<sup>239</sup>

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233 *Pella*, 753 F.3d at 725–26.

234 *Id.* at 728–29 (citations omitted).

235 *High-Tech*, 2014 U.S. Dist. LEXIS 110064, at \*17.

236 *Id.* at \*18.

237 *Id.* at \*21–23.

238 *Id.* at \*58.

239 Hearing schedule for *Adobe Systems, Inc. v. USDC-CASJ*, No. 14-7274, available at <http://www.ca9.uscourts.gov/calendar/view.php?hearing=March - James R. Browning U.S. Courthouse, San Francisco&dates=9-13, 17,18&year=2015> (last visited Feb. 2, 2015).

## IX. APPEAL

In developments in appellate procedure, the U.S. Supreme Court clarified when a lower court decision is considered “final” for purposes of filing a timely notice of appeal.

### 1. *Ray Haluch Gravel Co. v. Central Pension Fund*<sup>240</sup>

Under Federal Rule of Appellate Procedure 4(a)(1)(A), parties in civil actions normally have 30 days “after entry of judgment or order appealed from” to file a notice of appeal. Failure to file a timely notice of appeal is jurisdictional.<sup>241</sup>

This case raised the question of whether the thirty-day clock started when the substantive decision issued or when a subsequent contract-based fee and cost claim was resolved. In a prior decision, the Court concluded that in cases in which fee and cost claims are based on statutes, the time for filing a notice of appeal runs from entry of the decision on the merits.<sup>242</sup>

In *Haluch*, the funds filed their notice of appeal within thirty days of a decision on fee and cost claims, but well after the trial court’s decision on the merits. They argued that the rule of *Budinich* was inapplicable because their claims were based on contract provisions, not a statute. Writing for a unanimous court, Justice Kennedy rejected this distinction, concluding that “[o]perational consistency is not promoted by providing for different jurisdictional effect to district court decisions that leave unresolved otherwise identical fee claims based solely on whether the asserted right to fees is based on a contract or a statute.”<sup>243</sup> In reaching this conclusion, Justice Kennedy rejected concerns about “piecemeal litigation,” arguing that such concerns are “counterbalanced by the interest in determining with promptness and clarity whether the ruling on the merits will be appealed.”<sup>244</sup>

The cold conclusion was that “[t]here was no timely appeal of the District Court’s . . . order.”<sup>245</sup>

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240 134 S. Ct. 773 (2014).

241 28 U.S.C. § 1291; *see also Bowles v. Russell*, 551 U.S. 205, 214 (2007).

242 *See Budinich v. Becton Dickinson & Co.*, 486 U.S. 196 (1988).

243 *Haluch*, 134 S. Ct. at 780.

244 *Id.* at 781.

245 *Id.* at 783.

## X. PROCEDURAL DEVELOPMENTS IN PATENT LAW<sup>246</sup>

In procedural developments in patent law, the U.S. Supreme Court, in three instances, rejected the approach taken by the Federal Circuit. First, in *Nautilus, Inc. v. Biosig Instruments, Inc.*,<sup>247</sup> the Supreme Court rejected the Federal Circuit's standard for definitiveness of patent claims. Second, in *Medtronic v. Mirowski Family Ventures*,<sup>248</sup> the Supreme Court rejected the Federal Circuit's allocation of the burden of proof in declaratory relief actions, shifting the burden to the patentee. Finally, in *Octane Fitness, L.L.C. v. Icon Health & Fitness, Inc.*,<sup>249</sup> the Supreme Court rejected the Federal Circuit limits on fee petitions, and further held in *Highmark, Inc. v. Allcare Health Management System, Inc.*<sup>250</sup> that district court fee awards are reviewable only for abuse of discretion. In addition, as an important statutory development, trial procedures for the new Patent Trial and Appeal Board were finalized in 2012, providing for expedited, post-grant, third-party challenges to patents.

### 1. *Nautilus, Inc. v. Biosig Instruments, Inc.*<sup>251</sup>

U.S. Patent Law requires that a patent specification “conclude with one or more claims particularly pointing out and distinctly claiming the subject matter which the [applicant] regards as the invention.”<sup>252</sup> These claims are crucial because they establish the scope of the monopoly granted by a patent.

Until this decision, the applicable standard applied by the Federal Circuit was that a claim was sufficient if it was “amenable to construction” or did not suffer from “insoluble ambiguity.” Writing for a unanimous Supreme Court, Justice Ginsberg rejects these formulations, concluding that “the Federal Circuit invoked a standard more amorphous than the statutory definiteness requirement allows.”<sup>253</sup>

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246 This section is confined to procedural developments in patent law. However, no discussion of patent law in 2014 can ignore the leading substantive development in this area of the law, *Alice Corporation Pty. Ltd. v. CLS Bank International*. 134 S. Ct. 2347 (2014). Challenged in this action was a “computer-implemented scheme for mitigating ‘settlement risk’ (i.e. the risk that only one party to a financial transaction will pay what it owes) by using a third-party intermediary.” *Alice*, 134 S. Ct. at 2351-52. The question presented was whether this was “patent eligible.” This implicated the distinction between a new or useful process, machine manufacture, or composition of matter, on the one hand (patentable) versus a law of nature, natural phenomenon, or abstract idea, on the other (not patentable). This was last addressed by the Court in *Bilski v. Kappos*. 561 U.S. 593 (2010) (holding that the innovation was not patentable because it was an attempt to patent basic hedging practices). This distinction is crucial, the Court notes, because “‘monopolization of [the basic tools of scientific and technological work] through the grant of a patent might tend to impede innovation more than it would tend to promote it,’ thereby thwarting the primary object of the patent laws.” *Alice*, 134 S. Ct. at 2354 (citations omitted). Justice Thomas, writing for a unanimous Court, concluded that the *Alice* technology was not patentable. The result has been a significant reassessment of a number of patents and a possible reduction in enforcement actions by non-practicing entities that own a number of similar patents.

247 134 S. Ct. 2120 (2014).

248 134 S. Ct. 843 (2014).

249 134 S. Ct. 1749 (2014).

250 134 S. Ct. 1744 (2014).

251 134 S. Ct. 2120.

252 35 U.S.C. § 112.

253 *Biosig*, 134 S. Ct. at 2131.

This decision appears to reflect increasing concern by the Supreme Court about the quality of U.S. patents. The Court notes that “a patent must be precise enough to afford clear notice of what is claimed, thereby ‘appris[ing] the public of what is still open to them.’”<sup>254</sup> Absence of such clarity “foster[s] the innovation-discouraging ‘zone of uncertainty’ against which this court has warned.”<sup>255</sup> Moreover, the Court notes, it is in the interest of patentees to make sweeping, ambiguous claims, citing testimony and patent law reference works.<sup>256</sup>

The Court concludes that: “[A] patent’s claims, viewed in light of the specification and prosecution history, [must] inform those skilled in the art about the scope of the invention with reasonable certainty. The definitiveness requirement, so understood, mandates clarity, while recognizing that absolute precision is unattainable.”<sup>257</sup>

In setting this standard, the Court notes that the rejected standards “permeate the Federal Circuit’s recent decisions.”<sup>258</sup> While some commentators have suggested that the new standard provides less guidance than it might have, this decision is clearly a brushback against recent Federal Circuit decision-making, and should lead to tighter, clearer patent claims.

## 2. *Medtronic, Inc. v. Mirowski Family Ventures, LLC* <sup>259</sup>

Medtronic, a manufacturer of medical devices, entered into a licensing agreement with Mirowski to use certain of its patents. Upon the introduction of new devices to the market by Medtronic, Mirowski informed the manufacturer that its products infringed Mirowski’s patents. One option for Medtronic was to ignore the warning and await a patent infringement suit, with attendant risks of significant damages. Instead, Medtronic sought declaratory relief in district court.

The issue in this appeal was who bears the burden of proof in a declaratory relief action. Relying on the fact that in a patent infringement action the burden lies with the patentee, the trial court found that the burden of showing infringement should also be on the patentee in a declaratory relief action. The Federal Circuit reversed.

Justice Breyer, writing for a unanimous Court, reversed the Federal Circuit, concluding that: “In our view, the burden of persuasion is with the patentee, just as it would be had the patentee brought an infringement suit.”<sup>260</sup>

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254 *Id.* at 2129 (citation omitted).

255 *Id.* at 2130 (citation omitted).

256 *Id.* at 2129.

257 *Id.*

258 *Id.* at 2130.

259 134 S. Ct. 843 (2014).

260 *Id.* at 849.

The Court determined that its view was supported by traditional case law and public policy. Pragmatically, the Court noted that placing the burden on the alleged infringer creates an “obstacle” to an otherwise useful mechanism to challenge patents.<sup>261</sup>

Although a seemingly obscure decision on procedure, this decision protects a cost-effective procedure for challenging overbroad patents. It is another example of the Court pushing back against what it perceives to be a circuit court that is overprotective of patentees.

### 3. *Octane Fitness, L.L.C. v. Icon Health & Fitness, Inc.*<sup>262</sup>

#### *Highmark Inc. v. Allcare Health Management System, Inc.*<sup>263</sup>

Section 285 of the Patent Act provides that a district court “in exceptional cases may award reasonable attorney fees to the prevailing party.”<sup>264</sup> The Federal Circuit interpreted this provision narrowly, concluding that a case is “exceptional” in only two circumstances: (1) when “there has been material inappropriate conduct,” or (2) when the litigation is both (a) “brought in subjective bad faith,” and (b) “objectively baseless.”<sup>265</sup>

Justice Sotomayor, writing for the majority in *Octane Fitness*,<sup>266</sup> rejected this standard, finding that: “[T]he framework established by the Federal Circuit in *Brooks Furniture* is unduly rigid, and it impermissibly encumbers that statutory grant of discretion to district courts.”<sup>267</sup>

Relying on a plain reading of the statutory text and its legislative history, the Court concludes that:

We hold, then, that an “exceptional” case is simply one that stands out from others with respect to the substantive strength of a party’s litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated. District courts may determine whether a case is “exceptional” in the case-by-case exercise of their discretion, considering the totality of the circumstances.<sup>268</sup>

The decision of the Federal Circuit was reversed, and the case remanded for further proceedings consistent with the opinion.<sup>269</sup>

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261 *Id.* at 850-51.

262 134 S. Ct. 1749 (2014).

263 134 S. Ct. 1744 (2014).

264 35 U.S.C. § 285.

265 *Brooks Furn. Mfg., Inc. v. Dutailier Int’l, Inc.*, 393 F.3d 1378, 1381-82 (Fed. Cir. 2005).

266 Justice Sotomayor delivered the opinion of the Court in which Justices Roberts, Kennedy, Thomas, Ginsburg, Breyer, Alito, and Kagan joined. Justice Scalia joined the majority opinion with the exception of three footnotes.

267 *Octane Fitness*, 134 S. Ct. at 1755.

268 *Id.* at 1756.

269 *Id.* at 1758.

In *Highmark*, Justice Sotomayor, writing for a unanimous Court, criticized the Federal Circuit for analyzing fee awards *de novo*, as if they were questions of law. The Court noted with approval that Judge Mayer of the Federal Circuit dissented from this view.<sup>270</sup> The Court concluded: “For reasons we explain in *Octane*, the determination whether a case is ‘exceptional’ under § 285 is a matter of discretion. And as in our prior cases involving similar determinations, the exceptional-case determination is to be reviewed only for abuse of discretion.”<sup>271</sup>

Taken together, the two opinions tell the Federal Circuit to “back off” from protecting losing parties from paying fees in appropriate cases. Although these decisions are framed as matters of statutory interpretation and normal appellate review, they have been hailed as providing a mechanism to rein in abusive patent litigation.

#### 4. Patent Trial and Appeal Board Takes Off

The America Invents Act of 2012 contained new procedural mechanisms for expedited, post-grant, third-party challenges to patents.<sup>272</sup> Section 6 of the Act provided for Inter Partes Reexamination, Post-Grant Opposition and Business Methods Review. Each of these innovations was predicated on the perspective that a potentially significant number of patents were either not new or made overbroad claims, and that these problems should be addressable early by an expert administrative forum.

The forum for these cases is the Patent Trial and Appeal Board (“PTAB”), located within the Patent and Trademark Office.<sup>273</sup> Trial procedures for this new forum were finalized in late 2012.<sup>274</sup>

This year, the Patent and Trademark Office provided data on this court’s work and the resolution of its first litigated cases. The results are startling.

Cases filed per month have jumped from just over twenty per month in September 2012 to over 140 per month for September 2014.<sup>275</sup> This makes PTAB one of the busiest federal trial courts in the United States.

PTAB petitions breakdown by industry as 63.8% Electrical/Computer, 24.1% Mechanical, 4.0% Chemical, 7.8% Bio/Pharma, and 0.3% Design.<sup>276</sup>

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270 *Highmark*, 134 S. Ct. at 1748–49.

271 *Id.* at 1748 (citations omitted).

272 Leahy-Smith America Invents Act, Pub. L. No. 112-29, 125 Stat. 284 (2011) (effective Sept. 16, 2012).

273 35 U.S.C. § 6(a).

274 PATENT & TRADEMARK OFFICE, Rules of Practice Before the Patent Trial and Appeal Board and Judicial Review of Patent Trial and Appeal Board Decisions, 37 C.F.R. § 42.1 *et seq.* (2012).

275 PATENT & TRADEMARK OFFICE, *AIA Program Statistics-Graphical View and Subsets 1* (2015), available at [http://www.uspto.gov/ip/boards/bpai/stats/aia\\_trial\\_statistics.jsp](http://www.uspto.gov/ip/boards/bpai/stats/aia_trial_statistics.jsp).

276 *Id.* at 2. PATENT & TRADEMARK OFFICE, *Patent Trial and Appeal Board AIA Progress Statistics (as of 02/05/2015)*, available at [http://www.uspto.gov/sites/default/files/documents/aia\\_statistics\\_02-05-2015.pdf](http://www.uspto.gov/sites/default/files/documents/aia_statistics_02-05-2015.pdf) (last visited Feb. 12, 2015).

The most striking statistics reflect how tough PTAB panels have been on patent claims. For example, for *inter partes* reviews in the 2014 fiscal year, there were 210 settlements, thirty-nine adverse judgments, and 130 written opinions.<sup>277</sup> In percentage terms, 30% of all written opinions ended in an adverse judgment. This may reflect early challenges to very low quality patents, but the percentage of adverse judgments is very high.

Procedures at PTAB are highly expedited. And oral argument is typically before a three-judge panel consisting of expert judges who understand science and technology. One advocate reported to the Wall Street Journal that appearing before a PTAB panel was like “getting CAT-scanned, MRI-ed, and X-rayed, all within a three-hour period.”<sup>278</sup>

These proceedings are still very new, and not without their critics. Randall Rader, the former chief judge of the Federal Circuit, characterized the PTAB’s panels as “death squads . . . killing property rights.”<sup>279</sup>

Historically, antitrust counterclaims to patent infringement lawsuits were classic strategies to test the quality of a patent. Although not eliminated by the America Invents Act, the new, fast procedures at PTAB may begin to displace these actions.

## **XI. ETHICS**

In developments in professional ethics rules, the American Bar Association (“ABA”) limited lawyer access to jurors’ social media pages, and the California Bar is considering extending the duty of competence to include a “basic understanding” of e-discovery.

### **1. ABA Committee on Ethics & Professional Responsibility, Formal Op. 466<sup>280</sup>**

The American Bar Association has issued a new ethics opinion on lawyer review of a juror’s Internet presence. California has not adopted the ABA model rules, but the state has a rule that is analogous to the rule interpreted by this opinion. At issue was the applicability of ABA rules to use of social media sites to assess jurors. The springboard for the analysis is ABA Model Rule 3.5. In relevant part, it says:

A lawyer shall not:

- (a) seek to influence a judge, juror, prospective juror or other official by means prohibited by law;
- (b) communicate *ex parte* with such a person during the proceeding unless authorized by law or court order . . . .<sup>281</sup>

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277 *Id.* at 5.

278 Ashby Jones, *A New Weapon in Corporate Patent Wars*, WALL ST. J. (Mar. 10, 2014), <http://online.wsj.com/news/articles/SB10001424052702304020104579431393308282698>.

279 *Id.*

280 ABA Comm. on Ethics & Prof’l Responsibility, Formal Op. 466 (2014).

281 MODEL RULES OF PROF’L CONDUCT r. 3.5.

The key issue is when does a lawyer (or his or her agent) “communicate” with a juror. Using the analogy that it would be okay to drive “down the street where a prospective juror lives to observe the environs in order to glean publicly available information that could inform the lawyer’s jury-selection decisions,”<sup>282</sup> the ABA concludes that reviewing a publicly available web page, like a juror’s Facebook page, is not prohibited communication but allowable observation. However, an access request from a lawyer (or the lawyer’s agent) is a form of prohibited communication. But if the mere observation of a page creates a notice from the social media provider, that notice is not deemed to be communication by the lawyer, but communication from the service provider.

This is a logical and practical set of solutions to the nettlesome issue of when lawyers can ethically get information from social media pages.

The analogous California rule is Rules of Professional Conduct, Rule 5-320(B) that states: “During trial a member connected with the case shall not communicate directly or indirectly with a juror.”<sup>283</sup> This rule has yet to be definitively interpreted for social media pages.

However, in an analogous situation in which members are prohibited from contacting represented parties under Rule 2-100, the San Diego County Bar Legal Ethics Committee concluded that “nothing blocks an attorney from accessing a represented party’s public Facebook page.”<sup>284</sup> Asking for access, however, as in the ABA opinion, crosses the line.

## **2. State Bar Standing Committee on Professional Responsibility & Conduct, Proposed Formal Opinion Interim No. 11-0004 (ESI and Discovery Requests)<sup>285</sup>**

The California Bar’s Standing Committee on Professional Responsibility and Conduct invited and recently received comments on a draft ethics opinion that would conclude:

An attorney’s obligations under the ethical duty of competence evolve as new technologies develop and then become integrated with the practice of law. Attorney competence related to litigation generally requires, at a minimum, a basic understanding of, and facility with, issues relating to e-discovery, i.e. the discovery of electronically stored information (ESI). . . . Lack of competence in e-discovery issues can also result in certain circumstances in ethical violations of an attorney’s duty of confidentiality, the duty of candor and/or the ethical duty not to suppress evidence.<sup>286</sup>

Input on this proposed opinion closed on June 24, 2014. This opinion is expected to issue in some form. If one does not regularly keep up on ESI issues and the latest on

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282 ABA Comm. on Ethics & Prof’l Responsibility, Formal Op. 466, at 4 (2014).

283 Cal. Prof. Conduct, Rule 5-320(B).

284 San Diego County Bar Assoc., Legal Ethics Op. 2011-2 (2011), *available at* <https://www.sdcba.org/index.cfm?pg=LEEC2011-2>.

285 State Bar of Cal. Standing Comm. on Prof. Responsibility and Conduct, Formal Op. Interim No. 11-0004 (2014).

286 *Id.* at 1.

predictive coding, this potential adjustment in the rule of competence creates a strong incentive to sign up for a Continuing Legal Education program (“CLE”) (or two).

## **XII. NEW RULES**

Several new federal rules in appellate procedure, civil procedure, and evidence became effective on December 1, 2014. In September 2014, the Federal Judicial Conference forwarded a more controversial set of rule changes to the Supreme Court, which will potentially become effective by December 1, 2015. Further, several new state rules became effective on January 1, 2014 and July 1, 2014.

### **1. Federal Rules Effective December 1, 2014**

On April 25, 2014, Chief Justice Roberts forwarded proposed changes in the federal rules to the House of Representatives.<sup>287</sup> These rules became final on December 1, 2014.<sup>288</sup> Major changes include:

#### *1. Federal Rules of Appellate Procedure*

Rule 6(b)<sup>289</sup> is adjusted to provide a streamlined procedure for re-designating and forwarding the record on appeal for direct appeals of bankruptcy court decisions.

#### *2. Federal Rules of Civil Procedure*

Rule 77<sup>290</sup> is amended to provide that a court may require that the clerk’s office be open during specified hours on Saturday.

#### *3. Federal Rules of Evidence*

In the most significant amendment, the Federal Rules of Evidence are amended to provide that records that meet standard hearsay exceptions, including business records, presumptively come into evidence if the elements of the exception are met. Once this showing is made, the burden explicitly shifts to the opponent of admission to “show that the source of information or the method or circumstances of preparation indicate a lack of trustworthiness.” This approach applies to Records of Regularly Conducted Activities,<sup>291</sup> Absence of a Record of Regularly Conducted Activity,<sup>292</sup> and Public Records.<sup>293</sup>

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287 See SUMMARY OF THE REPORT OF THE JUDICIAL CONFERENCE COMMITTEE ON RULES OF PRACTICE AND PROCEDURE (Sept. 2013), available at <http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Reports/ST09-2013.pdf>.

288 See 160 CONG. REC. H7933 (daily ed. Nov. 12, 2014); H.R. Doc. No. 113-161 (2014) (FED. R. APP. P. 6); H.R. Doc. No. 113-163 (2014) (FED. R. CIV. P. 77); H.R. Doc. No. 113-164 (2014) (FED. R. EVID. 801, 803).

289 FED. R. APP. P. 6(b).

290 FED. R. CIV. P. 77.

291 FED. R. EVID. 803(6)(E).

292 FED. R. EVID. 803(7)(C).

293 FED. R. EVID. 803(8)(B).

## 2. More Controversial Federal Rules in the Pipeline

Further, the Federal Judicial Conference forwarded a more controversial set of rule changes to the Supreme Court in September 2014.<sup>294</sup> If these rules are approved by the Supreme Court early this year, they could become effective by December 1, 2015. These rules originally cut in half the number of interrogatories and depositions presumptively allowed under the Federal Rules of Civil Procedure, but those changes were dropped after strong negative responses from numerous legal organizations and individual lawyers.

The remaining proposals, however, are still significant. The most important are:

- Proposed Rule 26(b)(1) provides that the scope of discovery is limited to “matter that is relevant to any party’s claim or defense *and* proportional to the needs of the case, considering the importance of the issues at stake in the action, the amount in controversy, the parties’ relative access to relevant information, the parties resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the discovery in resolving the issues outweighs its likely benefit.”<sup>295</sup>
- Proposed Rule 37(e) significantly limits the ability of federal courts to issue terminating or adverse inference sanctions for spoliation of evidence.<sup>296</sup>

These proposed amendments have already been the subject of numerous articles and CLE programs. We expect more coverage throughout the year.

## 3. State Rules Effective on January 1, 2014 and July 1, 2014

The Ethics Standards for Neutral Arbitrators in Contractual Arbitration are amended to increase disclosures of (1) personal relationships of persons close to the arbitrator who also have relationships with one of the parties to the arbitration and (2) actual or possible business relationships with one of the parties to the arbitration. The most significant change is Standard 17, which is amended to limit “solicitation” of business.<sup>297</sup> On these same dates, amended California Rules of Court become effective regulating petitions under the California Environmental Quality Act.<sup>298</sup>

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294 See SUMMARY OF THE REPORT OF THE JUDICIAL CONFERENCE COMMITTEE ON RULES OF PRACTICE AND PROCEDURE (Sept. 2014), available at <http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Reports/ST09-2014.pdf>.

295 PROPOSED AMENDMENTS TO THE FED. R. CIV. P. 10 (2014) (emphasis added), available at [www.uscourts.gov/uscourts/RulesandPolicies/rules/civil\\_rules\\_redline.pdf](http://www.uscourts.gov/uscourts/RulesandPolicies/rules/civil_rules_redline.pdf).

296 *Id.* at 36.

297 AMENDMENTS TO ETHICS STANDARDS FOR NEUTRAL ARBITRATORS IN CONTRACTUAL ARBITRATION (2014), available at [http://www.courts.ca.gov/documents/Arb\\_Ethics\\_2014-07-01.pdf](http://www.courts.ca.gov/documents/Arb_Ethics_2014-07-01.pdf).

298 See AMENDMENTS TO CALIFORNIA RULES OF COURT R. 3.1365 (2014), available at [http://www.courts.ca.gov/documents/2014-07-01\\_Rules\\_doc.pdf](http://www.courts.ca.gov/documents/2014-07-01_Rules_doc.pdf).

### XIII. DEVELOPMENTS ABROAD

There were two important international developments in 2014. First, the European Union enacted a directive on private antitrust damage actions. Second, the Supreme Court of Canada addressed indirect purchaser class actions in three significant decisions.

#### 1. Directive 2014/104/E.U. of the European Parliament and of the Council of 26 November 2014 on Certain Rules Governing Actions Under National Law for Infringements of the Competition Law Provisions of the Member States and the European Union, 2014 O.J. (L349) 1<sup>299</sup>

On November 26, 2014, the European Union enacted standards for damage actions brought under the competition laws of the European Union or its Member States. Major changes include:

- **Full Compensation:** Article 3 provides that any natural or legal person harmed by a competition law violation is entitled to “obtain full compensation for that harm.”<sup>300</sup>
- **Disclosure of Evidence:** Article 5 provides for disclosure of “reasonably available facts and evidence sufficient to support the plausibility of [plaintiff’s] claim for damages.”<sup>301</sup> This is subject to a proportionality principle.<sup>302</sup> Confidentiality is to be protected,<sup>303</sup> as is “applicable legal professional privilege.”<sup>304</sup>
- **Collateral Estoppel:** Article 9 provides that “infringement” of local or E.U. competition law is “deemed to be irrefutably established” for purposes of a damage action by a “final decision of a national competition authority or by a review court.”<sup>305</sup>
- **Limitation Period:** Article 10 provides that the statute of limitations may not be less than five years. This period is tolled by actions of competition authorities and is triggered when the illegal activity “ceased and the claimant knows, or can reasonably be expected to know” about the activity.<sup>306</sup>

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299 2014 O.J. (L349) 1, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0104&from=EN>.

300 *Id.* at 12.

301 *Id.*

302 *Id.*

303 *Id.*

304 *Id.* at 13.

305 *Id.* at 14-15.

306 *Id.* at 15.

- **Joint and Several Liability:** Article 11 creates joint and several liability for “joint behavior.”<sup>307</sup> This principle is limited, however, for defined “small or medium-sized enterprises,” which are liable only for damages to their “own direct and indirect purchasers.”<sup>308</sup> A similar limitation protects any “immunity recipient.”<sup>309</sup>
- **Passing-On:** Article 12 provides that “direct or indirect purchasers” harmed by an infringement can recover for their injuries.<sup>310</sup> Recoveries are limited to “actual loss at any level of the supply chain,” but should not exceed the harm suffered at that level.<sup>311</sup> Article 13 recognizes a passing-on defense, but the burden of demonstrating passing-on “shall be on the defendant.” Indirect purchasers bear the burden of showing injury, but this is presumed when the indirect purchaser shows:
  - (1) the defendant violated the law;
  - (2) the violation resulted in an overcharge to the downstream claimant; and
  - (3) the claimant purchased goods or services that were the “object of the infringement” or “has purchased goods or services derived from or containing them.”<sup>312</sup>

The defendant can rebut this presumption by demonstrating “credibly to the satisfaction of the court that the overcharge was not, or was not entirely, passed on to the indirect purchaser.”<sup>313</sup>

- **Quantification of Harm:** Article 17 provides that “neither the burden or the standard of proof for the quantification of harm” may render “exercise of the right to damages practically impossible or excessively difficult.”<sup>314</sup>
- **Settlement:** Following a “consensual settlement, the claim of the injured part is reduced by the settling co-infringer’s share of the harm.”<sup>315</sup> “Any remaining claim of the settling claimant shall be exercised only against non-settling [defendants].”<sup>316</sup>

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307 *Id.*

308 *Id.*

309 *Id.*

310 *Id.* at 16.

311 *Id.*

312 *Id.*

313 *Id.* at 17.

314 *Id.*

315 *Id.* at 18.

316 *Id.*

- **Effective Date:** Member States “shall bring into force the laws, regulations and administrative provisions necessary to comply with” the Directive by December 27, 2016.<sup>317</sup>

These new standards set the stage for a new era of private litigation in the European Union. If your clients have potential E.U. exposure, this is a must-read statute and suggests that you will want to monitor nation-by-nation implementation of these standards.

These standards are also potentially interesting to U.S. practitioners. In particular, the structure for addressing passing-on issues appears quite practical. The creation of a rebuttable presumption that anti-competitive overcharges will pass to downstream purchasers, after a minimum showing, is potentially a good way to address the complexity of inter-level damage disputes.

## 2. *Pro-Sys Consultants, Ltd. v. Microsoft Corp.*<sup>318</sup>

### *Sun-Rype Products, Ltd. v. Archer Daniels Midland Co.*<sup>319</sup>

### *Infineon Technologies AG v. Option consommateurs*<sup>320</sup>

These three decisions bring a relatively pro-plaintiff perspective to private antitrust litigation in Canada. The most important policy decision is *Microsoft*, in which the Canadian court addresses a litany of rationales for denying or limiting indirect purchaser damage actions. The court, for example: rejected the assertion that direct purchasers are the most effective private enforcers of the antitrust laws; rejected the idea that indirect purchaser actions are too complex; and acknowledged that its decision was different from the U.S. Supreme Court’s decision in *Illinois Brick*, citing with approval various state repealers of the *Illinois Brick* rule and the Supreme Court’s own decision in *California v. ARC America*,<sup>321</sup> protecting such statutes from federal preemption.<sup>322</sup>

Canada’s high court rejected potential inter-level disputes as a basis for denying class certification, writing “to the extent that there is conflict between the class members as to how the aggregate amount is to be distributed . . . this is not a concern of respondents and is not a basis for denying indirect purchasers the right to be included in the class action.”<sup>323</sup>

The court also adopted the rationale of the Quebec Court of Appeal, which had held that a contract between a seller and an end-user in Quebec conferred class action jurisdiction on Quebec trial courts.<sup>324</sup>

317 *Id.*

318 [2013] S.C.R. 477 (Can.).

319 [2013] S.C.R. 545 (Can.).

320 [2013] S.C.R. 600 (Can.).

321 490 U.S. 93 (1989). The author represented California in this appeal.

322 *Microsoft*, [2013] S.C.R. 477, ¶¶ 44-59.

323 *Sun-Rype Prods.*, [2013] S.C.R. 545, ¶ 20.

324 *Infineon Techs.*, [2013] S.C.R. 600, ¶ 48.

Taken together, these decisions illuminate how different Canadian law is from U.S. law. Like the developments in the E.U., these decisions are very important to your international clients.

#### **XIV. OTHER DEVELOPMENTS**

The Green Bag, a legal periodical famous during the Progressive Era and recently revived as a publication focused on good legal writing,<sup>325</sup> recently honored a number of California judges and publications with exemplary legal writing awards.<sup>326</sup> Honorees include:

- District Judge Susan Ilston (N.D. Cal.) for her opinion in *In re National Security Letter*.<sup>327</sup> The opinion addresses complex national security and First Amendment issues with clarity and assurance.
- Circuit Judge Milan D. Smith, Jr. for his dissenting opinion in *Lane v. Facebook, Inc.*<sup>328</sup> Judge Smith was joined by five circuit judges in questioning an expansion of the *cy pres* doctrine as applied to class actions. His opinion is a model of economy and precision.
- Seventh Circuit Judge Diane Wood for her article in the California Law Review, *When to Hold, When to Fold and When to Reshuffle: The Art of Decisionmaking on a Multi-Member Court*.<sup>329</sup> This article starts with a quote from Mel Brooks and ends with thoughtful insights into how appellate courts really work.

Also singled out as among the best writing in the country were:

- Circuit Judge John T. Noonan for his opinion in *Kumar v. Holder*.<sup>330</sup> This is a thoughtful decision addressing the issue of what conduct is sufficient to eject an immigrant for his potential role in torturing political prisoners in his home country.
- Chief Circuit Judge Alex Kozinski for his opinion in *In re Motor Fuel Temperature Sales Practices Litigation*.<sup>331</sup> This is a short opinion rejecting the offer of an inter-circuit transfer of cases to another circuit. In effect, this is a judicial kiss-off, albeit done in meticulous prose.

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325 More on The Green Bag can be found at: <http://www.greenbag.org/>.

326 Editors, *Recommended Reading*, 2014 Green Bag Alm. 6-10.

327 930 F. Supp. 1064 (N.D. Cal. 2013).

328 709 F.3d 791 (9th Cir. 2013).

329 100 CALIF. L. REV. 1445 (2012).

330 728 F.3d 993 (9th Cir. 2013).

331 711 F.3d 1050 (9th Cir. 2013).

- Judge Otis T. Wright for his opinion in *Ingenuity 13 LLC v. Doe*.<sup>332</sup> This order starts with a quote from Star Trek's Mr. Spock and then dispatches a law firm that coerced settlements from individuals who had downloaded videos on pain of paying exorbitant legal fees.

These are examples of the best legal writing in the United States. Award-winning writings are reprinted in the 2014 *Green Bag Almanac and Reader*.

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332 No. 2:12-cv-8333-ODW (JCx), 2013 U.S. Dist. LEXIS 64564 (C.D. Cal. May 6, 2013).

# RESTORING BALANCE IN THE TEST FOR EXCLUSIONARY CONDUCT

By Thomas N. Dahdouh<sup>1</sup>

The Federal Trade Commission's recent monopolization cases against Intel<sup>2</sup> and Google,<sup>3</sup> two strikingly different recent decisions by Courts of Appeals – *Novell v. Microsoft*<sup>4</sup> and *ZF Meritor v. Eaton Corp.*,<sup>5</sup> and a recent article by Professor Herbert Hovenkamp<sup>6</sup> all demonstrate the ongoing tumult in Sherman Act Section Two monopolization theory. Courts have struggled for some time now with the vague and circular test for Sherman Act Section Two cases, first enunciated in *United States v. Grinnell Corp.*<sup>7</sup> Unfortunately, the line between exclusionary conduct and legitimate conduct cannot be delineated easily. Faced with the difficulty in assessing conduct in a fact-intensive and nuanced manner, some courts have sought “one-size-fits-all” tests that would allow a court to dismiss summarily meritless cases without engaging in fact-intensive investigation. Indeed, the Supreme Court's decisions in *Pacific Bell Telephone Co. v. linkLine Communications Inc.*<sup>8</sup> and *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*<sup>9</sup> have certainly encouraged such efforts. The reality is that the near limitless variation of exclusionary conduct – and the serious potential that such conduct could seriously impair competition – makes any such effort to find a uniform test likely to lead to a seriously under-deterrent enforcement regime.

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- 1 Regional Director, Western Region, Federal Trade Commission. The thoughts expressed in this article are the author's own, and do not reflect the views of the FTC, any Commissioner or anyone else. This article was developed from talks given at the Los Angeles County Bar Association in December 2013 and at the Golden State Antitrust Institute in San Francisco in October 2014.
  - 2 Complaint, *In the Matter of Intel Corp.*, No. 9341 (F.T.C. Dec. 16, 2009), available at <http://www.ftc.gov/os/adjpro/d9341/091216>. The matter was settled through a consent agreement, issued in 2010. Decision and Order, *In the Matter of Intel Corp.*, No. 9341 (F.T.C. Oct. 29, 2010), available at <http://www.ftc.gov/os/adjpro/d9341/1001102inteldo.pdf>.
  - 3 Statement of the Federal Trade Commission Regarding Google's Search Practices, *In the Matter of Google Inc.*, No. 111-0163 (F.T.C. Jan. 3, 2013), <http://www.ftc.gov/public-statements/2013/01/statement-federal-trade-commission-regarding-googles-search-practices>. All of the Commissioner's statements regarding the Google investigation are available online. F.T.C., GOOGLE AGREES TO CHANGE ITS BUSINESS PRACTICES TO RESOLVE FTC COMPETITION CONCERNS IN THE MARKETS FOR DEVICES LIKE SMART PHONES, GAMES AND TABLETS, AND IN ONLINE SEARCH (Jan. 3, 2013), <http://www.ftc.gov/news-events/press-releases/2013/01/google-agrees-change-its-business-practices-resolve-ftc>.
  - 4 731 F.3d 1064 (10th Cir. 2013), cert. denied, 2014 U.S. LEXIS 2960 (Apr. 28, 2014).
  - 5 696 F.3d 254 (3d Cir. 2012).
  - 6 Herbert J. Hovenkamp, *The Areeda-Turner Test for Exclusionary Pricing: A Critical Journal*, U. IOWA LEGAL STUDIES RESEARCH PAPER NO. 14-16 (Apr. 2014), available at <http://ssrn.com/abstract=2422120>.
  - 7 The test is whether a company has monopoly power (which generally requires a market share above 70% as well as high barriers to entry) and has engaged in “willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.” *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966); see also Einer Elhauge, *Defining Better Monopolization Standards*, 56 STANFORD L. REV. 253 (2003).
  - 8 555 U.S. 438 (2009).
  - 9 540 U.S. 398 (2004).

Rather, the right enforcement approach must utilize a flexible balancing test. The District of Columbia Circuit Court, sitting *en banc* in the *Microsoft* case, unanimously adopted the right overarching, rule-of-reason approach: a court must balance the anticompetitive effect of the exclusionary conduct against the procompetitive justification for the conduct.<sup>10</sup> This article suggests a further addition to the overarching balancing test: namely, that the balancing test be adjusted depending on the type of exclusionary conduct at issue in the case. This article proposes that one would first (1) identify the type of conduct involved and slot it along a continuum from most suspect to least suspect; and then (2) adjust how demanding the “balancing test” is along the two key inquiries of the balancing test: (a) the level of evidence necessary to show that the asserted justification for the conduct is nonpretextual and cognizable (that is, procompetitive and efficiency-enhancing), and (b) the level of causal proof necessary to show that the conduct played a role in the creation or maintenance of the defendant’s monopoly power.

This article will first explain this approach in more detail, before turning to discuss in more detail the allegations in *Google*, the *Novell* and *ZF Meritor* decisions, and Professor Hovenkamp’s article on predatory pricing.

## I. A CONDUCT-SPECIFIC BALANCING TEST

First, case-by-case adjudication by federal courts – and federal antitrust enforcement authorities – has developed implicit categories for exclusionary conduct from most to least suspect. The most suspect conduct includes the following:

- refusing to sell to a customer because the customer is also buying from a rival, as in *Lorain Journal Co. v. United States*;<sup>11</sup>
- treating a customer differently because it is a rival or would-be rival, as in the FTC’s first Intel case, *FTC v. Intel Corp.*;<sup>12</sup>
- “muscling” behavior – threats and tortious acts, including deceptive practices;<sup>13</sup> and

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10 *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001), *cert. denied*, 534 U.S. 952 (2001).

11 342 U.S. 143 (1951) (holding unlawful monopoly newspaper’s decision to refuse to accept advertising from companies that were also buying advertising time from rival radio station).

12 128 F.T.C. 213 (1999) (challenging, *inter alia*, Intel’s refusal to sell microprocessors to computer Original Equipment Manufacturer (“OEM”) customer Digital Equipment Corporation because Digital had sued Intel for patent infringement in microprocessors; Digital at the time was developing a rival microprocessor architecture that could have threatened Intel’s monopoly).

13 *Conwood Co. L.P. v. U.S. Tobacco Co.*, 290 F.3d 768 (6th Cir. 2002) (finding that monopolist violated Section Two, by, *inter alia*, removing rival retail display racks without retailers’ permission and providing misleading information to retailers about competing products). *See generally* Maurice E. Stucke, *When a Monopolist Deceives*, 76 ANTITRUST L. J. 823 (2010) (arguing that then-existing monopolization law theory was far too skeptical of the anticompetitive potential of deceptive practices by a monopolist).

- entering into exclusives with customers that foreclose rivals from the most efficient distribution outlets, as in *United States v. Dentsply International Inc.*<sup>14</sup>

Nor far off would be conduct that falls in what has been termed “cheap exclusion.” Cheap exclusion generally involves deception and tortious conduct.<sup>15</sup> Exclusionary practices that are both inexpensive to undertake and incapable of yielding any cost-reducing efficiencies are “cheap” in both senses of that term and are most likely to appeal to a firm bent on maintaining or acquiring market power by anticompetitive means. Classic examples are instances of deception in the standard-setting process. For example, in *Broadcom Corp. v. Qualcomm Inc.*,<sup>16</sup> the court held that a standard-setting participant’s false promise to license its patents that would read on the proposed standard could make out a monopolization claim. Another example is the *Conwood* case.<sup>17</sup> In that case, the plaintiff had adduced evidence that the monopolist had engaged in a wide range of tortious conduct, including removing retail display racks with competitors’ products without retailers’ permission, providing misleading information to retailers about competing products and entering into exclusive agreements with retailers to exclude products.<sup>18</sup>

In the middle are near-exclusives, loyalty discounts or significant conditional discounts that lead to *de facto* exclusivity. These practices – commonly referred to as “minimum share discounts” – were part of the concerns that formed the basis of the second *Intel* case brought by the FTC.<sup>19</sup> In *Intel*, the Commission found suspect the significance of the minimum share discounts involved – so-called “all unit” or first unit” discounts that were so large that relatively miniscule reductions in purchases could result in the loss of *all* the discounts.<sup>20</sup> Indeed, the OEM computer customers often

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14 399 F.3d 181, 191 (3d Cir. 2005) (holding that *de facto* exclusive dealing arrangements with certain distributors that foreclosed the most efficient avenues for distribution violated Section Two).

15 Susan A. Creighton, D. Bruce Hoffman, Thomas G. Krattenmaker & Ernest A. Nagata, *Cheap Exclusion*, 72 ANTITRUST L.J. 975 (2005).

16 501 F.3d 297 (3d Cir. 2007).

17 *Conwood*, 290 F.3d 768 (6th Cir. 2002).

18 *Id.* at 773–81. *But see* Joshua D. Wright, *Antitrust Analysis of Category Management: Conwood v. United States Tobacco Co.*, 17 SUP. CT. ECON. REV. 311, 330 (2009) (arguing that the Sixth Circuit failed “to distinguish authorized from unauthorized product removal, or systematic product destruction from limited, one-time events, [and thus] allowed harm to a competitor to substitute for evidence of harm to competition”).

19 Complaint ¶¶ 53–54, *In the Matter of Intel Corp.*, No. 9341 (F.T.C. Dec.16, 2009), <http://www.ftc.gov/os/adjpro/d9341/091216>.

20 Economic analysis explains that discounts that apply to all of the units that the buyer has purchased if and only if the buyer has met its volume or market share target can create a powerful incentive to meet or exceed the share target. Zhijun Chen & Greg Shaffer, *Naked Exclusion with Minimum Share Requirements*, 45 RAND J. OF ECON. 64 (Spring 2014); Janusz A. Ordovery & Greg Shaffer, *Exclusionary Discounts* (CCP Working Paper No. 07-13, (June 2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=995426](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=995426)).

needed these discounts simply to remain profitable in a particular market segment.<sup>21</sup> The Commission also objected to the conditions placed on some of the discounts.<sup>22</sup>

Also in the middle of the exclusionary continuum are claims that a manufacturer has created technological incompatibilities for interconnections with complementary products. In this second *Intel* case brought by the FTC,<sup>23</sup> the Commission indicated that Intel had crossed the line by generating incompatibilities in the “bus” – the connection that allowed the graphics chip to work together with the microprocessor – that would preclude competitors’ previously-compatible graphics chips from working together with Intel’s future microprocessors.<sup>24</sup> In that regard, the Commission alleged that Intel perceived the graphics chips manufacturers as a threat to Intel’s microprocessor monopoly, as well as competition in the graphics chip market.<sup>25</sup>

There is a fine line between issues relating to designing features and capabilities of a product that somehow adversely affect a rival or potential rival and incompatibilities in interconnections. The latter – suddenly ending a voluntary and presumably profitable course of enabling interconnections – may suggest that the change constitutes a deliberate effort to deter competition, particularly where the complementary product maker was poised to threaten the defendant’s monopoly market. As described later in this article, the issues in its *Google* decision fell more in the first category, while the issues that the FTC grappled with in its 2009 *Intel* action sounded squarely in the second.

In the FTC’s *Google* investigation,<sup>26</sup> certain companies alleged that Google’s redesign of its search engine result page reduced the prominence in the display of their results. Design changes that have some adverse effect on other companies are, to my mind, much more difficult to challenge than technological incompatibilities. This is simply because valid business justifications are more likely for design

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21 Amended Complaint at 36, *New York v. Intel Corp.* (D. Del. Oct. 12, 2009) (No. 09-827) (“Dell’s quarterly profit margins depended on Intel’s payments”), available at <http://www.ag.ny.gov/antitrust/legal-documents/people-v-intel-corporation>; *id.* at 56-57 (“A senior [Hewlett-Packard] executive emphatically vetoed [a plan to buy more of Advanced Micro Devices Inc. chips], because without the ‘Intel moneys . . . we do not make it financially’: ‘You can NOT use the commercial AMD line in the channel in any country, it must be done direct. If you do and we get caught (and we will) the Intel moneys (each month) is gone (they would terminate the deal). The risk is too high. Without the money we do not make it financially. . . .’”). The New York State Attorney General later settled this action against Intel on Feb. 9, 2012.

22 In some instances, Intel required that the OEM only bid Intel-based computers, and offer Advanced Micro Device Inc. (AMD) based computers only if the end user affirmatively asked for AMD. See *infra* text at n. 77.

23 See *supra* at n. 19.

24 Complaint ¶¶ 75-91, In the Matter of Intel Corp., No. 9341 (F.T.C. Dec. 16, 2009), available at <http://www.ftc.gov/os/adjpro/d9341/091216>.

25 *Id.*

26 See *supra* note 3.

changes that may make a product more desirable for consumers.<sup>27</sup> Consequently, design improvements are at the least-suspect end of the continuum. Courts have demonstrated some level of hostility to requiring a monopolist to design the features and capabilities of its own products to allow competitors to compete more effectively.<sup>28</sup>

Following this continuum as outlined above can give a court a better sense of how to assess the particular conduct at issue. A court can fit the alleged conduct along this continuum and then assess it further. In the figure below, I have arrayed the different types of exclusionary conduct. A court could then employ a sliding scale for the balancing test focused on two key metrics: (1) assessing the asserted business justification for the conduct; and (2) assessing the causal link between the conduct and the creation or maintenance of the company’s monopoly power.

**Focusing on Type of Conduct and Adjusting Test Accordingly Depending on the Degree of Potential Harm**

- ☐ Type of conduct arrayed from more problematic to less problematic:
  - ☐ Refusing to Sell to a Customer Because that Customer is Also Buying From a Rival
  - ☐ Treating a Customer Differently From Other Customers Because it is a Rival or Would-Be Rival
  - ☐ Cheap Exclusion: “Misleading” Deceptive Practices; Contracts Referencing Rivals Including MFN
  - ☐ Exclusives/Near Exclusives
  - ☐ Technological Incompatibilities for Interconnections with Complementary Products
  - ☐ Loyalty/Market Share Discounts
  - ☐ Predatory Pricing (*Eurois Group*)
  - ☐ Product Design Issues (a la Google)
- ☐ A sliding scale in assessing each category of conduct makes sense. Depending on where the conduct at issue is in this hierarchy, you would adjust the following key decisionmaking parameters in your Section 2 analysis:
  - ☐ Assessing Asserted Business Justifications for Conduct – How Much of a Showing is Enough?; How Closely is it Scrutinized?; Is it Balanced Against the Competitive Harm? How?
  - ☐ Causation Level of Proof: Without Conduct, No Monopoly Position (Rambus?) Vs. Type of Conduct Reasonably Appearing Capable of Making a Significant Contribution to Monopoly Position (Microsoft *En Banc*)

*Assessing the Business Justification for the Conduct:* The D.C. Circuit in *Microsoft* described how to assess any procompetitive justification for the conduct. First, the justification must be “nonpretextual” – that is, there must be some basis in evidence to support the claimed justification – and, second, the justification must

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27 There are certainly circumstances where a technological incompatibility occurs at the same time that a monopolist makes a design change. Those instances should be placed in the middle of the continuum, so that the court can fully balance the non-pretextual and procompetitive reasons of the design change fully against the harm to competition.

28 *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 286 (2d Cir. 1979) (“[A]ny firm, even a monopolist, may bring its products to market whenever and however it chooses.”).

be cognizable – that is, it must provide a “great[] efficiency or enhanced consumer” benefit.<sup>29</sup> It is fairly easy to adjust these two key assessments and vary their strength, depending on how suspect the conduct is.

For conduct at the more suspect level, a greater quantum of evidence that the justification is non-pretextual may be necessary. For example, an adjudicator could require not just testimony supporting the claim of business justification, which may be self-serving, but also contemporaneous documents justifying the conduct at the time it is implemented. Similarly, to the extent that the conduct falls into the less-suspect end of the spectrum, a lower standard of proof may suffice.

On the issue of cognizability, one can similarly construct an array of different levels of proof. For example, at the more suspect level, one might require that the conduct be narrowly tailored to achieve the efficiency or enhanced consumer benefit. If less restrictive alternatives exist to achieve the same benefits, then the conduct can be condemned. As one moves toward the less suspect end of the spectrum, one could drop the requirement that the conduct be narrowly tailored. Even if there are other easily achievable methods to gain the efficiency goal, particular conduct might be acceptable, so long as it does in fact logically advance an efficiency-enhancing or beneficial-to-consumers goal.

*Adjusting the Appropriate Level of Causal Proof:* Causation is a trickier matter. The DC Court in *Microsoft* stated that it would *not* require the plaintiff to prove that the conduct caused or maintained the monopoly power. The Court pointed out the difficulty of proving what would have happened in the absence of the defendant’s exclusionary conduct: “neither plaintiffs nor the court can confidently reconstruct a product’s hypothetical technological development in a world absent the defendant’s exclusionary conduct.”<sup>30</sup>

Indeed, the D.C. Circuit itself later mistakenly utilized a heightened causal test to wrongly dismiss monopolization claims. In *Rambus Inc. v. FTC*,<sup>31</sup> the court ignored its prior holding in *Microsoft* and required that the FTC prove that, “but for” Rambus’ deception during a standard-setting process that it had no patents (or pending patent applications) that read on a proposed technological standard, the standard-setting body would have picked another standard. As explained by scholars, such a daunting test is inappropriate for exclusionary claims of deception, as for nearly every other aspect of exclusionary conduct.<sup>32</sup> A test requiring a plaintiff to prove what would have happened absent the exclusionary conduct would frankly snuff out any challenge to exclusionary practices by a monopolist, rendering Section Two a statutory nullity. In a way, the test would be similar to a requirement that

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29 *United States v. Microsoft Corp.*, 253 F.3d 34, 59 (D.C. Cir. 2001), *cert. denied*, 534 U.S. 952 (2001).

30 *Id.* at 79.

31 522 F.3d 456, 461 (D.C. Cir. 2008), *cert. denied*, 129 S. Ct. 1318 (2009).

32 See generally Joel M. Wallace, *Rambus v. F.T.C. in the Context of Standard-Setting Organizations, Antitrust and the Patent Hold-Up Problem*, 24 BERKELEY TECH. L.J. 661, 683-84 (2009) (“The central fault of the D.C. Circuit’s analysis was the misapplication of its own decision in *Microsoft* regarding the proof of causation necessary to support a claim of anticompetitive conduct.”).

is sometimes advanced by defense counsel in monopolization cases that a plaintiff must show that the conduct in question had an effect on price. Again, given the impossibility of reconstructing a hypothetical world without the conduct, such a requirement should be rejected out of hand.

Rather, as the DC Circuit held in *Microsoft*, it is sufficient that the plaintiff show that the conduct is of a type reasonably appearing capable of making a significant contribution to the creation or maintenance of the company's monopoly position.<sup>33</sup> But, even as to this standard, there can be gradations of proof. For example, at the more suspect end of the spectrum, it may be sufficient to show that the conduct in question is similar to practices that have been condemned in other contexts as potentially exclusionary. In the middle, a plaintiff might need to show a bit more, such as how, as a matter of logic, the conduct in question could potentially undermine a rival's threat to the monopolist's market share.<sup>34</sup> At the least suspect end of the spectrum, one would want even more: for example, some evidence that the monopolist acted because it perceived that its monopoly was threatened or thought that the conduct could help it in some way in attaining or maintaining its monopoly.

*Applying These Two Metrics in a Balancing Context:* For the most suspect types of conduct, one would likely want to see a heightened showing of business justification in contemporaneous documents. One would also want to see evidence that the conduct at issue was narrowly tailored to achieve the demonstrated business justification. A similar test should be applied to most forms of cheap exclusion.

For issues in the middle ground, one would want to apply a moderate level of scrutiny on the asserted business justification for the change. For example, concerning technological incompatibilities, if an alternative design that was relatively easily available could have kept the connection intact and there was evidence – from internal documents – that the change was done, in part, to forestall competition in the monopoly product by producers of complementary products, then the change should be condemned. But if the alleged consumer benefit could not have been just

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33 *Microsoft*, 253 F.3d at 79.

34 Indeed, a compelling argument can be made that, despite protestations to the contrary, intent evidence is a key part of any Section Two challenge. Intent evidence can be quite illuminating in revealing the exclusionary logic behind certain conduct. See *Microsoft*, 253 F.3d at 59 (intent evidence is relevant because it helps the court “understand the likely effect of the monopolist’s conduct.”). The concern one hears about using intent evidence is that companies often use florid language in describing how they compete. This is really an overblown concern in the monopolization context, because a case must pass through so many threshold requirements before the court even makes it to assessing the nature of the conduct at issue. Moreover, courts are certainly adept at distinguishing between contemporaneous documents that trash talk generally and those that elucidate the anticompetitive logic behind decisions by a monopolist to employ certain conduct.

as easily improved without terminating the interconnections, then the change should not be condemned.<sup>35</sup>

Similarly, minimum share discounts also fall in the middle ground. The key question here is whether such discounts are structured so as to effectively foreclose the most efficient channels of distribution by rivals or otherwise dampen competition significantly.<sup>36</sup> The test should *not* be the *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*<sup>37</sup> predatory pricing test – a showing of prices below Average Variable Cost (“AVC”) during the predation period as well as proof that the predator will likely recoup any lost profits thereafter – because that test does not focus on the particular harm from near-exclusives like these. Although, as we will see in the *ZF Meritor* decision, this question is not free from controversy, discounts that are tied to a company achieving a certain percentage of their purchases from the monopolist must be assessed for their *foreclosure* effect from the conditions on the discount, not the *price* effect of the discount itself. That is, the fact that a minimum share discount is not below average variable cost should not matter to the analysis; rather, the test should focus on the practical effect that the aggregation of such contracts has on the ability of rivals to access the most efficient channels of distribution.

Moreover, the test must not be the same as the test for total exclusives. Exclusives – because of their higher potential for foreclosing rivals – require a much higher showing of business justification. For example, one would want to see contemporaneous documentation of any asserted justification before clearing long-term 100% exclusives by a monopolist. By contrast, there may be cognizable business justifications for minimum share discounts. For example, economic literature suggests that a seller may be able to use minimum share discounts to induce its distributors to work harder to sell the seller’s product, by providing customers with additional information.<sup>38</sup> One would still require some documentation of the efficiency justification, though, in order to forestall the possibility that the justification was

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35 In this regard, it should be pointed out that the treatise *Antitrust Law Development’s* description of the state of the law here is out of line with the D.C. Circuit’s explicit balancing test standard it developed in the *Microsoft* decision and its holdings in that case. Indeed, the treatise only highlights the portions of the *Microsoft* decision where the court rejected challenges to technological incompatibilities, while oddly ignoring other parts of the decision – particularly with respect to Microsoft’s integration of its browser with the Windows operating system – where the court upheld challenges to Microsoft’s introduction of technological incompatibilities. See ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 272-73 (7th ed. 2012). It is clear that, in examining design challenges, the DC Circuit was in fact following a balancing test – assessing the benefits of the design changes against their anticompetitive potential – rather than simply blessing any design change Microsoft made.

36 Economic thinking supports the potential for minimum share discounts to be anticompetitive. Theoretical models have been constructed under which such minimum-share discounts can deny rivals sufficient outlets for their products. See *supra* note 20. Such contracts can also dampen competition among the competitors that are in the market. See Chen and Shaffer, *supra* note 20.

37 509 U.S. 209 (1993).

38 David E. Mills, *Inducing Downstream Selling Effort with Market Share Discounts*, 17 INT’L J. OF ECON. OF BUS. 129 (Sept. 2010), <http://economics.virginia.edu/sites/economics.virginia.edu/files/Inducing%20Downstream%20Selling%20Effort%20with%20Market%20Share%20Discounts.pdf>.

pretextual. Nevertheless, some evidence that the monopolist was motivated in part by such legitimate reasons would go a long way.

By contrast, at the least suspect end of the spectrum, for conduct such as product design issues, an adjudicator should employ a less exacting balancing test. Again, as explained earlier, the design issues discussed here are changes in features or attributes of products, not technological incompatibilities between complementary products. In this area, the fact that consumers view a particular design as an improvement should suffice as a business justification and end any further analysis. Indeed, if the design makes a significant improvement in efficiency or otherwise lowers cost, that should be sufficient to clear it of further scrutiny. One could also posit that a heightened causal link would be necessary before condemning it. That is, one would want to see evidence that, in some way, the design logically helped the monopolist to attain or maintain its dominant position.

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With this general discussion regarding assessing exclusionary claims, we can better examine three recent decisions concerning monopolization issues and an important scholarly work about predatory pricing. First is the FTC’s investigation concerning claims of exclusionary conduct against Google. Second is the Tenth Circuit’s recent decision in *Novell*. Third is the Third Circuit’s decision in *ZF Meritor*. Finally, this article examines a call for a reexamination of *Brooke Group’s* tough standard for challenging predatory pricing by Professor Hovenkamp.

## II. GOOGLE

By any estimate, Google has monopoly power in general search – its only real competitor is Bing!, which has struggled since Microsoft introduced it.<sup>39</sup> In 2009, complainants began to raise questions about Google’s practices. These companies claimed that Google unlawfully promoted its own “Google Product” products (or Universal Search results; also sometimes called “One Box”) on its search results page at the expense of its rivals, and demoted rivals’ products on its search results page in order to maintain a monopoly over the fields of general search and search advertising.

An example of a “One Box” that Google used is below. The box was usually positioned within the first two or three of the results on the search results page.

The screenshot shows a Google search results page for the query "gas grills". At the top, navigation links for Web, Shopping, Maps, Images, Videos, More, and Search tools are visible. Below the navigation, it indicates "About 8,240,000 results (0.20 seconds)". The main content area features a "Shop for gas grills on Google" section, which is a sponsored advertisement. This section contains five product listings, each with an image, a name, a price, and a retailer. To the right of this section is a "Sponsored" ad for "Gasbarbecue nodig?" with a website URL and a description. Below the sponsored ad is another sponsored ad for "Catering Gas Grills" with a website URL and a description.

Product Name	Price	Retailer
GP-Grill Gas Grill - black/	£141.96	www.Ambient
Falcon Dominator	£888.00	Catering Appl.
Outback Omega 250	£129.00	Outback Direct
Blue Seal Cobra CS9	£897.60	Carlton Sales
Burco	£850.50	e-tradecounter

**Sponsored Ad 1:** Gasbarbecue nodig? www.vanhattemhoreca.nl/ \* Diverse BBQ's in de aanbieding Bestel veilig en snel online.

**Sponsored Ad 2:** Catering Gas Grills www.nisbets.co.uk/Cooking-Machines \* 10,305 seller reviews Top Quality Cooking Machines At low Prices. Free P&P Available!

39 Yahoo also has a search engine, but, since its search engine is run by Microsoft, it cannot be considered a separate competitor.

The theory advanced by Google’s rivals to the Federal Trade Commission staff investigating Google’s conduct was similar to the theory advanced in the *Microsoft* case. In that case, Microsoft acted to block a “nascent threat” to its monopoly (over operating systems) from a different kind of technology (browsers).<sup>40</sup> Similarly, in *Google*, the theory was that Google’s vertical rivals (those websites that offer search capabilities in niche categories, such as consumer products, local services, and travel – websites like TheFind, NexTag, Expedia, etc.), collectively, represented a “nascent threat” to Google’s power over the fields of general search and search advertising. While none of these vertical rivals, alone, could constrain Google’s monopoly, they allegedly served collectively to threaten the most valuable parts of Google’s search portfolio – the areas of search that are typically the most lucrative from an advertising standpoint. At its core, then, this alleged “nascent threat” was the provision of an alternative advertising platform that could erode or constrain Google’s ability to charge monopoly prices for search advertising. To reduce or eliminate this threat, the story goes, Google sought to handicap these “verticals.”

As the Commission examined these claims, it became clear that, while Google understood that vertical search engines could possibly take customers away, there was absolutely no support for the notion that Google instituted the algorithm changes, in whole or in part, *because* of this perceived threat from vertical search engines. Google instituted the “Universal Search” or “One Box” because its contemporaneous studies showed that consumers *liked them*. Every iteration of its algorithm changes – including every change to the Universal Search or One Box—was vetted by users carefully and fairly, and these contemporaneous, legitimate business reasons for the changes would have been nearly insurmountable to challenge, given antitrust’s general hostility to challenges to product design changes. The fact that Google’s competitor, Bing!, had been using Universal Searches and “One Boxes” would have made a challenge even more difficult.

As a result, the Commission chose not to challenge Google’s design changes to its algorithm.<sup>41</sup> However, two other aspects of Google’s conduct raised more troubling antitrust issues. Google agreed to cease its practices with respect to these.

First, Google, in at least two instances, “scraped” or copied the user-generated content on two rival local and travel sites – Yelp and TripAdvisor. In contrast to its search algorithm changes, Google did not improve this content – it merely took the content virtually wholesale and used it for its own offerings. It appeared that Google was doing this to self-start its own user reviews on its proprietary local and travel sites, where it sold various goods and services, not for its general search results business. It is no surprise that consumers generally prefer placing comments on sites that already contain voluminous comments.

Google did not remove Yelp’s contents on Google’s proprietary local and travel sites despite repeated requests from Yelp to do so. At one point, Google indicated that the only way for it to do so would be to stop crawling Yelp’s website for links, which would have effectively crushed Yelp’s business as Yelp would no longer have appeared in general

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40 *United States v. Microsoft Corp.*, 253 F.3d 34, 78 (D.C. Cir. 2001), *cert. denied*, 534 U.S. 952 (2001).

41 Statement of the Federal Trade Commission Regarding Google’s Search Practices, In the Matter of Google Inc., No. 111-0163 (F.T.C. Jan. 3, 2013), <http://www.ftc.gov/public-statements/2013/01/statement-federal-trade-commission-regarding-googles-search-practices>.

search results. In the Commission’s statement on Google, the majority expressed concern that, left unchecked, Google’s scraping of content from rival sites for its own proprietary sites could undermine incentives to innovate on the Internet.<sup>42</sup>

If the 800-pound gorilla in the Internet world could freely take any content that is intellectual property-protected to use on its pages where it is selling its own products and services (as opposed to using it as part of its general search business), they said, innovation could potentially be chilled on the Internet.<sup>43</sup> Google’s threats to delist these rivals entirely from Google’s search results when they protested the misappropriation of their content were even more egregious. In other words, the majority believed Google was using its power over search to extract something from an unwilling party.

Second, Google had limited the ability of advertisers to advertise simultaneously on Google and competing search engines through the means of restricting application program interfaces (“APIs”) on Google’s advertising tools. While larger businesses used their own advertising tools, smaller businesses were more reliant on Google-made advertising tools. Going back to the catalog of monopolistic conduct, this behavior is similar to a monopolist placing restrictions on buyers’ ability to purchase from the monopolist’s rivals. As such, this conduct merits serious concern. Two Commissioners advocated for relief here,<sup>44</sup> and Google voluntarily agreed to change its behavior on this issue as well.

Overall, I believe the Commission’s action in *Google* demonstrates it applies a careful, conduct-specific balancing test when assessing whether particular conduct violates Section Two.

### III. NOVELL

*Novell, Inc. v. Microsoft Corp.*,<sup>45</sup> by contrast, shows the dangers of courts and antitrust enforcers seeking to apply a “one-size-fits-all” test for monopolization claims.

In this case, WordPerfect claimed that Microsoft, just prior to the launch of Windows 95, withdrew certain APIs that WordPerfect needed to allow its applications to compete effectively against Microsoft’s Office suite. WordPerfect’s effort to challenge this as exclusionary conduct affecting the applications market was time-barred. However, because of the government’s action against Microsoft’s exclusionary efforts vis-à-vis its operating system market position, WordPerfect could still make a claim that this withdrawal of APIs improved Microsoft’s monopoly over its operating system.<sup>46</sup>

The Court of Appeals for the Tenth Circuit rejected this claim, finding it impossible to imagine that this withdrawal was exclusionary. The Court found that the act was not exclusionary because it failed the short-term profit sacrifice test, which assesses whether

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42 *Id.* at 3 n.2.

43 *See id.*

44 *Id.*

45 731 F.3d 1064 (10th Cir. 2013), *cert. denied*, 2014 U.S. LEXIS 2960 (Apr. 28, 2014).

46 *Id.* at 1067-71.

particular conduct is profitable in the short term. Because the withdrawal of the APIs from rivals such as Novell improved Microsoft's own profits in word processing applications, there was no sacrifice of short-term profits. Thus, it was not exclusionary, the court reasoned.<sup>47</sup> The decision goes on at some length about the dangers of over-enforcement with respect to technological incompatibilities.<sup>48</sup> Interestingly, however, the Court fails to cite one court decision in favor of a plaintiff that it felt was unjustified.

One can look throughout this extremely long opinion and not find one mention of any procompetitive reason for Microsoft's withdrawal of the APIs – for example, any claim that this withdrawal made Microsoft Word or Microsoft Office a better product for consumers.<sup>49</sup> Rather, there is a starkly anticompetitive quote from Bill Gates, then CEO of Microsoft, in contemporaneous documents that the withdrawal was done *precisely* to undercut rivals.<sup>50</sup> Nor is there any mention of the D.C. Circuit's seminal decision in *Microsoft* and its requirement that a court assess the exclusionary nature of the conduct, the procompetitive justifications for the conduct, and then weigh them against each other.

The Bush Administration has advanced a somewhat similar standard of “no economic sense” for refusals to deal.<sup>51</sup> The notion underlying this test is that the conduct would have to make no economic sense for the defendant before it could be condemned as exclusionary.

These tests all seem to want to import the logic of *Lorain Journal* and apply it across the board to a wide variety of conduct. *Lorain Journal* involved refusing to sell to a customer because that customer is buying from a competitor.<sup>52</sup> It is the monopolist equivalent of cutting off your nose to spite your face. It is relatively easy to assess – it sacrifices short-term profits; there is generally no justification for the conduct; and an adjudicator does not need to do much more analysis to conclude that the harm outweighs the benefit.

There is language in *Trinko*<sup>53</sup> that could lead one to think that such a test should be applied more broadly, but I do not think the opinion in *Trinko* supports such a crabbed notion of exclusionary conduct. In *Trinko*, the Court emphasized the fact that,

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47 *Id.* at 1075-81.

48 *Id.* at 1073-74.

49 The Court did seem to suggest that the result might be different if Novell could have challenged Microsoft vis-à-vis the applications market, but, given the logic of its opinion, it is not clear how that would have changed the result at all. As I note below, Novell and its WordPerfect were, at that point, serious challengers to Microsoft's overall dominance. Indeed, Novell, with an entire suite of Office-type products, was uniquely positioned to partner up with operating system and browser competitors to challenge Microsoft's dominance in operating systems.

50 In an October 3, 1994 email, Bill Gates, never one to mince words, explained: “I have decided that we should not publish these [APIs]. We should wait until we have a way to do a high level of integration [which] will be harder for the likes of Notes, WordPerfect to achieve, and which will give [Microsoft] Office a real advantage.” 731 F.3d at 1069.

51 Brief for the United States and Federal Trade Commission as Amici Curiae Supporting Petitioner, *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (No. 02-682), at 22 (“[C]onduct that would not make sense but for its tendency to reduce or eliminate competition” is required for actionable refusal to deal).

52 *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951).

53 *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, a case where the plaintiff prevailed, the defendant sacrificed profits by terminating what had been a profitable joint ticket package for access to its ski resorts as well as its competitors.<sup>54</sup> But, as one thoughtful commentator has pointed out, *Trinko's* “observation that Aspen’s sacrifice of profits evidences its anticompetitive intentions . . . is a far cry from a wholesale endorsement of ‘sacrifice’ as a *necessary* condition for” liability.<sup>55</sup> Indeed, the court goes on at length in *Trinko* to emphasize the facts in that matter – namely, that “the complaint there never alleged that Verizon voluntarily engaged in a course of dealing with its rivals, or would have ever done so absent statutory compulsion.”<sup>56</sup> Moreover, as the Court further noted, the “services allegedly withheld are not otherwise marketed or available to the public.”<sup>57</sup> In other words, the Court focused not only on the lack of short-term profit sacrificing, but the entire factual situation, most particularly the glaring fact that the plaintiff wanted the defendant to do something it *had never done at all*.

Indeed, the consequence of such standards as the “no economic sense” and “profit sacrifice” tests will be seriously underdeterrent. As noted above, cheap exclusion does not sacrifice short-term profits, but can be quite exclusionary. A particularly pernicious example comes from the FTC’s 2009 case against Intel challenging Intel’s deception regarding its compiler.<sup>58</sup> Intel marketed its compiler – which sits on top of software and interacts with the microprocessor – as working well with all types of microprocessors, including those of its only real rival, Advanced Micro Devices (“AMD”). But Intel designed its compiler to check what company’s microprocessor was working on a particular computer. If the check showed that the computer had an AMD chip, the compiler would slow the software down significantly, degrading the speed and performance of the computer. This was cheap, and its effects were devastating to competition from AMD. Software developers and independent testing groups routinely found AMD chips to perform significantly worse than Intel chips did, even though, without the ruse, the AMD chip may have performed better than Intel’s. Indeed, it took years and large expenditures for software developers and AMD to uncover what was happening. Because so much of microprocessor marketing depends on independent and third-party testing that evaluates performance claims and because the best profits are made early upon introduction of a new product, Intel’s deception concerning its compiler seriously undermined AMD’s sales for a significant period of time.<sup>59</sup>

*Novell* involved a situation different from and more complicated (in my view) than cheap exclusion. Nevertheless, I would posit that this type of deliberate technological incompatibility, with no valid business justification, can also have serious anticompetitive consequences. Microsoft first offered the APIs, leading companies like WordPerfect to

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54 *Trinko*, 540 U.S. at 408–11 (citing and discussing *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985)).

55 Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, ANTITRUST L. J. 3, 58 (2004).

56 *Trinko*, 540 U.S. at 409.

57 *Id.* at 410.

58 Complaint ¶¶ 56–61, *In the Matter of Intel Corp.*, No. 9341 (Dec. 16, 2009), <http://www.ftc.gov/os/adjpro/d9341/091216>.

59 *Id.*

design their software to be compatible with it, but later pulled the APIs.<sup>60</sup> This pulling the rug out from under partners that may become competitors,<sup>61</sup> after those partners have invested in what they thought was a set standard, is exactly where technological incompatibilities can have their most devastating impact on would-be rivals. It is similar to the *Intel* FTC case regarding the bus between the graphic chip and the microprocessor.<sup>62</sup> In both instances, the monopolist made a voluntary decision to cooperate and then renege. In both instances, the competitive consequences of such radical changes in technology markets, where virtually everything interacts with everything else and long lead times (and huge sunk investments) are required to bring products to market.

Nevertheless, the Tenth Circuit's decision in *Novell* shows the powerful pull of "one-size-fits-all" tests for exclusionary conduct under Section 2. Federal courts feel ill at ease deciding these types of cases, and are looking for an easy test.

Another variant on the short-term profit sacrifice test has been suggested by Judge Posner: namely, testing whether the conduct would foreclose an equally-efficient competitor.<sup>63</sup> Now the "equally-efficient competitor foreclosure" test is more nuanced than the short-term profit sacrifice or "no economic sense" tests. Yet it is rare that, in a problematic market, a rival to a monopolist (with seventy plus percent market share) will enjoy the same economies of scale and scope as the monopolist. Exclusionary conduct can foreclose a significant part of the market (for example, the most efficient distribution channels) while leaving the hypothetical "equally efficient" competitor with enough theoretical space to compete. Moreover, as described below, the proper test is *not* whether there is sufficient room for a rival to somehow survive, but rather whether there is space for the rival to pose a serious threat to the defendant's monopoly. The "equally efficient competitor" test does not address this issue.

#### IV. ZF MERITOR

The Third Circuit's decision in *ZF Meritor v. Eaton Corp.*<sup>64</sup> concerned defendant's market share and related discounts and rebates for its heavy-duty truck transmission products, which were found to be exclusionary conduct that violated the antitrust laws. The majority viewed the contract implementing the discounts and rebates as *de facto* exclusive dealing. They focused, in particular, on three aspects of the contracts: (1) the contracts had market share "targets" that the OEM buyer purchase up to 92% of their requirements from the defendant, with the defendant allowed to terminate or force the buyer to give back all discounts if the targets were not met; (2) the contracts mandated that the buyers advertise defendant's transmissions as its standard offering in its data books, and two of the four contracts mandated that the buyer remove rival products

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60 *Novell, Inc. v. Microsoft Corp.* 731 F.3d 1064, 1068–69 (10th Cir. 2013).

61 It bears reminding that WordPerfect, at that point in time, was then a strong competitor to Microsoft Word software, and could have easily joined with other competitors in helping to challenge Microsoft's operating system monopoly.

62 Complaint ¶¶ 75–91, *In the Matter of Intel Corp.*, No. 9341 (F.T.C. Dec. 16, 2009), <http://www.ftc.gov/os/adjpro/d9341/091216>.

63 RICHARD A. POSNER, *ANTITRUST LAW* 194–95 (2d Ed. 2001).

64 696 F.3d 254 (3d Cir. 2012).

from its listings; and (3) the contracts mandated that defendant's products be offered to the buyers' customers at a preferential price, which, the evidence showed, was achieved by raising the price of rival products.<sup>65</sup> Locked into a less-than-10 percent share, rival ZF Meritor exited the market.<sup>66</sup> The majority found these conditions to the contracts to violate Section Two.

This provoked a furious dissent from Judge Greenberg, pointing out several things: (1) while there were conditions placed on the contracts, these were not 100% exclusives; (2) the market share targets were not absolute contractual requirements; and (3), most importantly in his view, the contract price terms were always above cost.<sup>67</sup> For Judge Greenberg, plaintiffs were trying to re-label what was really an objection to the defendant's *prices* as objections to the *conditions* placed on those contracts. For Judge Greenberg, the matter should have been analyzed under the Supreme Court's *Brooke Group*<sup>68</sup> predatory pricing precedent, and, since the pricing was always above-cost, the complaint should have been dismissed.<sup>69</sup>

The majority's focus on the realities of the contracts at issue – rather than a more formalistic view – makes more sense. The majority was correctly focusing on the “practical effect” resulting from the contracts at issue.<sup>70</sup> That is, although the contracts were not expressly exclusive, the defendant had the right to terminate the agreements if the market share targets were not met, and, while it did not ever invoke that right, the OEMs thought that Eaton might cut them off. Because of Eaton's dominant position, the consequences of termination would be devastating to any OEM. As the court put it, “the OEMs had a strong economic incentive to adhere to the terms of the [agreements], and therefore were not free to walk away from the agreements and purchase products from the supplier of their choice.”<sup>71</sup> Moreover, while the targets were not 100%, the court rightly focused on the fact that the portion of the market that was foreclosed effectively impeded rivals from gaining the “the critical level necessary” to pose a real threat to the defendant's business.<sup>72</sup> In this regard, because Eaton had agreements with the four largest OEMs, the effect was to exclude rivals from access to the lion's share of these critical buyers.

Another aspect of Eaton's defense in the litigation that the majority rightly rejected was the notion that, because the OEMs testified that they were not coerced or compelled to enter into the contracts at issue, these deals could not be anticompetitive. Indeed, in his dissent, Judge Greenberg emphasizes that the OEMs were not opposed to these contracts.<sup>73</sup> A mantra often heard in monopoly investigations is that the intermediate

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65 *Id.* at 263–68.

66 *Id.* at 267.

67 *Id.* at 303–53 (Greenberg, J., dissenting).

68 *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

69 696 F.3d 254, 303 (3d Cir. 2012) (Greenberg, J., dissenting).

70 *ZF Meritor*, 696 F.3d at 282 (quoting *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 326 (1961)).

71 *Id.* at 287.

72 *Id.* at 286 (quoting *Dentsply*, 399 F.3d at 191).

73 *Id.* at 338–39 (Greenberg, J., dissenting).

distributor customers – be they OEMs or retailers – are not averse to the contracts in question. Intermediate distributors facing upstream monopolists, however, may not be good representatives for the consumers who ultimately face the anticompetitive consequences of the monopolist's conduct. The key concern of intermediate distributors facing an upstream monopolist is their competitive condition vis-à-vis their direct competitors – other intermediate distributors. In fact, if nearly all intermediate distributors are facing similar conduct by the monopolist, it will likely be relatively easy for the intermediate distributor to pass on the “cost” of the monopolist's conduct to end-users. Indeed, economic literature suggests that loyalty discounts may be used to increase the profits earned by the *entire* vertical chain of production – that is, both the upstream monopolist and intermediate distributors, to the detriment of consumers.<sup>74</sup> Consequently, the court was right to focus on the practical economic incentives resulting from these contracts, rather than on whether or not intermediate distributors felt threatened or were unhappy with the contracts.<sup>75</sup>

The majority also focused on another key aspect of these agreements, namely the provision barring OEMs from providing defendants' rivals' information in OEMs “data books,” which OEMs use to advertise their products to downstream truck buyers. The majority noted testimony that an OEM's data book was the “most important tool” that any buyer selecting component parts for a truck would use: if a product was not listed in a data book, it was “a disaster for the supplier.”<sup>76</sup> This aspect of the contracts in *Eaton* is not all that dissimilar from *Lorain Journal*, in that this restriction was aimed squarely at precluding OEM customers from purchasing Eaton's rivals' products. And, frankly, what was the business justification for Eaton insisting that the OEMs effectively hide products that they were trying to sell? In many ways, this restriction is similar to a restriction Intel imposed on one of its OEMs, Hewlett-Packard (“HP”), when it got HP to agree not to bid a computer product with Intel rival AMD's chip in it to a customer unless the customer specifically asked for it.<sup>77</sup>

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74 Roman Inderst & Greg Shaffer, *Market-Share Contracts as Facilitating Practices*, 41 RAND J. OF ECON. 709 (Winter 2010). In their model, the dominant upstream seller faces the problem of choosing a pricing policy that accomplishes the dual – and potentially conflicting – objectives of creating optimal pricing incentives for its downstream retailers and limiting the effect of competition from its upstream competitors. Minimum-share contracts can help to accomplish these goals by allowing the seller to increase its wholesale price to downstream purchasers above the competitive level while at the same time limiting the downstream purchasers' incentive to shift purchases to competing sellers' products due to the price increase because, for example, much or all of the price increase may be passed along to consumers. In this way, minimum share contracts increase the profits earned by the entire vertical chain of production, to the detriment of consumers.

75 A similar view often heard from intermediate distributors is that, even without the minimum-share contracts, they would not have purchased more rival products for resale. Intermediate distributors will often say that the contracts were “sleeves off a vest” in that their behavior would not have been different, even without the contracts. As explained earlier, it is virtually impossible for anyone – even savvy OEMs and retailers – to predict what would have happened but for the monopolist's exclusionary conduct. It is no more relevant for the final analysis whether OEMs and retailers testify as to what they think they would have done without the contracts in place. This kind of “Monday morning quarterbacking” is precisely why the D.C. Court of Appeals in *United States v. Microsoft* warned against placing a heightened causation requirement into monopolization law.

76 *ZF Meritor*, 696 F.3d at 287–88.

77 Complaint at 53–54, *New York v. Intel* (D. Del. Oct. 12, 2009), <http://www.ag.ny.gov/antitrust/legal-documents/people-v-intel-corporation>.

Ultimately, the majority got it right when it focused its inquiry on whether the restrictions all told would prevent a rival from “pos[ing] a real threat” to defendant’s monopoly.”<sup>78</sup> It is this last point that is really the rejoinder to arguments by some that the focus of foreclosure analysis should be on whether the extent of foreclosure would bar an equally-efficient competitor from competing. Proper Section Two enforcement should not be focused just on whether exclusionary conduct still leaves a rival with enough breathing room to struggle along on the margins. Rather, the proper focus is on whether the exclusionary conduct effectively barricades rivals into the least profitable segments of a marketplace precisely to make it impossible for that rival to *pose a real threat* to defendant’s monopoly position.

For example, in the *Intel* situation, the various restrictions Intel imposed did not drive AMD out of business. What they did do, however, was forestall AMD from breaking out of its small market share when it had the competitive edge over Intel in its technology. As detailed in both the FTC’s and New York Attorney General’s complaints against Intel,<sup>79</sup> AMD, in the 2002 time frame, had developed a uniquely attractive Hammer microprocessor technology that offered commercial end users – a segment of the market AMD had not been successful in – the benefit of higher performance while still being able to run legacy systems. This value proposition could have given AMD the ability to break into and gain significant market share in the highly profitable commercial segment of the computer marketplace. Intel’s various modes of exclusionary conduct, however, gave it the ability to effectively constrain AMD’s market share rise and thereby rob it of its ability to break out of its then-small market share.

## V. HOVENKAMP’S ASSAULT ON BROOKE GROUP

No less an authority than Professor Hovenkamp has called for a re-examination of the *Brooke Group* standard in a recent article, *The Areeda-Turner Test for Exclusionary Pricing: A Critical Journal*.<sup>80</sup> The predatory pricing test as enunciated by the Supreme Court in *Matsushita Elec. Industrial Co., Ltd. v. Zenith Radio Corp.*<sup>81</sup> and later clarified in *Brooke Group* requires two things. First, the plaintiff must show a market structure and arrangement of firms such that the predator could rationally have predicted that the predatory pricing strategy would be profitable. This is the notion of recoupment – that is, that the defendant could reasonably expect to be able to recoup losses from its predatorily low prices. Second, the plaintiff must show that the defendant’s prices over a significant number of sales were below a relevant measure of cost, presumptively average variable cost (“AVC”).

In his article, Hovenkamp first describes three key critiques of *Brooke Group* from economists: (1) AVC – is a poor surrogate for short-run marginal cost; (2) the test is

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78 *ZF Meritor*, 696 F.3d at 287-288 (citation omitted) (quoting *Microsoft*, 253 F.3d at 71).

79 Complaint ¶¶ 4-5, *In the Matter of Intel Corp.*, No. 9341 (F.T.C. Dec. 16, 2009); Complaint at 10-12, *New York v. Intel* (D. Del. Oct. 12, 2009).

80 Herbert J. Hovenkamp, *The Areeda-Turner Test for Exclusionary Pricing: A Critical Journal*, U. IOWA LEGAL STUDIES RESEARCH PAPER NO. 14-16 (Apr. 2014), available at <http://ssrn.com/abstract=2422120>.

81 475 U.S. 574 (1986).

seriously underdeterrent in markets with high fixed costs, which are markets most conducive to exclusion by strategic pricing; and (3) short run measures such as AVC are poor measures of strategic predatory pricing, which may be long-term.

Hovenkamp specifically criticizes the Department of Justice's loss in *United States v. AMR Corp.*,<sup>82</sup> where the DOJ was unsuccessful in seeking to include in variable cost the foregone profit of having the airplane serve a route different from the predatory route.

He also questions the recoupment requirement, and advocates instead that the ordinary structural requirements for monopolization (dominant firm, high entry barriers, customers insensitive to price increases) should suffice. Hovenkamp also points out that predatory pricing may be a mechanism to ensure conformity to a cartel's or oligopoly's price terms. He also suggests that the average variable cost standard should be amended in certain respect, particularly to include foregone profits of alternative uses, as the Department of Justice sought to do in the *American Airlines* case.

## **VI. WOULD A UNIFORM TEST IMPROVE THE ADMINISTRABILITY OF SECTION TWO?**

The greatest policy argument for imposing uniform tests is that, otherwise, there will be a huge “cost to the economy,” as Judge Greenberg's dissent ominously intones.<sup>83</sup> Monopolists will pull their punches, and customers of monopolists will face higher prices. But, as Professor Hovenkamp has pointed out, more uniform tests do not necessarily mean greater ease of administrability. In the context of predatory pricing cases, there are huge problems in following the *Brooke Group* pricing test. For example, as described by Professor Hovenkamp, how does a court calculate average variable cost when companies are selling multiple products, when significant capital costs are involved, and when depreciation must be factored in?<sup>84</sup> There is no guarantee that the “short-term profit sacrifice” or “equally efficient competitor” test is going to be any easier to administer in the non-price predation area. Does one examine only short-term profits from the market being monopolized, for example, or does one include short-term profits in other markets? How does one define profit? Does it include lost opportunity cost? Similarly, for the “equally efficient competitor” test, how does one calculate the efficiency of a company? If, for example, a monopolist has locked up through exclusives the most efficient distribution channels, how does one decide that the remaining distribution – areas that the monopolist has foregone seeking exclusives for – is going to be sufficiently profitable for an equally efficient competitor?

Furthermore, there is a lack of reality in these tests. One can understand that there are costs to rules that increase enforcement against price predation and against design improvements that foreclose competitors. But what are the “costs” to rules that proscribe “muscling” behavior such as destroying competitor racks in *Conwood* or deceiving software developers, as in the compiler part of the FTC's second *Intel* case? Indeed, what

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82 140 F. Supp. 1141 (D. Kan. 2001), *aff'd*, 335 F.3d 1109 (10th Cir. 2003).

83 *ZF Meritor v. Eaton Corp.*, 696 F.3d 254, 350 (3d Cir. 2012) (Greenburg, J., dissenting).

84 Hovenkamp, *supra* note 80 at 11.

are the costs to barring Google from vacuuming up competitor's content on the Internet and using it to sell its own paid services?

This brings us to the fundamental question Professor Hovenkamp asks in his piece. He is writing about predatory pricing standards, but I would posit that it applies equally well to other areas of Section Two law: These tests “require antitrust enforcers to surrender a great deal of territory on the promise of a rational test that is more capable of being administered. But if ease of administration is in fact elusive, then perhaps we are giving up too much and should develop . . . [rules] that [are] more receptive to plaintiffs.”<sup>85</sup> In the area of predatory pricing, he notes that only one predatory pricing plaintiff has ever made it past summary judgment in the over twenty-years that *Brooke Group* has been in the law.<sup>86</sup> One could similarly note that, in the area of Section Two enforcement generally, there are very few plaintiff victories either. There have been only a handful of matters – *Conwood*, *LePage*, *ZF Meritor*, and *Microsoft* – that, in recent memory, can be viewed as plaintiff wins in federal court. Are we sure that monopolistic practices are so rare?

Moreover, and this is important, a plaintiff does not even make it to the point that the exclusionary conduct is assessed before showing that the defendant has monopoly power, that is, “the power to control prices or exclude competition.”<sup>87</sup> The showing of monopoly power is no easy feat. A plaintiff must define a proper relevant market, show that the defendant has a market share in that market that is north of 70% (or show direct evidence of market power) and prove that that market position is a durable one, such as through showing high barriers to entry in that relevant market. Given all of these high initial hurdles – all of which are relatively easier-to-assess and administer in order to prevent false positives, it is difficult to fathom why some type of uniform simplified test for assessing the exclusionary conduct itself is so necessary.

Rather than formalistically applying one-size-fits-all rules that lead to serious under-deterrence, the better approach is the case-by-case approach – the common law approach – that the Supreme Court has enshrined as the touchstone of antitrust jurisprudence since the *Standard Oil*<sup>88</sup> case. After all, courts have repeatedly said that Section Two analysis is similar to the Rule of Reason analysis employed for Section One.<sup>89</sup> The standard under the Rule of Reason is quite a broad one. By contrast, do we really need so many artificially applied uniform tests to prevent overenforcement in the Section Two context? Rather, by carefully analyzing and categorizing conduct – and adjusting various metrics based on that categorization – courts and enforcers can better strike a balance that provides guidance for business at the same time that it provide deterrence against anticompetitive conduct.

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85 *Id.*

86 The one exception is *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917 (6th Cir. 2005), where the plaintiff survived a motion for summary judgment.

87 *United States v. E.I. DuPont de Nemours & Co.*, 351 U.S. 377, 391 (1956).

88 *United States v. Standard Oil Co.*, 221 U.S. 1 (1911).

89 *United States v. Microsoft Corp.*, 253 F.3d 34, 59 (D.C. Cir. 2001) (“[C]ourts routinely apply a similar balancing approach under the rubric of the ‘rule of reason.’”), *cert. denied*, 534 U.S. 952 (2001).

## KEYNOTE ADDRESS: A CONVERSATION WITH THE HONORABLE KATHRYN MICKLE WERDEGAR, JUSTICE OF THE CALIFORNIA SUPREME COURT

Panelists: Cheryl Lee Johnson and Kathleen J. Tuttle<sup>1</sup>

*For the second year in a row it has been our good fortune to have a justice of the California Supreme Court as our keynote speaker. At this year's GSI we welcomed Justice Kathryn Mickle Werdegard. The justice agreed to a question and answer format. The questioners were two former chairs of the Antitrust Section, Cheryl Lee Johnson and Kathleen Tuttle. Johnson and Tuttle began the presentation with a brief introduction, followed by questions posed to Justice Werdegard. What follows is an edited transcript of the conversation.*

**Johnson:** We're very pleased and honored to have with us Justice Kathryn Werdegard who has been on the California Supreme Court since 1994.

First, a few words about her background. After graduating from U.C. Berkeley, she went to Boalt Hall School of Law where she was one of two women in a class of 350. She was first in her class, and she was the first female elected Editor-in-Chief of the California Law Review. One of her classmates, Pete Wilson, our former governor, remarked that in the first semester, "everybody wanted to carry her books." After the first semester, "everybody wanted to see her notes."

After her second year, she married her physician husband, and they went to Washington, D.C. so that he could pursue his career. There, she enrolled in George Washington University School of Law where, once again, she graduated first in her class, was on Law Review and Order of Coif. While in Washington she joined the Civil Rights Division of the Department of Justice. Among other things, she worked on speeches for Attorney General Robert F. Kennedy, and assisted in writing an amicus brief urging the release of Martin Luther King, Jr., from jail.

**Tuttle:** After the Werdegards returned to California, Justice Werdegard became director of the criminal division of the California Continuing Education of the Bar, senior staff attorney with the California Court of Appeal and the California Supreme Court, and Professor and Associate Dean at the University of San Francisco School of Law.

In 1991, California had a new governor: Pete Wilson. His very first judicial appointment sent Werdegard to the First District Court of Appeal in San Francisco. That made her the only woman among 19 justices. When she was elevated to the California Supreme Court three years later, Justice Werdegard was only the third woman to serve on the high court. Justice Werdegard has long been on the radar of the California State Bar Antitrust Section. Among other things, in 2008, as many of you in this room remember, she contributed to the special issue of our *Competition* journal that celebrated

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1 Cheryl Lee Johnson is the Deputy Attorney General of the Office of the Attorney General's Antitrust Law Section in Los Angeles. Kathleen J. Tuttle is the Deputy-in-Charge of the Antitrust Section in the Los Angeles District Attorney's Office. Both panelists are former Chairs of the California State Bar Antitrust and Unfair Competition Law Section.

the Cartwright Act's centennial. We, and many Court observers, view Justice Werdegar as the go-to justice on UCL<sup>2</sup> and Cartwright Act cases. She wrote the majority opinions in *Clayworth*<sup>3</sup> and *Kwikset*<sup>4</sup>.

Justice Werdegar, we're very lucky to have you here today. Thank you for coming and sharing with us your experiences.

**Hon. Werdegar:** Thank you very much. I'm delighted to have this conversation with two such distinguished women attorneys. I'm very happy to see all of you here today.

**Johnson:** Well, let me start. Now, you attended two law schools at a time when opportunities for women in the law were quite limited. Can you tell us what inspired you to pursue a law degree and where you saw that law degree taking you?

**Hon. Werdegar:** To answer this question and some others, you have to understand what time period we're talking about. It's a long time ago. I entered law school in 1959. So you have to dial the clock back.

As to the question of what inspired me to go to law school—

I was working at U.C. San Francisco Medical Center where I met my future husband. I had never heard of a woman lawyer. But there, I met two women physicians. This was an absolute revelation to me that women could do things beyond what, at the time, were traditional career paths if a woman was going to work at all. Those were teaching, nursing, secretarial, some others. But a woman physician?

Well, happily for all of you and me, I knew medicine was not going to be my path. But those women doctors inspired me to think more seriously about what I might want to do. I considered some graduate programs, but I ultimately chose law.

As to where I thought my law career was going to take me? I had no idea. The first thing was to go to law school and see how that worked out.

**Johnson:** You were first in your class at two prestigious law schools and Editor-in-Chief of the California Law Review. Did these stellar credentials open a lot of doors for you when you sought a job in the legal sector?

**Hon. Werdegar:** I started out in Washington where, I would say, my credentials meant something. I was not given the federal clerkship that I applied for, but I was accepted to the U.S. Department of Justice attorney honors program in the civil rights division. This was in the Kennedy administration, and it was a thrilling beginning to a law career.

Coming back to California, I can't say that my record noticeably opened any doors. I applied to the State Attorney General, and I applied for a couple of judicial clerkships,

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2 Acronym stands for "Unfair Competition Law."

3 *Clayworth v. Pfizer, Inc.*, 49 Cal. 4th 758 (2010).

4 *Kwikset Corp. v. Superior Court*, 51 Cal. 4th 310 (2011).

and nothing was forthcoming. Boalt called me one day and said there's a law firm in San Francisco that is contemplating hiring its first woman, and this is a quote: "If they can persuade the senior partner. Would you be willing to interview?" Nothing materialized.

Boalt called again to say there was an opportunity for research and writing with the California College of Trial Judges, which is now CJER.<sup>5</sup> By that avenue, I started my career, which evolved into one of research, writing and teaching. As it turned out, that was a career that was very congenial to me.

**Johnson:** When you joined the Supreme Court in 1994, I understand the halls were adorned with portraits of every Supreme Court Justice that had been appointed since 1850. Every one of those is, of course, a man except for two. And three years ago, with the appointment of our new chief justice, we now have a majority of women on the Supreme Court. How do you think the gender composition of the Court affects its proceedings and decisions?

**Hon. Werdegar:** Well, I know one impact it had: On the restrooms.

(Laughter.)

In other respects, I can discern no impact. I do recall one time when there were three women and the three of us dissented or voted in opposition to our four male colleagues. That case, a civil matter, had absolutely no implications for gender. So I just don't see that there's been any impact, internally. Externally, to those in the bar and to women students and attorneys, it might be a wonderful impact.

**Johnson:** You've spoken frequently about the role of women in the law. Can you share some of your thoughts about the progress that women have made, or not made, as the case may be, in the profession since the time you joined?

**Hon. Werdegar:** Going back to the early 1960s when I entered the profession, of course the changes have been dramatic. When I got out of law school, I believe it's accurate to say only three percent of attorneys in California were women. In my class at Boalt, we started out with four women, and only two of us actually graduated. My second year at Boalt, a woman professor joined the faculty. There were ripples of excitement among the students, as the idea of a woman professor was such a novelty. It was just a different time.

When I was appointed to the Court of Appeal, I would typically be the only woman in the courtroom when we had oral argument. One morning when I had been on the Supreme Court for several years, we had a case where women represented both sides. When we got off the bench, Justice Stanley Mosk made a comment that "this is quite a morning for females." Now, of course, such a thing would be unremarkable.

I'm told that currently more than fifty percent of law school classes are women. And as you all know, women in the law are doing and can do anything, including United States Attorney General, deans, justices of the Supreme Court, managing partners,

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5 Acronym references the California Center for Judiciary Education and Research.

corporate counsel, sole practitioners, D.A.s, public defenders. All avenues are open. It's not exceptional to see women in those positions.

I do understand that there are still issues for women pursuing a career in law. And comments are made in the paper that there's not a sufficient percentage of women partners, perhaps, or managing partners. I think time is going to take care of that. And I also think, and hope, that firms are sensitive to the special needs of women who are still usually the primary caregivers in the family, as mothers and daughters. You want to retain, I would assume, women attorneys because they are among the best and most talented.

So, the changes I've seen have been almost incredible.

**Tuttle:** It's interesting that all six women who have been appointed to the California Supreme Court came from government service backgrounds to one extent or another, and that possibly reflected the more limited opportunities in the private sector going back in time. Does that background give justices a different judicial outlook than those from, say, the private sector?

**Hon. Werdegarr:** I would back up a little bit and say studies have suggested (not just in my Court but generally) that many women justices that were appointed did have government backgrounds, and the supposition was maybe that did reflect more opportunities in government service. As to whether attorneys from government service bring a different perspective, I'm not sure that's true. A government attorney might bring a broader perspective on an antitrust question or a criminal question because, serving in the government, you may have broader exposure than someone who represents individual clients. But I think you do come to the bench with the perspective that you've been advocating in your prior practice life. And, of course, you understand when you assume the bench that you put that perspective aside. I would say that an array of different perspectives on the bench is all for the better in the shaping of the law.

**Tuttle:** For well or ill, you are among a room full of litigants here today, some of whom have sought or will seek review of the California Supreme Court. Last year the Court received more than 4,000 petitions for review, yet issued 87 written opinions. What is the Court looking for in considering whether to accept a case? And are there specific things a petitioner can do to improve chances for review?

**Hon. Werdegarr:** Not so long ago, I would say to audiences that we get 10,000 petitions a year, and we can only accept 2 or 3 percent. That the numbers have dropped is in large part a reflection of the funding crisis in our courts. You're right, that we only grant a small percentage of cases, and we recently have issued about 87 opinions. We used to issue about 110 when we had a full complement of justices. Our former chief, Ron George, was always proud to point out that although we have seven justices, our output was far greater than the United States Supreme Court with their nine justices. One wonders what they are doing. Well, we know they go abroad during the summer.

(Laughter.)

**Hon. Werdegarr:** And we never close. So what are we looking for? Well, the first thing you want to do if you want the Court to take your case is get your petition on the A list. You all know we have an A list and a B list. It used to be a secret, but it's not anymore. That procedure is published. We meet at conference every Wednesday morning at 9:00, to vote on petitions for review, whether to grant or deny. The A list are the petitions that we talk about. The B list (as the former chief calls it in his wonderful book), is the consent agenda. We have central staffs who write conference memos on every petition. And the cover sheet tells us what the issue is, who the trial court judge was, who the Court of Appeal was, what the Court of Appeal held, who is petitioning, and the significance of the issue. So the cover sheet, which can continue on a second page, is really very valuable. Our very experienced central staff separates these petitions into the B list and A list. If a justice wants a B list petition to go on the A list, he or she can say so and that change will be made.

So what determines which list a case is on? I think you all know the rules. First thing is: Is there a published conflict among the courts of appeal? That's really one of the major things we're here to do, to resolve conflicts so that the law is clear. And I said, "published" conflict because you all know that unpublished opinions cannot be precedent. But don't be discouraged because if there are unpublished cases that are in conflict, even though you can't cite them in argument, you can tell us they exist. It does make us realize that the courts need guidance even if they are not publishing their conflict. So we want to straighten that out.

The other consideration is whether it's a significant issue of statewide importance. And you have to persuade us that although there may not be a conflict, as the highest court in the jurisdiction, we should address this issue. It has a broad impact beyond the parties. How do you bring that to our attention? This is where amicus *letters*, supportive of a review, can be very helpful. I'm not talking about another attorney who has a similar case who may want the issue resolved, especially her way. I'm talking about larger entities—trade unions, employer groups, hospitals, drug companies—large parts of the public that are impacted by this issue and really would appreciate our resolving it.

So those are the two ways that your petition will be placed on the A list. Now, sometimes you might think that your petition met those criteria, so why was it not granted? One reason is the Court might conclude that it's a little premature. We often hear around the conference table on a Wednesday morning, "Let's let the issue percolate. Let's get a little more input from our courts of appeal and get the benefit of their reasoning."

A major injustice will not really carry the day. Once in a very rare while, we will do a rescue mission where the injustice seems so egregious that we'll take the case, but this is an exception. As you all know, the courts of appeal correct for error. We cannot do so given our resources and how extensive the judiciary is in the State of California.

**Tuttle:** When it comes to preparation of a merits brief, your colleague Justice Goodwin Liu said: "Do let perfection be the enemy of the good." What makes for a persuasive or effective brief? And are there any approaches or styles that you would recommend?

**Hon. Werdegar:** Did my esteemed colleague explain what he meant?

(Laughter.)

**Tuttle:** He probably did, but I don't remember it.

**Hon. Werdegar:** In any case, I will tell you what I think many of us would agree would make an effective brief. First of all, focus on the important issues—two or three of them. Don't give us a scatter-shot brief. There may be a lot of things you, the petitioner, don't like about the Court of Appeal opinion, but please focus on the important issues. You don't want the wheat to get lost in the chaff.

Give us your strongest possible presentation of the authorities that are in your favor. This would include cases, certainly in the State Court of Appeal, but also those out of state and law review articles. We do conduct our own research, but point us in the direction you want us to go.

Scrupulous accuracy in recitation of the facts and characterization of your authorities. I know I needn't tell this group that your credibility is the coin of your realm. What I mean is, if a brief shades, misstates the record or what a case holds, you've lost your reader. Your credibility is so important.

Avoid excessive footnotes. I know the type is smaller and the lines are closer so maybe you get more pages that way, but avoid excessive footnotes.

Avoid hyperbole or emotionalism. Respond to your opponent's points. Now, when I say avoid hyperbole or emotionalism, I don't mean to ignore policy arguments. Although we classically say that policy is for the legislature, not the courts, we are concerned about the implications of our opinions, so you're free to mention the policy implications.

If you abide by those classic rules, you will write an effective brief. Make it as short as you effectively can.

**Johnson:** You've touched on the importance of the amicus briefs. And in a lot of the matters before the Supreme Court, we see a dozen, sometimes scores of amicus briefs. Do the justices actually read them? And what would you recommend to make that amicus brief more appealing and more likely to impact the decision to put it in the A pile or the B pile?

**Hon. Werdegar:** Well, by the time we get the actual briefs, the case has been granted. As I say, when you're writing an amicus letter in support of review, that doesn't have to be extensive. In fact, please not. As for amicus briefs, I recently saw a photograph in an article, either the *Daily Journal* or other publication, about how to make your briefs effective. It depicts an attorney or one of the justices, you can see only his shoes, and he's drowning in paper, the amicus briefs.

You're right that sometimes we receive an enormous amount. Some amicus briefs are useless, and some are very helpful. The very helpful ones are perhaps less usual than the ones that are useless, but I'll tell you what the helpful ones contain.

They are ones submitted by associations or entities that are concerned about the statewide importance of the issue, and that perhaps give the Court a different perspective or a fresh perspective on the implications of a rule in the case, one that maybe the parties haven't mentioned. The parties' interest can very well be different than an amicus interest. On occasion, we will find an amicus point of view or analysis to be what the Court ultimately wants to adopt, and it's not one that the parties necessarily wanted us to adopt. So a different slant on the issue, a statement of the impact of the opinion either way, can be very important. Fresh authorities are also useful.

What's useless are what we call the me-too briefs where the amicus just echoes what the parties said or what other amici said. If your point of view is the same as other amici, then join together because otherwise there is a lot of paper.

Sometimes we get the sense that amicus briefs are written by organizations who want to go back to their supporters and cite in their newsletter or the annual report that they participated in resolving the case. That's not too helpful to the Court.

Do we read them? That would depend on the justice's interest or whether he or she feels the need or has the time available. Our staff attorneys read every single one of them. So they are definitely read.

**Johnson:** Over the last 20 years, you've heard a lot of oral argument before the Supreme Court. Could you share some of your ideas for "must do" and "must not do" for appellate advocates in oral argument?

**Hon. Werdegar:** Well, I'm sure no one in this room needs that kind of guidance.

**Johnson:** But they would appreciate it.

**Hon. Werdegar:** It's very hard to be original on that subject, but I would be happy to give you my thoughts. On the "do" side: Anticipate interruptions. You all know the old adage that there are three oral arguments: The one you plan and prepare, the one you actually give, and the one afterwards you wish you had given.

So anticipate interruptions. Answer a justice's questions. Now, I know if you're standing before us and you're making this beautifully shaped, focused argument, and some justice says, "Counsel," and asks a question, you might think, "where has she been? I just said that," or you might think that's not the point. You don't want to stop. But you have to.

Sometimes attorneys—and as a member of the bench of course I like this—will say "Excellent question..."

(Laughter.)

Sometimes one's colleague's questions can be annoying to oneself because you want to hear what the attorney is saying at that moment, and it's interrupted. But that's how it goes. Answer the questions. Don't say "I'll get to that later."

Recognize softballs. Sometimes members of the Court will throw you a question that's meant to help you. Attorneys just don't anticipate this. They can't believe it, so they

are in their adversarial mode and get all tangled up in this friendly question, whereupon the justice will sometimes say “it was supposed to be a softball; you know you can say yes or no.”

Of course, be prepared. Be prepared with record citations, if they seem to be at all relevant to the legal point that you’re arguing. Know your cases; know your opposition’s cases. Concede when you have to, but don’t concede when you don’t have to. Of course I can’t tell you when it’s one and when it’s the other; but just concede if you have to, but don’t give away what you don’t have to.

If you have authorities against you, be prepared to distinguish them; if you can’t distinguish them, be prepared to say why they were on the wrong track.

Do think of the larger ramifications of your case. As I said, we’re not there to correct error. We’re there to announce rules of law that will guide people in the future and will operate going forward. Often a justice on the bench will say: What rule would you have us fashion? And attorneys might be so busy arguing their client’s case that they haven’t really thought of how they can articulate a general rule that will be good for their case.

On the “don’t” side: Don’t share argument unless you have to. In the early days on the Court we might have—because we hadn’t thought it through—amicus counsel argue three minutes at a time. It was useless to the Court. So we have adopted a rule. I think the minimum time you can yield to another attorney is 10 minutes. But don’t share it unless it’s of clear benefit to you. For instance, you might want to argue the particulars of your client’s case and then yield time to someone who is looking at the larger ramifications of the issue. You want them to present the larger perspective.

But attorneys will also stand up and say I’m So-and-So, I’m going to argue points A, B, C; my colleague is going to argue D, E, F. Well, the justices might want to be talking about D, E, F while the attorney is arguing A, B, C. The Court prefers if we don’t have a disjointed argument. So don’t do it unnecessarily, even though in some cases you might think it’s the most effective and appropriate way.

Don’t talk over a justice. Again, this goes back to the questions. When these questions come, don’t keep going. You have to stop. “Yes, Your Honor.”

And, finally, I know none of you would ever do this, but don’t address the bench “You guys.” It has happened. Justice Kennard one time responded, “Does that include me?” Of course you all know you’re not arguing to a jury, you’re arguing to an appellate court. And we do notice the difference.

When I started out, there really wasn’t a specialty bar handling appellate law. Some individuals were starting to specialize, some pioneers. Now, of course, there’s a well-established large appellate bar, and we benefit from that.

Sometimes we’ll get off the bench and say, “He must have been the trial attorney.”

(Laughter.)

So I hope that’s helpful to all of you.

**Johnson:** Recently, California's 90-day rule for judicial decisions has been criticized. One UCLA professor has said that it really diminishes the importance of oral argument and effectively forces the judges to confer prior to oral argument and even draft tentative opinions before oral argument. Do you have a reaction to that? Do you find your own decisions are persuaded by oral argument?

**Hon. Werdegar:** Well, Professor Bussel, I believe it was, indeed took real umbrage with our procedures, which are described as front-loading. It does do what he claimed. It forces us to look at the case before oral argument. It forces us to consider our views, to consider the tentative opinion of the assigned justice, and to come to a tentative conclusion. Yes, it does.

I don't think that's a bad thing. I disagree with his concerns and criticisms. I think we arrive on the bench a more focused group. We know what the tentative is; we know where our colleagues stand and I know where I stand. Sometimes, of course, I'm not sure and that's part of the value of oral argument. But we know where each of us tentatively stands. That gives counsel the best opportunity to address the Court's concerns, to correct misunderstandings that emerge as the Court asks questions. As a member of the bench myself, oral argument gives me the opportunity to test some of my tentative thoughts and to address some of my concerns.

I will often ask a question about something that's troubling me, and I'll get an answer that will assure me that where I think I'm going is the right way to go. Any one of us will often ask a question that will challenge what we know one of our colleague's points of view is, and we hope the attorney will illustrate to that colleague how wrong he or she is.

We are considered an active bench. Not every case is the same. Sometimes we sit there like dullards, but sometimes I wish that the 30 minutes for each side could be greatly extended. So I disagree. Compare our Court to the United States Supreme Court's oral argument. As I understand it, when they come to the bench, they don't know where their colleagues stand and don't know what the tentative resolution is going to be. And I'm told they often just talk at each other, barely giving counsel an opportunity to put forth his or her position.

Whether that's an accurate characterization, I can't say. But I do disagree with the idea that our so-called front-loading makes oral argument just a charade. Absolutely not.

Part of your question was: After oral argument, what has the impact of oral argument been? Well, rarely does oral argument completely turn around the tentative majority opinion so that the attorney that came in to argue, possibly winning, loses. Rarely. I was on the bench one time when the assigned justice got up and we went into the conference room and he said, "Whoa." We completely reversed our case. So argument can do that. But not often.

Oral argument can change the shape of the opinion. We might add something; we might take something out. It can change the mind of a justice who was with the opinion who then might write separately, or it can bring into the fold a justice who was doubtful. So enjoy your oral argument and know that it's beneficial to the Court.

**Hon. Werdegar:** I'll tell you how our post-argument conference goes. We get off the bench, and we immediately conference. And this has been a rigid rule. We often have lunches scheduled in advance with one lawyers group or another, especially in Los Angeles. Even though they are waiting for us, we don't yield to anything until we resolve that morning's cases. The assigned justice after oral argument will speak first. "Well, I haven't heard anything new," might be said. But that's not the end of it. If there is somebody in a dissent mode, that individual speaks next and presents his or her view. And then we go around the table, each justice speaking in turn. Sometimes there will be a string of "concur." Other times, we'll discuss for 40 minutes.

So it's not always the same. It really depends on the case. And the chief speaks last. That's our tradition.

**Tuttle:** We've gotten into this just a little bit in your last answer. Do you and your colleagues influence each other during conferences after oral argument? We're really curious, can decisions be significantly altered in these conferences?

**Hon. Werdegar:** Occasionally they can. We go around the conference table and everybody gets a chance to talk and air their concerns or their views. Rarely at that stage does one justice, speaking to an issue, change everybody's mind, but he might change a colleague's mind or change the analysis of an issue. Anything can happen. Our pre-argument views are tentative, notwithstanding that we have a calendar memo and our colleagues' preliminary responses. The discussion can be very valuable, and it might prompt a justice to change his or her mind.

**Tuttle:** When you were appointed to the Supreme Court in 1994, the pundits expected you to follow a largely conservative course with flashes of independence on women's issues. Yet fast forward to 2012, a Stanford study classified you as more liberal than the average California justice. Have your views evolved over the last two decades, or has society changed the way we define liberal and conservative? Or maybe some of both?

**Hon. Werdegar:** Well, I take each case as it comes, so I can't agree that I have some general views that might have changed. I appreciate your recitation of how I was characterized when I was appointed. At that time, I had a limited track record. I was largely an unknown quantity, and I think a lot of what was written about me was speculation, supposition, and so forth. I've now been on the Court 20 years, and I have a record. It's there for people to extract whatever they want to extract as to what my views are. But as I say, I take each case as it comes. I am who I've always been.

**Tuttle:** The work of a California Supreme Court justice is, one might say, rather rarefied and far above the fray of trial courts and the gritty disputes they handle. Some critics might even say that justices' heads are in the clouds, consumed with precedent, arcane footnotes. Shortly before your re-election in 2002, you were quoted as saying: "I want to understand the impact of what we're doing. I start with the law, but I'm never blind to the human element," which I happen to think was a very nice statement. Can you expand on the role that the human element plays in our high court's decision-making?

**Hon. Werdegar:** I'll try, but actually there's no definitive answer. I think every justice is concerned about the real-world impact of our decisions. I mentioned amicus

can help us there. But I've often been frustrated that we send these opinions out, and I, at least, don't know how it really worked out for the parties, for the industry, for the entity, for the interested personality, unless you read a law review article or the *Daily Journal* tells you what you did and how it will work. And they are not always right down the road. So that is a frustrating part of our work.

I think the human element is part of the real-world impact. One can be sensitive to the human element—we are impacting the lives of people—and that might alter the lens through which you're looking at the law and where the law should go. But in the end, it has to be the law that drives the resolution of the case. The balance between those two is really sort of existential, and I don't think quantifiable.

**Johnson:** I need to give you a soft ball. Can you tell us what decisions you're most proud of?

**Hon. Werdegarr:** It's interesting. I reflected on that. I wouldn't say "proud" because I don't think I bring pride to it, but the ones I'm most fond of, interestingly, without doing in-depth research, the ones that come to mind are some of my dissents. Now, why would that be? Well, if you're going to dissent, you're parting from the company of the majority. So you really have to think: Why am I doing this? Also, is it worth the resources? Because where does a dissent go? You hope maybe a future court or legislature or generations will see it your way. But basically, dissents usually just end where they are in that opinion.

My dissents are the opinions that I have felt strongly about. I'll name two or three of them. One was the *Merrill v. Navegar*<sup>6</sup> case, the 101 California shoot-out case. You might be familiar with it. Used in that massacre were TEC9/ DC-9s. Rapid-fire assault weapons. The majority viewed the case through the legislation that governed design defect. And the legislature basically immunized manufacturers from design defect in this area. I viewed it through the tort of negligent marketing. My opinion, if any of you have read it, said that the gun was marketed to the general civilian population, and it was marketed as being a rapid-fire assault weapon, rapidly assembled, fingerprint resistant. The point of my dissent was that there was no place in the civilian population for this kind of a weapon. There may be in law enforcement or the military. But there arguably was some negligence on the part of the manufacturer in not being more discriminating in who its market would be. That's one case.

Another one: The recent case (*Iskanian*)<sup>7</sup> which related to the impact of the FAA (Federal Arbitration Act), on class-action waivers in the area of employment and labor disputes. I dissented there saying that, yes, the FAA does allow class action waivers, but the majority is overlooking the federal law on collective bargaining and the rights of workers to act collectively, which I don't think the FAA trumps.

Then there was the cell phone case (*People v. Diaz*).<sup>8</sup> I was rather fond of that dissent because the classic rule that we all know, the search incident to arrest exception to the

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6 *Merrill v. Navegar, Inc.*, 26 Cal. 4th 465 (2001).

7 *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348 (2014).

8 51 Cal. 4th 84 (2011).

warrant requirement, just didn't seem to fit the kind of search that occurred there given that there's so much personal data on a cell phone. I said a new paradigm is probably required. It was gratifying that the United States Supreme Court, although not citing my case, came to a similar conclusion. But I don't always expect to be vindicated by the United States Supreme Court.

(Laughter.)

**Johnson:** You're up for re-election in a few weeks. I think a lot of us remember Justices Bird, Reynoso, and Grodin, who were ousted in 1986 as a result of a fairly brutal campaign that targeted specific rulings of theirs. Do you have any views on re-election campaigns? And do you think they have a chilling impact on the Court's rulings?

**Hon. Werdegar:** Do I have any views? Yes, I do. I think California so far has been largely immune. Because ours is a retention election, we have been spared some of the acrimony, the out-of-state money, and the disparaging campaigning that occurs in contested elections in many other states. I think our system is excellent because it does allow the electorate to vent if they really are exercised about something, but the judiciary is not politicized by contested elections.

**Johnson:** What about a chilling impact—

**Hon. Werdegar:** I'm not the first to think about that. Justice Otto Kaus spoke about the dilemma judges face when deciding controversial cases while facing a retention election. "It's like finding a crocodile in your bathtub when you go in to shave in the morning. You know it's there, and you try not to think about it, but it's hard to think about much else while you're shaving." His point was you don't want to think about it, but you can't help but do so. I doubt that he ever let it impact his decisions. I think of any justice I've ever known, it would have no impact in their ruling on a particular case.

**Johnson:** News reports of the appointment of Mariano-Florentino Cuellar has emphasized that he kind of represents an infusion of youth on the Court that has been more chronologically privileged and more moderate.

(Laughter.)

Do you think age brings a different perspective to the Court?

**Hon. Werdegar:** I anticipate that it certainly will. But more broadly, any new justice brings changes to the Court, brings a new perspective. Youth is certainly a perspective, whatever that entails. Professors have a different background. We will have two at least. We're waiting for a third appointment. They certainly have a different look at the law than practitioners, perhaps. They have been examining, approaching the law from a more abstract, academic point of view. This Court is going to have three new members early next year, and it's going to be very, very interesting. And I'm looking forward to seeing how that plays out.

**Tuttle:** You obviously can't discuss any pending cases but thinking down the road a little bit more broadly, what do you think might be some of the most prominent legal issues in California the next few years?

**Hon. Werdegar:** First, I'm going to mention privacy. I've just read this morning about drones that can float around your house and see what you're doing inside. Drones, cell phones. The Internet. Tracking of your activity on the Internet. Dissemination of the private information that you're required to give to your bank or your medical provider. The privacy issues are vast.

Alternative dispute resolution. The impact of mandatory arbitration and the restrictions that are imposed through mandatory arbitration. Consider what that is going to do to our civil courts and our right to jury trial.

Water law. Water law is going to be of major significance.

CEQA<sup>9</sup> cases I think are with us forever. And I think antitrust issues will continue in the near future.

**Tuttle:** Thank you.

**Johnson:** Now, we've been wondering what a Supreme Court justice does to mount a reelection campaign other than asking your spouse to vote.

(Laughter.)

Can you tell us what you've done, or do you have anything you want to tell this group of voters?

**Hon. Werdegar:** Well, unfortunately, twelve years ago I did mount a campaign. It was a very painful experience. You raise money, and how do you raise money? You give speeches to various groups. And where does that money go? This is a statewide election. It goes to mailers. I don't know how many of you get mailers in your box, Citizens For an Effective Democracy, etc., etc. You pay to have your name on mailers to counter the negativity that may come from other quarters.

It's unusual for an appellate justice in this state to mount a campaign. I'm not mounting a campaign this time. Anybody who is interested, please, find your way to the bottom of the ballot—because I think we are at the bottom of the ballot—and if you can find it in your heart to vote “yes,” do so. For all the justices, unless you have reason to believe otherwise, give them a yes.

**Johnson:** Okay. Our final question is a real hard ball: Do you have a favorite baseball team? And who is going to win the World Series?

**Hon. Werdegar:** Now, Cheryl, I actually do recognize a soft ball when I get one. The Giants. I lost faith much earlier in the season. I thought they were having a bad year. But it's going to be the Giants. And won't that be wonderful for us?

(Applause.)

**EMCEE:** Thank you, conversationalists. And especially thank you, Justice Werdegar. We very much appreciate your informing us and enlightening us.

**Hon. Werdegar:** It's been a great pleasure. Thank you.

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9 Acronym stands for the California Environmental Quality Act.

# THE UNITED STATES V. BAZAARVOICE MERGER TRIAL: A PANEL DISCUSSION INCLUDING INSIGHTS FROM TRIAL COUNSEL

Moderated by Karen Silverman<sup>1</sup>

## I. INTRODUCTION

In the summer of 2012 Bazaarvoice, the leading provider of product ratings and review software and services, finalized the acquisition of its primary rival, PowerReviews. Two days later, the United States opened an investigation that led to a lawsuit in the Northern District of California to unwind the deal. In the fall of 2013, the parties squared off in court for a three week trial before Judge William H. Orrick, III. In January of 2014, Judge Orrick handed a victory to the government, issuing a 141 page opinion finding that the acquisition violated Section 7 of the Clayton Act.<sup>2</sup>

The case was watched by the antitrust bar and others for several reasons. First, merger challenges are only rarely litigated all the way through a trial on the merits. Also, the case marked the first time the Antitrust Division had returned to the Northern District for a merger matter since its ill-fated challenge to Oracle's acquisition of PeopleSoft in 2004 in front of Judge Vaughn Walker.<sup>3</sup> The somewhat unique posture of the case also generated interest. Because a Hart-Scott-Rodino filing was not required, the government was seeking to unravel an already consummated transaction, rather than trying to enjoin a merger from happening in the first place. And the case was of interest because it involved two relatively small technology companies, raising issues of the correct standard for judging a merger in a dynamic part of the economy.

A distinguished and knowledgeable panel discussed the case:

- Peter Huston was the lead trial counsel for the government. Mr. Huston is currently a partner with Sidley Austin LLP in its San Francisco office and a member of its Antitrust/Competition and White Collar: Government Litigation & Investigations practice groups. At the time of the trial, he was the Assistant Chief of the San Francisco office of the Antitrust Division where he handled both civil and criminal investigations and litigation.
- Boris Feldman was the co-lead trial counsel for defendant Bazaarvoice. Mr. Feldman is a litigation partner with Wilson, Sonsini, Goodrich & Rosati in Palo Alto where he represents clients with securities, antitrust, M&A and corporate governance disputes and serves on the firm's board of directors.

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1 Karen Silverman is a partner with Latham & Watkins LLP where she is a member of the firm's Global Antitrust & Competition Practice Group, the Co-Chair of the firm's Information Technology Industry Group and the managing partner of the firm's San Francisco office.

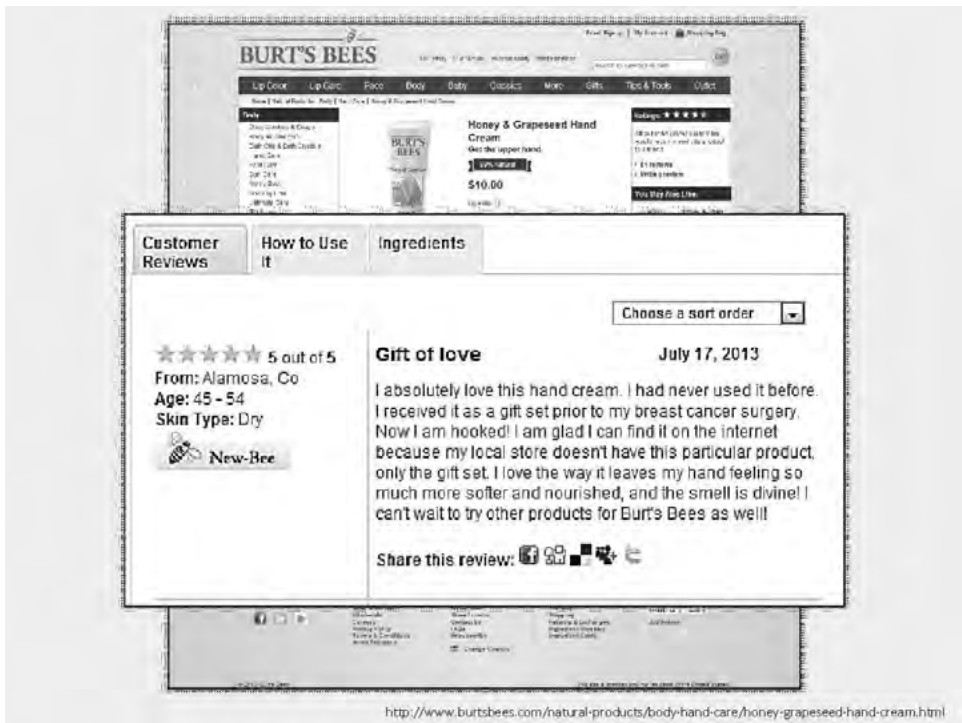
2 15 U.S.C. § 18; *United States v. Bazaarvoice, Inc.*, No. 13-cv-00133-WHO, 2014 WL 203966, at \*5 (N.D. Cal., Jan. 8, 2014).

3 *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

- Arthur Burke is a litigation partner with Davis Polk working out of its New York and Menlo Park offices. He represents clients in a variety of antitrust, securities, corporate governance and general litigation matters. In his antitrust practice, he advises clients on the competition law aspects of mergers and acquisitions.

## II. BACKGROUND

Many “eCommerce” companies that sell products online display customer ratings and reviews of their products. Ratings and review features on eCommerce websites allow prospective customers to see what others who have already used the product think about it. Reviewers rate the product, typically on a one to five scale, and supply a text review, often along with demographic information about themselves.



The ratings and review feature has become a ubiquitous part of online shopping. Consumers like to see authentic feedback from fellow consumers, and eCommerce companies have found that supplying this feedback is good for business in a number of ways. Having ratings and reviews on a website increases the likelihood that an internet search will direct a potential customer to the eCommerce website in the first place because of the way internet search algorithms work. It also has been shown that having ratings and reviews increases the likelihood that a visitor to a website will actually follow through and make a purchase. It also increases the likelihood that customers will be satisfied with their purchase, reducing the likelihood that the product will be returned.

Product ratings and reviews can be found on the websites of product manufacturers as well as on the websites of eCommerce retailers and can be shared between manufacturers and retailers in order to increase exposure, a feature called “syndication.”

Bazaarvoice and PowerReviews were the two leading suppliers of the software and services that collected, organized, moderated, displayed and syndicated ratings and reviews. Several other companies also provided ratings and review platforms and many eCommerce companies created the functionality in-house.

### III. THE TRIAL AND THE COURT’S RULING

During trial, the government focused heavily on the companies’ pre-transaction documents. As emerging companies that may not have been as sophisticated as more established companies, the documents were candid and talked about the potential for raising prices after the transaction. They talked about the elimination of competition and used fairly purple language in doing so, which the DOJ capitalized on at trial.

**Reasons to Consider PowerReviews GX-316**

**Pros**

- **Elimination of our primary competitor in both the US and Europe.** An expected impact of this consolidation is relief from the price erosion that Sales experiences in 30-40% of deals, per Osborne, of up to 15-30%. In addition, the market will place a premium on us having such a dominant market position, which is a powerful competitive moat.

— Brant Barton, Apr 21, 2011



## Bazaarvoice Syndication Network GX-541

I'm heating this email up again due to continued pressure on the syndication front...and now in our core R&R business.

\* \* \*

I really hate playing defense to these punks. And there's no defense like a good offense.

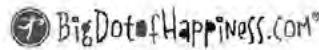
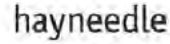
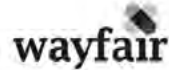
— Mike Svatek, Jul 20, 2011

How's the competitive assault going? Inquiring minds! I want to nuke those bastards – from space.

— Mike Svatek, Jul 25, 2011

Bazaarvoice, on the other hand, relied on the market realities, primarily through the testimony of 107 customers, which they put in the record either through live testimony or depositions. Bazaarvoice called twelve customers live. The government only called two. The government was arguing that the customer testimony was overweighted, if not irrelevant to how the Court should assess the market and the competitive effects of the transaction.

Live Customer Witnesses



84

2

NO COMPETITIVE HARM



HAVENT SEARCHED FOR ALTERNATIVES

In its ruling, the Court relied very heavily on the documents. The Court simply dismissed the customer testimony on the basis that the customers did not fully understand the markets in which they were purchasing services, which is an interesting proposition in markets with emerging companies. The Court dismissed post-merger evidence because it could be manipulated by the parties subsequent to the investigation.

The Court interestingly concluded that there were a few customers who might not be able to recover from this acquisition because they could not self-supply the reviews, but the Court did not really elaborate on how many of those customers there were or what percentage of the customer base they represented.

And then the Court fairly summarily concluded that entry was not easy, making it difficult to explore whether or not the Court's entry analysis included the question of repositioning by several other players out in the market that obviously trade in reviews but were not central to the Court's analysis.

After the Court issued its opinion, the parties negotiated a final judgment that included the divestiture of the PowerReviews assets to a third party, along with other remedies designed to insure that the buyer of those assets had a reasonable chance to replace the competition that had been lost. The stipulated final judgment eliminated the need for an appeal to the Ninth Circuit.

#### IV. DISCUSSION

***Moderator:** I first want to ask each of the panelists, starting with Peter, about the customer testimony question. I think that's the one that sets up the most dramatic departure from previous practice. The DOJ's position on the relevance of customer testimony in this case was in stark contrast to the position it took in the Oracle case and several earlier cases.*

**Huston:** In the Oracle trial, the DOJ definitely placed a heavier emphasis on customer testimony than we did in this trial. In this trial, it was the defendant that emphasized the customer testimony. Judge Walker in the Oracle case was very dismissive of the customer testimony, and Judge Orrick for the Bazaarvoice case was somewhat dismissive. So, basically, two judges in the Northern District have expressed some objections to customer testimony in merger trials. After Judge Orrick issued his opinion, there was a fair amount of commentary about this. But I want to take a step back and just make sure we keep this all in context. When we at the Department of Justice investigate mergers, typically we will first get a Hart-Scott-Rodino filing, and if we think there is an issue that we need to look into, we will seek clearance from the FTC. Then, we often ask the parties for customer lists, and we start calling those customers. That's the case despite the Oracle opinion and certainly despite the Bazaarvoice opinion. And that's how it has to be. Our attorneys need to quickly get a handle on the market. Obviously, we can talk to the parties, but they are obviously biased in favor of the deal. To get a disinterested view, we need to talk to the customers. That's going on as we speak. There are lawyers right now doing customer interviews back at the office. The customers will always be important in that context.

As for customer testimony at trial, I wanted to take a little bit of an issue with something that Karen said when she was presenting the background of the case, because Judge Orrick didn't completely dismiss the customer testimony wholesale. In fact, he cites customer testimony throughout the opinion. I did a rough count, and found at least twenty

five paragraphs of his opinion where he cites customer testimony to support his point, often corroborated by the parties' documents. He cites the customer testimony for how these customers used ratings and reviews, the features that they like and what the sale cycles were like, which became important in the case. And most importantly, he relied on customer testimony for market definition purposes. Bazaarvoice, not surprisingly, was trying to expand the boundaries of the market to include lots of things like "social commerce" tools such as Facebook. And Judge Orrick actually looked to customer testimony to show that the customers did not view these social commerce tools in the same way that they viewed ratings and reviews. And "in-house" solutions, also known as "self-supply," or "do-it-yourself," which Karen mentioned, was a big part of the case as well. Judge Orrick relied on customer testimony to show why several customers couldn't do it themselves, couldn't supply this in-house. He also cited customer testimony to show the head-to-head competition between Bazaarvoice and PowerReviews.

So he didn't reject customer testimony wholesale. He did, however, reject it when it came to the issue of the *effect* of the merger. Bazaarvoice was trying to show that these customers didn't think there was going to be any anticompetitive effect. And they argued that that issue should rule the day. And there are several reasons why the Court rejected that sort of "effects" testimony from customers in favor of expert testimony. In large part it comes down to the different vantage point that a customer has from an economic expert. A handful of customers testified live, but most of the testimony from the 107 customers came in by deposition. It turns out if you really dig into their depositions, what you often saw was that these customers hadn't paid very close attention to the merger. They hadn't really paid much attention to what the effects of the merger were going to be. I have one example—this is slightly unfair because it is one out of many, but there was a deposition of a company called Astral Brands. And the question at the deposition was: "Do you believe that the merger of Bazaarvoice and PowerReviews has harmed your company?" We will lay aside, for the moment, that that's probably the wrong question—this wasn't a backwards looking damages case, we were trying to look forward and see what the effect was going to be going forward. But the answer was as follows:

THE WITNESS: I don't really think of it in those terms. I don't know. Harmed? I don't know, I mean—I mean, I—probably not, but, I mean, I don't know—like, has it harmed our company? I don't—after the merger, I mean, nothing changed. Nothing—it wasn't, you know—because, like I said, I didn't know that they had merged until I was looking for a solution, another solution, and I was like: Oh, Power Reviews; and then: Oh, it's Bazaarvoice now. I mean, no. No. I—we've managed to move forward, I guess.

Lots of these customers when they were put on the spot, with no preparation, shoved into a deposition and asked this question out of the blue—have you been harmed?—they kind of fumbled around, and it was clear they hadn't really focused on the transaction or what its effects would be. The above example is a slightly extreme example, but that sort of answer was typical.

*Moderator: That's a good segue into Boris. What did you guys do with that kind of response?*

**Feldman:** First, it is a pleasure to be here today talking to you about a huge trial loss. You may think I am a little depressed here, but I am not, because tonight we are going to the World Series [displaying San Francisco Giants Rally Flag].

**Huston:** For the record, I, too, support the Giants.

**Feldman:** He supports them. He just thinks the government knows better than they do about baseball.

So what you just heard, I think, captures a disturbing attitude by the government. We are not going to have dueling customer quotes. I guess the reporter's here, so I should say for the record that I think that Judge Orrick's decision is second only to Justice Cardozo's in *Palsgraf* and that there's nothing that he didn't get right in the decision. Now let's go off the record. The government, their expert and the judge had an extremely paternalistic view of customers. So the customers weren't all Astroglide or whatever you just said, the customers were some of the most sophisticated companies in America—retailers and brands—and virtually with unanimity they said, “We don't care about this merger at all.”

It is very easy for somebody on Pennsylvania Avenue to say, “Well, they don't really know.” When the government's expert, lifetime professor/DOJ employee, was asked, “Who knows better about how this merger has affected the market, you or the customers?” He answered truthfully, “I do.”

So to find citations in the opinion to customer testimony on things like, “Would you use Facebook instead?” is one thing, but the opinion gave very short shrift to the fact that the only fair reading of the customer testimony was they were not worried about this merger at all. They had lots of alternatives.

## Selected Customers of Competitors' U.S. R&R



If you ever want to go back and dive into the record, look at the testimony of B&H Photo. Raise your hand if you know B&H Photo. They are the best, most sophisticated camera company in the world and their online efforts are dazzling. And we had a Hasidic Jew come out, we had to get him back before Shabbat, and he was in charge of all their online efforts. I think anybody who had listened to him and really thought about his testimony would understand that this is such a small part of what they do, that if they want to move away or build it inside they can in a minute.

So this trial—actually, the entire case was very simple and two-dimensional. The government had the worst antitrust documents you may have ever seen, certainly since the 1930s, and the company had customers who virtually unanimously said, “This merger doesn’t hurt us. We don’t expect it to hurt us. It’s fine.” And the documents won.

**Moderator:** *That’s not an unusual setup, at least around here, where you have a small company that’s not really astute about the significance of its writings and a customer base that’s still evolving and enthusiastic going forward. Art, as a practitioner, how do you apply all these lessons in the real world?*

**Burke:** I still advise clients, first and foremost, that customer reactions are critically important. So despite Oracle and despite Bazaarvoice, two cases which for different reasons didn’t seem to place a lot of importance on customer reactions, I certainly am not surprised to hear from Peter that it still is a critical component of the agency’s review, and that, frankly, if one is able to assuage customer concerns, in the vast majority of cases that is going to get your deal through and get it done more quickly. In the absence of vocal customer reactions, the Department of Justice and the Federal Trade Commission are usually, in my experience, going to allocate their resources in a different direction. They

have a lot of deals to review, a lot of cases to litigate. And if they are picking where they are going to exercise their prosecutorial discretion, they are usually going to do that in a case where the people who are supposedly being harmed by the deal actually care about it and are vocal about it. Certainly in my experience customers are not shy about complaining.

Customers complain for all kinds of reasons, many of which don't necessarily have a lot to do with antitrust, but they manage to sometimes dress up those complaints in antitrust terms in order to get better commercial leverage with merging parties. So despite the ruling here and despite the Oracle case, I think customer reactions are critical. And when advising clients, I tell them, aside from negotiating your deal, priority number one should be a customer communications plan, especially if the merging parties are competitors. I advise them to reach out to customers to find out who the squeaky wheels are, to try to get them comfortable so, again, there is not going to be that kind of problem down the road.

Now, in the absence of customer complaints, what made this attractive to the Division? I have to agree with Boris. It has to be the fact that there were just horrible documents, extraordinarily bad, and one might say that they reflect a candor on the part of the parties. The fact that more sophisticated companies, who have larger in-house legal departments and have regular training, manage not to use metaphors related to attack helicopters is not necessarily a reason that you should ignore that when a smaller company does use those metaphors. I can understand how the Judge and the Division might view those as being candid glimpses into the way the parties really do look at the business. The fact that larger companies may avoid that candor doesn't mean you should disregard those documents, it just means larger companies are sometimes better at obfuscating their true intentions. Certainly the lesson learned here is to encourage mid-level companies to get training in place, and it really goes well beyond antitrust to just compliance culture generally. One would not generally want to encourage one's employee to use military metaphors, attack gunships, etc., and there are good reasons far beyond antitrust for a compliance culture to try to get ahold of those kinds of documents and to educate employees not to think in that way. It is going to have collateral consequences, potentially not just for antitrust, but you can imagine all kinds of other compliance issues arise when people express themselves in that way.

My takeaway is, again, customers do still matter. Obviously it's important for even small companies to worry about how people express themselves in emails and PowerPoints, etc.



## GX-40

### The BV Challenge – Guns, Lots of Guns!

» Take it to PowerReviews the same way they have been harassing us and our clients, except that we'll bring



**GUNS, LOTS OF GUNS!**

© 2011 Bazaarvoice, Inc.

**Bazaarvoice**

40



## Menlogeddon GX-34

Our Response



39

**Huston:** What Art said makes my point to a certain extent. When he said, “get out there and get a communications plan for your customers because that’s important,” it tells me, as an enforcer, that customers are often the last to know if two merging parties have anticompetitive ambitions. The customers are going to hear the rosy picture from the merging parties about why the merger is so great for them, and then they relay that to us as we go out and interview them. But the documents, which we’ve talked about (and this wasn’t a jury trial, so the fact that there were militaristic pictures, I don’t think swayed the judge necessarily) were important. The Court saw a long paper trail. These companies had been talking about merging for over a year, on again and off again. That paper trail from that process presented a very clear picture. It was coherent, it was consistent, it was corroborated, and it showed that these were really the only two games in town, Bazaarvoice and PowerReviews. They had been battling it out for a long time, and this battle was very annoying to Bazaarvoice. They were losing money because of it and decided, let’s just buy them and get rid of this nagging competitive problem that we have. So that’s what they did. Those pieces of evidence were far more reliable than the customer testimony, and that’s one reason the Court went that way.

**Feldman:** Much of what Peter said I would agree with. The trial’s over now. The case settled. There will be no appeal. I think a fair reading of the documents was that there were executives in the company that wanted to do the deal to eliminate competition, especially price competition, and the competition between the two was quite spirited.

One of the things Peter didn’t mention is the board never bought that. They wanted to do it for other reasons having to do with data analytics, which was the market the company was moving toward. But even if you accepted that they had lust in their heart, it is not an intent statute. Had it gone up on appeal, one of the issues would have been that it was a consummated merger with no indication of price impact. Is it enough just to say it’s over, and look at what’s happening in the market?

Just one other point. To say that there are only two players in town, well, those two players are rat testicles compared to Amazon. And to me the biggest surprise of the trial was in a deposition excerpt that the government put on when the person in charge of all this for Amazon.com was asked, “Do you ever consider making your ratings and review software, which is dominant, available for other parties to buy?” He said, “That’s something we look at every day.” So Google, with all the things they do, and Amazon with all that they do, they don’t send out detail men to tech companies to sell their product review product today, but they could just snap their fingers and turn it on. It is just a switch, and once they flip it they obliterate everyone in the market.

Draw your own conclusion on how you advise clients. Here, you had a very strong case by the government of bad intent. You have players in the wings who dwarf the merging parties, for whom the merging parties are not even a rounding error, and customers who say they don’t care.

**Huston:** Your intent point is worthwhile. You’re right. It is not an intent statute and bad intent is not a formal element of a Section 7 violation. But from a trial perspective, as Tom Rosch, who mentored me and Karen and probably many others in this room, always said, you need to tell a story in any trial, including antitrust trials. Having the intent piece of the picture was important to tell that story. So that’s why we did what we did.

Boris is right, Amazon was the creator of ratings and reviews. It wasn't that long ago that Amazon was the only game in town. When they were just selling books, they decided to do this ratings and review thing. You could go online and figure out if a book was any good because you could see what real people said about the book, not just literary critics. It is true they are now a monster in the retail marketplace, no doubt about it, but as a retailer, they also are a competitor to Bazaarvoice and PowerReviews' customers. So they could enter the market; whether they would get any traction or not is unclear. There certainly wasn't any evidence that they were taking concrete steps to enter the market.

**Moderator:** *So having put documents in context and customer testimony in context, the next obvious question is: How did you use your experts? You referred to the economists, Peter, and the opinion actually is quite expansive on the different views that the economists threw up on each side. So why don't we go over to that topic.*

**Huston:** I think the only thing I have to say about that for now is: If you find yourself in an antitrust case involving network effects, which ours did, hire Carl Shapiro and you're probably going to do okay.

**Moderator:** *What was Professor Shapiro able to do with the customer data and the revenue data?*

**Feldman:** Ignore it. Nothing is better than that for me.

**Huston:** As Boris mentioned earlier, there was a point in the trial where the question was put to Professor Shapiro, "who knows better, you or the customers?" And he said, "I do." He acknowledged that, out of context, that might sound arrogant. But the Court obviously agreed. And the reason the Court agreed was because an expert is better situated to try and answer the ultimate question, which is: What's going to happen in the future?

These merger cases are kind of weird because you're trying to figure out what's probable as far as what's going to happen in the future. There are not very many other types of lawsuits where you really are trying to figure out what's going to happen in the future based on what we have seen in the past. And experts are ideally situated to crunch the testimony, look at the data, look at the wins and losses. Bazaarvoice had these memos they would send out every time they won a deal, and they would try and say who they were up against, what the sales cycle was like. So he analyzed that data. He did his best to construct some market share information. There was no reliable, independent market share information out there, so he had to use a proxy, but he did that and came up with something that the Court could hang onto, and we were able to meet the *Philadelphia National Bank* presumption.

## Competitor Count in Bazaarvoice "How the Deal Was Done" Documents *Ratings and Reviews Deals Only*



Source: GX1048

**Feldman:** Professor Shapiro, a brilliant man, and he makes a great witness and I'd use him in a minute. I think there are some judges who would have looked at his testimony as junk science. You can always nitpick anybody. We found a lot of mistakes, not me, NERA, who we used as our experts (who we thought were superb, although Judge Orrick didn't). If this case had gone up on appeal to the Ninth Circuit, depending on the panel, there might have been something said about these things that Professor Shapiro left out of his opinion and his willful ignorance that the customers made a difference, but in terms of courtroom performance, he's just great.

I am maybe more of a cynic than Peter, who I think is pure. I say this as a compliment. You can get an expert to say pretty much anything. When the judge decides which way he wants to go, then he picks that expert to help fill out the opinion. If Judge Orrick had decided, notwithstanding the lust in their heart, the two together didn't have any greater impact on the market, I think he could have easily gotten around Professor Shapiro's opinion.

**Burke:** I am not quite as cynical as Boris, but I am sympathetic to his view. I think increasingly lawyers view their experts as hired gladiators where they go into the octagon together, to mix metaphors. And the fact is experts are good at this. If you pick the right one, they have done this many times, they know all the tricks, and if they are prepared properly, so often I feel like they cancel each other out. That isn't to say there isn't an occasional incident where a clever lawyer actually gets a gotcha question. After this, I have to go down to Silicon Valley to take an expert's deposition. Hopefully that will be one of those instances.

In most cases the experts succeed in protecting their opinion, in thinking through it in a way that is internally consistent so it is hard to find a chink in the armor. And in many respects they sort of cancel each other out. And ultimately the decider, whoever that is, whether it is in the case of a judge or a jury or in a case where you are arguing to an antitrust agency, there's going to be enough information and substance from the economists they choose to support to justify their outcome. Which brings us back to why lawyers are important. The framing and presentation of the case by the lawyers have to be first and foremost. And the economists have to be in assistance and support of that. I am not suggesting that it happened here, I don't think it did, but it is important to not let the economist run away with the case. The lawyers have to be the ones who are leading the advocacy.

***Moderator:** So we have now heard from Peter as to how the government put its story together and its reliance on a narrative that was compelling. Boris, do you want to elaborate on the counter narrative?*

**Feldman:** Two things. You have all had cases where you're dealt a bad hand with documents. One approach is to have the witnesses play stupid, and say, "I don't know what that means." We did not take that approach in the depositions. The depositions here were as heartfelt as in any case. The government did a superb job. They deposed all the right people, and they had a lot of documents to use. Our view was you can't run away from it, they have to say, "Yeah, that's what I hoped. Yes, they really irritated me. Yes, I did think that the market was a duopoly at that point." But in the time since the merger, it is clear that other people have emerged, and we haven't seen any kind of price-stabilizing effect from the merger.

So that was really the best we could do with the documents and hope that the judge finds the witnesses credible. I got the feeling he didn't, really. That it was easy for him to say, "That's what they wrote then and that's what they say now, the only difference is the merger had been consummated."

In terms of all the customers, on one level it seems stupid that we deposed 107 customers. We would have done more, but the government kept going to court to try to prevent us from taking additional depositions. In a routine civil case you can often figure out who thinks they have a better case by who wants to slow it down and who wants to speed it up. If you have a plaintiff trying to slow the case down for trial, generally it is not that good a case. Here, when you have the government pushing all along to limit discovery, to restrict the number of depositions, to restrict the length of each deposition, that was a marker, for me, of what they thought—they had their documents and anything else could only detract from those. The way we picked the customers to depose was from a government response to an interrogatory which asked, "Which customers have you talked to in the course of your investigation?" Basically we said, "All right, we are going to depose everybody on that list."

And there were a couple that had grievances, they didn't like the way this syndication was handled or they were mad at Bazaarvoice or PowerReviews about that, but our view was if we just pull a sample of ten or twenty, even if we have a nun do it in her habit, people will say that's skewed and it is not ninety five percent statistical significance. So we took everybody the government identified as relevant and deposed them. We were under

very strict time limitations at trial, or we would have had more witnesses. In the end, it didn't overcome the documents.

**Huston:** I wish the executive depositions were as easy as Boris just made them sound, but in fact, rather than fighting the documents, they tried to obfuscate and talk about a lot of high-tech stuff that was off into the future. I don't think they were lying necessarily, but they were talking about what they saw down the road and how they hoped to position themselves for the coming battle with Google that kept them up at night. But the reality was we were really fighting about the market they were currently in. So they were difficult, multi-day depositions of the executives, and it was tough to get straight answers out of them, and they were pretty slippery.

On the point about the customer depositions, both sides wanted to get to trial quickly. From the government's perspective, we wanted to get to trial quickly because we thought this was an illegal transaction. Unlike the Hart-Scott-Rodino concept, where you can stop a deal before it happens, this had already happened. We didn't want anticompetitive harm, or if there already was such harm we wanted to limit it. We wanted to get to trial quickly for that reason. I suspect the defendant wanted to get to trial quickly because it didn't want this hanging over its head. So we settled on a fairly aggressive timetable and got the case to Judge Orrick. He moved heaven and earth, and rearranged his docket, but that didn't leave a lot of time for discovery. And I remember—I think it was Boris, maybe his colleague, Jon Jacobson, saying—at the outset of the case saying, “Your Honor, we might need thirty depositions from customers.” And I thought that seemed like a lot, but we were going to be okay with that. And then it turned out they shifted strategies, and it was 100. We were in fifty five different cities in twenty five different states doing depositions, triple and quadruple tracking in a compressed period of time.

**Feldman:** Once we started to take them, they were like Lay's potato chips.

***Moderator:** One of the issues that Judge Walker had in the Oracle trial was the repetitiveness of the customer testimony; it was no longer probative or particularly additive after a point. So it is sort of an interesting strategic call. Why don't you comment quickly, and then I want to turn it to the audience.*

**Burke:** I want to pick up one thing that Peter said that provides a useful lesson here. It is not news to anybody, but I have no doubt that the executives at Bazaarvoice do worry all the time about large players that are adjacent to them or maybe even in their market, if you count Amazon. The possibility of Google entering this business, or Facebook, I am confident that that is true. It is so often the case that with the companies we advise—they are paid to look over their shoulder and to be worried about larger companies in adjacent spaces entering their business. And they often say to us, “How can this deal be a problem. Look at these other enormous giants that are just breathing down our necks.” The simple truth is that it doesn't work. It doesn't work with the government, and it doesn't usually work with courts either. That isn't to say that it isn't true or that it isn't appropriate to present that. Part of a merger case is explaining the procompetitive rationale for the deal, why parties wanted to do it. So it is appropriate in that context to explain we are not doing this to eliminate competition, we are doing this to better compete with these larger companies that are near us. But I don't think that usually works as a defense. It certainly doesn't work with the government. As this case illustrates, it is a hard sell to the courts as

well. So that's another discontinuity that is an important point to explain to your clients. And it's a difficult conversation to have. Because often you do get an incredulous reaction, but, fortunately or unfortunately, that is sort of the world we live in.

**Feldman:** Unlike a traditional merger case where you may be looking at a failing company, our clients tend to be future roadkill defendants. They say, "We are great today, but three months from now some punk in a garage can knock us out."

*Moderator: It is very much about how dynamic our clients perceive the market to be, in contrast to the government, which is putting together a case, very often, based on a more static view of—not just the market, but the harms, particularly in the case of a consummated merger.*

**Huston:** Two points. So on the issue of what high-tech executives worry about, I will agree with the panel that they are often worried about, (A) who's going to eat my lunch, and, (B) how can I get to that next big thing and make a lot of money? And high-tech executives, they don't want to just open low margin restaurants that are highly competitive. They want to find a market where there's a monopoly to be had. That's where they can make some money. So they worry about those things, and there's nothing wrong with that and you can credit that. By the same token, while they are worried about the next thing, they are still competing in the current thing, and that's where the antitrust laws come in.

*Moderator: Isn't the question, though, whether the next thing is a competitive constraint on the current thing? The question I am asking is: Does DOJ credit the next thing when it can be demonstrated that it is a competitive constraint on whatever it's currently staring at, at the moment?*

**Huston:** The answer is certainly yes, and Carl Shapiro noted that in his report as well. And the judge also noted it in his opinion, basically saying we know what they are trying to do, but in the meantime it's clear that they have an anticompetitive intent and there was an anticompetitive effect from the transaction. But if you can demonstrate in an entry analysis that there is someone that's going to come in and change this and it's credible, then the government will credit that. And if the government does it, I think the Court will, as long as there is good enough evidence.

**Feldman:** I don't mean to interrupt, but there was no showing of anticompetitive effect. And when the professor was asked, "Did you do any research to show that there is?"—on day one of his testimony, he said, "Yes, and I found anticompetitive effect." And then when he slept on it and came back, he said, "No, I didn't look into whether there was an anticompetitive effect." He thought there was potential for it in the future, but there was no showing in the record whatsoever of anticompetitive effect.

I am not an antitrust scholar, but one of you can probably write a doctoral dissertation on whether what Peter said about they all want to get a monopoly, whether in most technology areas that isn't a good thing. If you look at most of the advances in technology from a user standpoint, there is generally a short period of near monopoly, not true monopoly, but total dominance of the market, and then they piss it away and somebody else knocks them out. So Instagram and Snapchat may be hot today, but the chance that you're going to finance your child's education by investing in them is low. Netscape for a period was just dominant, but it went away. So I understand that you don't want just one railroad, or one soap manufacturer. But it may be that in emerging areas of technology, the way you make progress and sustain the necessary investments to do it is somebody is

really good and they run up a huge market share and then somebody better comes along in a couple years.

**Huston:** More power to innovation and more power to people chasing the Holy Grail of monopoly profits, but when it comes to merging, we have different standards.

*Moderator: That is just so ripe. Questions?*

*Audience member: How does a transaction like this get to the DOJ, where it is a very obscure corner of the market, it is an acquisition of a small company and doesn't trigger any sort of filing and it appears that the customers are indifferent to the transaction and not really riled up?*

**Huston:** Good question. As I mentioned before, a lot of our deals come to us by Hart-Scott-Rodino filing. This one didn't because of the size of the parties threshold wasn't met. However, one of our attorneys in Washington was reviewing a different deal that had a Hart-Scott-Rodino filing, and it happened to mention this rating and review space. And in that filing, it mentioned that the ratings and review space was a duopoly. Of course, that's the kind of language antitrust lawyers are going to pick up a mile away, and that's what he did.

And our lawyers also monitor the press. And this lawyer was reviewing TechCrunch, or one of the other media outlets that cover technology markets, and saw this deal announced and recalled that he had seen the market space described as a duopoly. He did some digging, and we were off to the races.

*Moderator: But you set a land speed record for getting there, two days later, or something like that?*

**Huston:** We are able to open up investigations very quickly.

**Burke:** It is a really interesting and tough problem for parties who have a deal that has an issue. I have had situations where parties have said, "We figured out that there's some unusual reason the deal is actually not HSR-reportable." The value of this deal was \$168 million. It was a standard purchase price, as I recall, but because of the weird way the HSR rules work, PowerReviews had so little revenue and assets, it wasn't reportable. When companies find that out, they say, "That's great. I don't have to worry about HSR. Terrific news." Wait a second. You can still be sued afterwards.

And from a buyer's perspective, then you are really in the worst position because the sellers are gone, they got their money. They are in the Bahamas now, and they can't unwind that transaction. You can't get that back. It is all on you as the buyer under that situation. There are situations I have been involved in where, despite the fact that the transaction was not reportable, we proactively notified the agencies and let them have a pass at it. That's a hard decision to make. Honestly, in this transaction I would not have predicted that the agencies would have become aware of it any time soon. It is a very tough conversation to have with your client.

*Moderator: Peter, were you in conversation with the companies before they closed? Did you ask them not to close?*

**Huston:** Not personally. I got brought in a little later than that. I know there was communication with the company after the deal was closed about preservation of the PowerReviews assets while the investigation proceeded, but Boris might know more about that.

**Feldman:** The problem was there was an Inspector Javert on the other side. That's why God put him on this earth.

*Moderator: Other questions?*

*Audience Member: When did the documents become known to the DOJ, was that after you opened your investigation or before?*

**Huston:** After. Some documents were submitted voluntarily in response to our request and then CIDs were issued. Again, that happened before my time. When I came on the scene, my colleagues showed me some of these documents and I said, "Wow," and I said, "Find me some more." They kept coming and coming. And one of the issues we had at trial was that we had too much of this stuff. How do we prioritize and tell the story?

**Feldman:** You could describe it as antitrust porn.

*Moderator: Obviously you didn't think the threat of Google was realistic or that there was really anything out there that was going to curb their power in the future. What evidence would have been enough, and do you ever do a retrospective afterwards to figure out if you were right and that, in fact, there are players that enter the market?*

**Huston:** My understanding is merger retrospectives are done at the agencies from time to time. I can tell you in this instance there were some pretty powerful barriers to entry. Now, Google is a huge company, and if it throws its weight into something, it is probably going to succeed, although it could be described as is a slightly fickle company. So it can enter and exit because it has the luxury of having so many resources. But as I mentioned earlier, this was a network effects business. Karen mentioned earlier this concept of syndication. Samsung will have reviews of its products on its site, and it will push them out to all the retailers because the more reviews you have, the better. So manufacturers like to have a lot of reviews. The retailers like to have a lot of reviews, they share reviews with each other so they can both get their content count up. Bazaarvoice and PowerReviews were expert at making that syndication work, and it created this network effect loop, and they kind of had a lock on that. So for someone to come in the market they would have to figure out a way to break that loop. And companies tried. There were companies who had entered the market and failed. There were others who entered the market from Europe and were having a very tough go of it. So we definitely looked at that.



## Bazaarvoice's Syndication Network GX-411

From: Brett Hurt

\* \* \*

- Our syndication network is a competitive advantage today, but it can become a true competitive moat in the future.

- Brett Hurt, Mar 27, 2011

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If there had been some credible evidence that an Amazon or a Google or another tech giant had a plan on the books, and it looked like it was something that could succeed, the government would have investigated that, but we just didn't see that.

*Moderator: Other questions? Since we're making a record, go Giants! Thank you, everybody.*

# UNITED STATES V. BAZAARVOICE: THE ROLE OF CUSTOMER TESTIMONY IN CLAYTON ACT MERGER CHALLENGES

By Gregory J. Werden<sup>1</sup>

## I. INTRODUCTION

In June 2012 Bazaarvoice, Inc. acquired its primary competitor PowerReviews, Inc. The Antitrust Division of the U.S. Department of Justice promptly began investigating, and in January 2013, the Department brought suit in the Northern District of California seeking to unwind the deal. Following extraordinarily extensive third-party discovery and a three-week trial, Judge William H. Orrick held that the acquisition violated Section 7 of the Clayton Act.<sup>2</sup> Bazaarvoice then stipulated to the entry of a final judgment unwinding the deal, so there was no appeal.

The court found that Bazaarvoice was by far the largest provider of “product ratings and reviews platforms,” which are software tools and associated services for soliciting and disseminating customer feedback on e-commerce websites. PowerReviews was the second largest provider of such platforms.<sup>3</sup>

Vendors of product ratings and reviews platforms create, and implement on e-commerce websites, an interface for collection and display of purchaser feedback on specific products, including ratings on a five-star scale. Vendors also perform “moderation” services by screening out fraudulent, offensive, and other reviews that do not comport with the site’s standards. Vendors can provide “syndication” so that a website also displays feedback collected on other sites. E-commerce websites use feedback to decrease returns and increase “conversion” rates, i.e., the rates at which visitors to their sites make purchases. A website’s owner also may have its platform vendor track and analyze purchaser sentiment.<sup>4</sup>

Bazaarvoice contended at trial that no tangible anticompetitive effects, e.g., price increases, had occurred since the acquisition was completed.<sup>5</sup> It further contended that such effects would not occur because of competition from potential vendors of product ratings and reviews platforms, such as Amazon and eBay, which self-provide ratings and reviews solutions.

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1 The author is Senior Economic Counsel in the Antitrust Division of the U.S. Department of Justice. The views expressed herein are not purported to reflect those of the U.S. Department of Justice. Colleagues provided helpful comments on an earlier draft of this article.

2 *United States v. Bazaarvoice, Inc.*, No. 13-CV-00133-WHO, 2014 WL 203966 (N.D. Cal. Jan. 8, 2014).

3 *See id.* at \*1-2.

4 *See id.* at \*6.

5 The Department disputed this claim. Judge Orrick found the evidence inconclusive and observed that post-acquisition evidence has little probative value when it can be manipulated, as Bazaarvoice had the incentive and opportunity to do. *Id.* at \*57-61.

Bazaarvoice relied heavily on customers' views on how the acquisition had affected them and would affect them going forward. Judge Orrick noted that "none of the more than 100 current, former and potential customers who testified . . . believed that the acquisition had harmed or would harm them."<sup>6</sup>

Judge Orrick found that "the customers were the most credible sources of information on their need for, use of and substitutability of social commerce products, as well as regarding their companies' past responses to price increases," but he held that "[t]heir testimony on the impact and likely effect of the merger was speculative at best and is entitled to virtually no weight."<sup>7</sup>

Judge Orrick found customers' beliefs about future anticompetitive effects unhelpful because: "customers generally do not engage in a specific analysis of the effects of a merger. Many of them had given no thought to the effect of the merger or had no opinion. [And t]hey lacked the same information about the merger presented in court . . . ."<sup>8</sup>

Detailing the individual customer witnesses, Judge Orrick explained that: (1) "[c]onsidering competitive alternatives for [product ratings and reviews platforms] is not part of customers' day-to-day activities";<sup>9</sup> (2) "[m]any customers testified that they had never given any thought to the merger or had no opinion about it";<sup>10</sup> (3) "[o]thers were either unaware of alternatives or had conducted a limited review of their alternatives";<sup>11</sup> and (4) "others did not currently use" the product.<sup>12</sup>

Some in the antitrust community found Judge Orrick's reasoning "remarkable" and argued that customer "views regarding the ultimate competitive effects of a merger [often] should be given great weight."<sup>13</sup> This article explains that there was nothing remarkable about the treatment of customer testimony in *Bazaarvoice*.<sup>14</sup>

## II. WHAT CUSTOMERS DO AND DON'T KNOW

A central issue in nearly every merger case is the scope of the relevant market in which competitive effects of the transaction are to be assessed. The parties usually dispute how readily customers of the merging firms would substitute to other products in the face of a

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6 *Id.* at \*61.

7 *Id.*

8 *Id.* (citations omitted).

9 *Id.*

10 *Id.*

11 *Id.* at \*62.

12 *Id.*

13 Tim Muris & Christine Wilson, *Bazaarvoice: Protecting Consumers by Silencing the Consumer?*, CPI ANTITRUST CHRONICLE, Mar. 2014 (1), <https://www.competitionpolicyinternational.com/file/view/7137>; see also Franco Castelli, *Key Lessons from the Recent Bazaarvoice Decision*, CPI ANTITRUST CHRONICLE, Mar. 2014 (1), <https://www.competitionpolicyinternational.com/file/view/7141> ("[C]ustomer views regarding the likely competitive effects of a merger" should be "given considerable weight . . . when customers support a merger of two competing suppliers.").

14 For a similar view, see Sean P. Gates, *Is the Customer Never Right? Bazaarvoice and Customer Testimony in Merger Litigation*, ANTITRUST, Spring 2014, at 61.

small price increase. As noted above, Judge Orrick recognized that customer testimony is highly relevant to this key issue. Moreover, the federal enforcement agencies—the Justice Department and the Federal Trade Commission (“FTC”)—explained in 2006 that:

Customers typically are the best source, and in some cases they may be the only source, of critical information on the factors that govern their ability and willingness to substitute in the event of a price increase . . . . Customers also provide relevant information that they uniquely possess on how they choose products and suppliers.<sup>15</sup>

The agencies’ 2010 Horizontal Merger Guidelines restated the importance of evidence from customers on “how they would likely respond to a price increase, and the relative attractiveness of different products or suppliers.”<sup>16</sup>

The role of customer evidence in resolving the dispute over the scope of the relevant market is to provide the data. Customers can no more be expected to comprehend the legal concept of the relevant market than an accident victim can be expected to comprehend the law of negligence. And it is the rare case in which the experiences of all of the merging firms’ customers are the same.<sup>17</sup> With significant heterogeneity among the merging firms’ customers, no one customer could see the picture that eventually emerges from the mosaic of evidence elicited at trial, even if all the evidence came from customers.<sup>18</sup>

Furthermore, customers, even collectively, lack much of the information on which the federal enforcement agencies and courts rely in assessing the likely competitive effects of a merger. The Horizontal Merger Guidelines explain that the agencies rely on “substantial information from the merging parties,” declaring that “[d]ocuments created in the normal course are more probative than documents created as advocacy materials,”<sup>19</sup> and adding further that “[i]nformation from firms that are rivals to the merging parties can help illuminate how the market operates.”<sup>20</sup>

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15 U.S. Dep’t of Justice & Fed. Trade Comm’n, *Commentary on the Horizontal Merger Guidelines* 9 (Mar. 2006), available at <http://www.justice.gov/atr/public/guidelines/215247.pdf>; see also Vaughn R. Walker, *Search for a Competition Metric: The Role of Testimony of Customers, Competitors and Economists*, COMPETITION L. INT’L, Apr. 2006, at 3, 4 (“[O]ne marginal customer can tell us far more about the existence of an alleged market boundary than ten inframarginal customers who proclaim that meaningful substitutes do or do not exist.”).

16 U.S. Dep’t of Justice & Fed. Trade Comm’n, *Horizontal Merger Guidelines* § 2.2.2 (Aug. 19, 2010), <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf>.

17 That rare case was *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242 (8th Cir. 1988). It concerned high fructose corn syrup (“HFCS”), which at the time was used almost entirely in soft drinks. Only the cost of achieving a desired sweetness mattered to soft drink companies, and all would switch from HFCS back to sugar at the same relative prices.

18 The picture never becomes clear if the trial provides too few pieces of the mosaic. *United States v. Engelhard Corp.*, 970 F. Supp. 1463, 1470–81, *aff’d* 126 F.3d 1302 (11th Cir. 1997), was such a case. The Department challenged the proposed merger of two producers of gel quality attapulgitite (“GQA”), a mineral with diverse applications. The alternatives to GQA and the price inducing switching both varied across uses.

19 U.S. Dep’t of Justice & Fed. Trade Comm’n, *supra* note 16, § 2.2.1.

20 *Id.* § 2.2.3.

In particular, the Guidelines state that the agencies find very useful documents indicating the merging firms' intentions:

Explicit or implicit evidence that the merging parties intend to raise prices, reduce output or capacity, reduce product quality or variety, withdraw products or delay their introduction, or curtail research and development efforts after the merger, or explicit or implicit evidence that the ability to engage in such conduct motivated the merger, can be highly informative in evaluating the likely effects of a merger. Likewise, the Agencies look for reliable evidence that the merger is likely to result in efficiencies.<sup>21</sup>

When anticompetitive action is planned post merger, customers are apt to be the last to know. Merging firms might disseminate misinformation calculated to quell opposition or even elicit customer support for the merger.<sup>22</sup>

Judge Orrick stressed that the customers testifying in *Bazaarvoice* had given little thought to the competitive effects of the merger. That should have come as no surprise because customers would not rationally invest resources in assessing a supplier merger for an input that accounts for a small fraction of their total cost, as in *Bazaarvoice*, especially if their rivals would suffer equally from any anticompetitive effects.<sup>23</sup>

### III. WHAT JUDGES KNOW

The role of customer testimony in merger cases came into sharp focus with the 2004 rejection of two merger challenges relying on such evidence. In *United States v. Oracle Corp.*, Judge Vaughn R. Walker of the Northern District of California viewed the opinions of customers selected by the Justice Department as “speculation . . . not backed up by serious analysis that they had themselves performed or evidence they presented.”<sup>24</sup> He was struck by the witness’s failure “to present cost/benefit analyses” or “data from actual or probable” procurements of the software products at issue in the case.<sup>25</sup>

In *FTC v. Arch Coal, Inc.*, Judge John D. Bates of the District of the District of Columbia viewed the testimony of customers selected by the FTC as merely stating the “truism” that “a decrease in the number of suppliers *may* lead to a decrease in the level of competition in the market.”<sup>26</sup> He noted that: “Customers do not, of course, have the

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21 *Id.* § 2.2.1.

22 *Cf. United States v. Ivaco, Inc.*, 704 F. Supp. 1409, 1428 (W.D. Mich. 1989) (placing little weight on customer testimony supporting the transaction because it was premised on the belief that the merger would lead to the development of a new product yet the evidence at trial did not support that belief).

23 See Ken Heyer, *Predicting the Competitive Effects of Mergers by Listening to Customers*, 74 ANTITRUST L.J. 87, 103-09 (2007) (explaining why, in many cases, “it simply does not make economic sense for the customer to invest the time and effort required to become knowledgeable about all the factors that determine whether a proposed merger will prove harmful”).

24 331 F. Supp. 2d 1098, 1131 (N.D. Cal. 2004).

25 *Id.* at 1131.

26 329 F. Supp. 2d 109, 145-46 (D.D.C. 2004).

expertise to state what *will* happen in the [relevant] market, and none have attempted to do so.”<sup>27</sup>

Judge Bates explained in a subsequent speech that the key issue is “competency of the evidence.”<sup>28</sup> He welcomed testimony from customer witnesses to “facts” on which they are “competent to testify” because they have “actual knowledge,” but not “predictions or projections about the future.”<sup>29</sup> He declared that “customer evidence, often highly subjective and not buttressed by rational experience or demonstrable expertise, is unlikely to prove persuasive to federal judges in establishing likely anticompetitive effects.”<sup>30</sup> Judge Walker similarly stressed “competency” in a subsequent speech, also declaring that: “Customer testimony that is not substantiated by some type of market analysis cannot substitute for the predictions of an expert.”<sup>31</sup>

The judges’ remarks resonate with the Federal Rules of Evidence. Customer witnesses are not qualified as experts, so their testimony is subject to Rule 701, requiring that opinions be “helpful” and “rationally based on the witness’s perception.”<sup>32</sup> The Rules permit customer witnesses to offer facts and opinions based on their experience of the marketplace, but not to offer idle speculation or beliefs lacking foundation.

If Judges Bates and Walker are to be the guide, no court will give weight to customers’ beliefs about post-merger competition unless the court is convinced that they were rationally formed from experience of the marketplace: No court will give weight to the unsupported belief of a defense-selected customer that the market will remain sufficiently competitive after the merger, or to the unsupported belief of a government-selected customer that the market will not remain sufficiently competitive after the merger.

Customer testimony raises most standard evidentiary issues going to admissibility and weight. For example, if a customer witness were to rely, not on her personal experience, but rather what she has heard coworkers say, that testimony would be inadmissible hearsay.

Customer witnesses also can be biased. Judge Walker observed that “the choice of customers is almost always a product of selection bias. Seldom does it appear that the customers’ views represent the general customer population. Instead, it may often seem that the customers willing to come forward are those uniquely situated to be harmed or benefited by the transaction.”<sup>33</sup> The Horizontal Merger Guidelines also note that

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27 *Id.* at 146.

28 John D. Bates, *Customer Testimony of Anticompetitive Effects in Merger Litigation*, 2005 COLUM. BUS. L. REV. 279, 286.

29 *Id.*

30 *Id.* at 291.

31 Walker, *supra* note 15, at 3.

32 FED. R. EVID. 701.

33 Walker, *supra* note 15, at 4.

“customers may oppose, or favor, a merger for reasons unrelated to the antitrust issues raised by that merger.”<sup>34</sup>

#### IV. WHAT ANTITRUST LAWYERS NEED TO KNOW

The federal enforcement agencies take the position in their Horizontal Merger Guidelines that the “conclusions of well-informed and sophisticated customers on the likely impact of the merger itself can help” the agencies and the courts “because customers typically feel the consequences of both competitively beneficial and competitively harmful mergers.”<sup>35</sup> The agencies thus are confident that experience of the marketplace can provide a sound basis for such conclusions.

Experience of the marketplace could provide a sound basis for customer testimony on competitive effects when the merger has been consummated long enough to make useful direct observations of its actual effects. At the time of trial, customers could have already had the opportunity to observe first-hand how the merged firm and its close rivals behave after the merger and could be in a position to contrast that with the pre-merger situation.<sup>36</sup>

Experience of the marketplace also can be the basis for critical customer testimony on particular issues important to a court’s assessment of likely future effects from an unconsummated merger. Whether the entry of new competitors would prevent significant anticompetitive effects often is an important issue, and that issue often is informed by customer testimony on the willingness to purchase from a new entrant with an unproven product.<sup>37</sup>

Nevertheless, the agencies recognize that: “When direct customers of the merging firms compete against one another in a downstream market, their interests may not be

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34 U.S. Dep’t of Justice & Fed. Trade Comm’n, *supra* note 16, § 2.2.2. In the wake of the *Oracle* and *Arch Coal* decisions, both federal agencies argued that customers generally are unbiased. See Thomas O. Barnett, Deputy Assistant Attorney General, Antitrust Div., U.S. Dep’t of Justice, Antitrust Enforcement Priorities: A Year in Review, Remarks Before the Fall Forum of the Section of Antitrust Law, American Bar Association (Nov. 19, 2004) (“[C]ustomers remain the most objective marketplace participants. Their incentives generally are aligned with our goals of protecting competition . . . .”), available at <http://www.justice.gov/atr/public/speeches/206455.pdf>; Deborah Platt Majoras, Chairman, Fed. Trade Comm’n, U.S. Antitrust Practice—How Does it Affect European Business?, Remarks Before the Studienvereinigung Kartellrecht (Apr. 7, 2005) (“Customers are valuable sources of information about many mergers’ competitive effects because they have the most to lose from an anticompetitive deal, and usually have little incentive to provide misleading information.”), available at [http://www.ftc.gov/sites/default/files/documents/public\\_statements/u.s.antitrust-practice-how-does-it-affect-european-business/050411brussels.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/u.s.antitrust-practice-how-does-it-affect-european-business/050411brussels.pdf).

35 U.S. Dep’t of Justice & Fed. Trade Comm’n, *supra* note 16, § 2.2.2.

36 See, e.g., *New York v. Kraft Gen. Foods, Inc.*, 926 F. Supp. 321, 351 (S.D.N.Y. 1995) (assessing the competitive effects of a consummated merger of manufacturers of ready-to-eat breakfast cereals and relying on the opinions of large supermarket chains that tangible anticompetitive effects had not occurred).

37 See *Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410, 438 (5th Cir. 2008) (citing “customers’ testimony acknowledging reputation . . . as important for choosing bidders”); *United States v. United Tote, Inc.*, 768 F. Supp. 1064, 1078-79 (D. Del. 1991) (finding entry difficult when defense-selected customers testified that they would consider a new entrant’s product once it had “reliably performed” for another customer over a period of “one to two years”).

aligned with the interests of final consumers, especially if the direct customers expect to pass on any anticompetitive price increase.”<sup>38</sup> The merging firms’ customers could know enough to realize that they would not be the ones to feel any anticompetitive consequences of the merger.

Customer indifference to a merger could be portrayed by merging firms as evidence that the merger would be competitively benign. But the indifference of direct customers can mean that any harm from the merger would be felt downstream. Consumers, not retailers, are most likely to bear the competitive brunt of mergers between competing consumer goods manufacturers. Absent indications that direct customers would suffer a merger’s anticompetitive effects, there is little reason to listen to their views on likely effects.

Some of the merging firms’ customers might benefit from a merger that proves anticompetitive. Under a variety of circumstances, price increases from an anticompetitive merger benefit some customers by disproportionately harming other customers.<sup>39</sup> The Horizontal Merger Guidelines observe that: “A customer that is protected from adverse competitive effects by a long-term contract, or otherwise relatively immune from the merger’s harmful effects, may even welcome an anticompetitive merger that provides that customer with a competitive advantage over its downstream rivals.”<sup>40</sup>

When some customers favor a merger that other customers oppose, a trial judge might find that customer testimony is inconsistent and hence unhelpful. But the inconsistency of customer views need not reflect poor information or mere speculation; it also can arise when all customers agree that the merger would be anticompetitive.

## V. CONCLUSION

Customer testimony has long been important in merger cases under Section 7 of the Clayton Act, and it undoubtedly will remain so. But all evidence must be carefully scrutinized. Customers know some facts critical to a case from experience of the marketplace, but they do not know other critical facts. Customers might have a sound basis for predicting a future competitive effect based on experience of the marketplace, but judges are rightly skeptical and give such predictions no weight when no basis for them is presented. Courts may agree with Judge Robert H. Bork “that economic actors usually have accurate perceptions of economic realities,”<sup>41</sup> but they recognize that customers are not competent to testify outside the scope of their perceptions.

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38 U.S. Dep’t of Justice & Fed. Trade Comm’n, *supra* note 16, § 2.2.2.

39 See Joseph Farrell, *Listening to Interested Parties in Antitrust Investigations: Competitors, Customers, Complementors, and Relativity*, ANTITRUST, Spring 2004, at 64, 65–66; Heyer, *supra* note 23, at 91–102; Sheldon Kimmel, *The Effects of Cost Changes on Oligopolists’ Profits*, 40 J. INDUS. ECON. 441 (1992). That a direct customer can benefit from an increase in the cost of an input used more intensely by rivals was first noted in the antitrust context by Oliver E. Williamson, *Wage Rates as a Barrier to Entry: The Pennington Case in Perspective*, 82 Q.J. ECON. 85 (1968).

40 U.S. Dep’t of Justice & Fed. Trade Comm’n, *supra* note 16, § 2.2.2.

41 *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218 n.4 (D.D.C. 1986).

# **ST. ALPHONSUS MEDICAL CENTER-NAMPA AND FTC V. ST. LUKE'S HEALTH SYSTEM LTD.: A PANEL DISCUSSION ON THIS BIG STAKES TRIAL**

*Moderated by Paul J. Riehle<sup>1</sup>*

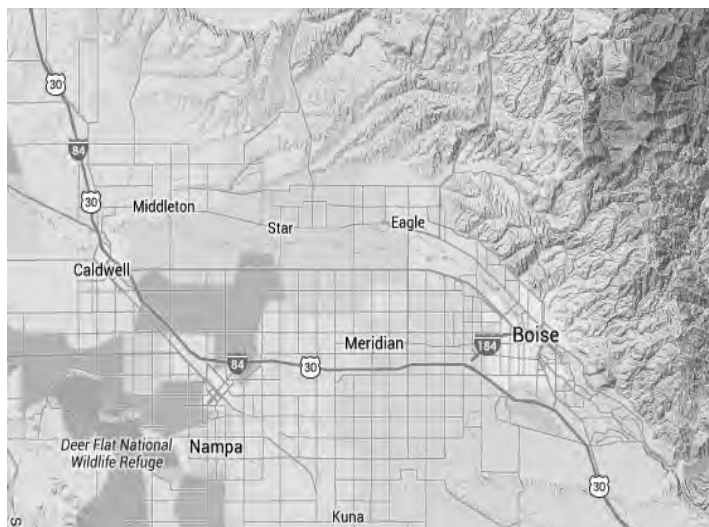
## **I. INTRODUCTION**

The *St. Luke's*<sup>2</sup> case involved the 2012 acquisition by St. Luke's Health System, Ltd. ("St. Luke's") of Saltzer Medical Group ("Saltzer"). St. Luke's is an integrated health system operating in Idaho and Oregon. Saltzer was an independent physicians' association ("IPA") in Nampa, Idaho.

The St. Alphonsus entities<sup>3</sup> and Treasure Valley Hospital ("TVH") first filed suit. The initial plaintiffs were joined by the Federal Trade Commission ("FTC") and the State of Idaho as plaintiffs.

There was no real dispute at trial that the product market was adult primary care services: plaintiffs claimed the product market was primary care services; and the defendants' position was that the market was primary care physicians ("PCPs").

However, a big issue in the case was the definition of the geographic market. Below is a map of Idaho's Treasure Valley.



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1 Paul Riehle is a partner at Sedgwick LLP in the San Francisco office, chairs the firm's Antitrust & Unfair Competition Practice Group, co-chairs its Class Action Practice Group and is a member of its Healthcare Task force. Mr. Riehle has been a member of the Executive Committee of the California State Bar's Antitrust & Unfair Competition Law Section since 2010. He currently serves as the Section's vice-chair for the Golden State Antitrust and Unfair Competition Law Institute.

2 *Saint Alphonsus Medical Center-Nampa, Inc. v. St. Luke's Health System, Ltd.*, Nos. 1:12-CV-00560-BLW, 1:13-CV-00116-BLW, 2014 WL 407446 (D. Idaho Jan. 24, 2014).

3 The entities are Saint Alphonsus Medical Group-Nampa Inc., Saint Alphonsus Health System Inc., and Saint Alphonsus Regional Medical Center, Inc.

Boise is the largest city in Idaho with a population of 205,000. Nampa is the second-largest city in Idaho with a population of 85,000 and is about 20 miles from Boise.

Plaintiff St. Alphonsus runs hospitals in Boise and in Nampa. Plaintiff TVH is a physician-owned hospital in Boise.

Defendant St. Luke's operates medical centers in Boise and Meridian, as well as medical centers in Nampa and clinics in all three cities. It does not have a hospital in Nampa or anywhere else in Canyon County. Defendant Saltzer was an IPA with the most physicians in Nampa.

Idaho District Court Judge B. Lynn Winmill agreed with plaintiffs that the geographic market was the city of Nampa. That finding caused the court to conclude that plaintiffs had made a *prima facie* case.

Pre-acquisition, St. Luke's had eight doctors in Nampa, and Saltzer had 16 doctors in Nampa.<sup>4</sup> The court found the affiliated entity post-acquisition would provide eighty percent of the primary care services to the market. The court's findings of fact also, however, demonstrated that the transaction advanced Affordable Care Act policies:

- The intent by St. Luke's and Saltzer was not anticompetitive, but rather to "improve patient outcomes" and the transaction would accomplish that objective.
- It promoted integrated, value-based healthcare that is a "consensus" solution to cost and quality concerns.
- It would "increase access to medical care" for the poor and uninsured.

After a four-week trial, fifty witnesses and 1,500 exhibits, Judge Winmill, held that the acquisition violated the Clayton Act, 15 U.S.C. § 18, and the Idaho Competition Act, Idaho Code § 48-106, and ordered a divestiture as the remedy.

On February 10, 2015, the Ninth Circuit affirmed the district court's judgment,<sup>5</sup> holding that the district court did not clearly err in determining that Nampa was the relevant geographic market, in its factual findings that the plaintiffs established a *prima facie* case that the merger will probably lead to anticompetitive effects in that market, and in concluding that the defendant did not rebut the plaintiffs' *prima facie* case where the defendants did not demonstrate that efficiencies resulting from the merger would have a positive effect on competition. The Court of Appeals also held that the district court did not abuse its discretion in ordering divestiture. The defendants are considering filing a petition for rehearing and/or a petition for a writ of *certiorari*.

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4 Notably, these numbers meant that the acquisition did not come close to meeting the Hart-Scott-Rodino merger reporting requirements.

5 *Saint Alphonsus Med. Ctr. v. St. Luke's Health Sys.*, No. 14-35173, slip op., 2015 WL 525540 (9th Cir. Feb. 10, 2015).

Two distinguished and knowledgeable panelists discussed the case:

- Thomas Greene, special litigation counsel with the Bureau of Competition, Federal Trade Commission in San Francisco, served as lead trial lawyer for the FTC in the *St. Luke's* case. Mr. Greene previously served in the California Attorney General's Office as Chief Assistant Attorney General for the Public Rights Division and Chief of the Antitrust Law Section. He is a past chair of the Multistate Antitrust Task Force of the National Association of Attorneys General and a recipient of the association's Marvin Award for national leadership. He is the former chair of the California Bar's Antitrust and Unfair Competition Law Section, and is a recipient of the section's Antitrust Lawyer of the Year Award.
- Jack R. Bierig was lead defense counsel for St. Luke's Health System Ltd. in the *St. Luke's* case. Mr. Bierig is a partner at Sidley Austin LLP in the firm's Chicago office. Mr. Bierig has written and lectured widely on antitrust and health care regulatory topics. He teaches Health Law and Food and Drug Law courses at the University of Chicago Law School and the Harris School of Public Policy. He also founded the Center for Conflict Resolution.
- Paul Riehle, partner at Sedgwick LLP and chair of the firm's Antitrust & Unfair Competition Practice Group, moderated this discussion. This discussion builds upon the recent panel discussion at the 2014 Golden State Institute by the Antitrust and Unfair Competition Law Section of the California State Bar. Mr. Riehle moderated the panel discussion with Messrs. Greene and Bierig.

**Moderator:** Judge Winnill found that the geographic market was Nampa. Boise is only twenty miles away from Nampa. One of the two non-governmental plaintiffs, St. Alphonsus, operated most of their hospitals in Boise. The other governmental plaintiff, TVH, is located only in Boise. Should Boise have been considered part of the geographic market?

**Greene:** I will start by putting this case in context. In the early 1990s, federal agencies, both the Federal Trade Commission and the Department of Justice, won a series of healthcare merger cases. However, starting circa 1995, nobody on the government side could win one of these cases. In *Butterworth* in 1996, the court took the view that if a nonprofit is the owner of a new, enlarged firm, that somehow that should take away the sting of increased concentration in the market.<sup>6</sup> *Sutter Health* was another landmark case.<sup>7</sup> There, the court adopted an extraordinarily wide geographic area, one that basically stretched from Sacramento to Palo Alto. Within that very expanded space, there was no increased concentration to speak of.

Then there was a reassessment period, which I refer to that as the years in the desert. Between 2001 and 2008, the government brought no healthcare merger cases. Starting in 2008, there have been a series of government wins.

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6 *Federal Trade Commission v. Butterworth Health Corp.*, 946 F.Supp. 1285, 1296-97 (W.D. Mich. 1996).

7 *California v. Sutter Health Sys.*, 130 F. Supp. 2d 1109 (N.D. Cal. 2001).

# Mixed Record of Government Enforcement Actions

- Rockford (1990)
- University Health (1991)
- Freeman (1995)
- Butterworth (1997)
- LIJMC (1997)
- Tenet (1999)
- Sutter Health (2001)
- Years in the Desert
- Evanston (2008)
- Inova (2008)
- OSF (2012)
- Reading (2012)
- Phoebe Putney (2013)
- St. Luke's (2014)
- ProMedica (2014)

So the fair question here is: What happened?

First, the economics have become very helpful in trying to determine what a realistic geographic market is. There is a completely different way of thinking about the scope of the geographic market.

Second, there has been a significant rejection of the idea that nonprofits are dramatically different than for-profits. As Judge Posner said, human nature doesn't change based on a corporate form.<sup>8</sup>

Third, all of the research since *Butterworth* has found that in concentrated markets, a nonprofit is pretty much the same as a for-profit in terms of real-world merger-specific efficiencies.

Finally, the court rejected the assertion that the Affordable Care Act protects otherwise anticompetitive mergers.

In *Sutter Health*, the court used the Elzinga-Hogarty test, a quantitative analysis developed in 1978. If ninety percent of a corporation's sales are in a specific geographic market, that's a strong geographic market; if it's seventy-five percent, less strong, sort of on the bubble. It is based on a flow analysis that had its origin in a series of research papers that were done on coal markets. If you can bring a flatcar or a railroad car of coal into a market, you can probably bring ten or twenty railroad cars of coal into a market. It was

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8 *Hospital Corporation of America v. FTC*, 807 F.2d 1381, 1390 (7th Cir. 1986).

really transportation costs that became the arbiter of whether the geographic market is wide or narrow. That is not the kind of market we have in healthcare, and that realization finally percolated through the economic analysis and the case law.

With respect to *Sutter Health*, this was one of the early moments in the years in the desert period. Tim Muris, Republican chair of the FTC said, in effect, “It is wrong we are losing the cases, it is wrong in the economics.” One of the first things he did was order the FTC’s Bureau of Economics to do a retrospective analysis of what happened in *Sutter Health*.

The predictions in court were that competitors from outside the market would discipline the newly merged entity and the fact it was a nonprofit would also ameliorate any price effects that would flow from the merger. Wrong on both counts. There were dramatic increases in prices and no discipline from the firms that the defense economist said would constrain the merged hospitals. Quite simply the economics were bad. The conclusions of more recent studies have said just that.<sup>9</sup>

With that context, we turn to the *St. Luke’s* case and how we determined that Nampa is the market. The standard for geographic market is “where buyers can turn for alternate sources of supply?”<sup>10</sup> So, the first question is: who are the buyers? In the healthcare context, the buyers are not consumers; they are insurers. There are two stages of competition. In the first stage, an insurer tries to set up a network, and it has an interest in having as broad a network as can be reasonably priced. The providers of care also want to be in the network because that’s a huge advantage to them. It is in that bargaining relationship between payer and provider that prices are set, and providers are either in or out of the network.<sup>11</sup> From the plaintiffs’ perspective in *St. Luke’s*, this interplay defined the geographic scope of the market, as bargaining leverage depends on substitute physician groups in the market.

The way one sorts out whether someone can get by without a merged firm is to ask the question: What is the outside option? If one does not do business with this new, more robust, merged firm, can one offer an insurance product at a reasonable price that’s going to be salable without the merged firm?

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9 See, e.g., Steven Tenn, *The Price Effects of Mergers: A Case Study of the Sutter-Summit Transaction* (FTC Working Paper No. 293, 2008) (explaining that distant competitors did not constrain prices and neither did non-profit status of health system); see also H.E. Frech et al., *Elzinga-Hogarty Tests and Alternative Approaches for Market Share Calculations in Hospital Markets*, 71 ANTITRUST L.J. 921 (2004) (discussing the theoretical weaknesses of Elzinga-Hogarty tests).

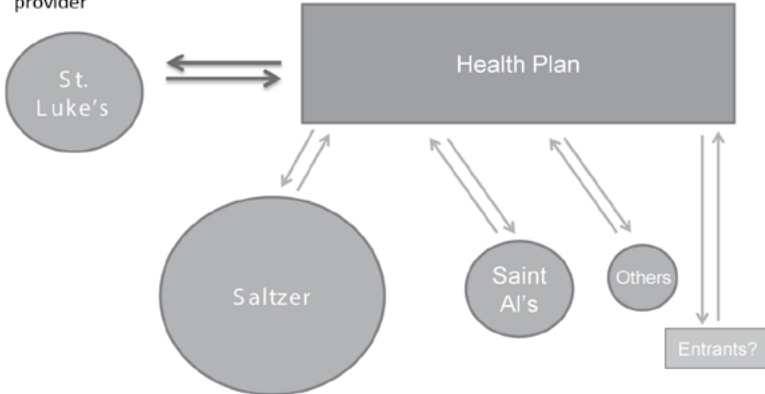
10 The standard for geographic market is “where buyers can turn for alternate sources of supply.” *Morgan, Strand, Wheeler & Biggs v. Radiology, Ltd.*, 924 F.2d 1484, 1490 (9th Cir. 1991).

11 “[T]he vast majority of health care consumers are not direct purchasers of health care—the consumers purchase health insurance and the insurance companies negotiate directly with the providers.” *Saint Alphonsus Medical Center-Nampa, Inc. v. St. Luke’s Health System, Ltd.*, Nos. 1:12-CV-00560-BLW, 1:13-CV-00116-BLW, 2014 WL 407446, at \*6 (D. Idaho Jan. 24, 2014) (emphasis added).

This slide represents the premerger world.

## Bargaining leverage depends on substitute physician groups in the market

- Before the Acquisition: Saltzer PCPs offer an attractive substitute for St. Luke's PCPs, and vice versa
  - The health plan thus has a credible "outside option" when it negotiates with each provider



Saltzer is the practice group that was acquired by St. Luke's. The medium-sized ball at the bottom left is the B-side company, Saltzer. St. Luke's is up on the top left. Before the acquisition, Saltzer PCPs offer an attractive substitute for St. Luke's PCPs, and vice versa. The health plan thus has a credible outside option when it negotiates with each provider.

This slide represents the post-merger world.



This shows that after the acquisition, a health plan loses a credible outside option and the provider gains negotiating leverage. Our economist used this slide to demonstrate that the outside option had essentially disappeared and given what was left, there was not much to create an alternate network with. Therefore, an increase in price could easily be extracted by this new, bulkier firm.

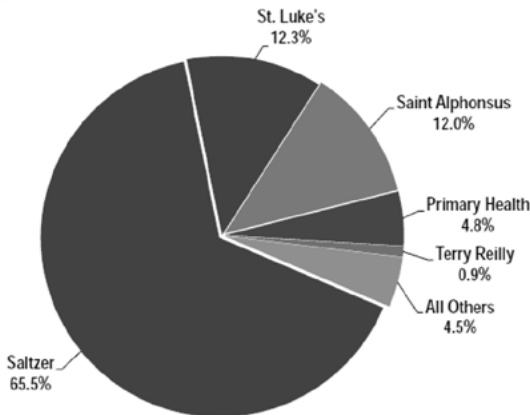
That is not the end of the story, of course. As trial lawyers, we don't rely simply on Herfindahl indices and general statements about leverage. The payors gave us very good testimony that they cannot sell their product without local primary care physicians. Dr. Dranove, our economist testified that sixty-eight percent of Nampa residents get their care locally and that those who get care outside of Nampa at their place of work confirmed that patients like to get their care close to home.

We received testimony and documents from St. Luke's that showed its executives thought Nampa was the appropriate geographic market. St. Luke's also determined that it needed Saltzer primary care physicians in order to market itself to employers in Nampa. On the other hand, personnel from St. Luke's clinic in West Boise, which was included in defendant's market, testified that its clinic "never competed with providers in Nampa."

So everything taken together—ordinary course documents and testimony from the parties, payors and our economists—resulted in the conclusion that Nampa was the geographic market.

The result is this meatball chart.

## St. Luke's and Saltzer Account for Nearly 80% of PCP services in Nampa



Market shares for Adult PCP Services in Nampa

TX 1789 (Dranove Report), Figure 18

Trial Slide: Government's Closing Argument

The red is the new combined St. Luke’s–Saltzer, which is just a hair under eighty percent of the Nampa market. This generated HHIs which were very high, and the deltas were multiples of the deltas allowed under the Guidelines.<sup>12</sup>

**Bierig:** Rather than debate over the facts, I will focus on the analytical issues that emerge from this case. The first is the definition of the geographic market. Of course, in antitrust cases, the definition of the geographic market is the beginning of any analysis of competitive effect.

The government’s position in the case is that competition occurs only when providers compete in offering services to payors in order to be in-network. The government also stated many times in the case that insurance companies have to offer primary care physicians in every town in order to be competitive. Defendants think that there is a fundamental analytical flaw in the FTC’s position: Specifically, once in-network, providers still have to compete vigorously on the basis of price because payors can’t adjust co-payment levels and incentivize providers to choose preferred providers in a network. In other words, there is tremendous price competition among providers to get patients to choose their services. Indeed, the Court of Appeals, in *FTC v. Freeman Hospital*,<sup>13</sup> found that the “decisive question” is how consumers would respond in the event of an anticompetitive price increase.

Here we don’t even have to deal with economic theory because we have a natural experiment. Prior to the affiliation, Saltzer was the dominant provider of primary care physician services in Nampa. Micron, which is an extremely large employer in Nampa, raised copayments in order to be treated by Saltzer physicians. Put another way, Micron made Saltzer an unpreferred provider. Interestingly enough, Saltzer patients left Nampa in droves and got care in Boise, Meridian, Caldwell and elsewhere. That indicates that Nampa is not a relevant geographic market.

Indeed, there’s an inconvenient truth here, to use our almost-President’s statement: As the court found, sixty-eight percent of Nampa residents currently receive adult primary care in Nampa. What that means is that nearly one-third of Nampa residents already receive adult primary care outside of Nampa—without any sort of anticompetitive price increase. The relevant question then is this: If there were a small but significant price increase, what would those sixty-eight percent of Nampa residents who currently receive adult primary care in Nampa do to get primary care? The fact is that most adults in Nampa work elsewhere, mostly in Meridian and Boise. This suggests that in the event of such an increase, a substantial number of people would seek adult primary care outside of Nampa as, in fact, they did when Micron raised copayment levels.

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12 The Herfindahl-Hirschman Index (“HHI”) is calculated by summing the squares of the market shares of all participants in the market. A market is considered highly concentrated if the HHI is above 2,500, and a merger that increases the HHI by more than 200 points is presumed to be likely to enhance market power. See U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES § 5.3 (2010), available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.html>.

13 *FTC v. Freeman Hospital*, 69 F.3d 260, 269 (8th Cir. 1995).

In one of the cases that Tom refers to as the “desert period,” the Court of Appeals in *FTC v. Tenet Healthcare*<sup>14</sup> held that the fact that twenty-two percent of patients in the market posited by the FTC got care outside that market undermined the FTC’s proffered market. In our case, thirty-two percent of patients get care outside of the FTC’s market.

Here is further proof that Nampa is not a relevant geographic market. Saltzer, on the government’s own theory, had basically a monopoly of adult primary care physicians in Nampa prior to the affiliation with St. Luke’s. But Saltzer by itself, with basically one hundred percent of the market, never was able to raise fees above competitive levels. That certainly indicates that Nampa is not a relevant market, because if it were, Saltzer would have been able to raise fees above competitive levels. Notably, subsequent to the affiliation, prices in Nampa have not risen above competitive levels.

**Moderator:** *Our next topic is: What must a plaintiff prove and what must the defense prove in a Section 7 case challenging the affiliation between a healthcare system and a defendant physician group?*

**Bierig:** There are three separate analytical issues. Before we turn to them, I want to make two important points. One, there is a huge asymmetry in the FTC’s view between the burden on the plaintiff and the burden on the defendant. Two, the FTC’s view is fundamentally incorrect because it leads to condemnation of transactions that actually promote competition and that advance federal health policy as reflected in the Affordable Care Act.

The first analytical issue is what is the plaintiff’s burden to prove a *prima facie* case? Second, if the plaintiff does prove a *prima facie* case, what does the defendant have to show to overcome the presumption of illegality? Third, if the defendant makes the requisite showing, who bears the burden of proving that there is a less restrictive manner of achieving the benefits of the transaction?

As to the first of these three questions, here is what the FTC says. Plaintiffs establish a *prima facie* case of a Section 7 violation and a presumption of illegality by showing that the transaction will result in undue concentration in a relevant market. HHI analysis,<sup>15</sup> in the FTC’s view, without more, makes out a *prima facie* case. Where an acquisition increases the HHI by 200 points, it is presumed likely to enhance market power and to be illegal.

The defense view is that the HHI analysis is just a starting point. That’s what the Court of Appeals, including two current Supreme Court Justices, said in *United States v. Baker Hughes*.<sup>16</sup> To make out a *prima facie* case, a plaintiff must show a substantial likelihood of actual anticompetitive effects.

Federal Trade Commissioner Joshua Wright articulated this same position about a year ago when he said that the FTC should encourage courts to abandon the use of

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14 *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045 (8th Cir. 1999).

15 See *supra* note 12.

16 *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 991-92 (D.C. Cir. 1990) (holding that plaintiff must show a substantial likelihood of actual anticompetitive effects to make out a *prima facie* case).

the structural presumption first in *Philadelphia National Bank*.<sup>17</sup> He gave two reasons for this position. First, the structural presumption endorsed by *Philadelphia National Bank* doesn't make economic sense. Commissioner Wright, who is an economist, points out that modern economic learning and empirical evidence do not support the notion that mergers that generate a post-merger firm with greater than thirty percent shares are systematically more likely to be anticompetitive. Second, this approach is far too sensitive to the market definition exercise.<sup>18</sup> As we have just seen, it is an artificial exercise to decide whether the market is really Nampa or a larger market that includes Nampa and Boise and other towns.

So as Judge Posner observed in the *HCA* case, courts should no longer rely on a very strict merger decision like *Philadelphia National Bank* in the 1960s, but should really inquire into the probability of harm to consumers.<sup>19</sup> That's what the defense thinks.

If the defense is right, what do plaintiffs have to show? The FTC is of the view that the possibility of any price increase is enough. Our view is that there has to be a proof of likelihood of anticompetitive pricing.

I want to emphasize "anticompetitive pricing." Price increases always occur, but price increases standing alone do not create any concern under the antitrust laws. There are some additional questions that need to be raised. One is: To what extent are price rises following acquisitions in other geographic markets relevant?

The FTC pointed to various price increases in other markets outside of Treasure Valley. Doing so raises a number of issues. First, those increases didn't demonstrate anticompetitive pricing. Prices always increase, but the relevant fact in other markets is very different from the market that is being analyzed.

A second question is this: To what extent is the presence of powerful purchasers a factor? In Boise, there were two or three insurance companies that dominated the market. They are not going to lie down and just accept anticompetitive pricing by providers. The presence of very strong buyers in a market must also factor into any analysis.

Another point. Boise is a very small community and the people on the board of St. Luke's are the heads or significant executives of the large local employers who would have to bear any price increase. So the question is not, as the FTC suggests, whether St. Luke's is nonprofit or not. Rather, the issue is whether the fact that the hospital board is comprised of business leaders whose companies will bear higher prices will affect the likelihood of a price increase.

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17 *United States v. Philadelphia Nat'l. Bank*, 374 U.S. 321, 363 (1963) (holding that plaintiffs establish a *prima facie* case of a Section 7 violation, and a presumption of illegality, by showing that the transaction will result in undue concentration in a relevant market).

18 Joshua D. Wright, Commissioner, FTC, "The FTC's Role in Shaping Antitrust Doctrine: Recent Successes and Future Targets" (Sept. 24, 2013), available at [http://www.ftc.gov/sites/default/files/documents/public\\_statements/ftc%20E2%80%99s-role-shaping-antitrust-doctrine-recent-successes-and-future-targets/130924globalantitrustsymposium.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/ftc%20E2%80%99s-role-shaping-antitrust-doctrine-recent-successes-and-future-targets/130924globalantitrustsymposium.pdf).

19 *Hospital Corp. of America v. FTC*, 807 F.2d 1381, 1386 (7th Cir. 1986) (stating that courts should no longer "rest, on the very strict merger decisions of the 1960's," but instead "inquire into the probability of harm to consumers").

Now, assuming that the plaintiff makes out a *prima facie* case, what does the defendant have to show in rebuttal? Here's the FTC's view: To rebut the "strong presumption of illegality," defendants must show that their claimed efficiencies are not only "extraordinary" but also "substantiated, verifiable and merger-specific."<sup>20</sup> Indeed, "Defendants must verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any cost of doing so), and how each would enhance the merged firm's ability and incentive to compete and why each would be merger-specific."<sup>21</sup> No one can meet that test.

The correct test is whether there is a reasonable likelihood that substantial pro-competitive benefits will take place over time. The District Court for the District of Columbia said it quite well: There is "a difference between efficiencies which are merely speculative and those which are based on a prediction backed by sound business judgment."<sup>22</sup> Or as the District of Columbia Court of Appeals said, a defendant cannot be required to produce evidence of pro-competitive benefits with "a degree of clairvoyance alien to Section 7."<sup>23</sup>

Here, there are several benefits from this transaction. It resulted in the treatment of all patients, regardless of ability to pay. It increased community outreach programs. And, probably most importantly, the transaction helped St. Luke's move toward being a fully-integrated clinic system and to facilitate the transition from fee-for-service to risk-based delivery of care. Those are very important pro-consumer benefits.

The question arises: How specific and demonstrable does that proof have to be? The defense view is that it does not have to be all that specific because the effects of a transaction cannot be measured at the time of the case. It is going to take a while for these effects to be seen. To require someone to have to prove, with the kind of specificity that the FTC is talking about, all these benefits is basically to say that a defendant can never win. However, the Ninth Circuit, although not in an antitrust case, but a case with some analogies, cautioned against undoing a healthcare merger where doing so might detract from the quality of care for patients and would mean that innovative procedures made possible by the transaction would have to be abandoned.<sup>24</sup>

This is a very important question that has never been answered, because most of the Section 7 cases are strictly horizontal cases in which two hospitals merge, and there are not a lot of pro-consumer benefits that arise from horizontal mergers. This is more of a vertical situation in which a physician group is affiliating with a hospital system, and there are very significant pro-consumer benefits that arise.

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20 Plaintiffs' Joint Pre-Trial Memorandum at 19, *Saint Alphonsus Medical Center-Nampa, Inc. v. St. Luke's Health System, Ltd.*, Nos. 1:12-CV-00560-BLW, 1:13-CV-00116-BLW (D. Idaho Sept. 10, 2013).

21 *Id.* (citing U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES (2010)).

22 *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1089 (D.D.C. 1997).

23 *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 987 (D.C. Cir. 1990).

24 *Miller v. Cal. Pac. Med. Ctr.*, 991 F.2d 536, 545 (9th Cir. 1993).

The final question on the burden issue is this: Who bears the burden of showing that the pro-competitive benefits could reasonably have been achieved in a manner less restrictive of competition? The FTC's position is that the defendant has the burden on the question of less restrictive alternatives. There is no law in Section 7 cases. Even in Section 1 cases, there are not too many cases that have gone this far, and so there is not a lot of law. The law that exists suggests in the Section 1 context that the burden reverts to the plaintiff on this issue. The leading case is the *Clorox* case in the Second Circuit.<sup>25</sup> There are two cases from the Ninth Circuit, *Hairston*<sup>26</sup> and *Bahn*,<sup>27</sup> in which the Ninth Circuit, albeit not with very thorough discussion, said that if the defendant rebuts the plaintiff's *prima facie* case, the burden goes back to the plaintiff to prove that there were ways less restrictive of competition to effectuate the transaction.

The problem with the FTC's position analytically, conceptually and from a policy point of view, is that a hospital system can never integrate through employment of physicians whose practices it acquires. That is because a joint venture offers, at least in theory, an alternative, less restrictive way of competition. In fact, there is no consensus on whether employment of physicians is as effective at achieving efficiency as joint ventures are. In my view, at least, the antitrust law should not result in favoring one legitimate structure over another.

This brings me to a very important and interesting conceptual issue in antitrust enforcement: What is the role of judicial restraint in Section 7 cases? On that, the Ninth Circuit in *United States v. Syfy* observed. "[A] court ought to exercise extreme caution because judicial intervention in a competitive situation can itself upset the balance of market forces, bringing about the very ills the antitrust laws were meant to prevent."<sup>28</sup>

Judge Easterbrook of the Seventh Circuit made the same point in a law review article: "If the court errs by condemning a beneficial practice, the benefits may be lost for good."<sup>29</sup> Put another way, a judgment erroneously prohibiting behavior with real pro-competitive potential will create significant and long term social costs.

The defense believes the *St. Luke's* trial court decision that this case is anti-patient and anti-consumer and that the intervention of the court is bringing about the very sort of anti-consumer result that the antitrust laws, as a consumer protection measures, were meant to prevent.

**Greene:** I will begin by briefly talking about efficiencies, because there are major differences in our perspective in terms of the case law and structure of the analysis.

The notion that there is little or no case law on where the burden lies and what it is, is incorrect. In *H&R Block*,<sup>30</sup> discussed at last year's Golden State Institute, the court

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25 *Clorox Co. v. Sterling Winthrop Inc.*, 117 F.3d 50, 56 (2d Cir. 1997).

26 *Hairston v. Pacific 10 Conference*, 101 F.3d 1315, 1318-19 (9th Cir. 1996).

27 *Bahn v. NME Hospitals, Inc.*, 929 F.2d 1404, 1413 (9th Cir. 1991).

28 *United States v. Syfy Enters.*, 903 F.2d 659, 663 (9th Cir. 1990).

29 Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEXAS L. REV. 1, 2-3 (1984).

30 *United States v. H & R Block, Inc.*, 833 F. Supp. 2d 36 (D.D.C. 2011).

ruled that the hurdle for demonstrating efficiency claims is high.<sup>31</sup> First, they have to be merger-specific. If the same benefits using a different strategy, a less anticompetitive strategy, is possible, then the efficiencies do not count. That is the essence of this idea of merger specificity. Secondly, the efficiencies have to be reasonably verifiable. A defendant cannot simply say, we are going to put on a show, and you will like it when you see it.

Here, St. Luke's failed to show that it needed to employ physicians in order to achieve the proposed gains. That was a conclusion of the court which was generated from a variety of sources. One was expert testimony. Plaintiffs' expert Dr. Kenneth Kizer, who now teaches at the University of California, Davis Medical School and was formerly the chief of health services for the Veterans Administration in the 1990s when he turned that system around, cited a number of other systems in which non-employment relationships—non-exclusive relationships—could generate the kinds of efficiencies that were being claimed for the St. Luke's transaction.

There were also problems with the defendants' evidence. Their expert said, in effect, "Well, I am not sure they'll be able to pull this off. In ten years we'll know. We just can't tell now." The head of clinical efficiencies, a physician, said, "I'm not sure we're going to get there in five to ten years, but we're trying."

Moreover, this was the last in a series of transactions, roughly twenty transactions in eighteen months, in which St. Luke's purchased practice groups. Plaintiffs' economist went back and looked at all those transactions, and the result, based on that econometric analysis, is that in most of those transactions, prices actually went up, cost did not go down, and in the others it was basically neutral.

When all of those pieces of evidence were put together, there was not much of a case here in terms of either merger specificity or verifiable improvements in quality or efficiency.

There were specific claims that only by way of this transaction could the B-side firm, which already had an electronic medical record system, be able to access the positive benefits of St. Luke's electronic medical records system. It turned out that St. Luke's was going to offer the Epic system, which they had just purchased, to every independent physician in Idaho, which meant that this was not a merger-specific benefit.

In advising clients, it is very important to have a sense that there is, in fact, a great deal of case authority out there. In *Rockford*, for example, the court evaluated a variety of frequently made claims, including improved standardization of care. The court there said no, that's not a merger-specific benefit. There are a variety of ways to do that and it does not offset the obvious anticompetitive implications of an eighty percent market share.<sup>32</sup>

Another interesting case is *OSF Healthcare*.<sup>33</sup> The court there ruled that claims are not enough. Failure to address cultural, financial, regulatory and other practical obstacles

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31 *Id.* at 89.

32 *United States v. Rockford Mem'l Corp.*, 717 F. Supp. 1251, 1291 (N.D. Ill. 1989) *aff'd* 898 F.2d 1278 (7th Cir. 1990).

33 *FTC v. OSF Healthcare System*, 852 F. Supp. 2d 1069 (N.D. Ill. 2012).

rendered the claims speculative.<sup>34</sup> Thus, it is not enough to say that a transaction will standardize care or cut costs or facilitate risk-based contracting. The defense has to be able to show how specifically the claimed result will flow from the deal. Simply, how do we practically get from here to that better place? The questions of what are the hurdles and how are they to be addressed have to be considered carefully in order for the claimed efficiencies to be counted.

On the question of burden, this is not a new world. The burden has been on the defense for a long time, and articulated in a variety of cases. *Heinz* holds that there must be rigorous analysis and the court has to be sure that the claims are more than speculation and promises.<sup>35</sup> The courts, Areeda and Hovenkamp, and others state that the burden on the defense is somewhere between extraordinary and enormous.<sup>36</sup> The idea is that once you show that there is a presumptively unlawful merger, the defense then has to show that the efficiencies will dramatically outweigh any anticompetitive problems. It is not a balancing test.

From a jurisprudential perspective, there are two rationales for this burden-shifting regimen. The first is that efficiencies are a defense and defendants bear the burden of any defense. The second, made by Areeda and Hovenkamp, is that those with the most knowledge should bear the burden of persuasion. In a merger, those who know best about efficiencies are the two companies that are merging. Presumably, in a pro-competitive merger, future efficiencies should be a big reason for the transaction. Thus, there should be ordinary course of business plans and specific things in the record that support the idea that there will be efficiencies.<sup>37</sup>

Finally, one of the most interesting aspects of this from my perspective is the economics. As I can tell you as someone involved in the Sutter/Summit matter, the economic analysis during that period was just terrible for plaintiffs. That world has changed very dramatically.

The most recent studies, at the time that we tried St. Luke's, economic analysis depicted no compelling benefit from employing physicians. But more recent studies find that somewhat looser relationships than employee and employer relationships result in better and cheaper care. Moreover, these studies demonstrate that the tightest

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34 *Id.* at 1093-94.

35 *FTC v. Heinz Co.*, 246 F.3d 708, 721-22 (D.C. Cir. 2001) (“[T]he court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those ‘efficiencies’ represent more than mere speculation and promises about post-merger behavior.”). “[T]he high market concentration levels present in this case require, in rebuttal, proof of *extraordinary efficiencies*.” *Id.* at 720 (emphasis added).

36 AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 976d.3 (2014) (Presumptive Rules for Efficiency Claims).

37 *Id.*

relationships—like those advocated by St. Luke’s—result in higher prices but with little or no improvement in quality.<sup>38</sup>

**Moderator:** What is the proper role of healthcare policy, specifically the Affordable Care Act, in evaluating the propriety of a transaction?

**Greene:** We showed versions of this slide in both opening and closing.

## The “Healthcare Reform” Defense Is Contradicted by the Affordable Care Act

“Furthermore, competition benefits the Shared Savings Program by allowing the opportunity for the formation of two or more ACOs in an area. Competition among ACOs can accelerate advancements in quality and efficiency. All of these benefits to Medicare patients would be reduced or eliminated if we were to allow ACOs to participate in the Shared Savings Program when their formation and participation would create market power.”



The Affordable Care Act is built upon a set of foundational ideas, the most important of which is that competition should be a major arbiter and major driver of healthcare outcomes in the United States. The Act is built upon the idea of competition. When you look at the Act’s DNA, one should not be surprised that the ACA specifically says that

38 Brief for Amicus Curiae Center for Payment Reform in Support of Plaintiff/Appellee Federal Trade Commission and Affirmance of District Court’s Order, *Saint Alphonsus Medical Center-Nampa Inc., St. Luke’s Health Sys., Ltd.*, No. 14-35173 (9th Cir. Aug. 20, 2014); see also Baker, et al., *Vertical Integration: Hospital Ownership is Associated with Higher Prices and Spending*, 33 HEALTH AFFAIRS 756, 762 (May 2014) (“Our study has two key findings. First, in its tightest form, vertical integration appears to lead to statistically and economically significant increases in hospital prices and spending. This is consistent with the hypothesis that vertical integration increases hospitals’ market power. . . Second, the consequences of looser forms of vertical integration were more benign and potentially socially beneficial. Increases in these forms of integration did not appear to increase prices or spending significantly and may even decrease hospital admissions.”); Kralewski et al., *Do Integrated Health Care Systems Provide Lower-Cost, Higher-Quality Care?*, PHYSICIAN EXEC. J. 14, 18 (March-April 2014) (“[O]ur data suggest that these large complex structures might increase costs with no gains in quality.”).

nothing in the Act “shall be construed to modify, impair, or supersede the operation of any of the antitrust laws.”<sup>39</sup>

When one looks at the fundamental policy underpinnings of the Affordable Care Act and its statutory text, competition is the order of the day. That’s the world that we want to protect at the federal level, both from an ACA perspective and the federal antitrust law perspective.

Implementing regulations for the creation of accountable care organizations (“ACOs”) make clear that facilitating creation of ACOs is not an excuse for anticompetitive mergers. The implementing regulations provide a structure for notifying federal antitrust agencies of ACOs that may be an antitrust problem. So essentially there is a partnership between CMS and the antitrust agencies to address potentially anticompetitive mergers under the ACA. The law here is quite clear that the ACA does not support the idea that it is a free pass to do anticompetitive mergers in healthcare.

The other aspect of this, which is a bit more subtle, is the argument that financial integration and clinical integration are the same, specifically the idea that the more financially integrated doctors and the hospital are, the more clinical integration is achieved. But that is not so. It turns out that less restrictive financial integration can lead to better clinical integration and lower costs.<sup>40</sup> Simply put, financial integration does not necessarily lead to clinical integration.

**Bierig:** On this topic, I am reminded, of what Elizabeth Taylor’s seventh husband said to her on their wedding day, “Don’t worry, I’ll be brief.”

The defense in *St. Luke’s* agrees on some of the views just articulated regarding the Affordable Care Act. But the real question is this: To what extent do healthcare considerations factor into the evaluation of efficiencies that arise from a transaction? To argue that healthcare considerations do not factor into that is really to ignore precedent.

In a Section 2 case 20 years ago, the Seventh Circuit said in *Marshfield Clinic*: “We live in an age of technology and specialization in medical services. Physician practices in groups, in alliances, in networks, utilizing expensive equipment and support. Twelve physicians competing in a county would be competing to provide horse-and-buggy medicine. Only as part of a large and sophisticated medical enterprise such as the Marshfield Clinic can they practice medicine in rural Wisconsin.”<sup>41</sup>

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39 42 U.S.C. § 18118(a).

40 See, e.g., Thomas C. Tsai & Ashish K. Jha, *Hospital Consolidation, Competition, and Quality: Is Bigger Necessarily Better?*, 312 J. AMERICAN MED. ASSOC. 29, 30 (July 2, 2014) (“Many small health care organizations are excellent, proving that size is no prerequisite for delivery of high-quality care. Higher health care cost from decreased competition should not be the price society has to pay to receive high-quality care.”); Abe Dunn & Adam Hale Shapiro, *Do Physicians Possess Market Power?*, 57 J. L. & ECON. 159, 186 (2014) (finding that physicians in concentrated markets are able to exercise market power); Alison Evans Cuellar & Paul J. Gertler, *Strategic Integration of Hospitals and Physicians*, 25 J. OF HEALTH ECON. 1 (2005) (“[Hospital-physician] integration “has little effect on efficiency, but is associated with an increase in prices . . .”).

41 *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1412 (7th Cir. 1995).

The analysis in *Marshfield Clinic* has tremendous relevance to the *St. Luke's* case because the Saltzer physicians were a small group of primary care and other related physicians in Nampa, Idaho. Through integration into the St. Luke's system, they were able to practice twenty-first century medicine by having much greater access to more robust electronic medical records and all sorts of data analytics; by being part of developing practice guidelines; and by being free from the economic constraints imposed by independent practice, which limits the number of no-pay and low-pay patients that a physician can see. So to say that healthcare policy doesn't enter into it is blink reality.

Similarly, in *Tenet Health Care* the Eighth Circuit found the fact that a transaction will lead to integrated delivery of care and ultimately, to better medical care is a relevant factor in antitrust analysis. Evidence that a transaction will lead to "integrated delivery" of care and ultimately "better medical care" is relevant.<sup>42</sup>

If you look at the findings of Judge Winmill in *St. Luke's*, you will see that all the benefits that he found from this case are the exact goals of the Affordable Care Act. To say that those factors have no place in antitrust analysis after Congress has sought to achieve them is a very narrow and wrong view of the antitrust laws.

**Moderator:** *Judge Winmill ordered divestiture, which has been stayed pending appeal. Is divestiture the proper remedy?*

**Bierig:** The answer is no. Here's the FTC's position: divestiture is the presumed remedy in Section 7 cases brought by the government. I don't fundamentally disagree that divestiture needs to be thought about as a remedy in any Section 7 case. But at the same time, divestiture should not be ordered without substantial evidence that the benefit outweighs the harm.

All these cases cited by the FTC about the propriety of divestiture arise in the case of purely horizontal mergers between two banks or hospitals, where there are none of the benefits that we see in this case. So the question from an antitrust policy issue is this: What factors overcome the presumption of in favor of divestiture? Here, there are two.

First, divestiture should not be ordered for a transaction in which substantial consumer benefits would be lost by the divestiture.<sup>43</sup> Second, divestiture should not be ordered where divestiture will not re-inject competition into the market. The purpose of divestiture is to put back into the market the competition that was supposedly lost as a result of the transaction.

Both of these factors are present here. As discussed already at length, there are clearly pro-consumer benefits that arise from this transaction. The court so found. The question that the court ought to be asking itself is this: Assuming that the transaction is unlawful, can we structure a remedy that will preserve these pro-

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42 *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1054 (8th Cir. 1999).

43 *See, e.g., Garabet v. Autonomous Techs. Corp.*, 116 F. Supp. 2d 1159, 1172 (C.D. Cal. 2000) (holding that divestiture should not be ordered without substantial evidence that the benefit outweighs the harm).

consumer benefits and at the same time address the concern about anticompetitive pricing that the plaintiffs voiced?

Also, in this case, when the affiliation with St. Luke's was announced, Saltzer's seven highest earners, most of the surgeons, left and went elsewhere. That result was economically devastating for Saltzer, which has been hemorrhaging money as a result. It is quite clear, even though the government won't acknowledge it, that in the event of divestiture, Saltzer will not survive as a competitive entity. Doctors will splinter off, retire or move elsewhere. Others will be picked off by St. Luke's or its real rival, which is St. Alphonsus. To the extent that the purpose of divestiture is to re-inject competition into a market, divestiture ought not to be ordered where it is quite clear that divestiture will not have that effect.

The defense believes that the Ninth Circuit should think seriously about whether divestiture should be not only the presumed remedy, but the inevitable remedy. In this case, it would be entirely the wrong remedy.

**Greene:** A couple of factual points here. The B-side firm was an extremely profitable firm. It was the last large independent practice group in the state of Idaho. It was doing just fine before it did this transaction. What they did lose, or what they will lose if they don't have the opportunity to affiliate with St. Luke's, is a thirty percent increase in pay—that was part of the transaction. Plaintiffs thought that was at least, in part, due to the increased market power associated with the deal.

With respect to the surgeons, they were essentially driven out by St. Luke's and the folks that were in favor of the deal within the Saltzer Medical Group. So that was, from plaintiffs' perspective, a self-inflicted wound. That was also the view the court took, that this was not something that was appropriate for consideration.

Finally, in the deal documents, Saltzer and St. Luke's went through an elaborate process that discussed what would happen if the court ordered divestiture. Among other things, Saltzer gets to keep \$11 million in the event they are ordered to divest.

There were a lot of factors here that are factual and important to the court as it considered its order. In terms of case authority, in *American Stores*, the Supreme Court ruled that divestiture is the "most suitable remedy in a suit for relief from a § 7 violation."<sup>44</sup> A number of cases say that. For example, the Ninth Circuit long ago said that divestiture "should always be in the forefront of a court's mind when a violation of § 7 has been found."<sup>45</sup>

The remedy defendants proposed was separate negotiating teams, one for Saltzer and one for St. Luke's. In the *Evanston* case, the FTC agreed to this sort of remedy in a retrospective merger challenge that took place seven years after the transaction.<sup>46</sup> The problem was the remedy was not used at all. Such remedies do not work and

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44 *California v. American Stores Co.*, 495 U.S. 271, 284 (1990).

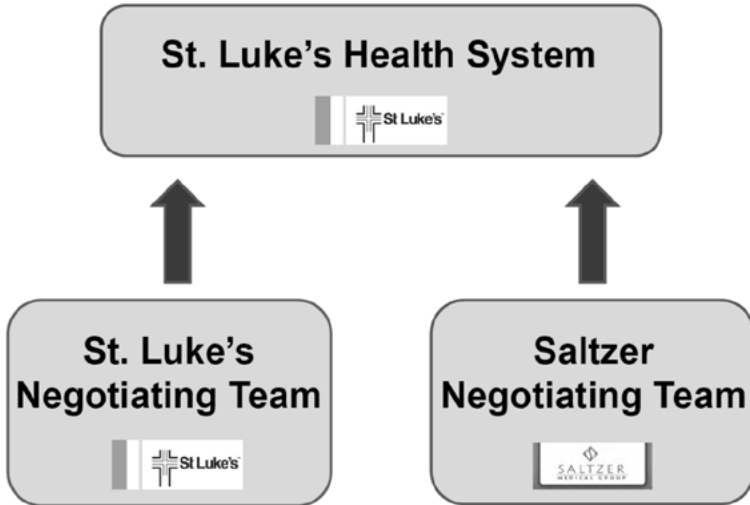
45 *Ash Grove Cement Co. v. FTC*, 577 F.2d 1368, 1380 (9th Cir. 1978).

46 Opinion of the Commission, *In re Evanston Northwestern Healthcare Corp.*, FTC Docket No. 9315 (Aug. 6, 2007), available at <http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf>.

would require extensive monitoring of literally thousands of services and prices associated with each of those services. From a public agency perspective, anything like this requires huge amounts of monitoring, is unworkable and is too easy to evade.

This is a slide that we used during closing arguments.

## “Two Negotiating Teams” — At Most an Intramural Scrimmage



Trial Slide (Governments' Closing Arguments)

The proposed two negotiating teams is no more than an intramural scrimmage. In fact, looking at the economics of this kind of proposal, if a patient did not go to Saltzer, where else would the patient go; typically, consumers in this particular market would go to the other provider.<sup>47</sup> So once they merged, if Saltzer prices went up, then St. Luke's would capture that business, and the reverse would also be true. From an economic theory perspective, what I just suggested is what a group of academic economists just shared with the Ninth Circuit in an amicus brief.<sup>48</sup>

The defendants proposed remedy does not work. At the end of the day, divestiture is the right remedy.

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47 Gautam Gowrisankaran et al. *Mergers When Prices Are Negotiated: Evidence from the Hospital Industry*, 105 AM. ECON. REV. 172, 196 (Jan. 2015) (“[S]eparate negotiations do not appear to solve the problem of bargaining leverage by hospitals.”).

48 Brief of Amici Curiae Economics Professors in Support of Plaintiffs/Appellees Urging Affirmance, *St. Alphonsus et al. v. St. Luke's Health*, No. 14-35173 (9th Cir. Aug. 20, 2014).

**ST. ALPHONSUS MEDICAL CENTER – NAMPA, INC., ET AL.  
AND FEDERAL TRADE COMMISSION, ET AL. V. ST. LUKE’S  
HEALTH SYSTEM, LTD., AND SALTZER MEDICAL GROUP,  
P.A.: A PHYSICIANS’ PRACTICE GROUP MERGER’S JOURNEY THROUGH  
SALUTARY HEALTH-RELATED GOALS, IRREPARABLE HARM, SELF-  
INFLECTED WOUNDS, AND THE REMEDY OF DIVESTITURE**

By Ari Y. Basser<sup>1</sup>

**I. INTRODUCTION AND BACKGROUND**

On January 24, 2014, following a bench trial in October 2013, Chief Judge B. Lynn Winnmill of the United States District Court for the District of Idaho found that St. Luke’s Health System, Ltd.’s (“St. Luke’s”) acquisition of the Saltzer Medical Group, P.A. (“Saltzer”)<sup>2</sup> violated Section 7 of the Clayton Act,<sup>3</sup> and the Idaho Competition Act,<sup>4</sup> because “the effect of such acquisition may be substantially to lessen competition.”<sup>5</sup> Upon such finding, the court entered a permanent injunction and ordered St. Luke’s to fully divest itself of Saltzer’s physicians and assets, and unwind the acquisition of Saltzer, which had been consummated at the end of 2012.

The court rejected the defendants’ request for a so-called “conduct-based remedy.” The court instead elected, in its discretion and after a thorough review of the evidence presented at trial, the remedy of “divestiture” to restore the market to its pre-acquisition structure, despite having previously denied Saint Alphonsus Health System, Inc.’s (“St. Alphonsus”) and Treasure Valley Hospital’s (“TVH”) request for a preliminary injunction. The defendants subsequently appealed the decision and judgment to the Ninth Circuit Court of Appeals,<sup>6</sup> where it was affirmed in favor of the Federal Trade Commission (“FTC”), the State of Idaho, St. Alphonsus, and TVH.<sup>7</sup>

Effective December 31, 2012, Boise, Idaho-based St. Luke’s acquired the tangible assets of physicians’ practice group Saltzer of Nampa, Idaho for \$16,000,000 (hereinafter referred to as the “Acquisition”). Included in the deal was a five-year professional services agreement (“PSA”), which obligated Saltzer’s physicians’ services exclusively to St. Luke’s and guaranteed that Saltzer’s physicians receive annual compensation at no less than a base

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1 Principal and Managing Attorney at Bassar Law. The views and opinions expressed in this article are those of the individual author and do not necessarily reflect the views or opinions of the firm.

2 Saltzer is Nampa, Idaho region’s largest independent physician association.

3 15 U.S.C. § 18.

4 IDAHO CODE § 48-106.

5 Findings of Fact & Conclusions of Law, *Saint Alphonsus Med. Ctr.-Nampa, Inc. v. St. Luke’s Health Sys. Ltd.*, No. 1:12-cv-00560-BLW (D. Idaho Jan. 24, 2014).

6 *St. Alphonsus Med. Ctr. – Nampa, Inc. v. St. Luke’s Health Sys.*, No. 14-35173 (9th Cir. June 16, 2014).

7 *St. Alphonsus Med. Ctr. – Nampa, Inc. v. St. Luke’s Health Sys.*, No. 14-35173, 2015 U.S. App. LEXIS 2098 (9th Cir. Feb. 10, 2015).

amount for two years after the agreement. St. Luke’s also received Saltzer’s intangible assets, personal property, and equipment.<sup>8</sup>

St. Alphonsus and TVH (collectively, “Plaintiffs”), two competing health care entities in Nampa, instituted a lawsuit in federal court in Idaho on November 12, 2012, asserting that St. Luke’s acquisition of Saltzer violated Section 7 of the Clayton Act. Both the FTC and the Idaho Attorney General were investigating the proposed acquisition. The Idaho Attorney General asked St. Luke’s to delay closing the deal to allow its office time to complete its investigation, and the FTC accelerated its investigation in an effort to complete it before the closing of the Acquisition. Meanwhile, St. Luke’s proceeded to close the Acquisition before the end of 2012. The FTC filed a lawsuit against St. Luke’s and Saltzer on March 12, 2013.

## II. GUIDING LAW: SECTION 7 OF THE CLAYTON ACT

Section 7 of the Clayton Act states: “No person . . . shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . of another person . . . where . . . the effect of such acquisition may be substantially to lessen competition . . . .”<sup>9</sup> The Clayton Act was designed to prevent harm to consumers.<sup>10</sup> An acquisition is illegal under Section 7 of the Clayton Act if “the effect of such acquisition may be substantially to lessen competition.”<sup>11</sup> Congress used the words “may be” “to indicate that its concern was with

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8 Plaintiff St. Alphonsus operates hospitals, out-patient clinics, and other health care facilities in the Treasure Valley of Idaho and Eastern Oregon. In Idaho, it owns and operates hospitals in Boise and Nampa. It is the only hospital in the City of Nampa. St. Alphonsus employs over 200 physicians who practice in what it calls the St. Alphonsus Medical Group (“SAMG”). Over sixty of the SAMG physicians provide primary care services. St. Alphonsus is owned by Michigan-based Trinity Health, which operates approximately fifty hospitals across the country. Plaintiff Treasure Valley Hospital is a nine-bed, physician-owned, for-profit hospital in Boise, largely used for out-patient surgeries. In the fall of 2012, St. Alphonsus and TVH jointly opened a new out-patient surgery center in Nampa.

St. Luke’s operates seven hospitals in Idaho—none of which are in Nampa—and operates an emergency clinic with out-patient services in Nampa. St. Luke’s employs or has entered into PSAs with each of its 500 physicians who have numerous medical specialties and are geographically distributed across Southern Idaho and Eastern Oregon. Prior to the fall of 2011, St. Luke’s did not employ any primary care physicians in Nampa. In the fall of 2011, seven physicians affiliated with the Mercy Physicians Group, and employed by St. Alphonsus in Nampa, decided to leave St. Alphonsus and join St. Luke’s.

Saltzer Medical Group consisted of forty-one physicians, nearly three quarters of whom provided adult or pediatric primary care services. Thirty-four of the Saltzer physicians, including sixteen of the adult primary care physicians and eight of the pediatricians, practice in Nampa. Saltzer is a very prestigious group with a long history, and is regarded as a “reputable and long-standing significant player” in the Treasure Valley health care community.

In December 2008, Saltzer and St. Luke’s executed a memorandum of understanding establishing an informal partnership alignment. In 2009, Saltzer initiated discussions with St. Luke’s regarding a closer affiliation. Negotiations progressed over approximately three years and “evolved significantly.” See Findings of Fact & Conclusions of Law, *supra* note 5, at 4-7, ¶¶ 1-21.

9 15 U.S.C. § 18.

10 See *Rebel Oil Co. v. Atl. Richfield Co.*, 51 F.3d 1421, 1446 (9th Cir. 1995) (“[T]he original Clayton Act’s primary aim was to prevent harm to consumers.”).

11 15 U.S.C. § 18.

probabilities, not certainties.”<sup>12</sup> Section 7 of the Clayton Act is prophylactic in nature; its fundamental purpose is “to arrest the trend toward concentration, the *tendency* to monopoly, before the consumer’s alternatives disappear[] through merger.”<sup>13</sup> Importantly, Section 7 necessarily “requires a prediction” of a transaction’s likely competitive effect, and “doubts are to be resolved against the transaction.”<sup>14</sup>

Plaintiffs in any case asserting a violation of Section 7 must show that the acquisition in question would produce “a firm controlling an undue percentage share of the relevant market, and [would] result[] in a significant increase in the concentration of firms in that market.”<sup>15</sup> “Such a showing establishes a ‘presumption’ that the merger will substantially lessen competition.”<sup>16</sup>

### **A. Plaintiffs May Seek a Preliminary Injunction to Prevent Irreparable Injury**

Section 16 of the Clayton Act empowers any person threatened with injury by a violation of the Sherman or Clayton Acts to seek injunctive relief in the federal courts.<sup>17</sup> Such actions are expressly subject to the “same conditions and principles” applied to injunctions “by courts of equity,” thus triggering traditional equitable prerequisites for injunctive relief.<sup>18</sup>

Equity treats the preliminary injunction as an “extraordinary remedy.”<sup>19</sup> A person seeking such relief must show that “irreparable injury is *likely* in the absence of an injunction.”<sup>20</sup> An injury is not irreparable if it can be remedied by money damages or some form of relief other than an injunction.<sup>21</sup> The irreparable harm must occur “before a decision on the merits can be rendered.”<sup>22</sup>

In an effort to block the consummation of the merger before any ruling on the merits as to whether or not it violated Section 7 of the Clayton Act, Plaintiffs moved for

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12 *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962).

13 *United States v. Philadelphia Nat’l Bank*, 374 U.S. 321, 367 (1963).

14 *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 906 (7th Cir. 1989) (citations omitted).

15 *Philadelphia Nat’l Bank*, 374 U.S. at 363.

16 *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2001) (citation omitted). To rebut this presumption, the defendants must produce evidence which clearly shows that the market’s concentration inaccurately predicts the likely competitive effects of the transaction. *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 631 (1974). Rebuttal evidence can take the form of a showing that “the anticompetitive effects of the merger will be offset by efficiencies resulting from the union of the two companies.” *Heinz*, 246 F.3d at 720. Other forms of rebuttal evidence may include a showing of “ease of entry into the market, the trend of the market either toward or away from concentration, and the continuation of active price competition.” *Heinz*, 246 F.3d at 715 n.7 (citation omitted) (internal quotation marks omitted).

17 See 15 U.S.C. § 26.

18 *Id.*

19 *Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7, 24 (2008).

20 *Id.* at 22.

21 See CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 2948.1 (2d ed. 1995).

22 See *id.*

preliminary injunctive relief. By Order dated December 20, 2012,<sup>23</sup> the court denied Plaintiffs’ motion for preliminary injunction finding that “irreparable harm” was not likely following the merger and prior to any decision on the merits—which, at that time, was anticipated to issue in the summer of 2013.

In opposing both Plaintiffs’ motion for a preliminary injunction and their argument that irreparable injury would occur because the combined entity would have increased leverage with health insurers—thereby resulting in higher premiums for customers—St. Luke’s responded that it had already entered into a memorandum of understanding with Idaho’s largest insurer, Blue Cross of Idaho, setting forth an agreement to enter into a contract on January 1, 2013 for a term of two years. The court determined that even assuming the Acquisition would give St. Luke’s leverage at some point, it would come too late to be exercised with regard to Idaho’s largest insurer before the case could be resolved on the merits.<sup>24</sup>

The court noted that since one of St. Alphonsus’s main hospitals providing a full range of imaging procedures is located in Nampa, Idaho, doctors would likely opt to send their patients—particularly those in Nampa—to St. Alphonsus’s hospital for imaging procedures as opposed to St. Luke’s hospitals, should St. Luke’s raise prices for comparable services.<sup>25</sup> In response to Plaintiffs’ contention that they would be forced to lay off 150 employees triggered by an immediate loss of referrals as a consequence of the merger—as allegedly happened in past instances where St. Luke’s had taken over physician practices—the court observed that, under the terms of the merger agreement, Saltzer’s physicians retained the right to make referral decisions based on the best interests of the patient. The court also concluded that St. Luke’s would not prompt Saltzer’s physicians to steer patients to St. Luke’s. Therefore, it found that any prediction of an immediate drop in referrals would not likely occur before trial, and any layoffs by the Plaintiffs would not likely be caused by St. Luke’s “steering” the patients away from them.<sup>26</sup>

The court based its decision on several critical assumptions.<sup>27</sup> *First*, the case was going to proceed on a fast track to trial, which would be held by July 29, 2013. *Second*, prior to trial, no measureable reduction in referrals to St. Alphonsus or TVH from Saltzer’s physicians would occur. *Third*, given the agreement between the merging entities, the integration of St. Luke’s and Saltzer would “take place gradually over time.” There were no plans to close Saltzer’s clinics or facilities, dispose or discontinue use of any major equipment, or alter Saltzer’s service offerings. Saltzer’s chief organizational structure would remain unchanged for at least one year. Converting Saltzer’s phone, email coding, billing, accounts receivables, and medical records systems would also not occur for over a year.

*Last*, and foreshadowing the ultimate remedy that was imposed, the Acquisition could be unwound and divestiture ordered in the event Plaintiffs prevailed on their antitrust

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23 *St. Alphonsus Med. Ctr. – Nampa, Inc. v. St. Luke’s Health Sys.*, No. 1-12-cv-00560-BLW, 2012 U.S. Dist. LEXIS 181363 (D. Idaho Dec. 20, 2012).

24 *Id.* at \*7.

25 *Id.* at \*7-8.

26 *Id.* at \*9.

27 *Id.* at \*11.

claims. The agreement reached between the merging parties gave Saltzer the right to repurchase its tangible assets from St. Luke's and ensured Saltzer access to the personnel, facilities, medical records, and resources it required to provide uninterrupted care to its patients. Also, according to the PSA, if the transaction were ever unwound, Saltzer would be allowed to return to operating as an independent physicians' group. The court further made clear that if its assumptions proved unfounded at any time prior to a trial on the merits, Plaintiffs were at liberty to renew their efforts to secure a preliminary injunction to freeze or even unwind the integration process.<sup>28</sup>

### **B. Anti-Competitive Effects in the Relevant Market Must Be Likely to Occur**

Courts may only proscribe merger activity that is likely to have anti-competitive effects in the relevant product and geographic market. In the January 24, 2014 opinion, the Idaho District Court found that the merger's *relevant product market* was adult primary care services sold to commercially-insured patients and the *relevant geographic market* was Nampa, Idaho, where a significant majority of the city's residents (68%) received their primary care services.<sup>29</sup>

Upon examining the issue of *market share* and whether the merger would likely have anti-competitive effects, the court observed that St. Luke's became the largest provider of adult primary care services in Nampa due to the Acquisition. Citing the *Merger Guidelines*,<sup>30</sup> the court noted that "market concentration is 'often one usual indicator of the likely competitive effects of a merger.'"<sup>31</sup> In evaluating that market concentration, the court noted that the FTC looks at both the pre- and post-merger market concentrations.

The court relied heavily on the *Herfindahl-Hirschman Index* ("HHI"), a metric which is customarily considered to be the preeminent measure of market concentration. The HHI is calculated by squaring the market share of each firm competing in a market and then summing the resulting numbers. The FTC uses HHI numbers to determine thresholds for evaluating "when an industry is considered highly concentrated or when potential mergers require investigation."<sup>32</sup> The court observed that a particular HHI will range anywhere from 0 to 10,000 points and that an HHI above 2,500 signals a highly concentrated market. Citing the *Merger Guidelines* § 5.3, the court further observed that a merger that increases the HHI by more than 200 points will be presumed to be likely to enhance market power. The court found that, as a result of the merger between St. Luke's and Saltzer, the HHI of the Nampa market would rise by 1,607 points to a post-merger HHI of 6,219, both values that are "well above the thresholds for a presumptively anticompetitive merger (more than

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28 *Id.*

29 Interestingly, Nampa and Boise are only about twenty miles apart, but nevertheless are considered distinct relevant markets. Approximately 68% of Nampa residents receive primary care from physicians located in Nampa, and only about 15% of Nampa residents obtain their primary care in Boise. Findings of Fact & Conclusions of Law, *supra* note 5, at 15.

30 DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (rev. ed. 2010), available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf> [hereinafter MERGER GUIDELINES].

31 Findings of Fact & Conclusions of Law, *supra* note 5, at 16 (citing MERGER GUIDELINES, *supra* note 30, § 5.3).

32 Findings of Fact & Conclusions of Law, *supra* note 5, at 16-17 (citation omitted).

double and seven times their respective thresholds, respectively).”<sup>33</sup> It was determined that St. Luke’s and Saltzer, as a combined entity, comprised 80% of the adult primary care physicians in Nampa, constituted the dominant provider in Nampa for primary care, and enjoyed significant bargaining leverage over health insurance plans.

Based on the HHI score and the finding that, when combined, St. Luke’s and Saltzer accounted for nearly 80% of the primary care physicians in Nampa, the court concluded that the Acquisition was “presumptively” anti-competitive under Section 7 of the Clayton Act.<sup>34</sup> Indeed, the court found that St. Luke’s and Saltzer were each other’s closest substitutes, thus effectively eliminating the ability of health plans to pit one against the other in negotiating pricing after the merger. Based on its view of the evidence, the court determined that it was likely that the combination would also create anti-competitive effects because of the merged entities’ ability to negotiate higher reimbursement rates from payors that would be passed on to patients, higher prices for ancillary services in the form of hospital outpatient provider-based rates for those services, and a reduction in referrals to third-party providers.

Regarding patient referrals, the court determined that while Saltzer’s physicians retained the ability to refer their patients to any practitioner or facility regardless of its affiliation with St. Luke’s, in accordance with the PSA, it was likely such physicians would nonetheless make increasing referrals to St. Luke’s as a consequence of the transaction. The court noted that St. Luke’s did not own a hospital in Nampa, whereas the Plaintiffs owned and operated the only health care facilities in Nampa. This likely shift in referrals further supported the court’s decision that the transaction would result in anti-competitive effects.

### ***C. Pro-Competitive Intentions Are Insufficient to Redress Anti-Competitive Effects***

To St. Luke’s credit, the court acknowledged that the Acquisition was motivated by pro-competitive intentions. The court was persuaded that the intent of the transaction was to improve the delivery of health care in the Nampa area rather than to degrade it.<sup>35</sup> In addition, the court determined that the merging parties intended the transaction to work to the benefit of patient outcomes and did not find any reason to believe that the transaction would have anything but that result.

Notwithstanding the parties’ intent, the court concluded that they could achieve the same goals through alternative arrangements that could avoid the potential to raise prices—a

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33 Findings of Fact & Conclusions of Law, *supra* note 5, at 17, ¶¶ 78-81 (citation omitted).

34 Findings of Fact & Conclusions of Law, *supra* note 5, at 17, ¶ 82.

35 The court noted: “[E]xperts . . . advocate moving away from our present fee-for-service health insurance reimbursement system that rewards providers, not for keeping their patients healthy, but for billing high volumes of expensive medical procedures. A far better system would focus on maintaining a patient’s health and quality of life, rewarding successful patient outcomes and innovation, and encouraging less expensive means of providing critical medical care. . . . [T]here is a broad if slow movement to such a system . . . away from our fragmented delivery system and toward a more integrated system where primary care physicians supervise the work of a team of specialists, all committed to a common goal of improving a patient’s health. . . . The Acquisition was intended by St. Luke’s and Saltzer primarily to improve patient outcomes.” Findings of Fact & Conclusions of Law, *supra* note 5, at 2-3.

conclusion St. Luke's attempted to dispute by proffering testimony that the parties had, unsuccessfully, attempted other forms of affiliation. The court did not find persuasive other arguments advanced by St. Luke's and Saltzer with respect to their position that the transaction actually increased efficiencies<sup>36</sup> and, in particular, rejected Saltzer's argument that it did not have the financial reserves to transition to value-based compensation on its own. Although the Ninth Circuit recognized St. Luke's intent to provide better service to patients after the merger, it found that St. Luke's did not prove that efficiencies resulting from the merger would have a positive effect on competition.<sup>37</sup>

#### **D. Ease of Entry May Mitigate the Anti-Competitive Effects of a Merger**

St. Luke's contended that other providers would enter the relevant market and compete, thereby mitigating any anti-competitive effects of the Acquisition—the “ease of entry” defense. To establish this defense, it was necessary for St. Luke's to show that entry by competitors would be “timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects” of a proposed transaction.<sup>38</sup> The higher the barriers to entry, the less likely it is that the “timely, likely and sufficient” test can be met.<sup>39</sup>

In analyzing whether evidence is sufficient to support an “ease of entry” defense, the “history of entry into the relevant market is a central factor in assessing the likelihood of entry in the future.”<sup>40</sup> The court found that St. Luke's failed to carry its burden of proving that entry by competitors was likely and would be timely. The court felt that entry was unlikely to mitigate the transaction's anti-competitive effects, noting that private physicians' groups would be unable to recruit family practitioners to Nampa—as previously demonstrated in 2013—and that they had been unsuccessful in recruiting pediatricians or general internists to Nampa in the two years prior to trial.

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36 On appeal, the Ninth Circuit emphasized its reluctance to accept an efficiencies defense; however, it noted that “a successful efficiencies defense requires proof that a merger is not, despite the existence of a prima facie case, anticompetitive.” *St. Alphonsus Med. Ctr. – Nampa, Inc. v. St. Luke's Health Sys.*, No. 14-35173, 2015 U.S. App. LEXIS 2098, at \*31 (9th Cir. Feb. 10, 2015). “[A] Clayton Act defendant must ‘clearly demonstrate’ that ‘the proposed merger enhances rather than hinders competition because of the increased efficiencies.’” *Id.* (citing *United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121, 137 (E.D.N.Y. 1997)).

37 *Id.* at \*34-35.

38 See MERGER GUIDELINES, *supra* note 30, § 9; *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 579 (1967).

39 *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 342 (S.D.N.Y. 2001), *aff'd*, 344 F.3d 229, 240 (2d Cir. 2003).

40 *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 56 (D.D.C. 1998); see also MERGER GUIDELINES, *supra* note 30, § 9 (“Recent examples of entry, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry efforts.”).

### E. Newly-Created Efficiencies of a Merger May Mitigate Its Anti-Competitive Effects

St. Luke's also argued, among other things, that the merger would create efficiencies that far outweigh any anti-competitive effects—commonly referred to as the “efficiencies defense.” The efficiencies defense requires convincing proof of significant and merger-specific efficiencies arising as a result of the merger.<sup>41</sup> Although the United States Supreme Court has not sanctioned the use of the efficiencies defense in a Section 7 case,<sup>42</sup> the trend among lower courts is to recognize the defense.<sup>43</sup> When high market concentrations will result from the merger, the defense requires “proof of extraordinary efficiencies.”<sup>44</sup>

Courts undertake a rigorous analysis of the kinds of efficiencies that are “urged by the parties in order to ensure that those ‘efficiencies’ represent more than just mere speculation and promises about post-merger behavior.”<sup>45</sup> The efficiencies must be merger-specific—that is, they must be “efficiencies that cannot be achieved by either company alone because, if they can, the merger’s asserted benefits can be achieved without the concomitant loss of a competitor.”<sup>46</sup> The *Merger Guidelines* only credit those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anti-competitive effects.<sup>47</sup> The court found that St. Luke’s did not carry its burden of showing convincing proof of significant and merger-specific efficiencies arising as a result of the Acquisition.

On January 24, 2014, after completing an evidentiary bench trial of the consolidated actions in October 2013, and reviewing further submissions by the parties in November 2013, the Idaho District Court ruled that the Acquisition violated Section 7 of the Clayton Act. The court ordered the divestiture of the affiliation between St. Luke’s and Saltzer.

## III. THE DIVESTITURE REMEDY IN ANTITRUST: COMPETITION RESTORED

The form and structure of mergers are numerous. Horizontal mergers, vertical mergers, and mergers with a mix of both horizontal and vertical dimensions typically present different competitive issues and challenges that require different remedial measures. Consequently, there can be wide variance with regard to selecting an appropriate merger remedy that effectively preserves competition in the relevant market.<sup>48</sup> The purpose of

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41 See PHILLIP E. AREEDA ET AL., ANTITRUST LAW 48, ¶ 971 (1998).

42 See *Procter & Gamble Co.*, 386 U.S. at 580.

43 See, e.g., *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 720 (D.C. Cir. 2001) (citations omitted).

44 *Id.*

45 *Id.* at 721.

46 *Id.* at 722 (citation omitted).

47 See MERGER GUIDELINES, *supra* note 30, § 10.

48 See U.S. DEP’T OF JUSTICE, ANTITRUST DIVISION, ANTITRUST DIVISION POLICY GUIDE TO MERGER REMEDIES (June 2011), available at <http://www.justice.gov/atr/public/guidelines/272350.pdf> [hereinafter ANTITRUST POLICY GUIDE].

relief in a Section 7 case is to restore competition lost through the unlawful acquisition.<sup>49</sup> The restoration of competition is the “key to the whole question of an antitrust remedy.”<sup>50</sup> “Fashioning appropriate equitable antitrust relief requires that courts balance the benefit to competition against the hardship or competitive disadvantage the remedy may cause.”<sup>51</sup>

As the United States Supreme Court has articulated, “[t]he relief in an antitrust case must be ‘effective to redress the violations’ and ‘to restore competition’[;] . . . divestiture is particularly appropriate where asset or stock acquisitions violate the antitrust laws,” adding, “[t]he District Court is clothed with ‘large discretion’ to fit the decree to the special needs of the individual case.”<sup>52</sup> A remedy that is carefully tailored to address the competitive harm that has been created by the proposed or consummated merger is the best way to ensure that relief will be effective.<sup>53</sup>

### ***A. Merger Remedies May Be Conduct or Structural in Nature***

Effective merger remedies typically include “conduct” or “structural” provisions, either, or both of which, can be used to preserve competition where appropriate. Conduct remedies, which the United States Department of Justice, Antitrust Division, views as valuable tools, ordinarily involve provisions that prescribe certain aspects of the firms’ post-consummation business conduct. Conduct provisions may preserve a merger’s potential efficiencies, while, at the same time, intending to remedy the competitive harm resulting from the merger.<sup>54</sup> Effective conduct remedies are tailored as precisely as possible to the competitive harms associated with the merger.

### ***B. Divestiture of an Existing Business Is a Preferred Structural Remedy***

The Antitrust Division has recognized that “**in structural remedies, the general preference is for the divestiture** of an existing business.”<sup>55</sup> The FTC explained that, “[d]ivestiture is desirable because, in general, a remedy is more likely to restore competition if the firms that engage in pre-merger competition are not under common ownership,<sup>6</sup> and there are ‘usually greater long-term costs associated with monitoring the efficacy of a conduct remedy than with imposing a structural solution.’”<sup>56</sup> Certain structural remedies, including those involving the sale of physical assets by the merging firms or requiring that the merged firms create new competitors through the sale or licensing of intellectual

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49 See *United States v. du Pont*, 353 U.S. 586, 607 (1957).

50 *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 326 (1961).

51 *Ginsburg v. InBev NV/SA*, 623 F.3d 1229, 1235 (8th Cir. 2010).

52 *Ford Motor Co. v. United States*, 405 U.S. 562, 573 (1972).

53 See *id.* (relief in a Section 7 action “necessarily must ‘fit the exigencies of the particular case’”); see also *United States v. Microsoft Corp.*, 253 F.3d 34, 107 (D.C. Cir. 2001) (relief “should be tailored to fit the wrong creating the occasion for the remedy”).

54 ANTITRUST POLICY GUIDE, *supra* note 48, at 6.

55 ANTITRUST POLICY GUIDE, *supra* note 48, at 9 (emphasis added); see also *E.I. du Pont de Nemours*, 366 U.S. at 329 (calling divestiture “a natural remedy” when a merger violates the antitrust laws).

56 *In re ProMedica Health Systems, Inc.*, No. 9346, 2012 FTC LEXIS 58, at \*162 (F.T.C. Mar. 28, 2012) (alteration in original) (quoting *In re Evanston Nw. Healthcare Corp.*, No. 9315, 2007 FTC LEXIS 210, at \*245-46 (F.T.C. Aug. 6, 2007)).

property rights,<sup>57</sup> have been referred to as simple, relatively easy to administer, and “sure” to preserve competition.<sup>58</sup>

The structural remedy of divestiture must enable firms to compete effectively in the relevant market. To achieve the goal of ensuring that the efficient current and future reduction and distribution of the relevant product will be achieved by divestiture, thereby effectively preserving the competition that would have been lost through the merger, the Antitrust Division often insists on the divestiture of an existing business entity that has already demonstrated the ability to compete in the relevant market.<sup>59</sup> A 1999 FTC study determined that the divestiture of on-going businesses succeeded at a higher rate than the divestiture of invested assets.<sup>60</sup>

Both the Department of Justice and the FTC (collectively, “the agencies”) are no doubt mindful of the considerable challenges that can be presented when deploying the remedy of divestiture in order to restore competition. The agencies recognize what they term “th[e] inherent need for prediction,” and have established guidelines that “reflect the congressional intent that merger enforcement should interdict competitive problems in their incipency and that certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal.”<sup>61</sup>

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57 See *United States v. 3D Sys. Corp.*, No. 1:01-cv-01237, 2002 U.S. Dist. LEXIS 18377, at \*7-9 (D.D.C. 2002).

58 See *E. I. du Pont de Nemours & Co.*, 351 U.S. at 377.

59 See ANTITRUST POLICY GUIDE, *supra* note 48, at 8.

60 See STAFF OF THE BUREAU OF COMPETITION, FED. TRADE COMM’N, A STUDY OF THE COMMISSIONS DIVESTITURE PROCESS § II.B.3 (1999).

61 See MERGER GUIDELINES, *supra* note 30, § 1. Prior to the establishment of the “pre-merger notification program” by Title II of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the “HSR Act”)—§ 7A of the Clayton Act, 15 U.S.C. § 18a—the agencies were often unaware of corporate mergers before they occurred and were frequently unable to restore competition following a determination that the mergers were anti-competitive. The Senate Report on the proposed legislation emphasized the need for more effective antitrust remedies in post-acquisition divestitures and merger cases. Quoting Assistant Attorney General Thomas Capler:

[D]ivestiture of stock or assets after an illegal merger is consummated is frequently an inadequate remedy for a variety of reasons . . . moreover, divestiture is normally a painfully slow process, and in some cases might never occur . . . firms under divestiture orders may deliberately delay to reap the benefits of the unlawful merger. During these delays anticompetitive consequences grow.

S. Rep. No. 94-803, at 1284 pt. 1 (1976).

The HSR Act prohibits the acquisition of voting securities and assets without filing notice to and getting approval from the antitrust agencies. The purpose of the HSR Act was to strengthen the agencies’ abilities to enforce antitrust laws by the creation of a premerger notification and waiting period requirement before any consummation of mergers and acquisitions. *The Clayton Act and the FTC Act: A Response to Dissatisfaction with a Broad Antitrust Statute*, ANTITRUST LAWS & TRADE REG. (MB) § 9.03[4][f][I] (1997). However, the HSR Act only applies to the acquisition of voting securities and assets of a certain value.

### C. *Divestiture Should Be Ordered Discriminately and When It Will Inure to the Public Interest*

Understandably, courts have been inclined to order divestiture to remedy the likely anti-competitive effects of a transaction, particularly where divestiture is “the remedy best suited to redress the ills of an anticompetitive merger.”<sup>62</sup> Divestiture “should always be in the forefront of a court’s mind when a violation of § 7 has been found.”<sup>63</sup>

However, divestiture should not be prescribed haphazardly as it has been referenced as the “least accessible end of a spectrum of injunctive relief” that should not be entered into “without substantial evidence that the benefit outweighs the harm.”<sup>64</sup> Divestiture has been characterized as a “drastic and rarely awarded remedy” that should not be awarded where it would “disserve the public interest.”<sup>65</sup> Courts are further mindful that “[s]ince divestiture is a remedy to restore competition and not to punish those who restrain trade, it is not to be used indiscriminately, without regard to the type of violation or whether other effective methods, less harsh, are available.”<sup>66</sup> Where the divested entity would be unable to compete effectively, divestiture may be an inappropriate remedy.<sup>67</sup>

A divestiture may be disfavored when the transaction has already been completed and unwinding it would harm the community.<sup>68</sup> Because the Clayton Act was not designed to be punitive, an order of divestiture may not be appropriate when such relief would “inure to no one’s benefit.”<sup>69</sup>

In considering whether divestiture was an appropriate remedy in the instant case, the Idaho District Court was mindful of the court’s admission in *Garabet* that “the costs and complexities of unwinding a merger may be considered in evaluating prejudice to the

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62 *California v. Am. Stores Co.*, 495 U.S. 271, 285 (1990).

63 *Ash Grove Cement Co. v. FTC*, 577 F.2d 1368, 1380 (9th Cir. 1978) (quoting *E. I. du Pont de Nemours & Co.*, 351 U.S. at 328-31) (internal quotation marks omitted).

64 *Garabet v. Autonomous Techs. Corp.*, 116 F. Supp. 2d 1159, 1172 (C.D. Cal. 2000).

65 *Taleff v. Sw. Airlines Co.*, 554 F. App’x 598, 598 (9th Cir. 2014) (citations omitted). See also *Kenecott Copper Corp. v. Curtiss-Wright Corp.*, 449 F. Supp. 951, 968 (S.D.N.Y. 1978) (“Divestiture . . . is a harsh remedy which should not be ordered without an opportunity for the presentation and consideration of less drastic alternative forms of relief appropriate to remedy the antitrust violations.”) (citations omitted), *aff’d in part & rev’d in part*, 584 F.2d 1195 (2d Cir. 1978).

66 *Timken Roller Bearing Co. v. United States*, 341 U.S. 593, 602-03 (1951).

67 See *United States v. General Dynamics Corp.*, 415 U.S. 486, 507-08 (1974) (affirming denial of a divestiture where the acquired company “even if it remained in the market, [it] did not have sufficient reserves to compete effectively”); see also *Mid-West Paper Prods. Co. v. Cont’l Grp., Inc.*, 596 F.2d 573, 587 (3d Cir. 1979) (cautioning against “overkill” such that the divestiture remedy’s “punitive impact may unduly cripple a defendant and lead to an overall deleterious effect upon competition”); *Nat’l Ass’n of Chain Drug Stores v. Express Scripts, Inc.*, No. 12-395, 2012 U.S. Dist. LEXIS 57884, at \*7-8 (W.D. Pa. Apr. 25, 2012) (declining to order divestiture where the divested entity “would likely be unable to survive on its own, much less compete against” the divesting entity).

68 See *United States v. First City Nat’l Bank*, 386 U.S. 361, 370-71 (1967); *Miller v. Cal. Pac. Med. Ctr.*, 991 F.2d 536, 545 (9th Cir. 1993).

69 *United States v. Rice Growers Ass’n*, No. S-84-1066 EJJ, 1986 U.S. Dist. LEXIS 30507, at \*34 (E.D. Cal. Jan. 31, 1986).

affected parties.”<sup>70</sup> However, St. Luke’s had previously represented to the court during the preliminary injunction proceedings that it would “not oppose divestiture on grounds that divestiture cannot be accomplished.”<sup>71</sup> Thus, the court determined that the cost and complexity of unwinding the transaction was not a defense to divestiture.<sup>72</sup>

St. Luke’s also argued that an unwound acquisition entity (Saltzer) would be significantly and negatively affected due to the departure of seven surgeons from Saltzer to St. Alphonsus. The court noted that, while that loss was a financial hardship, the seven surgeons who left Saltzer did so “in large part because of the acquisition.”<sup>73</sup> Courts do not consider “self-inflicted wounds” in fashioning the appropriate remedy.<sup>74</sup> Hence, having determined that Saltzer’s weakness—the loss of seven surgeons—was caused by the Acquisition, the court ruled that this could not be a reason to hold together the Acquisition. It further noted that any financial hardship was mitigated by St. Luke’s payment of nine million dollars for goodwill and intangibles as part of the Acquisition, a payment it had previously agreed Saltzer did not have to be pay back in the event the Acquisition was ever undone.<sup>75</sup>

St. Luke’s also proposed that divestiture be disregarded as a remedy and supported ordering itself and Saltzer to negotiate separately with health plans. St. Alphonsus argued that this proposed alternative of separate “negotiating teams” would be completely

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70 Findings of Fact & Conclusions of Law, *supra* note 5, at 48, ¶ 52 (citing *Garabet v. Autonomous Techs. Corp.*, 116 F. Supp. 2d 1159, 1173 (C.D. Cal. 2000)).

71 Findings of Fact & Conclusions of Law, *supra* note 5, at 48, ¶ 53.

72 Findings of Fact & Conclusions of Law, *supra* note 5, at 48, ¶ 54.

73 Findings of Fact & Conclusions of Law, *supra* note 5, at 48, ¶¶ 56–58.

74 See, e.g., *Sierra Club v. U.S. Army Corps of Eng’rs*, 645 F.3d 978, 996–97 (8th Cir. 2011); *Pappan Enters., Inc. v. Hardee’s Food Sys., Inc.*, 143 F.3d 800, 806 (3d Cir. 1998). St. Alphonsus maintained that Saltzer management knew—well in advance of the Acquisition—that proceeding with the transaction with St. Luke’s and penalizing the surgeons for working at TVH could cause them to leave, and that this could have a significant financial impact. Evidence was submitted that in 2011, a year before the transaction, Saltzer paid a consultant to analyze the impact on the group if the surgeons left. Nonetheless, Saltzer decided to proceed with the transaction. St. Luke’s also argued that even self-inflicted wounds can affect competition and should be considered. However, St. Alphonsus noted that if St. Luke’s arguments were to be credited, “this would create serious perverse incentives.” Answering Brief of Saint Alphonsus Medical Center-Nampa; Saint Alphonsus Health System Inc.; Saint Alphonsus Regional Medical Center, Inc.; and Treasure Valley Hospital Limited Partnership at 59, *St. Alphonsus Med. Ctr. – Nampa, Inc. v. St. Luke’s Health Sys.*, No. 14–35173 (9th Cir. July 16, 2014), ECF No. 60 [hereinafter Answering Brief of St. Alphonsus].

75 Findings of Fact & Conclusions of Law, *supra* note 5, at 48, ¶¶ 57–58.

inadequate, citing *ProMedica Health System v. FTC*.<sup>76</sup> To that end, relying on *Copperweld Corp. v. Independence Tube Corp.*,<sup>77</sup> St. Alphonsus argued that even if there was a separate Saltzer negotiating team, as St. Luke's suggested, as long as Saltzer was ultimately part of St. Luke's, it could be expected to act in St. Luke's interest. St. Alphonsus further argued that if St. Luke's bottom line was benefitted, whether negotiating team "Saltzer" or negotiating team "St. Luke's" succeed in getting more business, there would be "no incentive for a separate Saltzer negotiating team to vigorously compete."<sup>78</sup> The Idaho District Court found *ProMedica* persuasive and rejected the far more limited separate negotiating teams remedy propounded by St. Luke's.<sup>79</sup>

#### IV. CONCLUSION

In light of the final decision entered by the Ninth Circuit, which affirmed the lower court's decision and the important issues presented during trial and appeal, *St. Alphonsus* is, and shall continue to be, significantly instructive for hospitals and health systems' accountable care strategies. Hospitals have been acquiring and aligning with physicians' groups to create an integrated care continuum for patients, and moving toward value-based reimbursement. Clearly, the FTC has been scrutinizing such transactions in light of their potential anti-competitive effects, particularly with respect to any potential resulting leverage obtained by health insurers.

Importantly, *St. Alphonsus* demonstrates the reality that the salutary goals of Congress, in enacting antitrust laws to preserve competitive markets, are paramount to any salutary goals of the parties to the particular transaction. Here, as the Idaho District Court found, the Acquisition "was intended by St. Luke's and Saltzer primarily to improve patient outcomes" and "would have that effect if left intact."<sup>80</sup> The court applauded St. Luke's for

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76 749 F.3d 559 (6th Cir. 2014) (finding that the FTC did not abuse its discretion in rejecting "separate negotiating team" remedy). *ProMedica* involved a joinder of ProMedica Health Systems and St. Luke's Hospital. In *ProMedica*, the FTC concluded that the joinder was likely to substantially lessen competition in the market for the sale of general acute-care inpatient hospital services to commercial health plans—and in a separate relevant market consisting of inpatient OB services sold to commercial health plans—therefore, it violated Section 7 of the Clayton Act. The two merging hospitals proposed maintaining two separate negotiating teams that would prevent anti-competitive effects, while addressing the concerns of the financial viability of one of the hospitals. The FTC rejected the argument and cited case law favoring divestiture. Responding to an argument that the separate negotiating teams remedy had been approved in a past case, the FTC noted that the remedy had only been approved because the entities had fully integrated seven years earlier, making divestiture unworkable. The FTC distinguished that past case on the grounds that the parties in the case before it—just like the parties in *St. Alphonsus*—had not yet fully integrated. To remedy the violations, the FTC required ProMedica, among other things, to divest St. Luke's to an approved buyer in accordance with established FTC procedures.

77 467 U.S. 752, 769, 771 (1984) ("The officers of a single firm are not separate economic actors pursuing separate economic interests. . . . [W]ithout a formal 'agreement,' the subsidiary acts for the benefit of the parent, its sole shareholder.").

78 Answering Brief of St. Alphonsus, *supra* note 74, at 51.

79 Findings of Fact & Conclusions of Law, *supra* note 5, at 49, ¶¶ 60-62.

80 Findings of Fact & Conclusions of Law, *supra* note 5, at 3.

its efforts to improve the delivery of health care in the geographic market the Acquisition affected. The court even complimented St. Luke’s on its foresight and vision.<sup>81</sup>

But, after a thorough assessment, the Idaho District Court nonetheless concluded that the Acquisition was illegal under Section 7 of the Clayton Act because the effects of the merger “may be substantially to lessen competition,” noting that “the particular structure of the Acquisition – creating a huge market share for the combined entity – creates a substantial risk of anticompetitive price increases.”<sup>82</sup> The court cautioned that “the Clayton Act is in full force and effect, and it must be enforced,” adding, “[t]he Act does not give the Court discretion to set it aside to conduct a health care experiment.”<sup>83</sup>

This case is an example of the FTC’s vigorous challenge through trial and appeal to what it perceives to be an anti-competitive physicians’ practice group acquisition. It also stands as an important demonstration of the FTC’s commitment to combat what it deems anti-competitive transactions by aggressively implementing divestiture remedies—not merely conduct-based remedies—in the health care industry context even after an acquisition has been consummated.

*St. Alphonsus* reveals the vitality of the divestiture remedy and illustrates the critical burden merging parties bear to proffer evidence of the pro-competitive effects of the challenged transaction without exploiting so-called “self-inflicted wounds.” Merging parties are well-advised not to presume or take for granted that a court will order that a consummated transaction be unwound upon a finding that it has or would have an anti-competitive effect. Finally, and, importantly, even if acquisition agreements include language that may tend to negate or thwart a showing of irreparable harm—as the court confronted here—securing a consequent denial of a request for preliminary injunctive relief based on such language may prove to be a two-edged sword that ultimately cuts in support of granting divestiture upon a finding that the transaction violates Section 7 of the Clayton Act.

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81 Findings of Fact & Conclusions of Law, *supra* note 5, at 2-3.

82 Findings of Fact & Conclusions of Law, *supra* note 5, at 41, 51.

83 Findings of Fact & Conclusions of Law, *supra* note 5, at 51, ¶ 77.

# MAJOR LEAGUE BASEBALL IS EXEMPT FROM THE ANTITRUST LAWS – LIKE IT OR NOT: THE “UNREALISTIC,” “INCONSISTENT,” AND “ILLOGICAL” ANTITRUST EXEMPTION FOR BASEBALL THAT JUST WON’T GO AWAY.

By John L. Cooper and Racheal Turner<sup>1</sup>

The Athletics baseball team has been located in Oakland, California for many years. Several years ago, the A’s decided they would like to move their franchise to San Jose, which they anticipate would be a more profitable location. San Jose responded that it would also like to have the A’s relocate to their city. In 2009, the A’s asked Major League Baseball (MLB) for permission to move its franchise from Oakland to San Jose, but the league essentially shelved the request by sending it to a committee. San Jose then sued MLB, claiming that the refusal of its relocation request was an agreement among MLB team owners to preserve the San Francisco Giants’ monopoly in violation of the federal and state antitrust laws.

On October 11, 2013, Judge Ronald Whyte of the Northern District of California ruled that under longstanding United States Supreme Court precedent, “MLB’s alleged interference with the A’s relocation to San Jose is exempt from antitrust regulation.”<sup>2</sup> San Jose appealed to the Ninth Circuit Court of Appeals, arguing that the Court should overrule MLB’s historic exemption from the antitrust laws, which the Supreme Court itself has acknowledged may be described as “unrealistic, inconsistent, [and] illogical.”<sup>3</sup> On January 15, 2015 Judge Alex Kozinski issued the opinion of the Court affirming the District Court’s decision and refusing to limit or overturn baseball’s antitrust exemption.<sup>4</sup>

Baseball is the only national sport that is exempt from the antitrust laws. That anomalous exemption has existed for 92 years and withstood numerous court and Congressional challenges. So how did the judicially-created baseball antitrust exemption—which is widely acknowledged to be bad law—become the law-of-the-land? This exemption is a study in how judicial and legislative events transpire to freeze into the law a rule that is not only “illogical” but if considered afresh on a clean slate would never exist. As will be discussed in more detail below, the exemption was created in 1922 when the Supreme Court first held that baseball was not subject to the federal antitrust laws because it was not involved in interstate commerce. Over the years, the federal courts and the public adopted the view, without supporting legal analysis, that baseball was generally exempt from the antitrust laws, regardless of whether it was engaged in interstate commerce. Since 1953, the Supreme Court has considered this issue several

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1 Racheal Turner and John L. Cooper are partners at Farella Braun + Martel LLP. Turner is a member of the Business Litigation practice group, and Cooper is the senior member and founder of Farella’s Intellectual Property Litigation group. This article reflects the views of the authors and not necessarily those of Farella Braun + Martel LLP, its attorneys, or its clients.

2 *City of San Jose v. Office of the Comm’r of Baseball (San Jose v. MLB (Dist. Ct.))*, No. C-13-02787 RMW, 2013 WL 5609346, at \*11 (N.D. Cal., Oct. 11, 2013).

3 *See Radovich v. Nat’l Football League*, 352 U.S. 445, 451-52 (1957).

4 *See City of San Jose v. Office of the Comm’r of Baseball (San Jose v. MLB (9th Cir.))*, No. 14-15139, 2015 WL 178358 (9th Cir. Jan. 15, 2015).

times and explicitly refused to overturn baseball's exemption from federal antitrust laws on the grounds that Congress has not seen fit to do so, stating repeatedly that baseball's exemption can only be altered through legislation. Then, in 1998, Congress set baseball's antitrust exemption in stone by passing the Curt Flood Act, which revoked baseball's antitrust exemption with respect to employment issues, but explicitly maintained it for all other issues. Stated differently, Congress affirmatively carved out employment issues from baseball's antitrust exemption, but otherwise left "the business of baseball" exempt from federal antitrust laws.

Because of the Supreme Court's insistence that any change to baseball's antitrust exemption had to come from Congress, and because Congress expressly declined to make any change except with respect to employment issues, the federal courts, including the Supreme Court, must now defer to Congress's determination that baseball should continue to be exempt from antitrust laws. Regardless of how criticized it may be, if this exemption is to be changed, Congress will have to do the changing.

## **I. MLB'S FIRST BASE HIT – THE SUPREME COURT CONCLUDED THAT BASEBALL IS NOT SUBJECT TO FEDERAL ANTITRUST LAWS BECAUSE BASEBALL IS NOT IN INTERSTATE COMMERCE.**

Baseball's exemption from federal antitrust laws was created by the Supreme Court in 1922 in *Federal Baseball Club of Baltimore, Inc. v. National League of Professional Base Ball Clubs*.<sup>5</sup> In *Federal Baseball Club*, the issue was whether the league structure and the "reserve system," which restricted players' freedom to change teams,<sup>6</sup> violated federal antitrust laws.<sup>7</sup> Justice Holmes, writing for the Court, concluded that the antitrust laws did not apply to the business of baseball because the baseball teams were not involved in interstate commerce, even though they traveled from state to state to play the game.<sup>8</sup> He wrote:

The business is giving exhibitions of base ball, which are purely state affairs. It is true that in order to attain for these exhibitions the great popularity that they have achieved, competitions must be arranged between clubs from different cities and States. But the fact that in order to give the exhibitions the Leagues must induce free persons to cross state lines and must arrange and pay for their doing so is not enough to change the character of the business. . . . That which in its consummation is not commerce does not become commerce among the States because the transportation that we have mentioned takes place.<sup>9</sup>

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5 259 U.S. 200 (1922).

6 "The 'reserve clause' was a provision in baseball contracts that prevented players from signing with other clubs, even after their contracts had expired, without the express consent of the club they played for." *San Jose v. MLB (9th Cir.)*, 2015 WL 178358, at \*2 n.4.

7 *Federal Baseball Club*, 259 U.S. at 207.

8 *Id.* at 208-09.

9 *Id.*

Thus, the Court held that “the restrictions by contract that prevented the plaintiff from getting players to break their bargains and the other conduct charged against the defendants were not an interference with commerce among the States.”<sup>10</sup>

*Federal Baseball Club’s* ruling was the origin of baseball’s antitrust exemption, but—importantly—that exemption was rooted in the Supreme Court’s conclusion that the business of baseball was a “purely state affair[]” that did not constitute interstate commerce. But baseball’s exemption would not stay tethered to those roots.

## II. MLB STEALS SECOND – THE SUPREME COURT HOLDS BASEBALL IS OUTSIDE THE SCOPE OF FEDERAL ANTITRUST LAWS, WITHOUT CONSIDERING WHETHER IT OPERATES IN INTERSTATE COMMERCE.

The Supreme Court did not consider *Federal Baseball Club* again until thirty years later in *Toolson v. New York Yankees, Inc.*<sup>11</sup> There, the only issue before the Court was the reserve clause, but in an opinion that totaled only the following one-paragraph, the Court went beyond the narrow issue before it to hold that baseball was generally exempt from the antitrust laws:

In [*Federal Baseball Club*], this Court held that the business of providing public baseball games for profit between clubs of professional baseball players was not within the scope of the federal antitrust laws. Congress has had the ruling under consideration but has not seen fit to bring such business under these laws by legislation having prospective effect. The business has thus been left for thirty years to develop, on the understanding that it was not subject to existing antitrust legislation. The present cases ask us to overrule the prior decision and, with retrospective effect, hold the legislation applicable. We think that if there are evils in this field which now warrant application to it of the antitrust laws it should be by legislation. Without re-examination of the underlying issues, the judgments below are affirmed on the authority of [*Federal Baseball Club*], so far as that decision determines that Congress had no intention of including the business of baseball within the scope of the federal antitrust laws.<sup>12</sup>

The Court’s truncated opinion thus seemed to apply two rationales for maintaining the baseball exemption: (1) the baseball industry’s reliance on the exemption since 1922, and (2) Congress’s failure to enact legislation to overturn *Federal Baseball Club*. And while *Federal Baseball Club* narrowly held that baseball was not engaged in interstate commerce, the *Toolson* court interpreted the case far more broadly as “determin[ing] that Congress had no intention of including the business of baseball within the scope of the federal antitrust laws.”<sup>13</sup>

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10 *Id.* at 209.

11 346 U.S. 356 (1953).

12 *Id.* at 356-57.

13 *Id.* at 357.

In his dissent in *Toolson*, Justice Burton pointed out the per curium majority opinion's dramatic overstatement of the *Federal Baseball Club* decision, arguing that that decision only held that professional baseball was not engaged in interstate commerce in 1922:

Whatever may have been the situation when the *Federal Baseball Club* case was decided in 1922, I am not able to join today's decision which, in effect, announces that organized baseball, in 1953, still is not engaged in interstate trade or commerce.

. . . .

In the *Federal Baseball Club* case the Court did not state that even if the activities of organized baseball amounted to interstate trade or commerce those activities were exempt from the Sherman Act. The Court acted on its determination that the activities before it did not amount to interstate commerce.<sup>14</sup>

The *Toolson* dissent also correctly stated that Congress had not enacted an express exemption of professional baseball from federal antitrust laws.<sup>15</sup>

Notwithstanding the Court's narrow holding in *Federal Baseball Club* (as pointed out by the *Toolson* dissent), the judiciary as well as the public embraced the view that baseball was generally exempt from the antitrust laws.

### **III. MLB SCORES – THE SUPREME COURT REPEATEDLY AFFIRMS BASEBALL'S ANTITRUST EXEMPTION AND STATES THAT CONGRESS IS THE ONLY ENTITY THAT CAN OVERTURN IT.**

Following *Toolson*, in considering whether other types of sport or leisure were also exempt from federal antitrust laws under the same reasoning as baseball, the Supreme Court repeatedly refused to extend baseball's antitrust exemption to other sports or productions and limited the exemption to the "business of baseball."

In *United States v. Shubert*,<sup>16</sup> the Court held that baseball's antitrust exemption would not extend to theatre productions and commented on its prior ruling in *Toolson* as follows:

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14 *Id.* at 357, 360 (Burton, J., dissenting).

15 *Id.* at 364.

16 348 U.S. 222 (1955).

In *Toolson*, where the issue was the same as in *Federal Baseball*, the Court was confronted with a unique combination of circumstances. For over 30 years there had stood a decision of this Court specifically fixing the status of the baseball business under the antitrust laws and more particularly the validity of the so-called “reserve clause.” During this period, in reliance on the *Federal Baseball* precedent, the baseball business had grown and developed. . . . And Congress, although it had actively considered the ruling, had not seen fit to reject it by amendatory legislation. . . . “[W]ithout re-examination of the underlying issues,” the [*Toolson*] Court adhered to *Federal Baseball* “so far as that decision determines that Congress had no intention of including the business of baseball within the scope of the federal antitrust laws.” . . . In short, *Toolson* was a narrow application of the rule of *stare decisis*.

. . . . if the *Toolson* holding is to be expanded—or contracted—the appropriate remedy lies with Congress.<sup>17</sup>

Similarly, in *United States v. International Boxing Club of New York*,<sup>18</sup> the companion case to *Shubert*, the Court concluded that baseball’s antitrust exemption had been upheld in *Toolson* as a matter of *stare decisis* and thus could not justify extending the exemption to professional boxing.<sup>19</sup> The Court stated that Congress had considered legislation that would change the application of antitrust laws to organized professional sports but had “left intact the then-existing coverage of the antitrust laws.”<sup>20</sup>

In *Radovich v. National Football League*<sup>21</sup> the Court reviewed its prior baseball-exemption cases and held that football was subject to the antitrust laws but baseball was not.<sup>22</sup> In doing so, the Court recognized the “dubious validity” of the exemption for baseball but left it in place:

In *Toolson* we continued to hold the umbrella over baseball that was placed there some 31 years earlier by *Federal Baseball*. The Court did this because it was concluded that more harm would be done in overruling *Federal Baseball* than in upholding a ruling which at best was of dubious validity. Vast efforts had gone into the development and organization of baseball since that decision and enormous capital had been invested in reliance on its permanence. Congress had chosen to make no change. . . .

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17 *Id.* at 229-30 (citations omitted).

18 348 U.S. 236 (1955).

19 *Id.* at 243.

20 *Id.* at 242-44.

21 352 U.S. 445 (1957).

22 *Id.* at 450-52.

The Court was careful to restrict *Toolson's* coverage to baseball, following the judgment of *Federal Baseball* only so far as it “determines that Congress had no intention of including the business of baseball within the scope of the federal antitrust laws.” . . . “In short, *Toolson* was a narrow application of the rule of *stare decisis*.” And again, in *International Boxing Club*, it added, “*Toolson* neither overruled *Federal Baseball* nor necessarily reaffirmed all that was said in *Federal Baseball*. \* \* \* *Toolson* is not authority for exempting other businesses merely because of the circumstance that they are also based on the performance of local exhibitions.”<sup>23</sup>

The *Radovich Court* expressly held that the exemption applied only to baseball while recognizing that this discriminatory ruling may be “unrealistic, inconsistent, or illogical”:

[B]ut since *Toolson* and *Federal Baseball* are still cited as controlling authority in antitrust actions involving other fields of business, we now specifically limit the rule there established to the facts there involved, i.e., the business of organized professional baseball. . . .

If this ruling is unrealistic, inconsistent, or illogical, it is sufficient to answer, aside from the distinctions between the businesses, that were we considering the question of baseball for the first time upon a clean slate we would have no doubts. But *Federal Baseball* held the business of baseball outside the scope of the Act. No other business claiming the coverage of those cases has such an adjudication. We, therefore, conclude that the orderly way to eliminate error or discrimination, if any there be, is by legislation and not by court decision.<sup>24</sup>

In 1972, the Court revisited baseball's antitrust exemption in *Flood v. Kuhn*.<sup>25</sup> In *Flood*, the issue was, once again, whether the reserve clause in the contracts between baseball teams and players violated federal antitrust laws.<sup>26</sup> The majority opinion, by Justice Blackmun, overturned *Federal Baseball Club's* conclusion that baseball was not in interstate commerce, holding “[p]rofessional baseball is a business and it is engaged in interstate commerce.”<sup>27</sup> Despite rejecting the interstate-commerce-based reason for *Federal Baseball Club's* conclusion that federal antitrust laws did not apply to baseball, the *Flood Court* nonetheless reaffirmed baseball's exemption on grounds that Congress's inaction for “half a century” following *Federal Baseball Club* indicated Congress' intent for baseball to remain exempt from the antitrust laws.<sup>28</sup> The Court stated:

We continue to be loath, 50 years after *Federal Baseball* and almost two decades after *Toolson*, to overturn those cases judicially when Congress, by its positive inaction, has allowed those decisions to stand for so long and, far beyond mere inference and implication, has clearly evinced a desire not to disapprove them legislatively.

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23 *Id.* (citations omitted).

24 *Id.* at 451-52.

25 *Id.* 258 (1972).

26 *Id.* at 285.

27 *Id.* at 282.

28 *Id.* at 282-83.

If there is any inconsistency or illogic in all this, it is an inconsistency and illogic of long standing that is to be remedied by the Congress and not by this Court. If we were to act otherwise, we would be withdrawing from the conclusion as to congressional intent made in *Toolson* and from the concerns as to retrospectivity therein expressed. Under these circumstances, there is merit in consistency even though some might claim that beneath that consistency is a layer of inconsistency.<sup>29</sup>

The Court concluded that while baseball's antitrust exemption was an "aberration," it was well-established in the Court's case law and should only be overturned by Congress.<sup>30</sup>

Justices Douglas, Brennan, and Marshall dissented, arguing that the Court should correct the error it created and overrule *Federal Baseball Club* and *Toolson*, with Justice Douglas writing:

This Court's decision in [*Federal Baseball Club*], made in 1922, is a derelict in the stream of the law that we, its creator, should remove. Only a romantic view of a rather dismal business account over the last 50 years would keep that derelict in midstream.

. . . .

There can be no doubt 'that were we considering the question of baseball for the first time upon a clean slate' we would hold it to be subject to federal antitrust regulation. The unbroken silence of Congress should not prevent us from correcting our own mistakes.<sup>31</sup>

Thus, even though the entire Supreme Court was expressing—at a minimum—serious misgivings concerning the lack of any true legal justification for the baseball antitrust exemption, following the *Flood* case, the court-made law-of-the-land remained—baseball was exempt from the antitrust laws.

#### **IV. MLB HITS A HOMERUN – CONGRESS CONSIDERS BASEBALL'S ANTITRUST EXEMPTION AND ONLY OVERTURNS IT WITH RESPECT TO EMPLOYMENT ISSUES.**

In the 1998 Curt Flood Act,<sup>32</sup> Congress ratified the judicially created antitrust exemption for baseball. While Congress stated in the Curt Flood Act that federal antitrust laws would apply to MLB players and league employment issues, importantly, Congress expressly stated that it was not changing any other aspect of federal antitrust law's application to baseball. The Curt Flood Act states, in relevant part:

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29 *Id.* at 283–84.

30 *Id.* at 282.

31 *Id.* at 286–88 (Douglas, J., dissenting) (quoting *Radovich v. Nat'l Football League*, 352 U.S. 445, 452 (1957) (footnotes omitted)).

32 15 U.S.C. § 26b.

SEC. 2 PURPOSE

It is the purpose of this legislation to state that major league baseball players are covered under the antitrust laws (i.e., that major league baseball players will have the same rights under the antitrust laws as do other professional athletes, e.g., football and basketball players), along with a provision that makes it clear that ***the passage of this Act does not change the application of the antitrust laws in any other context*** or with respect to any other person or entity.

SEC. 3 APPLICATION OF THE ANTITRUST LAWS TO PROFESSIONAL MAJOR LEAGUE BASEBALL

. . . .

(b) No court shall rely on the enactment of this section as a basis for changing the application of the antitrust laws to any conduct, acts, practices, or agreements other than those set forth in subsection (a). ***This section does not create, permit or imply a cause of action by which to challenge under the antitrust laws,*** or otherwise apply the antitrust laws to, any conduct, acts, practices, or agreements that do not directly relate to or affect employment of major league baseball players to play baseball at the major league level, ***including but not limited to.***—

. . . .

(3) ***any conduct, acts, practices, or agreements of persons engaging in, conducting or participating in the business of organized professional baseball relating to or affecting franchise expansion, location or relocation, franchise ownership issues,*** including ownership transfers, the relationship between the Office of the Commissioner and franchise owners, the marketing or sales of the entertainment product of organized professional baseball and the licensing of intellectual property rights owned or held by organized professional baseball teams individually or collectively. . . .<sup>33</sup>

Thus, in enacting the Curt Flood Act, Congress considered baseball’s antitrust exemption and enacted a statute providing that it should only be reversed with respect to employment issues. As the District Court ruled in the *San Jose v. MLB* case, “despite the opportunity to do so, Congress chose not to alter the scope of the exemption with respect to any issues other than those ‘directly relating to or affecting employment of major league baseball players.’”<sup>34</sup> The Ninth Circuit agreed, concluding that the Flood Act “withdrew baseball’s antitrust exemption with respect to the reserve clause and other labor issues, but explicitly *maintained* it for franchise relocation.”<sup>35</sup> As the court explained:

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33 Curt Flood Act of 1998, Pub. L. 105-297, 112 Stat. 2824 (1998) (codified as 15 U.S.C. § 26b) (emphasis added).

34 *San Jose v. MLB (Dist. Ct.)*, No. C-13-02787 RMW, 2013 WL 5609346, at \*10 (N.D. Cal., Oct. 11, 2013) (citation omitted).

35 *San Jose v. MLB (9th Cir.)*, No. 14-15139, 2015 WL 178358, at \*4 (9th Cir. Jan. 15, 2015) (emphasis added).

[W]hen Congress specifically legislates in a field and explicitly exempts an issue from that legislation, our ability to infer congressional intent to leave that issue undisturbed is at its apex. . . . The exclusion of franchise relocation from the Curt Flood Act demonstrates that Congress (1) was aware of the possibility that the baseball exemption could apply to franchise relocation; (2) declined to alter the status quo with respect to relocation; and (3) had sufficient will to overturn the exemption in other areas.<sup>36</sup>

While some might argue that employment issues—such as the reserve system—were the only exemption from the antitrust laws that baseball enjoyed prior to the Curt Flood Act, the Supreme Court’s case law before the Act involved antitrust challenges to more than just employment issues, and the Court broadly characterized baseball’s exemption. Indeed, *Federal Baseball Club* raised an antitrust challenge to league structure, not just the reserve system.<sup>37</sup> *Toolson* included challenges to territorial restrictions and league structure, not just to the reserve system,<sup>38</sup> and the *Toolson* Court said it was reaffirming *Federal Baseball Club*’s decision that “Congress had no intention of including *the business of baseball* within the scope of the federal antitrust laws.”<sup>39</sup> The subsequent cases discussed above quoted *Toolson*’s “business of baseball” language.<sup>40</sup> And no Supreme Court case held that baseball’s antitrust exemption was limited to reserve clause issues. Further, in *San Jose v. MLB* the Ninth Circuit expressly rejected San Jose’s argument that the exemption was restricted to the reserve clause, concluding that the exemption extends to the baseball industry as a whole.<sup>41</sup>

Congress is presumed to know the state of the case law when it legislates.<sup>42</sup> Further, the legislative history of the Curt Flood Act indicates that Congress affirmatively believed that baseball’s antitrust exemption extended to more than just employment issues because the supporters of the bill described the bill as *partially* overriding baseball’s exemption. One of the Act’s co-sponsors, Senator Moynihan stated, “This bill is designed to be a *partial* repeal of major league baseball’s antitrust exemption. It would leave the exemption in place as it pertains to . . . the ability of major league baseball to control the relocation of franchises.”<sup>43</sup> Moreover, if Congress believed that employment issues were the only issues covered by the baseball antitrust exemption, then it would

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36 *Id.*

37 *See Federal Baseball Club of Baltimore v. Nat’l League of Prof’l Baseball Clubs*, 259 U.S. 200, 207 (1922).

38 *See San Jose v. MLB (Dist. Ct.)*, 2013 WL 5609346, at \*7 n.12 (“Similarly, *Toolson* also addressed certain territorial restrictions and issues of league structure.”).

39 *Toolson v. New York Yankees, Inc.*, 346 U.S. 356, 357 (1953) (emphasis added).

40 *United States v. Shubert*, 348 U.S. 222, 230 (1955); *United States v. Int’l Boxing Club of N.Y.*, 348 U.S. 236, 242 (1955); *Radovich v. Nat’l Football League*, 352 U.S. 445, 451–52 (1957).

41 *San Jose v. MLB (9th Cir.)*, No. 14-15139, 2015 WL 178358, at \*2-4 (9th Cir. Jan. 15, 2015).

42 *See, e.g., Bateman v. American Multi-Cinema, Inc.*, 623 F.3d 708, 720 (9th Cir. 2010) (“[W]e must presume that Congress is aware of past judicial interpretations and practices when it legislates . . . .”) (internal quotation marks omitted).

43 143 CONG. REC. S379-01 (DAILY ED. JAN. 21, 1997).

have had no need to so carefully state that antitrust law concerning all other baseball issues was not being changed.<sup>44</sup>

Thus, by enacting the Curt Flood Act, Congress affirmatively left in place the broad antitrust exemption for “the business of baseball,” with the narrow exception of employment issues. In other words, Congress could no longer be accused of silence or inaction; Congress acted to bring baseball’s employment issues under federal antitrust law and had expressly left in place the remainder of the judicially created exemption for “the business of baseball.”

## V. MLB’S GRAND SLAM – BASEBALL IS ALSO EXEMPT FROM STATE ANTITRUST CLAIMS

Baseball’s antitrust exemption is even more anomalous because for baseball, unlike other industries, the federal antitrust laws trump state antitrust laws. As the Ninth Circuit explained in *San Jose v. MLB*, “Baseball is an exception to the normal rule that ‘federal antitrust laws [] supplement, not displace, state antitrust remedies.’ . . . [T]he [Supreme] Court in *Flood* determined that state antitrust claims constitute an impermissible end run around the baseball exemption.”<sup>45</sup> As the Ninth Circuit recognized, ordinarily, federal antitrust laws do not replace state antitrust laws. But in *Flood*, the Supreme Court affirmed the dismissal of the state claims that were related to the federal antitrust claims on the basis that “national uniformity is required in any regulation of baseball” such that “the Commerce Clause precludes the application here of state antitrust law.”<sup>46</sup> Thus, baseball is exceptional not only because it is exempt from federal antitrust laws, but also because that federal exemption is deemed to make baseball exempt from state antitrust laws.

## VI. THE GAME IS NOW OVER FOR THE COURTS – ONLY CONGRESS CAN END BASEBALL’S ANTITRUST EXEMPTION.

Starting with its 1953 decision in *Toolson*, the Supreme Court has consistently criticized but refused to overturn its previously created exemption for baseball from federal antitrust laws, stating that Congress has not seen fit to do so and that any changes to baseball’s exemption should be by legislation. In *Toolson*, the Court said, “Congress has had the [*Federal Baseball Club*] ruling under consideration but has not seen fit to bring [the baseball] business under these [antitrust] laws . . . . We think that if there are evils in this field which now warrant application to it of the antitrust laws ***it should be by legislation.***”<sup>47</sup> Similarly, the *Radovich* Court stated, “We, therefore, conclude that the orderly way to eliminate error or discrimination [from baseball’s exemption], if any there

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44 See 15 U.S.C. § 26b(b) (“This section does not create, permit or imply a cause of action by which to challenge under the antitrust laws, or otherwise apply the antitrust laws to . . . (3) any conduct, acts, practices, or agreements of persons engaging in, conducting or participating in the business of organized professional baseball relating to or affecting franchise expansion, location or relocation, franchise ownership issues . . . .”).

45 *San Jose v. MLB (9th Cir.)*, 2015 WL 178358, at \*4.

46 *Flood v. Kuhn*, 407 U.S. 258, 284-85 (1972) (internal quotation marks and alterations omitted).

47 *Toolson v. New York Yankees, Inc.*, 346 U.S. 356, 357 (1953) (emphasis added).

be, **is by legislation and not by court decision.**"<sup>48</sup> In *Shubert*, the Court again stated, "If the *Toolson* holding [that the business of baseball is exempt from federal antitrust laws] is to be expanded—or contracted—the **appropriate remedy lies with Congress.**"<sup>49</sup> The *International Boxing Club* Court noted that that Congress had considered legislation affecting the application of antitrust laws to organized professional sports but had "left intact the then-existing coverage of the antitrust laws."<sup>50</sup> And most recently, in *Flood*, the Court said, "**Congress, by its positive inaction, has allowed [the baseball exemption] decisions to stand for so long and, far beyond mere inference and implication, has clearly evinced a desire not to disapprove them legislatively.** . . . If there is any inconsistency or illogic in all this, it is an inconsistency and illogic of long standing that **is to be remedied by the Congress and not by this Court.**"<sup>51</sup>

Although the Supreme Court originally had the power to change the law as to the exemption it had created, the Court did not do so and repeatedly stated that Congress was the only entity that could undo the judicially-created antitrust exemption for baseball. Accordingly, when Congress stated in the Curt Flood Act that it was **not** changing the antitrust law, except as to baseball employment issues, Congress cemented the court created antitrust exemption, regardless of its legal soundness, for the remainder of "the business of baseball."<sup>52</sup> As the Ninth Circuit recognized in *San Jose v. MLB*, Congress did not merely remain silent; Congress explicitly stated in the Curt Flood Act that it was changing the then current antitrust law **only** with respect to employment issues and was leaving the remainder of the exemption in place. In other words, even though it is "unrealistic, inconsistent, [and] illogical," the law-of-the-land is that baseball is exempt from the antitrust laws until Congress changes it. Ironically, no one disputes that the exemption lacks legal justification. Nonetheless, as a result of Congress' enactment of the Curt Flood Act, the Supreme Court has now **lost the power** to correct its own mistake.

Thus, to the extent that people or entities such as San Jose contend that baseball should not be immune from antitrust suits, they must appeal to Congress, not the courts, to change the law. For this reason, San Jose's anticipated appeal of the Ninth Circuit's ruling in *San Jose v. MLB* to the Supreme Court is undoubtedly doomed to strike out.

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48 *Radovich v. Nat'l Football League*, 352 U.S. 445, 452 (1957) (emphasis added).

49 *United States v. Shubert*, 348 U.S. 222, 230 (emphasis added) (internal quotation marks omitted).

50 *United States v. Int'l Boxing Club of N.Y.*, 348 U.S. 236, 243-33 (1955).

51 *Flood v. Kuhn*, 407 U.S. 258, 283-84 (1972) (emphasis added).

52 The City of San Jose and some commentators have argued that because the Curt Flood Act did not expressly create an antitrust exemption for all non-labor aspects of the business of baseball, the Supreme Court still has the power to abrogate baseball's antitrust exemption. See Philip L. Gregory & Donald J. Polden, *The Baseball Exemption: An Anomaly Whose Time Has Run*, 24 COMPETITION (2015). This argument ignores the six prior Supreme Court decisions since 1953 that have asserted that only Congress can modify baseball's antitrust exemption, as well as Congress's express statement in the Curt Flood Act that it was only changing baseball's existing antitrust exemption to apply the antitrust laws to employment/labor issues.

# THE BASEBALL EXEMPTION: AN ANOMALY WHOSE TIME HAS RUN

Philip L. Gregory and Donald J. Polden<sup>1</sup>

Both the United States District Court for the Northern District of California and the Ninth Circuit recently upheld the time-worn “baseball exemption” in a case filed by the City of San Jose<sup>2</sup> that concerned its efforts to attract the Oakland A’s professional baseball team to a new stadium in downtown San Jose.<sup>3</sup> Both decisions were fundamentally premised on the 1922 decision of the United States Supreme Court, *Federal Baseball Club v. National League*,<sup>4</sup> a decision decided on the now defunct argument that the business of baseball is an entirely intrastate affair. As Justice Oliver W. Holmes wrote, “the business is giving exhibitions of base ball, [sic] which are purely state affairs” and therefore not in interstate commerce notwithstanding “the fact that . . . the Leagues must induce free persons to cross state lines.”<sup>5</sup> A product of a bygone era, *Federal Baseball* is the most widely criticized of the Supreme Court’s antitrust decisions. Justice Harry Blackmun referred to the baseball “exemption” as an “anomaly” and “aberration,” writing that “[w]ith its reserve system enjoying exemption from the federal antitrust laws, baseball is, in a very distinct sense, an exception and an anomaly.”<sup>6</sup> Justice Douglas added that “[t]his Court’s decision in *Federal Baseball Club*. . . is a derelict in the stream of the law that we, its creator, should remove.”<sup>7</sup>

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1 Philip L. Gregory is a Partner in the law firm of Cotchett, Pitre & McCarthy, LLP, in Burlingame, California. He represents the City of San Jose in the antitrust litigation against Commissioner of Major League Baseball, an unincorporated association doing business as Major League Baseball and Allan Huber “But” Selig. Together with Joseph Cochett, Mr. Gregory argued the case before a panel of the Ninth Circuit Court of Appeals and before the District Court. Donald J. Polden is Dean Emeritus and Professor of Law at Santa Clara University where he teaches antitrust law. This article reflects the views of the authors and not necessarily those of Cotchett, Pitre & McCarthy LLP, its attorneys, or its clients.

2 The Plaintiffs are: (1) the City itself; (2) the entity responsible for winding up the affairs of the dissolved Redevelopment Agency of the City of San Jose; and (3) the joint powers authority formed by the city and the former redevelopment agency. Collectively, these Plaintiffs are referred to herein as “the City of San Jose.”

3 *City of San Jose v. Commissioner of Baseball*, No. C-13-02787 RMW, 2013 WL 5609346 (N.D. Cal. Oct. 11, 2013), *aff’d*, No. 14-15139, 2015 WL 178358 (9th Cir. Jan. 15, 2015).

4 259 U.S. 200 (1922).

5 *Id.* at 208-09.

6 *Flood v. Kuhn*, 407 U.S. 258, 282 (1972).

7 *Id.* at 286 (emphasis added).

The so-called “exemption”<sup>8</sup> from the reach of the antitrust laws continues today even through it has been acknowledged by a majority of the Supreme Court justices in another opinion as “unrealistic, inconsistent, or illogical.”<sup>9</sup> “[W]ere we considering the question of baseball for the first time upon a clean slate, we would have no doubt[ ]” that professional baseball would be subject to the federal antitrust laws.<sup>10</sup> In fact, professional baseball is the only sport—amateur, professional, collegiate—that is exempt from the reach of the nation’s competition laws.<sup>11</sup>

*Federal Baseball*, approaching its centennial anniversary, has not withstood the test of time. Other Commerce Clause decisions from that era have been updated in light of a keener awareness of real world business circumstances. As legal historian Stuart Banner writes in the introduction to this recent book, *The Baseball Trust*, “[s]carcely anyone believes that baseball’s exemption makes any sense.”<sup>12</sup> In this article, we will explore the lingering anomaly that is the baseball exemption and describe its impact on the City of San Jose as this local government entity seeks to attract a professional baseball team to strengthen its downtown area. The article describes the reasons why professional baseball will be better served if the U.S. Supreme Court abrogates the holding in its 1922 decision that spawned the exemption.

In the next section, we will provide the background of the current dispute between the Commissioner of Major League Baseball (“MLB”) and the City of San Jose. The following section of this article provides a brief background on the precedential constraints that courts encounter when they have addressed the exemption, and contrasts

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8 The term “exemption” has been used to describe the status of professional baseball’s immunity from private actions under the federal antitrust law. However, that status was first created, as we discuss in more detail below, by a U.S. Supreme Court decision holding that the regulatory powers of the U.S. Government granted under the Sherman Act could not reach a local activity such as baseball. That decision was made on the state of the law governing the federal government’s constitutional powers to reach conduct not in interstate commerce. The U.S. Supreme Court, in *Flood v. Kuhn*, subsequently admitted that the interstate commerce holding in its 1922 *Federal Baseball* case was no longer good law, but the Court thereafter failed to conform its holding to the evolving constitutional case law. Thus, the so-called exemption is really a judicially created immunity from antitrust law liability. Given the history of the Court’s treatment of professional baseball, the distinction between a judicially-created immunity and an “exemption” from the reach of the law is perhaps irrelevant because as long as the Court fails to address baseball’s immunity from federal antitrust law liability, there is no opportunity for definitive analysis of and justification for the immunity. For purposes of this Article, the authors use the conventional description, “exemption” or “business of baseball exemption” to describe this unusual jurisprudence.

9 *Radovich v. Nat’l Football League*, 352 U.S. 445, 452 (1957).

10 *Id.*

11 AMERICAN BAR ASSOCIATION: SECTION ON ANTITRUST LAW, SPORTS AND ANTITRUST LAW 1 (2014) (“Baseball is the only sport that enjoys immunity from the antitrust laws.”).

12 STUART BANNER, *THE BASEBALL TRUST: A HISTORY OF BASEBALL’S ANTITRUST EXEMPTION* xi (Oxford 2013); see generally Connie Mack & Richard M. Blau, *The Need for Fair Play: Repealing the Federal Baseball Antitrust Exemption*, 45 FLA. L. REV. 201 (1993); Samuel G. Mann, *In Name Only: How Major League Baseball’s Reliance on its Antitrust Exemption is Hurting the Game*, 54 WM. & MARY L. REV. 587 (2012); Mitchell Nathanson, *The Irrelevance of Baseball’s Antitrust Exemption: A Historical Review*, 58 RUTGERS L. REV. 1 (2005); Stephen F. Ross, *Reconsidering Flood v. Kuhn*, 12 U. MIAMI ENT. & SPORTS L. REV. 169 (Fall 1994/Spring 1995); Morgen A. Sullivan, Note, *A Derelict in the Stream of the Law: Overruling Baseball’s Antitrust Exemption*, 48 DUKE L.J. 1265, 1278–80 (1999) [hereinafter, Sullivan, *A Derelict*].

the quality of competition in other professional sports that do not have immunity from the antitrust laws. The final section of the article describes several reasons why the United State Supreme Court can and should abrogate the exemption and clearly define the scope of the nation's competition policies and antitrust laws on the business of baseball.

## I. THE FACTUAL BACKGROUND OF *CITY OF SAN JOSE V. MAJOR LEAGUE OF BASEBALL*<sup>13</sup>

On June 18, 2013, the City of San Jose filed its case against MLB, bringing both federal claims under the federal antitrust laws and California state law claims.<sup>14</sup> On August 7, 2013, MLB filed a motion to dismiss.<sup>15</sup> On October 11, 2013, the District Court denied the motion to dismiss as to the California state law interference claims for damages, but granted the motion to dismiss as to the federal and California antitrust and unfair competition claims under *Federal Baseball*.<sup>16</sup> This section of the article describes the factual background of the *City of San Jose* case and how it pertains to the District Court's invocation of the "business of baseball exemption." The factual background provides a compelling set of reasons why the anticompetitive cartel activities of professional baseball club owners should not be permitted to thwart a demand for professional sports in San Jose, the 11<sup>th</sup> largest city in the United States, and the efforts of City leaders to attract a professional team to their community.<sup>17</sup>

### A. The MLB Constitution

The Office of the Commissioner of Baseball, doing business as Major League Baseball, is an unincorporated association of thirty Major League Baseball Clubs, organized into the American League and the National League. All thirty clubs are bound by the Major League Constitution and the rules adopted and promulgated by the Commissioner pursuant thereto. The territorial rights of each of the 30 Major League Clubs are contained in Article VIII, Section 8 of the MLB Constitution: "The Major League Clubs shall have assigned operating territories within which they have the right and obligation to play baseball games as the home Club."<sup>18</sup> Under the MLB Constitution the vote of three-fourths of the Major

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13 This Factual Background Section is taken from the complaint filed on behalf of the City of San Jose.

14 Complaint, *City of San Jose v. Commissioner of Baseball*, 2013 WL 5609346 (N.D. Cal. Oct. 11, 2013) (No. 5:13CV02787).

15 Defendant's Motion to Dismiss, *City of San Jose v. Commissioner of Baseball*, 2013 WL 5609346 (N.D. Cal. Oct. 11, 2013) (No. 13-CV-02787-RMW).

16 *City of San Jose v. Commissioner of Baseball*, No. C-13-02787 RMW, 2013 WL 5609346 (N.D. Cal. Oct. 11, 2013).

17 It should be noted that even if the City of San Jose is ultimately able to convince the U.S. Supreme Court to prevent baseball's exemption from constraining the Oakland A's choices for relocation, there are several other issues that must be navigated successfully by the City before the A's are able to relocate, including financing, completion of site requirements, etc. However, the City is thwarted in taking up these political, community and economic steps if their "partner" in the process, the Oakland A's baseball organization, is prevented from even considering relocation due to action of MLB and its group of owners.

18 MAJOR LEAGUE BASEBALL, MAJOR LEAGUE CONSTITUTION 13, available at <http://bizofbaseball.com/docs/MLCConstitutionJune2005Update.pdf>

League Clubs is required for the “relocation of any of the Clubs.”<sup>19</sup> Similarly a three-fourths vote is required to amend the Constitution (which would be necessary to change the territorial rights specified in Article VIII, Section 8 of the MLB Constitution). A three-fourths vote is also required for there to be expansion by the addition of a new Club or Clubs.<sup>20</sup> Notably under Article VI, Sections 1-2, the Clubs agree that any disputes between the Clubs are to be decided solely by the Commissioner as arbitrator, and the Clubs agree not to engage in litigation between the Clubs.

Of the four two-team markets in MLB, only the San Francisco Giants and the Oakland Athletics do not share the exact same geographic boundaries. The following Clubs all share the same operating territories: the Los Angeles Dodgers and the Los Angeles Angels of Anaheim (Orange, Ventura, and Los Angeles Counties); the New York Mets and the New York Yankees (City of New York, Naussau, Suffolk, Rockland, and Westchester Counties in New York; Bergen, Hudson, Essex, and Union Counties in New Jersey; and a portion of Fairfield County in Connecticut); the Chicago White Sox and the Chicago Cubs (Cook, Lake, DuPage, Will, Kendall, McHenry and Grundy Counties in Illinois; and Lake and Porter Counties in Indiana). The relevant operating territories in the Bay Area are:

San Francisco Giants: San Francisco, San Mateo, Santa Clara, Santa Cruz, Monterey and Marin Counties in California.

Oakland Athletics: Alameda and Contra Costa Counties in California.<sup>21</sup>

## **B. Relevant History of the Athletics**

Based in Oakland, the Athletics are popularly known as “the A’s” and are a member of the Western Division of MLB’s American League. While the Athletics have often been playoff contenders, they have not returned to the World Series since 1990. The Athletics are one of the most economically disadvantaged MLB teams. Because of the economic structure of baseball, which does not split team revenues as evenly as other sports, there is wide disparity between rich and poor teams, and the Athletics are a poor team in revenues. The Athletics are heavily dependent on revenue sharing from other Clubs.

The Oakland Athletics are housed in the fourth-oldest ballpark in the majors, commonly known as the Oakland Coliseum. The Oakland Coliseum is the only remaining multi-purpose stadium in the United States, serving as a full-time home to both an MLB Club (the A’s) and a National Football League team (the Raiders).

Since the 1990’s, attendance at A’s games has plummeted and average attendance at the A’s home games is the 25th of the 30 MLB Clubs. In 2014, the A’s drew 2,003,628 for their home games (25,045 per game), ranking 25 of 30 Clubs; the Giants drew 3,368,697 for their home games (41,588 per game), ranking 4 of 30 Clubs.

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19 *Id. at Article V* § 2(b)(3).

20 *Id. at Article V* § 2(b)(1).

21 According to the 2010 census, the Giants’ territory includes 4.2 million people; the A’s territory 2.6 million.

### C. Relevant History of the Cross Bay Rival—The Giants

The San Francisco Giants are a Major League Baseball Club based in San Francisco, California, playing in the National League West Division. The Giants are currently the reigning World Series champion. The current home of the Giants is AT&T Park, located at the edge of downtown San Francisco and the San Francisco Bay. AT&T Park is widely-acclaimed as one of the best ballparks in the league with its state-of-the-art design and breathtaking views. However, before moving to AT&T Park in 2000, the Giants played their home games in Candlestick Park (from 1960–2000).

### D. The Territorial Dispute Between the A's and Giants

In the late 1980's, the Giants were hoping to build a stadium in the South Bay Area and the Giants then requested that MLB approve expansion of their territory into Santa Clara and Monterey Counties. Giants then-owner Bob Lurie had declared Candlestick Park "unfit for baseball" and engaged in what proved to be a failed campaign for a new ball park in San Francisco. After considering new stadium sites on the Peninsula and in the South Bay, the Giants sponsored a ballot measure to build a new stadium in Santa Clara. The Santa Clara voters summarily rejected that measure.

In 1990, in a final effort to keep the Giants in the Bay Area, Giants owner Bob Lurie pursued a new stadium in San Jose. However, the Giants faced territorial restrictions under MLB's Constitution, which expressly limited the Giants to San Francisco and San Mateo Counties. In order to overcome these restrictions, the Giants requested that MLB approve expansion of their territory into Santa Clara and Monterey Counties. As part of his request, Mr. Lurie reached out to then-A's owner Walter Haas. Over a handshake, Mr. Haas consented to the Giants' relocation to San Jose. According to an Oakland A's press release, Mr. Haas never granted the Giants an exclusive right to Santa Clara County, only his consent to pursue relocation of the Club to Santa Clara County in 1990. On June 14, 1990, MLB unanimously approved this expansion.

Commenting on this gentlemen's agreement, Baseball Commissioner Allan Huber "Bud" Selig said, "Walter Haas, the wonderful owner of the Oakland club, who did things in the best interest of baseball, granted permission . . . . What got lost there is they didn't feel it was permission in perpetuity."<sup>22</sup> Indeed, the MLB recorded minutes reflect that the San Francisco Giants were granted the Santa Clara County operating territory subject to them relocating to Santa Clara. Ultimately, like the voters in San Francisco and Santa Clara before them, San Jose voters rejected the Giants' proposal for a taxpayer-funded stadium both in 1990 and again in 1992. After rejection by the voters in San Jose, the Giants abandoned any interest in relocating to San Jose, and set their sights on selling the Club and moving to Tampa Bay, Florida. In 1992, after reaching a deal to relocate to Tampa Bay, by a 9–4 vote, MLB rejected the Florida deal and the Giants remained in San Francisco. The Giants eventually sold to a new ownership group and obtained private financing for the 2000 construction of AT&T Park in San Francisco's China Basin. Notably, this new stadium was closer to the A's home stadium than Candlestick Park.

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22 Mark Purdy, *Giants, A's Ownership Should Do What's Right for Baseball*, SAN JOSE MERCURY NEWS, May 13, 2012.

While the Giants were unable to successfully obtain a vote to move into the County of Santa Clara, the return of the County of Santa Clara to its original “operating territory” status under the MLB Constitution was never formally accomplished.

### **E. Bringing Baseball to San Jose**

As early as 2004, Baseball San Jose, a community organization promoting relocation of the Athletics to San Jose, lobbied the City of San Jose to authorize a new stadium in San Jose to lure the Athletics. San Jose is the tenth largest city in the United States and is the urban center of the Silicon Valley. By population, San Jose is significantly larger than San Francisco. In October 2004, San Jose and the San Jose Redevelopment Agency (“RDA”) began studying the potential for developing a ballpark in the Diridon Station area. That process culminated in a ballpark project on approximately 13.36 acres in San Jose, with a seating capacity of 32,000.

In 2005, investors led by John Fischer and Lew Wolff purchased the Athletics. Faced with abysmal attendance and an old stadium in Oakland, Wolff pursued a move to the South Bay. From 2006 to 2009, with MLB’s support, the Athletics attempted to build CISCO Field in Fremont, CA. As it became clear Fremont would not approve the stadium, Commissioner Selig wrote Mr. Wolff indicating that the Athletics had the right to “discuss a ballpark with other communities,”<sup>23</sup> e.g., San Jose.

A 2009 Economic Impact Analysis prepared by Conventions Sports and Leisure International (“CSL”) for the RDA detailed the economic benefits of the proposed Athletics stadium in San Jose (“CSL Study”).<sup>24</sup> The CSL Study provided estimates of the quantifiable impacts that would be generated by an Athletics stadium in San Jose, including: (1) \$96 million in new net direct spending in San Jose during a three year construction period; (2) \$558,000 in sales tax revenues to the City over the three year construction period; (3) 980 jobs supported annually due to ballpark development; (4) \$82.9 million in new net annual direct spending in San Jose following construction, with a thirty-year present value of \$1.8 billion; (5) \$130 million ballpark-produced annual net new output in the City; and (6) \$1.5 million per year in net new tax revenues would be generated for San Jose’s General Fund, and more than \$3.5 million per year for other local agencies. The net present value of the City tax revenues generated by the ballpark over a thirty-year and fifty-year period is estimated to be approximately \$31.2 million and \$42.0 million, respectively. Local hotels, restaurants, stores, and night spots would benefit, with the average ballpark attendee anticipated to spend \$47 at businesses outside of the stadium.<sup>25</sup>

Because of the MLB Constitution, the relocation of the Oakland Athletics to San Jose would purportedly place them within the “operating territory” of the San Francisco Giants Club, and therefore subject to application of Article VIII, Section 8 of the MLB Constitution. The Giants have taken the position that the 1990 consent by the Athletics

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23 Associated Press, *Selig Pushes For New A’s Ballpark*, ESPN MLB (Jan. 14, 2009, 7:48 PM), <http://sports.espn.go.com/mlb/news/story?id=3833512>

24 CONVENTIONS, SPORTS & LEISURE INTERNATIONAL, PROPOSED MAJOR LEAGUE BALLPARK (2009), available at [http://dig.abclocal.go.com/kg0/PDF/SJ\\_EI\\_Report.pdf](http://dig.abclocal.go.com/kg0/PDF/SJ_EI_Report.pdf).

25 *Id.* at i-vii.

to allow the Giants to relocate to San Jose barred the Athletics from moving to San Jose in perpetuity. In March 2009, Commissioner Selig appointed a special Relocation Committee to evaluate the Bay Area territorial issues.

On March 7, 2012, the Oakland Athletics issued a statement “regarding A’s and Giants sharing Bay Area territory,” containing the following points: (a) Of the four two-team markets in MLB, only the Giants and Athletics do not share the exact same geographic boundaries; and (b) the Athletics “are not seeking a move that seeks to alter or in any manner disturb MLB territorial rights.” Instead, the Athletics “seek an approval to create a new venue that our organization and MLB fully recognize is needed to eliminate [ ] dependence on revenue sharing.”<sup>26</sup>

In 2010, the San Jose City Council unanimously approved an environmental impact study (“EIS”). Upon approval of the EIS, San Jose Mayor Chuck Reed called for a public vote on whether the Athletics could purchase land and build a new stadium for the Athletics in San Jose. However, at Commissioner Selig’s request, Mayor Reed delayed the vote pending the MLB Relocation Committee’s determination of the A’s–Giants territorial dispute.

On September 10, 2010, through the efforts of the Silicon Valley Leadership Group, a letter from seventy-five of Silicon Valley’s leading CEOs was sent to MLB urging Commissioner Selig to approve the Athletics’ move to San Jose.

On November 8, 2011, the San Jose City Council executed an option agreement with the Athletics Investment Group (the “Option Agreement”). The Option Agreement granted the Athletics a two year option (with an opportunity to extend for an additional year) to purchase six parcels located in the Diridon Area of San Jose to build a new stadium for a purchase price of \$6,975,227 (the “San Jose Stadium Property”).<sup>27</sup> In exchange for the option to purchase these six properties from the JPA, the Athletics agreed to pay \$50,000 for the two year option, with the authority to extend the option term by one year for an additional \$25,000.<sup>28</sup>

On December 2, 2011, Stand For San Jose (a coalition group backed by the San Jose Giants to block the Athletics relocation to San Jose) filed a civil action under the California Environmental Quality Act (“CEQA”)<sup>29</sup> against the City of San Jose, the San Jose Redevelopment Agency, and the Athletics, among others, in Santa Clara Superior Court.<sup>30</sup>

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26 OAKLAND A’S, STATEMENT BY OAKLAND A’S OWNERSHIP REGARDING A’S AND GIANTS SHARING BAY AREA TERRITORY (2012), available at [http://oakland.athletics.mlb.com/news/print.jsp?ymd=20120307&content\\_id=27081248&vkey=pr\\_oak&c\\_id=oak](http://oakland.athletics.mlb.com/news/print.jsp?ymd=20120307&content_id=27081248&vkey=pr_oak&c_id=oak).

27 During this litigation, the Athletics extended the option for a third year.

28 The validity of the Option Agreement has been challenged in two consolidated suits presently before the California Superior Court for Santa Clara County. *Stand For San José v. City of San José*, No. 1-11-CV-214196 (Cal. Super. Ct. filed Dec. 2, 2011), No. 1-13-CV-250372 (filed July 30, 2013).

29 CAL. PUB. RES. § 21000 *et seq.*

30 *Stand For San Jose v. City of San Jose*, No. 1-11-CV-214196 (Cal. Super. Ct. filed Dec. 2, 2011).

As the years dragged on, the MLB Relocation Committee's activities remained shrouded in secrecy. Commissioner Selig issued a directive that the A's and the Giants were prohibited from discussing any aspect of the dispute in public. At the January 2012 owners' meetings, Commissioner Selig said the situation was on the "front burner."<sup>31</sup> On May 16, 2013, Commissioner Selig said the MLB Relocation Committee "is still at work."<sup>32</sup> As of the writing of this article, the Relocation Committee has yet to issue any report or recommendation that is publicly available. Commenting on the controversy, Commissioner Selig stated: "Wolff and the Oakland ownership group and management have worked very hard to obtain a facility that will allow them to compete into the 21st century . . . . The time has come for a thorough analysis of why a stadium deal has not been reached. The A's cannot and will not continue indefinitely in their current situation."<sup>33</sup> According to MLB's Case Management Statement in the underlying litigation, Commissioner Selig formally notified the Athletics' ownership on June 17, 2013 that its relocation proposal was not satisfactory.<sup>34</sup>

Despite MLB's refusal to approve the move, the Athletics still desire to move forward with the relocation to San Jose and construction of the stadium. When the original Option Agreement expired, San Jose agreed to a new Option and Purchase and Sale Agreement with the Athletics Investment Group. The 2014 Option Agreement provides the A's with rights to purchase the property for up to seven years for a purchase price of \$7 million. The 2014 Option Agreement also is subject to a CEQA action in Santa Clara Superior Court, Case No. 1-14-CV-274088, filed December 4, 2014.

## F. Procedural History

On June 18, 2013, San Jose filed its case against MLB in the United States District Court, Northern District of California.<sup>35</sup> The case was assigned to the Honorable Ronald M. Whyte. The Complaint alleged both federal claims under the federal antitrust laws and California state law claims, including claims for tortious interference of the Option Agreement.<sup>36</sup> On October 4, 2013, the District Court heard MLB's motion to dismiss. On October 11, 2013, Judge Whyte denied the motion to dismiss as to the California state law interference claims for damages, but granted the motion to dismiss as to the Sherman Act claims and the state law claims for violation of the Cartwright Act and for

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31 Mark Purdy, *A's Bid to Pursue Ballpark in San Jose is 'On the Front Burner' For MLB*, SAN JOSE MERCURY NEWS, Jan. 12, 2012.

32 Ronald Blum, *MLB Hoping for Large Replay Expansion in 2014*, THE BIG STORY (May 16, 2013, 6:00 PM), <http://bigstory.ap.org/article/mlb-hoping-large-replay-expansion-2014>.

33 Susan Slusser, *Committee to Look at A's Situation*, SF GATE (Mar. 20, 2009, 12:11PM), <http://blog.sfgate.com/athletics/2009/03/30/committee-to-look-at-as-situation/>.

34 MLB has not yet made this June 17, 2013 notice publicly available. For more information on this rejection, see Associated Press, *MLB Denied Oakland's Move to San Jose in June*, USA TODAY (Dec. 8, 2013, 10:44 PM), <http://www.usatoday.com/story/sports/mlb/2013/12/08/mlb-denied-oaklands-san-jose-move-request/3914285/>.

35 *City of San Jose v. Office of Comm'r of Baseball*, No. C-13-02787 RMW, 2013 WL 5609346 (N.D. Cal. Oct. 11, 2013).

36 Complaint, *City of San Jose v. Office of Comm'r of Baseball*, 2013 WL 5609346 (N.D. Cal. Oct. 11, 2013) (No. 5:13-CV-02787).

unfair competition.<sup>37</sup> On December 27, 2013, Judge Whyte dismissed without prejudice to refiling in the appropriate state court the two remaining tortious interference claims. On January 23, 2014, San Jose filed a notice of appeal. The case was argued before a panel of the Ninth Circuit Court of Appeals on August 12, 2014, and the panel entered an order and opinion on January 15, 2015 upholding the lower court decision.<sup>38</sup> Following entry of the orders dismissing the City of San Jose’s state and federal antitrust action, the San Jose City Council unanimously agreed that an appeal from the 9<sup>th</sup> Circuit’s decision should be taken to the United States Supreme Court.

## II. THE SCOPE AND REACH OF “THE BUSINESS OF BASEBALL’S” IMMUNITY FROM COMPETITION LAWS

Professional baseball’s exemption from the reach of the federal antitrust laws had an inauspicious launch in a 1922 opinion of the U.S. Supreme Court in a case involving baseball clubs’ ability to restrict mobility of their contracted players. The case was decided on a then hotly debated issue of the proper reach of the relatively new Sherman Antitrust Act. The basis for the Court’s holding—that baseball was a merely local business activity and therefore outside the reach of the Sherman Act because the challenged conduct was not in interstate commerce—was subsequently overruled by the Supreme Court.<sup>39</sup> Notwithstanding the reversal of the legal foundation for the case, and therefore the exemption, the Supreme Court failed to correct its error in two subsequent cases.<sup>40</sup> The Court is not alone in taking blame for the continuation of this anomalous ruling; Congress has passed up multiple, begged-for opportunities to align professional baseball’s conduct with national competition policy reflected in the Sherman Act. Thus, neither Congress nor the United State Supreme Court have been able to articulate a coherent theory of why professional baseball should alone among professional sports (and most of the United States economy) be exempt from national competition laws. Instead, the three Supreme Court cases’ creation, and then failure to fix this legal and conceptual anomaly, have spawned dozens of inconsistent lower court cases that have attempted to understand the purpose and scope of the exemption. The final straw in the twisted history of the “baseball exemption” came when Congress, in 1998, passed legislation that imposed antitrust norms on the player employment aspects of the largely undefined “business of baseball” but refused to either abrogate the judicially developed exemption or codify it into federal antitrust law.<sup>41</sup> This is the confused landscape into which the lower courts waded in the *City of San Jose v. MLB* litigation.

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37 *City of San Jose*, 2013 WL 5609346.

38 *City of San Jose v. Office of the Comm’r of Baseball*, No. 14-15139, 2015 WL 178358 (9th Cir. Jan. 15, 2015).

39 *Flood v. Kuhn*, 407 U.S. 258, 282 (1972).

40 This point was bluntly addressed in Justice Douglas’s dissenting opinion (joined by Justice Brennan) in the *Flood* case. He referred to the exemption as “a derelict in the stream of law that we, its creator, should remove.” *Flood*, 407 U.S. at 288 (Douglas, J., dissenting). Further, he concluded that “[t] here can be no doubt ‘that were we considering the question of baseball for the first time upon a clean slate’, we would hold it to be subject to federal antitrust regulation. The unbroken silence of Congress should not prevent us from correcting our own mistakes.” *Id.*

41 See *infra* note 76 and accompanying text.

## A. The *Federal Baseball Case*

In 1922, the United States Supreme Court decided to address the issue of whether the provisions of the Sherman Act<sup>42</sup> could reach the activities of professional baseball clubs. At issue was the baseball leagues' structure and practices of reserving players' contracts exclusively for the baseball clubs. One club, the Federal Baseball Club of Baltimore, sued under the Sherman Act, claiming that the leagues conspired to violate the antitrust laws, and it was initially successful in having summary judgment entered in its favor. The Court of Appeals for the District of Columbia, however, disagreed and held that the activities of the leagues were not within the Sherman Act.<sup>43</sup> The United States Supreme Court agreed with the Court of Appeals, holding, first, that baseball was a business and that "[t]he business is giving exhibitions of base ball, which are purely state affairs."<sup>44</sup> Further, the Court held that the business of baseball was not conducted or engaged in interstate commerce and that any interstate activities of the clubs were merely incidental to the state exhibitions and therefore "would not be called trade or commerce in the commonly accepted use of those words."<sup>45</sup> The Supreme Court concluded that "the restrictions by contract that prevented the plaintiff from getting players to break [the reserve system] and the other conduct charged against the defendants were not an interference with commerce among the States."<sup>46</sup>

## B. The Progeny of *Federal Baseball Case*—A "Trilogy" of U. S. Supreme Court Decisions

Thirty years after the *Federal Baseball* case was decided, the Supreme Court addressed the continuing vitality of professional baseball's immunity from claims under the Sherman Act in the case of *Toolson v. New York Yankees, Inc.*<sup>47</sup> The Court, in a *per curiam* opinion, stated that since *Federal Baseball* was decided:

Congress has had the ruling under consideration but has not seen fit to bring such business under these laws by legislation having prospective effect. The business has thus been left for thirty years to develop, on the understanding that it was not subject to existing antitrust legislation. The present cases ask us to overrule the prior decision and, with retrospective effect, hold the legislation applicable. We think that if there are evils in this field which now warrant application to it of the antitrust laws it should be by legislation. Without re-examination of the underlying issues, the judgments below are affirmed on the authority of [*Federal Baseball*], so far as that decision determines that Congress had no intention of including the business of baseball within the scope of the federal antitrust law.<sup>48</sup>

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42 15 U.S.C. §§ 1, 2.

43 *Nat'l League of Prof'l Baseball Clubs v. Fed. Baseball Club of Baltimore, Inc.*, 269 F. 681 (D.C. Cir. 1920).

44 *Fed. Baseball Club of Baltimore, Inc. v. Nat'l League of Prof'l Baseball Clubs*, 259 U.S. 200, 208 (1922).

45 *Federal Baseball*, 259 U.S. at 209.

46 *Id.*

47 346 U.S. 356 (1953).

48 *Id.* at 357.

Put in proper context, *Toolson* is unusual. First, even though the Supreme Court in *Federal Baseball* created the baseball exemption, the *Toolson* Court made it incumbent upon Congress to affirm or reject the exemption's continuing viability. Failing Congressional action, the *Toolson* Court inferred congressional acquiescence in the holding. This approach by the *Toolson* Court has been attacked for two primary reasons: First, a great deal of federal antitrust law is "judge-made law" as the statutes are very general and courts are required to define the scope and meaning of the broad statutory provisions.<sup>49</sup> Second, the "congressional inaction" doctrine has largely been abandoned by more analytically sound theories of interpretation of a lack of congressional response to a Supreme Court decision.<sup>50</sup>

The *Toolson* Court also expressed concern about the "retrospective effect" on baseball if the exemption was suddenly overturned. This concern has been met with skepticism because federal courts have considerable experience defining retroactive application of new judicial rulings.<sup>51</sup> In fact, contrary to dicta in *Toolson*, the *Federal Baseball* decision was not predicated on finding that "Congress had no intention of including the business of baseball within the scope of the federal antitrust law."<sup>52</sup> Rather, the *Federal Baseball* ruling was predicated on the then-Supreme Court's analysis about the reach of the Commerce Clause; the core holding of the case and one that was subsequently reversed in the *Flood* case.

In 1972, the Supreme Court revisited the holding in *Federal Baseball* and professional baseball's reserve clause in *Flood v. Kuhn*.<sup>53</sup> Curt Flood, an All-Star professional baseball player, was traded from the St. Louis Cardinals to the Philadelphia Phillies without his knowledge or permission. Such a trade was possible under the contracts offered by all MLB Clubs to players. Flood insisted on the right to sign a new contract with any team

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49 See *Leegin Creative Leather Products v. PSKS, Inc.*, 551 U.S. 877, 899 (2007) (citations omitted) ("From the beginning the Court has treated the Sherman Act as a common-law statute . . . Just as the common law adapts to modern understanding and greater experience, so too does the Sherman Act's prohibition on "restraint[s] of trade" evolve to meet the dynamics of present economic conditions. The case-by-case adjudication contemplated by the rule of reason has implemented this common-law approach.").

50 See *infra* note 96 and accompanying text.

51 The Supreme Court is adept at considering various ways of treating new holdings which have prospective and retrospective application issues. See Jill E. Fisch, *Retroactivity and Legal Change: An Equilibrium Approach*, 110 HARV. L. REV. 1055 (1997) (including the use of selective or modified prospectivity of Supreme Court holdings by courts, such as *James B. Beam Distillery Co. v. Georgia*, 501 U.S. 529 (1991)).

52 *Toolson*, 346 U.S. at 357.

53 407 U.S. 258 (1972).

as a “free agent.”<sup>54</sup> The then-Commissioner of Baseball, Bowie Kuhn, denied Flood’s request and Flood sued claiming that Major League Baseball, the two major leagues and the major league teams had violated, *inter alia*, the Sherman Act. The District Court dismissed Flood’s antitrust claims and that ruling was affirmed by the Second Circuit Court of Appeals.<sup>55</sup> The U. S. Supreme Court affirmed the dismissal of all Flood’s claims but on grounds different than those in *Federal Baseball*.

The *Flood* Court, reversing the holding in *Federal Baseball*, held that “professional baseball is a business and it is engaged in interstate commerce.”<sup>56</sup> Professional baseball was finally recognized as an economic activity that is in and affects interstate commerce. However, the Court went on to hold that Congress’s inaction for “a half a century” reflected a Congressional intention for baseball to remain outside the scope of antitrust laws.<sup>57</sup> Despite describing the baseball exemption as an “aberration,” the Court held that “the aberration is an established one . . . that has been with us now for half a century, one heretofore deemed fully entitled to the benefit of stare decisis, and one that has survived the Court’s expanding concept of interstate commerce. It rests on recognition and an acceptance of baseball’s unique characteristics and needs.”<sup>58</sup>

The Court determined that Congress has had “no intention to subject baseball’s reserve system to the reach of the antitrust statutes” and that this intentional inaction “has been deemed to be something other than mere congressional silence and passivity.”<sup>59</sup> The *Flood* Court proceeded to hold that the protection afforded to the reserve system could not be subject to an action under federal antitrust laws.

There were notable anomalies created by the *Flood* decision. First, while the *Flood* Court struck down the core holding of *Federal Baseball*—that baseball was a purely local activity not affecting interstate commerce—it concluded that congressional inaction to correct the erroneous decision compelled its decision that the exemption remained viable. But for the “congressional inaction” holding, the Court would have held that if the business of professional baseball was in interstate commerce, then, barring some other

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54 The background of the case made the effect of Major League Baseball’s refusal to permit Flood to sign with another team more pernicious. Flood’s team, the St. Louis Cardinals, had assigned rights to his contract to the Philadelphia Phillies and Flood, an African-American, expressed concerns about playing the rest of his career in a community known for racism and hostility to African-Americans. Flood, with the support of the Players’ Union, petitioned Commissioner Bowie Kuhn for permission to sign with another team, but Kuhn merely polled the team owners and discerned that they were opposed to Flood’s request to sign with another team. See Martin M. Tomlinson, *The Commissioner’s New Clothes: The Myth of Major League Baseball’s Antitrust Exemption*, 20 ST. THOMAS L. REV. 255, 267-68 (2008) [hereinafter Tomlinson, *The Commissioner’s New Clothes*].

55 *Flood v. Kuhn*, 443 F.2d 264 (2d Cir. 1971).

56 *Flood*, 407 U.S. at 282.

57 *Id.* The Court went on to write, “We continue to be loath, 50 years after *Federal Baseball* and almost two decades after *Toolsen*, to overturn those cases judicially when Congress, by its positive inaction, has allowed those decisions to stand for so long and, far beyond mere inference and implication, has clearly evinced a desire not to disapprove them legislatively.” *Id.* at 283-84. The Flood Court’s majority opinion generated biting dissenting opinions from Justices Douglas and Marshall. See *supra* note 40.

58 *Flood*, 407 U.S. at 282.

59 *Id.* at 283.

exemption or immunity, collusive activity by the leagues and clubs would fall within the reach of the antitrust statute. Second, the Court did not perform any full-blown antitrust analysis of why the reserve clause was pro-competitive or why the antitrust laws had not been violated by MLB's treatment of Flood's request. Instead, the Court alluded to "baseball's unique characteristics and needs"<sup>60</sup> but without ever describing them and attempting to balance them against the goals and purposes of the Sherman Act. Furthermore, in cases involving other professional sports where the antitrust exemption was found not to apply to team and league conduct, the Court had reiterated the ongoing viability of the baseball exemption, but failed to articulate any reason for this disparity in treatment.<sup>61</sup>

### C. Lower Court Treatment of the Baseball Exemption

The treatment of the baseball exemption in the lower courts has been similarly unsettled and, at times, incomprehensible.<sup>62</sup> While the Baseball Trilogy (the Supreme Court decisions in *Federal Baseball*, *Toolson*, and *Flood*) all involved the reserve (and related personnel) system, many cases have involved other aspects of the "business of baseball," including: (1) the scope of the baseball exemption with respect to personnel issues and ancillary activities; and (2) clubs location and re-location decisions. Some of these cases have construed the baseball exemption broadly; others have given the exemption a narrow construction.<sup>63</sup>

With respect to personnel issues and ancillary activities, the lower courts have held the following issues to be subject to the antitrust laws: a concessioner's long-term, exclusive contract to provide concessions for a professional baseball team;<sup>64</sup> agreements to broadcast baseball games;<sup>65</sup> and acts of discrimination against a female umpire.<sup>66</sup> In determining that the exemption does not apply to claims of discrimination by a female minor league umpire, one court reasoned that "the baseball exemption does immunize baseball from antitrust challenges to its league structure and its reserve system, [but does not] provide baseball with blanket immunity for anticompetitive behavior in every context in which it operates."<sup>67</sup> In the cases where the baseball exemption was found not to apply, the courts have analyzed whether the allegedly illegal conduct was related to,

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60 *Id.* at 282.

61 *See, e.g., Radovich v. Nat'l Football League*, 352 U.S. 445, 452 (1957).

62 *See* STUART BANNER, *THE BASEBALL TRUST: A HISTORY OF BASEBALL'S ANTITRUST EXEMPTION* 242-49 (Oxford 2013).

63 *See* Tomlinson, *The Commissioner's New Clothes*, *supra* note 54, at 271-282; Colleen Ganin, Note, *With San Jose at Bat, Federal Baseball is in the Bottom of the Ninth*, 56 ARIZ. L. REV. 1129, 1149-54 (2015) [hereinafter Ganin, *San Jose at Bat*].

64 *Twin City Sportservice, Inc. v. Charles O. Finley & Co, Inc.*, 676 F.2d 1291 (9th Cir. 1982).

65 *See, e.g., Henderson Broadcasting Corp. v. Houston Sports Ass'n, Inc.*, 541 F. Supp. 263 (S.D.Tex. 1982).

66 *Postema v. Nat'l League of Prof'l Baseball Clubs*, 799 F. Supp. 1475 (S.D.N.Y. 1992).

67 *Id.* at 1489.

but not an essential aspect, of the business of baseball. If the conduct is not integral to or an essential aspect of baseball, then it was not to be covered by the exemption.<sup>68</sup>

Courts have inconsistently applied the baseball exemption to alleged violations of the federal antitrust laws stemming from leagues' refusal to permit owners to locate their teams in desired venues. For example, *Piazza v. Major League Baseball*<sup>69</sup> involved efforts to relocate the San Francisco Giants to Tampa Bay, Florida. The district court concluded that the *Flood* Court "stripped from *Federal Baseball* and *Toolson* any precedential value those cases may have had beyond the particular facts there involved, i.e., the reserve clause."<sup>70</sup> The Florida Supreme Court, in a case involving the Florida Attorney General's efforts to force the league to permit the same investors' group to relocate the Giants to Tampa Bay, applied the *Piazza* decision and upheld the Attorney General's efforts to force the MLB to disclose information.<sup>71</sup>

Yet other cases involving the Giant's relocation efforts upheld applicability of the baseball exemption when MLB rejected the Giants' efforts. A District Court in Florida refused to apply the decisions in *Piazza* case and the Florida Supreme Court decision in *Butterworth*, holding that the *Federal Baseball* decision controlled and the exemption protected Major League Baseball from antitrust lawsuits.<sup>72</sup>

Several cases decided after *Flood* addressed the scope and applicability of the baseball exemption in situations involving player contracts and the reserve system. In one case, the Seventh Circuit Court of Appeals addressed the ability of a club to assign its rights in three players' contracts to other teams. The Seventh Circuit concluded that the Baseball Trilogy "intended to exempt the business of baseball, not any particular facts of that business, from the federal antitrust laws."<sup>73</sup> However, this appellate court opinion, like the Ninth Circuit Court of Appeals decision in *City of San Jose*, gave a broad reading to the scope of the exemption but these holdings have been contradicted by other court decisions and scholarly opinion.<sup>74</sup> Indeed, it is fair to conclude that the lower courts have paid considerable deference to the Supreme Court's decisions in *Federal Baseball*, *Toolson* and *Flood*, but they do so without conviction and without a clear sense of the fundamental reasoning behind the exemption.<sup>75</sup>

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68 *City of San Jose v. Commissioner of Baseball*, No. C-13-02787 RMW, 2013 WL 5609346 (N.D. Cal. 2013).

69 831 F. Supp. 420 (E.D. Pa. 1993).

70 *Id.* at 436.

71 *Butterworth v. Nat'l League of Prof. Baseball Clubs*, 644 So. 2d 1021 (Fla. 1994).

72 *Major League Baseball v. Butterworth*, 181 F. Supp. 2d 1316, 1330 (N.D. Fla. 2001).

73 *Charles O. Finley & Co. v. Kuhn*, 569 F.2d 527, 541 (7th Cir. 1978); see also, *Prof'l Baseball Schools & Clubs, Inc. v. Kuhn*, 693 F.2d 1085 (11th Cir. 1982); *Portland Baseball Club, Inc. v. Kuhn*, 491 F.2d 1101 (9th Cir. 1974) (per curiam) (writing only one sentence in dismissal of antitrust claims and citing *Flood*).

74 See Tomlinson, *The Commissioner's New Clothes*, *supra* note 54, at 271-77 (collecting and describing cases and commentary).

75 See Tomlinson, *Commissioner's New Clothes*, *supra* note 54, at 271-84 (describing the significant range of lower court opinions broadly viewing the reach of the exemption and narrowly construing the scope of the exception).

## D. The Curt Flood Act of 1998

Following the Supreme Court's decision in the *Flood* case, and a players strike in 1994-1995, Congress was prompted into action and passed the Curt Flood Act of 1998.<sup>76</sup> The Flood Act provides in section (a):

Subject to subsections (b) and (d) of this section, the conduct, acts, practices, or agreements of persons in the business of organized professional major league baseball directly relating to or affecting employment of major league baseball players to play baseball at the major league level are subject to the antitrust laws to the same extent such conduct, acts, practices, or agreements would be subject to the antitrust laws if engaged in by persons in any other professional sports business affecting interstate commerce.<sup>77</sup>

However, while extending the reach of the federal antitrust laws to employment-related issues in major league baseball, the Flood Act goes on in section (b) to provide: “[n]o court shall rely on the enactment of this section as a basis for changing the application of the antitrust laws to any conduct, acts, practices or agreements other than those set forth in subsection (a).”<sup>78</sup> To make clear the limited reach of the Flood Act, it also states that the Act “does not create, permit, or imply a cause of action by which to challenge under the antitrust laws, or otherwise apply the antitrust laws to”, among other things, (1) minor leagues and minor league reserve clauses; (2) franchise relocation or expansion, franchise ownership issues, or ownership transfers.<sup>79</sup> Thus, a fair reading of the Flood Act shows Congress intended to peel back the scope of the court-created baseball exemption only with respect to the “business of organized professional major league baseball directly relating to or affecting employment of major league baseball players,”<sup>80</sup> but not to any other aspect of professional baseball. The Flood Act fails to address exactly what conduct, activities, practices, and agreements are within (or outside) the baseball exemption. The legislative history—stating the Act “is intended to have not effect other than to clarify the status of major league players under the antitrust laws...the law will be the same after passage of the Act as it is today”<sup>81</sup>—does not materially resolve the lack of clarity over the scope and reach of the baseball exemption.

Following the *Flood* decision and the subsequent passage of the Curt Flood Act, questions remain as to what is the net effect of those two pronouncements—one legislative and the other judicial—on the continuing efficacy of the baseball exemption. Do they simply extend the reach of the antitrust laws only to the employment issues created by the reserve system—including the free agent rights of players—or do they articulate a broad and all-encompassing exemption from the antitrust laws for all things involved in baseball, including the farm system, employment of umpires, team relocation

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76 15 U.S.C. § 26b.

77 *Id.* § 26b(a).

78 *Id.* § 26b(b).

79 *Id.* § 26b(b)(1), (3).

80 *Id.* § 26b(a).

81 145 Cong. Rec. S9621 (daily ed. July 31, 1998) (statement of Sen. Hatch, a co-sponsor). *See also*, Tomilson, *The Commissioner's New Clothes*, *supra* note 54, at 286-88.

and collateral activities.<sup>82</sup> The Ninth Circuit in the *City of San Jose* case concluded that the baseball exemption remains unchanged, that the “business of baseball” is not limited to the reserve system, and that the Curt Flood Act affirmatively exempts MLB’s decisions on team location and relocation. Those debatable findings are addressed below.

## E. Antitrust in Other Professional Sports

Perhaps the greatest insight into the mischief of the baseball exemption is the rigorous application of the antitrust laws and national competition policy to all other major league sports while baseball remains immune. What is so special or unique about professional baseball that would justify such a glaring constraint on national competition policy in one narrow area of the economy?

Some notable examples of federal antitrust policy as a principled constraint on anticompetitive activity by other sports’ leagues and teams are:

- Striking down a National Football League rule that required unanimous approval of all owners to permit a team to relocate to the home territory of another team.<sup>83</sup>
- Finding that the NFL entered into a boycott of players who previously played in a competitor league.<sup>84</sup>
- Holding that the concerted action of NFL’s teams to cooperatively license their intellectual property rights in, for example, branded apparel was subject to scrutiny under the Sherman Act.<sup>85</sup>
- Applying the Sherman Act’s rule of reason analysis to a PGA rule that restricted members from playing in non-tour events.<sup>86</sup>

Without question, the application of federal antitrust laws to professional sports has enhanced the success of those sports by ensuring that the benefits of market-based economics guide them. Can the same be said of major league baseball? Courts have recognized that sports leagues need latitude in articulating rules of competition because such rules are necessary if there is to be a sport at all; but the antitrust laws have been

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82 Tomilson, *The Commissioner’s New Clothes*, *supra* note 54, at 271-72 (describing the “ample support” for the view that “the antitrust exemption applies only to the reserve system in professional baseball and nothing else”).

83 *Los Angeles Mem’l Coliseum Comm’n v. Nat’l Football League*, 726 F.2d 1381 (9th Cir. 1984).

84 *Bowman v. Nat’l Football League*, 402 F. Supp. 754 (1975).

85 *American Needle, Inc. v. Nat’l Football League*, 560 U.S. 183 (2010). Justice Stevens, writing for a unanimous Court, held, “The fact that NFL teams share an interest in making the entire league successful and profitable, and that they must cooperate in the production and scheduling of games, provides a perfectly sensible justification for making a host of collective decision. But the conduct at issue in this case is still concerted activity under the Sherman Act that is subject to [section] 1 analysis.” *Id.* at 202-03.

86 *Toscano v. PGA Tour, Inc.*, 201 F. Supp. 2d 1106 (E.D. Cal. 2002).

used to ensure that the articulation and enforcement of such rules is not overly broad.<sup>87</sup> Further, the antitrust laws have forced professional sports leagues to have valid and narrowly tailored polices for relocation of team franchises rather than fiat by the league office or cartel-like approval of competing owners.<sup>88</sup> Would an identical application of the federal antitrust laws to activities of MLB and the Clubs have a similar competition-enhancing effect?

### III. WHY THE U.S. SUPREME COURT SHOULD ABROGATE BASEBALL'S EXEMPTION FROM OUR NATION'S COMPETITION LAWS

There are several reasons why the United States Supreme Court should finally address the policy implications and continuing utility of the lingering vestige that is the exemption for "the business of baseball." The following sections address the most substantive reasons why the Court should grant certiorari and hear the *City of San Jose* case.

#### A. Neither Stare Decisis Nor Congressional Inaction Require Affirmation of the Baseball Exemption

Two prevalent arguments in support of maintenance of the baseball exemption are: (1) the Court has invited Congress to legislate in this area and, because Congress has failed to do so, courts should interpret such inaction as affirmation of *Federal Baseball's* exemption; and (2) the fundamental doctrine of *stare decisis* requires that the Supreme Court's decisions creating and continuing the baseball exemption should be honored until the Court reverses or distinguishes its judicially created exemption. Neither argument is particularly persuasive when viewed in a contemporary context

##### 1. Application of Doctrine of Stare Decisis

The history of the baseball exemption has been marked by many calls for either deference to Congress or deference to the doctrine of *stare decisis*. The *Toolson* Court suggested that, since the baseball exemption had been in existence for 30 years, the decision to extend or overrule the exemption created in *Federal Baseball* should be made by Congress. Remarkably, this holding was reaffirmed in *Flood v. Kuhn*. Deference to Congressional action is counterintuitive since the exemption was created by the Supreme Court in the first instance. Why should it be the sole province of the Congress to correct errors made by the Supreme Court? Given the Court's deference to Congress to codify or overrule the baseball exemption, can continuation of the baseball exemption be justified on the basis of judicial adherence to past decisions on the baseball exemption through the doctrine of *stare decisis*?

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87 See, e.g., *Denver Rocket's v. All-Pro Management, Inc.*, 325 F. Supp. 1049 (C.D. Cal. 1971) (providing an example of a Sherman Act action against a league rule that prohibited an otherwise qualified player from negotiating with any NBA team until four years after his high school graduation, with no exception).

88 See, e.g., *Los Angeles Mem'l Coliseum Comm'n*, 726 F.2d 1381; *Nat'l Basketball Ass'n v. SDC Basketball Club, Inc.*, 815 F.2d 562, 568 (9th Cir. 1987) ("Franchise movement restrictions are not invalid as a matter of law. . . [A]ntitrust analysis under *Raiders I* indicates that the question of what restraints are reasonable is one of fact.").

The Supreme Court has, on occasion and for proper reasons, reviewed longstanding precedent and reversed or modified its prior holdings to conform to modern circumstances. An important contemporary example is *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*<sup>89</sup>, in which the Supreme Court overruled a 96-year old ruling that held that vertical minimum price fixing is illegal per se under the Sherman Act.<sup>90</sup> The Court granted certiorari to determine if its 1911 holding in the *Dr. Miles* case should be reversed or modified in light of substantial criticism from many antitrust commentators. In particular, the Court considered criticism by economists and lawyers who argued that the economic effects of minimum resale price maintenance arrangements indicated that such arrangements were more likely pro-competitive and that the rule of presumptive illegality was inappropriate applied to this type of commercial restraint. After a comprehensive review of the post-*Dr. Miles* literature on these price arrangements, the Court held: “[W]e think that were the Court considering the issue as an original matter, the rule of reason, not the *per se* rule of unlawfulness, would be the appropriate standard to judge vertical price restraints.”<sup>91</sup> In determining whether the *Dr. Miles* case was entitled to deference under the doctrine of *stare decisis*, the *Leegin* Court concluded: “*Stare decisis* is not as significant in this case, however, because the issue before us is the scope of the Sherman Act. From the beginning the Court has treated the Sherman Act as a common-law statute.”<sup>92</sup>

The *Leegin* Court’s consideration of the prudential constraints of *stare decisis* included the notion that “the fact that a decision has been ‘called into serious question’ justifies our reevaluation of it.”<sup>93</sup> According to the Court, the need to review and overturn prior decision is relevant where subsequent decisions of the Court have “undermined their doctrinal underpinnings” of the longstanding rule.<sup>94</sup> Applying the *Leegin* Court’s reasoning to the Baseball Trilogy, it is clear that the Court itself has “called into serious question” the continuing need for and the logical integrity of the baseball exemption<sup>95</sup> and thus should review and overturn its prior holdings creating and continuing the baseball exemption.

## 2. Congressional Inaction

A second argument relates to the implications that courts can derive from the fact that Congress has failed to respond to the call in *Toolson* for legislative action to either affirm or overrule the holding in *Federal Baseball*. Congress has previously considered legislation

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89 551 U.S. 877 (2007).

90 *Id.* at 889 (overruling *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911)).

91 *Id.* at 899.

92 *Id.* (citing *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997)) (“[T]he general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act.”). Professor William Eskridge, Jr., a noteworthy scholar of legislative and statutory analysis, stated that “*Flood v. Kuhn* is an almost comical adherence to the strict rule against overruling statutory precedents, particularly considering that the Sherman Act developed essentially through a common law process.” William N. Eskridge, Jr., *Overruling Statutory Precedents*, 76 GEO.L.J. 1361, 1381. (1988) [hereinafter, Eskridge, *Overruling*].

93 *Leegin Creative Leather Products*, 551 U.S. at 900 (citing *Kahn*, 522 U.S. at 21).

94 *Id.* (citing *Dickerson v. United States*, 530 U.S. 428, 443 (2000)).

95 See *supra* note 58 and accompanying text.

addressing the existence and scope of professional baseball's antitrust exemption.<sup>96</sup> However, there are several plausible explanations as to why Congress never acted upon the Court's holding in *Federal Baseball*.<sup>97</sup> So, the question for the Court is whether Congressional inaction (except the Curt Flood Act, discussed below) in addressing *Federal Baseball's* creation of an exemption from enforcement of national competition policy can plausibly be interpreted as congressional approval of the exemption.<sup>98</sup> In significant part, this question was addressed in the Supreme Court's decision in *State Oil Co. v. Kahn*,<sup>99</sup> in which the Court overruled its longstanding application of the rule of per se liability to maximum resale price maintenance arrangements.<sup>100</sup> In addressing the argument that the per se rule applied by the *Albrecht* Court in 1968 had not been reversed or modified by congressional action and, therefore, there was an inference of congressional approval of the ruling, the Supreme Court stated:

In the area of antitrust law, there is a competing interest [against the Court's reluctance to overrule decisions involving statutory interpretation], well represented in this Court's decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience. Thus, the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress 'expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition.' Accordingly, this Court has reconsidered its decision construing the Sherman Act when the theoretical underpinnings of those decisions are called into serious question."<sup>101</sup>

This analysis suggests that Congressional inaction since 1922 when *Federal Baseball* was decided does not *per force* compel a conclusion that Congress has acquiesced in or otherwise approved of the judicially-created exemption for the business of baseball.<sup>102</sup>

The baseball exemption presents the most appropriate candidate for Supreme Court reappraisal in light of the Court's own protestations about the weak underpinnings of

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96 The Supreme Court in Flood found that, in the 19 years between its decisions in Toolson and Flood, "more than 50 bills [were] introduced in Congress relative to the applicability or nonapplicability of the antitrust laws to baseball." *Flood v. Kuhn*, 407 U.S. 258, 281 (1972). In the 42 years since Flood, Congress has held 45 hearings on baseball's antitrust exemption. See, e.g., S. 500, 103d Cong. (1993); H.R. 386, 104th Cong. (1995). These proposed bills would amend the Clayton Act to add that "the antitrust laws shall apply to the business of organized professional baseball."

97 See Eskridge, *Overruling*, *supra* note 92, at 1405-06 (stating that possible explanations include congressional apathy toward the Federal Baseball decision, failure of the formation of a majority congressional group to change the decision, other congressional priorities, and sustained efforts of baseball owners to block any curative legislation). See also, Sullivan, *A Derelict*, *supra* note 12, at 1278.

98 For a detailed examination of the application of the positive inaction doctrine to the baseball exemption, see, Sullivan, *A Derelict*, *supra* note 12, at 1276-87.

99 522 U.S. 3 (1997).

100 The Court in *State Oil Co. v. Kahn* overruled its decision in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), which held that vertical maximum price fixing arrangements were subject to the per se rule rather than the rule of reason analysis.

101 *Kahn*, 522 U.S. at 20-21 (citations omitted). See also *Leegin Creative Leather Products Inc., v. PSKS, Inc.*, 551 U.S. 877, 899-900 (2007).

102 See Sullivan, *A Derelict*, *supra* note 12, at 1282-83; Ganin, *San Jose at Bat*, note 63, at 1142-44.

the exemption as an expression of the policies of the Sherman Act. The *Flood* Court, following the full development of the Commerce Clause and the obvious irrelevance of the underpinnings of the *Federal Baseball* opinion, questioned the inherent purpose of the exemption while pleading for assistance from Congress. Following antitrust cases such as *Leegin* and *Khan*, it is the time for the Roberts Court to take up the fundamental issue of why MLB and the Clubs, unlike every other professional sport in America, should be exempt from the national competition policy reflected in the Sherman Act.

## **B. The Flood Act Does Not Immunize MLB From Antitrust Liability for Anti-competitive Conduct Preventing the A's Relocation Efforts**

The Ninth Circuit decision in *City of San Jose* provides an unusual interpretation of the Curt Flood Act.<sup>103</sup> Nearly all commentators and courts interpreting the Flood Act have taken the position that Congress meant what it said in the Act's "purpose" provision: The purpose for the enactment was to permit major league baseball players to have the same protections under the antitrust laws that are enjoyed by players in all other professional sports and, equally important, to take no steps to increase or reduce the reach of the antitrust laws in professional sports.<sup>104</sup> The legislative history of the Flood Act confirms that its purpose was quite narrow and intended to help end the 1994-95 players' strike that had crippled professional baseball. Most commentators and courts have taken that statutory language to heart in concluding that the Flood Act did not attempt, and should not be construed to legislatively articulate, a broad antitrust exemption for the business of baseball.<sup>105</sup> However, the Ninth Circuit reached a different conclusion in the *City of San Jose* case. That panel determined that the Flood Act "withdrew baseball's antitrust exemption with respect to the reserve clause and other labor issues, but explicitly *maintained* it for franchise relocation."<sup>106</sup> The Ninth

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103 15 U.S.C. § 26b.

104 The Flood Act states: "It is the purpose of this legislation to state that major league baseball players are covered under the antitrust laws (i.e., that major league baseball players will have the same rights under the antitrust laws as do other professional athletes, e.g., football and basketball players), along with a provision that makes it clear that the passage of this Act does not change the application of antitrust laws in any other context or with respect to any other person or entity." Pub. L. 105-297, § 3, 112 Stat. 2824.

105 BANNER, THE BASEBALL TRUST, *supra* note 12, at 246; Tomlinson, *The Commissioner's New Clothes*, *supra* note 54 at 288 ("It seems clear that (a) the Curt Flood Act explicitly applies federal antitrust laws to any surviving remnants of the reserve system, and (b) the Curt Flood Act does not alter the application or non-application of federal antitrust law to any other area of Major League Baseball.") *See also*, Ganin, *San Jose at Bat*, *supra* note 63, at 1148.

106 *City of San Jose v. Comm'r of Baseball*, No. 14-15139, 2015 WL 178358, \*4 (Jan. 15, 2015). Some commentary supports the Ninth Circuit's view in the *City of San Jose* case. *See* John L. Cooper & Racheal Turner, *Major League Baseball is Exempt From the Antitrust Law—Like It or Not*, 24 COMPETITION (2015) ("Congress affirmatively carved out employment issues from baseball's antitrust exemption, but otherwise left 'the business of baseball' exempt from federal antitrust laws.") *But see* Tomlinson, *The Commissioner's New Clothes*, *supra* note 54, at 286 ("The Committee Report certainly makes it clear that it does not view the antitrust exemption, as it applies or does not apply to any aspect of baseball other than employment negotiations between major league players and team owners, to be affected at all by the Curt Flood Act.")

Circuit panel attempted to bolster its unique take on the legislative purpose of the Flood Act with the following distinctive analysis:

In an ordinary case, congressional inaction ‘lacks persuasive significance because several equally tenable inferences may be drawn from such inaction.’ But when Congress specifically legislates in a field and explicitly exempts an issue from that legislation, our ability to infer congressional intent to leave the issue undisturbed is at its apex. The exclusion of franchise relocation from the Curt Flood Act demonstrates that Congress (1) was aware of the possibility that the baseball exemption could apply to franchise relocation; (2) declined to alter the status quo with respect to relocation; and (3) had sufficient will to overturn the exemption in other areas. *Flood’s* clear implication is that the scope of the baseball exemption is coextensive with the degree of congressional acquiescence, and the case for congressional acquiescence with respect to franchise relocation is in fact far stronger than it was for the reserve clause at issue in *Flood* itself.<sup>107</sup>

Given the clarity and precision of the purposes clause of the Flood Act, it is remarkable that a court has essentially rewritten the legislation to flesh out a full blown version of the exemption that the legislative drafters took great pains to prevent. Without question, the Supreme Court should grant the City of San Jose’s petition for certiorari to clarify this novel interpretation of the scope and meaning of the Curt Flood Act.

### **C. Abrogation of the Exemption Will Not Unfairly Disadvantage MLB Due to Its Reliance on Its Immunity**

The *Toolson* Court opinion fleetingly suggested that Congressional action was necessary to alter the *Federal Baseball* holding because MLB and the Clubs had relied on the 1922 decision in building their businesses. There are at least two aspects of this concern: Will prospective application of a reversal of the *Professional Baseball* rule unfairly affect the past agreements, policies and arrangements implemented by Clubs? Is it unfair to MLB and the Clubs to suddenly change the ground rules of antitrust exemption when MLB has supposedly relied on the exemption for many years?

This precise issue was recently addressed by the Supreme Court in the *Leegin Creative Leather Products* case. There the Court overruled the 93 year old *Dr. Miles* decision and held that resale price maintenance agreements between distributors and their dealers or retailers would be analyzed under the rule of reason rather than the per se rule. During that 93-year time period, Congress had passed legislation permitting such restraints if state fair trade laws were enacted in permitting States and then later repealing the exception for state fair trade legislation. Proponents of the rule in the *Dr. Miles* case had argued that long-time reliance on the holding in *Dr. Miles* (as well as the intervening Congressional action modifying the holding and then opting not to legislate in the area) warranted continuation of the rule of per se illegality. Disagreeing, the Court held:

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<sup>107</sup> *City of San Jose*, 2015 WL 178358, at \*4 (citations omitted).

Reliance interests do not require us to reaffirm *Dr. Miles*. To be sure, reliance on a judicial opinion is a significant reason to adhere to it, especially ‘in cases involving property and contract rights[.]’ The reliance interests here, however, like the reliance interest in *Khan*, cannot justify an inefficient rule . . . .<sup>108</sup>

In considering elimination of the baseball exemption, the Court should ask the essential questions: Has the exemption resulted in anti-competitive conduct, a stifling of innovation, and harm to fans and other consumers? Will MLB and the Clubs be more efficient if they must comply with national competition policy? This is an issue for the Supreme Court to address now.

#### **D. Uniform Application of Federal Antitrust Laws is Appropriate for All Professional Sports**

Related aspect to the issue of whether elimination of the exemption is fair to baseball is the question of what will happen to the business of baseball if the protections of the exemption are removed. If the exemption is eliminated, then MLB will be subject to the same antitrust rules that govern the rest of professional sports (and every other business operating in America). How unfair is such an outcome?

The Supreme Court recently visited the issue of antitrust liability for allegedly anticompetitive conduct by professional sport leagues in *American Needle, Inc. v. National Football League*.<sup>109</sup> The NFL had granted an exclusive licensing arrangement to manufacture NFL team uniforms, equipment, apparel, and headwear.<sup>110</sup> American Needle, a longtime headwear manufacturer, sued, claiming the granting of an exclusive arrangement to serve all teams to one manufacturer violated the Sherman Act.<sup>111</sup> In a unanimous opinion, the Supreme Court rejected the NFL’s argument that the teams were a single entity incapable of conspiring under Section 1. The Court held that the 32 NFL teams cannot be considered a single entity because they are “substantial, independently owned, independently managed business(es),” whose “objectives are not ‘common’” and are therefore not immune from antitrust scrutiny.<sup>112</sup> If a similar decision applied to professional baseball, MLB would not be able to engage in concerted activity affecting fans, suppliers, and others without analyzing the competitive aspects of their conduct. While increasing the expense and uncertainty of business decision-making by MLB and its Clubs, removing the exemption would protect consumers and those who do business with the teams.<sup>113</sup>

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108 *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 906 (2007) (citing *State Oil Co. v. Kahn*, 522 U.S. 3, 20 (1997)) (other citations omitted).

109 560 U.S. 183 (2010).

110 *Id.* at 187.

111 *Id.*

112 *Id.* at 196, 204 (citing *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984)).

113 The Supreme Court has repeatedly held that the fundamental purpose of the antitrust laws is to protect competition and consumers rather than to protect competitors. *Leegin*, 551 U.S. at 906; *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 338 (1990).

Overruling the Baseball Trilogy would also require application of the rule of reason to MLB's decisions on relocation of a Club or, as alleged in the City of San Jose's case, to engage in a deliberate and manipulative scheme to forestall consideration of the request. Relocation requests present an ideal situation for applying the pro-competition policies of the Sherman Act to cartel decision-making.<sup>114</sup> In other sports, the rule of reason has been applied to league decision-making on relocation requests and the result has been very active and competitive markets for team movement and, with it, greater responsiveness to sports fans.<sup>115</sup>

The Ninth Circuit's opinion in *City of San Jose* represents a contrary view. The court states that geographic and territorial restrictions on team mobility "is the league's basic organizing principle" and that:

Limitations on franchise relocation are designed to ensure access to baseball games for a broad range of markets and to safeguard the profitability—and thus viability—of each ball club. Interfering with franchise relocation rules therefore indisputably interferes with the public exhibit of professional baseball.<sup>116</sup>

In reality, baseball's version of "limitations on franchise relocation" has resulted in virtually no requests for franchise relocation being granted while other sports subject to the Sherman Act's rule of reason have benefited themselves and their fans with expansive growth and innovation. Since 1967, only one MLB team has been permitted to relocate territories while during the same period of time the National Football League, National Basketball League and the National Hockey League collectively saw twenty-two relocation moves.<sup>117</sup> Which sports league's fans are better off?

#### IV. CONCLUSION

The District Court and Ninth Circuit Court of Appeals opinions in *City of San Jose* provide an ideal opportunity for the United States Supreme Court to finally address why, if at all, professional baseball, a multi-national, multi-billion dollar business, should not be required to pass the threshold scrutiny provided by the Sherman Act. All other professional sports teams and leagues routinely make important business decisions that affect millions of fans throughout the world and that comply with federal competition policy and law. Why should the antitrust laws not apply to professional baseball? The Ninth Circuit in *City of San Jose* determined professional baseball does not need to comply with overarching national competition policy, relying on an outdated and discarded Supreme Court decision in *Federal Baseball*. The Ninth Circuit even went so far as to find that the Curt Flood Act affirmatively immunizes MLB's location decisions from the reach of the antitrust laws despite the clear statements

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114 See Michael J. Mozes & Ben Glicksman, *Adjusting the Stream? Analyzing Major League Baseball's Antitrust Exemption After American Needle*, 2 HARV. J. SPORTS & ENT. L. 265, 294 (2011).

115 See Ganin, *San Jose at Bat*, *supra* note 63, at 1164-68.

116 *City of San Jose v. Comm'r of Major League Baseball*, No. 14-15139, 2015 WL 178358, at \*3 (Jan. 15, 2015). It should be noted that, because the Ninth Circuit was reviewing a decision on a Motion to Dismiss, there was no underlying evidence supporting MLB's position on the role, if any, of geographic and territorial restrictions on team mobility to professional baseball.

117 Ganin, *San Jose at Bat*, *supra* note 63, at 1155.

of the Act's co-sponsors and the President of the United States that "the Act in no way codifies or extends the baseball exemption."<sup>118</sup> In fact, Congress has never recognized purportedly broad scope of baseball's antitrust exemption, with the Flood Act limiting the already narrow exemption to player labor disputes. Moreover, on the issue of franchise relocation, Congress has intimated that to the extent MLB attempts to broaden its limited exemption to franchise relocation, such expansion would be patently inappropriate and in direct contravention of federal antitrust laws.<sup>119</sup>

The Baseball Trilogy should not be construed to allow MLB *carte blanche* for all of its actions, especially the decision to prevent a Club from relocating to another city. While perhaps the exemption was historically necessary to protect the reserve clause, that does not mean the exemption should immunize all the decisions of MLB (and the decisions of specific Clubs). When MLB blocks a Club, such as the A's, from acquiring land, building a ballpark, and relocating the team, that practice should be subject to a proper rule of reason analysis as it is with any other professional sports league.<sup>120</sup>

Because the Baseball Trilogy fails to provide guidance, the Supreme Court needs to determine: (1) whether an exemption still exists; (2) what is the legal basis for the exemption; and (3) what is the scope of that exemption. As part of that analysis, the Supreme Court should find that franchise relocation does not fall within the scope or meaning of baseball's anomalous exemption. It is clearly time for the Supreme Court to revisit this conflicted area of antitrust law and find MLB subject to the same antitrust scrutiny as other professional sports. The national pastime should be subject to all of our Nation's laws.

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118 Tomilson, *The Commissioner's New Clothes*, *supra* note 54, at 287-88.

119 See *infra* note 75 and accompanying text.

120 See, e.g., *Los Angeles Mem'l Coliseum Comm'n v. Nat'l Football League*, 726 F.2d 1381, 1391 (9th Cir. 1984) ("Rule of reason used to engage in a 'thorough investigation of the industry at issue and a balancing of the arrangement's positive and negative effects on competition.'") (citation omitted).

# NOWHERE TO RUN, NOWHERE TO HIDE: IN THE AGE OF BIG DATA IS DATA SECURITY POSSIBLE AND CAN THE ENFORCEMENT AGENCIES AND PRIVATE LITIGATION ENSURE YOUR ONLINE INFORMATION REMAINS SAFE AND PRIVATE?

## A ROUNDTABLE

*Moderated by Niall E. Lynch<sup>1</sup>*

We have a distinguished group of panelists to discuss the very topical issue of privacy, computer security and data breaches. It is certainly interesting and encouraging to hear Judge Kathryn Mickle Werdegar, Justice of the California Supreme Court, say that privacy law will be a major legal issue in the next decade in California and the United States.

The title of today's program is "Nowhere to Run, Nowhere to Hide: In the Age of Big Data Is Data Security Possible and Can the Enforcement Agencies and Private Litigation Ensure Your Online Information Remains Safe and Private?" Every day we open the newspaper there are stories about data breaches. We are constantly being told to change our password, which is inconvenient. Apparently the number one password used in the United States is the word "password." In this country, we obviously have a problem with privacy and keeping our data secure.

We have a great list of panelists for this discussion who come from a variety of backgrounds, all of whom have experience in the privacy area. Our illustrious panel consists of:

- **Laura Berger** is an attorney in the Division of Privacy and Identity Protection at the Federal Trade Commission ("FTC"). She enforces federal laws that protect consumer privacy. Recently her law-enforcement work has focused on the privacy and security standards applicable to social media and the Internet of Things. She also has worked on the agency's efforts to educate app developers about privacy including the recent guide "Marketing your Mobile App: Get It Right from the Start." In addition, she was the author of the Commission's safeguards rule. She works in the FTC regional office in San Francisco. The FTC does a substantial amount of work in this area, and has a useful website with all sorts of tools and resources. The FTC has filed cases against every single major Internet company or computer company in the last couple years.
- **Adam Miller** is from the California State Attorney General's office. Adam has worked for the California Attorney General's office in San Francisco since 1997. He is the inaugural supervising Deputy Attorney General for the Privacy

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1 Niall E. Lynch is a partner at Latham & Watkins in San Francisco, California. Mr. Lynch is an antitrust lawyer who defends companies and individuals in criminal price fixing cases as well as FTC investigations and class-action litigation. Before joining Latham & Watkins, Mr. Lynch spent fifteen years at the Department of Justice, and was Assistant Chief of the San Francisco Office of the Antitrust Division. This article reflects the views of the authors and not necessarily those of Latham & Watkins, its attorneys, or its clients.

Enforcement and Protection Unit that was created in 2012. From 1997 until 2001, he worked in the licensing section where he prosecuted hundreds of vocational licenses for professional misconduct. From 2001 through 2012, he worked in the Antitrust Law Section where he investigated and prosecuted mergers and anti-competitive conduct involving markets such as computer software, Microsoft and hardware, flat panels, search advertising, oil and gas and film exhibition. Adam, too, comes from an enforcement agency that's been very, very active in this area and they have a host of resources on their website.

- **Ara Jabaghourian** is a partner at Cotchett, Pitre & McCarthy, where he has litigated and tried cases in numerous areas. A class action he tried was selected as one of the top verdicts by impact by the Daily Journal, and one of the Top 100 verdicts in the United States by the National Law Journal. He has been selected as a finalist for the Trial Lawyer of the Year of the Consumer Attorneys of California in 2011 and 2012. Ara was formerly a staff attorney with the Federal Trade Commission's Bureau of Competition in Washington, D.C. Ara has had experience in private litigation in the privacy area, and he'll talk a little bit about that.
- **Jim Snell** is a partner at Perkins Coie. Jim represents and counsels clients on a wide range of complex commercial matters including privacy and security, Internet and marketing and intellectual property litigation matters. Jim's extensive experience includes counseling and defense of class action and other litigation relating to privacy policies, terms of use, behavioral advertising, data collection and use, Telephone Consumer Protection Act ("TCPA"), call recording statutes, commercial e-mails, spyware and adware, data breach investigations and responses, data security, social media and computer crime statutes, including many different industries.

**Niall E. Lynch**, a partner in Latham & Watkins's Antitrust and Competition Practice Group, moderated this discussion. This discussion builds upon the recent panel discussion at the Antitrust Section's 2014 Golden State Institute in San Francisco. Mr. Lynch moderated the combined panel discussion and was joined by Messrs. Berger, Miller, Jabaghourian, and Snell.

*Moderator: Let me begin with Ms. Berger. What has been happening at FTC in terms of enforcement in the area of data security, privacy and data breaches?*

**Ms. Berger:** Well, I want to say how much I appreciate the chance to be here and just, of course, say that while I'm going to be speaking as a staff person and not on behalf of the Commission or any particular commissioner, I'm excited to talk to all of you about what the Commission has been up to lately in the area of privacy and data security.

With an audience like this – and I'm always excited to talk to an audience that is not primarily focused in their professional careers on the issues that I am immersed in – so I'd love to see if folks are willing at this late hour do a show of hands. How many of you have a professional focus on privacy or data security?

[No hands raised]

That’s amazing. A show of fatigue or actual audience makeup.

So let me just say cover a few basics. As many of you may know from your other work, our primary authority is Section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices.<sup>2</sup> And we use this tool a lot in the private and data security context. As Niall pointed out, we’ve been extremely active. Privacy and data security are for everybody. They are relevant even to companies that you represent that may not be technology companies or may not be on the cutting edge of developing technologies.

So, we’ve continued to focus on enforcing the deceptive or unfair standard, but we’ve started to apply that concept to lots of new technology. If time permits, I’ll talk about a few of these cases.

With deception, we’re looking at the truthfulness of what you say to consumers about your privacy or data security practices, which may entail evaluating whether your privacy settings live up to what they are supposed to do or may entail looking at a document like a privacy policy. Adam will tell you that you absolutely have to have a privacy policy here in California if you collect personally identifiable information.

But even if you think: “You know what? We don’t have to have a privacy policy and we don’t make any promises about privacy,” chances are, you still say something to consumers about privacy. We look at a website and we look at the signs that companies post in their storefronts and we look at settings and at other communications with consumers. And we may think your statements give consumers reasonable expectations about privacy, even if those statements don’t take the form of a privacy policy.

We have been applying these principles regarding deception or unfair conduct to some key areas, which I’ll highlight for you. So, this is what we’ve been up to lately.

One of those areas, of course, is Big Data. And there some of you may know, we issued a report on the activities of data brokers in May. I won’t have time to get into the details of that report, but it recommended, among other things, that Congress consider legislation in this area so that consumers can be more aware of data brokers’ activities and possibly exercise some control over those activities.

But that’s also been an area—Big Data has also been a key area for us in law enforcement. And these cases will highlight another law that we enforce, the Fair Credit Reporting Act (“FCRA”).<sup>3</sup> There are cases where, depending on what a data broker is doing, if they are doing something that bears on your eligibility for employment or a credit decision or other FCRA-protected activity, they are going to be subject to the requirements of that law.

*Moderator: Can you define “data broker”?*

**Ms. Berger:** A data broker for easy reference is a company that’s in the business of collecting or compiling information about consumers. And if you are engaged in FCRA-covered activities, you’re going to be subject to the specific requirements of that law.

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2 15 U.S.C. § 45.

3 15 U.S.C. § 1681.

Recently, we have alleged that a couple of companies that tell merchants whether or not to cash a consumer's check, based on their past financial transactions, failed to live up to their obligation under the FCRA to make sure the information they are using is accurate.

By comparison, you might not need accurate information to make a decision about marketing. But if you're making a decision that is covered by the FCRA, you need to take steps to maintain the accuracy of the information you are using. So, we alleged that, in the check cashing context, these companies were not living up to their accuracy obligations. We also had four recent cases in the employment context, where we alleged that data brokers who sold information to employers, to help them make hiring decisions, weren't living up to their obligations to make sure that the information they provided was accurate and to make sure that the people that they provided it to had the right kind purpose, known as a "permissible purpose," to acquire it.

*Moderator: So they passed on false information, and someone didn't get a job as a result?*

**Ms. Berger:** That's exactly the type of the things that can happen. So the FCRA requires companies that are engaged in the business of providing information that is used or expected to be used for certain purposes – like employment screening or making decisions about credit or insurance – to need to have procedures to maintain its accuracy and to fulfill other obligations under the law.

In addition to Big Data, we've also been very active in the area of mobile and connected devices. We've been working in the mobile space for quite a while, looking at the types of disclosures, privacy disclosures, that are effective over a mobile device. You may want to look at our updated guidance on online disclosures, the Dot.Com Disclosures, which now has screen shots showing many examples of mobile disclosures.

We've also been active in law enforcement in that area as well, bringing actions against app developers like Snapchat who make promises that they don't live up to – in that case, promises about the disappearing nature of photos and videos sent through the app.

And then, of course, we've had our first case in the Internet of Things area. The Internet of Things is what we talk about when there is a device that maybe traditionally wasn't connected to the Internet but now is connected, like the surveillance cameras at issue in the case of TRENDnet. This increased connectivity can have significant privacy implications for consumers, whose information could be at risk of being disclosed more broadly than they thought. In TRENDnet, we alleged that an IP camera maker failed to take reasonable steps to make sure that the code they used to operate their camera was secure against hackers. And as a result, hackers could access the video feeds of cameras inside consumers' homes and observe people going about their daily activities or observe children who were being monitored by the cameras.

The third key area I'd like to highlight is, of course, our safeguards program. We're continuing to really focus on that area. We have well over fifty cases where we allege companies were deceptive about their data security practices or that the practices were unfair because they caused or were likely to cause substantial injury to consumers, which consumers could not reasonably avoid, and which is not outweighed by countervailing benefits to consumers or to competition.

And many of those cases have involved more sensitive data, like financial or health information; but, you know, other cases have simply been based on the fact that companies failed to live up to their promises to provide at least reasonable data security.

**Moderator:** *I'm struck by the stories I read of the Chinese, North Korean, or Russian governments actively trying to hack our files and so forth. I am sympathetic to the companies. And given all the tech companies that have been charged with violations, the question is: Is the law being enforced too broadly? What do you think of that? And also, typically what is remedy that is imposed by the FTC?*

**Ms. Berger:** Niall has raised a really important question. How much data security is enough that you're not going to be the subject of law enforcement? If you are subject to a really insidious attack that nobody has ever thought of and it's really on the cutting edge, that is not likely going to be the basis for an action by us. We look at many, many data breaches where we see no reason to believe that the company failed to maintain reasonable data security, particularly in circumstances where the attack would have been – even with a very, very high level of data security – difficult to avoid.

If you look at the cases that we have brought, they are often cases where we allege that the company had multiple failures to defend against what we refer to as “widely-known vulnerabilities” by using tools that are often commonly available, or relatively low cost.

Under Section 5, we have only at our disposal equitable remedies.<sup>4</sup> In the privacy and data security context, our orders frequently impose an injunction against misrepresentations and a requirement to implement a comprehensive privacy or data security plan that will be audited by a third party. There may also be other appropriate injunctive relief – for example, regarding the use of cookies or the updating of security software. It just depends. Of course, there could be equitable monetary remedies if consumers suffer losses or there is unjust enrichment or something of that nature. Once a company is subject to an order, we may seek civil penalties for any violations of that order.

And under the FCRA, which I also mentioned, there are civil penalties, as there are under other statutes, like the kids' privacy law, known as COPPA (Children's Online Privacy Protection Act).

**Moderator:** *Thank you, Laura. Sounds like the FTC has been very busy. I do recommend everyone going to the website. It not only lists the cases they file but also best practices that companies can look to and read to make sure they have their own adequate data protections.*

*Let's now turn to state enforcement. The State of California is as busy, if not busier, than the FTC and seems to have more tools available to prosecute some of these cases. Adam, maybe you can talk a little bit about what the state agency has been up to.*

**Mr. Miller:** I also want to say my remarks are my own and do not represent the Office of the Attorney General. The Privacy Enforcement and Protection Unit is still a fairly new unit in the State Attorney General's Office. We're dedicated to protecting

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4 14 U.S.C. § 45(l).

consumer privacy. It's one of the few but growing numbers of dedicated such units across the country. And our basic tool, which a lot of you are familiar with, is unfair competition law.

We can use that law to get equitable remedies and penalties, significant penalties, against companies that violate state or federal privacy laws.

One of the strongest tools at our disposal is the California Online Privacy Protection Act, Business and Professions Code sections 22575-22579 ("CalOPPA").<sup>5</sup> And that's a provision which some people have already referred to and probably know if you go to the website and you see a privacy policy link at the bottom, that's probably a result of that law being passed in 2003. And it was the first, I think the only, law that specifically addresses a requirement that you have to have a privacy policy. What it requires is if you collect personally identifiable information, which is defined in the statute and includes such things as first and last name, home or physical address, e-mail, telephone, Social Security number, if you collect – if you're a commercial operator and collect that information from the users of your website or online service – you have to have a privacy policy.

And I agree with what Niall said that even if you don't do that – I have to qualify what he said – it's probably still a good policy even if you don't collect. You never know. If you have some third-party code on your website, you might be collecting more information than you think.

So one way we use this tool is we prosecuted Delta Airlines for their mobile app. And they had a mobile app called "Fly Delta" which at the time had somewhat limited functionality. You could go look at schedules; you could do a certain amount of stuff. And it had features that allowed Delta to track where you were, your geographical location, but there was no privacy policy within the app. And CalOPPA applies to both websites and online services, which is not defined in the statute, but our interpretation is that it includes mobile apps because mobile apps are online. If they are online, they are online services.

While Delta did have a privacy policy on their website, it was specific to the website; it didn't mention the mobile app at all. And it didn't say anything about the geographical tracking that was going on when you used Fly Delta.

What's interesting is even if you weren't a customer of Delta, you could download the app, even if you didn't buy a ticket, and it would still track you and collect information from you.

So that complaint was successfully demurred to by Delta. That is up on appeal right now. It's been briefed. There is no oral argument set yet.

But what's interesting, if you were here this morning and heard Tom Papageorge, he mentioned a recent California Supreme Court case, *Harris v. Pacific Anchor Transportation*, 329 P.3d 180 (Cal. 2014).

What was interesting about that case is the reason why the Delta lawsuit was demurred to, was federal preemption under the Airline Deregulation Act (“ADA”).<sup>6</sup> And what’s interesting about *Pacific Anchor* is that *Pacific Anchor* was decided under the FAAAA (the Federal Aviation Administration Authorization Act of 1994);<sup>7</sup> I usually just refer to it as F quadruple A – which is basically a transportation regulation statute, and the cases have basically said that the preemption provision in the Airline Deregulation Act, the ADA, is equivalent to the FAAAA. So what that means is in the same way that the California Supreme Court in *Pacific Anchor* decided that the FAAAA was not preempted by a state California law,<sup>8</sup> our argument in *Delta* would be that CalOPPA is similarly not preempted by the Airline Deregulation Act.

What have we been up to? So we’ve only been around for a couple of years. We’ve filed a couple of cases, including joining several multi-state settlements, including a case that’s probably going to be discussed in a little bit, which is the *Joffe v. Google* case involving Google Streetview.<sup>9</sup> We actually settled the case with Google and several other state attorneys general.

We also filed a case against Citibank Online. And this kind of dovetails into what Laura was talking about in terms of what type of hacking or access do you go after. We hear all the time there are foreign actors, state actors, hacking the government, JP Morgan; the federal government has reports of being hacked. And some businesses say, “We’re the victim,” which they are. “Why should we be punished because we had some brand-new innovative hack that no one ever thought of?” And I agree with Laura, if that’s really the case and that’s what the evidence shows, then we would likely not investigate or enforce any kind of case against that company. But the problem is that is sometimes used as an excuse, and there may be other aspects of how a company designs and implements their network, or their security design, which can facilitate the unusual hack. Sometimes it’s just a simple hack.

For instance, we settled the case against Citibank Online and did a stipulated final judgment where they had a very trivial exploit, which was a known exploit, where if you went to the Citibank Online website and had a Citibank credit card, you could log in and access other accounts. What this attacker did was he was able to log in with a valid credential, and then when you looked to the Universal Resource Locator (“URL”), or space bar at the top of your website or page, you can go to browse different sites, you would see a number of digits in the URL. He was able to change those digits one at a time, and they would show account information for other individuals.

The hacker, or hackers, were able to access over 300,000 accounts nationwide, over 80,000 in California. And we thought there wasn’t adequate security, and we were able to resolve a settlement with Citibank Online.

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6 Airline Deregulation Act of 1978, Pub. L. No. 95–504, 92 Stat 1705.

7 49 U.S.C. § 40101.

8 *Pacific Anchor*, 329 P.3d at 188 (Cal. 2014).

9 *Joffe v. Google, Inc.*, 746 F.3d 920 (9th Cir. 2013).

Another thing that we are looking at – this is not so much a kind of enforcement issue yet – but this dovetails with what Justice Werdegar mentioned in her remarks. She was talking about privacy in particular. She was talking about tracking activity on the Internet. And this is a subject that’s very important to the privacy unit and also the California legislature. And although the do-not-track standard, which is essentially a signal that is sent to a browser that’s supposed to be a standard that will let you know if a user does or does not want to be tracked, it hasn’t been established what that standard is, what the proper reaction is supposed to be. But the California legislature recently decided to pass a bill to try to do something dealing with do-not-track – which is AB370.<sup>10</sup> That modifies CalOPPA and was effective at the beginning of 2014.

Now, AB370 does not say whether you can or cannot track. Just like the California Supreme Court said in the case of *Apple Inc. v. Superior Court (Krescent)*, 292 P.3d 883 (Cal. 2013), this was a case involving a purchase of downloadable material over the internet. *Apple* is one of the few cases which cites CalOPPA, and it stated that CalOPPA is merely a disclosure regime.<sup>11</sup> CalOPPA doesn’t say you can’t capture personal information. It just says if you’re going to collect the information, just tell the users what you are going to collect. And AB370 builds upon that by saying if you collect PII, then you have to tell the user how your website or online service responds to a do-not-track signal. Just how you respond. Or how your site responds to some other mechanism for tracking over time, because do-not-track is simply one type of tracking. There are other possible ways of tracking as well now, and that may be developed in the future.

AB370 also requires you to disclose whether third parties might collect personal identifiable information. It is concerned with tracking people across time and across websites, such as by cookies. Another option to comply with AB370 is you can link to some kind of third-party protocol which offers users the choice of how to opt out. Not to recommend one site or another, but some examples of those are the Network Advertising Initiative (“NAI”) and the Digital Advertising Alliance (“DAA”). But we think best practice guidance is that you should actually say, yes or no; we do comply, or we don’t comply with a do-not-track signal.

And I also reinforce what Niall said: the California Attorney General, we were able to import a lot of material and also resources from the former Office of Privacy Protection, including Joann McNabb, who is our privacy unit’s Director of Privacy, Education, and Policy. And a lot of the materials that formerly resided with the Office of Privacy Protection are now on the AG’s website at [oag.ca.gov/privacy](http://oag.ca.gov/privacy).

*Moderator: Thank you, Adam. I think we’ll look back at this time today as the infancy of privacy law. Virtually any company that has an online presence on the Internet, which is basically every company, is going to be subject to some of these rules and laws in some regard. They are data collectors. And I think this is going to be a growth area, I mean, for those who are interested, for compliance counsel, and creating effective compliance programs.*

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10 CAL. BUS. & PROF. § 22575.

11 *Krescent*, 292 P. 3d at 895.

*It is not overstating it to say that many Internet companies are woefully unprepared for these types of laws and there's a substantial role for counsel to provide the advice necessary for companies to avoid some of these penalties.*

*Next I would like to address private litigation. It's different than the antitrust side where a government investigation will inevitably trigger a follow-on class-action lawsuit. There is active private litigation in the privacy area, but it does not always track government investigations. In terms of private litigation, think of the situations in which you're writing an e-mail to someone; you say you want to buy a pair of shoes, and suddenly a shoe ad pops up on the Internet. That's the world we're looking at. It's the use and misuse of your data by these companies to sell you things that maybe you don't want to buy. Let me ask Ara to talk about the plaintiff's perspective. What's happening in private litigation in the privacy space?*

**Mr. Jabaghourian:** I'm just going to go through some of the statutory schemes and kind of where the issues are. I'm not going through this entire presentation. But ultimately what you're going to see on these statutory schemes is you're going to see laws that were enacted twenty, thirty, forty years ago being applied to the Internet age, either through e-mail, through Facebook "Like" clicks, through Hulu video selections. You're seeing laws that were enacted in the sixties, seventies, and eighties being applied now to the Internet age. And I'm sure we'll have a lively discussion, I hope we do, as to whether or not that makes a difference or not.

The first one I put up is about the Federal Wiretap Act.<sup>12</sup> And you'll see there's a lot of litigation going on that's being brought related to scanning of the contents of e-mails. The scanning of WI-FI, people's personal WI-FI, by Google vehicles that go around taking pictures and downloading WI-FI. And issues are arising and actions are being brought under the Federal Wiretap Act which ultimately prohibits the interception of wire, oral or electronic communications. It was first enacted in 1968 and amended in 1986. And the fight, obviously, is electronic communications and other issues.

The Federal Wiretap Act set forth statutory damages per violation of \$10,000.<sup>13</sup> And that's another issue that you'll see come up on these types of cases, is actual damages which are statutory damages. And in the context of class actions, whether or not that violates due process if you're sticking it to millions and millions of folks.

The next one is the California parallel version of this, which is the California Invasion of Privacy Act,<sup>14</sup> which is under a penal code. And there's some differences there, but one of the differences between the Federal and California is in the Federal Wiretap Act you only need consent of one party. In California, you need consent of two parties. So that might explain why it is on your phone calls you hear this call is being recorded for training and technical purposes. I guess my silence is consent to that. I don't know what I'm supposed to do.

But that's the California Invasion of Privacy Act. These actions are usually brought in parallel to one another in the complaint.

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12 18 U.S.C. §§ 2510-2522.

13 *Id.* § 2520 (c)(2)(B).

14 CAL. PENAL §§ 630-638.

Next one I got here is the Video Privacy Protection Act.<sup>15</sup> This came out of Justice Bork’s confirmation hearing when it was leaked by the video store to the Washington Post on what this guy is watching. And I’m sure that Congress got nervous that they might be the guys going behind the special curtain room at the video store and made sure that law was enacted so their video selections are not put up in the Washington Post. That was enacted in 1988 under Ronald Reagan, being applied in active litigation with Hulu.

A couple more I’ll go through quickly is the Fair Credit Reporting Act.<sup>16</sup> And that was enacted in 1970. And the Telephone Consumer Protection Act,<sup>17</sup> which enacted in 1991. These also contain statutory damages. \$2500 per hit under the Fair Credit Reporting Act, and \$500 under the Telephone Consumer Protection Act.

Let’s get to the beef of this. I apologize for going so slow.

(Addressing reporter): And if I’m going too fast, I apologize there.

The issues that are cropping up on these cases – and I’ll tell you right off the bat, these cases have not been going too well for the plaintiffs – it is consent. Consent is essentially explicit consent and implied consent. And the explicit consent is when you press “okay” on that ninety-page form that if you want to use Gmail or Yahoo e-mail, “You’ve read our terms and conditions, click yes.” Guess what? You just agreed to something.

The interesting part of some of these e-mail cases were not so much, say, a Google user or a Gmail user or Google; what was interesting to me on these pages were non-Gmail users going, “so you’re a Yahoo user and you sent e-mail to somebody who has a Gmail account.” And guess what? Google scans that e-mail. That Yahoo person did not consent to that Google policy, and issues came up there.

The arguments that were raised were: where are you allowed to have implied consent? And apparently under one decision I just saw by Lucy Koh, implied consent means your knowledge from newspapers, your knowledge from talking to friends.<sup>18</sup> It’s almost so wide open that I guess the thinking is if you know they are scanning your e-mail from any source, you agree to it, which is a bit troublesome from a Libertarian standpoint but I’ll save that argument for later.

Under the Federal Wiretap Act, this argument is raised consistently, is the ordinary course of business exemption. Ultimately, in the Wiretap Act, it indicates that if it’s done in the ordinary course of business – and I have the language I can give to you later; I’m not going to waste your time – is if it’s in the ordinary course of business, that is not deemed to be a violation of the Federal Wiretap Act. So the arguments that are raised is: “Look, we’ve always been scanning this; we’ve always been doing this.” And you’ll see split decisions in two Google cases. One was a decision from Magistrate Grewal,<sup>19</sup>

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15 18 U.S.C. § 2710.

16 15 U.S.C. § 1681.

17 47 U.S.C. § 227.

18 *In re Google Inc.*, No. 13-MD-02430-LHK, 2013 WL 5423918 (N.D. Cal. Sept. 26, 2013).

19 *In re Google, Inc. Privacy Policy Litig.*, No. C-12-01382-PSG, 2013 WL 6248499 (N.D. Cal. Dec. 3, 2013).

and one was from Judge Lucy Koh. One was the Gmail case and one was dealing with Google's universal policy of taking Gmail, Google Maps and saying (inaudible) and exchanging information.

The difference was Lucy Koh found that there was an ordinary course restriction. It was a narrow meaning. It provided a restriction to what ordinary course means. It can't be subjective. It can't be "I do this or the industry does this, therefore it's okay."

Judge Grewal took a different perspective. He said, "Look, it's work." And the analysis is, "Look, this is what they have done, and this is what they have always done, and that's ordinary course; sorry, it's not a violation of the Act."

That issue, I don't know if it's going to percolate up because Judge Koh's case just got, essentially, effectively stripped down because class certification was not granted. So I don't know if that issue is going up or not.

Other issues that come up: Standing. The issue of damages. The issue between actual injury and statutory damages. The argument that was raised is, "look, you're getting \$10,000 a head but that's not your actual damage. What's the harm to you?" And the argument is, "look, legislation recognizes there's going to be a problem to try to prove damage, and they put the statutory damage claim to provide Article III standing."

So the arguments always come up. That argument, plaintiffs have been pretty successful. It's the other issues that they get slaughtered on. I haven't seen it go up to this point, but if somebody gets past summary judgment and is continuing to go, the statutory damage of \$10,000 a violation or \$5,000 a violation, is that going to cause due process concerns because on a class-action basis it's going to lead to big damages which are divorced from any actual injury. And there are California Supreme Court decisions and circuit decisions on that, whether or not that is permitted.

*Moderator: Thank you Ara. Let's hear from Jim. Jim represents Internet companies and technology companies faced with these issues. Jim, from your perspective, what's the landscape on civil litigation and also compliance? And do you agree with Ara that the bar is too high for plaintiffs in these cases?*

**Mr. Snell:** Well, first of all, on panels like this, they usually don't sit the plaintiff lawyer right next to defense lawyer . . . I hope you don't have to jump between us at some point, Niall.

[Laughter.]

I'd say that from a 10,000-foot level, this is a really fascinating area. Fascinating for folks like me, but also frustrating for clients. As Niall said, we're just at the beginning, I think, of privacy issues and litigation. Drones, webcams and other technologies are being introduced on a daily basis. There is now a thermal camera available for \$300 that you can connect to your iPhone and take pictures of things in the shadows and in the dark. I think we are just beginning to grapple with a lot of these new technology issues.

I think litigation is a pretty blunt instrument for dealing with privacy concerns. And I'll give one example: The California Invasion of Privacy Act statute in California is a statute that has been interpreted to prohibit recording of phone calls without the consent

of both parties. When the legislature passed that statute in 1967, the year I was born, there were really only landline phones. We didn't have cell phones; we didn't have cloud telephony services. And the legislature addressed "calls recorded for quality assurance," and the legislature said we don't intend for the statute to cover calls recorded for quality assurance, which is pro-consumer. Right? It's something that businesses should be doing.

Well, the exception the legislature added in 1967 to address recording of calls for quality assurance was an exception that states that if you get your call-recording equipment pursuant to a tariff of a public utility, you're exempt. Because at that time the place to get your quality assurance call-recording equipment was from the public utility. So now, plaintiffs' lawyers are applying the statute to today's robust call technology, and every case I'm aware of that I've handled for defendants has been one where the challenged recording was made for a pro consumer reason – quality assurance. But the argument is that the statutory exception does not apply to today's technology. And the plaintiff's counsel are creative in allegations. In one instance, the statement "Your call may be monitored for quality assurance" was given on the English recording but not on the Hispanic one; somebody missed that and a claim may be filed.

The damages under that statute are \$5,000 a call. It doesn't take that many calls to make it a billion dollar case. So this is an area where there's been a real mushrooming of litigation. But I think one of the things to echo what Ara says is what we see is new technology being applied to old statutes, and that's going to continue, I think.

There's four basic types of cases that I think we see. First, the alleged misuse of data. So what is somebody doing with data? Is it a wiretap concern? Is it a computer fraud and abuse concern? A second type of litigation we see is misrepresentation claims. So companies should be very careful about what they say in their privacy policy. Make sure you do what you say and say what you do. Don't make promises where you don't need to. Where you do, make sure they are accurate. Because one of the places where plaintiffs are able to overcome the hurdle of standing is where there's an alleged misrepresentation and, in fact, that can add up.

Third, alleged statutory violations. There's a host of statutes in this area that give rise to privacy litigation. The Telephone Consumer Protection Act, there's probably five cases, six cases a week filed in this country under that statute. Damages of \$500 or \$1,500 a call or text for violations. The Video Privacy Protection Act is another.

There's a very interesting issue in front of the U.S. Supreme Court right now on a case called *Spokeo*.<sup>20</sup> It's a Fair Credit Reporting Act case, but there's been a lot of amicus briefs filed by other parties. And the issue is whether a plaintiff who has suffered no concrete harm has Article III standing to pursue a case where there's been a statutory violation and a private right of action to pursue that violation. And in that Fair Credit Reporting Act case, *Spokeo*, the Court is considering whether a plaintiff who alleges there was a violation but cannot show harm, has standing. The U.S. Supreme Court is considering that issue right now.

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20 *Spokeo, Inc. v. Robins*, 135 S.Ct. 23 (2014).

If the U.S. Supreme Court decides that for standing the plaintiff has to have actual harm, notwithstanding what the statute says, I think there will be less plaintiffs who can allege these types of claims.

I think the fourth type of action that we're seeing is data breach, data security issues. And in those cases, the trend is that it's pretty hard to establish standing where there's just a fear of how your data might be misused; but where there's actual misuse, you can actually plead a case. Although it might be hard to plead a class action in that instance.

Just briefly on the litigation trends: I think privacy litigation is generally increasing, not decreasing. Plaintiffs, in general, are having trouble establishing injury. There's been some recent case law including a California U.S. Supreme Court case that lends some credence to injury claims by plaintiffs in class actions.

Arbitration clauses are being upheld, and so that's something that you see a lot of companies instituting. Where you do that, I think you want to make sure that there's a clickbox on the terms of use or explicit consent from the customer that they agreed to the terms of use, including the arbitration provision.

The decisions are uneven and not uniform in this area. We see some cases finding injury, and on similar facts other Courts find there was no injury. Class certification is generally hard to achieve, I think, right now. That's a trend that we're seeing. But if class certification is achieved, we're seeing pretty high settlements. The highest settlement of a TCPA case last month was \$53 million. And there was another recent TCPA case where the damages per class member were \$1,600 and there were many class members.

***Moderator:** So let me get this straight. The panelists have described a "parade of horrors" for any company involved in the Internet. Theories of laws, both old and new and some outdated and shoe-horned into certain conduct that people never anticipated. There's private litigation, government enforcement. This seems like a really dangerous area to be operating in.*

*Laura and Adam, what advice do you have for companies on how they can operate in a way that stays within the borders of the law and still is able to function in this current environment?*

**Ms. Berger:** So I think some of the advice has been mentioned already. Jim was talking about do what you say and say what you do. I think that's really important. Just to follow on something that Ara said, you know, giving an example of cases where private litigation can be defended by saying, "Oh, but the consumer agreed to this; they clicked a box," that does not, that is not going to necessarily prevent an FTC action.

We are looking to see if there's a material claim or omission that's likely to mislead a reasonable consumer. And we have – as in the Sears case in 2009<sup>21</sup> – we have alleged that that deception occurred where the relevant information was buried in a lengthy end-user licensing agreement.

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21 *In re Sears Holdings Management Corp.*, No. C-4264 (F.T.C. 2009), available at <http://www.ftc.gov/enforcement/cases-proceedings/082-3099/sears-holdings-management-corporation-corporation-matter>

The key if you're going to try to be truthful with consumers is to put yourself in their shoes. Think about the consumer on that website. Are you putting the material information in a place where a reasonable consumer is going to see it? If it's a mobile app, you have to think about that pretty creatively. If you're doing a connective device, like an IP camera that has no screen at all, you're going to have to think even more carefully about how to make sure you meet consumer expectations. But I think in the privacy area, that's a really important thing to think about.

For the start-up communities, I think a common mistake we see is launching a new site or service without really being ready, without having thought through all these issues. There is a push to get things done and get them out there, but you need to make sure they are going to meet consumers' reasonable expectation for privacy and security.

I think as has been mentioned, our website [www.business.ftc.gov](http://www.business.ftc.gov), is useful if you're looking for information to guide your businesses. Incidentally, if you're looking for a case list, you can find that, too. On that page, there's a tab for privacy and security, and if you go to legal resources you can find both our relevant business education and the case highlights, which are in reverse chronological order.

We've been at this a long time, starting with the FCRA and our online privacy and security work since the 1990s, so there is quite a lot of information.

*Moderator: Adam?*

**Mr. Miller:** Without going into the full breadth of what privacy might involve, focusing on CalOPPA and breach issues, I would agree with what Laura said. If you're going to collect someone's information, you need to tell them what you're collecting.

I think companies also need to have a better sense of what data they are actually collecting. Sometimes there's data stored in multiple storage areas, and I get the sense sometimes companies don't realize what they are doing or they just – there's a button on a website control panel that they decide: "Let's just push the button, collect more data."

In this area of Big Data where the volume and velocity of data is going to increase, a colleague of mine told me recently that data being collected in automobiles is going to be terabytes of data a day. When you have that much data, you really have to think "Do I really need it?" A lot of companies say you never know, this might come in handy sometime, or we might discover something. And I agree it might come in handy and certainly for certain public policy reasons that the FTC has pointed out in some of their Big Data reports, it might be useful to know a lot about school children or medical or health issues. For a business, it's really important they know what data they have and make sure that the customer knows that they are collecting it, and keep it safe.

In addition, if you're talking about keeping data safe, talking about breaches, California passed the first breach law in 2003; and now nearly every state in the country has such a data breach law with the exception of the federal government.

So what that means is you've got to know what kind of technology you have. And this has already been mentioned, if there's a patch out there for a known exploit and you don't do anything about it, that's going to be a problem.

*Moderator: I would like to hear from each of our panelists what do you predict will be the top issues or trends in privacy law in the next year or five years. Let's start with Ara Jabaghourian.*

**Mr. Jabaghourian:** I don't know; I'm no Nostradamus. Maybe I can pick what I would like to see.

Of these privacy laws I put up there, I always go back to what was the intent, what was the purpose of the law, to try to understand whether or not it applied to new technology. So even if the California Invasion of Privacy Act, the legislative history, the statement that was put in there was: "Use of such devices and techniques has created a serious threat to the free exercise of personal liberties and cannot be tolerated in a free civilized society."<sup>22</sup>

So then we take the issue of, all right, obviously they weren't thinking of e-mail or Internet or anything at that time, but how is that different? How is that different than a mail coming in from my mother or a call from my wife? How is an e-mail content different?

And the position that's been taken is, well, the ordinary course exception. The ordinary course exception, I find a little strange. You can either take one of two positions. One is: "Look, our industry has always done it this way"; or, two, "This is the way our company has always done it." If it's the first, that's just not the case. If you look at Yahoo and inception of AOL, Hotmail, Net Zero, they weren't scanning the contents of people's e-mail to do marketing. So let's take the second position: "Look, Google, Gmail has always done this when they started." Well, take the circumstance, I want to open up my own phone line. I want to call AR&J, and I'm going to listen to all your phone calls. Nobody is going to say, "Sorry, ordinary course of business, that's the way Ara has always done it and therefore it's okay."

So I'm hoping that this notion, the sixties, seventies notion of privacy, the issue of increasing rights, again even outside of any pecuniary interest, the position of being a citizen, how I would like to see privacy rights, I would really like to see some judges say: "Wait a minute." When eight companies go up and put in a New York Times editorial open letter saying we're against the NSA scanning your e-mails and doing all this, you're violating civil liberties, but it's okay for them to do it for profit,<sup>23</sup> I'm taken aback by both. And I'm hoping, and I don't know what the prediction will be, but I'm hoping the circuit starts to bring some of these privacy considerations and come up with a balance. Until legislation is enacted – I don't know if any is going to be enacted on this. I suspect given the way decisions are going, Silicon Valley is going to be sending a lot of money to the beltway to prevent any laws on this issue since the case law is going this way.

So, again, I don't know if that's a prediction or not, but that's kind of where I hope things go.

*Moderator: Jim Snell?*

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22 CAL. PENAL CODE § 630.

23 See GLOBAL GOVERNMENT SURVEILLANCE REFORM, <https://www.reformgovernmentsurveillance.com/> (last visited Feb. 16, 2015).

**Mr. Snell:** Thank you. A couple of predictions. Internet of Things is going to be a huge area, I think. This involves interconnected devices collecting, storing and processing various types of data. This includes video, being able to watch what's going on in your home from your iPhone, mobile device with cameras, etc. Workplace productivity, monitoring employees, the wired community. Think about how many times you're staring at a camera in our society. If you're looking at your phone, you're staring at a camera. Most people looking at your computer, you're staring at a camera. iPad, same thing. Throughout my whole day – my neighbor just installed cameras outside his house to prevent theft. His cameras are picking up every time I drive to and from work. I am staring at a camera now, recording this talk. There are multiple cameras at every intersection. So, Internet of Things is going to be a big issue.

Big Data and analytics. I think this is going to be a big issue because it really turns privacy on its head. As somebody was saying earlier today, businesses feel that they need to keep data based on the possibility that there may be analytics, perhaps in the future, that they can run on that data to better serve customers; and if they get rid of the data, their competitors may keep it, and those competitors may be running analytics and serving customers better and being more competitive.

Well, the traditional privacy notion is when you collect data, don't keep it longer than you need for the purpose it was collected. So the tension between those two concepts, I think, is going to be an interesting area.

Data breaches, I think, are getting more sophisticated. There's sort of an arms race right now in security technology and the criminals that are breaching it. Issues of government surveillance, I think. Right now, foreign companies are using the Snowden revelations as ways to be competitive with U.S. companies, and those foreign governments in many cases have as many or more surveillance tools than the U.S. government. And finally, just global privacy and security legal issues generally. I think that's going to be an interesting area.

*Moderator: Laura Berger?*

**Ms. Berger:** I already mentioned Big Data and mobile and data security and the Internet of Things. So I think I would just add to that that I agree, I think consumer demands for privacy and security of their information is going to continue to go up as awareness of these issues mounts.

*Moderator: Adam Miller?*

**Mr. Miller:** I would echo the Internet of Things. Also wearable devices, both medical and nonmedical. And I would also – I recently saw some advertisements and saw some stuff on TV about coding camps, where people are able to learn how to program in a couple of months. As a former computer science programmer, which was my major, I'm happy to see this is happening, but I'm wondering if they are teaching privacy by design. I'm concerned you're going to have these software developers where people just don't care about privacy issues, and that's going to create a lot of problems.

*Moderator: My prediction is that there will be pressure coming from two directions. First, from the people, everyday consumers, concerned about this issue. Although young people may have*

*different attitudes about privacy than older people, there will be pressure from consumers to strengthen data security laws. Second, there will be pressure from industry for clearer rules. We currently have a patchwork of rules between the FTC and the states. So I think these two constituencies are going to join together to encourage the creation of a national privacy law. There's been efforts in Congress to push that forward in the past, that have failed. But the bigger this issue becomes, and longer this goes on unresolved, there will be greater demand for a national universal standard coming from the federal government.*

*I want to thank all of the panelists, and hopefully you found this program informative and enjoyable.*

# HOW VIABLE IS THE PROSPECT OF ENFORCEMENT OF PRIVACY RIGHTS IN THE AGE OF BIG DATA? AN OVERVIEW OF TRENDS AND DEVELOPMENTS IN CONSUMER PRIVACY CLASS ACTIONS

By Matthew George<sup>1</sup>

## I. INTRODUCTION AND OVERVIEW

A nationwide retailer is hacked and account numbers for millions of customers hit the black market for criminals to use to commit fraud. A hospital leaks its patients' medical records on the Internet and reveals their diagnoses. Social media users learn companies are harvesting their private messages for data to sell them products. Each of these scenarios has become increasingly common news in the digital age of big data.

So where does that leave consumers when their personal information is exposed or misused? What recourse, if any, do they have in court when their privacy has been violated? While there are some laws that provide guidance on how personal information must be secured, many provide no private cause of action to consumers when their data is actually exposed. And, courts have dismissed many privacy cases at the pleading stage by rejecting plaintiffs' theories equating the loss or exposure of personal data with monetary harm—despite the undisputed fact that personal information is valuable to the companies that hold it and the criminals who want it.<sup>2</sup>

While difficult, private enforcement of consumer privacy in the age of big data is not a lost cause. As discussed below, plaintiffs have had some success testing the application of traditional legal principles (like standing) to this developing practice area and there are many state and federal statutes that can provide relief to consumers when their privacy is violated. This article explores some of the key claims and legal issues that have emerged in recent lawsuits brought over consumer privacy issues, particularly in the context of customer account data, medical information, and electronic communications.

## II. GETTING THROUGH THE COURTHOUSE DOORS – ARTICLE III STANDING AND DATA BREACHES

One of the biggest hurdles plaintiffs face asserting claims arising from data breaches is demonstrating Article III standing. As a threshold issue, standing is an “indispensable part of a plaintiff's case” that requires plaintiffs to allege injury-in-fact, causation, and

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1 Matthew George has advocated for employees and consumers for ten years, most recently as a partner at Girard Gibbs LLP. He has worked on lead counsel teams in class action privacy cases against Target, Adobe, Yahoo!, and Health Net, among others. He thanks his colleague Ashley Tveit for her assistance with the research and development of this article. The views expressed here are solely those of the author.

2 Org. Econ. Cooperation & Dev., *Exploring the Economics of Personal Data: A Survey of Methodologies for Measuring Monetary Value* (OECD Digital Econ. Papers, Paper No. 220, 2013), available at [http://www.oecd-ilibrary.org/science-and-technology/exploring-the-economics-of-personal-data\\_5k486qtxldmq-en](http://www.oecd-ilibrary.org/science-and-technology/exploring-the-economics-of-personal-data_5k486qtxldmq-en).

redressability tied to the defendant's conduct.<sup>3</sup> Because many data breaches do not necessarily result in immediate financial damages, some plaintiffs have encountered difficulty pleading alternate injury theories that satisfy Article III.

### **A. Early Privacy Breach Cases Find the Loss of Personal Data Confers Standing**

Given the lack of precedent in early data breach cases, courts were presented with the novel question of whether plaintiffs had standing when their account data was exposed. The Seventh and Ninth Circuits initially agreed that plaintiffs, whose personal data was stolen, could sufficiently allege injury-in-fact because of the threat of future harm from the exposure of their personal information.<sup>4</sup> However, the courts still affirmed dismissals of plaintiffs' claims because they found their requests for credit monitoring or mitigation damages were insufficient to support the claims alleged.

The First Circuit viewed mitigation damages differently, finding that the purchase of credit monitoring services in response to a data breach was recoverable damage so long as it was reasonable.<sup>5</sup> The First Circuit noted its finding was factually distinguishable from that of other courts because the plaintiffs before it had already experienced fraudulent charges as a result of the breach. In other cases where personal data has been lost or misplaced but not necessarily stolen or misused, mitigation damages have been deemed unreasonable because the courts found the threat of identity theft was too tenuous or unlikely.<sup>6</sup>

### **B. The Supreme Court's 2013 *Clapper v. Amnesty International* Decision Builds a New Barrier for Plaintiffs to Demonstrate Standing**

The Supreme Court's 2013 examination of Article III standing in *Clapper v. Amnesty International*<sup>7</sup> has provided defendants in privacy-related cases with new authority to defeat claims premised on the loss or misuse of personal information.

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3 *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561-61 (1992).

4 *See Krottner v. Starbucks Corp.*, 628 F.3d 1139 (9th Cir. 2010) (explaining that employees alleged their personal information including social security numbers were wrongfully obtained when a laptop containing their personnel records was stolen); *Pisciotta v. Old Nat'l Bancorp.*, 499 F.3d 629 (7th Cir. 2007) (explaining that consumers were impacted by hackers stealing information collected on bank's website). *But see Lambert v. Hartman*, 517 F.3d 433 (6th Cir. 2008) (noting, without analysis, that the risk of future identity theft was somewhat "hypothetical" and "conjectural") (citing *Daubemire v. City of Columbus*, 507 F.3d 383, 388 (6th Cir. 2007)).

5 *See Anderson v. Hannaford Bros. Co.*, 659 F.3d 151, 167 (1st Cir. 2011) (finding credit monitoring services where ID theft had occurred "recoverable as mitigation damages so long as they are reasonable").

6 *See, e.g., Willey v. J.P. Morgan Chase, N.A.*, No. 09 CIV. 1397(CM), 2009 WL 1938987 (S.D.N.Y. July 7, 2009); *McLoughlin v. People's United Bank, Inc.*, No. CIVA 308CV-00944 VLB, 2009 WL 2843269 (D. Conn. Aug. 31, 2009); *Shafiq v. Harley-Davidson, Inc.*, No. 07 CIV. 01365 (GBD), 2008 WL 763177 (S.D.N.Y. Mar. 20, 2008).

7 133 S. Ct. 1138 (2013).

In *Clapper*, the plaintiffs claimed that their constitutional rights were violated by the government's activities under the Foreign Intelligence Surveillance Act. The plaintiffs were a group of lawyers, activists, and journalists who engaged in international communications with persons who could have potentially been targeted by government surveillance for national security reasons. As a result of the government's surveillance programs, plaintiffs alleged that the risk of surveillance was "so substantial that they ha[d] been forced to take costly and burdensome measures to protect the confidentiality of their international communications" and the threat of surveillance would force them to pay for unnecessary "travel abroad in order to have in-person conversations."<sup>8</sup>

The Supreme Court agreed with the government that plaintiffs had not demonstrated injury-in-fact to confer standing because the plaintiffs' "threatened injury" was not "certainly impending."<sup>9</sup> The Court viewed the possible injuries as too attenuated, and declared that Article III standing is not "fanciful, paranoid, or otherwise unreasonable,"<sup>10</sup> and that plaintiffs could not "manufacture standing merely by inflicting harm on themselves based on fears of hypothetical harm."<sup>11</sup> The Court's ruling effectively meant that plaintiffs would only have been able to demonstrate standing if in fact they could have shown their communications were under surveillance, or that their sources were specific targets of the government's spying—a burden that would be nearly impossible to show given the secrecy of the government's security program.

Although it was not a consumer privacy case, *Clapper* has influenced a number of federal courts considering standing issues in recent data breach cases. Following the *Clapper* decision, some courts have taken a harder stance that merely the risk of future harm arising from the loss or exposure of personal data is insufficient to allege injury-in-fact.

For example, in *In re Science Applications International Corp. (SAIC) Backup Tape Data Theft Litigation*, personal information of U.S. military veterans had been stored on a computer that was stolen from a SAIC employee's car.<sup>12</sup> The plaintiffs argued they had suffered injury from the loss of privacy, the lost value of their personal and medical information, and the costs of monitoring their privacy. The court found these injuries too remote, stating that it was "highly unlikely that the crook even understood what the tapes were . . . [a]nd until Plaintiffs can aver that their records have been viewed (or certainly will be viewed), any harm to their privacy remains speculative."<sup>13</sup> Because it appeared that the plaintiffs' information was not the target of the criminal activity, the court found the risk was not substantial enough absent proof of some unauthorized use.

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8 *Id.* at 1145-46.

9 *Id.* at 1147 (internal quotations omitted) (citation omitted).

10 *Id.* at 1151 (internal quotations omitted) (citation omitted).

11 *Id.*

12 No. 12-347(JEB), 2014 WL 1858458, at \*1 (D.D.C. May 9, 2014).

13 *Id.* at \*9.

Several other courts have relied on *Clapper* to find that plaintiffs have no actionable injuries arising from privacy violations and data breaches.<sup>14</sup> They generally state that plaintiffs must prove not only that their information has been compromised, but also that it has resulted in tangible, economic injuries, and mitigation costs (like credit monitoring) are not always recognized as sufficient.<sup>15</sup> Courts have also disagreed with plaintiffs who argued they were damaged by having their data exposed through a diminution in value theory unless they also alleged that they planned to sell their personal data.<sup>16</sup> One court also rejected plaintiffs' statistical evidence that a data breach increased their risk of identity fraud—the “[n]amed Plaintiffs have alleged less than a 20% chance of being victimized by identity theft, identity fraud, medical fraud, or phishing, which does not create a substantial risk given the uncertainties in third party action required to produce harm here.”<sup>17</sup> Without allegations of monetary damages, courts following *Clapper* have considered plaintiffs' fears of future identity theft as paranoid, unlikely, and “contingent on a chain of attenuated hypothetical events and actions by third parties independent of the defendant.”<sup>18</sup> Under this line of reasoning, proven identity theft or a fraudulent unreimbursed charge on a plaintiff's credit card may be the only harm some courts will deem sufficient to allege injury and confer standing.<sup>19</sup>

While *Clapper* is a powerful tool for defendants to successfully argue motions to dismiss for lack of standing, as explored below, some courts have distinguished *Clapper* and found alternate avenues for plaintiffs to move forward with their claims.

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14 See, e.g., *Yunker v. Pandora Media, Inc.*, No. 11-cv-03113 JSW, 2013 WL 1282980 (N.D. Cal. Mar. 26, 2013) (court dismissed plaintiffs' claims alleging monetary loss arising from decrease in value of plaintiffs' personal information and reduction of phone memory space as a result of Pandora's application used to share personalized information with advertisers); *In re Barnes & Noble Pin Pad Litig.*, No. 12-cv-8617, 2013 WL 4759588 (N.D. Ill. Sept. 3, 2013) (court dismissed claims where only one plaintiff alleged she had experienced a fraudulent charge following a security breach at defendant's stores, and the fraudulent charge did not result in actual monetary loss); *Strautins v. Trustwave Holdings, Inc.*, 27 F. Supp. 3d 871 (N.D. Ill. 2014) (court dismissed plaintiffs' claims against computer security provider following cyber-attack on South Carolina Dept. of Revenue because despite cyber-attack, there was no actual proof data was stolen); *Galaria v. Nationwide Mut. Ins. Co.*, 998 F. Supp. 2d 646, 654-55 (S.D. Ohio 2014) (court dismissed claims of plaintiffs alleging they had a 19% increased risk of experiencing fraud as a result of a computer hack on an insurance provider that resulted in the dissemination of their personal information, because the increased risk was only slight).

15 See, e.g., *Moyer v. Michaels Stores, Inc.*, No. 1:14-cv-00561, 2014 WL 3511500 (N.D. Ill., July 14, 2014).

16 See *Yunker*, 2013 WL 1282980, at \*5; *In re Barnes & Noble Pin Pad Litig.*, 2013 WL 4759588, at \*5 (\$90 value of data on the black market did not create tangible injury unless plaintiffs had the ability to sell their data).

17 *Galaria*, 998 F. Supp. 2d at 655 n.8.

18 *Strautins*, 27 F. Supp. 3d at 876.

19 See, e.g., *In re Barnes & Noble Pin Pad Litig.*, 2013 WL 4759588, at \*6 (although one plaintiff had experienced an attempted fraudulent charge on her card, it had not gone through; therefore, the court found her damages were insufficient to establish standing); see also *In re Sci. Applications Int'l Corp.*, 2014 WL 1858458, at \*13 (two plaintiffs' claims survived a motion to dismiss because they had experienced identity theft that was plausibly linked to the security breach); *Lambert*, 517 F.3d at 437-38 (adequate injury alleged when plaintiff had tied actual identity theft to personal information posted on city defendant's website).

### C. Different Views of Standing in Data Breach Cases Emerge After *Clapper*

Prior to *Clapper*, a number of cases in the consumer privacy context, particularly those in the Ninth Circuit, held that plaintiffs had standing when their personal information had been wrongfully disclosed.<sup>20</sup> Since *Clapper*, additional opinions have rejected defendants' arguments that *Clapper* dooms plaintiffs' claims when their information privacy has been breached. For example, in *In re Sony Gaming Networks and Customer Data Security Breach Litigation*,<sup>21</sup> hackers had obtained customers' personal information, including their addresses, dates of birth, credit card information, and login credentials, but the plaintiffs did not have unauthorized charges to their accounts. The court still found the exposure constituted sufficient injury-in-fact, and reasoned that the *Clapper* decision did not create a new threshold standard for Article III standing. The court stated:

[T]he 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 requiring that the harm be "real and immediate." To the contrary, the Supreme Court's decision in *Clapper* simply reiterated an already well-established framework for assessing whether a plaintiff had sufficiently alleged an "injury-in-fact" for purposes of establishing Article III standing.<sup>22</sup>

Plaintiffs also survived *Clapper*-based challenges in a proposed class action arising from Adobe's 2013 data breach. In the Adobe case, the court articulated that "to require Plaintiffs to wait until they actually suffer identity theft or credit card fraud in order to have standing would run counter to the well-established principle that harm need not have already occurred or be 'literally certain' in order to constitute injury-in-fact."<sup>23</sup> The court also agreed that, unlike in other data breach cases where claims were dismissed, here the plaintiffs' data had been stolen by criminals, which logically meant it was likely to cause them harm—"[A]fter all, why would hackers target and steal personal customer data if not to misuse it?"<sup>24</sup>

At least one district court outside the Ninth Circuit has reached a similar conclusion, finding that *Clapper* did not create new standing requirements particularly given the differences between the constitutional issues at play in *Clapper* and those in traditional consumer privacy cases:

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20 See, e.g., *In re Facebook Privacy Litig.*, 791 F. Supp. 2d 705, 711-12 (N.D. Cal. 2011) (finding plaintiffs' allegations that their personal information was disclosed as opposed to just collected and retained by defendants sufficient for purposes of establishing Article III standing); *Doe 1 v. AOL, LLC*, 719 F. Supp. 2d 1102, 1108-09 (N.D. Cal. 2010) (finding plaintiffs' allegations that their personal information was collected and then disclosed sufficient for purposes of establishing standing).

21 996 F. Supp. 2d 942 (S.D. Cal. 2014).

22 *In re Sony Gaming Networks*, 996 F. Supp. 2d at 961.

23 *In re Adobe Systems, Inc. Privacy Litig.*, No. 5:13-cv-05226, 2014 WL 4379916, \*8 (N.D. Cal. Sept. 4, 2014).

24 *Id.* at \*9.

I respectfully disagree with my colleagues that *Clapper* should be read to overrule *Pisciotta*'s holding that an elevated risk of identity theft is a cognizable injury-in-fact. . . . The extent to which *Clapper*'s admittedly rigorous standing analysis should apply in a case that presents neither national security nor constitutional issues is an open question.<sup>25</sup>

In that case, credit and debit information had been stolen through the retail store's computers, but no identity thefts were alleged to have resulted. The court ultimately dismissed the claims because they did not meet other statutory requirements, but took the time to point out that the Supreme Court's recent *Susan B. Anthony List* decision catalogued a "myriad [of] circumstances" in which the risk of future harm could be established so long as it is credible and non-speculative.<sup>26</sup>

Another recent opinion resulting from Target's massive 2013 data breach also rejected the defendant's standing arguments. In *In re Target Corporation Customer Data Security Breach Litigation*, hackers had stolen customers' account data from in-store purchase transactions.<sup>27</sup> Some customers had alleged experiencing actual fraud on their accounts, while others had only alleged they were injured by having to change account information, pay associated fees, and incur late payment fees resulting from the inability to access their accounts. Target argued that the plaintiffs lacked standing because they had not alleged their expenses were unreimbursed or stated whether they had to close their bank accounts. The court disagreed, holding that Target's arguments "gloss[ed] over the actual allegations made and set a too-high standard for Plaintiffs to meet at the motion-to-dismiss stage. . . . Should discovery fail to bear out Plaintiffs' allegations, Target may move for summary judgment on the issue."<sup>28</sup>

Even with some recent decisions rejecting the application of *Clapper* to consumer privacy claims, ultimately, the facts of the case and evidence that fraud or identity theft has occurred as the result of a privacy breach will bolster the plaintiffs' claims when courts analyze that ruling at the pleading stage. And, the likelihood of identity theft can be elevated by concrete evidence—such as the presence of a plaintiff's data in criminal possession or evidence that it has already been misused to open phony credit card accounts or to make fraudulent charges.

### III. STATE AND FEDERAL STATUTES PERMIT THE PRIVATE ENFORCEMENT OF CONSUMER PRIVACY

While plaintiffs face a substantial risk of having their claims dismissed if they are unable to allege monetary damages as a result of a privacy violation or data breach, there may be statutory claims that permit private enforcement of their rights depending on the type of privacy breach, particularly those involving account information, medical records, or electronic communications.

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25 *Moyer v. Michaels Stores, Inc.*, No. 1:14-cv-00561, 2014 WL 3511500, at \*5 (N.D. Ill., July 14, 2014).

26 *Id.* at \*5 (citing *Susan B. Anthony List v. Driehaus*, 134 S. Ct. 2334, 2342-43 (2014)).

27 No. 14-2522 (PAM/JJK), 2014 WL 7192478 (D. Minn. Dec. 18, 2014).

28 *Id.* at \*2.

## A. Private Enforcement Under “Data Breach Notification” and Consumer Protection Laws

Data breaches involving credit and debit cards have been increasing in recent years and, while no federal statute exists to dictate how businesses must respond, nearly all states have enacted so-called “data breach notification” laws that may be used to enforce consumers’ rights.<sup>29</sup> For example, in California, a business that suffers a data breach must notify owners of the data “immediately following discovery” of the unauthorized access.<sup>30</sup> It also requires that the notification be in plain language, identify the information possibly subject to the breach, and provide contact information for credit reporting agencies. The law was recently amended to also require businesses that offer free credit monitoring as a remedy for a breach to offer it for a full year. Remedies available under California’s statute include damages and injunctive relief—which may require defendants to implement reasonable security standards to prevent additional breaches.

Plaintiffs affected by data breaches can also shoehorn their data breach notification claims into enforcement actions under general consumer protection and unfair competition laws.<sup>31</sup> And, if there was a product purchased that required the defendant to maintain personal information, plaintiffs may plead claims based on a loss in value of the product or service they purchased.<sup>32</sup> For example, in *In re Sony*, consumers alleged that they had paid a higher price due to representations that Sony’s security systems would protect their information. The court agreed that at least for the California consumer claims, the statutes allow for broad bases for damages: “[T]o the extent a consumer has ‘paid more for a product than he or she otherwise might have been willing to pay if the product had been labeled accurately,’ the consumer has lost money or property . . . .”<sup>33</sup>

## B. Private Enforcement to Protect Medical Information

In addition to data breaches involving financial account information, instances of loss of medical information have also been on the rise in the last few years. One study indicated that over twenty-nine million patient records had been breached since 2009, and that between 2012 and 2014 medical data breaches increased by 138%.<sup>34</sup> This is particularly alarming because health information can be more valuable to criminals than

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29 Katie W. Johnson, *Survey Reveals Breaches Are Increasing, but Executives Feel Unprepared to Respond*, BLOOMBERG BNA, Sept. 29, 2014, <http://www.bna.com/survey-reveals-breaches-n17179895519>. All states except Alabama, New Mexico, and South Dakota have enacted data breach notification statutes. *Security Breach Notification Laws*, NAT’L CONFERENCE OF STATE LEGISLATURES, <http://www.ncsl.org/research/telecommunications-and-information-technology/security-breach-notification-laws.aspx> (last visited Feb. 10, 2015). President Obama recently announced an attempt to pass a federal data breach notification law.

30 CAL. CIV. CODE § 1798.82(b).

31 See, e.g., *In re Sony Gaming Networks and Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 985–92 (2014) (providing an example of plaintiffs surviving a motion to dismiss under California state consumer protection laws).

32 *Moyer v. Michaels Stores, Inc.*, No. 1:14-cv-00561, 2014 WL 3511500, at \*5–6 (N.D. Ill. 2014).

33 *In re Sony*, 996 F. Supp. at 987.

34 Erin McCann, *HIPAA Data Breaches Climb 138 Percent*, HEALTHCARE IT NEWS, Feb. 6, 2014, <http://www.healthcareitnews.com/news/hipaa-data-breaches-climb-138-percent>.

financial information if they obtain medical services assuming someone else's identity and file false insurance claims.<sup>35</sup>

Medical privacy is regulated on federal and state levels. The federal regime—the Health Information Privacy Assurance Act (“HIPAA”)—regulates the use and disclosure of personal health information (“PHI”) by covered entities, such as medical providers, insurance companies, and their business associates, but it does not provide patients a private cause of action against hospitals or health care providers when they lose or improperly disclose their medication information.<sup>36</sup>

HIPAA's regulations are divided into three parts: the Privacy Rule, the Security Rule, and the Enforcement Rule. The Privacy Rule encompasses several requirements, including that PHI will only be shared to the minimum extent necessary to achieve the purposes of disclosure.<sup>37</sup> The Security Rule enumerates specific safeguards for physical and technological records.<sup>38</sup> The Enforcement Rule permits the Department of Health and Human Services (“DHHS”) to regulate inadequate privacy practices, and patient complaints for breaches must be handled through the DHHS Office of Civil Rights.<sup>39</sup> However, it is rare for the DHHS to enforce HIPAA through fines—although in 2011, it fined UCLA Hospital over complaints that employees were looking at celebrity patients' medical records.<sup>40</sup>

Some state laws also provide private enforcement mechanisms for breaches of medical privacy. In California, the Confidentiality in Medical Information Act (“CMIA”) contains both public and private enforcement provisions.<sup>41</sup> It permits private suits against medical providers for actual damages and nominal statutory damages of \$1,000 for negligent releases of medical information—even when no harm has been proven. This creates a significant enforcement angle for medical privacy breaches in California, and could subject hospitals or health maintenance organizations violating the law to significant damages.

Despite the private enforcement mechanisms in the CMIA, plaintiffs may still have a tough time in court. Recent decisions have held that the loss of medical data is not sufficient to plead a claim in the absence of proof that the data was viewed or misused by an unauthorized person.<sup>42</sup> For example, in the circumstance where a laptop containing

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35 Caroline Humer & Jim Finkle, *Your Medical Record Is Worth More to Hackers than Your Credit Card*, REUTERS, Sept. 24, 2014, <http://www.reuters.com/article/2014/09/24/us-cybersecurity-hospitals-idUSKCN0HJ21I20140924>.

36 45 C.F.R. pts. 160 & 164, subpts. A & E.

37 45 C.F.R. §§ 164.502(b), 164.514(d).

38 45 C.F.R. pts. 160 & 164, subpts. A & C.

39 45 C.F.R. pt. 79.

40 Charles Ornstein, *UCLA Health System Pays \$865,000 to Settle Celebrity Privacy Allegations*, PROPUBLICA, July 7, 2011, <http://www.propublica.org/article/ucla-health-system-pays-865000-to-settle-celebrity-privacy-allegations>.

41 CAL. CIV. CODE §§ 56-56.16.

42 See, e.g., *Regents of Univ. of Cal. v. Superior Court*, 220 Cal. App. 4th 549 (2013); *Sutter Health v. Superior Court*, 227 Cal. App. 4th 1546 (2014).

medical data was stolen, it was not sufficient to plead a claim simply because the medical data was obtained by a criminal; “[b]ecause no one (except perhaps the thief) knows what happened to the encrypted external hard drive and the password for the encrypted information, [the plaintiff] cannot allege her medical records were, in fact, viewed by an unauthorized individual.”<sup>43</sup> In another case where a thief had stolen a healthcare provider’s computer containing the medical records of about four million patients, a California appellate court stated that the CMIA “provides for liability for failing to ‘preserve[] the confidentiality’ of the medical records[;] . . . a plaintiff must allege a breach of confidentiality, not just a loss of possession.”<sup>44</sup> Thus, absent evidence of identity theft or publication of the medical records, cases alleging breaches of medical privacy still have difficulty advancing past the pleading stage.

### **C. Email, Social Media, and Data Harvesting – Private Enforcement of Electronic Communications Privacy**

Another growing area of privacy litigation involves claims against providers of web-based services (like email and search engines) and social media companies for data mining personal communications or tracking them on the Internet. These privacy cases differ from the data breach cases discussed above because they usually challenge some underlying business practice that *intends* to invade consumer privacy, rather than merely the loss of personal data that was held for operational purposes. Many plaintiffs are bringing suits under longstanding state and federal wiretap acts to challenge the increasing use of technology to understand consumer communications and behavior, which companies can then use for marketing and advertising.

On the federal level, the Electronic Communications Privacy Act (“ECPA”) protects the privacy of wire, oral, and electronic communications, including email and instant messages.<sup>45</sup> The ECPA prohibits tampering with computer lines or using other technology to ascertain the contents of any message without the authorization of one party to the communication. Some states also have more restrictive wiretap laws that impact businesses that process electronic communications between consumers. For example, the California Invasion of Privacy Act (“CIPA”) prohibits the interception of communications unless *all* parties consent.<sup>46</sup> California is one of many states to have such a requirement.<sup>47</sup> Many of these statutes provide private plaintiffs with rights to seek

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43 *Regents*, 220 Cal. App. 4th at 570.

44 *Sutter Health*, 227 Cal. App. 4th at 1557.

45 18 U.S.C. §§ 2510-2522.

46 CAL. PENAL CODE §§ 630-638.

47 Other states with all-party consent laws include Connecticut (CONN. GEN. STAT. §§ 53a-187, -189), Florida (FLA. STAT. § 934.03), Hawaii (HAW. REV. STAT. §§ 803-41 to 803-48), Maryland (MD. CODE ANN. § 10-402), Massachusetts (MASS. GEN. LAWS ch. 272, § 99), Montana (MONT. CODE ANN. § 45-8-213), New Hampshire (N.H. REV. STAT. ANN. § 570-a:2), Pennsylvania (18 PA. CONS. STAT. § 5704(4)), and Washington (WASH. REV. CODE § 9.73.030).

statutory damages and injunctive relief, and that is sufficient to confer statutory standing even though no actual damages can be attributed to the challenged conduct.<sup>48</sup>

In recent cases brought under these statutes, the defendants typically do not dispute fault for the conduct alleged, but they can get the claims dismissed if they can show that the users of the service consented to the wiretapping of their communications or that the business has to intercept the communications to provide the service. For example, consumers recently challenged Google's scanning and analysis of their emails for content that Google could use to build user profiles and sell premium advertisements.<sup>49</sup> At the motion to dismiss stage, Google argued its terms of service permitted it to scan its users' email, but the court disagreed, finding that the "policies did not explicitly notify Plaintiffs that Google would intercept users' emails for the purposes of creating user profiles or providing targeted advertising."<sup>50</sup> Similarly, the court rejected Google's argument that the scanning was necessary to maintain the free email service because it found the company violated its own privacy policies and the advertising was not instrumental to the ability to send email messages.<sup>51</sup>

In contrast, Google prevailed against consumer plaintiffs alleging Google's practice of using "cookies" to track their internet activity violated both the ECPA and CIPA.<sup>52</sup> Plaintiffs argued their web browsing was personal information that had been intercepted without their consent. In granting Google's motions to dismiss, the court explained that cookies are not "content" within the meaning of either statute because they are automatically generated and do not concern the contents or meaning of communications.<sup>53</sup> The decision is currently on appeal in the Third Circuit.

Consumers also recently challenged Facebook's scanning of their private messages in order to send targeted advertisements.<sup>54</sup> Facebook argued that because the practice enabled it to make money, it fell within its ordinary course of business. In denying Facebook's motion to dismiss, the court explained that an "electronic communications service provider cannot simply adopt any revenue-generating practice and deem it

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48 See *In re Google Inc. Gmail Litig.*, No. 5:13-MD-02430-LHK, 2013 WL 5423918, at \*17 (N.D. Cal. Sept. 26, 2013) ("Therefore, the Court finds that the allegation of a violation of CIPA, like an allegation of the violation of the Wiretap Act, is sufficient to confer standing without any independent allegation of injury."); see also *Steven Ades & Hart Woolery v. Omni Hotels Mgmt. Corp.*, No. 2:13-cv-02468, 2014 WL 4627271 (C.D. Cal. Sept. 8, 2014) (granting class certification for claims brought under CIPA because of a hotel reservation service recording phone conversations unannounced and without consent: "the only 'harm' required by § 637.2 'is the unauthorized recording'"); CAL. PENAL CODE § 637.2(c) ("It is not a necessary prerequisite to an action pursuant to this section that the plaintiff has suffered, or be threatened with, actual damages.").

49 *In re Google Inc. Gmail Litig.*, 2013 WL 5423918.

50 *Id.* at \*13.

51 *Id.* at \*11.

52 *In re Google Inc. Cookie Placement Consumer Privacy Litig.*, 988 F. Supp. 2d 434 (D. Del. 2013).

53 *Id.* at 444.

54 *Campbell v. Facebook, Inc.*, No. 4:13-cv-05996, 2014 WL 7336475 (N.D. Cal. Dec. 23, 2014).

‘ordinary’ by its own subjective standard.”<sup>55</sup> The court also found Facebook’s consent arguments inadequate because, similar to the *Gmail* case, even though its privacy policies mentioned scanning, they did not specifically encompass scanning message content to create targeted advertising, and any express or implied consent by users would have been deficient.

#### IV. CONCLUSION

Although there are significant challenges, lawsuits alleging consumer privacy violations are likely to increase as big data encompasses more aspects of people’s lives. Successful consumers have obtained settlement benefits like monetary compensation, free credit monitoring, and injunctive relief intended to reduce the risk of future privacy breaches. Even unsuccessful plaintiffs may positively influence corporate behavior by causing an increased investment in data security and compliance to limit the risk of future data breaches and lawsuits. Therefore, private enforcement of consumer privacy is an important tool to protect consumers’ rights in the age of big data.

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55 *Id.* at \*7; see also *See Kight v. CashCall, Inc.*, 200 Cal. App. 4th 1377, 1391 (2011) (“The statute . . . contains no exceptions applicable when a business monitors . . . even if the monitoring is for a legitimate business purpose.”). However, some courts have allowed an exception for “service monitoring” under certain circumstances. See *Sajfr v. BBG Commc’ns, Inc.*, No. 10-cv-2341 AJB(NLS), 2012 WL 398991, at \*6 (S.D. Cal. Jan. 10, 2012) (“[I]t was not intended to prohibit ‘service-observing’ because the legislature deemed that practice to be in the public’s best interest.”).

# THE DOCTOR IS IN, BUT YOUR MEDICAL INFORMATION IS OUT

## TRENDS IN CALIFORNIA PRIVACY CASES RELATING TO RELEASE OF MEDICAL INFORMATION

By Joseph R. Tiffany II, Connie J. Wolfe, Ph.D. and Allen Briskin<sup>1</sup>

Privacy breaches continue to be big news. In California, breaches of health care information are particularly sensitive, due to a number of state laws that provide legal remedies not available in other jurisdictions. While California's Civil Code sections 1798.29, 1798.82 and its Unfair Competition Law ("UCL")<sup>2</sup> are often relied on to remedy breaches of privacy, California also has the Confidentiality of Medical Information Act ("CMIA"),<sup>3</sup> providing that an individual may recover \$1,000 in nominal damages (plus actual damages if any) based on the negligent release of medical information by a health care provider or other covered party. As health care providers have moved toward the storage of medical data in large electronic databases containing information regarding many thousands of individuals, the potential number of people who may be affected by a single unauthorized release of medical information and the accompanying potential liability have skyrocketed. Until the past two years, however, there was little published authority interpreting the CMIA's definition of "medical information" or its prohibition on the "release" of such information. California courts have now provided guidance on these two critical issues affecting the potential liability of providers and others who sustain health care data breaches.

### I. SCOPE OF THE CMIA

The CMIA, enacted in 1981 and since amended several times, obligates any "provider of health care, health care service plan, pharmaceutical company or contractor" to maintain "medical information . . . in a manner that preserves the confidentiality of the information contained therein."<sup>4</sup> "Contractors" under the CMIA include medical groups, independent practice associations, certain pharmaceutical benefits managers and medical service organizations. The CMIA has recently been broadened to cover businesses that are "organized for the purpose of maintaining medical information" and "any business that offers software or hardware to consumers, including a mobile application or other related device that is designed to maintain medical information" (e.g., personal health record vendors), even though such entities are excluded from the definition of "provider of health care for purposes of any law other than this part, [section 56.06]."<sup>5</sup>

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1 Joseph R. Tiffany II is a partner in Pillsbury Winthrop Shaw Pittman LLP's Antitrust & Competition Practice Group. Connie J. Wolfe is a special counsel in Pillsbury Winthrop Shaw Pittman LLP's Antitrust & Competition Practice Group. Allen Briskin is a senior counsel in Pillsbury Winthrop Shaw Pittman LLP's Health Care & Life Sciences Practice Group. This article reflects the views of the authors and not necessarily those of Pillsbury Winthrop Shaw Pittman LLP, its attorneys, or its clients.

2 CAL. BUS. & PROF. § 17200 *et seq.*

3 CAL. CIV. CODE § 56 *et seq.*

4 CAL. CIV. CODE § 56.101.

5 *Id.* § 56.06(a), (b).

The CMIA generally prohibits the disclosure of an individual's medical information without the individual's authorization, unless a specific exception applies or the disclosure is required by law.<sup>6</sup> Health care providers and other parties subject to the CMIA are prohibited from sharing, selling, using for marketing purposes or otherwise using medical information for a purpose not necessary to provide health care services unless "expressly authorized."<sup>7</sup> In addition, the CMIA requires *employers* who obtain employee medical information to handle it confidentially and similarly prohibits their unauthorized disclosure of such information.<sup>8</sup>

The CMIA applies only to "medical information," which is defined as "any individually identifiable information, in electronic or physical form, in possession of or derived from a provider of health care, health care service plan, pharmaceutical company, or contractor regarding a patient's medical history, mental or physical condition, or treatment."<sup>9</sup>

Under this definition, for information to constitute "medical information," three elements must be established:

- (1) There must be individually identifiable information regarding an individual's medical history, mental or physical condition, or treatment;
- (2) Such information must be in the possession of or derived from a provider of health care, health care service plan, pharmaceutical company, or contractor; and
- (3) Such information must pertain to a "patient" of a provider of health care, i.e., one who has received health care services from that provider of health care.

The CMIA also includes a detailed list of specific medical information *excluded* from coverage under the Act. Data found in certain types of public social services records, industrial accident documentation,<sup>10</sup> and law enforcement records, among other sources, are on the exclusion list.<sup>11</sup>

Violations of the CMIA are subject to harsh penalties, which are in addition to any other remedies available to a plaintiff.<sup>12</sup> Such damages and penalties include:

Damages for Economic Loss: Any patient who has sustained economic loss or personal injury resulting from violation of any of the following prohibitions may recover

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6 *Id.* § 56.10(a).

7 *Id.* § 56.10(d), (e).

8 *Id.* § 56.20.

9 *Id.* § 56.05(j).

10 The CMIA clarifies, however, that even to the extent certain industrial accident information may be disclosed under section 56.30(f), disclosure of a patient's HIV status is not permitted without prior authorization from the patient unless the patient claims that the infection or exposure to HIV arose in the course of his or her employment.

11 CAL. CIV. CODE § 56.30.

12 *Id.* § 56.35.

compensatory damages; punitive damages (not to exceed \$3,000); attorneys' fees (not to exceed \$1,000); and the costs of litigation.<sup>13</sup> The prohibitions include: unauthorized "disclosure" of a patient's medical information;<sup>14</sup> unauthorized "release" of information regarding outpatient psychotherapy treatment;<sup>15</sup> violation of the CMIA's limitations on the use and disclosure of medical information by employers;<sup>16</sup> and third party administrators' "knowingly" using, disclosing or permitting its employees or agents to use or disclose medical information, except as reasonably necessary in connection with the administration or maintenance of the program, or with authorization.<sup>17</sup>

Damages for Negligent Disclosure: Any covered party "who negligently creates, maintains, preserves, stores, abandons, destroys, or disposes of medical information"<sup>18</sup> in violation of California Civil Code section 56.101 is subject to the following remedies under section 56.36(b): nominal damages of \$1,000 (which does not require "that the plaintiff suffered or was threatened with actual damages");<sup>19</sup> and/or actual damages, if any.

Civil/Criminal Penalties: If a violation of the CMIA results in an economic loss or personal injury to a patient, it is punishable as a misdemeanor.<sup>20</sup> For negligent disclosures, an administrative remedy or civil penalty of up to \$2,500 per violation may be assessed.<sup>21</sup> A person or entity (other than a licensed health care professional) who knowingly and willfully "obtains, discloses, or uses medical information in violation of [the CMIA] shall be liable for an administrative fine or civil penalty not to exceed \$25,000 per violation."<sup>22</sup> If the violation was carried out "for . . . purpose[s] of financial gain," the penalty may be increased to \$250,000 per violation and violators are also subject to disgorgement of any proceeds of that unlawful use.<sup>23</sup> Licensed health care professionals are subject to staggered penalties, ranging from \$2,500 to \$25,000 per violation.<sup>24</sup> If such professionals engaged in the violation "for financial gain," the penalty ranges from \$5,000 to \$250,000 per violation (for the third and subsequent violations), and disgorgement is also *available* at the highest tier.<sup>25</sup>

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13 *Id.*

14 *Id.* § 56.10.

15 *Id.* § 56.104.

16 *Id.* § 56.20.

17 *Id.* § 56.26(a).

18 *Id.* § 56.101.

19 *Id.* § 56.36(b)(1).

20 *Id.* § 56.36(a).

21 *Id.* § 56.36(c)(1).

22 *Id.* § 56.36(c)(2)(A).

23 *Id.* § 56.36(c)(3)(A).

24 *Id.* § 56.36(c)(2)(B).

25 *Id.* § 56.36(c)(3)(B).

## II. JUDICIAL INTERPRETATION OF THE SCOPE OF MEDICAL INFORMATION UNDER THE CMIA

In the years since the CMIA was implemented, various California courts have provided some guidance in further defining the term “medical information.” The California Supreme Court clarified that the accuracy of the information is not at issue—a CMIA claim does not require a plaintiff to show that the disclosure was false or misleading.<sup>26</sup> In addition, the California Court of Appeal for the Second District held that the term “medical information” under the CMIA is “broadly defined” and “[t]here is no question that ‘the patient’s name, address, age, and sex’ when combined with ‘a general description of the reason for treatment’; ‘the general nature of the injury’; and ‘the general condition of the patient’ comprise ‘medical information.’”<sup>27</sup> In another case, the Court of Appeal for the Second District held that the fact that a patient “received in vitro fertilization was clearly ‘medical information’ as defined in section 56.05, subdivision (g).”<sup>28</sup> In contrast, an anesthesiologist’s loud verbal review of a patient’s chart, including her HIV status, in a location where other patients could overhear was held not to violate the CMIA when there was no evidence that potential listeners were able to see the patient during the discussion and the defendant did not use the plaintiff’s full name, or disclose any other individually identifying information specified in the statute that would disclose her identity.<sup>29</sup>

Consequently, since the CMIA’s enactment, it has been unclear just how broadly the term “medical information” could be defined. As a result, until last year’s decision in *Eisenhower Medical Center v. Superior Court (Malanche)*, 226 Cal.App.4th 430 (Cal. Ct. App. 2014), it remained possible that the term could be construed as broadly as is the term “individually identifiable health information” under the Health Insurance Portability and Accountability Act (“HIPAA”), the federal statute providing privacy and security standards for health information. For example, in the preamble to the HIPAA Privacy Rule,<sup>30</sup> the Department of Health and Human Services (“HHS”) stated that a record that simply identifies the individual and provides the name of a health care provider that has provided unspecified services to the patient (e.g., hospital or physician) can, without any additional information being present, constitute individually identifiable health information. The HHS’s approach appears to be based on the reasoning that an individual’s provider–patient relationship with a specific health care provider is information that “relates” broadly to the individual’s health or condition, or health care

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26 *Brown v. Mortensen*, 253 P.3d 522, 533–34 (Cal. 2011).

27 *Garrett v. Young*, 109 Cal. App. 4th 1393, 1406 (Cal. Ct. App. 2003) (citation omitted) (holding that physician’s disclosure to the plaintiff’s employer that she suffered from itching and stress fell within a statutory exemption to the prohibition against disclosure of medical information, and that plaintiff had waived any right of recovery under the CMIA by openly discussing her conditions with supervisor and co-workers).

28 *Colleen M. v. Fertility and Surgical Associates of Thousand Oaks*, 132 Cal. App. 4th 1466, 1475 (Cal. Ct. App. 2005).

29 *Maureen K. v. Tuschka, M.D.*, 215 Cal. App. 4th 519 (Cal. Ct. App. 2013) (upholding summary judgment on a plaintiff’s CMIA claim based on loud discussions of her medical history in a pre-operative room).

30 45 C.F.R. §§ 160, 164(A), 164(E), 165.

received, and thus information may legally “relate” to an individual’s health or condition without divulging anything substantive about it. In the same way, “medical information” under the CMIA, defined as information that “regards” a patient’s medical history or physical condition, could potentially be deemed to apply to information as limited as the name of the health care provider who had a relationship with the individual.

In the *Eisenhower* case, a unanimous three-judge panel of the California Court of Appeal, Fourth Appellate District, examined whether a patient index containing personal identifying information qualifies as medical information under the CMIA, and held that it did not.<sup>31</sup>

The facts in *Eisenhower* involved the theft of a computer that contained an index of over 500,000 persons to whom the Eisenhower Medical Center (“EMC”) had assigned a clerical record number and included each person’s name, medical record number, age, birth date, and the last four digits of their social security number.<sup>32</sup> The medical record numbers were issued sequentially and did not contain any coded information. The computer was password-protected but not encrypted. EMC moved for summary judgment on the ground “that the index did not contain medical information within the meaning of the CMIA.”<sup>33</sup> The trial court denied EMC’s motion “based principally on its belief that the fact that a person was a patient at the hospital is medical information within the meaning of the CMIA.”<sup>34</sup> EMC appealed, arguing that “there was a disclosure or release of ‘individually identifiable information,’ but not medical information.”<sup>35</sup> The Court of Appeal agreed with EMC.

The court found that “[i]t is clear from the plain meaning of the statute that medical information cannot mean just any patient-related information held by a healthcare provider, but must be ‘individually identifiable information’ and must also include ‘a patient’s medical history, mental or physical condition, or treatment.’”<sup>36</sup> The court next applied the rule against surplusage, and found that to consider information to be “medical information” whenever any kind of personally identifying information about a patient was released, would “render meaningless the clause ‘regarding a patient’s medical history, mental or physical condition, or treatment.’”<sup>37</sup> The court found that EMC’s medical record number did not disclose anything about the nature of any medical treatment (if, in fact, treatment was provided) and that the fact that the person “was a patient is not in itself medical information as defined in section 56.05.”<sup>38</sup> The court further held that “[c]onfirmation that a person’s medical record exists somewhere is not medical information as defined under the CMIA.”<sup>39</sup>

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31 *Eisenhower Medical Center v. Superior Court* (Malanche), 226 Cal. App. 4th 430 (Cal. Ct. App. 2014).

32 *Id.* at 432.

33 *Id.* at 432-33.

34 *Id.* at 433.

35 *Id.* at 434.

36 *Id.* at 435 (citation omitted).

37 *Id.*

38 *Id.* at 435-36.

39 *Id.* at 436.

The court also found “noteworthy” the fact that section 56.16 of the CMIA allows an acute care hospital to release, at its discretion, certain limited patient information upon request, including a “general description of the reason for the treatment, the general nature of the injury, and the general condition of the patient, as well as nonmedical data.”<sup>40</sup> Although the court acknowledged that section 56.16 applied only when there has been a request for information, it found that the section “does lend some support for the belief that the mere fact that a person is or was a patient is not accorded the same level of privacy as specific information about his medical history.”<sup>41</sup> Finally, the court rejected the plaintiffs’ contention that EMC’s reporting of the theft to the HHS pursuant to the HIPAA data breach notification rule constituted an admission that the information was “medical information” because “federal law differs markedly from that in the CMIA.”<sup>42</sup>

The court concluded by holding “that under the CMIA a prohibited release by a health care provider must include more than individually identifiable information but must also include information relating to medical history, mental or physical condition, or treatment of the individual.”<sup>43</sup>

As to the flip side of the question, whether medical information that is disassociated from patient identifying information is encompassed by the CMIA, the plain language of the CMIA indicates that it is not, as the definition of “medical information” requires that the information include “individually identifiable information.”<sup>44</sup> In 2014, this issue was addressed by the California Court of Appeal, Second Appellate District, which considered the propriety of disclosing medical information with patient information redacted.<sup>45</sup> In *Snibbe*, an orthopedic surgeon’s postoperative orders were sought in discovery and the trial court ordered a limited production of a subset of those records, with patient identifying information redacted. The surgeon contended that while he had access to the records, he could not produce them without violating California privacy law, the CMIA and HIPAA. The Court of Appeal noted that patient privacy would not be violated when the surgeon failed to show that the postoperative orders could not be successfully redacted of patient identifying information.<sup>46</sup> In addition, the court noted that both the CMIA and HIPAA specifically provide exceptions for disclosure of medical information pursuant to court order.<sup>47</sup> As a result of the court order exception, the court did not directly rule on the issue of whether production of the redacted records would violate the CMIA. However, the court’s general discussion of the lack of privacy violation when individually identifiable information is redacted, along with the plain language of the CMIA definition of “medical information” as including such information should preclude any such disclosures from violating the CMIA.

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40 *Id.*

41 *Id.*

42 *Id.* at 436-37.

43 *Id.* at 437.

44 CAL. CIV. § 56.05(j).

45 *Snibbe v. Superior Court* (Gilbert), 224 Cal. App. 4th 184 (Cal. Ct. App. 2014), *review denied* (May 14, 2014).

46 *Id.* at 195-96.

47 *Id.* at 197-98. (citing CAL. CIV. § 56.10(b)(1) and 45 C.F.R. § 164.512(e)(1)(i)).

### III.WHAT CONSTITUTES UNAUTHORIZED “RELEASE” OF MEDICAL INFORMATION UNDER THE CMIA?

Early CMIA cases typically involved the allegedly unauthorized intentional release of medical information (often to the employer of a plaintiff). In such cases, it was generally clear that the information had been “released” by the defendant. More recently, a number of CMIA cases have involved allegations of data breaches, such as through the theft of a computer or the potential exposure of information resulting from hacking into electronic medical records. In such cases, there has been considerable dispute regarding whether the circumstances of such a breach are sufficient to constitute a “release” of information under the CMIA. As described above, the CMIA obligates a provider of health care, health care service plan, pharmaceutical company or contractor to maintain “medical information . . . in a manner that preserves the confidentiality of the information contained therein,” and any such party “who negligently . . . maintains, preserves, stores, abandons, destroys or disposes of medical information” is subject to specified remedies.<sup>48</sup> These remedies include nominal damages of \$1,000 and/or actual damages from “any person or entity who has negligently *released* confidential information or records.”<sup>49</sup>

The first published opinion to address the interpretation of the term “release” in the context of a data breach was *Regents of University of California v. Superior Court*, 220 Cal. App.4th 549 (Cal. Ct. App. 2013). In *Regents*, the Court of Appeal for the Second District considered the issue of whether there is a distinction between the terms “disclose” and “release” as used in the CMIA, and it held that although there is, the term “release” is to be broadly interpreted and does not require an affirmative act by a health care provider to state a claim under sections 56.101 and 56.36(b).<sup>50</sup> The *Regents* court held, however, that “more than an allegation of loss of possession by the health care provider is necessary to state a cause of action for negligent maintenance or storage of confidential medical information.”<sup>51</sup> The court reasoned that because section 56.369(b) is incorporated into section 56.101(a), a plaintiff cannot bring a private cause of action for damages for violation of section 56.101 unless a “release” occurs.<sup>52</sup> The Court of Appeal further held that a no “release” of medical information would occur unless the plaintiff could demonstrate that her medical records were actually accessed, viewed or used by an unauthorized party.<sup>53</sup>

Likewise in *Sutter Health*, the California Court of Appeal, Third Appellate District, held that plaintiffs could not state a CMIA claim based on the theft of their medical records when they were unable to allege that the information was actually viewed by an unauthorized person.<sup>54</sup> Although the *Sutter Health* holding was similar to that in *Regents*, it was based on different grounds. The *Regents* court reasoned that allegations of theft of

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48 CAL. CIV. § 56.101.

49 CAL. CIV. § 56.36(b) (emphasis added).

50 220 Cal. App. 4th 549, 564–69 (Cal. Ct. App. 2013).

51 *Id.* at 570.

52 *Id.* at 564.

53 *Id.* at 571 n. 15.

54 *Sutter Health v. Superior Court* (Atkins), 227 Cal. App. 4th 1546 (Cal. Ct. App. 2014).

a computer containing medical records were sufficient to state a claim for violation of section 56.101 (negligent maintenance of records), but found that the “release” of medical information triggering the remedy of \$1,000 in nominal damages under section 56.36(b) could not be established without allegations that medical records were actually accessed, viewed or used by someone.<sup>55</sup> The court therefore held that because the standards of section 56.36(b) are incorporated into section 56.101, there could be no private right of action for violating section 56.101 unless a “release” occurred. In contrast, the *Sutter Health* ruling was based on the conclusion that no violation of section 56.101 itself could be established without alleging an actual viewing of the medical information.

In *Sutter Health*, patients brought a class action complaint alleging CMIA claims based on the theft of a computer containing medical records and seeking nominal damages for each class member, amounting to approximately \$4 billion. The *Sutter Health* court ruled that plaintiffs had failed to establish a CMIA claim because they failed to allege that any unauthorized person actually viewed the medical records. The court first considered the legislative intent of the CMIA and noted that the requirements of section 56.101 were intended to protect the confidentiality of individually identifiable medical information, and that to violate the Act, “a provider of health care must make an unauthorized, unexcused disclosure of privileged medical information.”<sup>56</sup> The court reasoned that “no breach of confidentiality takes place until an unauthorized person views the medical information,” as it is the medical information, rather than the change in possession of the physical record, that is the focus of the Act.<sup>57</sup> The court explained that section 56.101 subjects health providers who “negligently” handle medical information to liability, that causation of injury is an essential element of negligence and that under the CMIA the required injury is a breach of confidentiality.<sup>58</sup> Applying this analysis to the allegations against Sutter Health, the court held that because the plaintiffs had not alleged an actual breach of confidentiality through the viewing of the information by an unauthorized party, Sutter Health’s demurrer should have been sustained.<sup>59</sup> Finding that the plaintiffs had not demonstrated a reasonable possibility they could allege an actual breach of confidentiality, the court held that the action must be dismissed.<sup>60</sup>

Following *Regents* and *Sutter Health*, it is apparent that allegations of theft or loss of medical records, without more, are insufficient to establish a CMIA claim. For example, in *Falkenberg v. Alere Home Monitoring, Inc.*, No. 13-cv-00341-JST, 2014 WL 5020431, at \*3 (N.D. Cal. 2014), which had been stayed pending the *Regents* and *Sutter Health* appeals, a federal district court dismissed plaintiffs’ CMIA claims because the complaint failed to allege that confidential medical information stored on a stolen computer had been actually viewed by a third party. Although plaintiffs argued that a different plaintiff might be able to allege such facts, the court found that such argument did “nothing

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55 *Regents*, 220 Cal. App. at 564, 571 n. 15.

56 *Sutter Health*, 227 Cal. App. 4th at 1557 (citing *Brown v. Mortensen*, 253 P.3d 522, 533-34 (Cal. 2011)).

57 *Id.*

58 *Id.* at 1557-58.

59 *Id.* at 1558-59.

60 *Id.* at 1559.

to salvage the complaint.”<sup>61</sup> Thus, under *Falkenberg*, unless a proposed CMIA class has at least one named plaintiff at the onset of an action who can allege that his or her information was actually viewed by a third party without authorization, the case will likely face dismissal at the pleading stage.

#### IV. CMIA ACTIONS FOR EMPLOYMENT DISCRIMINATION FOR FAILURE TO ALLOW ACCESS TO MEDICAL RECORDS

In addition to the CMIA’s requirement that employers who obtain employee medical information handle it confidentially, as described above, the CMIA also provides that “[n]o employee shall be discriminated against in terms or conditions of employment due to that employee’s refusal to sign an authorization [for release of medical information] under this part.”<sup>62</sup> The California Supreme Court interpreted the prohibition and held that an employer’s requirement for drug testing and disqualification of employees (and potential employees) who refused to authorize the physician conducting the test to release the results to the employer did not violate the CMIA.<sup>63</sup> In *Loder*, the California Supreme Court held that “[a]n employer ‘discriminates’ against an employee in violation of section 56.20, subdivision (b) if it improperly retaliates against or penalizes an employee for refusing to authorize the employee’s health care provider to disclose confidential medical information to the employer or others”<sup>64</sup> However, the court did not characterize an employer’s acts in disqualifying an employee or job applicant who refused to permit the employer to be informed of an employer-mandated medical examination or drug test to be discrimination, but rather found that such action was specifically authorized by section 56.20(b) as “necessary in the absence of medical information due to [the] employee’s refusal.”<sup>65</sup> The court noted that otherwise, any employer-mandated medical examination or drug testing procedure would be rendered “totally ineffective if an employer could not treat an individual who refuses to permit the employer to learn the ultimate results of the examination in the same fashion as an individual who refuses to complete the test.”<sup>66</sup>

Employment discrimination under the CMIA was addressed again recently in *Kao v. Univ. of San Francisco*, 229 Cal.App.4th 437 (Cal. Ct. App. 2014), *review denied* (Nov. 25, 2014). In *Kao*, the plaintiff (formerly a tenured professor) was terminated after refusing to participate in a “fitness-for-duty examination” (“FFD”) following various reports that his behavior had frightened other faculty members and school administrators.<sup>67</sup> Kao brought a CMIA claim (among others) in connection with his termination, alleging that he was fired for exercising his rights under the CMIA to refuse to release medical information.<sup>68</sup> The trial court instructed the jury that even “if Kao proved his refusal to

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61 *Falkenberg*, 2014 WL 5020431 at \*3.

62 CAL. CIV. § 56.20(b).

63 *Loder v. City of Glendale*, 927 P.2d 1200 (Cal. 1997), *cert. denied*, 52 U.S. 807 (1997).

64 *Id.* at 861.

65 *Id.*

66 *Id.*

67 229 Cal. App. 4th 437, 439-40 (Cal. Ct. App. 2014).

68 *Id.* at 452.

authorize release of confidential medical information for the FFD was ‘the motivating reason for [his] discharge,’ USF ‘nevertheless avoids liability by showing that . . . its decision to discharge Kao was necessary because John Kao refused to take the FFD examination.’”<sup>69</sup> The Court of Appeal found that the evidence that supported findings that the FFD was job related and consistent with business necessity also supported a finding that his discharge was “necessary” within the meaning of Civil Code section 56.20, subdivision (b).<sup>70</sup> The court reasoned that because the university “unquestionably has a duty . . . to maintain a campus where people can safely work,” and Kao’s behavior was reported to frighten people and “cast a pall of ‘fear and confusion’ over the math department,” the “jury could reasonably find that it was vital to the university’s business to obtain an independent assessment of his fitness for duty.”<sup>71</sup> The court therefore affirmed the judgment against Kao on his CMIA claim.

## V. STANDING TO BRING A CMIA CLAIM

In CMIA cases, it is often difficult for plaintiffs to plead or prove that they have been harmed by the theft, loss or exposure of their medical information. Therefore such actions are often based on a theory that plaintiffs have been exposed to an increased risk of future harm as a result of the breach. In cases brought in federal court, defendants have opposed CMIA actions by challenging plaintiffs’ Article III standing to bring a claim. In some cases, such challenges have been successful. For example, in *Whitaker v. Health Net of Cal., Inc.*, No. CIV S-11-0910 KJM-DAD, 2012 WL 174961 (E.D. Cal. 2012), a district court in the Eastern District of California held that plaintiffs failed to satisfy the injury-in-fact requirement when the only “injury” alleged was a health provider’s loss of server drives containing plaintiffs’ personal and medical information. The plaintiffs in *Whitaker* had contended that they had “standing because of the threat posed by the loss of their information.”<sup>72</sup> The court reasoned that the “only allegation of particularized, real and immediate harm alleged” was plaintiffs’ allegation “that one of them received a letter informing them their minor daughter’s [s]ocial [s]ecurity number ha[d] been misused,” and the daughter was not a member of the class.<sup>73</sup> Based on these allegations, the court held that plaintiffs’ potential harm was “wholly conjectural and hypothetical” and that plaintiffs therefore lacked standing to bring their claims.<sup>74</sup> Plaintiffs in *Whitaker* had attempted to rely on two (non-CMIA) Ninth Circuit cases, *Krottner v. Starbucks Corp.*, 628 F.3d 1139 (9th Cir. 2010) and *Ruiz v. Gap, Inc.*, 380 F. App’x 689 (9th Cir. 2010),<sup>75</sup>

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69 *Id.* at 453.

70 *Id.*

71 *Id.* at 452 (citation omitted).

72 2012 WL 174961, at \* 2.

73 *Id.* at \*3.

74 *Id.* at \*4.

75 The Ninth Circuit *Ruiz* opinion is unpublished and therefore not precedent in the Ninth Circuit. 9TH CIR. R. 36-3(a); *see also* FED. R. APP. R. 32.1.

which the *Whitaker* court found distinguishable.<sup>76</sup> Both of those Ninth Circuit cases involved the targeted theft of laptops from corporate businesses.<sup>77</sup>

In *Krottner*, one of the plaintiffs alleged that someone attempted to open a bank account in his name using his personal information following the theft.<sup>78</sup> “On these facts,” the *Krottner* court found that the plaintiffs had “alleged a credible threat of real and immediate harm stemming from the theft of a laptop containing their unencrypted personal data.”<sup>79</sup> In *Ruiz*, plaintiff “alleged, with support from an expert affidavit, that he was at a greater risk of identity theft.”<sup>80</sup> The *Ruiz* plaintiffs’ expert affidavit asserted that it was “substantially likely that the laptops were stolen for the Gap employee applicant data”<sup>81</sup> which was “easily accessible”<sup>82</sup> on the laptop. In fact, it appears that the *Ruiz* thief had to circumvent “multiple security measures” to gain access to the corporate facility and “passed by a number of other unsecured laptops in the same vicinity” to take a laptop that “was in the process of downloading the sensitive and personal information.”<sup>83</sup>

The plaintiffs in *Whitaker* argued that there was “no difference between theft and loss” but the court held that “[e]ven if that is so, plaintiffs do not explain how the loss here has actually harmed them or threatens to harm them, or that third parties have accessed their data” and found their potential harm was too “conjectural and hypothetical” to support standing.<sup>84</sup>

Following *Whitaker*, similar standing arguments relying on “possible future harm” have been raised in a number of non-CMIA cases. In 2013, the United States Supreme Court issued a ruling in *Clapper v. Amnesty Int’l USA*, 133 S.Ct. 1138 (2013), which some defendants have attempted to use to limit *Krottner*’s impact. In *Clapper*, attorneys and human rights, labor, legal and media organizations brought an action challenging a provision of the Foreign Intelligence Surveillance Act of 1978<sup>85</sup> (“FISA”), and attempted to satisfy the Article III standing requirement based on their fear of impending future

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76 *Whitaker*, 2012 WL 174961 at \*2-\*3.

77 The *Krottner* complaint alleged that “according to the Wisconsin Department of Agriculture, [a] laptop containing personal information was stolen from the [Starbucks] corporate facility.” Class Action Complaint at ¶ 16 *Krottner v. Starbucks Corp.*, 2009 WL 7382290 (W.D. Wash 2009) (No. 2:09-cv-00216-RAJ). And in *Ruiz*, the thief stole the laptop computers from the secured offices of a vendor who processed Gap job applications, bypassing other laptops to take those selected. Expert Report of Dr. Larry Ponemon at ¶¶ 3-4, attached as Ex. N to Rivas Decl. [Dkt.No.105-14], *Ruiz v. Gap, Inc.*, No. CV07-05739-SC, filed November 13, 2007 (N.D. Cal.).

78 *Krottner*, 628 F.3d at 1142.

79 *Id.* at 1143.

80 *Ruiz*, 380 F. App’x at 691.

81 *Ruiz v. Gap, Inc.*, 622 F. Supp. 2d 908, 912-13 (N.D. Cal. 2009), *aff’d*, 380 F. App’x 689, 2010 WL 2170993 (9th Cir. 2010).

82 *Ruiz v. Gap, Inc.*, 540 F. Supp. 2d 1121, 1125 (N.D. Cal. 2008).

83 Expert Report of Dr. Larry Ponemon at ¶¶ 3-4, attached as Ex. N to Rivas Decl. [Dkt.No.105-14], *Ruiz v. Gap, Inc.*, No. CV07-05739-SC, filed Nov. 13, 2007 (N.D. Cal.).

84 *Whitaker v. Health Net of Cal., Inc.*, 2012 WL 174961, \*2, \*4 (E.D. Cal. 2012).

85 50 U.S.C. § 1801, *et seq.*

injury and the costs they incurred to avoid surveillance, among other things.<sup>86</sup> Plaintiffs alleged that parties to their communications were likely targets of FISA surveillance, that enactment of the provision interfered with their ability to obtain information and that they had “undertaken ‘costly and burdensome measures’ to protect the confidentiality of sensitive communications.”<sup>87</sup> The Supreme Court found that the plaintiffs’ theory of standing relied “on a highly attenuated chain of possibilities” and therefore did not satisfy the requirement that the threatened injury must be certainly impending.<sup>88</sup> In addition, the Court held that even if the injury requirement were established, the plaintiffs could not establish that any surveillance injury was traceable to the challenged provision, rather than another mechanism of surveillance.<sup>89</sup> Nor were plaintiffs able to prevail on the basis of measures they had implemented to avoid surveillance, as the Court found that such costs were not incurred to avoid a certainly impending harm, and that such costs suffered the same traceability defect.<sup>90</sup>

In 2014, a district court judge in the Southern District of California found that *Clapper* did not overrule or modify the Article III standard established in *Krottner*.<sup>91</sup> In *Sony Gaming*, plaintiffs brought an action based on allegations that hackers had accessed Sony’s Network and stolen sensitive personal information (including credit card numbers and codes, login information, birth dates, etc.) of millions of customers, and that Sony delayed in notifying its customers of the breach.<sup>92</sup> Sony argued that the allegations were insufficient to establish standing, but the court found that plaintiffs had “plausibly alleged a ‘credible threat’ of impending harm based on the disclosure of their [p]ersonal [i]nformation following intrusion.”<sup>93</sup> Similarly, in *In re Adobe Systems, Inc. Privacy Litigation*, No. 13-CV-05226-LHK, 2014 WL 4379916 (N.D. Cal. 2014), a district court in the Northern District of California held that the plaintiffs’ allegations that hackers deliberately targeted Adobe’s servers and spent several weeks collecting personal data, including usernames and passwords and credit card numbers and expiration dates, and that some of the stolen data had already surfaced on the internet, satisfied standing requirements of both *Krottner* and *Clapper*. The court noted that under those circumstances, there was “no need to speculate” as to whether plaintiffs’ information had been stolen, whether the hackers intended to misuse the stolen information or whether they would be able to do so.<sup>94</sup> The court noted that the danger that the stolen information would be misused could “plausibly be described as ‘certainly impending’” and that the threatened injury could

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86 *Clapper*, 133 S.Ct. at 1145–46.

87 *Id.*

88 *Id.* at 1148.

89 *Id.* at 1149.

90 *Id.* at 1151–52.

91 *In re Sony Gaming Networks and Customer Data Security Breach Litigation*, 996 F. Supp. 2d 942, 961 (S.D. Cal. 2014).

92 *Id.* at 955.

93 *Id.* at 962.

94 *In re Adobe Systems*, 2014 WL 4379916, at \*8.

only be more imminent if the allegations had stated that the information had already been misused.<sup>95</sup>

In contrast, when allegations of harm are more remote, courts have declined to find standing. For example, in *Yunker v. Pandora Media, Inc.*, No. 11-CV-03113 JSW, 2013 WL 1282980, at \*5 (N.D. Cal. 2013), the court found that Yunker's allegations of potential future harm were insufficient to establish standing. In that case, the plaintiff claimed violations of the UCL and various privacy laws based on allegations that defendant did not anonymize his personal information (consisting of his age, gender, location and user id), even though it represented that it would, and further permitted advertising libraries to access the personal information.<sup>96</sup> The court found the case distinguishable from *Krottner* because Yunker did not allege the disclosure of sensitive financial information, such as a social security number or a credit card number, nor had he "alleged that anyone has breached Pandora's servers."<sup>97</sup> The court found that allegations that the information was provided to advertising libraries were insufficient to establish standing, in that "at best" such factual allegations "show it might be possible that, in the future, he could be the victim of identity theft," and that the possibility of future harm was "insufficient to establish standing."<sup>98</sup> Likewise, in the *In re Google, Inc. Privacy Policy Litigation*, No. 5:12-CV-01382, 2014 WL 3707508, at \*6 (N.D. Cal. 2014), a district court held that allegations of risk of future harm from the unauthorized disclosure of commingled user data, such as account information with search queries, was too conjectural to satisfy standing requirements. The court distinguished the case from *Krottner*, as the disclosure there "was a result of laptop theft containing sensitive personal information of almost 100,000 Starbucks employees," and further noted that in *Google* no criminal activity was alleged.<sup>99</sup>

Thus far, it is unclear how significant an impact *Clapper* will have on the Article III standing threshold for privacy cases. Based on the recent cases discussed above, breaches that appear to be targeted and deliberate attempts to access the personal data at issue, such as in *Krottner*, *Sony Gaming*, and *Adobe*, may be more likely to lead to allegations that satisfy the Article III standing requirement. In contrast, for incidents in which the data is potentially available for access but there is no evidence of theft, such as *Google*, *Yunkers*, or *Whitaker* (or potentially in theft cases in which there is nothing to suggest that personal information is the target of the theft, such as random equipment theft),<sup>100</sup> there may not be sufficient allegations to establish standing to bring an action. In addition, in a number of cases it appears that the standing analysis was impacted by the sensitivity

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95 *Id.*

96 *Yunker*, 2013 WL 1282980, at \*1.

97 *Id.* at \*5.

98 *Id.*

99 *In re Google*, 2014 WL 3707508, at \*6.

100 See, e.g., *In re Science Applications Int'l Corp. (SAIC)*, No. 12-347 JEB, 2014 WL 1858458 (D.C. 2014) (dismissing privacy claims of most plaintiffs based on allegations of theft of personal information on several data tapes stolen from an employee's car along with a GPS system and stereo on the grounds that mere loss of data is insufficient to confer standing, but finding that two plaintiffs plausibly alleged that their data was accessed or abused when personal information similar to that contained on the tapes was misused).

of the information stolen or lost—the more sensitive the information and more likely to lead to damages, the more likely that standing will be found. With respect to medical information, one might argue that it is all sensitive, but even so, there would likely be substantial variation in the sensitivity of the types of data at issue (e.g., record of sexually transmitted disease versus record of a dermatologist visit). In addition, with the recent decisions in *Sutter Health* and *Regents*, the standing argument may have less significance in CMIA cases, as the standards for bringing such an action now appear higher than those for establishing standing. However, Article III standing may still be a viable issue in any medical information breach action that is brought under other privacy laws.

## VI. OTHER CALIFORNIA PRIVACY PROVISIONS TARGETED AT MEDICAL INFORMATION

There are a number of other relevant laws targeting the confidentiality of California residents' medical information.

Health and Safety Code section 1280.15(a): This section requires that certain clinics, health facilities, home health agencies and hospices “shall prevent unlawful or unauthorized access to, and use or disclosure of, patients’ medical information” and establishes an administrative penalty of up to \$25,000 per patient, and up to \$17,000 per each subsequent occurrence of unlawful or unauthorized access, use or disclosure of the patient’s medical information.<sup>101</sup> In addition, the health care providers subject to this statute must notify the California Department of Public Health (“CDPH”) and all affected patients (or their representatives) within fifteen days of the breach (unless asked not to do so by law enforcement).<sup>102</sup> Violations of the disclosure requirement are subject to administrative penalties of up to \$250,000 per incident (in combination with those authorized in subsection (a)).<sup>103</sup> The CDPH relies on this provision to allow it to evaluate breaches of confidentiality and seek penalties on an ongoing basis.<sup>104</sup> In addition to its use by the CDPH, because the statute adopts a slightly different formulation from that of the CMIA (as it specifically prohibits unauthorized access), section 1280.15 has been used to target unauthorized activities of health care employees.<sup>105</sup>

Health and Safety Code section 1280.18(a): This section requires that “[e]very provider of health care shall establish and implement appropriate administrative, technical, and physical safeguards to protect the privacy of a patient’s medical information” and “shall reasonably safeguard confidential medical information from any unauthorized access or unlawful access, use, or disclosure.”<sup>106</sup> The CDPH may assess administrative fines against any person or provider of health care for any violation of section 1280.18 or of the CMIA,

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101 CAL. HEALTH & SAFETY § 1280.15(a).

102 *Id.* § 1280.15(b),(c).

103 *Id.* § 1280.15(d).

104 *See, e.g.*, List of Penalties, CAL. DEPT. OF PUB. HEALTH, <http://www.cdph.ca.gov/> (search site for “breach of confidentiality” for a list of penalties issued by year).

105 *See, e.g.*, *Scholink v. Salinas Valley Memorial Healthcare System*, No. H040057, 2014 WL 6991708, at \*3 (Cal. Ct. App. 2014).

106 CAL. HEALTH & SAFETY § 1280.18(a).

in the same amount as provided in Civil Code section 56.36.<sup>107</sup> The provision allowing for fines does not apply to clinics, health facilities, home health agencies and hospices subject to section 1280.15, above.<sup>108</sup>

California Civil Code section 1798.81.5: This section requires businesses that own, license, or maintain “personal information” (which includes, among other things, a subset of “medical information” subject to the CMIA)<sup>109</sup> about California residents 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.”<sup>110</sup> In addition, these businesses must require that any contractors to which they disclose such information agree by contract to maintain such security procedures and practices.<sup>111</sup> As noted above, if these businesses are also either “organized for the purpose of maintaining medical information” or offer “software or hardware to consumers, including a mobile application or other related device that is designed to maintain medical information” (e.g., personal health record vendors), they are also deemed to be “provider[s] of health care” for the purpose of subjecting them to the CMIA.<sup>112</sup> However, while other “provider[s] of health care” under CMIA are exempt from the security requirements of section 1798.81.5,<sup>113</sup> that exemption does not apply to such personal health record vendors and others.<sup>114</sup>

California Civil Code section 1798.82: This is California’s data breach reporting law, which includes “medical information” within the definition of “personal information” when accompanied by “[a]n individual’s first name or first initial and last name” if one or the other is not encrypted.<sup>115</sup> Pursuant to section 1798.82(a), a business or state agency must notify any California resident whose unencrypted personal information, as defined, was acquired, or reasonably believed to have been acquired, by an unauthorized person. In addition, pursuant to section 1798.82(g), a person or business that is required to issue a security breach notification to more than 500 California residents as a result of a single breach of the security system is required to electronically submit a copy of the security breach notification, excluding any personally identifiable information, to the Attorney General.

California Civil Code section 1798.91: This section prohibits a business from seeking to obtain medical information from an individual for direct marketing purposes without, (1) clearly disclosing how the information will be used and shared, and

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107 *Id.* § 1280.17(a)(1).

108 *Id.* § 1280.17(a)(2).

109 CAL. CIV. § 1798.81.5(d)(2) defines “medical information” as “any individually identifiable information, in electronic or physical form, regarding the individual’s medical history or medical treatment or diagnosis by a health care professional.”

110 *Id.* § 1798.81.5(b).

111 *Id.* § 1798.81.5(c).

112 *Id.* §§ 56.06(a), (b).

113 *Id.* § 1798.81.5(e)(1).

114 *Id.* §§ 56.06(a),(b).

115 *Id.* § 1798.82.

(2) getting the individual's consent.<sup>116</sup> If information is requested orally, an audio recording of the consent must be retained for two years after the conversation.<sup>117</sup> This section is distinguishable from the CMIA in that it does not apply to a provider of health care, health care service plan, or contractor as defined in Civil Code section 56.05.<sup>118</sup> This section has not been heavily relied on in litigation, perhaps because of difficulties associated with establishing any injury resulting from violations.

California Health & Safety Code section 120980: This section imposes civil penalties upon the negligent or willful and malicious disclosure of the results of an HIV test to any third party in a manner that identifies or provides identifying characteristics of the person to whom the test results refer, and provides for the possibility of criminal sanctions if the disclosure results in economic, bodily, or psychological harm to that person.<sup>119</sup> There are exceptions to this rule, including one permitting the physician who ordered the test to include the result in the patient's medical record and then to disclose that medical record to certain providers of care, for the purposes of diagnosis, care, or treatment.<sup>120</sup>

California Welfare and Insurance Code section 5328 of the Lanterman-Petris-Short ("LPS") Act: This section contains a confidentiality provision protecting "information and records obtained in the course of providing services" relating to voluntary and involuntary mental health assessment and treatment.<sup>121</sup> Section 5328 *et seq.* provide detailed restrictions on the disclosure of records, limiting who, and for what purposes, information may be disclosed and detailing the consent process for various types of disclosures.<sup>122</sup> Disclosure of information in violation of section 5328 is actionable under California Welfare and Insurance Code section 5330, which provides that "any person" may bring an action for damages for release of his or her confidential information in violation of the LPS Act for: (1) the greater of \$10,000 or treble damages if the release was willful and knowing; or (2) for both \$1,000 in statutory damages (without requiring a showing of actual damages) and the amount of actual damages for negligent release.<sup>123</sup> A plaintiff may also recover court costs and reasonable attorney's fees.<sup>124</sup>

## VII. UNFAIR COMPETITION LAW CLAIMS

In addition to CMIA claims, some plaintiffs have asserted claims under the UCL associated with alleged losses or theft of medical information. To state a claim under the UCL, a plaintiff must demonstrate that some business act or practice is either "unlawful,

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116 *Id.* § 1798.91(c).

117 *Id.* § 1798.91(b)(2).

118 *Id.* § 1798.91(d).

119 CAL. HEALTH & SAFETY § 120980.

120 *Id.* § 120980(l).

121 CAL. WELF. & INST. § 5328.

122 *Id.* §§ 5328.01-5328.06.

123 *Id.* § 5330(a), (b).

124 *Id.* § 5330(d).

unfair or fraudulent.”<sup>125</sup> In *California Consumer Health Care Council v. Kaiser Foundation Health Plan, Inc.*,<sup>126</sup> a plaintiff sued Kaiser, alleging that its practice of transmitting allegedly “irrelevant” medical information to its attorneys concerning Kaiser patients who had brought, or might be contemplating, medical malpractice claims against Kaiser violated the UCL. The plaintiff alleged that Kaiser “engaged in the following practices: (1) ‘disclosing medical information regarding patients without first obtaining such patient’s authorization or otherwise being authorized to do so under the law’; (2) ‘sharing, selling or otherwise using medical information regarding such patients for a purpose not necessary to provide health care services to the patients’; and (3) ‘concealing’ these practices from patients.”<sup>127</sup> These actions allegedly violated the UCL under all three prongs as it was: (1) unlawful because Kaiser violated the CMIA and rights to privacy under the California Constitution; (2) unfair because the harm to patients outweighs the “utility” of Kaiser’s acts; and (3) fraudulent and misleading because Kaiser represented that it used and disclosed patient medical information only in accordance with the law.<sup>128</sup> The court held that the alleged practices were not unlawful under the UCL because the disclosure fell within an exception to the CMIA permitting disclosure to persons responsible for defending professional liability claims for Kaiser, and that the exception did not exclude “irrelevant” information.<sup>129</sup> The court likewise held that plaintiff’s constitutional privacy claim failed because she did not have a reasonable expectation of privacy in light of the CMIA exception, and because a patient signaling an intent to bring a malpractice claim cannot reasonably expect his or her information to be kept from the health care provider’s attorneys.<sup>130</sup> In addition, the court found that the UCL claim was precluded by the injury requirement of section 17200, as the plaintiff was a public interest organization and did not allege that it was authorized to represent any Kaiser patient who had been or was likely to be injured by the policy.<sup>131</sup>

More recently, plaintiffs brought a UCL claim in *Falkenberg v. Alere Home Monitoring, Inc.*,<sup>132</sup> which was denied for lack of standing. In *Falkenberg*, the plaintiffs’ UCL claim was based on the theory that the theft of an employee’s laptop containing confidential medical information resulted in lost money or property consisting of “expenditures on credit monitoring, increased risk of identity theft, and expenditures made to Defendant based on the reasonable expectation that Defendant would maintain the privacy of the personal and medical information of the Plaintiffs and the class.”<sup>133</sup> The court first characterized the injury requirement under the UCL (loss of money or property) as “more stringent than the federal Article III standing requirement, [which] ‘may be intangible and need

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125 CAL. BUS. & PROF. § 17200.

126 42 Cal. App. 4th 21 (2006).

127 *Id.* at 25-26.

128 *Id.* at 26.

129 *Id.* at 28 (citing CAL. CIV. § 56.10(e)(4)).

130 *Id.* at 32.

131 *Id.* at 33-34.

132 No. 13-cv-00341-JST, 2014 WL 5020431 (N.D. Cal. Oct. 7, 2014).

133 *Id.* at \*4.

not involve lost money or property’ . . . .”<sup>134</sup> The court then compared the claim to that brought in *Ruiz v. Gap, Inc.*,<sup>135</sup> which was based on allegations that plaintiffs lost property when their confidential personal information was contained on stolen laptops.<sup>136</sup> The court noted that in *Ruiz*, the plaintiffs failed to present “any authority to support the contention that unauthorized release of personal information constitutes a loss of property,” and noted that same was true in *Falkenberg*, “finding that in the absence of any such authority, Plaintiffs have not alleged any loss of property.”<sup>137</sup> The court also found that while the plaintiffs claimed to have expended money on credit monitoring, the defendant had offered one year of credit monitoring to all plaintiffs, thus “[w]ithout specifically identifying what expenditures were necessary in excess of this offer, Plaintiffs cannot establish what money was lost.”<sup>138</sup>

Because of the high potential damages associated with the CMIA, in contrast to the equitable remedies available under the UCL, UCL claims have not typically been a primary means for seeking relief in medical information breach cases. In addition, the injury requirement makes UCL actions challenging, as it may be difficult to tie any particular financial injury to the lost or stolen information. Consequently, for a UCL claim to survive in a medical information loss, theft or breach case, plaintiffs will need to allege sufficient facts to establish exactly what money or property was lost and how such a loss “resulted from” the alleged breach.

## VIII. UNRESOLVED ISSUES AND FUTURE TRENDS

### Violations of Notice Requirements

The CMIA does not contain its own notice requirement in the event of a data breach, but disclosures encompassed by the CMIA remain subject to the notification provisions of California Civil Code section 1798.82(d).<sup>139</sup> The disclosure is required to be made “in the most expedient time possible” (with exceptions for delay due to law enforcement agency requirements for a delay so as not to impede an investigation).<sup>140</sup> In addition to the notification, when the notifying party was the source of the breach it must also offer to provide appropriate identity theft prevention and mitigation services for at least 12 months if the information exposed (or that may have been exposed) included a social security or California driver’s license or identification card number and an individual’s last name, with first name or initial, and either the names or data elements were not

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134 *Id.*

135 540 F. Supp. 2d 1121, 1125 (N.D. Cal.2008), *aff’d*, 380 Fed.Appx. 689 (9th Cir. 2010).

136 *Falkenberg*, 2014 WL 5020431, at \*4

137 *Id.* (quoting *Ruiz*, 540 F. Supp. 2d at 1127).

138 *Id.*

139 CAL. CIV. § 1798.82(d). In contrast, covered entities and business associates subject to HIPAA that comply with the notice requirements under the HIPAA Data Breach Notification (section 13402(f) of the Federal Health Information Technology for Economic and Clinical Health Act) are deemed to have complied with the disclosure requirements of California Civil Code section 1798.82(d), but not the statute’s other requirements such as identity theft protection, if applicable. 45 C.F.R. § 164(D).

140 *Id.* § 1798.82(a), (c).

encrypted.<sup>141</sup> In many cases, when lawsuits are filed after notification, they target not only laws prohibiting disclosure, but also violations of the notification requirements, such as unreasonable delay, or insufficient compliance with the content requirements for notice. California Civil Code section 1798.84(b) provides that “any customer injured by a violation of this title may institute a civil action to recover damages.”<sup>142</sup>

It is possible that an identity theft type of injury could occur from defects in the notice procedure or timing (e.g., identity theft occurred after breach was identified but before compliant notice was sent and harm therefore might have been prevented absent the notice defects). However, in most cases, this type of injury is not alleged, or cannot be established. Rather, plaintiffs may attempt to satisfy the “injury” requirements by pleading an “informational injury”: essentially, that injury resulted from not receiving information to which affected persons are statutorily entitled. Plaintiffs have not met with much success in raising this argument in California. In *Boorstein v. CBS Interactive, Inc.*,<sup>143</sup> the most recent published decision addressing the requirement for “injury” under section 1798.84 in the context of violations of California’s Shine the Light Law<sup>144</sup> (requiring certain disclosures upon customer request when personal information has been disclosed and used by third parties for marketing purposes), the court held that no California cases recognize the “informational injury” the plaintiff allegedly suffered.<sup>145</sup> However, in that case the plaintiff had not requested the informational notice, as required by the statute, and so the situation would not be identical to an alleged violation of section 1798.82(d), in which notice is required without any action by the persons affected. Thus, although the “informational injury” argument has not succeeded in any Shine the Light case applying section 1798.84 following *Boorstein*, it is unclear whether a successful argument could potentially be made in asserting violations of section 1782(d).<sup>146</sup>

#### Other Potential Covered Parties

In 2013 (effective January 1, 2014), the CMIA was amended to clarify its application to personal health record (“PHR”) vendors.<sup>147</sup> The emergence of various internet-based businesses offering patients their own means of storing and managing their medical information, often through mobile applications, raised privacy concerns in the legislature.<sup>148</sup> Although certain businesses organized for the purposes of maintaining

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141 *Id.* § 1798.82(d)(2)(g).

142 *Id.* § 1798.84(b).

143 165 Cal. Rptr. 3d 669 (Cal. App. Ct. 2013).

144 CAL. CIV. § 1798.83.

145 *Boorstein*, 165 Cal. Rptr. 3d at 679-681.

146 *See, e.g., Baxter v. Rodale, Inc.*, 555 Fed. Appx. 728 (9th Cir. 2014) (plaintiff failed to state a claim); *Murray v. Time Inc.*, 554 Fed. Appx. 654 (9th Cir. 2014) (dismissed for lack of standing); *King v. Conde Nast Publications*, 554 Fed. Appx. 545 (9th Cir. 2014) (dismissed for lack of standing); *Miller v. Hearst Communications Inc.*, 554 Fed. Appx. 657 (9th Cir. 2014) (dismissed for lack of standing). All of these decisions are unpublished.

147 A.B. 658, chap. 296, 2013 Leg. (Cal. 2013), amending Cal. Civ. § 56.06(b); *see also* Analysis of Assembly Judiciary Committee of A.B. 658, at 1 (Cal. Apr. 15, 2013).

148 A.B. 658, chap. 296, 2013 Leg. (Cal. 2013); Analysis of Assembly Judiciary Committee, at 1,3 (Cal. Apr. 15, 2013).

medical information have been subject to the CMIA since 1993, the amendment was intended to ensure that the CMIA would apply to all PHR vendors that maintain medical information, including through mobile applications provided to patients, whether or not the business was organized for that purpose.<sup>149</sup>

During the legislative process, industry representatives expressed a concern that the amendment be clearly defined so as not to encompass those businesses that maintain personal health information generated directly by consumers, such as personal fitness information.<sup>150</sup> Because “medical information” is defined under the CMIA as limited to information “*in possession of or derived from* a provider of health care, health care service plan, pharmaceutical company, or contractor”<sup>151</sup> information contributed by a patient directly would not appear to be encompassed.<sup>152</sup> However, the bill’s author addressed the concern by clarifying that the provisions added by the bill only apply to medical information that originates with a health care provider, health care service plan, or medical contractor.<sup>153</sup> The final amendment limited the covered businesses to those offering “software or hardware to consumers, including a mobile application or other related device that is designed to maintain medical information.”<sup>154</sup>

As health monitoring equipment and applications become increasingly advanced, and the level of personal health information maintained by non-health care entities increases, it is likely that ongoing privacy concerns about health information created by an individual will prompt future legislation. Currently, personal fitness data is distinguished from covered medical information on the ground that personal fitness data is not in the hands of, or coming from, specific types of health care providers. As technology continues to develop and transfer of electronic health information between patients and health care providers becomes more common, it may become increasingly difficult to maintain the distinction between information possessed by, or derived from, health care providers and that generated by a patient. Future legislation may potentially be initiated to increase protections on personal fitness data, whether through modification of the CMIA or by bolstering California’s other privacy protection statutes, such as Civil Code section 1798.81.5, which already requires implementation of “reasonable security procedures and practices” for protecting Californians’ personal information which is

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149 *Id.*

150 A.B. 658, chap. 296, 2013 Leg. (Cal. 2013); Analysis of Assembly Committee on Judiciary, at 4 (Cal. Apr. 15, 2013).

151 “Contractor” means any person or entity that is a medical group, independent practice association, pharmaceutical benefits manager, or a medical service organization and is not a health care service plan or provider of health care. “Contractor” does not include insurance institutions as defined in subdivision (k) of Section 791.02 of the Insurance Code or pharmaceutical benefits managers licensed pursuant to the Knox-Keene Health Care Service Plan Act of 1975 (Chapter 2.2 (commencing with Section 1340) of Division 2 of the Health and Safety Code). CAL. CIV. § 56.05(d).

152 CAL. CIV. § 56.05(j) (emphasis added).

153 CAL. CIV. § 56.06(b), citing Cal. Civ. § 56.05(j); see also A.B. 658, chap. 296, 2013 Leg. (Cal. 2013); Analysis of Assembly Judiciary Committee, at 4 (Cal. Apr. 15, 2013).

154 CAL. CIV. § 56.06(b).

defined to include “medical information.”<sup>155</sup> The term “medical information” under section 1798.81.5 is defined as “any individually identifiable information, in electronic or physical form, regarding the individual’s medical history or medical treatment or diagnosis by a health care professional.”<sup>156</sup> Privacy rights organizations may seek to expand that definition in the future to include information regarding a person’s physical condition. Currently, Civil Code section 1798.81.5(e) specifically excludes entities regulated by the CMIA and HIPAA.

### The Treatment of Patient Lists From Specialized Health Care Providers

Although one California Court of Appeal (in *Eisenhower*) has held that release of individually identifying information relating to patients, when divorced from any specific medical information, is not actionable, many important issues remained unresolved.<sup>157</sup> For example, the *Eisenhower* decision expressly declined to address whether the fact that a person was a patient of a particular healthcare provider, such as a physician whose specialty might be readily determined, or a specialized facility such as an AIDS clinic, may rise to the level of medical information.<sup>158</sup> There are numerous other situations where this issue could arise, for example, infertility clinics, obesity treatment clinics, sleep disorder centers, mental health facilities, etc. Likewise, depending on the nature of a physician’s specialty, the disclosure of a patient’s name associated with a particular physician might be considered disclosure of healthcare information. While these issues have not yet been resolved, healthcare providers and others subject to the CMIA are well advised to treat patient lists as confidential and protect them against disclosure.

### Vendor Disclosure Issues

Under the CMIA, information may be disclosed to certain contractors and service providers. In fact, many health care providers rely heavily on third-party vendors for data processing, billing or other administrative services. Under the HIPAA Privacy Rules, covered entities and business associates may be held liable under certain circumstances for the acts of their agents,<sup>159</sup> but it remains unclear the extent to which health care providers will be held liable under the CMIA for the breaches of their vendors. In addition, unlike HIPAA, which has established a specific “minimum necessary standard” that applies to uses and disclosures of protected health information by covered entities and their business associates,<sup>160</sup> the standards for disclosure under the CMIA are less clear. For example: (1) “information may be disclosed to providers of health care, health care service plans, contractors, or other health care professionals or facilities for purposes of diagnosis or treatment of the patient”; (2) “information may

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155 CAL. CIV. §§ 1798.81.5(b), 1798.81.5(d)(1).

156 *Id.* § 1798.81.5 (d)(D)(2).

157 *See, e.g., Eisenhower Medical Center*, 172 Cal. Rptr. 3d 165 (Cal. App. Ct. 2014) (holding that patient lists do not constitute medical information); *Maureen K v. Tuscka, M.D.*, 155 Cal. Rptr. 3d 620 (Cal. App. Ct. 2013) (holding that description of patient’s medical history without information revealing the patients identity did not violate CMIA).

158 *Eisenhower*, 172 Cal. Rptr. 3d at 171, n.3-4.

159 45 C.F.R. § 160.402(c).

160 45 C.F.R. §§ 164.502(b), 164.514(d).

be disclosed to an insurer, employer, health care service plan [etc.] *to the extent necessary to allow responsibility for payment to be determined and payment to be made*"; and (3) "information may be disclosed to a person or entity that provides billing, claims management, medical data processing, or other administrative services" seemingly without qualification.<sup>161</sup> Future cases may help clarify disclosure limitations and liability under the CMIA with respect to its relationship to third-party vendors.

### Class Certification

The potential release of medical information, whether occurring through improper disposal of records, computer hacking or theft, frequently involves mass data. However, there has yet to be any published decision in which a CMIA class has been certified. Following the decisions in *Regents and Sutter*, such certification appears increasingly unlikely – at least for those classes based on theft of information. Under current law, the CMIA now requires that plaintiffs plead and prove that their medical information was actually viewed by an unauthorized individual. For cases involving physical thefts, such as those of computers, drives or disks, such viewing will likely be difficult to establish unless the thief is identified and his viewing of the information can somehow be confirmed. For instances of hacking, there may be an electronic record of viewing, but problems may still exist at the class certification phase. As in many other types of privacy-related actions, even if a class member's information is viewed, there may be difficulties associated with establishing that any harm resulted from the viewing. Even if one or more members of a putative class experiences misuse of their personal or medical information, it may be difficult to establish a correlation between the theft or breach and any privacy-related injury. In this era of pervasive electronic presence, many people have had their information disclosed through a wide variety of data breaches and/or through self-disclosure. Any named plaintiff will likely be scrutinized closely for individualized issues associated with his or her data history. In addition, it has yet to be determined the extent to which each class member will have to establish that his or her information was viewed, which could potentially defeat class certification. In instances of data breaches involving millions of individuals, it would appear unlikely that all data would be uniformly accessed and viewed.

Plaintiffs seeking class certification also may encounter limitations in obtaining information from potential class members to support certification arguments, as even disclosure of putative class member names may be limited, depending upon the nature of the class. If the putative class is one which is identified by inclusion in specific health provider records, such as those of an infertility or weight loss clinic or a particular physician, medical information about the patient may arguably be inferred from the class list, and the court may preclude provision of patient lists to plaintiff's counsel. For example, in one non-CMIA case, the California Court of Appeal, Second Appellate District, held that in a class action case involving patients who received incorrect medication for syphilis, constitutional rights to privacy prohibited disclosure of the putative class members' names and addresses to class counsel without affirmative consent.<sup>162</sup> The court

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161 CAL. CIV. § 56.10(c) (emphasis added).

162 *Los Angeles Gay and Lesbian Center v. Superior Court* (Bomersheim), 125 Cal. Rptr. 3d. 169 (Cal. Ct. App. 2011).

held that “no class members’ name, identifying information or medical information is to be disclosed without that class members’ [sic] prior authorization,” and that the trial court must “take steps to ensure that the names, identifying information, and medical information of the class members are not subject to disclosure under any circumstances in any public proceeding or public filing.”<sup>163</sup> Although names and contact information for class members may not necessarily require the same level of protection in all CMIA cases, this case illustrates that contacting putative class members in some circumstances (e.g., when the nature of the class itself discloses personal health information) in order to obtain information to assist with class certification may be challenging. Even though solutions may be found, such as through coding or redacting information, these methodologies impose additional burden and cost.

## **IX. CONCLUSION**

Barring dramatic advances in technology or human behavior, data breaches involving medical information should be expected to continue to pose serious risks. Although recent decisions in the California Court of Appeal have made it more difficult for class action plaintiffs to pursue lawsuits against health care providers and others that sustain breaches of medical information, California law continues to make special demands upon those that create or receive, or use, disclose, or maintain, medical information. Some of these demands go beyond what may be required of those parties under HIPAA and apply to a number of parties that are not subject to HIPAA. While those who work with medical information may welcome the limited protection from lawsuits that these recent court cases offer, it will remain important to stay abreast of future developments, both in the legislature and in the courts, regarding this rapidly evolving subject.

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163 *Id.* at 186.

# THE STATE OF DATA-BREACH LITIGATION AND ENFORCEMENT: BEFORE THE 2013 MEGA BREACHES AND BEYOND

By *Evan M. Wooten*<sup>1</sup>

Over the past year, data breach and security have come to dominate the privacy law landscape. High-profile breaches at numerous retailers leading into the 2013 holiday season brought widespread awareness to risks that businesses have been navigating for the better part of a decade, if not longer. Consumers awoke to the reality that electronic systems are under constant threat of intrusion from malware, hackers, and foreign states. Lawmakers reacted to consumer alarm and unrest with calls for accountability and reform. Industry groups, governmental entities, and information-sharing systems representing public and private bodies increased efforts to identify threats and enhance security. And, of course, litigation ensued.

After a brief overview, this article will explore (i) traditional data-breach litigation and public enforcement efforts; (ii) the state and federal response to recent high-profile breaches; and (iii) significant developments in case law and enforcement since the 2013 mega breaches. The 2014 holiday season brought more high profile breaches, bringing the issue back into focus and ensuring additional litigation. Data-breach lawsuits are nothing new, but there can be no question that the data-security landscape is changing. The question is, will changes in public perception and awareness auger different results in litigation and enforcement? Thus far, the answer has been mostly ‘no,’ but several developments warrant attention and bear watching in the future. Practitioners will want to familiarize themselves with existing law and keep close tabs on evolving issues.

## DATA BREACH OVERVIEW

Corporate legal spending on data security in the United States increased from \$1 billion in 2013 to \$1.4 billion in 2014, and is expected to climb to \$1.5 billion in 2015—a 7.9% increase that dwarfs the next highest practice area (2.7% for class actions).<sup>2</sup> The issue is firmly on the radar of attorneys, businesses, regulators, and legislators. But data breach is not a new phenomenon. As Senator Rockefeller of West Virginia has observed, “[f]or nearly a decade, we’ve had major data breaches at companies both large and small.”<sup>3</sup> Companies in the United States have been hit particularly hard, at least financially speaking. In 2012, the United States “experienced the highest total average cost at more than \$5.4 million” per data breach, or \$188 per compromised record, costs that include detection, escalation, customer notification, remediation, and lost business, among other

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1 Evan Wooten is an associate at Mayer Brown LLP, a member of Mayer Brown’s consumer class action and commercial law groups, and co-editor of Mayer Brown’s Privacy and Security publications and newsletter. This article reflects the views of the author and not necessarily those of Mayer Brown LLP, its attorneys, or its clients.

2 BTI CONSULTING GROUP, INC., BTI LEGAL SPENDING OUTLOOK 2015: CHANGES, TRENDS AND OPPORTUNITIES FOR LAW FIRMS (2014).

3 *Protecting Personal Consumer Information from Cyber Attacks and Data Breaches: Hearing Before the S. Comm. on Commerce, Sci. & Transp.*, 113th Congress (2014) (statement of Sen. John D. “Jay” Rockefeller IV, Chairman, S. Comm. on Commerce, Sci. & Transp.).

things.<sup>4</sup> These figures do not include breaches of more than 100,000 consumer records—what the Ponemon Institute refers to as “mega” breaches—because those breaches had, in the past, been atypical.<sup>5</sup> But mega breaches are becoming more common or, at least, more visible.

The mega breaches of 2013 and 2014 cast new light on data-breach litigation, but data-breach lawsuits are nothing new. The earliest examples of data breach—at least those that reached the courts—involved stolen or mislaid laptops and other hard assets. In a typical fact pattern, employees would leave laptop computers in cars or hotel rooms, and thieves would make off with the hard assets and any data they contained. Sometimes the thefts were the result of concerted criminal effort, other times the result of employee carelessness. Although it is tempting to view these scenarios as outdated and inconsequential by comparison to sophisticated cyber-attacks, recent data suggests that human error (35%) and system malfunction (29%) are nearly as common causes of data breach as malicious or criminal attacks (37%),<sup>6</sup> and mislaid laptops are as common causes of litigation as malware, even in 2014. As discussed below, the context and cause of a breach could play an important role in judicial outcomes. Principles developed in the early data-breach cases continue to hold sway, for the most part, though several recent cases have departed from traditional views.

#### TRADITIONAL RULES OF PRIVATE DATA-BREACH LITIGATION

As discussed in greater detail below, there is no general data-security statute in the United States. Although some federal statutes, such as the Health Insurance Portability and Accountability Act (“HIPAA”)<sup>7</sup> and the Gramm–Leach–Bliley Act (“GLBA”),<sup>8</sup> address data security in specific industries (health care and financial services, respectively) and most states have data-breach notification laws (which are expanding in scope), most data-breach lawsuits begin in state court, alleging causes of action under state common law.<sup>9</sup>

The basic allegation underlying most data-breach complaints is that companies took inadequate steps to safeguard consumer data, which resulted in or contributed to a breach. The particular breach could take many forms, e.g., malicious intrusion or probe into electronic systems, such as by malware or virus; compromise of point-of-sale technologies, such as credit-card readers or ATMs; rogue employees disclosing company records for profit or other impermissible motive; laptops and other company data left unsecured or unattended; or corporate espionage. Similarly, the breached data can take many forms: names, addresses, social security numbers, medical records, personal

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4 PONEMON INSTITUTE, 2013 COST OF DATA BREACH STUDY: GLOBAL ANALYSIS 1, 5 (2013), available at <http://www.ponemon.org/local/upload/file/2013%20Report%20GLOBAL%20CODB%20FINAL%205-2.pdf>.

5 *Id.* at 3.

6 *Id.* at 7.

7 29 U.S.C. § 1181 *et seq.*

8 15 U.S.C. § 6801 *et seq.*

9 This article does not address data-security lawsuits in contexts subject to specific legislation, such as HIPAA or the GLBA.

identification numbers (“PINs”), passwords, credit card numbers, and other personally identifiable information (“PII”). Consumers usually claim injuries in increased risk of identity theft and/or the diminution in value of their PII.

Although the basic allegations were essentially the same, early data-breach cases tested numerous theories of recovery, most commonly: (1) breach of contract, express or implied; (2) unjust enrichment; (3) invasion of privacy; (4) negligence; (5) misrepresentation (negligent or intentional); (6) infliction of emotional distress (negligent or intentional); and (7) violation of state consumer protection, unfair competition, and/or deceptive practices laws—analogue to the Federal Trade Commission Act (“FTCA”),<sup>10</sup> such as California’s Unfair Competition Law (“UCL”),<sup>11</sup> sometimes called “little” or “mini-FTC” acts. Courts have generally rejected each of these theories, using reasoning that can be summed up as follows: data-breach plaintiffs, who allege that their private information was compromised, cannot allege or establish that their data was actually purloined, disseminated, or misused.

Breach of contract allegations are generally dismissed for the simple reason that companies do not promise, as a matter of contract, to safeguard or protect consumer data from third-party intrusion.<sup>12</sup> Historically, courts have refused to construe generic statements on company websites or promotional materials—that consumer data was safe or protected by certain security measures, such as firewalls or encryption—as express contractual obligations, or to imply contracts from such statements or the customer relationship at large.<sup>13</sup>

Unjust enrichment, or “quasi contract” as it is known in some states, is an alternative to breach of contract: “a plaintiff may not recover for unjust enrichment where a ‘valid, express contract governing the subject matter of the dispute exists.’”<sup>14</sup> In most data-breach cases, a valid contract or privacy policy exists (negating a quasi-contract claim), but does not promise to protect data from intrusion.

Common-law invasion of privacy claims require, among other things, that plaintiff information be “published,” i.e., publicly disseminated or disclosed to an appreciable number of people. Traditionally, data-breach plaintiffs have been able to allege that their

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10 15 U.S.C. § 41 *et seq.*

11 CAL. BUS. & PROF. CODE § 17200 *et seq.*

12 *See, e.g., In re Zappos.com, Inc.*, No. 3:12-cv-00325-RCJ-VPC, 2013 WL 4830497, at \*3 (D. Nev. Sept. 9, 2013) (“Plaintiffs allege that [defendant] breached a contract to safeguard their data. But there is no allegation of any express or implied contract.”).

13 *Id.* (“[S]tatements on [defendant’s] website . . . that its servers were protected by a secure firewall and that customers’ data was safe . . . do not create any contractual obligations.”).

14 *In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 984 (S.D. Cal. 2014) (describing Florida, Massachusetts, Michigan, Missouri, New Hampshire, New York, Ohio, and Texas law).

data was compromised, but not that the data was disseminated publicly. In such cases, courts have dismissed invasion of privacy claims for lack of publication.<sup>15</sup>

Similarly, courts have dismissed negligence, negligent misrepresentation, and negligent infliction of emotional distress claims, citing the “economic loss doctrine.” Torts, including those sounding in negligence, can only be pursued to redress personal or property damage, as opposed to purely economic losses.<sup>16</sup> To recover for economic losses, plaintiffs must sue in contract. But as discussed above, consumer contracts rarely impose data-security obligations.

And while unfair competition and deceptive practice claims are not subject to the economic loss rule, such state laws often only authorize injunctive relief or restitution, rather than compensatory damages for economic loss.<sup>17</sup> Other consumer protection statutes authorize compensatory damage awards,<sup>18</sup> but courts interpreting those statutes have traditionally held data-breach plaintiffs to a very high standard, one most plaintiffs cannot meet. A data breach is actionable under some state statutes, for example, only if the defendant was “systematically reckless,” the breach was “aggravated by [a] failure to give prompt notice,” and the breach resulted in “very widespread and serious harm to other companies and to innumerable consumers.”<sup>19</sup>

In sum, early data-breach cases rarely survived motions to dismiss (or demurrers), primarily because plaintiffs could not allege a compensable injury. This rule has crystallized in a line of cases applying the “case” or “controversy” requirement of Article III of the U.S. Constitution to data-breach complaints, particularly since the Supreme Court’s 2013 decision in *Clapper v. Amnesty International USA*.<sup>20</sup> Article III limits the jurisdiction of federal courts to true cases or controversies: the plaintiff must have suffered “actual or imminent” injury as opposed to “hypothetical” or “conjectural” harm.<sup>21</sup> To have standing to pursue any cause of action in federal court, a plaintiff must allege (1) a “concrete and particularized injury” that is (2) “fairly traceable” to the defendant’s conduct and which is also (3) likely redressed by the judicial resolution.<sup>22</sup> The Supreme Court has referred to these requirements as the “irreducible constitutional minimum” of all lawsuits in U.S. federal court.<sup>23</sup>

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15 See, e.g., *Galaria v. Nationwide Mut. Ins. Co.*, 998 F. Supp. 2d 646, 661–63 (S.D. Ohio 2014) (dismissing invasion of privacy claims that failed to allege that defendant “publicized” or “disclosed” plaintiff PII “to the public at large, or to so many persons that the matter must be regarded as substantially certain to become one of public knowledge”).

16 See, e.g., *Zappos.com*, 2013 WL 4830497, at \*3–4.

17 See, e.g., CAL. BUS. & PROF. CODE §§ 17203–04.

18 See, e.g., 815 Ill. COMP. STAT. ANN. 505/10a(a); MASS. GEN. LAWS ANN. ch. 93A, § 9.

19 *In re Michaels Stores Pin Pad Litig.*, 830 F. Supp. 2d 518, 526 (N.D. Ill. 2011) (applying the Illinois Consumer Fraud and Deceptive Business Practices Act) (alteration in original); see also *In re TJX Cos. Retail Sec. Breach Litig.*, 564 F.3d 489(1st Cir. 2009) (applying the Massachusetts Consumer Protection Law).

20 133 S. Ct. 1138 (2013).

21 *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560–61 (1992).

22 *Id.*

23 *Id.*

*Clapper* was not a data-breach case. Rather, U.S. journalists reporting on foreign affairs sued to invalidate 2008 amendments to the Foreign Intelligence Surveillance Act (“FISA”), which relaxed warrant requirements for surveillance of non-U.S. persons located abroad.<sup>24</sup> The journalists feared their foreign communications would be surveilled, and some traveled long distances to meet personally with their contacts, incurring travel costs.<sup>25</sup> The Second Circuit Court of Appeals found these costs sufficient to satisfy Article III, but the Supreme Court disagreed. According to the Supreme Court, the threat of potential surveillance was not sufficiently imminent, i.e., “certainly impending.”<sup>26</sup> Put another way, the “theory of *future* injury [was] too speculative to satisfy” Article III, resting on a chain of “highly attenuated” inferences, including that the government would target the journalists’ contacts, obtain a warrant, and in fact intercept the journalists’ communications.<sup>27</sup>

The Supreme Court rejected the journalists’ challenge, even though they incurred actual, demonstrable costs to prevent potential surveillance. The fears the journalists paid to allay were still hypothetical or conjectural, and it has long been the rule that plaintiffs “cannot manufacture standing merely by inflicting harm on themselves.”<sup>28</sup> Otherwise, a loophole would exist in the “irreducible constitutional minimum”: standing would depend largely on what a plaintiff had done as opposed to what harm had been done to the plaintiff.

Although *Clapper* was not a data-breach case, courts and observers quickly saw the parallels between the *Clapper* facts and the data-breach context. Data-breach victims might perceive a threat of future identify theft and even incur costs to prevent that threat, e.g., purchasing credit monitoring services, obtaining new credit cards, conducting a private investigation, etc. But few data-breach plaintiffs can allege that their accounts or records have been accessed or misused.

Before *Clapper*, many courts dismissed data-breach complaints for lack of Article III standing,<sup>29</sup> but the results were not uniform.<sup>30</sup> Since *Clapper*, however, courts have generally dismissed data-breach complaints where the plaintiff could not allege data

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24 *Clapper*, 133 S. Ct. at 1142.

25 *Id.* at 1145–46.

26 *Id.* at 1143.

27 *Id.* at 1143, 1148 (emphasis in original).

28 *Id.* at 1151.

29 See, e.g., *Reilly v. Ceridian Corp.*, 664 F.3d 38, 42 (3d Cir. 2011) (finding no standing for customers of payroll processing firm absent proof hacker “read, copied, and understood” their data).

30 Cf. *Pisciotta v. Old Nat’l Bancorp.*, 499 F.3d 629, 634 (7th Cir. 2007) (finding standing for bank customers due to “increased risk” of future harm following data hack).

misuse or identity theft, a rule emerging as the “majority” view.<sup>31</sup> And while Article III applies only in federal cases (including those alleging state-law causes of action), the standing defense is not limited to federal courts. State courts have held that data-breach plaintiffs cannot maintain actions without an imminent or “certainly impending” risk of data misuse, citing *Clapper* and similar federal decisions.<sup>32</sup>

A recent decision of the D.C. District Court illustrates the prevailing view.<sup>33</sup> In September 2011, a thief broke into the car of an employee of a government contractor and stole the car stereo, GPS, and several backup tapes that contained personal and medical information about nearly five million U.S. military service members and their families.<sup>34</sup> The theft led to eight separate class actions across Texas, California, and the District of Columbia that ultimately were consolidated for trial.<sup>35</sup> All told, plaintiffs from twenty-four states collaborated on a consolidated complaint, alleging twenty causes of action, including negligence, breach of contract, and violation of various state consumer protection laws.<sup>36</sup> The plaintiffs asserted numerous injuries, including an increased risk of identity theft, expenses incurred to mitigate that risk, and diminished value of their PII.<sup>37</sup>

While sympathizing with the plight of the service members and recognizing its ruling offered “cold comfort,” the district court dismissed the consolidated complaint for lack of standing.<sup>38</sup> The plaintiffs’ fears were “rational,” even “reasonable,” but they were not “certainly impending.”<sup>39</sup> Echoing the concerns of many courts, the district judge explained that the data tapes “could be uploaded onto [the thief’s] computer and fully deciphered, or they could be lying in a landfill somewhere in Texas because she trashed them after achieving her main goal of boosting the car stereo and GPS.”<sup>40</sup> According

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31 *U.S. Hotel & Resort Mgmt., Inc. v. Onity, Inc.*, No. CIV. 13-1499 SRN/FLN, 2014 WL 3748639, at \*5 (D. Minn. July 30, 2014) (“In the ‘lost data’ context, where the courts have split somewhat on the question of standing, it now appears that a majority of the courts to have addressed the ‘lost data’ issue hold that plaintiffs whose confidential data has been exposed, or possibly exposed, by theft or a breach of an inadequate computer security system, but who have not yet had their identity stolen or their data otherwise actually abused, lack standing to sue the party who failed to protect their data.”); *see also* *In re Sci. Applications Int’l Corp. (SAIC) Backup Tape Data Theft Litig.*, Misc. Action No. 12-347 (JEB), MDL No. 2360, 2014 WL 1858458, at \*8 (D.D.C. May 9, 2014) (“[S]ince *Clapper* was handed down last year, courts have been even more emphatic in rejecting ‘increased risk’ as a theory of standing in data-breach cases.”).

32 *See, e.g., Vides v. Advocate Health & Hosps. Corp.*, No. 13-CH-2701 (Ill. 19th Judicial Cir. May 27, 2014) (finding that because threat of identity theft depended on “chain of attenuated and hypothetical events” including “whether [patient] data was actually taken after the removal, whether it was subsequently sold or otherwise transferred, whether anyone who obtained the data attempted to use it, and whether or not they succeeded,” it thus was not “imminent” or “certainly impending”).

33 *In re SAIC*, 2014 WL 1858458.

34 *Id.* at \*1.

35 *Id.* at \*1-3.

36 *Id.*

37 *Id.* at \*3.

38 *Id.* at \*6-7.

39 *Id.*

40 *Id.* at \*6.

to the district court, “there is simply no way to know” what becomes of breached data “until either the crook is apprehended or the data is actually used.”<sup>41</sup> And under Article III, courts cannot get involved unless and “until something untoward happens.”<sup>42</sup>

Put another way, every data breach theoretically increases the likelihood that consumers’ data will be accessed, disseminated, or misused. But “how much *more likely* [plaintiffs] are to become victims than the general public is not the same as . . . how likely they are to become victims.”<sup>43</sup> Absent allegations that actual harm is imminent, courts generally dismiss data-breach complaints for lack of standing.

#### *TRADITIONAL OUTCOMES OF PUBLIC DATA-BREACH ENFORCEMENT ACTIONS*

In addition to private litigation, public enforcement bodies have brought complaints in the wake of data breaches, particularly, the Federal Trade Commission (“FTC”) and state attorneys general. The FTCA empowers the FTC to prevent “unfair or deceptive” acts and practices through administrative enforcement actions and other processes (e.g., rulemaking).<sup>44</sup> Likewise, most mini-FTC acts authorize state attorneys general and other public prosecutors (such as city and district attorneys) to sue for unfair competition or deceptive practices.<sup>45</sup> Unlike private litigants, who are sometimes limited to restitution and injunctive relief in unfair competition actions, public prosecutors generally can pursue additional monetary relief, such as civil penalties and attorneys’ fees.<sup>46</sup> The FTC, for example, may seek “redress” in a federal district court for any injury done to consumers, including damages and restitution,<sup>47</sup> after finding liability in an administrative trial. The FTC also may sue to recover civil penalties for knowing violations of a final agency order (including violations by third parties).<sup>48</sup>

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41 *Id.*

42 *Id.* at \*7.

43 *Galaria v. Nationwide Mut. Ins. Co.*, 998 F. Supp. 2d 646, 654 (S.D. Ohio 2014) (emphasis in original).

44 15 U.S.C. § 45.

45 *See, e.g.*, CAL. BUS. & PROF. CODE §§ 17204, 17206; 815 ILL. COMP. STAT. ANN. 505/10; MASS. GEN. LAWS ANN. 93A § 4.

46 *See, e.g.*, CAL. BUS. & PROF. CODE § 17206 (authorizing courts to impose a civil penalty not to exceed \$2,500 for each violation of the statute in actions brought by California public prosecutors); 815 Ill. Comp. Stat. Ann. 505/7 (“Court may impose a civil penalty in a sum not to exceed \$50,000 against any person found by the Court to have engaged in any method, act or practice declared unlawful under this Act” in actions by the Illinois attorney general or state’s attorney); MASS. GEN. LAWS ANN. 93A § 4 (authorizing a civil penalty of not more than \$5,000 for knowing violations as well as reasonable costs of investigation and litigation, including attorneys’ fees, in actions by the Massachusetts attorney general).

47 15 U.S.C. § 57b (authorizing courts to award relief necessary to redress consumer injury, including but not limited to refunds and damages); *F.T.C. v. Nat’l Bus. Consultants, Inc.*, 781 F. Supp. 1136, 1141 (E.D. La. 1991) (noting that courts’ authority includes ability to order restitution).

48 15 U.S.C. § 45(m).

Over the past decade, the FTC has brought and settled fifty data-breach complaints through its administrative process.<sup>49</sup> The FTCA does not specifically empower the FTC to investigate, regulate, or seek enforcement regarding data security, but the FTC has assumed authority in this and other privacy and technology-related fields, while at the same time calling for federal legislation.<sup>50</sup> The practice, which is not without criticism, has led observers to describe the FTC as America’s “technology cop” or the “Federal Technology Commission.”<sup>51</sup> Initially, the FTC brought data-breach complaints under the “deceptive” prong of its general enforcement authority, but now proceeds primarily under both the “deceptive” and the “unfairness” prongs.<sup>52</sup>

Until recently, each of the FTC’s data-breach enforcement actions ended in settlement (memorialized in consent decrees), and no challenge to the FTC’s authority reached a court or resulted in a judicial decision. Moreover, the FTC has not promulgated any rules or regulations regarding data security, citing (among other things) the need for greater rulemaking authority and a desire to preserve and promote flexibility and technological advancement in data security.<sup>53</sup> Some have criticized the FTC for filing enforcement actions without first issuing standards to guide company compliance.<sup>54</sup> Nonetheless, a review of the FTC’s recent data-breach settlements reveals several common features, which may exemplify the FTC’s current view of acceptable best practices.

For example, the four data-breach settlements consummated in 2013 (there were no such settlements in 2014) each required that the settling companies: (1) designate dedicated personnel to be responsible for an “information security program”; (2) identify “material internal and external risks” to data security, particularly in connection with employee training and management, information systems, and threat detection; (3) implement “reasonable safeguards” to control and prevent such risks; (4) develop “reasonable steps” to select secure vendors who will have access to company data; and (5) evaluate, monitor,

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49 *Protecting Personal Consumer Information from Cyber Attacks and Data Breaches, Before the S. Comm. on Commerce, Sci. & Transp.*, 113th Congress 4 (2014) (prepared statement of the Federal Trade Commission), available at [http://www.ftc.gov/system/files/documents/public\\_statements/293861/140326datasecurity.pdf](http://www.ftc.gov/system/files/documents/public_statements/293861/140326datasecurity.pdf).

50 *See id.* at 10-12.

51 Brian Fung, *The FTC Was Built 100 Years Ago to Fight Monopolists. Now, It’s Washington’s Most Powerful Technology Cop*, WASH. POST, Sept. 25, 2014, <http://www.washingtonpost.com/blogs/the-switch/wp/2014/09/25/the-ftc-was-built-100-years-ago-to-fight-monopolists-now-its-washingtons-most-powerful-technology-cop/> (quoting Geoffrey Manne, Executive Director of the International Center for Law and Economics).

52 *See, e.g., F.T.C. v. Wyndham Worldwide Corp.*, 10 F. Supp. 3d 602, 607 (D.N.J. Apr. 7, 2014) (asserting both prongs), *motion to certify appeal granted* (June 23, 2014).

53 Andrew Scurria, *FTC Wants Rulemaking Power For Cybersecurity Reforms*, LAW360, Mar. 26, 2014 (“It’s critically important that there be flexibility embedded in any legislation to allow the FTC to adapt any rule to emerging and evolving technology.”) (quoting Edith Ramirez, FTC Chairwoman, in remarks to the Senate Commerce Committee at a March 26, 2014 hearing).

54 *Wyndham*, 10 F. Supp. 3d at 616.

and adjust such measures regularly (over a twenty-year period in the consent decrees).<sup>55</sup> These requirements are largely process-based, rather than technological, in keeping with the FTC's currently-stated aim to preserve flexibility and develop data-security standards through a common law case-specific approach.<sup>56</sup>

State attorneys general also have pursued data-breach complaints, though not with the frequency of the FTC. Most states have data-breach notification laws on the books and have for some time.<sup>57</sup> These statutes typically require companies to give expedient notice (e.g., “without unreasonable delay”) after learning of a data breach (e.g., upon reasonable belief of unauthorized acquisition of customer information).<sup>58</sup> Some statutes even set a deadline by which companies must notify consumers, though notice can be delayed in most cases for law enforcement purposes or to determine the scope of the breach and restore the integrity of information systems.<sup>59</sup>

Many states also require that breached companies notify the state attorney general (or other state authority) of a data breach,<sup>60</sup> and attorneys general are authorized to bring suit to enforce the statutes.<sup>61</sup> Several attorneys general have already done so. For example, in 2011, Indiana Attorney General Greg Zoeller brought and settled a suit alleging that health insurer WellPoint, Inc. waited too long (four months) to notify consumers of a breach and failed to notify the Attorney General's office altogether.<sup>62</sup> WellPoint paid \$100,000 to the State and offered affected customers up to two years of credit-monitoring services to resolve the suit.<sup>63</sup> Similarly, in 2013, California Attorney General Kamala Harris filed and later settled a complaint alleging that Kaiser Foundation Health

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55 See, e.g., Agreement Containing Consent Order, *CBR Sys., Inc.*, File No. 112 3120 (Jan. 28, 2013), available at <http://www.ftc.gov/sites/default/files/documents/cases/2013/01/130128cbragree.pdf>; Agreement Containing Consent Order, *TRENDnet, Inc.*, File No. 122 3090 (Sept. 4, 2013), available at <http://www.ftc.gov/sites/default/files/documents/cases/2013/09/130903trendnetorder.pdf>; Agreement Containing Consent Order, *Compete, Inc.*, File No. 102 3155 (Oct. 22, 2012), available at <http://www.ftc.gov/sites/default/files/documents/cases/2012/10/121022competeincagrceorder.pdf> (approved Feb. 25, 2013); Agreement Containing Consent Order, *Accretive Health, Inc.*, File No. 122 3077 (Dec. 31, 2013), available at [http://www.ftc.gov/sites/default/files/documents/cases/131231accretivehealthorder\\_0.pdf](http://www.ftc.gov/sites/default/files/documents/cases/131231accretivehealthorder_0.pdf).

56 The recent consent decrees did not contain an express monetary component, though the costs of compliance could be significant.

57 Alabama, New Mexico, and South Dakota have not yet passed data-breach notification laws.

58 See, e.g., 815 ILL. COMP. STAT. §§ 530/10; MASS. GEN. LAWS ANN. 93H § 3; N.Y. GEN. BUS. LA § 899-aa.

59 See, e.g., ME. REV. STAT. tit. 10, § 1348 (seven business days after required investigation); OHIO REV. CODE § 1347.12 (no later than forty-five days after discovery); VT. STAT. ANN. tit. 9, § 2435 (same); WIS. STAT. § 134.98 (same).

60 See, e.g., IND. CODE ANN. § 24-4.9-3-1 (notice to the attorney general); MASS. GEN. LAWS ANN. 93H § 3 (notice to the attorney general and the director of consumer affairs and business regulation).

61 See, e.g., IND. CODE ANN. § 24-4.9-4-2; MASS. GEN. LAWS ANN. 93H § 6.

62 See Press Release, Office of the Indiana Attorney General, Attorney General Reaches Settlement With WellPoint in Consumer Data Breach (July 5, 2011), available at [http://www.in.gov/portal/news\\_events/71252.htm](http://www.in.gov/portal/news_events/71252.htm).

63 See *id.*

Plan, Inc. was slow to disclose a 2011 breach (again, four months).<sup>64</sup> Kaiser paid \$150,000 to resolve the dispute and agreed to provide notice of future breaches on a rolling basis, rather than at the conclusion of the internal investigation.<sup>65</sup> As will be shown below, similar suits have been brought and settled since the 2013 mega breaches, while several states have revamped their data-breach notification laws.

### THE LATE 2013 MEGA BREACHES

The discussion thus far has generally described the state of litigation and enforcement before the mega breaches of late 2013. Although the perception may be that the law only began to develop around that time, or has since undergone radical transformation, that is not the case. For the most part, the law remains the same, though there have been several notable developments since late 2013, with more almost certain to come.

### THE FEDERAL LAW RESPONSE

A flurry of congressional activity followed the late 2013 mega breaches. Congress called representatives of breached companies to testify in open session, committees and subcommittees launched probes and authored reports, and lawmakers in both houses proposed legislation.<sup>66</sup> But legislators could not agree on a uniform approach to data security, and the majority of proposals languished and stalled. In late 2014, however, Congress passed, and the President signed into law, five bills addressing data security in federal agencies and systems. These bills marked the first major data-security legislation since 2002's Federal Information Security Management Act ("FISMA"),<sup>67</sup> which required federal agencies to develop data-security measures and to certify their procedures annually with the Office of Management and Budget ("OMB").<sup>68</sup>

The new bills include the following: (1) the Federal Information Security Modernization Act,<sup>69</sup> which amends FISMA and replaces the annual certification model (compliance checklists) with a requirement to "continuously monitor" information systems for data security; (2) the Cybersecurity Workforce Assessment Act,<sup>70</sup> which requires the Department of Homeland Security ("DHS") to enhance cybersecurity workforce readiness; (3) the Homeland Security Workforce Assessment Act,<sup>71</sup> which establishes data-security positions within the DHS; (4) the National Cybersecurity Protection

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64 See Allison Grande, *Calif. AG Puts A Clock on Data-Breach Reporting*, LAW360, Feb. 3, 2014.

65 See *id.*

66 See, e.g., Juan Carlos Rodriguez, *Senate Dems Target Cybercrime With Data Security Bill*, LAW360, Jan. 31, 2014 (discussing the Data Security and Breach Notification Act introduced by Sens. Dianne Feinstein, D-Calif.; John Rockefeller, D-W.Va.; Mark Pryor, D-Ark.; and Bill Nelson, D-Fla).

67 44 U.S.C. § 3541, *et seq.*

68 See generally Eric Chabrow, *Obama Signs 5 Cybersecurity Bills*, GOV INFO SECURITY, Dec. 18, 2014, <http://www.govinfosecurity.com/obama-signs-5-cybersecurity-bills-a-7697>.

69 Federal Information Security Modernization Act of 2014, Pub. L. No. 113-283, 128 Stat. 3073.

70 Cybersecurity Workforce Assessment Act, Pub. L. No. 113-246, 128 Stat. 2880 (2014) (codified at 6 U.S.C. § 146).

71 Border Patrol Agent Pay Reform Act of 2014, Pub. L. No. 113-277, 128 Stat. 2995 (codified at 6 U.S.C. § 146).

Act,<sup>72</sup> which formalizes the National Cybersecurity and Communications Integration Center (“NCCIC”), the government’s data-security incident response center; and (5) the Cybersecurity Enhancement Act,<sup>73</sup> which authorizes the Commerce Department’s National Institute of Standards and Technology (“NIST”) to develop voluntary data-security standards for critical infrastructure.<sup>74</sup>

The new data-security bills only affect federal agencies, and any critical infrastructure standards promulgated by NIST will be voluntary. Congress has yet to address data security in the private sector or to set (or authorize) mandatory standards, but Congress could still act, and calls for federal data-security legislation continue. Indeed, in the lead up to the 2015 State of the Union and during the address itself, President Barack Obama urged Congress to enact national data-security laws, including a uniform data-breach notification standard and liability protection for companies that share data-security information with the federal government.

Obviously, enactment of any federal legislation would greatly impact data-breach litigation and enforcement. Congress could clarify whether the FTC has authority to regulate data breach: it could expand that authority, remove it (to the extent it exists), or repose regulatory authority in some other body—even a new regulatory entity created specifically to oversee data security or other privacy or technology issues. Congress itself could set data-security standards or delegate the task to regulators or entities such as NIST or the NCCIC. The standards could be as broad as “reasonable” security and “continuous monitoring” or be composed of specific, technological requirements.

Federal legislation could preempt state laws, in whole or in part, or preempt less restrictive state laws while permitting more stringent state pronouncements, as with HIPAA. Importantly, federal legislation could create a private right of action for aggrieved individuals, which could preempt state-law causes of action or complement such claims. Even if a statute does not expressly provide a private right of action, the right could be implied if courts conclude Congress “intended to create the private remedy,”<sup>75</sup> as with Rule 10b-5 of the Security Exchange Commission. And even if federal statutes and regulations do not provide a private right of action, they could still inform the duties imposed in common-law negligence actions. In the HIPAA context, for example, state courts have begun to hold that HIPAA regulations may inform the duty of care in state-

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72 National Cybersecurity Protection Act of 2014, Pub. L. No. 113-282, 128 Stat. 3066 (codified at 6 U.S.C. § 148.

73 Cybersecurity Enhancement Act of 2014, Pub. L. No. 113-274, 128 Stat. 2971.

74 Pursuant to Executive Order 13636 (Feb. 12, 2013), NIST released the first version of its Framework for Improving Critical Infrastructure Cybersecurity on February 12, 2014. See NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY, FRAMEWORK FOR IMPROVING CRITICAL INFRASTRUCTURE CYBERSECURITY (2014), available at <http://www.nist.gov/cyberframework/upload/cybersecurity-framework-021214-final.pdf>.

75 Transamerica Mortg. Advisors, Inc. (TAMA) v. Lewis, 444 U.S. 11, 15-16 (1979).

law actions for negligent breach of patient confidentiality, even though HIPAA provides no private right of action and preempts contrary state laws.<sup>76</sup>

Potential legislation is also important for another, less obvious reason, as a result of recent developments in certain federal circuits. Statutes establishing private rights of action often set statutory damages amounts, which a plaintiff can claim irrespective of actual harm. In establishing a private right of action for damages, Congress can delineate what a plaintiff must plead to pursue and recover statutory damages, i.e., statutory standing. But, historically, Congress cannot confer Article III standing, and statutory standing is no substitute for constitutional standing. Put another way, “[i]n no event ... may Congress abrogate the [irreducible] Art. III minima.”<sup>77</sup> As such, even if Congress establishes (or courts imply) a private right of action for data-breach victims, plaintiffs would still have to satisfy Article III to bring suit—something plaintiffs have traditionally found difficult to do.

Several federal appellate decisions, however, have cast uncertainty on the rule that a mere statutory violation (without actual injury) can confer Article III standing. Courts in the Sixth and Ninth Circuits have allowed plaintiffs to pursue statutory violations and damages under the Fair Credit Reporting Act (“FCRA”)<sup>78</sup> and the Real Estate Settlement Procedures Act (“RESPA”)<sup>79</sup> *without* alleging actual injury.<sup>80</sup> And dicta from a Seventh Circuit decision<sup>81</sup> has led district courts in that circuit to find Article III satisfied “without proof of injury” under statutes such as FCRA.<sup>82</sup> Courts in the Second

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76 See, e.g., *Byrne v. Avery Ctr. for Obstetrics & Gynecology, P.C.*, 102 A.3d 32, 41-43 (Conn. 2014); *Bonney v. Stephens Mem’l Hosp.*, 17 A.3d 123, 128 (Me. 2011); *Fanean v. Rite Aid Corp. of Delaware, Inc.*, 984 A.2d 812, 823 (Del. Super. Ct. 2009); *Young v. Carran*, 289 S.W.3d 586 (Ky. Ct. App. 2008); *Acosta v. Byrum*, 638 S.E. 2d 246, 253 (N.C. Ct. App. 2006).

77 *Gladstone Realtors v. Vill. of Bellwood*, 441 U.S. 91, 100 (1979); see also *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) (describing the “irreducible constitutional minimum” of standing).

78 15 U.S.C. § 1681 *et seq.*

79 12 U.S.C. § 2607.

80 *Edwards v. First Am. Corp.*, 610 F.3d 514, 517 (9th Cir. 2010) (writing in a RESPA case that “injury required by Article III can exist solely by virtue of statutes creating legal rights, invasion of which creates standing”) (internal quotations omitted) (citation omitted); *Beaudry v. TeleCheck Servs., Inc.*, 579 F.3d 702, 707 (6th Cir. 2009) (writing in a FCRA case that Congress “has the power to create new legal rights, including rights of action whose only injury-in-fact involves the violation of that statutory right”) (internal quotations omitted) (citation omitted).

81 *Murray v. GMAC Mortg. Corp.*, 434 F.3d 948, 953 (7th Cir. 2006).

82 See, e.g., *Armes v. Sogro, Inc.*, 932 F. Supp. 2d 931, 937-38 (E.D. Wis. 2013) (“[B]ecause the FCRA provides for awards of statutory damages where a violation is willful, ‘actual damages are not necessarily a precondition for suit.’”) (quoting *Killingsworth v. HSBC Bank Nev., N.A.*, 507 F.3d 614, 622 (7th Cir. 2007)).

and Fourth Circuits, meanwhile, have held to the traditional view that actual injury must be established even in statutory-damage cases,<sup>83</sup> while the Third Circuit itself is split.<sup>84</sup>

Courts have generally rejected efforts to ground data-breach claims in federal statutes such as FCRA and the Stored Communications Act (“SCA”),<sup>85</sup> which prohibits electronic communications services and remote computing services from divulging customer information.<sup>86</sup> Until that changes, the confusion surrounding constitutional standing in the statutory damages context should not greatly affect data-breach complaints. But if Congress enacts data-security legislation and fixes statutory damages, the debate would become highly relevant. Removing or undermining the actual injury bar could lead to a significant increase in actionable data-breach complaints.

### THE STATE LAW RESPONSE

As discussed, most states had data-breach notification laws on the books before the late 2013 mega breaches. Since that time, more states have passed breach-notification laws,<sup>87</sup> while other states have made significant amendments to their existing statutes. Florida, for example, amended its statute in July 2014, reducing the breach-notification deadline to thirty days and requiring breached companies to provide data-security policies and a “computer forensics report” to the state attorney general in the event of a breach.<sup>88</sup> California, on the other hand, expanded its requirement of “reasonable security” measures—which used to apply only to companies that “own or license” customer information—to all businesses that “maintain” the personal information of California residents.<sup>89</sup> Under the new law, any company that maintains personal information on California residents will have to employ reasonable security measures or potentially face suit from the California Attorney General. These changes could foreshadow amendments in other states or lead to increased enforcement efforts by public prosecutors. State attorneys general continue to file and settle data-breach complaints. In November 2014, for example, Massachusetts Attorney General Martha Coakley settled a

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83 *David v. Alphin*, 704 F.3d 327, 338 (4th Cir. 2013) (writing that federal courts have jurisdiction “only where [plaintiffs] have both statutory and constitutional standing”); *Kendall v. Emp. Ret. Plan of Avon Prods.*, 561 F.3d 112, 119 (2d Cir. 2009) (writing that plaintiffs “must allege some injury or deprivation of a right, even if right is statutorily created”).

84 *Compare Alston v. Countrywide Fin. Corp.*, 585 F.3d 753, 763 (3d Cir. 2009) (“[P]laintiff need not demonstrate that he or she suffered actual monetary damages” to have Article III standing to sue under RESPA) with *Fair Hous. Council of Suburban Philadelphia v. Main Line Times*, 141 F.3d 439, 443-44 (3d Cir. 1998) (“[A] violation of the [statute] does not automatically confer standing on any plaintiff.”).

85 18 U.S.C. § 2702.

86 See, e.g., *In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 1011-12 (S.D. Cal. 2014) (dismissing FCRA claims because breached company was not a credit reporting agency); *Burrows v. Purchasing Power, LLC*, No. 1:12-CV-22800-UU, 2012 WL 9391827, at \*4-5 (S.D. Fla. Oct. 18, 2012) (dismissing SCA claims because breached company did not qualify as an electronic communications or remote computing service).

87 In April 2014, Kentucky passed its data-breach notification bill, becoming the forty-seventh state to do so. See KY. REV. STAT. ANN. § 365.732.

88 FLA. STAT. ANN. § 501.171.

89 A.B. 1710, 2014 Cal. Legis. Serv. Ch. 855 (eff. Jan. 1, 2015) (amending Cal. Civ. Code §§ 1798.81.5, 1798.82, 1798.85).

data-breach complaint against a Boston hospital resulting from the 2012 theft of a doctor's unencrypted laptop,<sup>90</sup> the state's fourth such settlement since 2012.

NOTABLE DEVELOPMENTS IN LITIGATION AND ENFORCEMENT

Perhaps the most significant decision since the late 2013 mega breaches was reached in the regulatory context. While most FTC enforcement actions have ended in settlement, two companies have challenged the FTC's authority over data security and one challenge resulted in a decision on the merits by a district court.

On April 7, 2014, a New Jersey district court denied a motion to dismiss a FTC complaint stemming from multiple hacks of the Wyndham hotel chain from 2008 through 2010.<sup>91</sup> Wyndham and numerous *amici* argued that the FTC lacked statutory authority over data security, citing the existence of more specific legislation (such as HIPAA and GLBA), ongoing debate about the need for new legislation, and the FTC's failure to set clear data-security standards.<sup>92</sup> But the district court took the opposite approach, declining to "carve out" a data-security exception to what it viewed as broad FTC "unfairness" authority.<sup>93</sup> The court found no conflict with existing data-security legislation (only complementary authority) and concluded that "the FTC does *not* necessarily need to formally publish rules and regulations" before bringing suit for alleged data-security violations.<sup>94</sup>

The court was clear that its decision had no bearing on Wyndham's potential liability under the FTCA and did not represent a "blank check" for the FTC to bring suit "against every business that has [ever] been hacked."<sup>95</sup> But the court offered no indication of what limits might surround the FTC's authority or what circumstances might warrant dismissal of an FTC complaint, other than to say its decision was limited to the facts alleged in the *Wyndham* complaint.<sup>96</sup> The court recognized, however, the "importance of data security" and the issues posed by data-breach lawsuits.<sup>97</sup> As such, the court certified an immediate interlocutory appeal to the Third Circuit,<sup>98</sup> which remains

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90 See Press Release, Office of the Massachusetts Attorney General, Beth Israel Deaconess Medical Center to Pay \$100,000 Over Data Breach Allegations (Nov. 21, 2011), *available at* <http://www.mass.gov/ago/news-and-updates/press-releases/2014/2014-11-21-beth-israel-data-breach.html>.

91 *F.T.C. v. Wyndham Worldwide Corp.*, 10 F. Supp. 3d 602, 608 (D.N.J. Apr. 7, 2014).

92 *Id.* at 610-12.

93 *Id.* at 612.

94 *Id.* at 613-19 (emphasis in original).

95 *Id.* at 610.

96 *Id.*

97 *Id.* at 609-10.

98 *Id.* at 633-36.

pending. Assuming the case does not resolve beforehand, the Third Circuit's ruling will almost certainly be one of the biggest privacy law developments of 2015.<sup>99</sup>

On the private litigation side, case law developments have been more subtle. While many courts continue to apply traditional principles to dismiss data-breach complaints,<sup>100</sup> several courts have reached different results by applying the same or slightly modified principles. In early 2014, two California district courts dismissed the bulk of two data-breach lawsuits, but left intact claims for misrepresentation under California consumer protection laws.

In *In re LinkedIn User Privacy Litigation*, the court allowed a California Unfair Competition Law ("UCL") claim to proceed after LinkedIn represented in its User Agreement that customer data would "be protected with industry standard protocols and technology."<sup>101</sup> The court found that the plaintiff had standing under Article III and the UCL because she purchased LinkedIn's premium service in reliance on the representation.<sup>102</sup> The "critical distinction" between the plaintiff's theory of economic injury and traditional data-breach cases was the allegation that the plaintiff's "payment or overpayment was caused by LinkedIn's alleged misrepresentations."<sup>103</sup> The court dismissed the plaintiff's breach of contract and additional UCL claims, which had been the subject of a prior dismissal,<sup>104</sup> with prejudice, for lack of standing.<sup>105</sup>

Similarly, in *In re Sony Gaming Networks & Customer Data Security Breach Litigation*, the court dismissed forty-five of the plaintiffs' fifty-three causes of action under the laws of nine different states and the FCRA, but let stand claims under California's UCL, False Advertising Act,<sup>106</sup> Consumer Legal Remedies Act,<sup>107</sup> and breach-notification statute;<sup>108</sup> as well as claims under the Florida, Michigan, Missouri, and New Hampshire mini-FTC acts and for breach of the implied covenant of good faith and fair dealing

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99 In addition to the FTC, the Federal Communications Commission ("FCC") entered the data-breach fray in October 2014, fining two telecommunications companies a combined \$10 million for allegedly storing customer data on unsecured internet servers. See Press Release, Federal Communications Commission, FCC Plans \$10M Fine For Carriers That Breached Consumer Privacy (Oct. 24, 2014), available at <http://www.fcc.gov/document/10m-fine-proposed-against-terracom-and-yourtel-privacy-breaches>. The FCC grounded its authority in the statutory directive to ensure "just and reasonable" charges for communications services, 42 U.S.C. § 201(b), an approach that is likely to draw challenges similar to those levied against the FTC.

100 See, e.g., *S. Hotel & Resort Mgmt., Inc. v. Onity, Inc.*, No. CIV. 13-1499 SRN/FLN, 2014 WL 3748639 (D. Minn. July 30, 2014); *In re Sci. Applications Int'l Corp. (SAIC) Backup Tape Data Theft Litig., Misc. Action No. 12-347 (JEB)*, MDL No. 2360, 2014 WL 1858458 (D.D.C. May 9, 2014); *Galaria v. Nationwide Mut. Ins. Co.*, 998 F. Supp. 2d 646, 646 (S.D. Ohio 2014).

101 No. 5:12-CV-03088-EJD, 2014 WL 1323713, at \*1, \*6 (N.D. Cal. Mar. 28, 2014).

102 *Id.* at \*5-6.

103 *Id.* at \*5.

104 *In re LinkedIn User Privacy Litig.*, 932 F. Supp. 2d 1089, 1092-95 (N.D. Cal. 2013).

105 *In re LinkedIn User Privacy Litigation*, No. 5:12-CV-03088-EJD, 2014 WL 1323713, at \*9 (N.D. Cal. Mar. 28, 2014).

106 CAL. BUS. & PROF. CODE § 17500 et seq.

107 CAL. CIV. CODE § 1770 et seq.

108 CAL. CIV. CODE § 1798.80 et seq.

under California law.<sup>109</sup> As in *LinkedIn*, the surviving causes of action were predicated in commitments to “take ‘reasonable steps’ to secure” customer data and “use industry-standard encryption to prevent unauthorized access to sensitive financial information” in the defendant’s privacy policy and terms of use.<sup>110</sup>

But the *Sony Gaming* court went a step further than *LinkedIn*. The court accepted the plaintiffs’ allegation that the data breach posed a “credible threat” of harm, a formulation of the Article III standard drawn from *Krottner v. Starbucks Corporation*,<sup>111</sup> a pre-*Clapper* decision by the Ninth Circuit Court of Appeals.<sup>112</sup> The *Sony Gaming* defendants argued that *Clapper* “tightened” the Article III standard, but the district court disagreed, finding no conflict between its ruling and *Clapper*.<sup>113</sup> According to the court, “although the Supreme Court’s word choice in *Clapper* differed from the Ninth Circuit’s word choice in *Krottner*,” “credible threat” versus “certainly impending,” “*Clapper* did not set forth a new Article III framework” or overrule *Krottner*.<sup>114</sup> The court thus allowed a limited subset of claims to survive, even though the plaintiffs did not allege data misuse or identity theft.

The California district court in *In re Adobe Systems, Inc. Privacy Litigation*<sup>115</sup> went yet a step further, holding that even if *Clapper* overruled *Krottner*, plaintiffs still had Article III standing to sue for data breach.<sup>116</sup> The plaintiffs had alleged that “hackers deliberately targeted Adobe’s servers and spent several weeks collecting” customers’ PII, including plaintiffs’.<sup>117</sup> The court contrasted the situation to *In re SAIC*, where the court wondered whether data lifted from a contractor’s laptop was lying in a landfill somewhere.<sup>118</sup> The *Adobe* plaintiffs alleged that “[s]ome of the stolen data has already surfaced on the Internet, and other hackers ha[d] . . . misused it to discover vulnerabilities in Adobe’s products.”<sup>119</sup> The court thus found that “the risk that plaintiffs’ personal data [would] be misused by the hackers who breached Adobe’s network [was] immediate and very real”—sufficient to satisfy Article III.<sup>120</sup>

The contrast between *SAIC* and *Adobe* represents a subtle, but potentially significant shift in data-breach jurisprudence. Before—in the context of laptop theft, when less was known about sophisticated rings of hackers and targeted intrusion software—courts assumed that plaintiff data had not been misused, absent allegations to the contrary. More

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109 *In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 1013-14 (S.D. Cal. 2014)

110 *Id.* at 990.

111 628 F.3d 1139, 1142 (9th Cir. 2010).

112 *In re Sony Gaming*, 996 F. Supp. 2d at 961.

113 *Id.*

114 *Id.*

115 No. 13-CV-05226-LHK, 2014 WL 4379916 (N.D. Cal. Sept. 4, 2014).

116 *Id.* at \*8.

117 *Id.*

118 *Id.* at \*9.

119 *Id.* at \*8.

120 *Id.*

recently, in the context of deliberate, targeted hacks by organized hackers, courts are more willing to assume that data will be accessed or misused. As Judge Lucy H. Koh put it in the *Adobe* decision, “why would hackers target and steal personal customer data if not to misuse it?”<sup>121</sup> In this way, the context—even the publicity—surrounding a data breach may play a significant role in the judicial outcome. But it is important to note that *LinkedIn* and *Sony Gaming* involved specific representations to safeguard consumer data, while *Adobe* included some allegations of actual data misuse. Most courts, faced with complaints that do not involve specific representations or actual misuse, continue to dismiss data-breach complaints, applying fundamental principles of constitutional law.

As Judge Salas noted in the *Wyndham* decision, “we live in a digital age that is rapidly evolving,” where “maintaining privacy is, perhaps, an ongoing struggle”: data security “undoubtedly raises a variety of thorny legal issues that Congress and the courts will continue to grapple with for the foreseeable future.”<sup>122</sup> As they do, businesses and practitioners should pay close attention, alert to major changes and subtle trends.

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121 *Id.* at \*9.

122 *F.T.C. v. Wyndham Worldwide Corp.*, 10 F. Supp. 3d 602, 609–10 (D.N.J. Apr. 7, 2014).

# THE CONTINUING VIOLATIONS DOCTRINE: LIMITATION IN NAME ONLY, OR A RESUSCITATION OF THE CLAYTON ACT'S STATUTE OF LIMITATIONS?

By Stephen McIntyre and Kenneth R. O'Rourke<sup>1</sup>

## I. INTRODUCTION

Congress first gave private plaintiffs a right to sue for federal antitrust violations in 1914, when it passed the Clayton Antitrust Act.<sup>2</sup> Congress did not initially enact a statute of limitations. For the next several decades, courts looked to state statutes to determine the applicable limitations period in each case.<sup>3</sup> As a result, “a plaintiff injured in several jurisdictions [was] permitted to select as his forum the State with the most favorable statute,” and defendants “remain[ed] in constant jeopardy until the longest period of limitations ha[d] transpired.”<sup>4</sup> Finally, in 1955, Congress took action to remedy the problem by mandating a “uniform statute of limitations applicable to all private treble damage actions.”<sup>5</sup> It enacted Section 4B of the Clayton Act, which requires antitrust plaintiffs to bring suit within four years from the time their cause of action accrues.<sup>6</sup>

Sixty years later, defendants once again face an unsettling lack of uniformity in federal antitrust actions. Though the Clayton Act imposes a four-year limitation on treble damage actions, several courts of appeals have created an exception that all but swallows the rule. These courts hold that the “continuing violations” doctrine permits a plaintiff to sue at any point after a defendant’s allegedly unlawful conduct has ceased, so long as inflated prices—the prototypical effect of an antitrust violation—persist. This interpretation of the doctrine turns Section 4B on its head, permitting plaintiffs to keep the limitations period running—and treble damages accumulating—for years after the underlying collusion has ended. Instead of a “uniform statute of limitations” with a definitive ending point, defendants now face a *limitless* statute of limitations depending on the jurisdiction in which a federal antitrust claim is litigated.

The “continuing violations” doctrine, properly understood, applies where defendants have committed an “overt act” during the four-year limitations period. Neither passively receiving serial payments, nor pricing products pursuant to a prior agreement, constitutes an overt act. This interpretation comports with a century of Supreme Court

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1 Kenneth R. O'Rourke is a partner in O'Melveny & Myers LLP's Antitrust & Competition Practice Group. Stephen McIntyre is an associate in O'Melveny & Myers LLP's Antitrust & Competition Practice Group. This article reflects the views of the authors and not necessarily those of O'Melveny & Myers LLP, its attorneys, or its clients.

2 15 U.S.C. §§ 12–27, 29 U.S.C. §§ 52–53.

3 See, e.g., *Schiffman Bros., Inc. v. Texas Co.*, 196 F.2d 695, 696 (7th Cir. 1952) (“[I]nasmuch as Congress has enacted no statutes of limitations covering private actions for treble damages under the Clayton Act, in order to ascertain the applicable limitation we must necessarily look to the statute of the state where the cause of action arises and in which the suit is brought.”).

4 S. Rep. 84–619 (1955), *reprinted in* 1955 U.S.C.C.A.N. 2328, 2330–31 WL 3839.

5 *Id.* at 2231.

6 15 U.S.C. § 15b.

jurisprudence, the purposes of the Clayton Act's statute of limitations, and commonsense. In contrast, decisions that apply the continuing violations doctrine to the receipt of serial payments or to continued pricing do so based on a mere five words of *dicta*. We think it illogical to upend decades of prior decisions on the basis of so little.

## II. ACCRUAL OF CAUSES OF ACTION UNDER THE CLAYTON ACT'S STATUTE OF LIMITATIONS

In *Zenith Radio Corporation v. Hazeltine Research, Inc.*,<sup>7</sup> the Supreme Court laid down the standard for when an antitrust claim accrues under the Clayton Act's statute of limitations. "Generally," the Court held, "a cause of action accrues and the statute begins to run when a defendant commits an act that injures a plaintiff's business."<sup>8</sup> Therefore, "if a plaintiff feels the adverse impact of an antitrust conspiracy on a particular date, a cause of action immediately accrues to him," and "he must sue within the requisite number of years" from that date.<sup>9</sup>

At the same time, the Supreme Court noted exceptions to the general accrual rule. One of these has become known as the "continuing violations" or "continuing conspiracy" doctrine. As the Court put it in *Zenith Radio*, "[i]n the context of a continuing conspiracy to violate the antitrust laws, . . . each time a plaintiff is injured by an act of the defendants[,] a cause of action accrues to him to recover the damages caused by that act and that, as to those damages, the statute of limitations runs from the commission of the act."<sup>10</sup>

The Court was not announcing a new doctrine, but rather was restating one that had been in place for decades. The continuing violations doctrine has long been applied in a variety of contexts, including antitrust, as a matter of federal common law.<sup>11</sup> As early as 1910 (prior to passage of the Clayton Act), in an opinion by Justice Oliver Wendell Holmes, the Supreme Court held that an antitrust conspiracy may "have a continuance in time."<sup>12</sup> Specifically, an antitrust conspiracy is "continuing" where "the plot contemplates bringing to pass a continuous result that will not continue without the continuous co-operation of the conspirators to keep it up, and there is such continuous co-operation."<sup>13</sup> Reversing the circuit court's dismissal of the case, the Court held that the government's indictment was timely.<sup>14</sup>

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7 401 U.S. 321 (1971).

8 *Id.* at 338.

9 *Id.* at 339 (emphasis added).

10 *Id.* at 338.

11 *See, e.g., Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481, 502 n.15 (1968) (applying doctrine in antitrust case); *Local Lodge No. 1424 v. Nat'l Labor Relations Bd.*, 362 U.S. 411, 422–23 (1960) (discussing doctrine's application in cases brought under National Labor Relations Act); *see also Hensley v. City of Columbus*, 557 F.3d 693, 697 (6th Cir. 2009) ("[The 'continuing violation' doctrine] is rooted in general principles of common law and is independent of any specific action.").

12 *United States v. Kissel*, 218 U.S. 601, 607 (1910).

13 *Id.*

14 *Id.* at 608–10.

The following general rule has emerged from these and other decisions: there can be no “continuing violation” of the antitrust laws—meaning that the statute of limitations cannot be extended past the usual four years—unless the defendants are shown to have committed an “overt act” during the limitations period.<sup>15</sup> In the words of Justice Holmes, there must be “continuous co-operation . . . [by] the conspirators” to keep the antitrust conspiracy alive.<sup>16</sup> Without this “continuity of action,”<sup>17</sup> the violation is not a continuing one, and normal statute of limitations accrual principles apply.

As this history suggests, the continuing violations doctrine focuses “on the timing of the causes of injury, i.e., the defendant’s overt acts, as opposed to the effects of the overt acts.”<sup>18</sup> Defendants’ conduct may produce an *effect* that endures over a period of time, but unless the plaintiff can point to overt *action* during the limitations period, the continuing violations exception will not apply. Therefore, to sustain an antitrust cause of action, the plaintiff must base his or her claim for damages “on some injurious act occurring during the limitations period, not merely the abatable but unabated inertial consequences of some pre-limitations action.”<sup>19</sup>

What constitutes an “overt act”? The classic definition, provided by the Ninth Circuit, consists of two elements: “1) It must be a new and independent act that is not merely a reaffirmation of a previous act; and 2) it must inflict new and accumulating injury on the plaintiff.”<sup>20</sup> With the notable exception of the Third Circuit, which holds that a reaffirmation *can* keep the limitations period running,<sup>21</sup> this formulation of the “overt act” rule has been adopted by courts across the country, including five courts of appeals.<sup>22</sup>

Additionally, since the continuing violations doctrine is an equitable rule,<sup>23</sup> it ordinarily does not apply where the plaintiff had actual or constructive knowledge of the defendants’ conduct—even if the conduct might otherwise be considered a continuing

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15 See, e.g., *Z Techs. Corp. v. Lubrizol Corp.*, 753 F.3d 594, 598 (6th Cir. 2014); *Midwestern Mach. Co. v. Nw. Airlines, Inc.*, 392 F.3d 265, 269 (8th Cir. 2004); *Eichman v. Fotomat Corp.*, 880 F.2d 149, 160 (9th Cir. 1989).

16 *Kissel*, 218 U.S. at 607.

17 *Fiswick v. United States*, 329 U.S. 211, 216 (1946).

18 *Varner v. Peterson Farms*, 371 F.3d 1011, 1019 (8th Cir. 2004) (quoting *DXS, Inc. v. Siemens Med. Sys., Inc.*, 100 F.3d 462, 467 (6th Cir. 1996)); see also *Fiswick*, 329 U.S. at 216 (“Though the result of a conspiracy may be continuing, the conspiracy does not thereby become a continuing one.”).

19 This particular formulation of the rule is often repeated, but its origin is *Poster Exchange, Inc. v. Nat’l Screen Serv. Corp.*, 517 F.2d 117, 128 (5th Cir. 1975).

20 *Pace Indus., Inc. v. Three Phoenix Co.*, 813 F.2d 234, 238 (9th Cir. 1987).

21 *West Penn Allegheny Health Sys., Inc. v. UPMC*, 627 F.3d 85, 107–08 (3d Cir. 2010).

22 See, e.g., *Varner*, 371 F.3d at 1019; *Pilkington v. United Airlines*, 112 F.3d 1532, 1536–37 (11th Cir. 1997); *DXS*, 100 F.3d at 467; *Kaw Valley Elec. Coop. Co. v. Kan. Elec. Power Coop., Inc.*, 872 F.2d 931, 933 (10th Cir. 1989); *Pace Indus.*, 813 F.2d at 238; *In re Fiorillo*, 494 B.R. 119, 154 (Bankr. D. Mass. 2013); *Allen v. Dairy Farmers of Am., Inc.*, 748 F. Supp. 2d 323, 350 (D. Vt. 2010); *In re Ciprofloxacin Hydrochloride Antitrust Litig.*, 261 F. Supp. 2d 188, 228 (E.D.N.Y. 2003); *Xechem, Inc. v. Bristol-Myers Squibb Co.*, 274 F. Supp. 2d 937, 944–45 (N.D. Ill. 2003).

23 See *Wilson v. Brinker Int’l, Inc.*, 382 F.3d 765, 772 (8th Cir. 2004); *Pegram v. Honeywell, Inc.*, 361 F.3d 272, 279 (5th Cir. 2004).

violation.<sup>24</sup> Any other interpretation of the doctrine would “permit plaintiffs who know of the defendant’s pattern of activity simply to wait, ‘sleeping on their rights,’ as the pattern continues and treble damages accumulate.”<sup>25</sup>

Indeed, the continuing violations doctrine is often described as “narrow,”<sup>26</sup> and even “disfavored.”<sup>27</sup> In construing the Clayton Act’s statute of limitations, the Supreme Court has held that any rule that could potentially “extend[] the limitations period to many decades” would violate Congress’ intent in passing the statute and “thwart[] the basic objective of repose underlying the very notion of a limitations period.”<sup>28</sup>

### III. CONTINUED PRICING AND THE RECEIPT OF PAYMENTS FOR SALES AT SUPRACOMPETITIVE PRICES

A recurrent but unresolved issue in antitrust cases brought by direct or indirect purchasers is whether making sales at allegedly supracompetitive prices during the limitations period gives rise to a “continuing violation.” In the absence of clear direction from the Supreme Court, the lower courts have starkly split on this important question.

Numerous federal courts have held that the continued receipt of fixed or inflated payments does *not* constitute a continuing violation of the antitrust laws.<sup>29</sup> As the Sixth Circuit explained in a 2014 decision, “profits, sales, and other benefits accrued as a result of an initial wrongful act are not treated as ‘independent acts.’ Rather, they are uniformly viewed as ‘ripples’ caused by the initial injury.”<sup>30</sup> Though the defendants may have *benefitted* from earlier conduct during the limitations period, that consequence “does not render the [pre-limitations] act a continuing violation of the antitrust laws.”<sup>31</sup>

The First and Second Circuits have also held (albeit in non-antitrust contexts) that receiving unlawful payments pursuant to a pre-limitations conspiracy is not an “overt act,” and therefore does not give rise to a continuing conspiracy. In *United States v.*

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24 See *Montanez v. Sec’y Penn. Dep’t of Corrections*, 773 F.3d 472, 481 (3d Cir. 2014); *Z Techs. Corp. v. Lubrizol Corp.*, 753 F.3d 594, 603 (6th Cir. 2014).

25 *Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 187 (1997) (quoting *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345, 352 (1983)).

26 See, e.g., *Oja v. U.S. Army Corps of Eng’rs*, 440 F.3d 1122, 1126 (9th Cir. 2006) (Privacy Act); *Young v. DaimlerChrysler Corp.*, 52 F. App’x 637, 640 (6th Cir. 2002) (employment discrimination); *Woltring v. Specialized Loan Servicing, LLC*, No. 14-cv-0222, 2014 WL 2708581, at \*6 (E.D. Wis. June 16, 2014) (Fair Debt Collections Practices Act); *Lee v. City of Columbus*, No. 07-cv-1230, 2008 WL 5146504, at \*2 (S.D. Ohio Dec. 5, 2008) (Section 1983).

27 See *Stouter v. Smithtown Central Sch. Dist.*, 687 F. Supp. 2d 224, 230 (E.D.N.Y. 2010) (“[T]he continuing violation doctrine is heavily disfavored in the Second Circuit and courts have been loath to apply it absent a showing of compelling circumstances.”) (quotation omitted) (citation omitted).

28 *Rotella v. Wood*, 528 U.S. 549, 554 (2000).

29 See *Z Techs.*, 753 F.3d at 600; *Insulate SB, Inc. v. Advanced Finishing Sys., Inc.*, No. 13-cv-2664, 2014 WL 943224, at \*7 (D. Minn. Mar. 11, 2014); *Smith v. eBay Corp.*, No. 10-cv-3825, 2012 WL 27718, at \*3 (N.D. Cal. Jan. 5, 2012); *Stanislaus Food Prods. Co. v. USS-POSCO Indus.*, No. 09-cv-0560, 2010 WL 3521979, at \*16 (E.D. Cal. Sept. 3, 2010); *In re Ciprofloxacin Hydrochloride Antitrust Litig.*, 261 F. Supp. 2d 188, 227-29 (E.D.N.Y. 2003).

30 *Z Techs.*, 753 F.3d at 600.

31 *Id.* (quoting *Barnosky Oils, Inc. v. Union Oil Co. of Calif.*, 665 F.2d 74, 82 (6th Cir. 1981)).

*Doherty*, for example, then-Judge Stephen Breyer wrote for the First Circuit that “where receiving the payoff merely consists of a lengthy, indefinite series of ordinary, typically noncriminal, unilateral actions, such as receiving [allegedly inflated] salary payments . . . we do not see how one can reasonably say that the conspiracy continues.”<sup>32</sup> For its part, the Second Circuit has applied the *Doherty* rule to hold that receiving “serial payments” as a result of a “multi-year scheme to fix below-market rates on interest” does not constitute an overt act.<sup>33</sup>

In contrast, the Fourth, Eighth, Ninth, and Eleventh Circuits have held that continued sales at supracompetitive prices *do* qualify as a continuing violation.<sup>34</sup> Remarkably, each of these courts has reached this conclusion without engaging in any extended analysis of the doctrine. In fact, in the most recent of these decisions, the Eighth Circuit premised its holding on a hypothetical fear that failing to apply the continuing violations doctrine would permit “two parties [to] agree to divide markets for the purpose of raising prices, wait four years to raise prices, then reap the profits of their illegal agreement with impunity.”<sup>35</sup> However, this situation is already covered by the “speculative damages” doctrine, which holds that an antitrust plaintiff need not (and, indeed, *cannot*) bring a cause of action so long as damages remain wholly speculative.<sup>36</sup> In such a case, the plaintiff’s cause of action does not accrue until the “monopolist[s] actually

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32 867 F.2d 47, 62 (1st Cir. 1989).

33 *United States v. Grimm*, 738 F.3d 498, 499, 502–04 (2d Cir. 2013).

34 *See In re Wholesale Grocery Prods. Antitrust Litig.*, 752 F.3d 728, 736–37 (8th Cir. 2014); *Oliver v. SD-3C LLC*, 751 F.3d 1081, 1086 (9th Cir. 2014); *In re Cotton Yarn Antitrust Litig.*, 751 F.3d 1081, 1086–87 (4th Cir. 2007); *Morton’s Mkt., Inc. v. Gustafson’s Dairy, Inc.*, 198 F.3d 823, 828 (11th Cir. 1999), amended in part, 211 F.3d 1224 (11th Cir. 2000).

35 *Wholesale Grocery*, 752 F.3d at 736.

36 *See Zenith Radio Corp. v. Hazeltine Research, Inc.* 401 U.S. 321, 339 (1971). (“On the other hand, it is hornbook law, in antitrust actions as in others, that even if injury and a cause of action have accrued as of a certain date, future damages that might arise from the conduct sued on are unrecoverable if the fact of their accrual is speculative or their amount and nature unprovable.”); *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 295 (2d Cir. 1979) (“Plainly, at the time a monopolist commits anticompetitive conduct it is entirely speculative how much damage that action will cause its purchasers in the future. Indeed, some of the buyers who will later feel the brunt of the violation may not even be in existence at the time. Not until the monopolist actually sets an inflated price and its customers determine the amount of their purchases can a reasonable estimate be made. The purchaser’s cause of action, therefore, accrues only on the date damages are ‘suffered.’”) (citation omitted).

*Berkey Photo* has often been erroneously construed as addressing the “continuing violations” doctrine, when in fact, it only applies the “speculative damages” exception. Without this necessary context, *Berkey Photo* may be read as suggesting that the limitations period continues running as long as any consumers continue purchasing products from the defendants at inflated prices. However, as Professor Herbert Hovenkamp notes, interpreting *Berkey Photo* in that manner would conflict with numerous decisions of other circuits holding that a “continuing violation” tolls the statute of limitation only if the acts that are alleged to continue the violation are sufficiently independent of the initial unlawful act. The monopolist’s simple charging of its profit-maximizing price is a naturally expected consequence of monopoly and can hardly be said to be independent.

2 PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 320c4 (4th ed. 2014). Professor Hovenkamp explains that in the situation described in *Berkey Photo*, “the consumer injury occurs when the [monopolistic conduct] succeeds in strengthening or lengthening the antitrust defendant’s monopoly, thus forcing the consumer to pay more.” *Id.* ¶ 320c1.

exercise[] [their] illicit power to extract an excessive price.”<sup>37</sup> That situation, however, has nothing to do with continuing violations.

In the absence of extensive reasoning, how have four courts of appeals managed to reach this same outcome? The answer lies in a single line of *dicta*.

In *Klehr v. A.O. Smith Corporation*, the Supreme Court interpreted the Clayton Act’s statute of limitations as applied to civil Racketeer Influenced and Corrupt Organizations Act (“RICO”) actions.<sup>38</sup> In so doing, the Court majority (per Justice Breyer) drew a comparison to the continuing violations doctrine in antitrust cases. Conjuring up a hypothetical “price-fixing conspiracy that brings about a series of unlawfully high priced sales over a period of years,” Justice Breyer explained that “each overt act that is part of the violation and that injures the plaintiff,” *e.g.*, each sale to the plaintiff, “starts the statutory period running again.”<sup>39</sup> The Fourth, Eighth, Ninth, and Eleventh Circuits have each taken Justice Breyer’s line as conclusive authority for the proposition that continued sales at inflated prices keep the Clayton Act’s limitations period running.

But there’s a catch. The Supreme Court in *Klehr* did *not* actually hold that mere continuous sales qualify as a continuing violation of the antitrust laws for statute of limitations purposes. If anything the Court’s holding supports the *opposite* conclusion. *Klehr* required the Court to consider the Third Circuit’s “last predicate act” rule, which held that the limitations period for a civil RICO action ran from the time the plaintiff knew or should have known of the last injury, or last predicate act, which was part of the same alleged pattern of racketeering activity.<sup>40</sup> The Court rejected this rule because it “create[d] a limitations period that [was] longer than Congress could have contemplated,” since “a series of predicate acts . . . can continue indefinitely.”<sup>41</sup> This outcome was unacceptable to the Court, since it would “lengthen[] the limitations period dramatically.”<sup>42</sup> Citing *Zenith Radio*, the Court observed that the Third Circuit’s rule also conflicted with “the ordinary Clayton Act rule, applicable in private antitrust treble damage actions.”<sup>43</sup>

Because the Court’s (possibly offhand) statement about sales constituting “overt acts” was not vital to—and in fact may *conflict* with—the holding in *Klehr*, it is not binding on the lower courts.<sup>44</sup> The question of whether continued sales at inflated prices keep the Clayton Act statute of limitations running therefore was not settled by *Klehr*.

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37 *Berkey Photo*, 603 F.2d at 295.

38 *Klehr v. A.O. Smith Corporation*, 521 U.S. 179,183 (1984). The Court has previously held that civil RICO actions are subject to the Clayton Act’s four-year statute of limitations. *Id.*

39 *Id.* at 189 (quoting 2 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 338b (rev. ed. 1995)).

40 *See Id.* at 186–87 (quoting *Keystone Ins. Co. v. Houghton*, 863 F.2d 1125, 1130 (3d Cir. 1988)).

41 *Id.* at 187.

42 *Id.*

43 *Id.* at 188 (citing *Zenith Radio Corp. v. Hazeltine Research, Inc.* 401 U.S. 321, 338 (1971)).

44 *See Humphrey’s Ex’r v. United States*, 295 U.S. 602, 626 (1935) (“In the course of the opinion of the court, expressions occur which tend to sustain the government’s contention, but these are beyond the point involved and, therefore, do not come within the rule of stare decisis.”).

#### IV. WHY THE CONTINUED RECEIPT OF PAYMENTS FOR SALES AT SUPRACOMPETITIVE PRICES DOES NOT CONSTITUTE A CONTINUING VIOLATION

The Supreme Court's *Klehr dictum* is too thin a reed to support the heavy proposition that in all antitrust cases brought by purchasers seeking to recover overcharges on purchases, the Clayton Act's statute of limitations is potentially limitless. While suggesting that "each sale to the plaintiff" could "start[] the statutory period running again," the Court made no indication that it intended to paint with so broad a brush.<sup>45</sup> Indeed, converting a suggestion made by way of a passing "*e.g.*"<sup>46</sup> into conclusive authority for such a sweeping rule would be incongruous, especially since *Klehr* expressly rejects doctrines that would "lengthen[] the limitations period dramatically," "thereby conflict[ing] with a basic objective—repose—that underlies limitations periods."<sup>47</sup> Only a narrower construction of the continuing violations doctrine can be squared with this instruction.

The Supreme Court has previously emphasized that a continuing violation refers to an *active* conspiracy, as distinct from a completed conspiracy that produces continuing effects. Justice Oliver Wendell Holmes explained that the limitations period may be extended only where "the plot contemplates bringing to pass a continuous result *that will not continue without the continuous cooperation of the conspirators to keep it up*, and there is such continuous cooperation."<sup>48</sup> Without such continuous cooperation, the conspiracy itself does not continue—regardless of whether the conspiracy caused lasting effects.<sup>49</sup>

The Supreme Court reiterated this point decades later in *Fiswick v. United States*, a case in which German nationals were accused of conspiring to defraud the United States by failing to disclose their membership in the Nazi party, in violation of the Alien Registration Act.<sup>50</sup> In addressing whether the conspiracy was a continuing one, the Court declared: "Though the result of a conspiracy may be continuing, the conspiracy itself does not thereby become a continuing one."<sup>51</sup> Rather, the essential question is whether there is "[c]ontinuity of action to produce the unlawful result, or . . . 'continuous cooperation of the coconspirators to keep it up.'"<sup>52</sup>

So, are inflated prices an overt act, or merely the result of a prior antitrust violation? According to Professor Hovenkamp, "it would seem that high prices following . . . the creation of a monopoly are mere 'inertial consequences' that one naturally expects to flow from such acts."<sup>53</sup> In language reminiscent of the Supreme Court's holding in

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45 See *Klehr*, 521 U.S. at 189 (quotation omitted) (citation omitted).

46 See *id.* ("[E].g., each sale to the plaintiff.").

47 *Id.* at 187.

48 *United States v. Kissel*, 218 U.S. 601, 607 (1910) (emphasis added).

49 *Id.* at 607–8.

50 329 U.S. 211, 213–14 (1946).

51 *Id.* at 216.

52 *Id.* (quoting *Kissel*, 218 U.S. at 607).

53 2 Areeda, *supra* note 36, at ¶ 320c1.

*Klehr*, Hovenkamp warns that “if the mere charging of a monopoly price constitutes a ‘continuing violation’ tolling the statute, then we have indefinitely lengthened the statute of limitation.”<sup>54</sup>

Given that the charging of inflated prices is the paradigmatic consumer antitrust injury—and in virtually all conspiracy cases, the main object of the defendants’ collusion—inflated prices are merely a “naturally expected consequence” of the alleged violation.<sup>55</sup> (As the professor notes, the outcome may be different where the conspirators hold “a series of ongoing meetings to correct a cartel,” or “exchange . . . pricing information” during the limitations period.<sup>56</sup> In these cases, it is conceivable that there could be further overt actions necessary to enforce the cartel agreement.<sup>57</sup>)

Continuous sales at inflated prices also do not qualify as “overt acts” under the widely recognized *Pace Industries* definition. As noted above, that case defines “overt act” to mean “a new and independent act” that “inflict[s] new and accumulating injury on the plaintiff.”<sup>58</sup> Since the very purpose of most antitrust violations is to *charge higher prices*,<sup>59</sup> whether directly (such as by price-fixing or dividing markets) or indirectly (such as by acquiring or extending a monopoly), one can hardly describe that outcome as “new and independent” of the original conspiracy or violation.<sup>60</sup> As the Sixth Circuit explains, continued sales resulting from an “initial wrongful act” are not independent, but rather constitute “‘ripples’ caused by the initial injury.”<sup>61</sup>

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54 *Id.*

55 *Id.* at ¶ 320c4.

56 *Id.* at ¶ 320c2.

57 *Id.* Professor Hovenkamp suggests that in certain cases, it *may* be appropriate to *infer* continuing acts from higher prices—which is different from treating the higher prices themselves as continuing acts. Specifically, Hovenkamp states that “if a cartel in a competitively structured market caused overnight increases in short-term prices, one would expect prices to move back to the cartel level very quickly after cartel enforcement ceased.” *Id.* He concludes that in these circumstances, “it would be reasonable to infer continuing acts from continuing higher prices.” *Id.*

By contrast, where the cartel is more “structural,” inferring continuing acts from higher prices is not appropriate. *Id.* “For example,” Hovenkamp writes, “if two firms decide to divide the paint market, with one making latex water-based paint and the other oil-based paint, carrying out the agreement could require significant commitments to certain technologies, and these firms might not enter each other’s markets for many years after they stop ‘enforcing’ their market division.” *Id.* In such a case, the continuing effect of higher prices should *not* be taken as evidence of continuing overt acts, *i.e.*, a continuing violation. *Id.*

58 *Pace Indus., Inc. v. Three Phoenix Co.*, 813 F.2d 234, 238 (9th Cir. 1987).

59 *See, e.g., Todd v. Exxon Corp.*, 275 F.3d 191, 201 (2d Cir. 2001) (“The traditional horizontal conspiracy case involves an agreement among sellers with the purpose of raising prices to supracompetitive levels.”).

60 *See Ill. Brick Co. v. Illinois*, 431 U.S. 720, 756 (1977) (“The Senate Report accompanying the new Act expressly found that ‘[t]he economic burden of most antitrust violations is borne by the consumer in the form of higher prices for goods and services.’”) (quoting S. Rep. 94–803, at 39); *Pilkington v. United States*, 112 F.3d 1532, 1537 (11th Cir. 1997) (“The injuries were all part of the same bankruptcy scheme and all lead to the loss of [the plaintiff’s] interest in the practice; neither the acts nor the injuries were new.”).

61 *Z Techs. Corp. v. Lubrizol Corp.*, 753 F.3d 594, 600 (6th Cir. 2014).

Moreover, if the harm resulting from the defendants' original anticompetitive agreement or conduct was the imposition of supracompetitive prices, then by definition, the *continued* imposition of those prices does not cause a "new" or "accumulating" injury.<sup>62</sup> The same injury does not become "new" simply because it continues over time. The defendants' "receipt of payments merely [is] the 'result' of the conspiracy."<sup>63</sup> Therefore, as many courts have now recognized, continued sales are *not* "new and independent" overt acts causing "new and accumulating" injury, but rather "the abatable but unabated inertial consequences of some pre-limitations action."<sup>64</sup>

Deeming each sale an "overt act" would be especially problematic in cases brought by indirect purchasers. Setting aside the issue of whether federal Clayton Act accrual principles should apply to indirect purchaser state law claims,<sup>65</sup> an indirect purchaser's purported injury—purchasing something at an elevated price—is *even more* attenuated from any upstream "act of the defendants"<sup>66</sup> than a direct purchaser's injury. As the authors of a recent petition for certiorari pointed out to the Supreme Court, indirect purchasers do not even have dealings with the accused conspirators.<sup>67</sup> Treating their every purchase from third parties as an "overt act" *by the defendants* would render the term "act" meaningless.<sup>68</sup>

It bears noting that the Sherman Act's primary intended beneficiaries are consumers.<sup>69</sup> Congress was surely aware of this when it passed the Clayton Act's statute of limitations. Many if not most private antitrust actions are initiated by purchasers, and in virtually

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62 See *Martinez v. Western Ohio Health Care Corp.*, 872 F. Supp. 469, 472 (S.D. Ohio 1994) ("Moreover, the continued retention of such fees does not inflict a new and accumulating injury upon the Plaintiffs; rather, they continue to suffer the same injury that was previously inflicted upon them, albeit in an ever increasing amount.").

63 *United States v. Doherty*, 867 F.2d 47, 61 (1st Cir. 1989).

64 *Z Techs.*, 753 F.3d at 600 (quoting *Barnosky Oils, Inc. v. Union Oil Co. of Calif.*, 665 F.2d 74, 81 (6th Cir. 1981)).

65 In general, the accrual of a state law cause of action depends on the laws of the particular state, rather than federal law. See, e.g., *Bradford v. Bracken Cnty.*, 767 F. Supp. 2d 740, 750–51 (E.D. Ky. 2011). We note that while most states recognize the continuing violations (or "continuing tort") doctrine, the contours of that doctrine may vary significantly across jurisdictions. At least one state has overturned the doctrine by statute. See *Garg v. Macomb Cnty. Comm. Mental Health Servs.*, 696 N.W.2d 646 (Mich. 2005) (overruling continuing violations doctrine as conflicting with Mich. Comp. Law Ann. § 600.5827).

66 *Zenith Radio Corp. v. Hazeltine Research, Inc.* 401 U.S. 321, 338 (1971).

67 Petition for Writ of Certiorari at 8, *SD-3C, LLC v. Oliver*, No. 14-641 (indirect purchaser plaintiffs "purchas[ed] SD Cards from SD-3C licensees (like Samsung) or downstream resellers").

68 *Id.* at 13 (arguing that Ninth Circuit holding that "any purchase *by the plaintiffs* constitutes an overt act *by the defendants*, even when the plaintiff purchased the goods from someone other than the defendant . . . practically reverses *Zenith's* rule and makes the defendant's overt acts irrelevant").

69 See *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) ("Congress designed the Sherman Act as a 'consumer welfare prescription.'") (quoting ROBERT BORK, *THE ANTITRUST PARADOX* 66 (1978)).

all of these cases, the plaintiffs claim injuries resulting from inflated prices.<sup>70</sup> With this in mind, it therefore strains credulity to suggest that Congress could have intended an “exception” that would render its legislative four-year limitations period meaningless in *nearly all* consumer antitrust actions. This is precisely the outcome the Supreme Court rejected in *Klehr*.

Given the multitude of problems associated with deeming mere continued sales a “continuing violation,” we believe the Supreme Court’s *Klehr dictum* is neither analytically correct nor controlling.

## V. HOW TO GET IT RIGHT

A compelling approach to the continuing violations doctrine is one taken by Justice Breyer during his tenure on the First Circuit. In *United States v. Doherty*, the defendants were Boston policemen who had allegedly conspired to steal advance copies of civil service examinations in order to fraudulently obtain promotions.<sup>71</sup> While *Doherty* was not a civil antitrust action (it was a criminal fraud case), the relevant legal standard was the same—whether the alleged co-conspirators had committed an “overt act” during the limitations period.<sup>72</sup> The court asked “whether each defendant’s receipt of salary payments after July 1981 can count as an ‘overt act’ for statute of limitations purposes.”<sup>73</sup> The government took the position that “each monthly payment [to the defendants] constitute[d] an overt act.”<sup>74</sup>

The First Circuit reversed the conviction at issue, holding that the officers’ continuing receipt of inflated salary payments during the limitations period could not sustain the government’s prosecution.<sup>75</sup> Writing for the court, Judge Breyer articulated the following rule:

[W]here receiving the payoff [of a conspiracy] merely consists of a lengthy, indefinite series of ordinary, typically noncriminal, unilateral actions, such as receiving salary payments, *and* there is no evidence that any concerted activity posing the special societal dangers of conspiracy is still taking place, we do not see how one can reasonably say that the conspiracy continues. Rather, in these latter circumstances, one would ordinarily view the receipt of payments merely as the “result” of the conspiracy.<sup>76</sup>

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70 See, e.g., *Reiter*, 442 U.S. at 343 (“Certainly the leading proponents of the [Sherman Act] perceived the treble-damages remedy of what is now § 4 as a means of protecting consumers from overcharges resulting from price fixing.”); *United States v. Gravelly*, 840 F.2d 1156, 1161 (4th Cir. 1988) (“Horizontal price fixing is a root evil forbidden by the Sherman Act.”); *In re Dairy Farmers of Am., Inc. Cheese Antitrust Litig.*, No. 09-cv-3690, 2013 WL 4506000, at \*10 (N.D. Ill. Aug. 23, 2013) (describing “higher prices” as “typical antitrust injury”).

71 *United States v. Doherty*, 867 F.2d 47, 51 (1st Cir. 1989).

72 *Id.* at 60–61.

73 *Id.* at 61.

74 *Id.*

75 See *id.* at 61–62.

76 *Id.* at 61 (citing *Fiswick v. United States*, 329 U.S. 211, 216 (1946)).

In a follow-on case to *Doherty*, the First Circuit explained the wisdom in this rule. Accepting the government’s interpretation would have “stripp[ed] statutes of limitations of all meaning,” the court wrote, leaving the limitations period “with no fixed outer rim.”<sup>77</sup> That result would have been “untenable.”<sup>78</sup>

In contrast to the Justice Breyer’s passing *dictum* in *Klehr*, Justice Breyer’s *Doherty* rule is faithful to the past century of Supreme Court precedent—including the actual holding of *Klehr* itself. Under *Doherty*, there is no continuing violation unless “concerted activity posing the special societal dangers of conspiracy is still taking place.”<sup>79</sup> Or, as Justice Holmes put it, there must be “continuous co-operation of the conspirators” to keep the scheme alive,<sup>80</sup> not merely passive enjoyment of benefits flowing from earlier conduct. Antitrust plaintiffs’ continuous purchase of goods or services at inflated prices is just the type of “lengthy, indefinite series of ordinary, typically noncriminal, unilateral actions” that Justice Breyer held could not be imputed to alleged conspirators under a continuing conspiracy theory.

The *Doherty* rule strikes the proper balance between plaintiffs’ right to relief and defendants’ right to repose. The rule permits plaintiffs to pursue their case so long as “the special . . . dangers [attendant to] conspiracies”—actual overt acts—are still present,<sup>81</sup> and starts the limitations clock running once the “conspiracy has completed its influence on an otherwise legitimate course of common dealing that remains ongoing for a prolonged time.”<sup>82</sup> This rule also would not interfere with plaintiffs’ ability to avail themselves of other judicially recognized tolling doctrines when applicable, such as the fraudulent concealment rule.<sup>83</sup>

## VI. CONCLUSION

Three years after deciding *Klehr*, the Supreme Court was once again asked to interpret the Clayton Act’s statute of limitations in the civil RICO context. In *Rotella v. Wood*, the Court considered the “injury pattern and discovery rule,” yet another take on

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77 *United States v. Nazzaro*, 889 F.2d 1158, 1163 (1st Cir. 1989).

78 *Id.*

79 *Doherty*, 867 F.2d at 61.

80 *United States v. Kissel*, 218 U.S. 601, 607 (1910).

81 *Doherty*, 867 F.2d at 61.

82 *United States v. Grimm*, 738 F.3d 498, 503 (2d Cir. 2013) (applying *Doherty*).

83 See *id.* (“[O]vert acts have ended when the conspiracy has completed its influence on an otherwise legitimate course of common dealing that remains ongoing for a prolonged time, without measures of concealment, adjustment or any other corrupt intervention by any conspirator.”).

Additionally, antitrust plaintiffs might still seek injunctive relief under Section 16 of the Clayton Act, which is not subject to the statute of limitations in Section 4B. See *Int’l Tel. & Tel. Corp. v. Gen. Tel. & Elec. Corp.*, 518 F.2d 913, 927 (9th Cir. 1975). Rather, claims for injunctive relief are subject to the equitable doctrine of laches. See *id.* at 927–28. While courts still generally apply a four-year limitations period, “equitable relief will not be barred by laches if the trial court, in the exercise of its discretion, determines (1) that sufficient reasons cognizable in equity excuse the delay or (2) that the delay caused defendants no prejudice.” *Argus, Inc. v. Eastman Kodak Co.*, 552 F. Supp. 589, 599 (S.D.N.Y. 1982) (citing *Int’l Tel. & Tel. Corp.*, 518 F.2d 913, 929 (9th Cir. 1975)).

when civil RICO actions accrue.<sup>84</sup> The Court again remarked that it would be “strange” to adopt an accrual rule that resulted in an “unusually long basic limitations period,” given that Congress had specifically sought to “avoid[] any such policy” in passing the Clayton Act’s four-year statute of limitations.<sup>85</sup> The Court rejected the “injury pattern and discovery rule” precisely because it threatened to extend the Clayton Act limitations period to “many decades” beyond the four years prescribed by statute.<sup>86</sup>

The continuing violations doctrine, as presently interpreted in decisions from the Fourth, Eighth, Ninth, and Eleventh Circuits, has the potential to accomplish exactly what the Supreme Court has forbidden: keeping defendants on the hook for “many decades,” if not indefinitely, even when their anticompetitive conduct ceased years earlier—while memories fade, evidence is lost, and treble damages accumulate.<sup>87</sup> What’s more, this supposedly “narrow” doctrine stands to eviscerate the notion of repose in virtually *every single* consumer antitrust action filed in this country. It is time to correct this misapprehension before the Clayton Act’s four-year statute of limitations itself fades from memory.

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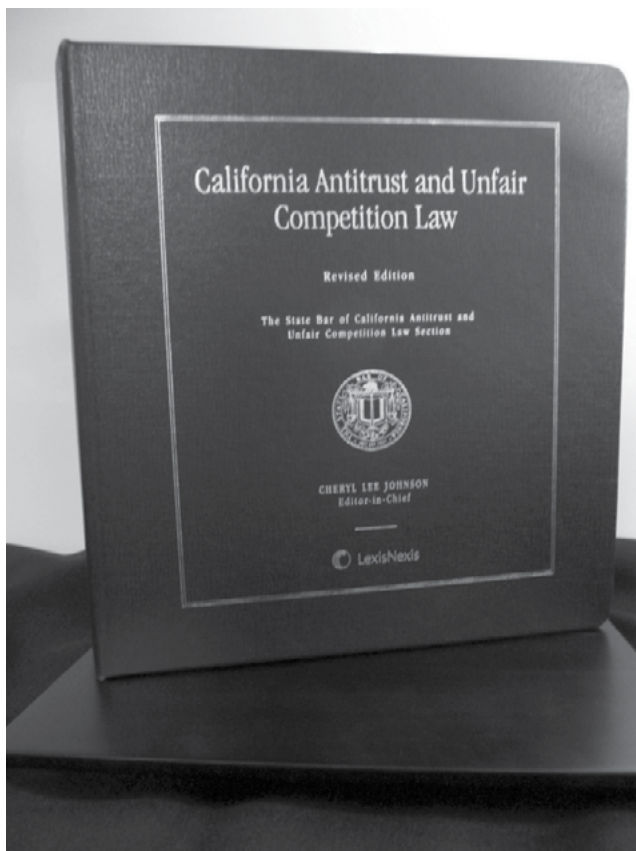
84 *Rotella v. Wood*, 528 U.S. 549, 551–52 (2000).

85 *Id.* at 558.

86 *Id.* at 554.

87 *See Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 187 (1997) (“Indeed, the rule would permit plaintiffs who know of the defendant’s pattern of activity simply to wait, ‘sleeping on their rights,’ as the pattern continues and treble damages accumulate, perhaps bringing suit only long after the ‘memories of witnesses have faded or evidence is lost.’”) (quoting *Wilson v. Garcia*, 471 U.S. 261, 271 (1985)).

# California Antitrust and Unfair Competition Law - Revised Edition



*Cheryl Lee Johnson, Editor-in-Chief*

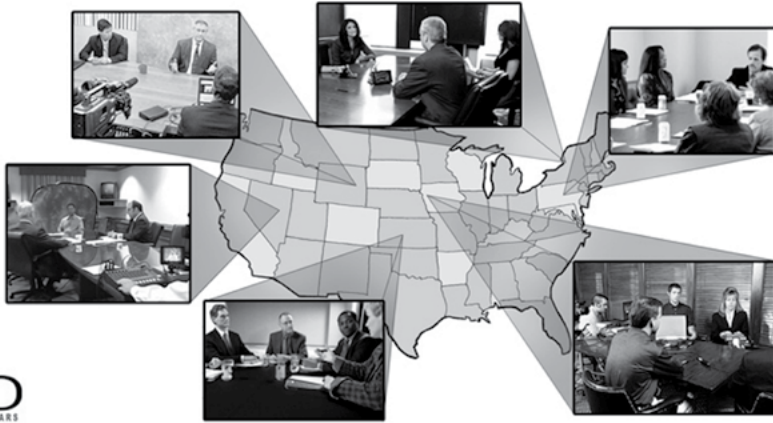
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