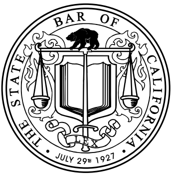


competition

Vol 25, No. 1
Spring 2016

The Journal of the Antitrust, UCL and Privacy Section of the State Bar of California

Chair's Column
Paul J. Riehle

Editor's Column
Heather S. Tewksbury

Golden State Institute's 25th Anniversary Edition

CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW UPDATE: PROCEDURAL LAW
By Thomas Greene

CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW UPDATE: SUBSTANTIVE LAW
By Thomas A. Papageorge

2015: A YEAR OF BIG PLAINTIFF WINS IN ANTITRUST AND PRIVACY CASES
By Thomas N. Dahdouh

KEYNOTE ADDRESS: A CONVERSATION WITH THE HONORABLE TANI CANTIL-SAKAUYE, CHIEF JUSTICE OF CALIFORNIA
By Cheryl Lee Johnson and Kathleen Tuttle

GOLDEN STATE INSTITUTE 25TH ANNIVERSARY RETROSPECTIVE AND PROSPECTIVE VIEWS ON CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW
By Moderator: Honorable Susan Illston; Panelists: Craig Corbitt, Daniel Wall, Kimberly Kralowec, and William Stern

MANAGING ANTITRUST AND COMPLEX BUSINESS TRIALS—A VIEW FROM THE BENCH
By Niall Lynch

THE *NEXIUM* TRIAL PIONEERS *ACTAVIS*' ACTIVATION: A ROUNDTABLE OF *NEXIUM*'S COUNSEL REFLECT ON THEIR SIX-WEEK TRIAL
By Moderator: Cheryl Lee Johnson; Panelists: Kristen Johnson, Steve Shadowen, John Schmidtlein, and Doug Baldridge

BIG STAKES ANTITRUST TRIALS: O'BANNON V. NATIONAL COLLEGIATE ATHLETIC ASSOCIATION
By David Kesselman

SETTLEMENT NEGOTIATION TACTICS, CONSIDERATIONS, AND SETTLEMENT AGREEMENT PROVISIONS IN ANTITRUST AND UCL CASES
By Moderator Paul Riehle; Panelists: Joseph R. Saveri, Holly House, and Heather Tewksbury

CONSIDERATIONS, NOT LIMITATIONS: AN ARGUMENT AGAINST DEFINING THE ANTICOMPETITIVE HARM UNDER *F.T.C. V. ACTAVIS* AS THE "ELIMINATION OF THE RISK OF POTENTIAL COMPETITION"
By Anna M. Fabish

THE DECISION OF THE SUPREME PEOPLE'S COURT IN *QIHOO V. TENCENT* AND THE RULE OF LAW IN CHINA: SEEKING TRUTH FROM FACTS
By Emilio Varanini and Feng Jiang

ROYAL PRINTING AND THE FTAIA
By Robert E. Freitas

THE UCL—NOW A MONEY BACK GUARANTEE
By Michele Floyd

FTC DATA SECURITY ENFORCEMENT: ANALYZING THE PAST, PRESENT, AND FUTURE
By Crystal N. Skelton

The Journal of the
Antitrust, UCL and Privacy Section
of the State Bar of California

Chair's Column
Paul J. Riehle

Editor's Column
Heather S. Tewksbury

Golden State Institutes
25th Anniversary Edition

Vol. 25, No. 1

Spring 2016

Golden State Institute's 25th Anniversary Edition

Editor-in-Chief
HEATHER S. TEWKSBURY
Partner
Wilmer Cutler Pickering Hale and Dorr LLP
Palo Alto, CA

Deputy Vice Chair
PETER K. HUSTON
Sidley & Austion LLP
San Francisco, CA

Article Editors

ERIK SHALLMAN
NEHA MEHTA
SAHAR MAALI
Wilmer Cutter Pickering Hale and Dorr LLP
Palo Alto, CA

CONNOR JOHNSON
Wilmer Cutler Pickering Hale and Dorr LLP
Los Angeles, CA

NANA WILBERFORCE
WILLIAM DESMOND
Wilmer Cutler Pickering Hale and Dorr LLP
Washington, DC

MARGARET E. O'GRADY
Wilmer Cutler Pickering Hale and Dorr LLP
Boston, MA

ANTITRUST, UCL AND PRIVACY SECTION EXECUTIVE COMMITTEE 2015-2016

OFFICERS

Paul J. Riehle, **Chair**, San Francisco
Niall E. Lynch, **Vice Chair**, Golden State Institute, San Francisco
Heather S. Tewksbury, **Vice Chair**, Publications (Competition), Palo Alto
Peter K. Huston, **Deputy Vice Chair**, Publications (Competition), San Francisco
Dominique C. Alepin, **Vice Chair,** Publications (Treatise), Los Angeles
Aaron M. Sheanin, **Deputy Vice Chair,** Publications (Treatise), San Francisco
Eric P. Enson, **Deputy Vice Chair,** Publications (Treatise), Los Angeles
Sarretta C. McDonough, **Vice Chair**, Programs (UCL), San Francisco
Steven N. Williams, **Vice Chair**, eBriefs, Burlingame
Jill M. Manning, **Vice Chair**, Webinars, Los Angeles
Elizabeth C. Pritzker, **Secretary**, Los Angeles
Thomas Dahdouh, **Immediate Past Chair**, Los Angeles

MEMBERS

Lee F. Berger, Washington
Anna M. Fabish, Los Angeles
Qianwei Fu, San Francisco
Robert Edward Freitas, Redwood City
Courtney A. Palko, Los Angeles
E. Kate Patchen, San Francisco

ADVISORS

Aton Arbisser, Los Angeles
Asim M. Bhansali, San Francisco
Maxwell M. Blecher, Los Angeles
Albert J. Boro, Jr., San Francisco
Craig C. Corbitt, San Francisco
John F. Cove, Jr., Oakland
Kathleen E. Foote, San Francisco
Elaine F. Foreman, San Jose
J. Thomas Greene, San Francisco
Paul R. Griffin, San Francisco
Don T. Hibner, Jr., Los Angeles
Thomas S. Hixson, San Francisco
Geoffrey T. Holtz, San Francisco
Holly A. House, San Francisco
Cheryl L. Johnson, Los Angeles
David Kesselman, Los Angeles
Kimberly A. Kralowec, San Francisco
Susan G. Kupfer, San Francisco
John M. Landry, Los Angeles
Jesse W. Markham, San Francisco
Daniel J. Mogin, San Diego
Kenneth R. O'Rourke, Los Angeles
Thomas A. Papageorge, San Diego
Roxane A. Polidora, San Francisco
Robert B. Pringle, San Francisco
J. Thomas Rosch, Washington
Lisa M. Saveri, San Francisco
Francis O. Scarpulla, San Francisco
Karen E. Silverman, San Francisco
Bruce L. Simon, San Francisco
Gary R. Spratling, San Francisco
William L. Stern, San Francisco
Anita F. Stork, San Francisco
Bonny E. Sweeney, San Diego
Kevin Y. Teruya, Los Angeles
Kathleen J. Tuttle, Los Angeles
Howard Ullman, San Francisco
Craig A. Waldman, San Francisco

Mitch Wood, Section Coordinator
Ana Castillo, Administrative Support

competition

The Journal of the Antitrust, UCL and Privacy Section
of the State Bar of California

The views expressed in *Competition* are those of the individual authors and do not necessarily represent the position of the Antitrust, UCL and Privacy Section.
Copyright © 2016 Antitrust, UCL and Privacy Section of the State Bar of California

CHAIR'S COLUMN

Paul Riehle
Sedgwick LLP
San Francisco, CA

With many thanks to the authors, editors and other contributors, the Antitrust, Unfair Competition Law & Privacy Section of the California State Bar is proud to provide you with another edition of *Competition*. This issue is chock full of interesting articles involving each substantive focus of the Section and also reprises in polished written form last Fall's Golden State Institute, our twenty-fifth!

Special thanks to our Editor-in-Chief, Heather Tewksbury, and her team at Wilmer Hale, particularly Heather's assistant Michelle Stephens. This is Heather's second year as the chief and the journal has benefited greatly by her leadership.

The Section presents many opportunities for publication in addition to *Competition*. Please contact Chery Johnson, Deputy Attorney General at the California Department of Justice, about working on the seminal treatise California Antitrust and Unfair Competition Law or Steve Williams at Cotchett Pitre & McCarthy regarding writing for our monthly E-Briefs. For speaking opportunities, please contact Jill Manning at Steyer Lowenthal Boodrookas Alvarez & Smith LLP about becoming a panelist or moderator for one of our many webinars.

Please Save the Date of November 3, 2016 for the Golden State Institute, once again featuring the trial lawyers from two big stakes antitrust trials, a conversation with a sitting California Supreme Court Justice – this year our guest is Justice Carol Corrigan – a panel of federal district court judges (Ninth Circuit nominee Northern District of California Judge Lucy Koh, Southern District of New York Judge Denise Cote, and Northern District of California Judge James Donato), and Renata B. Hesse, the new head of the Antitrust Division of the United States Department of Justice, as well as other interesting, informative speakers on matters of import to our practice. That evening we honor Paul Griffith of Winston & Strawn as our 2016 Antitrust Lawyer of the Year. Thank you to Niall Lynch of Latham & Watkins for chairing this year's GSI and putting together another fantastic program.

Many thanks to our immediate past Chair Tom Dahdouh, Regional Director for the FTC's Western Region, for his tireless efforts in virtually every facet of our Section's activities, his vision to add privacy to the scope of our efforts, and for running our Executive Committee so successfully last year.

In closing, please join me in remembering Tom Rosch, who passed away March 30, 2016. Tom was one of the leading antitrust lawyers of his generation: Director of the FTC's Bureau of Competition from 1973 to 1976; Chair of the ABA's Antitrust Section in 1990; a Federal Trade Commissioner from 2006 to 2013; and lead counsel in more than 100 federal and state antitrust cases with the government, McCutcheon, Doyle and Latham & Watkins. He was also active in and a strong supporter of our Section as a former Chair, our 2003 Antitrust Lawyer of the Year, an Advisor for many years and most recently as a panelist at the 2013 Golden State Institute.

EDITOR'S NOTE

Heather S. Tewksbury
Wilmer Cutler Pickering Hale & Dorr LLP
Palo Alto, CA

The 25th Anniversary of the Golden State Institute.

This special edition of *Competition* celebrates 25 years of the Golden State Institute with articles that highlight comments from the Chief Justice of the California Supreme Court, federal judges, and recognized practitioners. This edition also provides a survey of the past 25 years of competition law, and substantive discussions on key antitrust, unfair competition, and privacy issues.

Starting the issue off are comprehensive articles by the three Toms—**Tom Greene, Tom Papageorge**, and recent past Section Chair, **Tom Dahdouh**—on several key procedural and substantive developments in California antitrust, unfair competition, and privacy law. Also, **Cheryl Johnson** and **Kathleen Tuttle** reprise the keynote address given by **Chief Justice Tani Cantil-Sakauye** of the California Supreme Court.

Last year's GSI also offered a series of roundtable discussions covering 25 years of development in antitrust and unfair competition law and the groundbreaking cases of 2015. This issue reprises those roundtables and also provides a focused discussion on key substantive legal issues.

- In commemoration of the Golden State Institute's anniversary, **Judge Susan Illston** moderated a panel of four experienced and prominent practitioners—**Craig Corbitt, Daniel Wall, Kimberly Kralowec**, and **William Stern**—from the plaintiff and defense bars. These practitioners reflected upon twenty-five years of development in state and federal antitrust law as well as California's Unfair Competition Law, discussed the current state of the law, and offered their views of emerging hot topics for the future.
- Reprising the popular "judges panel," **Niall Lynch** moderated a roundtable with Judges **William H. Orrick III**, **Christina A. Snyder**, and **Jon S. Tigar**, focusing on a discussion of how the judges handle antitrust and complex business cases, as well as general trial practices lawyers in their courts should follow, and those they should avoid.
- Our "Big Stakes" Trials panels also made an appearance at last year's GSI with two special roundtables.

    - **Cheryl Lee Johnson** moderated a panel of lead trial lawyers **Kristen Johnson, Steve Shadowen**, **John Schmidtlein**, and **Doug Baldridge**. This article summarizes the Supreme Court's landmark decision in *F.T.C. v. Actavis* and recounts the views of the lead trial lawyers on the seventeen days of the Nexium trial.
    - **David Kesselman** analyzes *O'Bannon v. NCAA* by detailing a panel discussion with **Michael Lehmann** and **Gregory Curtner**, who served as counsel for the parties in the litigation.
    - Our GSI roundtable articles conclude with a discussion on settlement issues, led by Section Chair **Paul Riehle**, with panelists **Joseph R. Saveri**, **Holly**

House, and **Heather Tewksbury**. The article discusses the mechanics of class action settlements, and other settlement considerations, which are rarely the subject of frank public discussion.

The issue continues on with substantive legal analysis offered by an impressive slate of authors.

- **Anna Fabish**'s article on *F.T.C. v. Actavis*, delves into a discussion of the major disagreement following the Supreme Court decision on defining the anticompetitive harm that underlies a reverse payment antitrust violation.
- In a discussion of a recent Supreme People's Court antitrust case **Emilio Varanini** and **Feng Jiang** examine how antitrust law can and is helping to improve the rule of law in China.
- **Bob Freitas** discusses the exception to the direct purchaser rule that the Ninth Circuit created in *Royal Printing Co. v. Kimberly-Clark Co.* The article further describes the "full overcharge" rule that emerged from *Royal Printing* and argues that *Royal Printing*, which is a pre-FTAIA decision, does not justify a lessening of the FTAIA's proof requirements.
- This article by **Michele Floyd** seeks to analyze the Ninth Circuit's opinion in *Pulaski & Middleman, LLC v. Google, Inc.*, in which the Court adopted an expansive definition of restitution under the UCL.
- In an era of massive data collection, **Crystal Skelton** explores the evolving data security regulatory environment. This Article contends that the Federal Trade Commission already has a robust enforcement apparatus addressing concerns about the protection of private, digital consumer information.

Thank you to members of the executive committee for their tremendous work on GSI and this issue of *Competition*. And a special thanks and congratulations to our authors and editors for producing another outstanding issue!

Vol 25, No. 1 Spring 2016

The Journal of the Antitrust, UCL and Privacy Section of the State Bar of California

TABLE OF CONTENTS

GOLDEN STATE INSTITUTE'S
25TH ANNIVERSARY EDITION

Articles Page

CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW UPDATE: PROCEDURAL LAW
By Thomas Greene 1

CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW UPDATE: SUBSTANTIVE LAW
By Thomas A. Papageorge 20

2015: A YEAR OF BIG PLAINTIFF WINS IN ANTITRUST AND PRIVACY CASES
By Thomas N. Dahdouh 38

KEYNOTE ADDRESS: A CONVERSATION WITH THE HONORABLE TANI CANTIL-SAKAUYE, CHIEF JUSTICE OF CALIFORNIA
By Cheryl Lee Johnson and Kathleen Tuttle 66

ROUNDTABLE DISCUSSIONS AT THE GOLDEN STATE INSTITUTE

GOLDEN STATE INSTITUTE 25TH ANNIVERSARY RETROSPECTIVE AND PROSPECTIVE VIEWS ON CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW
By Moderator: Honorable Susan Illston; Panelists: Craig Corbitt, Daniel Wall, Kimberly Kralowec, and William Stern 79

MANAGING ANTITRUST AND COMPLEX BUSINESS TRIALS— A VIEW FROM THE BENCH
By Niall Lynch 93

THE *NEXIUM* TRIAL PIONEERS *ACTAVIS*' ACTIVATION: A ROUNDTABLE OF *NEXIUM*'S COUNSEL REFLECT ON THEIR SIX-WEEK TRIAL
By Moderator: Cheryl Lee Johnson; Panelists: Kristen Johnson, Steve Shadowen, John Schmidtlein, and Doug Baldridge 109

BIG STAKES ANTITRUST TRIALS: *O'BANNON V. NATIONAL COLLEGIATE ATHLETIC ASSOCIATION*
By David Kesselman 135

SETTLEMENT NEGOTIATION TACTICS, CONSIDERATIONS, AND SETTLEMENT AGREEMENT PROVISIONS IN ANTITRUST AND UCL CASES
By Moderator Paul Riehle; Panelists: Joseph R. Saveri, Holly House, and Heather Tewksbury 144

DEVELOPMENTS IN ANTITRUST, UNFAIR COMPETITION, AND PRIVACY LAW

CONSIDERATIONS, NOT LIMITATIONS: AN ARGUMENT AGAINST DEFINING THE ANTICOMPETITIVE HARM UNDER *F.T.C. v. ACTAVIS* AS THE "ELIMINATION OF THE RISK OF POTENTIAL COMPETITION"
By Anna M. Fabish 212

THE DECISION OF THE SUPREME PEOPLE'S COURT IN *QIHOO v. TENCENT* AND THE RULE OF LAW IN CHINA: SEEKING TRUTH FROM FACTS
By Emilio Varanini and Feng Jiang 233

***ROYAL PRINTING* AND THE FTAIA**
By Robert E. Freitas 276

THE UCL—NOW A MONEY BACK GUARANTEE
By Michele Floyd 294

FTC DATA SECURITY ENFORCEMENT: ANALYZING THE PAST, PRESENT, AND FUTURE
By Crystal N. Skelton 305

CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW UPDATE: PROCEDURAL LAW

By Thomas Greene[1]

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, presenting federal and California procedural developments in the areas of jurisdiction, pleadings, discovery, evidence, patent and copyright procedures, appeals, and ethics. Please consult other references for all of the developments that may be important to your practice.

II. JURISDICTION

A. United States Supreme Court Limits International Reach of United States Courts

1. *OBB Personenverkehr AG v. Sachs*[2]

This case arose from a tragic accident in Austria. The plaintiff was seriously injured when she tried to board an OBB train at Innsbruck in Austria. The plaintiff, a Berkeley resident, subsequently sued OBB, the Austrian state-owned railway system, in United States District Court in San Francisco.

The question before the Supreme Court was the scope of the Foreign Sovereign Immunities Act.[3] That Act generally provides that no foreign state nor any agency or instrumentality of such a state can be sued in federal court. However, specific exceptions abrogate this rule. One of these is an exception for suits "based upon a commercial activity carried on in the United States."[4]

The plaintiff alleged that she had purchased a Eurail pass in the United States, which she argued trigged the "commercial activity" exception of the Act. Writing for a unanimous Court, Chief Justice Roberts concluded that her injury was not "based upon" OBB's commercial activities in the United States. Rather, he wrote:

> Under any theory of the case that Sachs presents, there is nothing wrongful about the sale of the Eurail pass standing alone. Without the existence of the unsafe boarding conditions in Innsbruck, there would have been nothing to warn Sachs about when she bought the Eurail pass. However Sachs frames her suit, the incident in Innsbruck remains its foundation.[5]

---

1 Thomas Greene is special litigation counsel with the Bureau of Competition, Federal Trade Commission. The views expressed in this Article are those of the author, and do not necessarily reflect those of the Federal Trade Commission. This Article is adapted from a presentation delivered at the Golden State Antitrust and Unfair Competition Law Institute on October 29, 2015, and reflects developments as of that date.

2 136 S. Ct. 390 (2015).

3 28 U.S.C. § 1605.

4 28 U.S.C. § 1605(a)(2).

5 *Sachs*, 136 S. Ct. at 396.

Closing the door on plaintiff's action, the Chief Justice cited a letter from Justice Holmes to then-Professor Frankfurter, noting that Holmes "wrote that the 'essentials' of a personal injury narrative will be found at the 'point of contact'—'the place where the boy got his fingers pinched.'"[6]

III. PLEADINGS

A. California Legislature Beefs Up Sanctions for Bad Faith Pleadings

Until the early 1990s, a basic tool for litigators facing bad faith tactics in state court was California Civil Procedure Code § 128.5. This provision was eviscerated by a 1992 decision that required a showing of both objective and subjective bad faith.[7] The statute received a *coup de grace* in 1995 when the California Legislature limited its use to cases initiated on or before December 31, 1994. At the same time, however, the Legislature enacted California Civil Procedure Code §128.7, which is roughly analogous to Federal Rule of Civil Procedure 11. Section 128.7 is still in use today.

In the most recent session of the Legislature, Section 128.5 was brought back to life. The new legislation was premised on the view that courts "have lost an important tool used to ensure that bad faith actions that can materially harm the other party or the fairness of a trial are discouraged."[8]

In its new incarnation, Section 128.5:

- Authorizes courts to "order a party, the party's attorney, or both to pay the reasonable expenses, including attorney's fees, incurred by another party as a result of bad-faith actions or tactics that are frivolous *or* intended to cause unnecessary delay."[9]
- Applies to "[a]ctions or tactics" that include "making or opposing of motions."[10] However, the section does not apply to "disclosures and discovery requests, responses, objections, and motions."[11]
- Defines "Frivolous" as: "totally and completely without merit *or* for the sole purpose of harassing an opposing party."[12]
- Requires compliance with the procedural requirements of Section 128.7, which means giving the offending party or attorney notice of a potential motion and the opportunity to correct the offensive conduct.[13]

---

6 *Id.* (internal citation omitted).

7 W. Coast Dev. v. Reed, 2 Cal. App. 4th 693 (1992).

8 Bill Analysis: Concurrence in Senate Amendments AB 2494 (Cooley), Assembly 2013-2014 (Cal. Aug. 25, 2014), *available at* http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab_2451-2500/ab_2494_cfa_20140825_195951_asm_floor.html.

9 Cal. Civ. Proc. Code § 128.5(a) (emphasis added).

10 § 128.5(b)(1).

11 § 128.5(e).

12 § 128.5(b)(2) (emphasis added).

13 § 128.5(f).

New Section 128.5 became effective on January 1, 2016 and is slated to sunset on January 1, 2018 unless reenacted.[14] Use of the new provision requires notice to the California Research Bureau of the California State Library. This will inform the Legislature on the usefulness of this provision.[15]

This section still sets a high bar for sanctions and does not apply to discovery processes. However, it does eliminate the previous requirement that sanctions under Section 128.5 require proof of both objective and subjective bad faith. You can expect to see motions under revived Section 128.5 become commonplace in state courts very quickly.

B. Class and Representative Actions

1. California Supreme Court Finds Class Action Waiver Not Unconscionable, and Therefore Enforceable

Sanchez v. Valencia Holding Co., LLC[16]

This is the post-*Concepcion* decision on the enforceability of a class action waiver in an arbitration agreement.

The case grew out of the purchase of a late model Mercedes-Benz for $53,000. After the sale, Mr. Sanchez complained that Valencia, a car dealer specializing in used luxury automobiles, made false representations about the condition of the vehicle and failed to fully disclose the financial terms of the purchase. Sanchez sued on behalf of himself and a class of similarly situated customers alleging violations of the Consumer Legal Remedies Act, the Unfair Competition Law, and the Song-Beverly Consumer Warranty Act.

The issue on appeal was the extent to which the Federal Arbitration Act ("FAA"), as construed by *AT&T Mobility LLC v. Concepcion*,[17] preempted the bar against class action waivers contained in the Consumer Legal Remedies Act ("CLRA"). The court concludes that "the CLRA's anti-waiver provision is preempted insofar as it bars class waivers in arbitration agreements covered by the FAA."[18] However, the court goes on to state: "*Concepcion* requires enforcement of the class waiver but does not limit the unconscionability rules applicable to other provisions of the arbitration agreement."[19]

Thus, while the headline for this decision is that the California Supreme Court has now implemented *Concepcion*, the major importance of this decision is a restatement (and, according to the dissent, a dilution) of the California standard for unconscionability.

Under California law, "the doctrine of unconscionability has both a procedural and a substantive element, the former focusing on oppression or surprise due to unequal

---

14 § 128.5(i).

15 § 128.5(h)(1).

16 61 Cal. 4th 899 (2015).

17 563 U.S. 333 (2011).

18 *Sanchez*, 61 Cal. 4th at 924.

19 *Id*. at 907.

bargaining power, the latter on overly harsh or one-sided results."[20] As applied, "the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice-versa."[21]

The court opines that while there have been many formulations of the doctrine, "[a]ll of these formulations point to the central idea that unconscionability doctrine is concerned not with 'a simple old-fashioned bad bargain,' but with terms that are 'unreasonably favorable to the more powerful party.'"[22]

In applying this unified theory to the *Sanchez* facts, the court found that with respect to the procedural prong of the test, "the adhesive nature of the contract is sufficient to establish some degree of procedural unconscionability."[23]

The court then goes through an analysis of the arbitration agreement itself to see if it constitutes substantive unconscionability. This analysis proceeds through every major provision of the arbitration agreement and is very detailed and fact-driven. At the end of the process, the court finds that, on balance, the various provisions of the agreement are not unconscionable. For example, limiting appeals to arbitral decisions that were either zero or $100,000 was determined to have value for both the consumer and the car dealer. Likewise, special review provisions for any grants of injunctive relief were appropriate "[b]ecause of the broad impact that injunctive relief may have on the car seller's business, the additional arbitral review when such relief is granted furnishes a 'margin of safety' that provides the party with superior bargaining strength a type of extra protection for which it has a legitimate commercial need."[24]

Justice Chin concurred in the result, but dissented on what he regards as a significant reformulation of the California unconscionability standard, writing: "I part company with the majority insofar as it continues to endorse several alternative formulations for substantive unconscionability, i.e. overly harsh, unduly oppressive, unfairly one-sided."[25] Instead, he argues for a "shock the conscience" standard, which he believes is more limiting than the standard articulated by the majority.[26]

There are four important takeaways from this decision: First, the California Supreme Court agrees that the FAA, as interpreted by *Concepcion*, preempts the anti-arbitration waiver portion of the CLRA. Second, if the dissent is to be believed, the Court has lowered the bar for unconscionability determinations in state courts. Third, to the extent this is correct, this decision will affect far more than cases dealing with arbitration agreements. Finally, this is a very detailed, fact-based opinion. It does not reject arbitration agreements altogether. Rather, it carefully weighs their value to both the consumer and the seller. This decision invites study by representatives of sellers and consumers.

---

20 *Id*. at 910 (quoting Sonic-Calabasas A., Inc. v. Moreno, 57 Cal. 4th 1109, 1133 (2013)).

21 *Id*. at 911 (citations omitted).

22 *Id*. (citations omitted).

23 *Id*. at 915.

24 *Id*. at 917.

25 *Id*. at 936 (Chin, J., concurring and dissenting) (citations omitted).

26 *Id*. at 935–36 (Chin, J., concurring and dissenting).

2. Ninth Circuit Limits Restitution in Government UCL Action to Extent Claims Were Settled in a CAFA Class Action

California v. Intelligender, LLC[27]

Intelligender sold an over-the-counter product that claimed to predict the sex of babies in vitro. These claims were challenged in a class action that was transferred to a federal court pursuant to the Class Action Fairness Act. A modest settlement compromised class members' claims for restitution.

Class members were notified of the settlement, and notices were also sent to public enforcement agencies pursuant to 28 U.S.C. § 1715. This provision requires notices to federal and state agencies, and allows them to challenge the fairness of any proposed settlement. No public agency challenged the *Intelligender* settlement. Subsequently, the San Diego City Attorney's Office filed a public action under the Unfair Competition Law seeking restitution and injunctive relief for the same practices.

The issue before the Ninth Circuit was the extent to which the class settlement affected the city attorney's action. The court started its opinion with the statement: "This case sits squarely at the intersection of the Class Action Fairness Act ('CAFA') and a sovereign's right to protect its citizens from unscrupulous, fraudulent, or harmful business practices."[28] The key legal issue was whether class members were in sufficient privity with the state and its enforcement action to warrant the application of res judicata to the state's claims. The court noted that caution was appropriate, stating: "And, as the Supreme Court recently cautioned, 'issuing an injunction under the relitigation exception is resorting to heavy artillery. For that reason, every benefit of the doubt goes toward the state court; an injunction can issue only if preclusion is clear beyond peradventure.'"[29]

However, in this case, the court concluded that the state, through the San Diego City Attorney, could not seek restitution for members of the class. Further, an injunction was proper to keep the city attorney from seeking such relief under *res judicata* principles.[30] This left open claims for penalties and injunctive relief.[31]

3. Ninth Circuit Overturns Trial Court's Determination that Individual Calculations of Restitution Claims Preclude Class Certification

Pulaski & Middleman, LLC v. Google, Inc.[32]

This was a class action brought under California's Unfair Competition Law ("UCL") and False Advertising Law ("FAL") by purchasers of advertising services from Google. The

---

27 771 F.3d 1169 (9th Cir. 2014).

28 *Id*. at 1171.

29 *Id*. at 1176-77 (quoting Smith v. Bayer Corp., 131 S. Ct. 2368, 2375-76 (2011) (footnote omitted) (citations omitted)).

30 *Id*. at 1179.

31 *Id*. at 1181-82.

32 802 F.3d 979 (9th Cir. 2015).

gravamen of the case was the allegation that Google failed to disclose that some ads were displayed on websites that had no customers, but nonetheless charged for these ads.

In determining whether class certification was proper, the federal trial court found that plaintiffs did not demonstrate that common issues predominated because, "even assuming the plaintiff class could prevail on liability, common questions did not predominate on the issues of entitlement to restitution and amount of restitution due each class member."[33]

The Ninth Circuit reversed, criticizing the trial court for failing to take into account the fact that "[e]ntitlement to restitution is a separate inquiry from the amount of restitution owed."[34] The court went on to reaffirm its seminal decision in *Yokoyama v. Midland National Life Insurance Co.* that "damage calculations alone cannot defeat certification."[35]

In reaching its decision, the Ninth Circuit brushed aside respondent's argument that *Comcast Corp. v. Behrend*[36] required common issues to predominate in damage calculations. Instead, it wrote:

> In *Levya v. Medline Industries, Inc.*, we reaffirmed that damage calculations alone cannot defeat class certification. We explained that Comcast stood for the proposition that "plaintiffs must be able to show that their damages stemmed from the defendant's actions that created the legal liability." . . . "[B]ut the Court did not hold that proponents of class certification must rely on a classwide damages model to demonstrate predominance."[37]

This decision is a clean win for class plaintiffs, and significantly clarifies the scope of *Comcast* in this circuit.

4. A Potentially Big Year for Class Action Jurisprudence in the United States Supreme Court May Be Affected by the Death of Justice Scalia

The Supreme Court's docket for this term could have dramatically altered class action jurisprudence. In particular, attorneys for the United States Chamber of Commerce expected that three of these cases—*Tyson Foods*, *Spokeo,* and *Campbell-Ewald*—could "really hammer class actions."[38] So far this Term, this has not been true. Three of these cases have now been decided—*DIRECTV*, *Campbell-Ewald,* and *Tyson Foods*—with defendants winning one and plaintiffs winning two. The remaining case—*Spokeo*—has the potential for major impact, but the resolution of this case may well be affected by the death of Justice Scalia. The decided cases have not been decided by the usual splits of justices into liberal and conservative camps, and it now appears that this Term is unlikely to be remembered for hammering class actions.

---

33 *Id.* at 984.

34 *Id.* at 985.

35 594 F.3d 1087, 1094 (9th Cir. 2010).

36 133 S. Ct. 1426 (2013).

37 *Pulaski & Middleman*, 802 F.3d at 987-88 (citations omitted).

38 Lawrence Hurley, *U.S. Supreme Court's Business Docket Targets Class Actions*, Reuters (Oct. 2, 2015), http://www.reuters.com/article/us-usa-court-business-idUSKCN0RW1CF20151002.

DIRECTV, Inc. v. Imburgia[39]

DIRECTV was the first of the four cases decided by the Court. The issue was the extent to which language in an arbitration agreement used in 2007 allowing class actions if the "law of your state" precluded limits on class actions in arbitration agreements. At the time this version of the DIRECTV arbitration agreement was employed, California law prohibited class action waivers. Subsequently in *AT&T Mobility LLC v. Concepcion*, the Court struck down this rule as preempted by the Federal Arbitration Act.[40]

Justice Breyer wrote the majority opinion for an unusual coalition of Justices, including the Chief Justice and Justices Scalia, Kennedy, Alito, and Kagin. Justice Thomas dissented. Justice Ginsburg separately dissented and was joined by Justice Sotomayor.

According to Justice Breyer, the question presented was whether the language in the agreement allowing for class actions based on local law "included *invalid* California law."[41] His opinion is animated by a Federalism concern. He writes:

> No one denies that lower courts must follow this Court's holding in *Concepcion* . . . Lower court judges are certainly free to note their disagreement with a decision of this Court. But the "Supremacy Clause forbids state courts to disassociate themselves from federal law because of disagreement with its content or a refusal to recognize the superior authority of its source."[42]

He then goes on to conclude that relying on a statute that is not general, but that is not only invalid but also specifically limits arbitration, offends the Federal Arbitration Act.

With one exception, this decision is unlikely to make waves in class action law because it is based on a vintage agreement that is unlikely to be used again.

The exception, however, is potentially a big one. Justice Ginsberg's stinging dissent opines that the Court's recent string of arbitration decisions "misreads the FAA to deprive consumers of effective relief against powerful economic entities that write no-class-action arbitration clauses into their form contracts."[43] This part of her dissent appears to offer a detailed roadmap to how a more liberal majority of the Court might revisit and alter these cases.

Campbell-Ewald Co. v. Gomez[44]

The other decided case is *Campbell-Ewald*. This case presents the question of whether an unaccepted settlement offer for the full value of a class representative's claim moots a class action under Article III. This case clarified that such an offer does not deny a federal

---

39 136 S. Ct. 463 (2015).

40 563 U.S. 333, 352 (2011).

41 *DIRECTV*, 136 S. Ct at 469.

42 *Id*. at 468 (internal citations omitted).

43 *Id*. at 476.

44 136 S. Ct. 663 (2016).

court of jurisdiction, clarifying an earlier decision by the Court in *Genesis HealthCare Corp. v. Symczyk*[45] and resolving a major split in the circuits.[46]

Justice Ginsburg, writing for a majority consisting of herself, Justices Kennedy, Breyer, Sotomayor, and Kagan, and joined by Justice Thomas, concludes that "we hold that [Class Plaintiff's] complaint was not effaced by Campbell's unaccepted offer to satisfy his individual claim."[47]

Bouaphakeo v. Tyson Foods, Inc.[48]

Tyson Foods was a class action on behalf of employees who worked in a Tyson slaughter house. To do their work safely, employees "donned and doffed" protective clothing before and after each shift. Class plaintiffs asserted that when their time putting on and taking off protective gear was included in their work weeks, they worked overtime for which they were not compensated. To determine the scope of uncompensated overtime, plaintiffs had an expert take video of a sample of employees in various departments in the plant to determine how much time—on average—was required to don and doff their protective clothing. The issue in the case was whether, under the predominance requirement in Federal Rule of Civil Procedure 23(b)(3), the plaintiffs could reasonably infer that individual plaintiffs took the average amount of time determined by the expert to put on and take off their safety equipment. If the answer was yes, the case could proceed as a class action.

Justice Kennedy wrote the majority opinion sustaining the lower court's approval of class treatment of the employees' claims. Justice Kennedy was joined by Chief Justice Roberts and Justices Ginsburg, Breyer, Sotomayor, and Kagan. The Chief Justice wrote a separate concurring opinion. Justice Thomas dissented and was joined by Justice Alito.

The Court rejected the invitation of petitioner and various *amici* to announce a "broad rule" against using so-called "representative evidence" in class actions.[49] The Court found that:

> A categorical exclusion of that sort, however, would make little sense. A representative or statistical sample, like all evidence, is a means to establish or defend against liability. Its permissibility turns not on the form a proceeding takes—be it a class or individual action—but on the degree to which the evidence is reliable in proving or disproving the elements of the relevant case of action.[50]

The Court went on to determine that the statistical analysis could have been used in either an individual or class action, allowing it to distinguish the statistical analysis it disapproved of in *Wal-Mart*.[51]

---

45 133 S. Ct. 1523 (2013).

46 *Campbell-Ewald*, 136 S. Ct. at 669-70.

47 *Id*. at 670.

48 No. 14-1146 (U.S. Mar. 22, 2016).

49 *Id*. at 10.

50 *Id*. (citation omitted).

51 *Id*. at 12-14 (discussing Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338 (2011)).

This would appear to be a clean win for class plaintiffs. However, the majority analysis left open how the lower court would insure that uninjured workers would be precluded from receiving any recovery from the class action. The majority dismissed the problem as one of Tyson's own making, in that the company did not keep any records of the time employees spent donning and doffing safety equipment. [52] The Chief Justice in his concurring opinion, however, suggested that this will be a major, if not insurmountable, hurdle in the lower court.[53]

Justice Thomas's dissent is very critical of the majority's analysis, arguing, among other points, that this decision contradicts the Court's earlier *Comcast* decision on predominance.[54]

This case may mark a pendulum shift away from the Court's prior decisions. How dramatic that shift might be is unclear, but the vote split suggests that the Court has less appetite than in the past for further weakening class actions in federal courts.

Robins v. Spokeo, Inc.[55]

In *Spokeo*—a case that has been argued but not decided—the question presented is whether Congress can authorize plaintiffs who have not suffered concrete harm to sue for statutory damages even if they allegedly did not suffer Article III injury. This appeal arises from alleged violations of the Fair Credit Reporting Act for posting inaccurate information on the Internet about plaintiff and members of his class. Plaintiff asserted that his employment prospects had been affected by defendant's inaccurate reports. The Ninth Circuit concluded that this constituted injury within the meaning of Article III.

On the other side, Spokeo, the United States Chamber of Commerce, and a "Who's Who" of Silicon Valley *amici* argue that there was no injury and that plaintiff had no Article III standing. They also argue that resolution of this case in favor of Spokeo would preclude actions under the Debt Collection Practices Act, the Fair Housing Act, the Americans with Disabilities Act, the Telephone Consumer Protection Act, and numerous other federal statutes.

This is an important case, but one with potential dry rot at its core. Plaintiff claimed actual injury in his complaint and in all subsequent pleadings. There has been no trial court determination that he was not injured. This means that the Court may be flirting with a potential advisory opinion if it proceeds.

IV. DISCOVERY

A. Judge Peck (S.D.N.Y.) Provides a Retrospective on his *Da Silva Moore* Decision, Creating a Handy Reference on Technology Assisted Review

1. *Rio Tinto PLC v. Vale S.A.*[56]

---

52 *Id*. at 15-17.

53 *Id*. at 5-6 (Roberts, C.J., concurring).

54 *Id*. at 7-8 (Thomas, J., dissenting) (discussing Comcast Corp. v. Behrend, 133 S. Ct. 1426 (2013)).

55 742 F.3d 409 (9th Cir. 2014), *cert. granted*, 135 S. Ct. 1892 (Apr. 27, 2015) (No. 13-1339).

56 306 F.R.D. 125 (S.D.N.Y. 2015) (Peck, M.J.).

Judge Andrew Peck of the Southern District of New York is a thought-leader on the use of advanced technology to assist with discovery. For example, he wrote the first opinion in the nation recognizing and validating the use of Technology Assisted Review ("TAR") to tame the dramatically larger sets of e-documents that have become common in major cases.[57]

Rio Tinto provided Judge Peck the opportunity to summarize the current law on TAR and comment on possible future developments. Highlights include:

- "In the three years since *Da Silva Moore*, the case law has developed to the point that it is now black letter law that where the producing party wants to utilize TAR for document review, courts will permit it."[58]
- "In contrast, where the requesting party has sought to force the producing party to use TAR, the courts have refused."[59]
- "One TAR issue that remains open is how transparent and cooperative the parties need to be with respect to the seed or training sets."[60]
- However, "[i]f the TAR methodology uses 'continuous active learning' (CAL) as opposed to simple passive learning (SPL) or simple active learning (SAL), the contents of the seed set is much less significant."[61]

Judge Peck's actual mission in this decision is to approve a proposed TAR protocol developed cooperatively between the parties, which he attaches to his decision. Overall, this decision is a succinct and useful guide to the current law of Technology Assisted Review.

B. New Federal Rules of Civil Procedure—Effective on December 1, 2015—Make Major Changes in Federal Discovery and Spoliation Rules

On December 1, 2015, significant changes in the Federal Rules of Civil Procedure, became effective for Rules 1, 4, 16, 26, 30, 31, 34, 37, 55, and 84.

Highlights include:

- Rule 1, relating to the scope and purpose of the Federal Rules of Civil Procedure, is amended to require that the rules "should be construed, administered, *and employed by the court and the parties* to secure the just, speedy, and inexpensive determination of every action and proceeding." The Committee Note states that the amended rule is designed to make clear that "the parties share the responsibility" to use the rules in a cost-effective manner. Moreover, the Note continues: "Effective advocacy is consistent with—and indeed depends upon—cooperative and proportional use of procedure."
- Rule 4, relating to summons, is amended to authorize the dismissal of an action if a defendant is not served within ninety days after the complaint is filed in court, unless good cause is shown by the plaintiff.[62] In addition, the Appendix of Forms is amended for Rule 4 to provide text to be used when seeking a waiver of service.

---

57 Da Silva Moore v. Publicis Groupe & MSL Grp., 287 F.R.D. 182 (S.D.N.Y. 2012) (Peck, M.J.), *aff'd*, 2012 WL 1446534 (S.D.N.Y. Apr. 26, 2012).

58 *Rio Tinto,* 306 F.R.D. at 127 (emphasis added) (citations omitted).

59 *Id.* at 128 n.1 (citations omitted).

60 *Id.* at 128 (citations omitted).

61 *Id.*

62 Fed. R. Civ. P. 4(m).

- Rule 16 is amended to require the issuance of a scheduling order within "*the earlier of 90 days after any defendant has been served with the complaint or 60 days after any defendant has appeared*."[63] Courts are also authorized and encouraged to issue orders that "provide for disclosure, discovery, *or preservation* of electronically stored information."[64] This is buttressed by a new requirement that parties discuss preservation issues in their pre-hearing conference.
- Rule 26(b)(1) is amended to limit discovery to material that is "relevant to any party's claims or defenses *and proportional to the needs of the case considering the importance of the issues at stake, 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 proposed discovery outweighs its likely benefit . . .*"

Most of these factors already appear in Rule 26(b)(2)(C)(iii), which was adopted in 1983. The Committee Note argues that "the present amendment restores the proportionality factors to their original place in defining the scope of discovery." That conclusion was previously disputed in a series of comments on the rule from many plaintiffs' representatives and law professors who argued that the new rule would unduly limit the traditional scope of discovery.[65]

Criticism of earlier proposals led to changes that soften potential problems with inclusion of proportionality as a limit on the scope of discovery. For example, the "amount in controversy" factor was dropped to second position in the list of proportionality factors, giving primacy to "importance of the issues." In addition, a new factor—"relative access to information"—was added to address information asymmetry.

The Committee Note makes clear that the change is not "intended to permit the opposing party to refuse discovery simply by making a boilerplate objection that it is not proportional." The Note also includes that statement that "the burden of responding to discovery lies heavier on the party who has more information and properly so." The Note also discusses the relationship of the various proportionality factors, noting, for example that "monetary stakes are only one factor, to be balanced against other factors."

The Committee Note also points out that technology assisted review should be seriously considered to reduce the burden of discovery, noting: "Computer-based methods of searching such information continue to develop . . . [and] . . . [c]ourts and parties should be willing to consider the opportunities for reducing the burden or expense of discovery as reliable means of searching electronically stored information become available."

- Rule 26(b)(2)(C) is amended to give courts "on motion or on its own" the power to limit discovery that is outside the scope of Rule 26(b)(1).
- Rules 30(a)(2), relating to depositions by oral examination, 31(a)(2), relating to depositions by written question, and 33(a)(1), relating to interrogatories, are amended to cross-reference the new proportionality principle enunciated in

---

63 Fed. R. Civ. P. 16(b)(2).

64 Fed. R. Civ. P. 16(b)(3)(iii).

65 A useful resource on the evolution of these rules is Thomas Allman's summary of the final rules package sent to Congress. Thomas Y. Allman, *The 2015 Civil Rules Package as Transmitted* to *Congress*, Sedona Conf. J., Fall 2015. Mr. Allman is the former General Counsel and Chair Emeritus of the Sedona Conference WG 1 on E-Discovery and the E-Discovery Committee of Lawyers for Civil Justice.

amended Rule 26(b)(1). These changes replace an initial proposal to halve the number of allowed depositions and interrogatories, which generated strong protests at public hearings.

- Rule 34, relating to production of documents and electronically stored information ("ESI"), is changed in three ways:

    - o Responding parties must respond "within 30 days after being served or—if the request was delivered under Rule 26(d)(2)—within 30 days after the parties' first Rule 26(f) conference."
    - o "The responding party may . . . produce copies of documents or of [ESI] instead of permitting inspection."
    - o "An objection must state whether any responsive materials are being withheld on the basis of that objection."

- Rule 37, relating to failures to disclose or to cooperate, is significantly altered:

    - o Rule 37(e) applies to "[ESI] that should have been preserved in the anticipation or conduct of litigation . . . ."
    - o Rule 37(e)(1) is amended to require a finding of "prejudice to another party" and limits sanctions to "measures no greater than necessary to cure the prejudice."
    - o For the most serious sanctions, notably adverse inference instructions or terminating sanctions, Rule 37(e)(2) requires a showing that "the party acted with the intent to deprive another party of the information's use in the litigation."

With respect to Rule 37, the Committee Note comments that:

- Amended Rule 37(e) applies only to ESI.
- Rule 37 does not create any new duty, so is "based on [the] common-law duty" to preserve.
- The new rule leaves open the effect of a non-common law duty to preserve on the operation of the rule. An example of such a duty is the duty imposed on corporate entities by the Sarbanes-Oxley Act to retain information related to a government investigation.[66]
- Counsels courts to be "sensitive" to the related sophistication of some parties with respect to preservation.
- "[T]he initial focus should be on whether the lost information can be restored or replaced through additional discovery."
- "The rule does not place a burden of proving or disproving prejudice on one party or the other," noting that "placing the burden of proving prejudice on the party that did not lose the information may be unfair."
- The requirement for a kind of ESI specific intent "rejects cases such as *Residential Funding Corp. v. DeGeorge Financial Corp.*, 306 F.3d 99 (2d Cir. 2002), that authorize the giving of adverse-inference instructions on a finding of negligence or gross

---

66 15 U.S.C. § 1520.

negligence." This leaves open how this new *mens rea* requirement might be met via circumstantial evidence.

- Though adverse inference instructions are circumscribed, the new rule "would not prohibit a court from allowing the parties to present evidence to the jury concerning the loss and likely relevance of information and instructing the jury that it may consider that evidence, along with all the other evidence in the case, in making its decision."

All in all, these new rules are not as bad as some of the early hearings may have suggested. However, the keys to appropriate interpretation of these rules are (1) a full understanding of the drafting history, particularly as the draft rules and notes were changed to make them more even-handed, and (2) a mastery of the rich lode of commentary in the new Committee Notes.

V. EVIDENCE

A. Second District Court of Appeals Provides Additional Guidance on the Admissibility of Expert Opinion after *Sargon*

1. *Cooper v. Takeda Pharmaceuticals America, Inc.*[67]

In 2012, the California Supreme Court significantly altered state practice with respect to expert opinion evidence in *Sargon Enterprises, Inc. v. University of Southern California*.[68] *Sargon* underscored the role of state trial judges as "gatekeepers," and ushered in a new era for expert testimony in state practice.[69]

The *Sargon* court extensively cited to federal decisions, notably *Daubert v. Merrell Dow Pharmaceuticals, Inc.*[70] and *Kumho Tire Co., Ltd. v. Carmichael*.[71] This raised the important question of the extent to which California courts would be adopting *Daubert*.[72]

The issue in *Takeda Pharmaceuticals* was the admissibility of expert testimony by a leading cancer researcher on the cause of plaintiff's bladder cancer. Plaintiff's expert considered various causes of plaintiff's illness—notably his smoking behavior and possible exposure to environmental pollutants—but concluded in a "differential diagnosis" that the most substantial cause of his cancer was Takeda's diabetes drug, Actos.

The trial court excluded the testimony of plaintiff's expert for failing to definitively exclude causes other than Actos for plaintiff's cancer, and then granted a motion for judgment notwithstanding the verdict for lack of proof of causation. The court of appeal

---

67 239 Cal. App. 4th 555 (2015).

68 55 Cal. 4th 747 (2012). *Sargon* and its immediate progeny were discussed in our 2013 program materials.

69 *Id.* at 769.

70 509 U.S. 579 (1993).

71 526 U.S. 137 (1999).

72 *See* David L. Faigman & Edward J. Imwinkelried, *Wading into the* Daubert *Tide*: Sargon Enterprises, Inc. v. University of Southern California, 64 Hastings L.J. 1665 (2013). The same authors wrote an earlier article that was extensively cited by the California Supreme Court in its *Sargon* decision. *See* Edward J. Imwinkelried & David L. Faigman, *Evidence Code Section 802*: *The Neglected Key to Rationalizing the California Law of Expert Testimony*, 42 Loy. L.A. L. Rev. 427 (2009).

criticized the trial court for: (1) failing to take into account the basic standard of proof in a civil case involving multiple causes of injury, and (2) failing to limit its gatekeeper role to the confines of *Sargon*.

On the overall standard of proof, the appellate court noted:

> The law is well settled that in a personal injury action causation must be proved within a reasonable medical probability, based upon competent expert testimony. . . . A possible cause only becomes "probable" when, in the absence of other reasonable causal explanations, it becomes more likely than not that the injury was the result of its action.[73]

Given this standard, "the plaintiff must offer an expert opinion that contains a reasoned explanation illuminating why the facts have convinced the expert, and therefore should convince the jury, that it is *more probable than not* the negligent act was a cause-in-fact of the plaintiff's injury."[74] Thus, "it is not necessary for a plaintiff to establish the negligence of the defendant as the proximate cause of injury with absolute certainty *so as to exclude every other possible case of plaintiff's illness,* even if the expert's opinion was reached by performance of a differential diagnosis."[75]

On abuse of the *Sargon* standard, the trial court criticized the statistical analysis in over a dozen articles and studies relied on by plaintiff's expert, arguing that they did not definitively rule out other causes of defendant's injury. As described by the court of appeal:

> The trial court abused its discretion by essentially stepping in and resolving the debate over the validity of the studies. In particular, the trial court's piecemeal rejection of individual studies was inappropriate and ignored the testimony of [another plaintiff's expert] that the results of the individual studies as a whole, including in the meta-analysis, was what really persuaded them that Actos causes bladder cancer. All studies have limitations and flaws, and it is entirely valid to interpret each study's results by taking into account these limitations and flaws. However, it is essential that the results of other studies conducted by other scientists on the same subject, that aim to correct for the limitations and flaws in prior studies, be taken into account, and the body of studies be considered as a whole.[76]

Quoting from *Sargon*, the court recalled that:

> The trial court's preliminary determination whether the expert opinion is founded on sound logic is not a decision on its persuasiveness. The court must not weigh an opinion's probative value or substitute its own opinion for the expert's opinion. Rather, the court must simply determine whether the matter relied on can provide a reasonable basis for the opinion or whether that opinion is based on a leap of logic or conjecture.[77]

---

73 Cooper v. Takeda Pharms. Am., Inc., 239 Cal. App. 4th 555, 577 (2015) (quoting Jones v. Ortho Pharm. Corp., 163 Cal. App. 3d 396, 402-03 (1985)).

74 *Id.* at 578 (quoting Jennings v. Palomar Pomerado Health Sys., Inc., 114 Cal. App. 4th 1108, 1118 (2003)).

75 *Id.*

76 *Id.* at 589.

77 *Id.* at 592 (quoting Sargon v. Univ. of S. Cal., 5 Cal. 4th 747, 772 (2012)).

There are at least three major takeaways from this decision. The first, and most important, is that the gatekeeper function exercised by state trial courts is far more limited than the role assumed by many federal trial courts under *Daubert*. Second, the conclusions of the expert must be understood against the background of the burden of proof carried by the party sponsoring the expert. As in all civil cases, the burden is preponderance, not certainty, so some leeway is both necessary and appropriate. Finally, the court rejects the classic attack strategy used by both defendants and plaintiffs to pick apart individual studies, rather than view them as a whole.

B. State and Federal Courts Clarify Admissibility of Web-Based Content

1. *In re K.B.*[78]

In re K.B. arose from the prosecution in state court of a minor for possession of a firearm. K.B. and an adult defendant were on felony probation, which terms forbade their possession of firearms. During a search of their apartment authorized by their probation, officers observed two guns tossed out of the back window of the apartment through a curtain made of camouflage cloth. The issue was whether either defendant possessed a firearm in violation of their probation conditions.

The cell phones of the two occupants were seized, and the phones searched. This revealed incriminating Instagram photos of the two individuals brandishing handguns wearing the same clothes they wore at the time of the search and standing before a curtain that matched the curtains in their apartment. Over the objection of the defense, these photos were admitted into evidence at trial.

On appeal, K.B. argued that the prosecutor had not sufficiently authenticated the photos, relying on *People v. Beckley*.[79] The court demurred, agreeing with the People that the photos were authenticated by the fact that the phone was password protected and the content clearly associated with defendant K.B. The court also noted that:

> In making the initial authenticity determination, the court need only conclude that a prima facie showing has been made that the photograph is an accurate representation of what it purports to depict. The ultimate determination of authenticity of the evidence is with the trier of fact, who must consider any rebuttal evidence and balance it against the authenticating evidence in order to arrive at a final determination on whether the photograph, in fact, is authentic.[80]

This burden shifting analysis dramatically reduces the burden on those seeking admission of web-based content.

2. *United States v. Lizarraga-Tirado*[81]

In *Lizarraga-Tirado,* a federal criminal case, the defendant was accused of being a previously removed alien who illegally reentered the United States. At the time of his arrest,

---

78 238 Cal. App. 4th 989 (2015).

79 185 Cal. App. 4th 509 (2010).

80 *In re K.B.*, 238 Cal. App. 4th at 997.

81 789 F.3d 1107 (9th Cir. 2015).

a Border Patrol Agent contemporaneously recorded the GPS coordinates of defendant's arrest using a handheld GPS device. At trial, these coordinates were entered into Google Earth, which showed that the arrest took place within the borders of the United States.

Defendant argued that the Google report was inadmissible hearsay. In an opinion by Judge Kozinski, the court noted that: "For hearsay purposes, a statement is defined as 'a person's oral assertion, written assertion or non-verbal conduct, if the person intended it as an assertion.'"[82] The Google Earth representation would only be hearsay if the location was drawn in by a human actor. If not, as in this case, it was not hearsay.

However, analogizing the Google Earth image to a machine that "tells" us something, like a clock, the court stated that a decision that a statement by a machine or technology is not hearsay does not end the inquiry. According to the court:

> A proponent must show that a machine is reliable and correctly calibrated, and that the data put into the machine (here GPS coordinates) is accurate. A specific subsection of the authentication rule allows for authentication of a "process or system" with evidence "describing [the] process or system and showing that it produces an accurate result." . . . That burden could be met, for example, with testimony from a Google Earth programmer or a witness who frequently works with and relies on the program. It could also be met through judicial notice of the program's reliability as the Advisory Committee Notes specifically contemplate.[83]

This decision nicely summarizes the interplay of hearsay and authentication rules, and provides a tutorial on the various ways Web content can be authenticated.

VI. PATENT AND COPYRIGHT PROCEDURES

A. Federal Circuit Begins to Review PTAB Decisions

Last year's program covered expedited review procedures used by the Patent Trial and Appeal Board ("PTAB") at the Patent and Trademark Office.[84] The first PTAB cases to reach the Federal Circuit were decided this year. So far, PTAB has been largely successful.

1. *Versata Development Group, Inc. v. SAP America, Inc.*[85]

In *Versata*, for example, the Federal Circuit in a Covered Business Method ("CBM") review:

- Sustained PTAB's "broadest reasonable interpretation" approach to claim construction;[86]

---

82 *Id.* at 1109 (citations omitted).

83 *Id.* at 1110 (citations omitted).

84 Thomas Greene & Thomas A. Papageorge, *California Antitrust and Unfair Competition Law and Federal and State Procedural Law Developments*, 24 Competition 1, 38 (2015).

85 793 F.3d 1306 (Fed. Cir. 2015).

86 *Id.* at 1327.

- Sustained PTAB's authority under 35 U.S.C. § 101 to determine if claims in the challenged patent represent an abstract idea, rather than a patentable invention;[87] and
- Affirmed PTAB's conclusion that four claims in a patent were unpatentable under Section 101.[88]

2. *Microsoft Corp. v. Proxyconn, Inc.*[89]

In *Microsoft*, PTAB got mixed marks for an *inter partes* review. The Federal Circuit:

- Reaffirmed PTAB's use of its "broadest reasonable interpretation standard" in *inter partes* reviews; [90]
- Overturned PTAB's dismissal of some claims but affirmed others;[91] and
- Sustained the ability of PTAB to limit amendments of patent claims through internal judicial process, and not just via regulation.[92]

Taken together, these decisions show a new administrative tribunal going through some growing pains, but nonetheless largely fulfilling its function under the America Invents Act to expedite review of potentially faulty patents.

B. Copyright Holders Must Consider Fair Use Before Sending Takedown Notices

1. *Lenz v. Universal Music Corp.*[93]

This appeal arose from the posting of a YouTube video by a young mother of her infant son dancing to a Prince song. She received a "takedown" notice from the copyright holder pursuant to the Digital Millennium Copyright Act ("DMCA")[94] and things went from there.

There are two important takeaways from this case. First, in a decision of first impression, the Ninth Circuit concludes that the DCMA incorporates the "fair use" doctrine codified in 17 U.S.C. § 107.[95] Second, the court concludes that a copyright holder must consider the fair use doctrine before issuing a takedown notice, or potentially face liability for misrepresentation.

---

87 *Id.* at 1329.

88 *Id.* at 1336.

89 789 F.3d 1292 (Fed. Cir. 2015).

90 *Id.* at 1297 (citing *In re* Cuozzo Speed Techs., LLC, 778 F.3d 1271, 1282 (Fed. Cir. 2015)).

91 *Id.* at 1298, 1302.

92 *Id.* at 1306.

93 801 F.3d 1126 (9th Cir. 2015).

94 17 U.S.C. § 512.

95 *Lenz*, 801 F.3d at 1132.

VII. APPEALS

A. United States Supreme Court Clarifies When a Notice of Appeal is Due in an MDL Proceeding

1. *Gelboim v. Bank of America Corp.*[96]

This decision arose from consolidated actions seeking damages for manipulation of the London InterBank Offered Rate ("LIBOR"). Plaintiff Gelboim represented a class asserting a single claim that defendants had conspired to fix this important reference rate in violation of federal antitrust law in order to keep their borrowing costs low. The trial court dismissed the action based on a failure to demonstrate antitrust injury.

Petitioner appealed, but the Second Circuit dismissed the appeal because the "order appealed from did not dispose of all claims *in the consolidated action*."[97] In the Supreme Court, petitioners argued that dismissal of their case in its entirety removed their case from the multidistrict litigation ("MDL") and triggered their right to appeal under 28 U.S.C. § 1291. Respondent banks argued that consolidated cases proceed as a single unit throughout the consolidation. Deciding for petitioner, a unanimous Court concluded that:

> The sensible solution to the appeal-clock trigger is evident: When the transferee court overseeing the pretrial proceedings in multidistrict litigation grants a defendant's dispositive motion "on all issues in some transferred cases, [those cases] become immediately appealable . . . while cases where other issues remain would not be appealable at that time."[98]

The headline for this case is that if all of your claims are dismissed—even in the context of an MDL proceeding—you can and must appeal.

But the Court was not unsympathetic to the point that appeals are best considered together. The Court noted the appropriateness of granting certifications for interlocutory appeals under Federal Rule of Civil Procedure 54(b), but warned that "Rule 54(b) is designed to permit acceleration of appeals in multiple-claim cases, not to retard appeals in single-claim cases."[99] In this regard, this decision is a tutorial on how to use disparate rules to cobble together practical procedures to platoon appeals in complex, MDL proceedings.

B. Local Rules for First District Court of Appeal of CaliforniaAugment Requirements for E-Briefs

1. Local Rules of the Court of Appeal First Appellate District: Rule 16, Electronic Filing

It is always important to check local rules before submitting a brief or pleading. This is particularly true in California where local courts have significant discretion over their own processes. A case in point is new Local Rule 16 for the Court of Appeal for the First Appellate District specifying requirements for electronic filing of briefs and records on appeal.

---

96 135 S. Ct. 897 (2015).

97 *Id.* at 904 (emphasis added).

98 *Id.* at 905 (alterations in original) (quoting David F. Herr, Multidistrict Litig. Manual: Practice Before the Judicial Panel on Multidistrict Litig. § 9:21, at 312 (2014)).

99 *Id.* at 906.

For e-briefs, the rule provides that: "*Electronic bookmarks* to each topic heading in the text (as listed in the table of contents) in briefs are recommended and required for all briefs exceeding forty (40) pages."[100] In a similar vein: "Each part of the record . . . shall clearly state the volume and page numbers included within that part and include an index of contents, with a *descriptive electronic bookmark* including exhibit number or letter."[101]

These are certainly reasonable requirements, but one does need to build sufficient time into the briefing process to meet them. This rule became effective on May 1, 2015.

VIII. ETHICS

A. California Bar Issues Opinion on Ethical Duties of Attorneys When Handling Discovery of ESI

1. State Bar Standing Committee on Professional Responsibility & Conduct, Formal Opinion No. 2015-193 (Handling of Discovery of ESI)[102]

This opinion addresses the ethical duties of a California attorney "in the handling of discovery of [ESI]." This takes the form of a hypothetical that raises questions about the duty of competence, the duty to supervise subordinates in the gathering and protection of ESI, and the duty of confidentiality.

Discovery in major cases has increasing become e-discovery. Failure to understand the nuances of this part of practice is no longer acceptable in California. As pointedly noted by the Committee: "Depending on the factual circumstances, a lack of technical knowledge in handling e-discovery may render an attorney ethically incompetent to handle certain matters involving e-discovery, absent curative assistance under rule 3-110(C), even where the attorney may otherwise be highly experienced."[103]

The effects of this opinion are not limited to ethics cases. This opinion has already been featured in a case imposing substantial spoliation sanctions on a company and its lawyers in United States District Court.[104] Specifically, lead counsel had to pay significant monetary sanctions for failure to set a litigation hold[105] and failure to supervise subordinate attorneys and non-attorney employees.[106] In addition, the court imposed an adverse inference instruction on his client.

This is a must-read for California lawyers, and is worth sharing with technology employees who assist you with e-discovery tasks.

---

100 Cal. Ct. App. 1st Dist. Local R. 16(b)(3) (emphasis added).

101 Cal. Ct. App. 1st Dist. Local R. 16(d)(1) (emphasis added).

102 State Bar of Cal. Standing Comm. on Prof. Responsibility & Conduct, Formal Op. No. 2015-193 (2015), *available at* http://ethics.calbar.ca.gov/Portals/9/documents/Opinions/CAL%202015-193%20%5B11-0004%5D%20(06-30-15)%20-%20FINAL.pdf.

103 *Id.* at 7.

104 HM Elecs., Inc. v. R.F. Techs., Inc., No. 12-CV-2884, 2015 WL 4714908, at *21-22 (S.D. Cal. Aug. 7, 2015).

105 *Id.*

106 *Id.* at *24.

CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW UPDATE: SUBSTANTIVE LAW

By Thomas A. Papageorge[1]

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, presenting cases that reflect recent California substantive law developments related to the Cartwright Act, the Unfair Practices Act, covenants not to compete, the Consumer Legal Remedies Act, the Unfair Competition Law, and false advertising law. Please consult other references for all of the developments that may be important to your practice.

II. CARTWRIGHT ACT[2]

A. California Supreme Court: "Reverse Payment" Patent Settlements Are Not Immune From Traditional Cartwright Act Scrutiny

1. *In re Cipro Cases I & II*[3]

On May 7, 2015, the California Supreme Court delivered its much-anticipated opinion in the *In re Cipro Cases I & II* Cartwright Act antitrust litigation, an important part of the high-stakes national debate over "reverse payment" patent settlements that has raised fundamental questions about the interaction between patent rights and antitrust principles.

The lengthy coordinated class action matter in *In re Cipro Cases I & II* involved plaintiffs' antitrust claims concerning ciprofloxafin (branded as "Cipro"), an antibiotic patented by Bayer Corporation. Plaintiffs alleged that Bayer and several generic drug manufacturers violated the Cartwright Act, the Unfair Competition Law, and common law monopolization principles by entering into a patent infringement settlement in which Bayer agreed to make payments (ultimately totaling $398 million) in exchange for the generic manufacturers' agreement not to manufacture the generic version of Cipro until the patent expired—an arrangement characterized by the plaintiffs as "pay-for-delay" monopolization and by the defendants as legitimate "reverse payments" to settle *bona fide* patent litigation.

The trial court granted defendants' summary judgment motion, ruling that the settlements were neither illegal per se under the Cartwright Act nor unreasonable under the rule of reason, and finding no triable issue as to whether the agreements produced "anticompetitive effects beyond the exclusionary scope of the patent itself."

---

1 Thomas A. Papageorge is the head of the Consumer Protection Unit, San Diego District Attorney's Office. The views expressed in this Article are those of the author, and do not necessarily reflect those of the San Diego District Attorney's Office. This Article is adapted from a presentation delivered at the Golden State Antitrust and Unfair Competition Law Institute on October 29, 2015, and reflects developments as of that date.

2 Cal. Bus. & Prof. Code § 16720 *et seq.*

3 61 Cal. 4th 116 (2015).

The Fourth District affirmed summary judgment for defendants, adopting defendants' proposed legal standard derived from *In re Tamoxifen Citrate Antitrust Litigation*,[4] where 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.[5]

The Fourth District rejected a per se analysis, and under the rule of reason found the agreements to be a "natural byproduct of patent litigation" that was consistent with federal and state policies favoring dispute resolution. The court summarized its version of the *Tamoxifen* rule: "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."[6]

The California Supreme Court granted plaintiffs' petition for review on February 15, 2012,[7] and extensive *amici* participation followed, both before and after the United States Supreme Court's opinion in *F.T.C. v. Actavis, Inc.*,[8] which held that the FTC's Section 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.[9] The Supreme Court then dismissed the settling Bayer defendants from the pending review.[10]

On May 7, 2015, the California Supreme Court issued its unanimous opinion, authored by Justice Werdegar, clarifying the applicability of the Cartwright Act to such agreements and the legal standard to be applied in this analysis. The Court summarized its conclusion as follows:

> Purchasing freedom from the possibility of competition, whether done by a patentee or anyone else, is illegal. An agreement to exchange consideration for elimination of any portion of the period of competition that would have been expected had a patent been litigated is a violation of the Cartwright Act.[11]

The Court also provided an instructive review of the contemporary state of Cartwright Act analysis as a whole, including the interactions between federal and state antitrust laws and between per se, rule of reason, and "quick look" forms of antitrust analysis.

---

4 466 F.3d 187 (2d Cir. 2006).

5 *In re* Cipro Cases I & II, 200 Cal. App. 4th 442 (2011).

6 *Id*. at 467.

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

8 133 S. Ct. 2223 (2013).

9 Final Approval Order and Judgment, *In re* Cipro Cases I & II, Nos. 4154 & 4220 (Cal. Sup. Ct. San Diego Nov. 18, 2013).

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

11 *In re* Cipro Cases I & II, 61 Cal. 4th 116, 150 (2015).

Construction of the Cartwright Act and Preemption Issues:

(1) Because the Sherman Act and the Cartwright Act have different origins, "[i]nterpretations of federal antitrust law are at most instructive, not conclusive, when construing the Cartwright Act."[12]

(2) A presumption against federal preemption applies to the Cartwright Act because "[s]tate antitrust law ordinarily is fully compatible with federal law . . . and federal law is intended only 'to supplement, not displace, state antitrust remedies.'" The "Cartwright Act is broader in range and deeper in reach than the Sherman Act," but "this greater domain has never been thought to pose supremacy clause problems. To the contrary, in light of the established state role, a presumption against preemption applies," and state law is not preempted here.[13]

(3) Although patent law is federal, patent law and its presumptions do not preempt California's Cartwright Act framework for analyzing the anticompetitive effects of reverse payment patent settlements: "[T]hat a settlement resolves a patent dispute does not immunize the agreement from antitrust attack" under the Cartwright Act.[14]

Forms of Cartwright Act Analysis:

(1) Under the basic principle that "only unreasonable restraints of trade are prohibited," the United States and California Supreme Courts apply the rule of reason to antitrust allegations, which rule provides for an antitrust "inquiry limited to whether the challenged conduct promotes or suppresses competition" on balance.[15]

(2) Both Supreme Courts also recognize "categories of agreements or practices that can be said to always lack redeeming value and thus qualify as per se illegal."[16]

(3) The Court noted that modern federal and state antitrust analysis is better viewed as a "continuum" rather than a series of discrete tests. Thus, current antitrust analysis also employs a "quick look" approach with aspects of rule of reason and per se analyses. In the "quick look" process, when anticompetitive effects are readily apparent even to an untrained observer, then the "defendant may be asked to come forward with procompetitive justifications for a challenged restraint without the plaintiff having to introduce elaborate market analysis first."[17]

(4) Further, as a proper function of contemporary rule of reason analysis, California courts "may devise rules for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints."[18]

---

12 *Id*. at 142.

13 *Id*. at 161.

14 *Id*.

15 *Id*. at 145.

16 *Id*. at 146.

17 *Id*. at 147.

18 *Id*. at 146.

Agreements to Monopolize and to Divide Markets:

(1) "[A]greements to establish or maintain a monopoly are restraints of trade made unlawful by the Cartwright Act."[19]
(2) Under the Cartwright Act, "businesses may not engage in a horizontal allocation of markets with would-be competitors dividing up territories or customers."[20]

Proper Cartwright Act Antitrust Analysis of "Reverse Payment" Patent Settlements:

(1) "Reverse payment" settlements that agree to treat a patent as valid are not immune from federal or state antitrust scrutiny. The United States Supreme Court decision in *Actavis* makes clear that "for antitrust purposes patents are no longer to be treated as presumptively ironclad," thus it was error for the lower courts to apply the "scope of the patent" test that is based on that presumption.[21]
(2) Instead, "[u]nder the Cartwright Act, the baseline for measuring the procompetitive or anticompetitive effects of a settlement enforcing a challenged patent is not the patent's [ordinary] full life, but its expected life had enforcement been sought."[22]
(3) The Supreme Court also provided detailed instruction on the allocation of the burdens of proof and persuasion in such structured rule of reason inquiries.[23]

Disposition:

Because "the rule of reason these courts applied is not the structured rule of reason for reverse payment patent settlements we articulate today to effectuate the purposes of the Cartwright Act," the trial and appellate court analyses were in error, necessitating reversal and remand for further proceedings consistent with this opinion.[24]

B. Major League Baseball's Antitrust Exemption Also Bars Cartwright Act and UCL Claims

1. *City of San Jose v. Office of the Commissioner of Baseball*[25]

The Ninth Circuit has held that the City of San Jose's claims under the Sherman Act, the Cartwright Act, and the Unfair Competition Law ("UCL") against Major League Baseball for blocking the Oakland A's proposed relocation to San Jose were barred by baseball's longstanding exemption from the antitrust laws under *Flood v. Kuhn*[26] and its predecessors.

After holding that professional baseball's anomalous Sherman Act exemption continues to apply to franchise relocation disputes, the Ninth Circuit further held that "San Jose's state

---

19 *Id*. at 148.

20 *Id*.

21 *Id*. at 149.

22 *Id*.

23 *Id*. at 151-55.

24 *Id*. at 163.

25 776 F.3d 686 (9th Cir. 2015), *cert. denied*, 136 S. Ct. 36 (Oct. 5, 2015).

26 407 U.S. 258 (1972).

antitrust claims necessarily fall with its federal claims," because "[b]aseball is an exception to the normal rule that 'federal antitrust laws supplement, not displace, state antitrust remedies.'"[27] This issue had been addressed in *Flood*, where the Supreme Court affirmed dismissal of the plaintiff's state law claims because "state antitrust regulation would conflict with federal policy and because national uniformity is required in any regulation of baseball."[28]

Citing *Chavez v. Whirlpool Corp.*,[29] the court further concluded that San Jose's allegations under the UCL must also fail because "[i]f the same conduct is alleged to be both an antitrust violation and an 'unfair' business act or practice *for the same reason* . . . the determination that the conduct is not an unreasonable restraint of trade necessarily implies that the conduct is not 'unfair' toward consumers." An independent claim under California's UCL is therefore barred so long as MLB's activities are lawful under the antitrust laws."[30]

C. Cartwright Act and UCL Claims Fail in Hospital Employment Termination Suit

1. *Decambre v. Rady Children's Hospital–San Diego*[31]

Plaintiff physician Decambre, following her dismissal by defendant Children's Hospital, sued the hospital alleging retaliation, racial discrimination, and wrongful termination, as well as violations of the Cartwright Act and the UCL. Defendant responded with a motion to strike under California's anti-SLAPP statute and a demurrer to all causes of action, both of which were granted by the trial court. The court of appeal affirmed those portions of the motion to strike and demurrer relating to the trade regulation causes of action.[32]

Where legal claims address activities protected by California's anti-SLAPP statute, such as the hospital peer-review process here, plaintiffs must demonstrate their likelihood of prevailing on the merits of those claims in order to defeat an anti-SLAPP motion to strike. Plaintiff Decambre was unable to make such a showing for her Cartwright Act and UCL claims.

Plaintiff would have had to demonstrate not injury to herself as a competitor but injury to competition in the healthcare market at issue. In the context of hospital staffing decisions, successful allegations of the requisite injury to competition might include: "negative impacts upon overall prices, quantity or quality of medical services resulting from the plaintiff's absence as an available provider at the facility."[33] Plaintiff presented no such evidence, and the court granted the motion to strike and the demurrer to the Cartwright Act and UCL claims.

---

27 *City of San Jose v. Comm'r of Baseball,* 776 F.3d at 691.

28 *See Flood*, 407 U.S. at 284.

29 93 Cal. App. 4th 363, 113 (2001).

30 *City of San Jose v. Comm'r of Baseball*, 776 F.3d at 691-92 (emphasis added).

31 235 Cal. App. 4th 1 (2015).

32 *Id*. at 27.

33 *Id*. at 25-26.

D. Other Cartwright Act Developments

1. *In re Capacitors Antitrust Litigation*[34]

Indirect purchasers of capacitors sufficiently alleged the injury-in-fact required to establish Article III standing to bring an antitrust conspiracy suit against defendant capacitor manufacturers under the Sherman Act, the Cartwright Act, and the UCL.

2. *Feitelson v. Google, Inc.*[35]

"Plaintiffs cannot state claims under the Clayton and Cartwright Acts because the subject [software applications] are not tangible commodities (nor do they cover tangible commodities) within the scope of the Clayton and Cartwright Acts."[36]

III. UNFAIR PRACTICES ACT[37]

A. Tort, UPA, and UCL Challenge by Second-Lowest Bidder for Public Works Contract Attracts Supreme Court Review

1. *Roy Allan Slurry Seal, Inc., v. American Asphalt South, Inc.*[38]

Plaintiff, the unsuccessful second-lowest bidder on public works roadway contracts, sued the winning bidder for predatory pricing and unfair economic advantage under the Unfair Practices Act ("UPA"), the UCL, and the tort of intentional interference with prospective economic advantage. Plaintiff claimed that the winning bid was predicated on violations of California's prevailing-wage laws for work on public contracts. Defendant's demurrer to all three causes of action was granted.

The Second Appellate District restored the plaintiff's cause of action for intentional interference with prospective economic advantage. However the court found claims of defendant's lowered costs alone to be insufficient to establish the requisite elements of a UPA sales-below-cost case and also insufficient to demonstrate the irreparable injury needed to secure a UCL injunction. "The winning bidder's lower wages lowered its cost, and lowering one's cost [does not alone] constitute predatory pricing."[39] Thus the trial court properly granted the defendant's demurrer to the UPA predatory pricing allegation.

Similarly, the plaintiff failed to submit sufficient evidence of irreparable harm it would suffer if the winning bidder were not enjoined, as is required for bidders to be awarded injunctive relief

---

34 106 F. Supp. 3d 1051 (N.D. Cal. 2015).

35 80 F. Supp. 3d 1019 (N.D. Cal. 2015).

36 *Id.* at 1032.

37 Cal. Bus. & Prof. Code § 17000 *et seq.*

38 234 Cal. App. 4th 748 (2015), *reviewed and superseded by* 184 Cal. Rptr. 3d 279 (Cal. Ct. App. 2015). Previously published opinions superseded by grant of review and selected unpublished cases are presented here for their insights into relevant legal trends, but such opinions must not be cited or relied on by a court or a party in any action in California state courts. *See generally*, Cal. R. Ct. 8.1115; Dunbar v. Albertson's, Inc., 141 Cal. App. 4th 1422 (2006); Faitz v. Ruegg, 114 Cal. App. 3d 967 (1981).

39 Roy Allan Slurry Seal, Inc., 184 Cal. Rptr. 3d at 297.

under the UCL, so the UCL injunction demurrer was also sustained. The Supreme Court granted review on June 10, vacating this opinion, and suggesting the Court's interest in the tort theory (the subject of a vigorous dissent) and/or the UCL and UPA issues here.

B. First District Rejects UPA and UCL Claims Alleging Below-Cost Gas Sales by Competitor

1. *Dixon Gas Club, LLC v. Safeway, Inc.*[40]

Plaintiff Dixon Gas Club, a retail gas station in Northern California, filed suit under the UPA and the UCL, claiming that its competitor Safeway had unlawfully and unfairly engaged in below-cost sales and "loss leader" tactics in the sale of fuel at Safeway's gas station near to plaintiff's station. In an unpublished opinion, the First Appellate District affirmed the trial court's dismissal of those claims.

Plaintiff could not establish the requisite UPA sales-below-cost purpose, but argued that such purpose was not required to apply the UCL's "unfairness" doctrine to these practices. However, the First District concluded: "The mere fact that a price is set below cost and thereby injures one or more competitors does not establish unfairness under the UCL. Rather, the plaintiff must prove that the pricing is set at predatory levels, such that the competition suffers antitrust injury, not just injury from robust, yet otherwise fair, competition," citing the tethering principles of *Cel-Tech Communications v. Los Angeles Cellular Telephone Co.*[41] Since plaintiff had presented insufficient evidence of harm to competition rather than its own interests, the UCL unfairness claim must fail, as had the UPA sales-below-cost claim.

IV. COVENANTS NOT TO COMPETE[42]

A. Ninth Circuit: California's Rule on Non-Competition Covenants May Include Settlements

1. *Golden v. Calfornia Emergency Physicians Medical Group*[43]

A California emergency room doctor appealed a United States District Court order enforcing a settlement agreement between the doctor and the defendant medical group, which agreement contained a provision barring the plaintiff doctor from employment by a consortium that manages a large number of medical facilities in California.

The Ninth Circuit concluded that while "[t]he courts of California have not clearly indicated the boundaries of section 16600's stark prohibition" they have "nevertheless intimated that they extend to a considerable breadth. At the very least, we have no reason to believe that the State has drawn section 16600 simply to prohibit 'covenants not to compete' and not also other contractual restraints on professional practice."[44] The Ninth Circuit

---

40 No. VG08387771, 2015 WL 4557388 (Cal. Ct. App. July 29, 2015).

41 20 Cal. 4th 163 (1999).

42 Cal. Bus. & Prof. Code § 16600 *et seq.*

43 782 F.3d 1083 (9th Cir. 2015).

44 *Id.* at 1093.

remanded for consideration of whether the agreement constituted "a restraint of substantial character to Dr. Golden's practice" and a potential violation of California's non-competition principle.[45]

V. CONSUMER LEGAL REMEDIES ACT[46]

A. Sixth District Restores UCL and CLRA Claims for Laptop Computer Failures Occurring Post-Warranty; Nationwide Class Certified

1. *Rutledge v. Hewlett-Packard Co.*[47]

Plaintiffs, various computer buyers suffering failures of their Hewlett-Packard ("HP") computer inverters and screens occurring outside the warranty term, sued defendant HP under the UCL and the Consumer Legal Remedies Act ("CLRA") and other theories, and sought to certify a nationwide class for these purposes. Two separate trial courts ultimately rejected certain plaintiffs' UCL and CLRA claims and separately certified a class but denied nationwide certification. Appeals from both sides followed.

The Sixth Appellate District restored the previously-rejected UCL and CLRA claims: "We find [plaintiffs'] evidence creates a triable issue of fact as to whether the . . . inverters were defective and whether HP had knowledge of the defects."[48] Such knowledge would implicate the exception to the rule in *Daugherty v. American Honda Motor Co.*[49] that manufacturers are generally not liable, absent affirmative misrepresentations, for failures to disclose such post-warranty defects unless the defects involve safety issues.

Further, the appellate court found sufficient California contacts and operant facts to warrant a nationwide class: "We find the trial court's order denying nationwide class certification must be reversed. The record shows that California had sufficient contacts with the claims such that California has an interest in applying its laws to nonresident plaintiffs satisfying constitutional principles."[50]

B. UCL and CLRA Claims Regarding "Waterproof" High-SPF Sunscreen Are Preempted by Federal Food, Drug, and Cosmetic Act

1. *Eckler v. Neutrogena Corp.*[51]

Plaintiffs Eckler and Engel filed separate lawsuits (later coordinated) against sunscreen manufacturer Neutrogena based on events in 2003 to 2006. Both plaintiffs claimed Neutrogena falsely represented its sunscreen products as "waterproof" and "sweatproof," and plaintiff Eckler further alleged that product labels for SPF 50+ sunscreen omitted the material fact that sunscreens rated greater than SPF 50 offer no more protection than those

---

45 *Id.*

46 Cal. Civ. Code § 1750 *et seq.*

47 238 Cal. App. 4th 1164 (2015), *review denied* Nov. 10, 2015.

48 *Id.* at 1179.

49 144 Cal. App. 4th 824 (2006).

50 *Rutledge*, 238 Cal. App. 4th at 1189.

51 238 Cal. App. 4th 433 (2015), *review denied* Oct. 21, 2015.

rated at SPF 50. In 2012 the United States Food and Drug Administration ("FDA") at last promulgated its Final Rule banning use of "waterproof" and "sweatproof," but only after a three-decade regulatory process not finalized at the time of the events.

Plaintiff Engel contended that "waterproof" and related terms were effectively banned by the FDA's 1993 "tentative final monograph," but the Second Appellate District found that "he is mistaken" because "the tentative final monograph was not an 'order,' as Engel argues, nor was it in any sense final."[52]

The appellate court concluded:

> Engel seeks to declare that product descriptions on sunscreen labels that were, until the FDA's Final Rule, in compliance with federal law, nevertheless violated California law. He therefore seeks enforcement of a state requirement "that is different from or in addition to, or that is otherwise not identical with" a requirement under the FDCA, and thus, his suit is subject to [the FDA's] express preemption provision.[53]

Under the same reasoning, the Second District held Eckler's SPF 50+ claim to be preempted:

> [W]e conclude that Eckler's action is foreclosed under the doctrine of implied preemption. That the FDA has not issued a final determination on the issue of products with SPF values above 50 is not a reason to permit suits like Eckler's. It is a reason to allow the federal agency to complete its Congressionally mandated objectives without states imposing a premature patchwork of disparate requirements.[54]

That this process has occupied more than three decades evidently did not alter the court's conclusion.

C. Misrepresentations of "Six-Month Warranty" Requires Reversal of Judgment for Defendant Car Dealer

1. *Jones v. Credit Auto Center, Inc.*[55]

Car buyer Jones sued the defendant car dealership and its surety claiming breach of contract under the Song-Beverly Act and deceptive sales practices under the CLRA consisting of alleged misrepresentations that the purchased vehicle "came with a six-month warranty," when in fact the purchase of a $495 service contract was required to obtain the warranty.

The Appellate Division of the Los Angeles Superior Court reversed the trial court's judgment for defendants as to the Song-Beverly Act and CLRA claims. The CLRA claim merited reversal because there was substantial evidence that the warranty misrepresentations and failure to disclose required preconditions constituted "[r]epresenting that goods or

---

52 *Id*. at 455-56.

53 *Id*. at 456.

54 *Id*. at 459.

55 237 Cal. App. 4th Supp. 1 (2015).

services . . . have characteristics [or] benefits . . . which they do not have," which is unlawful under the CLRA.[56]

D. Other CLRA Developments

1. *Sarun v. Dignity Health*[57]

Plaintiff Sarun, an emergency-room patient at defendant's hospital, sought a class action against the hospital in a suit under the UCL and CLRA alleging deceptive billing practices. The Second District overruled the trial court's grant of defendant's demurrer and restored the plaintiff's complaint, finding that the partially-paid hospital bill was sufficient to establish loss of "money or property" under the UCL, and was also sufficient to establish "any damage" under the CLRA.

VI. UNFAIR COMPETITION LAW[58]

A. Arbitration and Unconscionability Issues in Consumer and Employment Contracts after *Concepcion, Sanchez,* and *Iskanian*

The United States Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*[59] upholding the preemptive effect of the Federal Arbitration Act ("FAA")[60] on inconsistent state principles, erected a formidable barrier to UCL or False Advertising Law ("FAL") actions challenging the unfair business practices or employment policies of defendants using contracts with mandatory arbitration clauses.

Since *Concepcion*, the California Supreme Court has acknowledged, in cases such as *Iskanian*,[61] the broad preemptive scope of the FAA and has abrogated prior California doctrines limiting the reach of mandatory arbitration. But the relationship between arbitration provisions and unconscionability principles remains the subject of extensive litigation.

Significantly, in the wake of *Iskanian* and the Supreme Court's new *Sanchez*[62] opinion, plaintiffs are now adopting new legal theories and mechanisms—including the Labor Code Private Attorney General Act—to reach beyond arbitration clauses and bring disputes over consumer contracts and employment practices before trial courts instead of arbitration panels.

The following "scorecard" first presents the California Supreme Court's two major statements on arbitration and unconscionability principles in the past eighteen months, and then surveys some of the more prominent UCL appellate opinions applying those principles to a variety of factual situations in the post-*Concepcion* legal environment.

---

56 *Id.* at 13 (citing Cal. Civ. Code § 1770 (a)(5)).

57 232 Cal. App. 4th 1159 (2015).

58 Cal. Bus. & Prof. Code § 17200 *et seq.*

59 563 U.S. 333 (2011).

60 9 U.S.C. § 1 *et seq.*

61 Iskanian v. CLS Transp. Los Angeles, LLC, 59 Cal. 4th 348 (2014).

62 Sanchez v. Valencia Holding Co., 61 Cal. 4th 899 (2015).

1. California Supreme Court Upholds Auto Contract Arbitration Provisions But Affirms Continuing Applicability of Unconscionability to California Contracts

Sanchez v. Valencia Holding Co.[63]

On August 3, 2015, the California Supreme Court delivered its long-awaited opinion in *Sanchez*, upholding the arbitration clause in the industry-standard auto purchase/sale contract but emphasizing that unconscionability principles remain applicable to all California contracts and must be applied to each set of facts on a case-by-case basis.

In *Sanchez*, which became the lead case on this issue statewide, the Second District Court of Appeal had held that the class-action waiver and arbitration clause in the industry-standard auto contract were unconscionable under general California contract principles, notwithstanding the Federal Arbitration Act and *Concepcion*.[64]

The California Supreme Court granted review in March 2012 and stayed at least ten *Concepcion*-related appellate cases pending its decision, many of which cases involved the claimed unconscionability of the arbitration and class-action waiver provisions in the auto purchase/sales contract used by most California car dealerships.

After three years of consideration, the Court reversed the Second District and upheld the enforceability of the class-action waiver and mandatory arbitration provisions in that contract, but not before reaffirming the general applicability of unconscionability principles to California contracts: "[W]e hold that *Concepcion* requires enforcement of the class waiver but does not limit the unconscionability rules applicable to other provisions of the arbitration agreement. Applying those rules, we agree with Valencia that the Court of Appeal erred as a matter of state law in finding the agreement unconscionable. Accordingly, we reverse the judgment below."[65]

However, applying the reasoning of its prior decision in *Sonic-Calabasas A, Inc. v. Moreno*,[66] the Supreme Court reaffirmed that general unconscionability principles continue to apply to all California contracts, including both arbitration and non-arbitration provisions. The Court had held in *Sonic-Calabasas A, Inc.* that California courts should continue to enforce unconscionability rules after *Concepcion* so long as those rules do not interfere with the "fundamental attributes of arbitration."[67]

Thus, even after *Concepcion*, state principles of unconscionability apply to arbitration and non-arbitration contract terms, although such state unconscionability rules "must not facially discriminate against arbitration and must be enforced evenhandedly . . . and must not disfavor arbitration *as applied* by imposing procedural requirements that interfere with fundamental attributes of arbitration.'"[68]

---

63 *Id*.

64 Sanchez v. Valencia Holding Co., 201 Cal. App. 4th 74 (2011), *review granted*, 272 P.3d 976 (Cal. 2012).

65 *Sanchez*, 61 Cal. 4th at 907.

66 57 Cal. 4th 1109 (2013).

67 *Id*. at 1143.

68 *Sanchez*, 61 Cal. 4th at 913.

The Court held that *Concepcion* prohibits the use of unconscionability principles or other state doctrines to prohibit whole *categories* of arbitration (such as class-action arbitration provisions) or to otherwise interfere, expressly or as applied, with the FAA's policy promoting arbitration. But while avoiding such categorical prohibitions or interference, our courts still must employ case-by-case factual analysis of any allegations of unconscionability, including both its procedural and substantive elements, in order to determine whether unconscionable contract terms are present.

Applying these principles to each of the arbitration provisions in *Sanchez*, the Supreme Court reversed the Second District's finding of unconscionability, concluding that the applicable sliding scale of unconscionability analysis weighed in the dealership's favor. Notwithstanding the adhesion contract context, the various substantive terms of the arbitration provisions were not so unfair or one-sided as to render the agreement unconscionable.[69]

Aftermath of *Sanchez*

The immediate outcome of the *Sanchez* opinion is a substantial setback for California car buyers, including those in several other pending appeals, and consumer advocates who believe the form-contract provisions imposed here are inherently one-sided and oppressive. The Court's unwillingness to find the required substantive and procedural unconscionability on these facts was a clear victory for auto dealerships and others employing the types of mandatory waivers and arbitration terms found in the standard auto contract.

However, viewed more broadly, the *Sanchez* opinion may prove to be a split decision for business interests and consumer advocates. The Court's apparent commitment to the continuing applicability of unconscionability principles, and its willingness to judge each case on its specific facts, together will permit plaintiffs a measure of latitude to challenge certain unfair arbitration terms, so long as the unconscionability principles applied do not discriminate against whole categories of arbitration or unduly interfere with the fundamental attributes of arbitration. The recent First District opinion in *Carlson v. Home Team Pest Defense, Inc.,*[70] discussed below, illustrates the opportunities that remain viable for plaintiffs under the principles in *Sanchez*.

It is unsurprising then that some commentators see signs in opinions such as *Iskanian* and *Sanchez* that there is "support within the California Supreme Court for carving out an exception" to the broad sweep of *Concepcion*.[71] While *Concepcion* has broadly changed the arbitration landscape in California and challenges to FAA-protected aspects of arbitration will generally fail, these opinions suggest the newly reconstituted California Supreme Court may be willing to push back and test the boundaries of *Concepcion*.

---

69 *Id*. at 914-24.

70 239 Cal. App. 4th 619 (2015).

71 *See, e.g.*, Ronald W. Novotny, *Gauging the Future of* Iskanian *and FAA Preemption in California*, L.A. Law., Mar. 2015, at 10.

2. California Supreme Court: *Concepcion* Abrogated *Gentry* But Does Not Bar Labor Code Private Attorney General Act Actions

Iskanian v. CLS Transportation Los Angeles, LLC[72]

Significantly altering the landscape of labor law rights in California, the Supreme Court held that *Concepcion* impliedly overruled *Gentry v. Superior Court*,[73] and thus mandatory arbitration provisions must be enforced even when they require arbitration of wage and hour issues protected by California's labor laws. However, the Court further ruled that an arbitration agreement requiring the employee to give up the right to bring representative actions under the Private Attorney General Act of 2004 ("PAGA")[74] is against public policy and unenforceable.

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 . . . and our holding to the contrary in *Gentry* . . . has been abrogated by recent United State Supreme Court precedent."[75] Further, "*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."[76]

Importantly, the Court distinguished between FAA-protected arbitration requirements in *private* disputes and attempts to force employees to waive *public* rights provided by the legislature in PAGA, which permits private plaintiffs to bring "private attorney general" cases enforcing state labor laws. "[T]he rule against PAGA waivers does not frustrate the FAA's objectives because, as explained below, 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 Labor and Workforce Development Agency."[77]

"[T]he FAA's goal of promoting arbitration as a means of private dispute resolution does not preclude our Legislature from deputizing employees to prosecute Labor Code violations on the state's behalf [under PAGA]."[78] Thus, "[w]e conclude that California's public policy prohibiting waiver of PAGA claims, whose sole purpose is to vindicate the Labor and Workforce Development 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."[79]

Aftermath of *Iskanian*

The holding in *Iskanian*, carving out PAGA representative actions from the realm of private arbitration governed by the FAA, has given rise to a new wave of plaintiffs' lawsuits and

---

72 59 Cal. 4th 348 (2014).

73 42 Cal. 4th 443 (2007).

74 Cal. Lab. Code § 2698 *et seq*.

75 *Iskanian*, 59 Cal. 4th at 360.

76 *Id*. at 366.

77 *Id*. at 384.

78 *Id*. at 361.

79 *Id*. at 388-89.

class actions utilizing this exception in employment and wage-and-hour disputes. Examples, among many others, are *Williams v. Superior Court*[80] and *Franco v. Arakelian Enterprises, Inc.*,[81] both discussed further *infra*.

3. Arbitration Clauses Enforced:

Sanchez v. Valencia Holding Co., LLC[82]

As discussed at VI.A.1. *supra*.

Iskanian v. CLS Transportation Los Angeles[83]

As discussed at VI.A.2. *supra*.

Khalatian v. Prime Time Shuttle, Inc.[84]

The Second Appellate District held that all claims brought by an airport shuttle bus driver against his employer were subject to arbitration as required by the employment contract. The interstate commerce aspect of the airport services supported clear FAA preemption of any inconsistent California wage-and-hour laws to the contrary. "We find the Federal Arbitration Act . . . applies to the parties' arbitration agreement, and all of plaintiff's claims are arbitrable."[85]

4. Arbitration Clauses Rejected:

Carlson v. Home Team Pest Defense, Inc.[86]

Demonstrating that California courts will invalidate some unconscionable arbitration provisions even after *Sanchez*, the First Appellate District has held that an arbitration provision in a retailer's employment contract was unconscionable and unenforceable notwithstanding the Federal Arbitration Act and *Concepcion*. The First District expressly relied on the Supreme Court's opinion in *Sanchez* for the proposition that unconscionability principles remain applicable to California contracts and are not ousted entirely by the FAA and *Concepcion*, but rather must be adjudicated on a case-by-case basis.

Plaintiff Carlson, an office-manager employee at defendant's Home Team Pest Defense store, filed suit against the defendant for wrongful termination and other causes of action.

The trial court denied the defendant's motion to compel arbitration, holding that the employment agreement was both procedurally and substantively unconscionable. The court found oppression and surprise in the online process, requiring plaintiff to sign her contract

---

80 237 Cal. App. 4th 642 (2015).

81 234 Cal. App. 4th 947 (2015).

82 61 Cal. 4th 899 (2015).

83 59 Cal. 4th 348 (2014).

84 237 Cal. App. 4th 651 (2015).

85 *Id.* at 654.

86 239 Cal. App. 4th 619 (2015).

without access to the firm's dispute policy. The court also found substantive unconscionability because the contract exempted from arbitration those claims most likely to be brought only by the employer against its employees.

The First District affirmed the trial court's denial of arbitration: "We agree with the trial court's conclusions and also reject Home's contentions that (1) state law unconscionability principles are preempted by the [FAA]; and (2) the trial court abused its discretion by refusing to sever unconscionable provisions from the agreement in this case."[87]

The appellate court agreed that the arbitration agreement was both procedurally and substantively unconscionable and was thus unenforceable, and noted that its conclusion was supported by the Supreme Court's opinion in *Sanchez*, which endorsed continued appropriate application of unconscionability principles to California contracts.[88]

The First District noted that under the FAA an agreement to arbitrate is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[89] As the Supreme Court acknowledged in *Concepcion*, this FAA savings clause allows agreements to arbitrate to be invalidated by "generally applicable contract defenses, such as fraud, duress, or unconscionability."[90]

The appellate opinion also cited *Sonic-Calabasas A, Inc. v. Moreno*[91] for the proposition that California courts may continue to enforce unconscionability rules post-*Concepcion* as long as they do not interfere with the fundamental attributes of arbitration. And here "[o]ur conclusion that the Agreement is unconscionable and unenforceable against Carlson does not mandate any procedural rules that are inconsistent with the fundamental attributes of arbitration. In fact, our principal concern with the Agreement rests on its failure to hold Home to the same obligation *to arbitrate* that it holds Carlson."[92]

5. Arbitration Clauses Limiting PAGA Rights Rejected

Williams v. Superior Court[93]

Following the principles of *Iskanian*, *supra*, the Second Appellate District held that a labor contract term purporting to impose a waiver of the right to bring representative actions under the PAGA is unenforceable. Further, the appellate court held that the plaintiff may of right litigate his entire claim in superior court, rather than be forced to split the claim into an arbitrable individual element and a non-arbitrable representative claim under PAGA.[94]

---

87 *Id.* at 624.

88 *Id.* at 637.

89 *Id.*

90 *Id.*

91 57 Cal. 4th 1109 (2013).

92 *Carlson*, 239 Cal. App. 4th at 638.

93 237 Cal. App. 4th 642 (2015).

94 *Id.* at 648-49.

Franco v. Arakelian Enterprises, Inc.[95]

In a case subsequently granted review, the Second District determined that the class-representative waiver in plaintiff's employment contract was enforceable under the principles of *Concepcion* and *Iskanian*. However, the putative waiver of the right to bring representative claims under PAGA was unenforceable, as the latter claims are public representative actions, not private actions subject to FAA preemption. Because the rights asserted in an action under PAGA are those of the state rather than of the plaintiff-employee, the right to prosecute such an action cannot be waived by private agreement.

6. UCL Preemption/Bar Arising From Federal or State Regulatory Schemes

The California and federal courts continue to wrestle with the multi-faceted issue of the applicability of the Unfair Competition Law to specific business practices and contexts where other regulatory schemes are involved. Claims of federal preemption, or preclusion or bar by state regulatory schemes, have recently produced a number of important results.

Holdings of No Preemption of or Bar to UCL Action:

In ***Williams v. Superior Court,***[96] and ***Franco v. Arakelian Enterprises, Inc.***,[97] the Second District found no Federal Arbitration Act preemption of employee actions brought under the California Private Attorney General Act.[98]

In ***Pegastaff v. Pacific Gas & Electric Co.,***[99] the First District held that the plaintiff subcontractor's Superior Court lawsuit over his claims against PG&E and against private contractors would not hinder or interfere with the exercise of the regulatory authority of the California Public Utilities Commission.

In ***Godfrey v. Oakland Port Services Corp.,***[100] port workers sued defendant motor carrier in a wage-and-hour action under the UCL. The trial court entered judgment for the employees after trial and the First District affirmed, holding that the Federal Aviation Administration Authorization Act did not preempt California law governing meal and rest breaks as applied to this employer.

Holdings of Preemption of or Bar to UCL Action:

In ***Fischer v. Time Warner Cable Inc.***,[101] cable customers brought a UCL case challenging defendant cable channel's bundling of certain sports channels into a basic cable package, necessitating an additional $9 per month fee. The Second Appellate District held that the plaintiffs' UCL challenge to these cable-service bundling practices was preempted by Federal Communications Commission regulations that specifically address and permit such bundling decisions by regulated cable providers.

---

95 211 Cal. App. 4th 314 (2012), *reviewed and superseded by* 149 Cal. Rptr. 3d 530 (Cal. Ct. App. 2013).

96 237 Cal. App. 4th 642 (2015).

97 211 Cal. App. 4th 314 (2015).

98 Cal. Lab. Code § 2698 *et seq.*

99 239 Cal. App. 4th 1303 (2015), *reh'g denied* Sept. 22, 2015.

100 230 Cal. App. 4th 1267 (2014), *reh'g denied* Dec. 1, 2014, *review denied* Feb. 11, 2015.

101 234 Cal. App. 4th 784 (2015), *review denied* June 10, 2015.

Eckler v. Neutrogena Corp.,[102] as discussed at V.B.1. *supra*.

Tamas v. Safeway, Inc.,[103] as discussed at VII.B *infra*.

VII. FALSE ADVERTISING LAW[104]

A. *In re Tobacco Cases II*[105]

In yet another appeal in the lengthy class-action battle over advertising for "Lights" and "Golds" cigarettes, after remand from the Supreme Court and a bench trial, the Fourth District held: (1) the correct measure of restitution under the UCL for misleadingly labeling cigarettes was the difference between the price paid and the actual value received; (2) UCL injunctive authority is discretionary and the trial court was not required to grant smokers' requested injunction against labeling of cigarettes as "Lights" or "Golds," in particular since federal law now prohibits such language; and (3) defendant as the prevailing party was entitled to $765,000 in costs as a matter of right.

B. *Tamas v. Safeway, Inc.*[106]

Plaintiff Tamas, a consumer purchaser of Greek yogurt products, sought a class action against the retailer Safeway and its yogurt manufacturer under the UCL and CLRA, alleging violations of the Sherman Food, Drug, and Cosmetic Law by misbranding food containing milk protein concentrate (MPC) as "yogurt." The trial court sustained defendants' demurrer without leave to amend.

The Fourth District held that the federal FDA regulations in this field barred a UCL and CLRA action based on a previously-stayed FDA regulatory announcement:

> The regulation relied upon by Tamas to preclude the use of MPC in yogurt is one that she admits was stayed by the FDA shortly after it was enacted . . . The glacial pace at which the FDA has moved in attempting to resolve those concerns and redraft a new formal regulation did not . . . operate as a stealth reenactment of the stayed rule.

In sum, "assessing the relative benefits and detriments of allowing MPC to be used as an additive in yogurt is an issue that will have to be decided by the FDA," thus the demurrer was sustained.[107]

---

102 238 Cal. App. 4th 433 (2015).

103 235 Cal. App. 4th 294 (2015), *reh'g denied* Mar. 17, 2015.

104 Cal. Bus. & Prof. Code § 17500 *et seq.*

105 240 Cal. App. 4th 779 (2015), *review denied* Dec. 9, 2015.

106 235 Cal. App. 4th 294 (2015), *reh'g denied* Mar. 17, 2015.

107 *Id.* at 306.

VIII. PUBLIC ENFORCEMENT OF UCL, FAL, AND RELATED STATUTES

A. *People v. Superior Court (Cahuenga's The Spot)*[108]

The Los Angeles City Attorney's Office brought a UCL enforcement action against a number of Los Angeles-area marijuana dispensaries for violations of Los Angeles Municipal Code regulations. The Second District held that the UCL's civil penalties are part of the equitable remedies a court may impose, and are not elements of a UCL cause of action. The Second District also rejected a broad litany of challenges to the People's civil penalty and UCL authority, including claims that UCL penalties actions trigger a right to jury trial.

B. *Loan Payment Administration LLC v. Hubanks*[109]

In a UCL civil law enforcement action brought by the Monterey and Marin District Attorneys' Offices against loan modification solicitations, the district court affirmed that injunctions against law enforcement agencies performing their duties must meet stringent criteria, which defendant here failed to meet. "[A]n injunction would prohibit local officials from enforcing statutes designed to protect consumers from the risk of fraud," which constitutes a "strong public interest." Defendant "has not shown that the public interest weighs in favor of granting an injunction."[110]

---

108 234 Cal. App. 4th 1360 (2015).

109 No. 14-CV-04420, 2015 WL 1245895 (N.D. Cal. 2015).

110 *Id*. at *16.

2015: A YEAR OF BIG PLAINTIFF WINS IN ANTITRUST AND PRIVACY CASES

By Thomas N. Dahdouh[1]

I. INTRODUCTION

The year 2015 will go down as a year of big plaintiff wins in federal antitrust and privacy decisions, particularly notable for those cases brought by government law enforcement officials. With only one loss in the lineup,[2] these victories suggest that active enforcement of the antitrust and privacy laws is alive and well in the federal courts. These wins stand in stark relief to the dire forecasts of some that federal courts are too tilted to the defense side.[3]

This Article summarizes eleven major court holdings and attempts to put each decision in context. The cases are generally arranged by area of law, beginning with two Sherman Act Section 1 cases, following with a hybrid Sherman Act Section 1/Section 2 case, then describing two new Sherman Act Section 2 matters, discussing one state-action immunity case, continuing with three major merger challenges, and finally ending with two important privacy cases.

II. SUMMARY OF DECISIONS

A. Section 1 Per Se Challenge: *United States v. Apple, Inc.*[4]

In this decision, the Second Circuit affirmed the lower court and found that Apple orchestrated a conspiracy among book publishers that had the effect of raising the prices of ebooks.[5] Writing for the majority of the three judge panel, Judge Livingston found the agreement both per se unlawful and unlawful under a full rule of reason analysis.[6] Concurring Judge Lohier joined in the opinion only insofar as it found the agreement to be per se unlawful.[7] Finally, Circuit Judge Dennis Jacobs dissented.[8] As a result, the lower court's decision was upheld, but only on a per se theory.

The background facts in this lawsuit are amazing and worth a close review. In 2007, Amazon released the new Kindle ebook reader.[9] When pricing ebooks for sale on the Kindle, Amazon placed certain *New York Times* bestsellers and new releases at $9.99, the same

---

1 Regional Director, Western Region, Federal Trade Commission. This Article is based on remarks first delivered at the Golden State Antitrust and Unfair Competition Law Institute on October 29, 2015. The author's remarks are his own, and do not reflect the views of the Federal Trade Commission, any individual Commissioner, or anyone other than himself.

2 *See* F.T.C. v. Steris Corp., No. 15-CV-1080, 2015 U.S. Dist. LEXIS 128470 (N.D. Ohio Sept. 24, 2015).

3 *See, e.g.,* Gene Crew & Holly Gaudreau, Clayworth v. Pfizer: *California Supreme Court Lays Down the Law in Favor of Strict Antitrust Enforcement,* 19 COMPETITION 23, 24 (2010) (bemoaning the "U.S. Supreme Court's steady drift away from strict enforcement of the antitrust laws").

4 791 F.3d 290 (2d Cir. 2015).

5 *Id.* at 339.

6 *Id.* at 335.

7 *Id.* at 339-40.

8 *Id.* at 340.

9 *Id.* at 299.

or slightly lower than the wholesale price for which it paid book publishers.[10] According to the district judge and the majority of the Second Circuit panel, this was a classic "loss-leading" strategy designed to propel interest in and adoption of the new Kindle.[11]

According to the court, book publishers did not like this low price and were fearful that $9.99 would become the permanent price-point as ebooks caught on, driving down the prices they could charge for print books.[12] In the face of this perceived threat, the Big Six publishers (Simon and Schuster, HarperCollins, Random House, Macmillan, the Penguin Group, and Hachette)[13] started to get together on a regular basis, meeting at dinner events to discuss "common challenges."[14] Many of the publishers began to withhold their books from Amazon for a period of time after a book's first print release—a practice known as "windowing."[15] By late 2009, four of the Big Six had announced such plans.[16] However, the publishers worried that piracy and other issues would make windowing an unsustainable long-term strategy.[17]

Then along came Apple, seeking to launch an iBookstore business with the pending release of its iPad in 2010.[18] Apple began negotiating with each of the Big Six. Importantly for the publishers, Apple's team expressed the belief that Amazon's price point was not ingrained in consumers' minds and that Apple could sell new releases and bestsellers at higher prices, between $12.99 and $14.99.[19] In return for higher retail prices, Apple requested the publishers to decrease their wholesale prices and allow Apple to make a small profit on each sale.[20]

The Big Six began to keep each other apprised about negotiations with the Apple team.[21] Apple quickly realized that the Big Six saw an advantage in using Apple to increase their leverage on Amazon.[22] Acting on this realization, Apple ditched the wholesale pricing strategy in favor of one where it acted as an agent for the book publisher and received a commission on every sale.[23] This gave the *publisher*, rather than the *retailer*, more control over pricing, although Apple did set price caps.[24] However, according to the district court, Apple did not want any

---

10 *Id.*

11 *Id.* at 299, 332.

12 *Id.* at 299-300.

13 The Big Six were reduced to the Big Five with the combination of Random House and Penguin in 2013. *See* Jane Ciabattari, *Now There Are 5,* Library Journal (Sept. 3, 2013), http://lj.libraryjournal.com/2013/09/publishing/now-there-are-5/.

14 *Apple Inc.,* 791 F.3d at 300.

15 *Id.*

16 *Id.* at 300-01.

17 *Id.* at 301.

18 *Id.*

19 *Id.* at 302.

20 *Id.*

21 *Id.*

22 *Id.* at 303.

23 *Id.*

24 *Id.* at 304.

price competition with Amazon, and so hit upon a requirement that book publishers who sold to Apple *had* to switch over all their ebook retailers, including Amazon, to an agency model.[25] Or as Apple's team told the publishers: "'all publishers' would need to move 'all retailers' to an agency model."[26]

Apple's strategy continued to evolve, and soon Apple's in-house counsel suggested replacing the explicit agency requirement with a "Most Favored Nations" ("MFN") clause.[27] Under the MFN clause, the publisher could not charge a higher price on Apple's iBookstore than other retailers charged.[28] According to the court, the MFN clause would place sufficient pressure on the Big Six to move Amazon to an agency model—without an explicit reference to Amazon or any other retailer in the Apple contracts.[29]

The MFN clause also gave each of the publishers a stake in Apple's quest for a critical mass of publishers to join the iBookstore because "[w]hile no one Publisher could effect an industry-wide shift in prices or change the public's perception of a book's value, if they moved together they could."[30]

In the final negotiations, the book publishers pushed back against Apple's proposed price caps. Apple relented because, as Steve Jobs famously wrote in an email, Apple could "live with" more lenient pricing provided Amazon was also moved to an agency model.[31] Apple's testimony at trial made it clear that the company knew it was effectively forcing the book publishers to move to an agency model, and that its representatives orchestrated efforts to convince holdout book publishers to go along.[32] Apple even kept the book publishers apprised about which other publishers were on board.[33]

When Steve Jobs presented the iPad in 2010, he also announced the iBookstore, including pricing.[34] After the presentation, Jobs was asked why someone should purchase an ebook from Apple for $14.99 as opposed to $9.99 with Amazon or Barnes & Noble, and Jobs confidently replied, "[t]hat won't be the case . . . the price will be the same. . . .[P]ublishers will actually withhold their [e]books from Amazon . . . because they are not happy with the

---

25 *Id.* at 303-04.

26 *Id.* at 304 (internal citations omitted).

27 *Id.*

28 *Id.*

29 *Id.* at 305. Publishers already stood to make less money per sale under an agency model, which would be further compounded if they were forced to sell all ebooks at Amazon's lowest price. *Id.* Practically, then, the MFN clause would force publishers to move Amazon to an agency model in order to offset lower short-term profits through greater pricing control and the ability to protect traditional print sales. *Id.*

30 *Id.* (alteration in original) (internal quotation marks omitted) (internal citation omitted).

31 *Id.* at 306.

32 *See id.* at 306-07. For example, the Apple team reminded publishers that this was a "rare opportunity" to take control over pricing, and one executive directly told one holdout publisher that it "had no choice but to move Amazon to an agency model if it wanted to sign an agency agreement with Apple." *Id.* (internal citations omitted).

33 *Id.* at 308.

34 *Id.* (alterations in original) (internal citations omitted).

price."[35] Soon after the announcement, book publishers turned up the heat on Amazon and got it to agree to an agency model.[36] The publishers informed Apple of their progress.[37]

The trial court found that the evidence showed an agreement between the Big Six and Apple to raise ebook prices, and that the agreement's effects even bled over to hardcover books.[38] Under the Apple contract, publishers were incentivized to raise hardcover prices so they could charge higher ebook prices.

On appeal, Apple argued that it could be charged only with "unwittingly facilitating" the publishers' joint conduct.[39] Of course, it is a dark moment in the land of antitrust defense when counsel is forced to argue that a client is an "unwitting" participant, and the majority soundly rejected this claim and found that Apple was a conscious participant in the conspiracy.[40] For the majority, the most salient factor was that Apple had to be conscious of the conspiracy's effect on its rival, Amazon.[41] Indeed, Apple telegraphed its knowledge through its first iteration of the proposed contract—namely, the requirement that the Big Six move "all retailers" over to the agency model: If Apple had no idea that the Big Six were collectively moving against Amazon, why did it reference competing ebook retailers in its initial proposed contracts? Finally, the court found that the evidence supported the notion that Apple was the conscious orchestrator of the agreement—indeed, the linchpin.[42] Without Apple's participation, the conspiracy could have broken down, as previous collective efforts to move against Amazon had faltered. By bringing each of the Big Six under a contract with Apple, Apple ensured that the key problems of previous collective efforts—the difficulty in detecting and punishing cheating—would not be repeated, ensuring the success of the conspiracy.

Also on appeal, Apple argued that the contract terms in the final version of the contract, including the MFN clause, are generally lawful and viewed as procompetitive, and thus that Apple could not be condemned for seeking such clauses.[43] The court, however, disagreed, finding that in certain circumstances an MFN clause can actually "facilitate anticompetitive horizontal coordination by reduc[ing] [a company's] incentive to deviate from a coordinated horizontal arrangement."[44] In other words, what is often designed to provide a buyer protection against being overcharged, i.e. a price ceiling, can become a price floor if utilized by a monopolist or a cartel. This is exactly why the Supreme Court has repeatedly emphasized that the per se bar against price-fixing extends to collective efforts to tamper with any significant facet of horizontal competition. For example, in *Catalano, Inc. v. Target*

---

35 *Id.*

36 *Id.* at 309.

37 *Id.*

38 *Id.* at 310, 312.

39 *Id.* at 316.

40 *Id.*

41 *Id.* at 316-17.

42 *See id.* at 316, 319.

43 *Id.* at 319.

44 *Id.* at 320 (alterations in original) (internal citations omitted).

Sales, Inc.,[45] the Supreme Court had no problem condemning as per se unlawful the fixing of credit terms by a group of competitors.[46]

The majority easily dispatched Apple's argument that per se condemnation was inappropriate because of the Supreme Court's decision in *BMI*.[47] In *BMI*, the Court examined a music licensing regime in which copyright owners banded together to negotiate blanket licenses allowing licensees to perform any licensed work for a flat fee.[48] Although the scheme was per se price fixing, the Court upheld it under a rule of reason analysis.[49] For the Apple court, the salient distinguishing factor in *BMI* was that the resulting product—widespread, easy licensing of music—would have been impossible without fixing the prices charged for the licenses.[50] In other words, restraining competition was the only way to ensure that the product was available at all. In contrast, the court found that Apple could not claim "that creating an ebook retail market is possible only if the participating publishers coordinate with one another on price."[51]

The majority also rejected Apple's argument that the conspiracy allowed it to challenge Amazon's market dominance and effective monopoly.[52] The dissent characterized this as a "deconcentrating" argument and accepted that there was a procompetitive effect in upsetting "a market that had been dominated by a monopolist and insulated from competition through below-cost pricing."[53] Judge Livingston, however, cleverly turned to Sherman Act Section 2 monopolization law, and noted that there is no bar in American law to monopoly per se, nor is there any requirement that markets must be adjusted so that higher-cost producers like Apple can enter and make a profit.[54] This was the thrust of *Brooke Group*, which set a high standard to prove that a competitor is engaged in predatory pricing to drive out rivals: "That below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured . . . ."[55] Finally, the majority disagreed with the fundamental assumption underlying the dissent that, if forced to match Amazon's low prices, Apple would not have entered the market.[56] The majority noted that others, including Barnes & Noble and Google, had planned to enter the ebook market, and that, in the same way, Apple may have been able to enter as well.[57]

---

45 446 U.S. 643 (1980).

46 *Id.* at 650.

47 *Apple, Inc.,* 791 F.3d at 325-26 (citing Broad. Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1, 4-6 (1979)).

48 *Id.* at 325.

49 *Id.* at 325-26.

50 *Id.* at 326.

51 *Id.*

52 *Id.* at 331.

53 *Id.* at 349 (Jacobs, J., dissenting).

54 *Id.* at 331.

55 *Id.* at 332 (quoting Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993)).

56 *Id.* at 333.

57 *Id.*

The decision is a reminder that courts will sometimes find per se liability for an alleged participant, even when that participant was not in horizontal competition with other alleged participants. In many ways, this decision harkens back to an earlier case, *F.T.C. v. Toys "R" Us, Inc.,*[58] where the retailer organized an effort by manufacturers to restrict the types of toy products sold to rival club stores.[59] For attorneys counseling companies, *Apple* and *Toys "R" Us* are reminders that companies in a vertical relationship with manufacturers—such as distributors or retailers—need to be mindful to prevent themselves from playing potentially problematic roles as conduits for anticompetitive price or bidding discussions between those manufacturers. The same holds true for manufacturers vis-à-vis retailers or distributors.

B. Section 1 Rule of Reason Challenge: *O'Bannon v. NCAA*[60]

In this private litigation, current and former college student-athletes sued the NCAA to challenge its rules barring student-athletes from receiving a share of revenues that colleges receive for licensing the student athletes' names, images, and likenesses in videogames and live game telecasts.[61] The lower court found the rules violated Sherman Act Section 1 under a full rule of reason analysis.[62]

The NCAA proffered several legitimate business justifications for its rules: (1) preserving amateurism in college sports; (2) promoting competitive balance among various teams in different leagues; (3) ensuring integration of academics and athletics; and (4) increasing output of student athletics.[63]

The lower court dismissed most of these concerns, but recognized that large payments to student-athletes could potentially undermine (1) the popularity of college sports (a "public perception of amateurism" notion);[64] and (2) the integration of student-athletes into academics by creating a wedge between student-athletes and the broader campus community.[65]

Consequently, the court found that plaintiffs had proven anticompetitive effects of the NCAA's rules but that defendants had met their burden of showing procompetitive effects of their business justifications, which shifted the burden back to plaintiffs to prove that there were less restrictive alternatives to achieve the asserted justifications.[66]

So how should a judge determine whether proven business justifications can be achieved in other, less restrictive ways? Surprisingly, there is not a lot of guidance, perhaps because so few cases have reached the final stage of a rule of reason analysis.

---

58 221 F.3d 928 (7th Cir. 2000).

59 *Id.* at 930.

60 802 F.3d 1049 (9th Cir. 2015).

61 O'Bannon v. NCAA, 7 F. Supp. 3d 955, 963 (N.D. Cal. 2014).

62 *Id.* at 1007.

63 *Id.* at 999-1004.

64 *Id.* at 1001 ("[Restrictions on student-athlete compensation] might justify a restriction on large payments to student-athletes while in school . . . .").

65 *Id.* at 980, 1003.

66 *Id.* at 1004.

There are a few lines from Areeda and Hovenkamp suggesting that the alternative (1) must be "substantially less restrictive" and (2) "virtually as effective in serving the legitimate objective without significantly increased cost."[67] This examination should be "based on actual experience in analogous situations elsewhere or else be fairly obvious."[68] Of course, with a dearth of other decisions, the judge is left with few "analogous situations," and sometimes what is "fairly obvious" to one person is not so obvious to another.

In *O'Bannon*, the lower court found that two plaintiff-suggested alternatives met this test: (1) allowing schools to award stipends to student-athletes up to the full cost of attendance; and (2) letting schools hold in trust equal shares of its licensing revenue up to $5000 a year that athletes could receive after they leave college.[69]

The Ninth Circuit's opinion endorsed the district court's decisions on everything but the less restrictive alternatives.[70] The court agreed with the first alternative, but found the lower court had erred in suggesting that student-athletes could have up to $5000 a year in licensing revenues placed into a trust fund.[71] Judge Thomas dissented from this last ruling and disagreed that the district court clearly erred in its order.[72]

At first blush, the district court's end result looked an awful lot like micro-managing: Judge Wilken found that student-athletes could receive licensing revenues, but no more than $5000 a year, on an equal basis with each player in the same class at a particular school, and only in a trust. Courts in antitrust have generally been leery of remedies that are overly regulatory because they entangle the court systems in the ongoing business affairs of corporations.[73] But the Supreme Court's rule of reason jurisprudence virtually mandates that, at the end of the analysis, the judge is going to have to make some tough and often razor-thin distinctions in the "balancing" part of the analysis. Indeed, the open-endedness and vagueness of the *Standard Oil*[74] standard seem to invite such an end result.

But, at the same time, Judge Thomas's dissent raises the legitimate question of whether the appellate court "Monday-morning quarterbacked" this decision. That is, having gone this far in a bench trial, the issue is whether an appellate court should defer to the not-unreasonable judgments of a lower court judge who has heard all the testimony and reviewed all the evidence. One possible option is that appellate courts should give substantial deference to the district court's decision on the final "balancing." That is obviously not what a majority of

---

67 10 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 1760d, at 387 (3d ed. 2011). Although these comments are actually contained within the treatise's section on tying law, they are general in nature to any rule of reason analysis and hence applicable to this situation.

68 11 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 1913b, at 375-76 (3d ed. 2011).

69 *O'Bannon,* 7 F. Supp. 3d at 1005.

70 O'Bannon v. NCAA, 802 F.3d 1049, 1053 (9th Cir. 2015).

71 *Id.*

72 *Id.* at 1079 (Thomas, C.J., concurring in part and dissenting in part).

73 *See generally* Howard A. Shelanski & J. Gregory Sidak*, Antitrust Divestitures in Network Industries*, 68 U. Chi. L. Rev. 1, 34-35 (2001).

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

the Ninth Circuit panel thought, but it may be the wisest course, particularly as courts start to see more rule of reason cases "go the distance."

C. Section 1 and 2 Hybrid: *United States v. American Express Co.*[75]

In 2010, the DOJ filed complaints against Visa, MasterCard, and American Express over rules they applied to their merchants.[76] Visa and MasterCard settled with the DOJ; American Express took the matter to litigation.[77] At bottom, the rules prevented merchants from steering consumers to use certain credit cards by prohibiting them from: (1) offering incentives to consumers to use lower-cost cards; (2) indicating preference for competing cards; and (3) disclosing merchant fees to consumers.[78] The DOJ claimed that the credit card companies' rules effectively blocked merchants from rewarding lower-cost competitors with increased volume.[79] Importantly to the court, the DOJ did not challenge rules preventing merchants from putting a fee on American Express transactions, nor from "mischaracterizing" American Express cards.[80]

The court analyzed these as vertical nonprice restraints in a full rule of reason analysis under Sherman Act Section 1. Importantly, however, the court noted that the restraints were more akin to exclusive dealing or tying restraints, which sound more in Sherman Act Section 2 than typical nonprice vertical restraints. The court found that, unlike most vertical restraints that hinder intrabrand competition in order to foster interbrand competition, these restraints had a direct and pernicious effect on interbrand competition.[81] In particular, the restraints effectively blocked merchants' ability to steer end-user customers to particular credit cards, which, in the court's view, was the key way that merchants could foster interbrand competition between the credit card companies.[82] This observation by the court colors its entire analysis, and clearly takes the conduct at issue out of the land of traditional vertical restraints, which are generally viewed as procompetitive.

In determining the relevant product market, the court excluded debit cards and found a product market of credit card network services.[83] Additionally, the court found American Express had market power based on: (1) a 26.4% market share;[84] (2) evidence that American Express successfully raised prices without suffering merchant defections;[85] and (3) American Express' loyal cardholder base.[86]

---

75 88 F. Supp. 3d 143 (E.D.N.Y. 2015).

76 *Id.* at 149.

77 *Id.*

78 *See id.* at 162-66.

79 *Id.* at 151 (noting the rules "prevent[ed] merchants from steering additional charge volume to their least expensive network").

80 *Id.* at 163.

81 *See id.* at 167-68.

82 *Id.* at 168.

83 *Id.* at 175.

84 *Id.* at 188-90.

85 *Id.* at 195-202.

86 *Id.* at 191-95. The court called this phenomenon "cardholder insistence." *Id.* at 191.

The court found that the anti-steering rules buttressed the credit card network's market power by effectively making it impossible for merchants, who are responsible for paying the fees, to influence credit card choices of consumers, who are responsible for driving demand for network services.[87] The court found that these rules "disrupt the normal price-setting mechanism by reinforcing an asymmetry of information between the two sides of the payment card platform."[88] In particular, the court found that these rules prevent steering, which is "both procompetitive and ubiquitous."[89]

From this view, the court was easily able to condemn the rules at issue. For anticompetitive effects, the court found that the rules led to higher rates, which merchants were then forced to pass on to consumers in the form of higher retail prices: "In effect, Amex's [rules] deny its competitors the ability to recognize a 'competitive reward' for offering merchants lower swipe fees, and thereby suppress an important avenue of horizontal interbrand competition."[90] For the court, a most telling historical example was the failure of Discover's lower swipe price to increase Discover's volume, caused in large part by the anti-steering rules of Visa, MasterCard, and American Express.[91]

The court then passed over American Express' asserted justifications for the restraints.[92] American Express argued that it needed the rules to ensure a "frictionless" point of sale customer experience[93] and to prevent merchant "free-riding."[94] The court found these arguments unpersuasive: the first is undermined by the fact that the rules even bar steering that never mentions American Express;[95] and the second is lacking because American Express charges some customers for the very add-on services that it claims would be "free rode" upon—that is, the ride is *not* free.[96] With these findings, the court found the restraints at issue violative of Sherman Act Section 1 and subsequently entered an order enjoining them.[97]

Although styled as a challenge to a vertical restraint, the peculiar facts of this case—namely, that the restraints at issue were implemented by a company with market power and served to impede interbrand competition—suggest that this case is not about to signal a change in courts' generally lenient attitude toward vertical restraints.

---

87 *Id.* at 207.

88 *Id.* at 209.

89 *Id.* at 150.

90 *Id.* at 210.

91 *Id.* at 213-14.

92 *See id.* at 224-38.

93 *Id.* at 225.

94 *Id.* at 234.

95 *Id.* at 228.

96 *Id.* at 236.

97 *See* Order Entering Permanent Injunction as to the American Express Defendants, United States v. Am. Exp. Co., No. 10-CV-4496-NGG-RER (E.D.N.Y. Apr. 30, 2015).

D. Section 2 Challenge to Exclusive Dealing: *McWane, Inc. v. F.T.C.*[98]

This case represents the first litigation of a Federal Trade Commission ("FTC") challenge to purely unlawful vertical conduct since the 1990s. Interestingly, though, the FTC's original complaint did not only allege unlawful vertical conduct, but included some eight counts, several of which alleged unlawful horizontal conduct such as price-fixing.[99] The FTC, however, deadlocked two-to-two on the horizontal allegations and found liability on just one theory: unlawful Sherman Act Section 2 exclusive dealing or monopoly maintenance.[100]

Consequently, as the matter moved out of the FTC's adjudicative process, the sole finding of liability concerned allegedly unlawful vertical conduct—namely, McWane's Full Support Program.[101] Under this program, McWane, a company with almost fifty percent of the domestic market for pipe fittings,[102] announced to its distributors that, with limited exceptions, unless they bought all of their domestic fittings from McWane, they would lose their rebates and be cut off from purchases for twelve weeks.[103] According to the FTC complaint, McWane's Full Support Program harmed competition by foreclosing its sole rival Star's access to necessary distributors and contributed significantly to Star's lost sales.[104]

Although the FTC did not quantify the exact percentage of foreclosure from this exclusive dealing, it presented evidence showing that the two largest distributors—with fifty to sixty percent of the distribution market—prohibited their branches from purchasing fittings from Star.[105] It also presented evidence that the Full Support Program, by depriving Star of access to distribution, prevented Star from achieving sufficient sales to purchase its own foundry.[106] Without its own foundry, Star was prevented from achieving efficient scale to credibly threaten McWane's monopoly position.[107]

The FTC backed up its evidence with internal documents from McWane laying out much of the anticompetitive intent behind the Full Support Program. While intent is not an element for finding unlawful exclusive dealing or a Sherman Act Section 2 monopoly maintenance claim, documents such as these can provide powerful assistance to courts by undermining any claimed efficiency justifications for exclusive dealing programs. Indeed, it has previously been argued that documentary intent evidence can be quite valuable in demonstrating that asserted procompetitive justifications for particular conduct are in fact "pretextual."[108]

---

98 783 F.3d 814 (11th Cir. 2015).

99 Complaint, *In re* McWane, Inc., F.T.C. Dkt. No. 9351 (Jan. 4, 2012).

100 *In re* McWane, Inc., F.T.C. Dkt. No. 9351 (Jan. 30, 2014), 2014 WL 556261 at *1-2.

101 *Id.* at *22.

102 *Id.* at *1.

103 *Id.* at *21.

104 *Id.* at *58.

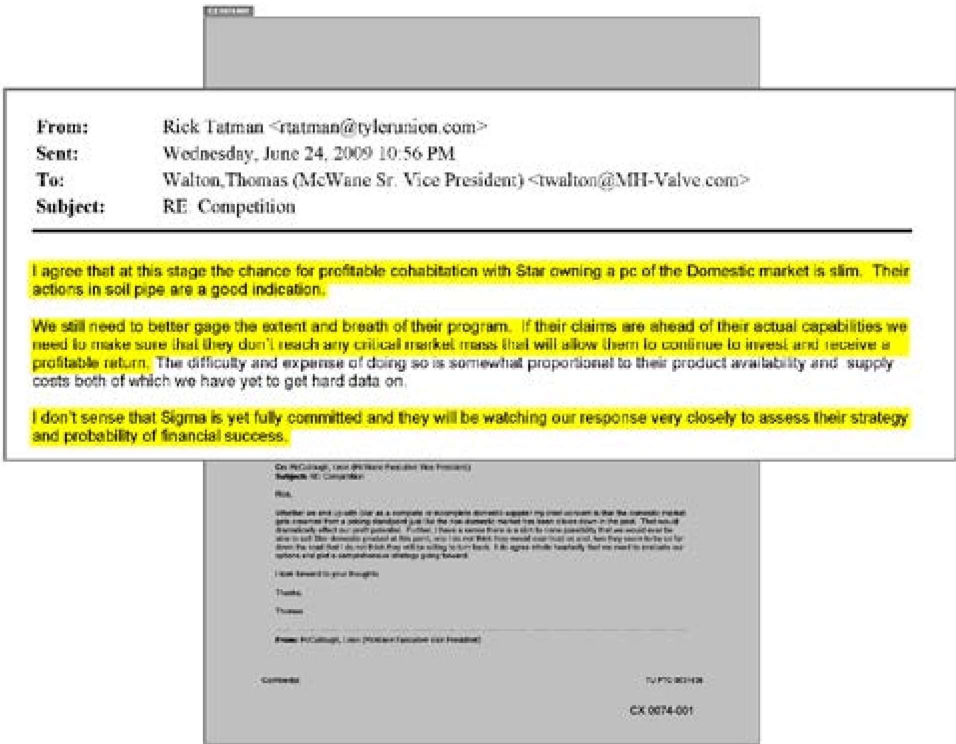
105 *Id.*

106 *Id.* at *9.

107 *Id.* at *25.

108 Thomas N. Dahdouh, *Restoring Balance in the Test for Exclusionary Conduct,* 24 Competition 51, 57 n.34 (2015).

For example, as shown in Figure 1, one internal McWane document spoke of needing to ensure that Star could not reach "critical market mass" that would allow it to invest in building its own foundry:



From: Rick Tatman <rtatman@tylerunion.com>
Sent: Wednesday, June 24, 2009 10:56 PM
To: Walton,Thomas (McWane Sr. Vice President) <twalton@MH-Valve.com>
Subject: RE: Competition

I agree that at this stage the chance for profitable cohabitation with Star owning a pc of the Domestic market is slim. Their actions in soil pipe are a good indication.

We still need to better gage the extent and breath of their program. If their claims are ahead of their actual capabilities we need to make sure that they don't reach any critical market mass that will allow them to continue to invest and receive a profitable return. The difficulty and expense of doing so is somewhat proportional to their product availability and supply costs both of which we have yet to get hard data on.

I don't sense that Sigma is yet fully committed and they will be watching our response very closely to assess their strategy and probability of financial success.

CX 0074-001

Figure 1: "[N]eed to make sure they don't reach any critical market mass that will allow them to continue to invest . . . ." [FTC Plaintiff Exhibit]

A second document, shown in Figure 2, revealed that McWane hit upon exclusive distribution as a method to raise Star's costs and "protect [McWane's] Brand:"

Response Options

1. **Wait and See approach**
   + Allows time to more accurately assess Star or Sigma's game plan & true competitive strengths and weaknesses
   - Gives them time to continue building their business model

2. **Handle on a Job by Job basis**
   + All parties will understand the other's price floor
   - Sends negative pricing signals to distribution

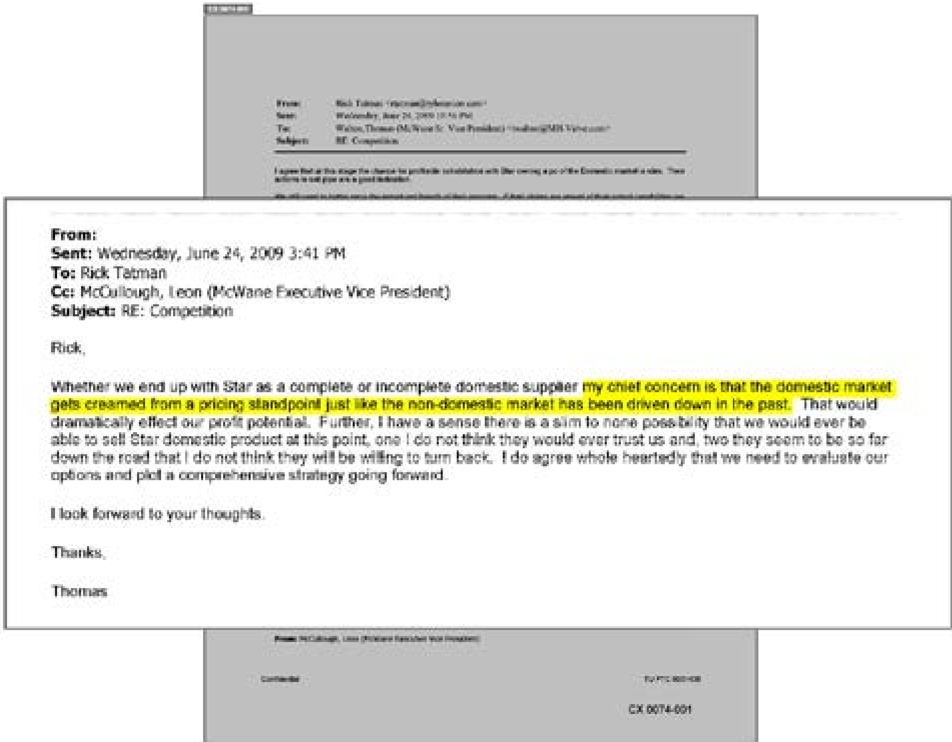
3. **Protect the Brand through Exclusive Distribution**
   + Avoids the job by job auction scenario within a particular distributor
   + Potentially raises the level of supply concern among contractors
   + Forces Star/Sigma to absorb the costs associated with having a more full line before they can secure major distribution
   - Managing relationship issues with customers – Old Loyalty Program
   - Potential collateral damage to ND product line sales
   - If they indeed have the fortitude to invest this would force them to speed that process up

6/29/09 RST

CX 1649-009

Figure 2: Exclusive Distribution Raises Star's Costs [FTC Plaintiff Exhibit]

A third document, shown in Figure 3, reveals that McWane was particularly concerned that Star's successful entry would drive down prices:



From:
Sent: Wednesday, June 24, 2009 3:41 PM
To: Rick Tatman
Cc: McCullough, Leon (McWane Executive Vice President)
Subject: RE: Competition

Rick,

Whether we end up with Star as a complete or incomplete domestic supplier my chief concern is that the domestic market gets creamed from a pricing standpoint just like the non-domestic market has been driven down in the past. That would dramatically effect our profit potential. Further, I have a sense there is a slim to none possibility that we would ever be able to sell Star domestic product at this point, one I do not think they would ever trust us and, two they seem to be so far down the road that I do not think they will be willing to turn back. I do agree whole heartedly that we need to evaluate our options and plot a comprehensive strategy going forward.

I look forward to your thoughts.

Thanks,

Thomas

CX 0074-001

Figure 3: "[M]y chief concern is that the domestic market gets creamed from a pricing standpoint . . . ." [FTC Plaintiff Exhibit]

The Eleventh Circuit's opinion is notable for its careful and balanced explication of Sherman Act Section 2 monopolization law. First, the court adopted the D.C. Circuit's burden-shifting balancing test as enunciated in the seminal *United States v. Microsoft Corp.* en banc decision:[109] that is, the court held that it must balance the likelihood of harm to competition against any legitimate procompetitive justifications for the conduct.[110] In this test, the plaintiff has the burden of showing a likelihood of harm to competition, while the defendant must prove any procompetitive justification.[111]

In doing so, however, the court importantly rejected the notion that the FTC must prove that the program caused McWane to keep its monopoly power or kept prices higher.[112] Rather,

109 McWane, Inc. v. F.T.C., 783 F.3d 814, 833 (11th Cir. 2015) ("[T]he D.C. Circuit has synthesized a structured, 'rule of reason'-style approach to monopolization cases that has been cited with approval." (citing United States v. Microsoft Corp., 253 F.3d 34, 58-59 (D.C. Cir. 2001) (en banc))).

110 *See id.*

111 *Id.*

112 *Id.* at 836-37.

again following the *Microsoft* opinion, the court held that the plaintiff need only prove that the Full Support Program "reasonably appear[ed] to be a significant contribution to maintaining [McWane's] monopoly power."[113] Consequently, the court rejected defense arguments that the fact that Star was still able to enter somehow relieved McWane of liability for its conduct.[114] Rather, the court found that the Program significantly contributed to key dealers freezing out Star.[115] The court credited the testimony of Star executives that the program deprived Star of sales needed to invest in a foundry and led to withdrawn sales after announcement of the program, and noted that there were no alternative channels of distribution.[116]

In one part of the opinion that may limit its general application to other instances of exclusive dealing or unlawful monopolization, the court credited evidence put on by the FTC that prices rose after the program went into effect.[117] While the court went out of its way to say that the FTC did not need to prove that the Full Support Program was the sole cause of the price increase, it did refer to this evidence as "perhaps [the] most powerful evidence of anticompetitive harm."[118] Of course, it is often quite difficult to prove that prices rose as a result of particular conduct, so requiring evidence of a price effect to show a Sherman Act Section 2 monopolization case is not appropriate. Nevertheless, the court clearly did not require evidence of a price effect; it simply noted that, when available, such evidence is "powerful" indicia of anticompetitive harm.[119]

The court next dealt with McWane's asserted procompetitive justifications for the Program. McWane argued that exclusive dealing was needed to preserve enough sales to keep its last domestic foundry afloat.[120] The court had no trouble dismissing this as a cognizable procompetitive justification for antitrust purposes, finding that while such a goal is not unlawful, neither is it a procompetitive justification.[121] Next, McWane argued that the Full Support Program prevented Star from "cherrypicking" by selling only the few highest selling fittings and leaving McWane to sell the remaining items.[122] The court noted that McWane failed to explain why the company could not compete by simply reducing prices on its most common fittings and increasing prices for the less common fittings, why the collapse of a full line seller would harm consumers, or why "full-line forcing" was necessary.[123] In any event, citing documents like those in Figures 1, 2, and 3, the court concluded that the "internal documents belie the notion that the Full Support Program was designed for

---

113 *Id.* at 837 (emphasis omitted) (internal citations omitted).

114 *Id.* at 832 ("On this record, we are unprepared to say that Star's entry and growth foreclose a finding that McWane possessed monopoly power in the relevant market.").

115 *Id.* at 838.

116 *Id.* at 839.

117 *Id.* 838-39.

118 *Id.* at 838.

119 *Id.*

120 *Id.* at 841.

121 *Id.* (citing United States v. Microsoft Corp., 253 F.3d 34, 71 (D.C. Cir. 2001) (en banc)).

122 *Id.*

123 *Id.*

any procompetitive benefit."[124] The court explicitly noted that the asserted procompetitive justifications were, at best, pretextual.[125]

There is much to like in this opinion. By explicitly adopting the *Microsoft* balancing test and rejecting a "but for" causation test, the court squarely advanced a balanced approach to Sherman Act Section 2 enforcement. Moreover, it explicitly rejected a "form over substance" analysis of exclusive dealing claims that bless exclusive contracts if the foreclosure effect was not one-hundred percent or if the contracts solely involved a loss of discounts, which ignores compelling evidence that, in certain circumstances, such contracts can nevertheless deprive rivals of the most efficient distribution channels. Finally, by not shying away from utilizing intent evidence to show that asserted procompetitive justifications are in fact pretextual, the court kept the analysis focused by examining allegedly exclusionary conduct in a case-by-case, fact-specific way.

E. Section 2 Challenge to Product Hopping: *New York v. Actavis PLC*[126]

Actavis is another Sherman Act Section 2 case, but involves a very different type of conduct from *McWane*, which invoked more traditional notions of exclusive contracts that foreclose rivals from vital distribution outlets. The New York State Attorney General's office filed this lawsuit, alleging that Actavis engaged in a new form of anticompetitive behavior by pharmaceutical companies—namely, anticompetitive product hopping.[127] According to the complaint, as Namenda IR, Actavis' twice-daily drug designed to treat moderate-to-severe Alzheimer's disease, neared the end of its patent exclusivity period in July 2015, Actavis introduced a new once-daily version called Namenda XR.[128] The patents on XR ensure exclusivity, and thus prohibit generic versions of XR from entering the market until 2029.[129] Faced with the prospect of competition from generic IR, Actavis allegedly decided to withdraw virtually all Namenda IR from the market in order to force Alzheimer's patients who depend on Namenda IR to switch to Namenda XR before generic IR becomes available.[130]

Because generic competition depends heavily on state drug substitution laws that allow pharmacists to substitute generic IR for Namenda IR but not for XR—the New York Attorney General's office alleged that Actavis' forced-switch scheme would likely impede generic competition for IR.[131] Moreover, the substantial transaction costs of switching from once-daily XR back to twice-daily IR therapy would likely further ensure that Actavis would maintain their effective monopoly in the relevant drug market beyond the time granted by their IR patents.[132]

---

124 *Id.*

125 *Id.* at 841-42.

126 787 F.3d 638 (2d Cir. 2015).

127 Amended Complaint ¶¶ 1-2, New York v. Actavis, PLC, No. 14-CV-7473-RWS (S.D.N.Y. Dec. 10, 2014). The original complaint called this practice a "forced switch," but the practice has become more colloquially known as "product hopping."

128 *Id.* ¶¶ 3-4; *see also id.* at 67-97.

129 New York v. Actavis, PLC, No. 14-CV-7473, (S.D.N.Y. Dec. 11, 2014), 2014 WL 7015198 at *12.

130 Amended Complaint ¶¶ 76-97, *Actavis,* No. 14-CV-7473-RWS.

131 *Id.* ¶¶ 3-4; *see also id.* ¶¶ 21-27, 71.

132 *Id.* ¶ 71.

The district court issued an injunction,[133] and the Second Circuit affirmed.[134] On its face, this is an amazing result: A decision *forcing* a company to continuing selling something it had withdrawn from the market! A Sherman Act Section 2 judgment concerning the very core of product design changes—something some would view as largely sacrosanct![135]

In its analysis, the Second Circuit focused on the fact that the product hopping in question here coerced consumers—because it forced them to switch to the new product.[136] But it should be pointed out that many product redesigns and follow-on products are in effect "coercive." High switching costs in high tech products like computers can make it virtually impossible not to buy the new version of a computer. For example, consumers were not thrilled when the first generation iPad slowly but effectively died barely three years after its release because Apple chose not to support that version in its most recent operating systems. What did they do? They went out and bought a newer version of the iPad. Were they coerced? Hard to tell: the line here can be a hard one to draw.

On the other hand, the court had in its possession a lot of evidence suggesting that any legitimate explanations for withdrawing Namenda IR were pretextual. Documents show Actavis' CEO saying that the company was "trying to . . . put barriers or obstacles to generic competition."[137] Furthermore, internal documents revealed that Actavis studied the issues of switching and found that only thirty percent of patients would voluntarily switch to the new product.[138] By contrast, according to the documents, if the old product were withdrawn, eighty to one-hundred percent would switch.[139]

Nevertheless, the absence of a compelling story of why this behavior is "exclusionary"—that is, not competition on the merits—is troubling. Is there a better way of analyzing this conduct rather than simply relying on the fact that the conduct at issue had a coercive effect on consumers? Perhaps the result here can be justified as exclusionary because the behavior sacrificed short-term profits. This is the monopolization equivalent of "cutting off your nose" to undercut a rival. It is akin to *Lorain Journal Co. v. United States*,[140] where the monopoly newspaper decided to refuse to sell advertising space to customers who also advertised on its radio station rival, in an attempt to "destroy[]" its rival.[141] Establishing that a particular practice sacrifices short-term profits should not be a *requirement* or even a *necessary factor* to make out a Sherman Act Section 2 violation, as some have argued, because "cheap" forms of exclusion, such as deception, can be quite destructive, too, and should be

133 *Actavis,* 2014 WL 7015198 at *45.

134 New York v. Actavis PLC, 787 F.3d 638, 663 (2d Cir. 2015), *cert. dismissed sub nom.* Allergan PLC v. New York, 136 S. Ct. 581 (2015).

135 Courts have shown some level of hostility toward second-guessing product design decisions by companies. *See, e.g.,* Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 286 (2d Cir. 1979) ("[A]ny firm, even a monopolist, may generally bring its products to market whenever and however it chooses.").

136 *Id.* at 652-54.

137 *Id.* at 658 (internal citations omitted).

138 *Id.* at 648.

139 *Id.* at 654.

140 342 U.S. 143 (1951).

141 *Id.* at 148-49.

condemned under Sherman Act Section 2 when appropriate. Nevertheless, the fact that a particular conduct did in fact sacrifice short-term profits can be a telling indication that it was not done for some rational market participant purpose, but rather was done solely to kneecap a rival.

The Second Circuit finally reaches this point, but only toward the end of its opinion. The actual amount of additional sales Actavis expected from the new drug's introduction because of the withdrawal of the old drug is confidential, but the opinion clearly states that the incremental sales were *less* than the annual $1.5 billion in sales Actavis made every year from selling the old drug.[142] Consequently, Actavis sacrificed significant profits by withdrawing the old product from the market, and could provide no explanation as to why this loss made economic sense absent the elimination of generic competition.[143] Such evidence provides a sounder basis to assert that Actavis' conduct was something other than "competition on the merits" than the theory of consumer coercion articulated by the court elsewhere.

F. State-Action Immunity Further Limited: *North Carolina State Board of Dental Examiners v. F.T.C.*[144]

This Supreme Court decision answered a question long open in the area of state-action immunity to the antitrust laws. As developed through several Supreme Court decisions, state-action antitrust immunity requires that the particular state conduct at issue meet two requirements: (1) the conduct must be pursuant to a clearly articulated state policy, and (2) the policy involved must be actively supervised by the state.[145] In *Town of Hallie v. City of Eau Claire*,[146] the Supreme Court held that state actors such as municipalities need only meet the first requirement of clear articulation.[147] According to the Court, a showing of active supervision was not necessary because municipalities present "little or no danger that [they are] involved in a private price-fixing arrangement."[148] In dicta, the Court also suggested that state agencies might be treated the same as municipalities, and likely only need to meet the first clear articulation requirement.[149] *North Carolina State Board of Dental Examiners* raised the issue of whether a state regulatory board made up of market participants is immune to antitrust scrutiny.[150]

The FTC sued the Board of Dental Examiners (the "Board"), alleging that the Board's actions in sending cease-and-desist letters to non-dentists offering teeth whitening services were anticompetitive.[151] The Board, mostly made up of private dentists elected by their

---

142 *Actavis,* 787 F.3d at 659.

143 *Id.*

144 135 S. Ct. 1101 (2015).

145 Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980).

146 471 U.S. 34 (1985).

147 *See id.* at 47 ("Once it is clear that state authorization exists, there is no need to require the State to supervise actively the municipality's execution of what is a properly delegated function.").

148 *Id.* (emphasis omitted).

149 *Id.* at 46 n.10.

150 N.C. State Bd. of Dental Examiners v. F.T.C., 135 S. Ct. 1101, 1107 (2015).

151 *Id.* at 1108.

dentist colleagues, invoked state action immunity in defending against the suit.[152] In its decision, the Supreme Court squarely held against the Board.[153] It found that a state board made up of a controlling number of market participants can only invoke state action if it is acting under a clearly articulated policy to displace competition *and* it is actively supervised.[154]

Although this decision has sparked some concern about liability implications for state professional and licensing boards, its impact is likely to be quite limited. In essence, the focus of the Supreme Court's opinion is to ensure that "scope of practice" decisions—those that are most likely to raise anticompetitive concerns—are not decided by boards that are effectively cartels of private market participants without any type of state supervision or review whatsoever. Or as the Court put it in *Midcal Aluminum*: "The national policy in favor of competition cannot be thwarted by casting . . . a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement."[155]

G. Healthcare Merger Challenge: *Saint Alphonsus Medical Center–Nampa Inc. v. St. Luke's Health System, Ltd.*[156]

St. Luke's Health System, a hospital that owned physician groups in Nampa, Idaho, sought to purchase Saltzer, the largest remaining independent physician group in Nampa.[157] St. Luke's had previously acquired a group of primary care physicians who competed with Saltzer.[158] The FTC, joined by the State of Idaho and two local hospitals, argued that, together, the two physician groups gave St. Luke's eighty percent of the Nampa primary care physician services market.[159] The district court ultimately enjoined the acquisition,[160] and the Ninth Circuit affirmed.[161]

In both the district and appellate court decisions, the courts focused on geographic market and competitive effects on health insurance companies as the appropriate "buyer" for health care services.[162] This is a major change from the health care combination challenges of the 1990s and early 2000s, where the focus was instead on where ultimate consumers, i.e. patients, might be willing to travel in defining relevant geographic market and competitive

---

152 *Id.* at 1109.

153 *Id.* at 1117.

154 *Id.* at 1110.

155 Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 106 (1980).

156 778 F.3d 775 (9th Cir. 2015).

157 *Id.* at 781.

158 Saint Alphonsus Med. Ctr.–Nampa, Inc. v. St. Luke's Health Sys., Ltd., Nos. 12-CV-00560-BLW, 13-CV-00116-BLW, 2014 WL 407446, at *1 (D. Idaho Jan. 24, 2014).

159 *Id.*

160 *Id.* at *26.

161 Saint Alphonsus Med. Ctr.–Nampa Inc. v. St. Luke's Health Sys., Ltd., 778 F.3d 775, 793 (9th Cir. 2015).

162 *Saint Alphonsus,* 2014 WL 407446, at *6-7; *Saint Alphonsus,* 778 F.3d at 784. The Ninth Circuit's decision in turn relied on a recent Sixth Circuit that provides a fuller explanation of this new economic reasoning undergirding proper geographic market and competitive effects analysis in healthcare merger review. *ProMedica Health Sys., Inc. v. F.T.C.*, 749 F.3d 559, 562 (6th Cir. 2014).

effects.[163] That old analysis was heavily criticized by economists as placing the focus on the wrong "customer."[164] The real buyer in the health care industry is the health insurance company, not the ultimate patient. The relevant geographic market is the one to which the major health insurance providers can steer their customers. It is health insurance companies that must cobble together provider panels that are sufficient to attract large employers to their plans. And if a health insurer says it cannot steer ultimate customers to far away locations for physician services, then providers in those locations do not belong in the relevant geographic market, nor are they likely to affect the competitive conditions in the market at issue. Understanding the practicable options that health insurers can turn to in a particular geographic market in the event of an acquisition also informs the competitive effects analysis. The key is understanding the practicable options that a health insurer can use as leverage when negotiating with each provider group. Reduce those options with a merger or acquisition, and competition is likely to be substantially lessened.[165] Consequently, getting the court in *St. Luke's* to adopt this more modern approach was a huge win for the FTC.

The court also rejected efficiencies claims advanced by the parties to justify the deal. As the court put it and as the agencies have long required, "[t]he defendant must also demonstrate that the claimed efficiencies are 'merger-specific.'"[166] For example, St. Luke's failed to show the necessity of *employing* physicians, since other less restrictive forms of collaboration—such as contracting or joint ventures—can achieve the same benefits.[167] The court also noted that, "even if we assume that the claimed efficiencies were merger-specific, the defense would nonetheless fail. . . . [St Luke's] did not demonstrate that efficiencies resulting from the merger would have a positive effect on competition."[168] Although some have voiced concern about this comment and whether it presages judicial hostility to any type of efficiencies defense, I do not believe that the court intended such a result. Rather, the court's opinion simply reflects the notion that, once a court has found that a merger is likely to harm competition, it is incumbent on the proponents of that merger to explain why the efficiencies resulting from the merger are likely to be of net benefit to consumers in a competitive marketplace. In sum, the efficiencies must be so output-enhancing and beneficial to consumers such that they overwhelm any other negative effects arising from the deal. And that simply was not done by the defendants in this case.

---

163 *See, e.g.,* California v. Sutter Hosp. Sys., 130 F. Supp. 2d 1109 (N.D. Cal. 2001) (adopting a large geographic market encompassing the San Francisco East Bay all the way to the Central Valley). That decision, along with others, relied on a test originally developed using data from coal and beer markets by Kenneth Elzinga and Thomas Hogarty. Kenneth G. Elzinga & Thomas F. Hogarty, *The Problem of Geographic Market Delineation in Antimerger Suits,* 18 Antitrust Bull. 45 (1973).

164 *See, e.g.,* Cory S. Capps et al., *Antitrust Policy and Hospital Mergers: Recommendations for a New Approach,* 47 Antitrust Bull. 677 (2002). Another problem with that old analysis is that it assumed that, if some patients before a merger are being treated outside an area, more will follow if prices increase. But the evidence shows that patients who are seeking care outside a proposed area are not doing so because of price, but for other reasons, such as that they work outside the area. Therefore, the assumption that others will seek care elsewhere if some have done so is not valid. *See id.* at 682.

165 Cory Capps & David Dranove, *Hospital Consolidation and Negotiated PPO Prices,* 23 Health Aff. 175 (2004) (focusing on how mergers can reduce health insurers' bargaining leverage and lead to higher prices).

166 *Saint Alphonsus,* 778 F.3d at 790 (internal citation omitted).

167 *Id.* at 791.

168 *Id.* at 791-92.

H. Narrower Market Merger Challenge: *F.T.C. v. Sysco Corp.*[169]

In this merger challenge, the two largest foodservice distributors—Sysco and U.S. Foods—sought to merge in a deal valued at $8.2 billion.[170] The FTC filed suit in D.C. federal court to block the merger, alleging that that the distributors were the only two with truly nationwide distribution capability.[171] The companies first tried to gain regulatory approval by spinning off eleven of U.S. Foods' distribution centers to a regional food service distributor, but the FTC rejected the sale as inadequate to address the competitive harms it believed flowed from the merger.[172]

The primary issue in the litigation was the product market. The FTC alleged a product market of broadline foodservice distributors, which are characterized by distinct attributes "such as a vast array of product offerings, private label offerings, next-day delivery, and value-added services."[173] Within that market, the FTC alleged a more specific market of broadline food service distribution services sold to national customers—that is, customers with a nationwide or multi-regional footprint such as group purchasing organizations, foodservice management companies, hospitality chains, and national chain restaurants.[174] The FTC alleged that the two entities held fifty-nine percent of this narrower market.[175] On the other hand, Sysco argued for a broader definition of the foodservice market including not only broadline food distributors but also other distributors, such as specialty or systems distributors.[176] Sysco and U.S. Foods made up only twenty-five percent of this broader market.[177]

Applying the *Brown Shoe*[178] qualitative factors, the court favored the FTC's approach, noting how these broadline distributors maintain a vast array of products and services, are organized as separate business units, offer delivery flexibility, serve a distinct set of customers, benchmark prices only against other broadline distributors, and are recognized in the foodservice industry as a distinct channel of distribution.[179] The defendants countered that customers in the market are not dependent on broadline distributors, but can and do allocate their business between the various distribution channels.[180] But the court felt that, as in *Whole Foods*[181] and *Staples*,[182] the possibility that customers can switch some sales to other modes of distribution outside the market did not alter the demarcation of the product

169 113 F. Supp. 3d 1 (D.D.C. 2015).

170 *Id.* at 15, 20.

171 Complaint ¶ 1, F.T.C. v. Sysco Corp., No. 15-CV-00256-APM (D.D.C. Feb. 20, 2015).

172 *Sysco Corp.,* 113 F. Supp. 3d at 21.

173 *Id.* at 24.

174 *Id.*

175 *Id.* at 25.

176 *Id.*

177 *Id.*

178 Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962).

179 *See Sysco Corp.,* 113 F. Supp. 3d at 27-30.

180 *Id.* at 30.

181 F.T.C. v. Whole Foods Mkt., Inc., 548 F.3d 1028 (D.C. Cir. 2008).

182 F.T.C. v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997).

market.[183] In this regard, the court credited the uniform testimony of customers about the product market, as well as the merging parties' internal documents.[184]

The court went on at length about the battle of the experts regarding divergent studies with respect to this product market.[185] Despite noting serious issues with the FTC expert's work, the court ultimately credited his findings and analysis, in part because the expert's conclusions matched the "business realities" of the testimony and documents.[186]

In arguing for a narrower market focused on national customers, the FTC relied upon the *Merger Guidelines* to suggest that a market may be defined around a subset of customers targeted for price discrimination.[187] The court did not necessarily endorse this concept, but rather focused on the *Brown Shoe* factors to find such a narrower market.[188] In particular, the judge noted that regional broadline distributors had formed cooperatives to try to compete for national customers,[189] and that the parties' own documents referred to national customers as a distinct group with different needs.[190]

Once the product market was established, the court had no trouble concluding that the divestiture of U.S. Foods' eleven distribution centers would not fix the problem—the regional distributor set to acquire the distribution centers would not "step into [U.S. Foods]'s shoes" and provide the same competitive intensity as U.S. Foods.[191] As a result, the court preliminarily enjoined the merger.[192]

Sysco stands in a line of cases—including *Whole Foods* and *Staples*—that found narrow markets based on customer preference. For attorneys advising merging parties on antitrust implications, these decisions suggest that a deeper dive into the merging parties' customer base may be necessary.

I. "Actual Potential Competition" Theory: *F.T.C. v. Steris Corp.*[193]

One notable loss for the federal law enforcement agencies this year occurred in the area of "actual potential competition." A little background is necessary here to provide context. Mergers involving potential competitors may be challenged on two theories: the "perceived potential competition" theory and the "actual potential competition" theory. Under the former, a company that is perceived by market participants as potentially entering the market may have a significant procompetitive effect on the marketplace. Acquisition of the perceived

---

183 *Sysco Corp.,* 113 F. Supp. 3d at 30-31.

184 *Id.* at 32-33.

185 *Id.* at 33-37.

186 *Id.* at 36-37.

187 *Id.* at 38-39.

188 *Id.* at 40-43.

189 *Id.* at 40.

190 *Id.* at 41-43.

191 *Id.* at 73.

192 *Id.* at 88.

193 No. 15-CV-1080, 2015 U.S. Dist. LEXIS 128470 (N.D. Ohio Sep. 24, 2015).

entrant by an incumbent (or vice-versa) may thus result in decreased competition in that marketplace. Under the latter, a company is actually planning to enter the market and would increase competition, but a merger with an incumbent prevents that procompetitive effect. Over forty years ago, the Supreme Court accepted the perceived potential competition theory, but left open whether a merger may violate Section 7 under the actual potential competition theory.[194] Federal enforcement authorities have long sought to advance the law on actual potential competition. One area of concern among law enforcers has been a requirement by some lower courts of "clear proof" that the acquiring firm would in fact have entered the relevant market but for the acquisition in question,[195] which is a position even the FTC held at one time.[196] The concern among law enforcers is that "clear proof" is too daunting a standard because it appears to require something significantly more than the usual standard of "reasonable probability."[197]

In *F.T.C. v. Steris Corp.*[198] the FTC filed suit to challenge Steris' acquisition of Synergy, claiming that Synergy was poised to enter the US market for gamma sterilization services just before the acquisition.[199] According to the FTC's complaint, Steris, headquartered in Mentor, Ohio, and United Kingdom-based Synergy both provide contract sterilization services for companies that need to ensure their products are free of unwanted microorganisms before they reach customers. Implanted medical devices and human tissue products, for example, must meet stringent requirements for sterilization. For most companies, in-house sterilization is not a viable alternative. Instead, these customers bring their products to sterilization service facilities on a contract basis, typically within five-hundred miles of the companies' manufacturing or distribution facilities to minimize shipping costs. Today, gamma radiation, generated by the radioactive isotope cobalt-60, is considered the only feasible method of sterilizing large volumes of dense and heterogeneously packaged products. Only Steris and one other company, Sterigenics, provide contract gamma sterilization services in the United States, according to the FTC's complaint. At the time the proposed merger was announced, Synergy was implementing a strategy to open new plants that would provide contract x-ray sterilization services. These services—which currently are not available in the United States—would provide a competitive alternative to gamma radiation, according to the complaint. Because it uses electricity rather than cobalt-60, x-ray sterilization does not raise many of the environmental and regulatory issues associated with gamma sterilization. According to the FTC, it is unlikely that new competitors in the market for contract radiation sterilization services would replicate the competition that would be eliminated by the merger.

---

194 United States v. Marine Bancorp., 418 U.S. 602, 639-40 (1974).

195 F.T.C. v. Atl. Richfield Co., 549 F.2d 289, 300 (4th Cir. 1977).

196 In re B.A.T. Indus., Ltd., 104 F.T.C. 852, 926-28 (1984).

197 *See* Mary Lou Steptoe, Acting Dir., Bureau of Competition, Fed. Trade Comm'n, Remarks before the ABA Section of Antitrust Law, Annual Meeting: Potential Competition and Vertical Mergers: Theories and Law Enforcement Action at the Federal Trade Commission (Aug. 9, 1994) ("[T]he time may be ripe to reexamine what the phrase 'clear proof' really means . . . ."). "Clear proof" is closest to the "clear and convincing evidence" standard which has been defined to require a "highly probable" showing, well beyond the usual civil standard of a preponderance of the evidence. Black's Law Dictionary 674 (10th ed. 2014).

198 No. 15-CV-1080, 2015 U.S. Dist. LEXIS 128470 (N.D. Ohio Sept. 24, 2015).

199 *Id.* at *5.

Consequently, the FTC alleged that the effect of the deal was to allow Steris to insulate itself against increased competition in that market by foreclosing the actual potential competition that an independent Synergy would have brought to the market for gamma sterilization services.[200]

The court, however, rejected the FTC's effort to preliminarily enjoin the merger.[201] For purposes of deciding the motion for a preliminary injunction, the court accepted the FTC's formulation that the test was whether the competitor "probably" would have entered the market, but found the evidence in this instance to be lacking.[202] In other words, the judge seemed to accept a lower standard of proof while still ruling against the agency.

The court credited post-acquisition documents and testimony that Synergy's internal committees never formally approved the entry into gamma sterilization because of (1) a lack of customer commitments;[203] and (2) cost-related problems with procuring the necessary machinery.[204] The FTC argued that much of this evidence appeared pretextual, and that Synergy demonstrated that it had made a decision to enter when, shortly after the Steris acquisition was announced, it made public statements that it had "signed an agreement with a [manufacturer of gamma technology machines] for X-ray technology to be deployed in the United States."[205] While literally true, the statement certainly suggested entry was imminent. The court, however, discounted this evidence.

As this decision shows, actual potential competition cases often turn on subjective evidence, which is always difficult to prove. Given the varying "spin" of the evidence between the merging parties and the FTC, it is no wonder that the court looked for some type of objective evidence showing that Synergy actually intended to enter. What it found—no final sign off, a lack of customer commitments, and problems with procuring the necessary machinery—led the court to conclude that Synergy would not have probably entered the marketplace. What this may suggest is that, while the judge said he was utilizing a lower standard of proof, he may in fact have been employing a heightened test.

J. Class Action Privacy Case Surmounts Standing Challenge: *Remijas v. Neiman Marcus Group, LLC*[206]

The Seventh Circuit overturned the district court's dismissal of a class action brought against Nieman Marcus, a high-end retailer.[207] While the decision appeared to breathe renewed vigor into data breach class actions, it did have some dicta that may prove troublesome to certain privacy plaintiffs with respect to the injury-in-fact requirement.

---

200 *Id.*

201 *Id.* at *63-64.

202 *Id.* at *9-10.

203 *Id.* at *44-54.

204 *Id.* at *44-59.

205 *Id.* at *60.

206 794 F.3d 688 (7th Cir. 2015).

207 *Id.* at 690.

In the decision, the court found that a class of consumers whose financial information was compromised in a 2013 hack of Neiman Marcus's data systems showed injury-in-fact and thus had standing to sue.[208] In doing so, the court specifically rejected the defendant's argument that the class's injuries were too speculative because the hackers had yet to use the personal information for fraudulent charges or to assume consumers' identities.[209] Adopting a Northern District of California judge's reasoning in *In re Adobe Systems, Inc. Privacy Litigation*,[210] the court found that "Neiman Marcus customers should not have to wait until hackers commit identity theft or credit-card fraud in order to give the class standing, because there is an 'objectively reasonable likelihood' that such an injury will occur."[211] In arriving at this decision, the court noted that the purpose of the data breach was to steal consumers' private information in order to make fraudulent charges or assume those consumers' identities.[212] It further noted that studies show that hackers sometimes wait for up to a year or more before utilizing stolen data.[213] The court also accepted as a concrete injury the fact that consumers notified of the breach "lost time and money protecting themselves against future identity theft and fraudulent charges" by signing up for credit-monitoring services.[214] Consequently, the court found that the class had sufficient injury to survive a Rule 12(b)(1) motion.[215]

At the same time, while the court did not rule on whether other injuries put forth by the plaintiffs sufficed for standing, it did go on in dicta to suggest that two other theories of injury were "dubious."[216] The first injury that the Seventh Circuit found questionable was the notion that plaintiffs were overcharged "because the store failed to invest in an adequate security system."[217] Although the court noted that this "premium" or "overcharge" analysis has been accepted in the product liability context, the court suggested that this analysis did not apply in the data security breach situation, and seemed to suggest that it did not agree with an Eleventh Circuit decision, *Resnick v. AvMed, Inc.*,[218] that in fact found such injury to meet the standing requirement in a data breach case.

The second injury plaintiffs alleged was that they had "a concrete injury in the loss of their private information, which they characterize as an intangible commodity."[219] The court cast doubt on this proposition as well, noting that this claim "assumes that federal law recognizes such a property right while refer[ring] [the court] to no authority that would support such a finding."[220] Plaintiffs also cited to California's and Illinois's Data Breach Acts as support for the notion that

---

208 *Id.* at 689-90.

209 *Id.* at 693.

210 *Id.* (citing *In re* Adobe Sys., Inc. Privacy Litig., 66 F. Supp. 3d 1197, 1214 (N.D. Cal. 2014)).

211 *Id.* at 693 (quoting Clapper v. Amnesty Int'l USA, 133 S. Ct. 1138, 1147 (2013)).

212 *Id.*

213 *Id.* at 694.

214 *Id.*

215 *Id.*

216 *Id.*

217 *Id.*

218 693 F.3d, 1317, 1328 (11th Cir. 2012).

219 *Id.* at 695.

220 *Id.*

Neiman Marcus's actions violated a state law right.[221] While the Seventh Circuit acknowledged that an actual or threatened violation of a state-law right can confer Article III standing, the court questioned whether Neiman Marcus had in fact violated those statutes.[222] According to the court, a California state appellate court has found that a delay in notification is not a cognizable injury,[223] and that the Illinois statute in question required a showing of "actual damages."[224]

In addition to finding injury in fact, the court found that plaintiffs also had pled causation and redressability sufficient to meet all three requirements for Article III standing.[225] Neiman Marcus argued that plaintiffs could not show that their injury was caused by the breach at Neiman Marcus because other large stores, such as Target, had experienced similar breaches during the same time period.[226] The court disposed of this argument, finding that it was "certainly plausible" for pleading purposes that the plaintiffs' injuries stemmed from the Neiman Marcus data breach.[227] If there were multiple companies that could have exposed plaintiffs' personal information to the hackers, the court found it was the *defendant*'s burden to prove that their negligent actions were not the but-for cause of the plaintiff's injury.[228]

Finally, the court easily disposed of Neiman Marcus' argument that the plaintiffs had nothing further to redress because they had already been reimbursed for any fraudulent charges, noting that consumers had not been reimbursed for mitigation expenses (such as obtaining long-term credit monitoring services) or future injuries.[229] The court specifically mentioned that credit and debit card issuers have limitations on when they will reimburse for fraudulent charges, and that such policies are a "business practice," not a "federal requirement."[230]

This case suggests that the tide is starting to turn in favor of plaintiffs in getting past the standing hurdle in privacy challenges. Whether this leads to more judgments against companies for privacy violations remains to be seen.

K. FTC Privacy Case Surmounts Challenge: *F.T.C. v. Wyndham Worldwide Corp.*[231]

In a long-awaited ruling, the Third Circuit upheld a district court determination that an FTC challenge to allegedly lax data security practices at Wyndham's hotels could go forward as an "unfair practice" that violates Section 5 of the Federal Trade Commission Act ("FTC Act").[232] While this decision solely focused on Section 5 of the FTC Act, it is likely to

---

221 *Id.*

222 *Id.* at 695-96.

223 *Id.* at 695 (citing Price v. Starbucks Corp., 192 Cal. App. 4th 1136, 1143 (2011)).

224 *Id.* (citing People v. United Constr. of Am., Inc., 981 N.E.2d 404, 411 (Ill. App. Ct. 2012)).

225 *Id.* at 696-97.

226 *Id.* at 696.

227 *Id.*

228 *Id.*

229 *Id.* at 696-97.

230 *Id.* at 697.

231 799 F.3d 236 (3d Cir. 2015).

232 *Id.* at 259.

reinvigorate efforts by federal, state, and local law enforcement agencies as well as the private bar to challenge potentially deceptive or unfair privacy practices.

According to the FTC complaint, in 2008 and 2009, hackers successfully accessed Wyndham's computer systems and stole personal and financial information for 619,000 customers, which resulted in at least $10.6 million in fraudulent losses.[233] The FTC filed suit in June 2012, alleging that Wyndham engaged in unfair security practices that "unreasonably and unnecessarily exposed consumers' personal data to unauthorized access and theft."[234] Among other things, the FTC alleged that the company failed to use firewalls at critical network points, did not restrict specific IP addresses, did not use encryption for certain customer files, and did not require users to change default or factory-set passwords.[235]

In affirming the district court's decision allowing the case proceed, the appellate court rejected several of Wyndham's contentions. The first basket of challenges relate to the meaning of "unfairness," the second to subsequent congressional action, and the third to whether Wyndham had adequate notice that its conduct could violate the FTC Act.

1. The Meaning of Unfairness

First, Wyndham alleged that the plain meaning of the term "unfair" required a showing of further evidence beyond the three-part test the FTC has used since 1980.[236] A little background is in order here. As codified by Congress in Section 5(n) of the FTC Act in 1994, a finding of unfairness requires the FTC to show that (1) the act or practice causes or is likely to cause substantially injury to consumers (2) which is not reasonably avoidable by consumers themselves and (3) which is not outweighed by countervailing benefits to consumers or competition.[237] This provision also bars the agency from relying primarily on public policy considerations as the basis for determining that a practice is unfair.[238] Wyndham referenced 1930s Supreme Court case law to argue that a finding of unfairness also requires "unscrupulous or unethical behavior,"[239] but the court noted that subsequent Supreme Court precedent rejected that additional requirement.[240]

Next, Wyndham argued that the dictionary definition of "unfair" required that the practice be "not equitable" or "marked by injustice, partiality, or deception,"[241] but the court dismissed this argument because it found that the conduct alleged met such a test.[242] In particular, the court focused on how difficult it would be for consumers to reasonably avoid Wyndham's unreasonable data security because the company's privacy policy deceptively

233 *Id.* at 242.

234 *Id.* at 241-42.

235 *Id.* at 256.

236 *Id.* at 244.

237 15 U.S.C. § 45(n).

238 *Id.*

239 *Wyndham,* 799 F.3d at 244 (citing F.T.C. v. R.F. Keppel & Brother, 291 U.S. 304 (1934)).

240 *Id.* at 244-45 (citing F.T.C. v. Sperry & Hutchinson Co., 405 U.S. 233, 244 n.5 (1972)).

241 *Id.* at 245 (internal citation omitted).

242 *Id.*

overstated its cybersecurity,[243] although it left open the possibility that unfairness in data breach situations could be shown even absent a privacy policy that overstates cybersecurity protections.[244]

The court also rejected the claim that unfairness could not be shown here because the direct cause of the harm was criminal activity by third parties, and thus that Wyndham did not directly cause the harm to consumers.[245] In this regard, the court noted that a company's conduct need not be the *most* proximate cause of an injury, and focused on the fact that actual harm is not necessary to make out a claim of unfairness: rather, the standard for unfairness is whether there was an increased likelihood of harm to consumers as a result of the practice in question.[246] The court found the cybersecurity intrusions to be a plausible and foreseeable result of the allegedly lax security.[247]

Finally, the court rejected Wyndham's argument that giving the FTC authority over lax security practices could lead to FTC liability for poor physical security or lax clean-up procedures at brick-and-mortar retail establishments.[248] In colorful language, Wyndham argued that even a banana peel left on a shop floor could lead to FTC liability.[249] The court's "tart" response was that, "were Wyndham a supermarket, leaving so many banana peels all over the place that 619,000 customers fall hardly suggests it should be immune from liability . . . ."[250]

2. Subsequent Congressional Action and FTC Agency Inaction

Wyndham next argued that subsequent legislative acts excluded consumer privacy violations from the scope of Section 5 of the FTC Act.[251] Wyndham noted that three separate Congressional actions gave the FTC authority to promulgate regulations in the privacy arena: the 2003 amendments to the Fair Credit Reporting Act gave the FTC the ability to develop regulations for the proper disposal of consumer data; the 1999 Gramm-Leach-Bliley Act required the FTC to establish standards for financial institutions to protect consumers' personal information; and the Children's Online Privacy Protection Act gave the FTC authority to promulgate regulations concerning children's websites.[252] Citing *F.D.A. v. Brown & Williamson Tobacco Corp.,* Wyndham concluded that in enacting these specific measures, Congress had excluded FTC authority over cybersecurity.[253] The court disagreed, finding that all these laws either required FTC action (rather than gave authority) or granted the FTC greater leeway to take action.[254] In other words, none of these legislative actions

---

243 *Id.* at 245-46.

244 *Id.* at 246 n.5.

245 *Id.* at 246.

246 *Id.*

247 *Id.*

248 *Id.* at 246-47.

249 *Id.* at 246.

250 *Id.* at 247.

251 *Id.*

252 *Id.* at 247.

253 *Id.*

254 *Id.* at 248.

was "inexplicable" if the FTC already had some authority over privacy violations under Section 5.[255] The court also found unpersuasive the claim that the FTC had somehow disclaimed its authority over cybersecurity through statements made to Congress.[256]

3. Fair Notice

Wyndham's final argument was that "the FTC failed to give fair notice of the specific cybersecurity standards the company was required to follow."[257] The court appeared puzzled by Wyndham's shifting legal arguments regarding what type of notice it was entitled to here, noting seven different positions Wyndham took on appeal.[258] The court concluded that Wyndham was not entitled to know with "ascertainable certainty" what cybersecurity practices were required to meet Section 5, and instead focused on whether "Wyndham had fair notice that its conduct could fall within the meaning of the statute."[259] The court found the FTC met this requirement handily, given public pronouncements and settlements it had entered into with other companies engaged in lax data security practices.[260]

In sum, this decision was a "must win" for the FTC, reaffirming its authority to challenge unreasonable cybersecurity practices. It, along with *Neiman Marcus,* suggests that federal courts are becoming more hospitable to privacy challenges, both by law enforcement agencies and by the private bar.

III. CONCLUSION

The year 2015 will go down in history for its big plaintiff wins in both antitrust and privacy. These decisions also advance the thinking in major areas of antitrust law and privacy law. Full Section 1 rule of reason adjudications, new ground broken in Section 2 monopolization law, and important affirmation of the FTC's authority in the privacy realm are three key developments that occurred in 2015. All in all, as noted above, it was a year that shows that vigorous antitrust and privacy enforcement remains alive and well in the federal courts.

---

255 *Id*.

256 *Id*. at 248-49.

257 *Id*. at 249.

258 *Id*. at 252-53.

259 *Id*. at 255.

260 *Id*. at 255-59.

KEYNOTE ADDRESS: A CONVERSATION WITH THE HONORABLE TANI CANTIL-SAKAUYE, CHIEF JUSTICE OF CALIFORNIA

Panelists: Cheryl Lee Johnson and Kathleen J. Tuttle[1]

For the third year in a row it has been our good fortune to have a member of the California Supreme Court as our keynote speaker. At this GSI, we welcomed our Chief Justice, Tani Gorre Cantil-Sakauye. The questioners were two former chairs of the Antitrust Section, Cheryl Johnson and Kathleen Tuttle. Johnson and Tuttle began the presentation with a brief introduction followed by questions posed to Chief Justice Cantil-Sakauye. What follows is an edited transcript of that conversation.

Johnson: It is our great honor to have with us today Chief Justice of the California Supreme Court, Tani Gorre Cantil-Sakauye. When confirmed in 2011, she became the first Asian-Filipina American, and only the second woman Chief Justice of California's Supreme Court.

We'd first like to say a few words about the Chief Justice's background. She was born in Sacramento, the fourth child of first generation Asian-American farmworkers. She received both her undergraduate degree (with honors) in rhetoric and law degree at U.C. Davis, and during school, she supported herself by waitressing. Her first law job was as a deputy district attorney in Sacramento. She then served in two senior positions for Governor Deukmejian: first, as his deputy legal affairs secretary, and then as his deputy legislative secretary. In 1990, she was appointed to the Sacramento Municipal Court, and in 1997, was elevated to the Superior Court. There, Justice Cantil-Sakauye established the first Sacramento court dedicated to domestic violence issues.

In 2005, Governor Arnold Schwarzenegger appointed our honored guest to the California Court of Appeal, where she served for five years. During that time, Supreme Court Chief Justice Ron George appointed her to the Judicial Council of California, the Constitutional policy-making body of the judicial branch. In 2010, Governor Schwarzenegger appointed her to the California Supreme Court, as Chief Justice, to replace retiring Chief Justice Ron George.

Alongside the rather daunting job of running the largest court system in the nation, Chief Justice Cantil-Sakauye has continued to pursue her longtime interest in community and non-profit organizations, including a civics-learning project on the Constitution and the power of democracy. She and her husband, Mark Sakauye, a retired police lieutenant, have two wonderful daughters.

***Tuttle*:** Madam Chief Justice, thanks so much for being here. There is a great vignette about you that no doubt some in this room have heard before. A very long time ago, your mother took you to see Gloria Ochoa, one of the first Filipino American lawyers in California. As the story goes, your mother threw you an elbow jab, and said "you could do that too." Was it that motherly encouragement or something more that compelled you to pursue a career in law?

---

1 Cheryl Lee Johnson is with the Antitrust Section of the Office of the California Attorney General and Editor-In-Chief of *California Antitrust and Unfair Competition Law.* 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.

Chief Justice: Thank you Kathleen, and thank you Cheryl. First let me say it's a pleasure to be here with all of you, and also with my former colleague, Justice Judge Rick, who is now retired. What a pleasure to see you again. And thank you for that question.

As the youngest of four children, it was rare that my mother even spoke directly to me. So the fact that she singled me out and dragged me to the Filipino community center to see a person whom I'd never seen, to use the word "lawyer" which I'd never heard and didn't know the meaning of, I knew that was a big day. Later on, of course, I met Gloria Ochoa. She remains a good friend of mine and we served on several organizations together.

To return to your question, it wasn't only that jab, it was my mother's intensity on that day. I think she saw that meeting as important because of some of the experiences in the Filipino community. Also, later on, a professor of mine became a mentor, and encouraged me to go on to law school. The mentor, who wore yellow leisure suits with white shoes and a white belt, gave me some wise words about trying to further my education, and I joined the speech and debate team. I learned that many of the young men I was debating against, and that I was beating, went on to law school. That further piqued my interest in the law. There was always this undercurrent in the Filipino community where I grew up, about certain events that happened to me and I've always retained that feeling of urgency.

***Tuttle*:** How did experiences in your childhood affect your perception of our legal system?

Chief Justice: One of the memories that I recall is from the age of nine years, when our house was taken from us by eminent domain. What I understand about that now is far different from what I knew at nine. At nine, I just knew the family home was being taken and we were moving. And of course, you can imagine the disruption that occurs when you live in a community that includes your grandmother and your siblings in the same home. I remember my mother going to court as a pro se, and coming back feeling very disrespected. I remember to this day the judge who ruled against her argument. His name has resonated in our house for years.

I also remember that uncles of mine who wanted to marry Caucasian women had to go out of state to marry at that time. I also remember that we lived near the Capitol; we would go to the Capitol park to have picnics. My mother warned us never to go into the Capitol itself, it had these big beautiful oak doors and a lot of pillars and marble. I never understood why I couldn't go in there. So, there were all of these memories in my early childhood about authority and law, and who was in charge, and whether you could be part of it.

***Tuttle*:** After law school, your application to the Sacramento Public Defender was rejected because you were considered too young. Instead, you took a job with the District Attorney's Office. Do you think your career would have gone in a somewhat different direction had you started as a public defender?

Chief Justice: That's a good question Kathleen. I think it may have only in the sense that you think about "location, location, location." So I applied here in San Francisco, and thereafter when I didn't get the job, I went back to my home town of Sacramento and applied at the DA's office, because a criminal defense attorney advised me that you can do more justice if you do it from the DA's office. It was later my luck that the DA's office was in Sacramento, the state capital, and maybe three or four blocks from the Governor's Office.

It's not that I had any connection with the Governor's Office except that I knew some of the staff. I also applied to the Governor's Office and worked there at a time when George Deukmejian was looking for young prosecutors for the bench. I didn't even know that because I didn't yet have enough years to apply to the bench. Of course, had I been in San Francisco, there would have been different opportunities for young lawyers that would not necessarily have involved an invitation to interview the Governor's Office. It's really in the Governor's Office that I first realized as a very young lawyer, that the governor appoints lawyers to be judges, that there were several levels of courts, and that the governor regularly makes a difference in the appointment process. That's what I mean about "location."

Johnson**:** Following law school, when law jobs were scarce, you briefly worked as a black jack dealer. Did you learn anything from that experience that you are willing to share with us?

Chief Justice: Well let me clarify. In law school in my first year, Harrah's came to the UC Davis campus to interview. I had a job in my first year after law school, but it didn't pay well. I was working for a criminal defense lawyer, and was doing some research on a homicide that he was defending. I interviewed at Harrah's and got a job working for the summer and periodic holidays. I learned a great deal. At this stage, I'd spent most of my life in school. I'd never really seen drunk people sitting at a table making decisions. I certainly observed humanity at its best and at its worst.

Black jack dealers are a lot like bartenders in the sense that you are anonymous; they will never see you again, so they tell you things that you probably wouldn't otherwise share. Little did they know that I would soon be a lawyer, and they would fail to recognize me in the DA's office.

I learned about controlled risk taking, and frankly, I learned about how to pick a jury from watching humanity at the black jack table—people who thought they knew third base, people who were confident, and people who came and split tens. I learned about human behavior just sitting there, quietly dealing for six hours a day. I also learned about the people around me, including the pit bosses and the hierarchy.

This helped me to know about people and body language when I became a prosecutor. To this day, I view it as valuable experiment, a place where you can observe taking risks in a controlled environment with limited knowledge and it served a purpose. So I've enjoyed it, I have learned from it, and I'm glad I had that opportunity. I would not do it again, it's a different time and place, but it was invaluable at that time in the '80s.

Johnson**:** I think that will make some think twice before they talk at a blackjack table again. So, to change topics, can you describe for us your path to becoming the Chief Justice in California, and was it a path that you knew you were on?

Chief Justice: Well, to that question I'm going to say, assume facts not in evidence. I had no path to Chief Justice. I will say that when I received the phone call, it stunned me. The truth is, to be selected for the Supreme Court historically with the last maybe 5 to 6 governors of California, you rarely apply. You are called to be put on a list to be interviewed. Of course, I didn't expect to be on that list. When I went to the DA's office, I thought I would be a career prosecutor. I enjoyed trial, I enjoyed witnesses, and I enjoyed the hubbub of the court room. When I applied to the court of appeals for a change of atmosphere, I

enjoyed that work too, so I never really planned on becoming Chief Justice, and I enjoyed all the work I'd had up to that point.

But I also would note that I joined organizations and committees. When people asked me to serve on something, I would say yes, even though I knew very little about the positions at the time. I thought, I'll do my best. I joined activities, got to know people and that really put me four seats down from Chief Justice George on the Judicial Council, the constitutional policy- making body for the judicial branch. Up to that point, I had only seen Chief George across the room and I didn't know him. But in time, while serving on the Council, I did a fair amount of work and got to know him and a great deal about judicial branch operations. I strongly suspect that Chief George gave Governor Schwarzenegger a short list of recommended candidates. That's the only way I think I got in the pack. If I hadn't served on those committees and been willing to be part of a greater team, I would not have made that list because I wouldn't have been on anybody's radar.

***Johnson*:** The California Supreme Court is often lauded for its diversity. We have four women and five non-white members of the Supreme Court, but sometimes, we don't see the same levels of diversity in the lower courts. What do you see is the value of diversity in the judiciary and do you think we can expect to see an increased percentage of diversity in the coming years?

Chief Justice: You are right, Cheryl, that our judiciary in California, the largest in the country, arguably the best-trained in the world, does not reflect anything near the diversity of the population in California or even of the state bar. The value of diversity cannot be understated or overvalued. Diversity brings different voices, ideas, perspectives, and ways of thinking about issues to the table. The Supreme Court, for example, is the most diverse Supreme Court in the country. We bring a variety of experiences and we come from many different disciplines. It's so important to see the application of the rule of law, and any changes, clarifications and developments in the rule of law from the different lenses of experience.

I'm not just talking about ethnic diversity or gender diversity; I'm talking about professional diversity, geographic diversity and socioeconomic diversity. All of these different factors make us individuals, and they influence how we move forward, when we grant review of cases, and the decisions we make.

As California's demographics change, and the majority becomes a minority, it is so important that our institutions reflect our population, our breadth of views, and our blended cultures. The laws apply to all people. This governor in particular, after all it's his second time around for appointments, brings a broader prospective and that's important. He also has a larger menu of options because law schools are now graduating more and more women, and we are 50 percent of the lawyers in this state. So, I think you're going to see greater diversity as we have already begun to see, and elect governors who are attuned to making sure that the California judiciary keeps pace with its population.

***Johnson*:** Turning to a related but different issue, that is, access to our courts. We're all aware, especially those of us in this room, of California's court-funding crisis. You've stated when we can no longer guarantee timely access to justice and when we can no longer provide a litigant a courtroom in his or her community of his or her peers, then we are denying the protections of democracy. Since 2010, 52 court houses and 202 courtrooms

have been closed in our state, and these courts were ones used by something like over two million people. Have we reached a point where the judicial system is denying the protections of democracy, and if so, what can be done about it?

Chief Justice: That's a great question, and I appreciate that because when I took office as Chief Justice of California in 2011, we were into what was at least our second year of a downward spiral. The most frightening words I heard in 2011 from the economists and the department of finance near the Governor's Office were, "we don't believe we've hit bottom." And so the judicial branch certainly picked up speed in 2011-on my watch-in suffering the greatest revenue reductions in the history of the state. We were also the branch that suffered the greatest cuts nationally.

The reasons for that are varied, but you have to understand one basic factor about California's budget—there is very little flexibility. So much of the California budget is constrained by Proposition 98 education finance as well as by federal restrictions on receiving matching grants. When it's time to cut the state fund and state revenue, there is only a very small section of the entire pie that can actually be cut, and the judicial branch is smack right in the middle of that slice. We are only 1.4 percent of the state general fund so we receive only about one and one quarter cents of every dollar that you pay for taxes. One and one-quarter percent. And on that, we run the biggest judicial system in the country.

So yes, back in 2011, I'd say until about 2013, in my view, we were undermining democracy and we were reactive as a branch because we didn't know how big the cuts would be and when they would be coming. Sometimes, the cuts came twice a year in mid-year. Courts could not close the spigot of cases being filed. We must take everything that comes or is filed, and all cases must be addressed sooner or later in some way, shape or form. During that time, we saw a spike in filings for domestic violence, a spike in foreclosure modifications, a spike in unlawful terminations, and a spike in conservatorships and dissolutions. All of these reflect the ills of the economy, and they were landing in our courts.

At the same time, we kept getting cuts and more cuts and we were reacting. So, in the throes of that time, I felt and strongly believed that we were not providing the level of enforcement of rights that people were entitled too. It was not timely, and if it's not timely, it's basically denied. We were closing courthouses because we were laying off people and staff. Even in some counties like San Bernardino and Riverside where the greatest growth population exists in the Inland Empire, we were closing courthouses. In Fresno, they closed five courthouses; in San Bernardino, three or four courthouses.

People had to drive two hours for access to court. All of you know too that your case is not resolved in one day in court. And many of these folks were pro se. There was no possible way their cases were going to be expedited for them. So it was a time when we seemed to be in a bit of a free-fall. And then along came Proposition 30, with some tax revenue coming back; since then, we have received a fair amount of reinvestment in the judicial branch. Not nearly as much as was taken, however. We are a branch that normally operates with about three billion dollars; we had over a billion dollars taken during that great recession, and had a billion and five taken from our construction fund used to repair court buildings. So, we have had reinvestment, but we have received nothing near what was taken.

In addition, we're talking about freezing the courts at the 2008 baseline. But in 2015, we know that the costs of doing business are not what they were in 2008. We still have trial courts that are on 21 days of furlough. These are courthouses in smaller, relatively impoverished counties, such as Madera and Kings, counties you probably don't think a great deal about. But they are part of our court system and those people are entitled to equal access as well. There shouldn't be greater access in San Diego than in Madera. But the truth of the matter is, there is.

And the Governor's Office and the legislature are working with us on that, but this continues to be a challenge for the judicial branch, in part, because many people don't understand the good work of lawyers and the good work of the courts that enforce the laws, or the hundreds of laws that are passed every year. Governor Brown just signed 800 bills. Where will those new laws all end up? Sooner or later they're coming to us through you. That's what happens, and that's our dilemma and that's what we try to keep pace with. I believe the courts have done some very efficient things, but there's only so many efficiencies you can create when you are missing two billion dollars.

***Johnson*:** I assume the crisis in judicial funding that you have spoken about isn't unique to California, but you've indicated we were hit the hardest. As it happens, our state legislature is increasingly made up of government and business people, as opposed to lawyers or those with legal backgrounds. So can this state legislature, so constituted, adequately respond to judiciary issues?

Chief Justice: Well, I believe this legislature certainly has the bandwidth and talent to do so. What they don't have, however, is time. If you've ever been in the Capitol, you see all the different groups that bombard the legislators' offices with various important issues. I don't discount any of the issues they bring to their representatives. However, as you just pointed out, fewer and fewer lawyers, probably due to term limits, are seeking elective office. They're not in Sacramento. We have a few lawyers and we are friends and work with them. But, in the judicial branch, we feel that we have had to considerably increase our profile in the Capitol, joining with lawyers in the bench/bar coalitions to constantly talk about the important work that lawyers and judges do for the very same constituents who come urging that laws be passed.

I give a "state of the judiciary" speech every year in the legislature, and I explain to them the Jeffersonian quote that their laws are a dead letter without lawyers and courts to enforce and interpret them. And that is sometimes revelatory to members who come up to me and say "I never thought of that." I think to myself, I know you're busy, but really, you've got to step back and look at this. So we have a lot of work cut out for us. We are diligently walking the halls, asking lawyers to join with us in the Capitol to talk to your members about the needs of the judiciary, and to understand that those needs need to be balanced with other important needs in the government of California.

***Johnson*:** Now we know that funding our court system is a major public challenge, but the cost of litigating for private litigants is also greatly increasing. We have to hire our own court reporters, the delays in the courts increase the cost of litigating, and the costs of getting and reviewing electronically stored information is astronomical in many cases. Is the judiciary prepared to address those issues, and what can be done about them?

Chief Justice: Let me say this. You are absolutely right that over the course of at least a decade if not longer, the public cost of funding a judiciary has been shifted to lawyers and users under a fee for service model. This is what I've called a "pay for play model." We've seen fines and fees increase. California has a higher filing fee than any other state for first papers and for additional papers. We know that there has been this shift, but the reason we've had higher fees, is in large part, because we saw the general fund wither.

And so when that stream of funding withers, we have gone to the state bar and lawyers asking if you will agree to a fee increase here or there, with a sunset date to help fund us through this general funding crisis. So the lawyers have gulped and bravely stepped up to the higher fees that they are willing to pay for a period of time to balance the reduced general fund. However, what we've seen over time, is when that happens, the reduced general fund never does get reimbursed. The money doesn't come back.

And so we've had the situation that you have described concerning court reporters. Courts don't have court reporters because they don't have the funds to hire them as employees. When it comes time to lay court people off, they lay off people in the civil departments including court reporters, because you can't lay off people in criminal areas due to the constitutionally guaranteed rights that are involved. You have described a dilemma that we are discussing with the Governor's Office right now, about having sustainable, predictable funding, which allows us to plan for efficiencies and have a budget we can count on.

Are we ready to address those efficiencies? Yes, but not alone. Not alone, and by that I mean we need to hear from you about what you think we should be doing. We know we need to get California's judiciary into the electronic age. We are working on that; we have a plan for which we're seeking funding and that will hopefully expedite e-filing and searchable documents.

On the other hand we need to hear from you about other efficiencies. So I've appointed a Futures Commission that looks at what California's judicial branch should look like in the future. And we've asked for public input and public proposals. We're looking for big ideas-- big ideas that can help us facilitate trials and hearings without sacrificing due process. The use of electronics, use of video recording, use of video interpreters and use of electronic hearings where they are not substantive evidentiary hearings should be considered. We are looking to change culture and to create a judicial branch that your children would expect to use, without waiting in lines, coming to court, coming back, and having to do everything in person. So, yes, we are ready, and excited about taking on efficiencies, with some already underway.

But we know we can't do this alone. We know we need your input and advice about what you want your branch to look like in the future. Together, our voices will hopefully encourage the Governor and the legislature to give us what we need to effectuate that kind of change.

***Tuttle*:** Well, our next question was going to be, "What is your vision for the court?" We talked about adequate funding and achieving efficiencies; are there other aspects of where you would like to see the courts go?

Chief Justice: Yes. Well, there are so many good ideas out there. My vision of the justice system is really what I call "access 3D," that is, access to the justice system and rule of law through three dimensions. My short hand version is that the judicial branch and rule of law would be accessed through three dimensions which are probably no surprise to anyone here.

First, we have to have a physical access dimension. That is our courthouses, with courtrooms open and adequately staffed, and in counties that need and use them. We need to make sure we continue to build our courthouses, and systematically repair them so they are safe and ADA compliant. We have a plan and funding for that; we have built 22 courthouses and have 24 in different phases. These courthouses are deemed in immediate critical need, which means they are falling down. We thank you, the lawyers, for allowing us to build because you've agreed to an increased fee for a period of time that is used solely to build courthouses. Now, we are the only judiciary in the United States that builds our own courthouses, and frankly, if we didn't, I am skeptical that we would get any funding to repair or rebuild them. So, again we thank the lawyers for this collaborative effort. That's physical access.

The next 3D access has to be remote. I, for one, would like to conduct most of my meetings and hearings on my phone or my tablet. After all, most of my personal business is conducted on my phone or on my tablet, as, I suspect, is yours. And yet, when it's critical, I expect to go in person to be able to put on my witnesses and to speak on my behalf or my client's behalf. But access has to be available remotely.

We need to do so much more on the digital platform. We're going to the Governor with our plan asking for one-time funding to start incentivizing courts to use computers and e-access. We will provide seed money for these courts to provide innovative ways to access non-evidentiary hearings on your phone or on your tablet.

We're also looking at the third component of access which is equal access. I've talked about California's diversity. Seven million people in California don't speak enough English to have meaningful experiences in court. Yet, we make decisions in English about where their children go, where they live, whether they keep their jobs, and whether they go into conservatorships. Over 40 percent of Californians go home at night and speak a language other than English. We know we have to provide language access in the courts, because it's frankly unjust, if you ask me, if someone doesn't understand their rights and they are in court being spoken to in a language they don't understand.

Also, equal access means assuring that pro bono services are available for people who want and need easier access to the law. That does not mean matching a lawyer to every pro se litigant, but it does mean furthering our civil union project to provide an attorney in certain kinds of civil cases where there is an attorney on the other side. Thank you to the lawyers who participate. It also means trying to electronically provide better services and more forms so people can go to a library and do some things themselves.

So Access 3D is the vision and the lens through which we will get programs to better access the court system for people who need it.

***Tuttle*:** Let's switch and talk about law students. The Sacramento Lawyer reported that you made more money waitressing and waiting tables in college than you did during your first year of law. Now law school is extremely expensive. Are you concerned about the level of debt that lawyers have and their ability to work in the public sector?

Chief Justice: Absolutely. Every lawyer who works at the Supreme Court, the Court of Appeal and the trial courts and the judicial council staff is a public sector lawyer. Those who do legal aid, provide pro bono services and volunteer their time are only able to do so, frankly, because they have been able to manage their debt. But, what we're seeing is a

reduced number coming into public sector work, and it is often because of the staggering cost of law school after college. This is why one of the things you'll hear in the Capitol when we fight over budgets is that I fully recognize the need of the UC and the public K through 12 systems to have adequate funding. When I lobby for money, it is not about taking it from one of those educational entities, because that is a zero-sum game. There is a recognition that we're all in this together, and there has to be a balance. Students should not have to graduate with limited or few choices because of something as intractable as school debt. We are trying to ensure that when students graduate with staggering debt, there are programs that permit them to do some kind of legal aid work in a way that works with their schedule and that can be done from home, on a tablet, advising, but not necessarily establishing an attorney-client relationship. We hope that may entice some of those folks to come into the public sector when they're available and when it's right for them and their family.

***Tuttle*:** Well, I'm a little bit speechless, as we came in armed with lots of prepared and broad-ranging questions and the Chief Justice has been expansively responding without any notes of any kind; I can see why you got high marks in debate and public speaking. So let me now ask you, once a petition for review has been granted, and we know that that is a rare event, what do you find makes the most effective merits brief? Are there approaches you find especially helpful or harmful, and what would be on your dos and don'ts list?

Chief Justice: Okay, so now you've cleared the first hurdle. You now have proven to us that your case is significant, because, after all, it's gone through one to three judicial reviews, and you have cleared the largest hurdle, which is getting the petition for review granted. Once you begin your merits briefing, what we need to know is why you should win, stated clearly with examples drawn from case law and the facts in the record that apply. In short, what makes your case so much more persuasive than that of the other side.

Keep in mind, that in most instances, where the Supreme Court grants review, the question is really open to debate among reasonable minds. There's very often a conflict in the Court of Appeal jurisprudence, and so there is no clear or right answer, generally speaking, by the time a case comes to the Supreme Court for review. If there was a clear answer, we would not be granting review and it could be found in the appellate jurisprudence. So when an issue comes to the Supreme Court, it is one that is really up for grabs in the sense that we realize there are two conflicting bodies of law with good reasons on both sides, and we need to clarify and provide one rule. Your job is to clearly, factually and honestly, represent why it is that your position should win.

Keep in mind that as you are arguing to us why it is you should win, the long-winded, hide-the-ball, relying-on-facts-not-in-the-record tactics, are not appreciated because we read the record. We read the record closely. We fight over the record. We fight over reasonable inferences and unreasonable inferences in the record. So be honest. Tell us what the record does and does not say. Explain why you read the record the way you read it.

Explain the policy behind the rule that you espouse and why we should adopt it. I guarantee you that in almost every oral argument before the California Supreme Court, when you are standing there at the podium, someone is going to ask you, "Well, what rule would you have us adopt?" Do not make it up right then and there-we can tell. You are coming to this court asking us to adopt your side, and in order to win, you have to have a sound reason for it. You need to have a rule and an analysis.

In order to save yourself some time or to score points in oral argument, put your rule and analysis in your brief. Your brief is where you win. It's not in the 30 minutes you get in front of us. It's in your writing, and we read so much, that clarity, a road map, honesty and policy are all factors you should consider in the merits brief to persuade us how we should decide a case.

***Johnson*:** I'd like to back up just a bit. The Court receives over four thousand petitions for review, yet issues only about 80 opinions each year. What can practitioners do to increase their chances that their petition might be accepted by the Supreme Court?

Chief Justice: A great question too. We receive many, many petitions. Many petitions for review are basically the end of the process after a black letter law decision by a court of appeal or lower court. So in order to actually have a petition granted, you need to know that we only grant review on certain occasions under several circumstances.

One, there is a conflict in the courts of appeal case law. Your petition for review has a greater chance of being granted when you point out the conflict or the tension in the cases that leads to mischievous results. Why should we intervene? That's what you need to tell us--is there conflict, tension, or a concern that this law is going to be used the wrong way.

You also need to tell us that this issue happens with enough frequency that the Supreme Court needs to become involved. We see many meritorious issues, but we look at them, and we ask "Well how often does this happen?" And if it's rare, then it's unlikely that we will intervene unless, aside from the rarity, the issue is so significant to California that we need to step in.

You should also explain why this Court should hear the case. When I read petitions, mind you I worked in the Governor's Office and in the legislature, I look at some and I may ask if this isn't better resolved in the legislature? If there's the language of the statutes, but differences about what the parties think the statutes should say, maybe you have a quicker fix through the legislature.

Those are questions we ask ourselves. Should we intervene? Why should we intervene? Is this the right vehicle? You may have a great issue, and it may even be one we've been searching for, because we do ask our staff to keep an eye out for certain issues. And so maybe your petition for review comes in, but it comes in on a demurrer, but we may think we're going to need to get into facts and we're limited by this record, so this isn't a great vehicle to address that issue. Then you need to tell us why it is that we don't have to be constrained by the procedural posture of the case and we should still get to the issue. Furthermore, there might be an interesting issue lurking, but you've already lost on another issue on the case. So, even if we could grant review, ultimately you are going to lose even if we write this new rule. We're not really anxious to take on a case where the petitioner is going to lose anyway, so we're not going to articulate a new rule unless the vehicle is otherwise perfect. So just put yourself in the shoes of a court of seven that sees four thousand petitions a year. Ask how do you convince someone at the petition conferences held every Wednesday in my chambers, to stand up and say to all his or her colleagues that we need to grant review on this.

***Johnson*:** We're often seeing scores of amicus briefs being filed on both sides of the cases that are up before our Supreme Court. Does anybody read them, and what in your opinion makes an effective amicus brief?

Chief Justice: Yes we read the amicus briefs. I will say that I have seen outstanding amicus briefing at the Supreme Court, more so than I've ever seen at the court of appeal level. Here's the beauty of amicus briefing from a justice's point of view. As you know, we grant review based on the issue; we may rephrase the issue and we may pull one issue out of five issues. We work in very arcane areas. We work on worker's comp law. We work in unfair competition. We work in billing. We work in many discrete areas.

An amicus brief tells us about the world in which we are operating. It tells us that if you rule a certain way, this is going to happen in the world you are tinkering with. Amicus briefs give us a more global perspective of the impact of our ruling or the impact of either side's position because we won't necessarily know the practice and procedure in that discrete area. So amicus briefing is really important. We read them and we rely on them. Some of the best arguments come out of amicus briefs that do not repeat the petitioner or respondent's arguments. Briefs that repeat parties' positions are not going to be useful.

We want you to tell us in amicus briefs what we would be doing, the impact of it, and give us a portrait of the universe. That's what the briefs do and they're helpful and we read them, we argue about them, we ask for supplemental briefing. And sometimes when we want briefing and we're not sure we're going to get it so, we actually say in our supplemental briefing request, oh and by the way would USDOJ please consider weighing in on this case.

***Johnson*:** One last question. We've talked a little about oral argument, but does oral argument really influence the Court's decisions very often, and what lessons can be drawn as to what oral argument is effective in influencing the Court? Are there certain styles that are a total turn-off?

Chief Justice: The United States Supreme Court has a different way of preparing for oral argument as you may know. There, oral argument is held and the justice is not assigned to write the opinion until after oral argument. But in California, at the California Supreme Court, we have an entirely different way of approaching oral argument and preparation of the case. We have what we call a front-loaded system. That means that after I've assigned the case to the Justice, and the briefing periods end and all briefs are in, the assigned justice will write a calendar memo. The calendar memo lays out the facts, the law, the procedural history, the attorneys, and the judge's earlier rulings. The memo will also offer an "I conclude," or "I tentatively think we should do this" or "I tentatively think this should be the rule."

At that point, the calendar memo is circulated to the other six justices. We then all weigh in with our written views of the result and the analysis underlying the result. Once there are at least four votes in favor of the result, not necessarily the analysis, I will set the case for oral argument on the calendar for the next month. Now, at that point, when the justices are sitting on the bench during oral argument, we are very, very familiar with your case. We all bring different points of view, but what happens at oral argument is that the party has an opportunity to shape the analysis. Perhaps not often, but certainly I've seen dispositions of cases flip because of oral argument from the calendar memo's conclusion. But always, almost universally, the case, as a result of oral argument, receives a better analysis to get to the result.

Oral argument allows us to refine the analysis and the ultimate disposition. It helps us to say "well we don't want to go there now," "well we want to be narrow here," "we want to confine the result to the facts," or "we should not send it back to the court of appeal now

because the parties told us it would do no good." But let me also say that oral argument is an opportunity, especially at this Court, to really hear what are the justices' concerns. There is no bashful hiding of the ball; the justices come out and they will tell you what their problems with your positions are.

If you were to take a step back, you might be able to determine a split in opinion, where the dissent is, and where the problems are in the analysis. So oral argument is valuable, and it does change outcomes. More often it changes the analysis. And I will say this, the ultimate rule that comes out of a case is always important. But it is the analysis that you brilliant attorneys take and apply in all its permutations. I think the analysis is as important as the result, and we fight more about the analysis than the result.

***Johnson*:** Okay. I said that I was asking the last question, but I think we'd be remiss not to talk about juggling a family with a career. What are the lessons that you have learned on that topic?

Chief Justice: I'm still learning them, and they are the same issues you face. We have families and responsibilities; our children and our parents don't care that we're in meetings or on the bench, because they want to know right now, what's for dinner. So I juggle the same as all of you, and do it with a sense of humor and a sense of privilege. But the truth is, Cheryl, I could not have accepted this job any earlier than I did in my career. I wouldn't have left my kids in middle school with their father alone, not that that would not have been fine, but I have two girls and they are mommy's girls and I had to wait until they got into high school. As a result of my spending half of each week between San Francisco and Los Angeles, they have become closer to their father. But it is always a learning experience. Every day is a learning experience, requiring a huge dose of humor while trying to eat well and stay healthy so you have the energy and the peace of mind to react appropriately. It's a wild ride.

***Tuttle*:** You've said of yourself, and I love this, you're a "boots-on-the-ground-kind-of-girl." You were educated at publicly funded institutions from primary through law school. You've spent your entire working life in public service including nearly 20 years as a sitting judge. Does this background give a justice certain advantages and are there any disadvantages?

Chief Justice: Thank you, Kathleen. Well, I know that I call myself a boots-on-the-ground-person, and I say that in respect to our currently constituted Supreme Court. We have several people on the Supreme Court who are boots-on-the-ground like me--public lawyers, municipal court judges (when that level of court existed in California), superior court judges, and court of appeal justices. I feel I have sat in every chair in the courtroom; I've been a juror three times; I have sat through jury service to verdict twice. So I feel like I've been in every seat, though perhaps not the defense seat, but some of my closest friends are defense attorneys and I will say, I feel like I could sit in their seats. And yes, I think that makes me boots-on-the-ground as compared to some who, for instance, are very bright academicians. But together, we bring a blend that works in the correct way. So a boots-on-the-ground analysis always asks how well does this work in the real world. Both as a judge and a lawyer, when an issue arose, I, like you, run into the library, pull the Cal Reporter, flip to the headnotes, go to the page and then say this is my answer, this is what I'm going to argue. So I write for the practitioner and for the person who is going to use it. I consider that my advantage, as I think I'm very practical. We had some earlier discussions about why

we are here in the Julia Morgan Ballroom, and I agreed with your conclusion because I am practical. It's cheaper.

(Laughter and Applause.)

EMCEE: Please join us in thanking our Chief Justice for a thoroughly enlightening and engaging conversation.

GOLDEN STATE INSTITUTE 25TH ANNIVERSARY RETROSPECTIVE AND PROSPECTIVE VIEWS ON CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW

Edited by Craig Corbitt[1]

I. INTRODUCTION

To commemorate the twenty-fifth anniversary of the Golden State Institute, there was a panel discussion of significant past and future trends in law and practice, in both state and federal antitrust laws and California's Unfair Competition Law ("UCL")[2]. Senior District Judge Susan Illston was the moderator, and the panelists were four experienced and prominent practitioners. Craig Corbitt and Dan Wall discussed antitrust developments from the plaintiff and defense perspectives, respectively, while Kim Kralowec and Will Stern discussed plaintiff and defense perspectives on the UCL.

- Judge Illston was appointed to the Northern District of California in 1995 by President Clinton, and took Senior Status in 2013. Before that she was in private practice for over twenty years with Cotchett & Illston in Burlingame, where she litigated numerous antitrust cases, among others. She has presided over many antitrust and other complex cases on the bench, including the massive LCD criminal and civil price-fixing litigation and other high-profile cases such as *United States v. Barry Bonds.*
- Craig Corbitt is Of Counsel to Zelle LLP in San Francisco. He has been a practicing antitrust lawyer for nearly forty years, a majority of the time representing plaintiffs in both individual and class cases. He has been honored numerous times by *Best Lawyers, Global Competition Review, Super Lawyers*, and others. Craig was the California State Bar's Antitrust, UCC, and Privacy Section's "2015 Antitrust Lawyer of the Year."
- Daniel Wall is a partner of Latham & Watkins LLP in San Francisco. He has been an antitrust lawyer for almost thirty-five years, representing defendants in litigation and companies in mergers and counseling. He has been honored numerous times by *Chambers USA, Best Lawyers, Global Competition Review,* and *Super Lawyers*, and was named one of the "Top 100 Lawyers in California" by the *Daily Journal* in 2011.
- Kimberly Kralowec is the principal of the Kralowec Law Group in San Francisco. During her nearly twenty-five years as a litigator, Kimberly has represented plaintiffs in class actions involving antitrust and the UCL, in areas including consumer finance, employment (wage and hour and misclassification), and civil rights (Unruh Act). Kimberly publishes *The UCL Practitioner*,[3] a legal weblog covering the UCL, Consumer Legal Remedies Act, and class action law in California and the Ninth Circuit. Kimberly has been selected by the *Daily Journal* as one of the "Top 100 Labor & Employment Lawyers in California" as well as one of the "Top 75 Woman Lawyers (Litigation) in California," and received a 2013 "California Lawyer Attorney of the Year" Award.
- William Stern is a partner of Morrison & Foerster in San Francisco. He has been practicing for nearly thirty-five years, primarily representing defendants in consumer class actions. He is the author of *The Rutter Group's Bus. & Prof. C. §17200 Practice*,

---

1 Craig C. Corbitt, Of Counsel, Zelle LLP.

2 Cal. Bus. & Prof. Code § 17200.

3 UCL Practitioner, http://www.uclpractitioner.com/ (last visited Mar. 10, 2016).

and was the principal author of the 2004 voter initiative Proposition 64, which amended and narrowed the standing requirements of the UCL. William has been honored numerous times by *Best Lawyers* and *Super Lawyers*, and is a fellow of the American College of Consumer Financial Services Lawyers.

II. DISCUSSION

Judge Illston: *Thank you, and good afternoon, ladies and gentlemen. I am delighted to be here with all of you and with such a splendid panel this afternoon. We are going to do a retrospective and a little bit of a prospective on the twenty-five years that the Golden State Institute has been tracking antitrust and unfair competition law issues. To that end, we'll get to some questions and answers in just a moment. First, though, I wanted to start with a joke, of course, and my joke is going to be a joke on the Australian Competition Commission. Nothing like this could ever happen here, this is about Australia.*

There were a group of three business owners who were sitting in the anteroom of the Australian Competition Commission offices, each waiting to be charged for having gotten into dreadful trouble. Eventually the conversation turned among them to why are you here, what have you done? The first said, "Well, I charged higher prices than everybody else, and they accused me of profiteering." The second said, "I charged lower prices than everybody else, and they accused me of predatory pricing." The third said, "I charged the same prices as everybody else, and they accused me of collusion and price-fixing."

As I say, that could only happen in Australia. But if it were to happen here, we have experts on the panel to deal with price-fixing.

First, we thought we would talk a little bit about the antitrust side of things. Our time is limited, and we are going to discuss on the antitrust side three primary questions or issues that have come up that are interesting. One is the rise of the major cartel cases that we have seen, certainly out here, second is the globalization of antitrust and the consequences of that to the practice, and the third is antitrust in the high-tech field.

For those of you who have been here and paying any attention at all, in the last twenty-five years one of the biggest things that has happened has been the rise of the huge global price-fixing cases. They have spawned criminal prosecution, all kinds of civil litigation, class actions, direct actions and everything else. In this district alone we have had the LCD *cases, the* Optical Disc Drives (ODD), DRAM, *and many others.*

So first I'd like to ask Dan and Craig: explain this to us, what do you attribute this to and how has it affected your practice? Dan?

Wall: Thank you for joining us here today. I am really happy to be a part of this program. Actually, I am conflicted because it means that I am old enough to be asked to be on a retrospective panel now, which is too bad.

But as we thought about this, one of the things, it was an interesting thing to try to think, what are the big things that have happened in the last twenty-five years? And one of the ones that just seemed to me to be so hugely transformative to the practice of antitrust law really comes out of the DOJ corporate leniency policy in 1993. That's when it went into effect. It really was transformative of criminal antitrust law and, therefore, indirectly of class actions.

If you remember back then, if you were around then as a few of us were, criminal law was not a very important part of the practice. It really wasn't anything of any great consequence, it was mostly cases that people called the "roadrunner cases," paving contractors and school milk lunch programs and things like that. Meanwhile, it's obvious that there were gigantic amounts of price-fixing going on all over the world in all sorts of different industries.

It really wasn't until the corporate leniency that came along that created the incentive system for people to self-report this that we saw this enormous change in both the frequency and the scale of the cartel cases that went along. Much of this happened right here in the Northern District of California, where the San Francisco field office, which at that time was led by Gary Spratling, prosecuted some of the first key cases and secured for itself a very unique role within the antitrust division as the one field office that had a very strong charter to go after cartel cases.

That then sort of intersected with the existence of this extraordinary plaintiffs' bar that has always been here in San Francisco, and that is obviously well-represented to my left, but so many of the great antitrust plaintiff lawyers in the country were also here, and it has made this one of the districts that had a natural home for this kind of case, particularly the follow-on class action case, which led to the inevitable direct purchaser case, followed by the inevitable indirect purchaser case, which, of course, allowed the plaintiff lawyers to engage in their own market division as to who would do which one.

No, as if it doesn't happen, yeah. Somehow I guess it's okay. So here we are.

Judge Illston: *Here we are. Craig, what do you say about that?*

Corbitt: Well, I think Dan certainly has the big picture right. I am gratified to hear such a proud defense lawyer admit that there was enormous cartel behavior all over the world.

Wall: But not by my clients.

Corbitt: And of course we know that from the concentration of cases here and the information we got in discovery.

As Judge Illston mentioned, there have been enormous cases here, *DRAM, LCD, CRT, ODD,* new ones, relatively new ones like *Capacitors, Lithium Ion Batteries,* and so forth that have really made this district the center of this kind of litigation across the country.

Part of it, I think, is the high-tech reputation that this area has, deservedly so. Part of it also was the judges. You know, not only Judge Illston, but Judge Alsup, Judge Conti, who had the *CRT* case, Judge Hamilton with *DRAM*, were all highly regarded jurists, and the multidistrict litigation panel really had no problem about sending these cases here.

Dan mentioned the deep plaintiffs' bar. I don't know how deep it is, but it is certainly bigger than it was twenty-five years ago. That's a huge change. Maybe we will hear more about that tonight. But when I started out with Fred Furth in 1979, there were a few people that did this, mostly alumni of Joe Alioto—Mayor Joe Alioto—Guido Saveri, Fred, Fran Scarpulla, and some others, but not that many. There are many, many more now, new firms that are spinoffs of people who have left their former ones.

As a consequence, for example, I think in *LCD* there were over 100 indirect cases filed, and many direct purchaser cases. Opt-outs are a huge deal now, which they weren't twenty-five years ago, that's when it started.

And the state attorneys general are in there in a big way in many of these cases. So it's all very, very complicated to deal with.

That is a huge change for plaintiffs' lawyers in having to deal not just with defense counsel and the judge, but with all the various co-plaintiffs' constituency groups and the state attorneys general, who may not have exactly the same interests. That's been a big—that's exciting, but it's been a big challenge and a big change in the practice.

Judge Illston: *Nobody ever said market allocation was easy, Craig. But one of the other things that both Dan and Craig have alluded to that has been a big change in the last twenty-five years as well is class action practice. The rules, the guidance that we have gotten from the Supreme Court about class actions over the past couple of decades have altered the landscape somewhat. So does that affect antitrust cases, there's so much class action activity in them, does it and how does it, Dan?*

Wall: Well, sure. A lot has changed in twenty-five years in this area. Twenty-five years ago there was practically an irrefutable presumption that class certification was appropriate in most antitrust cases, if not all antitrust cases.

In fact, I met Susan Illston when she whacked me in a class certification case on the *Kodak* cases that Holly House, I, and others had. That was a monopolization case. At that time, the prevailing reading of the Supreme Court's *Eisen*[4] decision was that every issue that touched on the merits was off-limits. There was no practical ability for a defendant to appeal an adverse class certification decision. So it was almost all district court-level law that was made, and it was overwhelmingly in favor of class certification in antitrust cases.

Things have gotten a little bit better for the defendants. I think the first major reason for that was just the amendments to Rule 23 that allowed for Rule 23(f) appeals. And it is not that very many cases go up, it is just that a few do now and they have created some amount of pro-defendant case law that has evened things out a little bit.

I think we are probably in a transition period right now because of the obviously intentional efforts that the conservative majority on the Supreme Court is making to take class certification cases right now. We have *Wal-Mart,*[5] *Comcast,*[6] *AmEx,*[7] *Tyson Foods* being argued the week after next,[8] and it has been consistently changing those standards, whether it's eliminating the *Eisen* presumptions or subjecting extra proof to greater scrutiny or, what I think is the most important thing, which is the emphasis that *Wal-Mart* tells us to place on dissimilarities rather than just whether people in the class have something in common.

---

4 Eisen v. Carlisle & Jacqueline, 417 U.S. 156 (1974).

5 Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011).

6 Comcast Corp. v. Behrend, 133 S. Ct. 1426 (2013).

7 Am. Express Co. v. Italian Colors Rest., 133 S. Ct. 2304 (2013).

8 The Supreme Court subsequently decided *Tyson* after this panel. *See* Tyson Foods v. Bouaphakeo, No. 14-1146 (U.S. Mar. 22, 2016).

I think it is hard to tell whether we are going to be in a world where class certification is still the norm in antitrust cases or not. The Supreme Court has told us it is not presumed even in antitrust cases, but certainly at the moment, I say that certification remains more likely than not.

Judge Illston: *Craig.*

Corbitt: Well, from personal experience, that's not always true. I don't know if it was ever irrefutable. Defendants certainly fought these things hard enough.

But it is certainly true in the last twenty-five years it has gotten much more difficult for plaintiffs, not just in the law, but in how things have to be done. In those days we had *Eisen* and there wasn't the emphasis on economics that there is today. And getting the material to support the class motion, as Dan mentioned, merits used to be bifurcated and it was something that was done early in the case, before you really had—as a plaintiff's lawyer fronting the costs yourself—before you had to spend a lot of money. Now it seems like you have to prove the whole case before you can even bring the class motion. I think in a close case, if the judge perceives it is a strong case on the merits and that defendants actually may be guilty of conspiring, if there's a grand jury or indictments or something, that obviously really helps.

I think that the trend, as amplified by the *Wal-Mart* case and some others, such as *Hydrogen Peroxide*[9] in the Third Circuit is, if anything, probably going to intensify in favor of defendants. There are some cases now where cert's been granted, and I think one or two have been argued, and Tom Greene went into some of these this morning.

And one in particular is the *Tyson Foods* case, because a big issue in the class with these experts battling back and forth is how you can demonstrate a measure of damages on a class-wide basis and is it possible to come up with some formula that can be applied to all the class members? And, of course, plaintiffs' economists do their big reports with regressions and so forth. The defendants always derisively dismiss those as averaging, saying economists never do that, which is crazy.

But the issue in the *Tyson Foods* case really kind of gets to the heart in an antitrust case of that practice and whether or not that is legitimate. And if that is decided in the way that favors the defendants, as a lot of people think that it will be, that will have a huge impact on the practice and make it that much more difficult to get the class certified.

Where you have got a period of years, maybe many different products all affected by the conspiracy, different prices, different levels of distribution, it is going to be harder. So that's a prospective, somewhat pessimistic view from the plaintiffs' standpoint.

Judge Illston: *Even now it is certainly true that the merits discussion has been rocketed forward to the beginning of the case in a way that it never was previously. I still think that the development of sophisticated economic tools will help all of us at some point figure out what the actual economic consequences were of given patterns and behavior. So I think there's promise in that and the tools are more sophisticated than they were fifty years ago when some of the damage law was first written by the Supreme Court, but it's a challenge to stay up.*

---

9 *In re* Hydrogen Peroxide Antitrust Litig., 552 F.3d 305 (3d Cir. 2008).

Corbitt: Can I just respond to something that you said, Judge?

At the beginning of the case, which used to be defined as deciding whether to certify the class, that can now be four or five years after the complaint is filed and millions of dollars and thousands of hours expended before you actually get to that stage and get a ruling on that. Of course, that's pretty much make or break for a plaintiff's case.

Wall: I just had an experience a couple weeks ago where a very prominent plaintiff's lawyer who filed a couple of actions in a matter I am handling called me and basically explained to me that his cases were individual cases because he was done with class actions. He says he just felt that it was getting too difficult, too time-consuming, and he was trying to find another path that could allow cases to go forward more quickly.

Judge Illston: *This raises an interesting question, which brings us to our point number two, which is sort of the globalization of antitrust. Certainly we have seen that, even in the context of United States antitrust law, many of these cartel cases have involved a lot of foreign players, sometimes it's United States corporations with foreign subsidiaries, sometimes it's foreign corporations with United States subsidiaries, but the world having flattened as it did, the consequences are felt in many reaches of the various different national jurisdictions. So has that changed the antitrust practice somehow?*

Wall: I really think this is one of the most profound changes that has occurred in the last twenty-five years because it's that issue and it's so many more. Somewhere in the last twenty-five years it's stopped becoming a United States law issue. It became—there's now over one-hundred countries that have their own antitrust laws, but principally there is the United States and there is Europe and there is this kind of uneasy mix of it.

Particularly around here, with the high-tech economy and the global footprint of the high-tech economy, we have seen that manifest itself in very different standards being applied to certain practices in the United States and Europe, and I take that a step further, that the degree of difference varying from administration to administration in the United States, which means that there's opportunity for global forum shopping.

There's profound counseling challenges in trying to figure out, how do you manage a global company? Do you do different things in different places? Do you manage to the most restrictive standard, which is the only one that's going to make you safe everywhere? And so forth. We have obviously seen Silicon Valley companies and other companies flock to Brussels to complain about Microsoft. Now they are flocking to Brussels to complain about Google, which is forum shopping for sure. And it's made everything—really made everything more interesting, a lot harder, a lot more expensive, you travel a lot more, and you eat at a lot better restaurants.

But then you deal with these incredibly complicated jurisdictional issues that, Judge Illston, you had to deal with, the saga of what do you do with a product that was made outside of the United States and shipped somewhere else, incredibly complicated stuff on top of the native antitrust complexity of all of this.

Judge Illston: *Craig, have you seen that?*

Mr. Corbitt: Yeah, I think Dan is absolutely right on this one. And it's become increasingly the case in the last few years since the Europeans finally got around to authorizing

a forum of collective action. It is still not quite the same as here, but after talking about it for many, many years, it's now real in the U.K. and in other places.

There are American firms, Hausfeld, probably the best-known one, where Mike Lehmann, who was up here a while ago, and his partners have opened offices not only in London, but in Berlin, and I think in Brussels.

And a thing that—one thing that is just coming to be a big change in the last couple years, which I think will be really significant in the years to come, is the advent of these litigation financing companies, like Burford and others, that basically will lend money in exchange for a stake of the case. And that's controversial, but it is a way to get these things off the ground and be able to afford to do that and cover the risk of the loser-pays rule that otherwise may not be possible.

The FTAIA,[10] which I am sure everyone in the room is somewhat familiar with, is a huge issue in many of these cases, particularly these cartel cases, like *LCD* and the others we mentioned. You know, that area of the law is really unsettled. It has largely been a pro plaintiff resolution of it up to now, except *Motorola*,[11] but they were in sort of a unique fact situation compared with the way class action claims are typically handled. But this issue has not been addressed by the Supreme Court in many years. They declined the chance to do so in *Motorola*. However, I think this issue will be up there in the Supreme Court eventually, and this may also be something that really cuts back on United States jurisdiction and will drive an increase in plaintiff lawyers seeking to go to Europe or Asia.

Judge Illston: *One thing I learned earlier this year is that the European Union, through several of its directives, is requiring European Union member states to draft up laws that will allow for claims to be made by consumers effectively against anticompetitive behavior. They are not embracing class actions altogether, but they are talking about that. But at the very least, they are in the process of drafting up rules and regulations. Their slate is kind of clean, and it is a really intriguing time over there to see how they will come out. They are taking guidance from the United States and other jurisdictions who have had this kind of regulation, but I think they are going to be careful what they accept and what they reject when they come up with those.*

We have been talking about antitrust over the last twenty-five years. I think at this time it might be good to talk about UCL over the last twenty-five years. With antitrust we were retrospective just to the recent development of antitrust in the last twenty-five years. With UCL, as somebody said, the last twenty-five years is the UCL. That's kind of all there's been. Practically speaking, the whole history of it has been during this period that this institute has been functioning.

Although the statutes were drafted in the 1930s, the UCL was infrequently invoked until the 1990s, and even then it was mostly a catch-all. At the end of all the real causes of action, there would be a UCL cause of action. Prop 64, about which more later, changed some of that, and then from my personal point of view, CAFA[12] *changed some of that, too. Because with the enactment of CAFA, much of the UCL, which persons like myself had watched with interest but not any particular alarm in*

---

10 Foreign Trade Antitrust Improvement Act, 15 U.S.C. § 6a.

11 Motorola Mobility LLC v. AU Optronics Corp., 775 F.3d 816 (9th Cir. 2014), *cert. denied,* 135 S. Ct. 2837 (June 15, 2015).

12 Class Action Fairness Act, 28 U.S.C. §§ 1332(d), 1453, 1711-1715.

the development in the state court, now had to deal with it because CAFA brings many of those UCL cases over to the federal side. For good or for ill, much of the UCL law gets drafted by federal judges, who perhaps aren't the best ones to do it. These are some of the issues that we will talk about, and we have real experts here to do so.

So first we had a few areas where we were going to cover, the first is the UCL's applicability outside the borders of California. That's something Kim was going to bring us up to date on.

Kralowec: Thank you, Your Honor, and thanks to everyone for coming. The UCL can be an extremely powerful cause of action, just standing all by itself in a complaint. It has been applied nationwide in appropriate cases, and the question is whether your case is one where it would be a good idea to seek nationwide class certification or not.

The first case that really started to grapple with that issue was decided in 1999, a case called *Norwest Mortgage, Inc., v. Superior Court.*[13] And all the cases we are mentioning, the full cites are in the materials. In that case, the court of appeal divided up the case into three different categories. The trial court had granted nationwide class certification, and the defendant was challenging that ruling on appeal. And essentially what the court said is that California residents, of course, can assert a UCL claim regardless of where the conduct occurred. Category 2 is non-California residents who may have been affected by conduct occurring in California. And Category 3 is non-California residents where the conduct occurred entirely in other states, by actors outside of California.

And the court held that in this particular case, class certification was not proper as to Category 3, non-Californians. Because the defendant in this particular case was not a California corporation, they were based outside California, and the specific wrongdoing that was being challenged happened outside of California. And that case has been kind of the basic framework that has been applied in later cases.

One very interesting case was handed down by the California Supreme Court in 2011, *Sullivan v. Oracle Corp.*[14] And in that case, the Supreme Court was looking at Categories 1 and 2, so California residents, Category 1, and then Category 2, non-California residents, where the conduct allegedly occurred in California. And the UCL claim was predicated on violations of the California Labor Code. And the Court held that California residents who were harmed in state, while they were working in state, could bring a UCL claim. The Court held that out-of-state residents who are harmed out of state could not invoke the UCL to seek a remedy for violation of the Federal Fair Labor Standards Act. And the reason for that was that the Court determined that the violation actually occurred outside of state. So even though the defendant, Oracle, was based in California, made certain decisions regarding how to compensate their employees in California, the violation was not consummated until the wages were paid or not paid. And there was no evidence in the record of where that occurred.

So the Court left the door open, that if you could show that the California-based defendant made its employment-related definitions in California and paid its employees within the state, out-of-state people who were harmed might be able to invoke the UCL.

---

13 72 Cal. App. 4th 214 (1999).

14 51 Cal. 4th 1191 (2011).

It was very interesting. The Court cited in Footnote 10 *Wershba v. Apple Computer, Inc.,*[15] in which nationwide class certification was granted in a Category 2 case where the defendant, Apple, was based in California. So I think the Court recognized that nationwide classes are appropriate in some cases.

The most recent received was a case called *Rutledge v. Hewlett-Packard Co.,*[16] in which the court of appeal reversed an order denying a nationwide class, also citing *Apple*, in a case against Hewlett-Packard, which is based here and conducts its business here and makes its decisions from its California corporate headquarters.

So the decision that you face if you are a plaintiff's lawyer as I am deciding whether I am going to bring a particular case, if the defendant is based in California, I can choose to simply assert claims on behalf of a California class only, file in state court, and have some hope of remaining there. If I choose to try to assert a nationwide class, then there's a very serious probability that we would be removed under CAFA, which may be fine. But you need to weigh that decision very carefully, and if you want to stay in state court with a California class or try for a nationwide class and try to convince a federal judge to grant that.

I think there will be more litigation, and I think this issue of how many of the decisions have to be made in California versus, you know, larger corporations often have operations across the country, I think that's where we will see more litigation.

Judge Illston: *Will, I want you to tell us about some of the same issues, but as related to safety. You have seen lately a lot of safety-related defects and warranty issues that may or may not come under the UCL.*

Stern: Well, the issue about safety claims comes up in the context of omission claims under the fraudulent prong of the UCL. And of all the hot topics that are percolating right now in the UCL, I would say that omissions claims are probably one of the top two or three hot topics. It's easy to understand why: If you can get an omission claim past a motion to dismiss, past summary judgment and push it toward class certification, you have almost automatic commonality because your argument is going to be on the plaintiff's side that everybody didn't hear the same omission. So there's a big advantage to bringing an omission claim.

So how do you bring an omission claim and what is it? Typically a defendant has no duty to disclose a defect unless it is a material defect. And in Kim's world and mine, typically this evolves into whether or not the undisclosed defect affects safety or whether it affects some other aspect of the product's functionality, but not safety.

So, for example, if you're an auto manufacturer, sudden accelerations, brake problems, those would clearly be omission cases. Those would get past a motion to dismiss. On the other hand, if it is an undisclosed claim that you don't get very good quality reception on the radio, and so my Sirius radio, when I drive to work in the morning, doesn't come in as clearly as I would like it, typically not.

---

15 91 Cal. App. 4th 224 (2001).

16 238 Cal. App. 4th 1164 (2015).

So the safety issue has become kind of a fault line in terms of whether you can or cannot state an omission claim under the fraudulent prong of the UCL. And it's been that the fault line has been drawn on the safety line for probably ten years or so, starting with a case called *Daugherty v. American Honda Motor Co., Inc.*[17]

That was recently upset by the *Rutledge* decision that Kim referred to a moment ago, because a different aspect of the same *Rutledge* case, which also addressed nationwide classes, addresses whether that safety fault line should be the gatekeeper, if you will, in terms of whether you can bring an omission claim or not.

What's interesting about *Rutledge* is that last year there was a bill in the California Legislature which was one of the top three priority bills sponsored by the Association of California Trial Lawyers to overturn *Daugherty* and overrule the safety feature in terms of whether you can bring an omission claim or not. And that bill died.

So what then happened is this spring, the court of appeal decided the *Rutledge* case and decided to abrogate the safety requirement in terms of whether you can bring an omission claim or not.

That case involved a computer defect. It had nothing to do with safety features in the computer. By the way, the case has been going on so long, twelve or fifteen years, the computer that's at issue in the Hewlett-Packard case is probably in the Smithsonian. Nobody has one of these anymore. But that's partly why just what happens here, this case has been up and down the courts of appeal twice. So a petition for review has been filed in *Rutledge*. They extended their time to just about Thanksgiving.[18]

And the argument is going to be that we now have a conflict among the courts of appeal because you have *Daugherty* on the one hand and now you have *Rutledge* on the other.

Judge Illston: *Something to look forward to. But in the meantime, and perhaps over the last fifteen or twenty years that the case has been pending, to the extent the plaintiffs ever are able to, how will they measure restitution and obtain restitution as a remedy for that?*

Kralowec: Those are very good questions. By the way, I would say I don't see a conflict between *Daugherty* and *Rutledge*, but that's another panel, probably.

Business and Professions Code Section 17203 is the source for the remedy of restitution, and it allows the trial court to enter "such orders as may be necessary to restore to any person any money or property that may have been acquired by means of the unfair competition."[19]

There's nothing else in the statute, no further guidance as to "what may have been acquired by means of" actually means in practice, and it's something that litigants have been struggling with. The first case that really gave any guidance on this that was meaningful was the *Colgan v. Leatherman Tool Group, Inc.* case in 2006,[20] in which the trial court had ordered $13 million in restitution.

---

17 144 Cal. App. 4th 824 (2006).

18 Review was denied in *Rutledge* on November 10, 2015.

19 Cal. Bus. & Prof. Code § 17203.

20 135 Cal. App. 4th 663 (2006).

That case, it was a "Made in the U.S.A." case where the defendant's tools were not entirely made in the U.S.A., but they were marketed that way and labeled that way. The trial court based the $13 million award on the thought that what would be fair to consumers would be to award twenty-five percent of the average wholesale price of these mislabeled tools.

The court of appeal reversed the restitution award in its entirety, holding that there was not substantial evidence in the record to support that measure, and in fact, I think, held that that would not be an appropriate measure regardless. But the court also talked about how could you measure restitution and what sorts of evidence would you put on in order to support an actual monetary restitution award. And the court cited the *Restatement of Restitution*, which I think is a very helpful source of guidance in this area, and suggested a couple of possible measures.

One would be the portion of the purchase price attributable to the false representation, so how much more was the defendant able to charge if you label your product as "Made in the U.S.A.," how many more units are you able to sell of your product if you falsely labeled it "Made in the U.S.A.?" These are questions that would probably require expert testimony, which was not offered in the *Colgan* case.

Another measure would be the difference between the price paid and the value received. So how much are the foreign-manufactured tools worth? You might put on evidence of the price for comparable tools made in China. And then the question becomes what's a comparable tool, are there even any tools in the market that are comparable? Again, an area where I think that expert testimony may have to be put on.

There was an interim case that was not cited. It is called *In re Vioxx Class Cases*, decided in 2009,[21] and in that case the court pretty much held that the appropriate measure would be the difference between the price paid and the value received. That was another case in which the court held that plaintiffs had not put on substantial evidence of that.

Finally the most recent case is called *In re Tobacco II Cases,*[22] which might be a familiar name. That's another case that's been going on for a very long time. The case involves light cigarettes and the defendant's failure to disclose that they are just as dangerous as regular cigarettes. And this is the case that led to the landmark opinion on Prop 64 standing a few years ago. The court of appeal, again, held that there was no evidence in the record to support a restitution award and affirmed the trial court's decision to deny any monetary relief, even though the plaintiffs had proven that the defendant's conduct was, in fact, deceptive and people had been deceived.

And the question the court was grappling with was whether this price paid versus value received measure is the only measure that's allowed under the UCL, or are there other cases where a different measure might be appropriate, and are there any cases where a full value measure of restitution might be appropriate, a case where the product really doesn't have any value at all, but for the misrepresentation?

And I think it leads to a number of questions. The cases we are seeing are all involving a failure of proof. So we have yet to see a case where a plaintiff was successful in convincing a court to apply one measure of restitution or another.

---

21 180 Cal. App. 4th 116 (2009).

22 46 Cal. 4th 298 (2009).

I think there are questions about what if you had never bought the product at all, but for the misrepresentation? There are examples such as a wine connoisseur and the bottle was mislabeled being from the Napa Valley, would that person have bought the product at all? If food is falsely labeled as kosher and it is actually not, some people might not care, they might buy the food anyway, but an observant Jewish family, it would be worthless to them.

So there are a lot of unresolved questions here, and I think that the stronger proof you put on, the greater the evidentiary showing you make, the court is going to be more likely to accept your proposed measures.

We did have an example of that in the Ninth Circuit in a case called *Pulaski & Middleman, LLC v. Google, Inc.,*[23] a class certification context, but the court did hold that the plaintiffs had submitted a measure of restitution that would be workable at trial.

Judge Illston: *What Kim just said, "A measure of restitution that would be workable at trial." My only advice to you is if you are going to bring a case like this, try to think what you are going to urge as the measure of damages or restitution, how you are going to measure and find some way you'll be able to prove something that will support that, because otherwise we get just way off into the weeds before anybody can figure out if this case can even sort of survive the process.*

There's an awful lot more intellectual work that needs to be done up front in some of these cases, I think. Because we figure restitution, that's in the Restatement, *everybody knows what restitution is, I'll worry about that later.*

Well, you need to build that into the theory of the case in the beginning, otherwise it can flounder.

One last thing I wanted to ask Will about, as we are going to the actual wisdom, is Prop 64 and standing under Kwikset *and monetary losses and how are we to evaluate that?*

Stern: Okay. Restitution, which we just talked about, Kim talked about, I would say is the second of the three hot topics in the UCL. Prop 64 standing, I think, is probably the third.

We are still, ten years, twelve years after Prop 64, we are still grappling with that. You need to show injury in fact and loss of money or property in order to have Prop 64 standing.

So what does that mean? We used to think it meant, and the drafters of Prop 64 thought it meant, that it was congruent with what you could recover as restitution at the end of the case, what Kim just talked about. We now know that it is broader than that, because the California Supreme Court has reminded us of that now several times. It's broader in settling disputes.

The best way to describe it is to kind of go back to my old, dumb example, which I still think applies. If you think about restitution as true restitution and also loss of money or property as a situation in which Kim gives up a dollar and Will Stern gets that dollar, then that's going to be a recoverable item of restitution. It is also going to be something that will satisfy loss of money or property. The moment you diverge from that paradigm, then you have problems on the plaintiff's side, you have opportunity on the defendant's side.

---

23 802 F.3d 979 (9th Cir. 2015).

For example, Will Stern got the dollar, but it didn't come from Kim. It came from Judge Illston. That's not necessarily restitution, not necessarily loss of money or property for standing purposes.

Or the alternative situation, the dollar was received—Kim gave up the dollar—but it was received by Craig or Dan Wall. Again, you are breaking from the paradigm, and you may not be in a scenario in which you could satisfy standing.

Where these walls are breaking down particularly are in the area of business, B-to-B cases, business-to-business cases, direct competitor cases in which things that you and I would think of as traditional damages, you need to lay out to be pled.

And we'll get past a demurrer for the purposes of satisfying loss of money or property, an example being the recent case in your materials, *Law Offices of Matthew Higbee v. Expungement Assistance Services.*[24] That was a case in which a law firm was suing a non-law firm that was providing expungement services for practicing law without a law license. And the defendant demurred, and the argument was this wasn't a true loss of property claim, not a true restitution. What did you lose? And the lawyer said, "What I lost was I had to spend more time and money advertising my services to compete with you." Even though, go back to my paradigm, the defendant didn't get that money. It went to the newspapers and it went to other advertising services. That was, nevertheless, sufficient to show loss of money or property for standing purposes.

So I guess, to kind of cap this discussion, what we do know is that standing is broader than restitution that you'll be able to recover and prove at trial. Exactly how broad that is, we are still experimenting with.

Judge Illston: *So as far as looking into the future, there are questions and puzzles and conundrums left. We have just a couple of more minutes for this panel.*

I wanted to circle back to one thing that's been alluded to by all four of the speakers. In one way or another we have talked about the members of our high-tech community here and the Silicon Valley-type companies that have been the key players in many of these lawsuits that have been described this morning or this afternoon. But there's—particularly for folks in the competition and antitrust field—there's an interesting relationship between intellectual property and some of the competition rules. I wanted to know, Dan, if you had anything you wanted to add on that?

Wall: I don't think that you could have a complete retrospective on what's happened in California antitrust without noting the tremendous amount of attention and work that has come out of the high-tech community. The cases, even though many of them were not venued here or didn't even involve first-parties that are here, like *United States v. Microsoft,*[25] certainly it emanated from the work of lawyers in this area representing companies in the Silicon Valley. The FTC cases against Intel, the *Rambus* case, the *Oracle* merger case, all the manifestations of the *Google* cases and on and on and on and on.

---

24 214 Cal. App. 4th 544 (2014).

25 253 F.3d 34 (D.C. Cir. 2001).

And they have been—the *Kodak* cases that dealt very centrally with the role of antitrust and intellectual property law—they have really every imaginable issue that could have come up and seems to have come up.

There have been landmark decisions on what one can do and not do with their intellectual property rights that emanated out of the cases that involve Silicon Valley companies. There's been a lot of academic and judicial attention, agency attention, to the role of innovation in competition, both in a sense that possibly an adverse competitive effect of a merger or something else is to reduce innovation, but also just as another way of looking at competition itself, not just price, but how innovative is the industry.

Tremendous number of cases that in one way or the other deal with the control of platforms. Some of them are obvious platforms, like the *Google* disputes are clearly about the control of a platform. The *Microsoft* case was clearly about the control of a platform.

But also less obvious platforms, like the *Kodak* cases and the other cases having to do with manufacturers controlling the replacement parts that work only with their machines. Massive amount of work done on that.

And then industry standards, that the high-tech industry is heavily based upon industry standards.

It's really been an interesting revolution from twenty-five years ago, where we were worried about—from standard-setting was that the process might get rigged by competitors who came along and sort of co-opted the process and pushed their own interests. Now we are dealing with fascinating issues about the control of standard essential patents. Is there an antitrust restriction on when you can actually enforce your right to a standard essential patent that you had committed that you had licensed to folks?

For me, I actually think that this has been consistently the most interesting part of the practice over the last twenty-five years. Because when I started, what were the industries in San Francisco? There were a few banks that are all in Charlotte or someplace like that now. And then this amazing thing happened fifty miles south of here, and it really has given us all a wonderful ride.

Corbitt: Right. That's clearly been a huge development and is ongoing, as Dan said. I think it also relates to what we were talking about before with international globalization of antitrust, because you don't just worry if you are a defense lawyer representing them or a plaintiff's lawyer looking at an angle to make some money off of this.

You don't just think of that in the United States anymore.

The Europeans obviously are investigating Microsoft and Intel and now Google very hard and the standards that they are applying, their law and their approach to this, may be a lot different than what you would find in this country.

So that's another thing prospectively that I think is going to be a big deal in the future.

Judge Illston: *Well, that brings us to a close. As you have noticed, we can't tell you what the future is going to bring, but I can make two predictions for you: One is that it is going to be very, very interesting for everyone in this room to watch and figure out how the law develops; and two, none of you are going to be out of work any time soon based on what we have seen. Thank you.*

MANAGING ANTITRUST AND COMPLEX BUSINESS TRIALS—A VIEW FROM THE BENCH

With Judges William H. Orrick III, Christina A. Snyder, and Jon S. Tigar
Moderated by Niall E. Lynch[1]

Trying an antitrust or complex business case in federal court presents a significant challenge to any lawyer. Antitrust cases present unique and complex legal issues that must be conveyed in an understandable way to a jury. In addition, marshaling the facts in a clear and persuasive manner and effectively using expert witnesses creates additional challenges for trial counsel. Finally, on top of the complex legal and factual issues, trial counsel must ensure that their case does not run afoul of the District Court Judge's expectations of how the lawyers should conduct themselves in their courtroom. Understanding the perspective of the trial judge can make the presentation of your case run more smoothly and effectively.

Thus, on October 29, 2015, Judges William H. Orrick III,[2] Christina A. Snyder,[3] and Jon S. Tigar[4] spoke at the 25th Annual Golden State Antitrust and Unfair Competition Law Institute on the topic of managing antitrust and complex business trials. They discussed their real world experience in managing complex cases, and provided invaluable tips to litigants on how to effectively try cases in their courtrooms.

***Moderator**: Let's start with having each of the judges provide us with a brief background on their prior experience in antitrust and/or complex business trials. As well as any general comments and observations on presiding over complex business trials, including practice tips for lawyers trying complex cases in your courtroom.*

JUDGE SNYDER: I have presided over numerous antitrust cases during the course of my career. However, I don't recall one that has gone to trial. Unfortunately, they often result in summary judgment one way or the other, and that seems to be my experience. In fact, in preparing for this panel, it turned out that the youngest among us, Judge Orrick, is the only one that's tried an antitrust case at this point in time. So it is a matter of, I guess, being in the right place at the right time.

That said, I have certainly tried many complex cases and am familiar with case management and issues of that nature. I think that one of the important things that any practitioner can do with a complex case is really to sit down and think, "How can I make this simple?"

I heard Judge Illston on an earlier panel today talk about restitution and that it is very important, if you are going to have a claim for restitution, you know exactly what that claim is. And that is often the problem in many complex cases, be they antitrust cases or other cases of that nature. So I think the best advice I can give today, and I will probably have a lot more to say, but the best thing I can say, know your case, know your evidence, know who your witnesses will be and come into court on your first occasion with as clear a concept of where you're going with the case.

---

1 Niall E. Lynch is a partner at Latham & Watkins LLP in San Francisco, California.

2 Judge, United States District Court, Northern District of California.

3 Judge, United States District Court, Central District of California.

4 Judge, United States District Court, Northern District of California.

JUDGE ORRICK: I did have the good fortune of trying a Clayton Act Section 7 case as my first trial within a month of the time that I got on the bench. One of my colleagues was kind enough to give me a case that was scheduled for a five-week bench trial.

What I knew about antitrust was not very much, actually very little, except that I'm probably the only person in the room at whose house used to be, for a short period of time, a life-size cutout of Senator Sherman—because my dad was an antitrust lawyer. So that's all I knew before I got the case.

I know more now, and I have had a couple of patent trials in addition to that. I am happy to talk about the *Bazaarvoice* trial. There is somebody in the room who actually knows a lot more about that trial than I do, a fabulous lawyer, Peter Huston, who represented the government, but I'll have a few things to say about it too.

My tips for people here are, and it's surprising that I need to say this, but develop a theme and tell a story when you're trying a case. Remember that throughout the case, and particularly during trial, you should be thinking that you're on stage a quarter of a mile before you get to court. And if you're not treating other people really well, particularly my courtroom deputy, you can assume that I am going to know that, and you should also assume that the jury's going to pick up on the kind of person that you are. So being a good person actually matters a huge amount.

And then my final tip for you is that you need to be the master of everything you do, starting with being honest about your case, but also knowing how the technology works and being ready with deposition excerpts when you're cross-examining people. If you can't do that, you're going to be marked down by the jury or by the judge. Those are my tips.

JUDGE TIGAR: Although I have substantial trial experience, I haven't tried an antitrust case. I was on the state court for 11 years before I joined the federal bench, and I was able to try some cases when I was at the Keker firm.

Even so, I have to say, sitting next to Judges Snyder and Orrick and with this audience, I feel like I am talking about country music while I am sitting with Johnny Cash. I was able to try some complex cases while I was a lawyer at Keker. On the state court I did real estate fraud cases, a bunch of breach of contract and multi-defendant cases.

I think Judge Snyder and Orrick hit upon the same thing that I came here to discuss: simplify, simplify, simplify. The complex case you are trying is more similar to other kinds of cases than it is different. It is just more complicated. But the need to simplify and clarify is the same. I think what happens in the big cases is lawyers will get lost in the weeds. There are a few things they came to tell the court and came to tell the jury, and they have to stay focused on those things.

If you—for example, let's say you represent a defendant, and your client's conduct wasn't good but the plaintiff didn't suffer any injury. Well, if you are making 25 arguments and 24 of them are weak and the 25th one is there was no injury, you are diluting the point. It doesn't mean you concede every one of your opponent's arguments, it just means focus on the case.

I also think Judge Orrick got it right when he said, try to be a good person, and if you can't do that, pretend like you're a good person. You have to play the long game. Complex

litigation trials tend to be longer than other trials, so they become an opportunity for people to show their true form—whether or not that's a good thing. Don't get excited about nickel-and-dime controversies. Be the calmest, most efficient person in the court all the time, and you will start to become the person people gravitate towards—not just the judge, who will help you with rulings, but also the jury. You want the court to look forward to hearing from you, and I can't tell you how much of an advantage that will give you in the margin.

I have to say, in these big cases you have to make it easy for the jury. They *want* to do a good job for you. They have a lot of enthusiasm. They like you. You should read the letters I get from them afterwards. They are so invested in doing a good job. If you make it hard for them, they can't do a good job. And if you make it hard for them and your opponent makes it easy, then you are shooting yourself in the foot.

Things like juror notebooks with copies of the jury instructions and the most important documents, pictures of witnesses with their names for the notebooks so they can remember who the witnesses are, stipulating to a mid-case argument when the case is so long and the jury is going to forget the testimony. Things like that, I think, can be really helpful.

Moderator: *Before we get to the actual trial, let's discuss framing the issues for the trial, in particular, motions in limine and pretrial briefs. For this I'll start with Judge Orrick. What kinds of issues are effectively raised in motions in limine, which ones aren't, and specifically with regard to* Daubert *motions, which are quite popular for antitrust lawyers—one lawyer in an earlier panel said something about letting the dogs of Daubert out before trial. Tell us how you look at motions in limine in general and framing what will actually get before the jury or, in a bench trial, be presented before the judge.*

JUDGE ORRICK: I think that dog should stay in the kennel a fair amount more than it does.

I have a rule of limiting motions *in limine to* 25 pages, as many as people want to bring in 25 pages. But what that rule should do, and it doesn't always, is limit the number of motions they bring.

I have a trial coming up on Monday where in those 25 pages, times two for two parties, there are, I think, 35 motions *in limine*. That's a little too much. Your goal should be to focus me on an issue that's prejudicial to your case or one that you want me to have a strong heads-up on so that when the issue arises, I will have thought about it. Because I am less experienced than my distinguished colleagues, I don't mind seeing the 35 motions *in limine* that I am going to rule on Monday because they tell me who these lawyers are and lets me think about a number of different issues I may not have considered. But I'd be selective, more selective than they are when raising them.

I think that's what I look for with respect to motions *in limine.* A lot of them are just sort of a waste of time, in my experience.

With respect to *Daubert*, particularly for the people in this room, you usually hire people who have a lot of experience, and I am usually not going to cut somebody out unless the theory is really out there. And the way that I'll know that the theory is out there is if I have considered the issue before during the course of the case, if it's been raised somehow in motions for summary judgment or in some way that I can wrap my head around it.

But if somebody has a lot of expertise on some issue, I am going to want to hear from them.

JUDGE SNYDER: I agree on the *Daubert* situation. I think *Daubert* motions are grossly overused and people do bring them when you have a perfectly fine expert economist who may be a professor at some school and he may have a theory and it may not have been tested in the fashion that the defense lawyer would like, but the fact of the matter is it is really a matter for cross-examination. I rarely exclude experts unless they really have nothing to say that can be helpful to the jury.

As far as motions *in limine*, the only thing I would say is I typically let lawyers file a reasonable number. I don't have a set number, but my rule is five pages on a motion, five pages on the response, no replies and we settle things at the pretrial conference as best we can. I don't like to have these motions go into a trial.

I will tell you that every judge just becomes very unhappy when presented with a motion *in limine* that is really a disguised motion for summary judgment, which often happens. And you just have to say, "The time for that motion has passed. We are not going back there."

And I think that kind of summarizes my philosophy.

JUDGE TIGAR: In the interest of time, let me just say that I strongly agree with Judge Snyder's summary judgment point and with the *Daubert* point that both judges made. I would only add that occasionally the court gets a motion that says, "We want you to exclude any document that wasn't produced in discovery." But the motion is not directed at any particular document or exhibit. A motion like that wastes the court's time, because the court doesn't know what document you're worried about, or even whether you asked for it. It's just sort of a general request that courts enforce abstract discovery rules. If someone springs something on you at trial that they didn't produce but should have, fine, we'll deal with it at trial. But a motion *in limine* like that is silly.

Or "Can you stop them from talking about some issue?" Well, is there any evidence in the case that relates to that issue? Why don't you tell me what the evidence is and ask me to exclude *that* evidence. That's how motions work. Motions *in limine* are designed primarily to determine questions about whether evidence will be admitted or not or whether a certain rule of law will govern versus some other rule of law in the case. That's it, that's what they are good for.

If you get too far afield from those, usually you are going to try the court's patience. This applies to our next topic. If you are a senior person in the case, you have to exercise a really firm hand on the number and length and quality and utility of the motions *in limine.* You can't just issue an instruction to the most junior lawyer in the office and say, "Gin up as many summary objections as you can," or, "How many motions *in limine* can you come up with." Most of those motions are going to be losers. And not only are you going to lose all the losers, your credibility with the court is shot, and we haven't even picked a jury yet.

And it works the other way too. It's not all stick and no carrot. If you file a reasonable number of motions and objections to evidence and many of them are solid, that really enhances your credibility with the court.

Moderator*: Keeping on the theme of evidentiary objections, during trial how do you like to deal*

with evidentiary issues? Sidebars, rule in front of the jury, beginning of the day? Do you like them briefed, do you not, what works well, what doesn't, what is your general attitude towards evidentiary objections, Judge Snyder?

JUDGE SNYDER: Generally I dislike sidebars, and I tell the attorneys that we are going to resolve the major issues either before we commence taking evidence, over the noon hour, or at the end of the day. I try to know—maybe I have sidebars one or two times during a trial when something comes up that's something unexpected. I think they are a waste of the jury's time.

And I think one of my important tasks is making sure that we really keep the case moving for the jury because we are there asking people to devote a lot of time, take a lot of time out of their lives, and I think we have to be very respectful of them. And sidebars and all these other private discussions in their presence where they feel excluded from the conversation do no good.

JUDGE TIGAR: Same here. Same on sidebars, same on the opportunity cost of my time, and particularly the cost of the jury's time.

I would add also, I am not aware—I would love to see an objection that takes more than five words, because I am not aware of one. So if you are saying more than five words when you object, you are coaching the witness or making a speech in front of the jury. We don't do that. The way it's supposed to go, for example, is "objection; hearsay." Fine. I look at the other side so they can tell me if there's a hearsay exception. Unless I think the objection has no merit, in which case I overrule it. I don't need to hear from the other side. Five words or less, cite the evidence code. I'll either make the right call on the law, or I won't. But we're not going to have a lot of argument.

We are not going to have a sidebar. We are not. You may feel aggrieved by something I did, but this is only an evidentiary ruling in the middle of a trial. That's what's happening. So it gets the amount of time appropriate to that event. It is not that it's not important. Everything's important. Some things are one-minute issues, some things are one-hour issues.

This is one evidentiary ruling in the middle of a trial. If you feel the court erred, you'll have a chance to make a record at the beginning of the day or at lunchtime or at the end of the day.

JUDGE ORRICK: I also agree with that. In my trials I start at 8:00, and at 7:30 the lawyers come in and we deal with all the big issues that are coming up. And aside from that, I want the five-word objections that Judge Tigar was just describing. That's all we need.

***Moderator**: We have talked about juries and the need to be clear to juries. Let's now talk about jury selection. I think a lot of discussion and speculation among lawyers goes into what makes a good juror in an antitrust case because different crosscurrents can come into play in an antitrust case about which jurors might be sympathetic to your side and which ones will not. Therefore, do you allow jury questionnaires in complex cases, do you find them helpful, do you allow lawyers to ask questions in terms of* voir dire, *what's been effective, what's your general attitude towards jury and jury selections?*

JUDGE TIGAR: I am a big believer that lawyers should be able to pick a jury they have confidence in. So I allow *voir dire* in most cases. In complex cases I expect a questionnaire. If it is a good questionnaire, I may ask no questions myself, and I'll let the lawyers conduct the questioning.

In general, in any trial I am prepared to ask the questions that are really hot-button questions for the jurors, so lawyers are not at risk for having the jurors dislike them from the beginning. I will let the air out of the tire.

For example, in an employment discrimination case, it is important to know the experience these prospective jurors may have had, sexual harassment or difficulties in the workplace. Those are difficult questions. Sometimes the lawyers will say, "Can you take these questions?" I am happy to do that.

Putting that to one side, with a good questionnaire I might not need to ask a lot of questions.

I do set time limits. It is not unlimited.

I had one case where I felt jury selection was so important I put no time limits on it. It is possible. I don't think any of the cases we are discussing today fall into that category.

Having said that, there are limits on the questions lawyers can ask. You know what those limits are, questions that suggest the jury outcome of the case would be, asking jurors to promise to vote a certain way if certain facts come in, that kind of thing, those are off limits.

I guess the main thing is I really want—I want the lawyers to have a lot of confidence in the jury. I try to do whatever I can to send that message to them.

JUDGE SNYDER: I do pretty much the same. The one thing I probably do is limit *voir dire* and try to ask the questions myself.

That said, when there are very sensitive issues, I will invite the lawyers and any particular juror over to sidebar, because I think it is important that the jury understands the answers have to be truthful. And although the answers may be embarrassing, we will do everything to shield them from having to reveal anything embarrassing to a bunch of strangers in the room, but it is very important they be candid.

There are times it makes very, very good sense to do that. I can recall an occasion where I had a woman in the jury who said, "I have to come over and tell you something." So she came over to the side. "I am a convicted felon. I shouldn't be on this jury." We said, "Maybe you should go."

JUDGE ORRICK: I generally agree, particularly with Judge Snyder. I do more of the *voir dire* myself. I say that I limit each side to 15 minutes, which so far has been ample, it turns out. But in cases where issues are getting fleshed out by the lawyers after my *voir dire*, I will let them go until the questions turn into argument, and then I would stop them.

JUDGE TIGAR: I need to make one clarification. In a noncomplex case, I ask the questions. So I ask the questions first and give the lawyers their own time after that.

Moderator*: Next topic is trial management. Complex cases can be quit lengthy. There is the classic example of the 13-year IBM antitrust case that was filed in 1969 and resolved in 1982. Since that case, there has been substantial efforts by courts to try to make complex cases shorter and more manageable. Judge Snyder, focusing on time limits for trials, is that something that you have adopted or considered in complex cases? Do you impose time limits for opening, examination of witnesses or closing, how do you set the time limits, when do you give relief from the time limits that have been set, and what other tools do you use to focus the trial and move it along?*

JUDGE SNYDER: I do use time limits in civil cases, not in every case, but where I sense that the parties are going to go on and on and on. I will sit them down at the pretrial conference and say, "Look, this case should require 18 hours at trial, and you can go and discuss it, come back and tell me if you think that's unreasonable."

And typically what I would do, I do not include opening statements as part of that, it is just the time that you get testimony. I don't include closing argument.

I have never had a case where people have not completed the case within the time limits, although I am prepared to give people extra time if I think they have had a particularly difficult witness to cross-examine or there's some real reason to extend the time limits. But thus far the time limits that we have agreed upon, generally, the time's never been used and the parties get to the jury, and I think the jury appreciates it.

JUDGE ORRICK: I love time limits. I think they are great, and I impose them regularly and with impunity. I think the *Bazaarvoice* case is a good example of that.

My colleague who transferred the case had scheduled five weeks for a bench trial, and with the extraordinary experience that I described at the beginning of this panel, at the first conference with the lawyers, I told them that they would each finish their case in 27 hours. So I cut the trial basically in half, which was sufficient, I think, to do it.

Lawyers—being focused on what kind of an examination, what kind of points you are making, how every witness develops a theme of your case, is critically important. In my antitrust trial, the government was particularly good, as was Wilson Sonsini on the other side. Every time somebody stood up, I knew I had to listen because they had something important to say, but they weren't going to say too much.

I think time limits help focus that theme, and I use them happily.

JUDGE TIGAR: I set time limits in every civil case. I set them separately for witness examination, and as I think both judges, I know Judge Snyder said, for opening statement and closing argument.

The beauty of time limits is I am out of the game of worrying about, "is this question irrelevant?," "is this examination taking too much time?" I can stay out of it. Because you just get one block of time if you are examining the witness, whether it's direct or cross, your clock is running. You decide what's important and how much time each issue should take.

You want to take all the time in the world to repeat yourself during the cross-examination of this witness, that's fine. It's possible that you're boring the jury, and you are certainly taking away time that might be used with another witness. But I don't need to get involved with that. The system is self-policing.

I would say to the people in the room if you want to win a case, be the person who is prepared to try that case in a reasonable amount of time and start preparing that trial from the beginning and show up ready to try that case. Don't be scared of time limits. Time limits are your friend.

I used to send out letters to jurors when I was in the State Court, just a practice that I had. A "how did you like it," customer service kind of thing. I did that for several years.

The only negative comment I regularly got on the letters—and by the way, jurors love serving on juries. The one regular comment I got, "Why do they repeat the same questions over and over again? Why are they doing that?"

Time limits force you to really become the best lawyer. If you walk into trial and you are ready to try your case in a reasonable time and your opponent is not, you have an advantage. I love time limits, and I think juries love them, too.

***Moderator**: There's been a lot of discussion about making cases simple for juries. I think a lot of lawyers translate that into having graphics. I think you would be surprised how much time is spent on graphics. I would like to start with Judge Orrick, and hear your views on graphics. Do you allow them in opening, during questioning of fact witnesses, when do you require them to be disclosed to the other side, and what graphics do you think have been most effective and what should be avoided?*

JUDGE ORRICK: I am a fan of certain kinds of graphics, simple graphics, graphics that show chronology with events in a readable format. Those things I always enjoy, just helps me figure out what the case is.

I do allow graphics in openings. I require that they be exchanged on the Wednesday before the trial starts on the Monday, and if there's a problem with them, we have a conference on Friday, phone conference on Friday before.

If graphics are going to be used with witnesses during the trial, I require that they be disclosed by the evening before so that if there are any problems with what I am going to see, they can be raised at the 7:30 conference. But I do think graphics are great, although a lot of people try to do too much with them.

JUDGE SNYDER: I think graphics can be very helpful. I think there are times—for those of you who appear in the Central District, I am in the Spring Street courthouse, which is not technologically friendly, to say the very least. So it is sometimes hard for people to come in and do the same bells-and-whistles graphics that one would do in another courtroom. That said, I think they can be helpful. I think they can be overdone, also. I think it really depends upon the case.

I had the experience of trying a fairly high profile copyright case a few weeks ago which involved copyright infringement related to raps and whether, in fact, their sampling infringed on the work of an Egyptian composer. We had Egyptian law. And while the case is pending, I won't get into the details we had more musical equipment that I can begin to discuss, but it was necessary in that case to demonstrate to the jury the various positions of the experts and the parties.

JUDGE TIGAR: I agree with much of what's already said. Judges and juries have different learning styles, which means if you present information in two ways, you are

maximizing the chances that the information will be received and understood by the person you are talking to. And the flip side of that is if you don't do that, you are minimizing the chances that the information will be understood. I think graphics and the other kinds of things that Judge Snyder was talking about have an important place in trial.

I would add, first, we have the discretion as trial judges to admit demonstrative exhibits. That's the difference between your foam board staying in the courtroom when the jury goes back to deliberate and it going back with them into the jury room. The way to convince the court to do that is to create a nonargumentative graphic that when it comes time to have it admitted is not going to hobble you in terms of convincing the court that the exhibit has value to the jury.

The argumentative graphic might allow you to have some fun with a particular witness, but that's really going to be its only day in the sun. If you do something a little more even-handed, you'll have the opportunity to have it last throughout the trial.

The other thing I will say is that federal courts have great rules on summary evidence. In complex cases you have so much underlying data and documents, not only is summary evidence in paper form or testimony helpful, graphics are a great way of getting that information across to a jury.

Moderator*: One innovation we have seen some judges adopt, although it is not common, is allowing direct addresses by the lawyers to the jury during the course of trial, sort of an interim closing or explanatory period where the lawyers can speak directly to the jury. Is this something you have ever tried, Judge Snyder, or anything similar?*

JUDGE SNYDER: Not really.

JUDGE TIGAR: I haven't done it, but I think it's the new frontier. I also think honestly, in most cases, even complex cases, under time limits, the trial's not going to go on long enough where this is really going to be an issue. But you might have a case where you decide that you're disadvantaged because you had a great witness that testified four weeks ago and the testimony has become diluted by the passage of time. And for the jury to do its best job, you'd like them to keep that witness's testimony in mind. I haven't done it because no one's ever asked me for it. I think in a case like that, if somebody asked me, I'd probably say okay.

JUDGE ORRICK: I am looking at Judge Illston because I had to do that—or was able to do it in the trial before her eight or nine years ago. I don't know how she found it. I thought it was okay. I haven't done it in any of my cases, but I am always willing.

I am always willing to do something that the lawyers think is a smart idea because you know your case better than I do. And if you have a thought about how something can be presented in a clearer, better way, I am always going to be interested in it. It doesn't mean that I will always agree with it, but you should make the pitch if it is something that you want to do.

Moderator: *Let's now talk about witnesses and cross-examination, redirect, and recross. How much leeway do you give during cross and redirect, do you allow anything beyond the redirect, when do you allow video deposition excerpts for impeachment, do you find that effective, do you allow jurors to ask questions of witnesses and under what circumstances, and do you, as a judge, ask witnesses questions?*

JUDGE TIGAR: Let me take those out of order. I impose time limits on all my civil cases, so I am a little less concerned about how long things take. I don't have an arbitrary limit on the amount of redirect or cross.

For me there's direct examination, cross-examination. I think people have some leeway on cross-examination because witness credibility is a little hard to define with any precision.

So now I have had a direct and a cross, now I know what the scope of everybody's examination is going to be, and I expect that that's going to shrink. If you're asking questions that are not within the ambit of what was just asked, then I'm probably going to sustain an objection. You exceeded the scope. And that just takes care of itself. I haven't had a lot of problem with repetitive back-and-forth because the lawyers are usually able to tell when the jury is getting bored.

In a bench trial, I ask a lot of questions because I am the trier of fact. In a jury trial, I only ask questions if I didn't hear what the witness said because I figure at least one juror probably didn't hear the witness either, because I am sitting pretty close to the witness. I'll also ask a follow-up question if I literally didn't understand what the witness said. That doesn't happen much, but it does happen, and in that instance I think my job requires me on behalf of the jury to ask the question and, also, I need to understand the witnesses, too. But otherwise I think in a jury trial the lawyers should be allowed to ask their questions and not have the judge weighing in.

I let my jurors ask questions. Not directly. They write them down on a piece of paper, and I review them with the lawyers. And then assuming there's no objection or any objection has been overruled, I will ask the jury's question at a break between the lawyers' questioning.

And then I guess the last thing, you asked about video deposition excerpts. I was in a big, big, big complex trial in Los Angeles as a lawyer, and I was able to cross-examine a witness very effectively that way. It was great. Have you ever done that—raise your hand—and it worked out? It's great. You can really have the jury eating out of the palm of your hand because you have the witness sitting there and they are saying something and then there's the TV of them saying the opposite thing. That's like lawyer candy.

Having done it to good effect, I have never had anybody object to it, but if somebody said, "You know, I think that may put too much emphasis on cross," I'd at least have a hearing to think about it, because I know from firsthand experience it is effective.

JUDGE ORRICK: So, Peter Huston, where are you? I love having video deposition excerpts in cross. It can be just devastating.

My favorite example appeared in the *Bazaarvoice* trial, where the defendants put on one of these masters of the universe from Silicon Valley who was really very smooth and smart. He seemed like quite a good witness on direct. And the government's lawyer got up on cross and said, "Mr. So-and-so, are you taking your testimony seriously?"

I looked over and thought, what, is this the first false note that the government had made in the case? What is he talking about? Then they ran the video from the deposition. And when this witness was being sworn in, he looked over directly at the camera and winked, and it just—the rest of the cross-examination, it was a beautiful thing. It was just a heck of a setup.

So I think video excerpts are fabulous. Cross-examination in general is something that I like, I give a lot of latitude in cross-examination. And I probably do—there's probably more redirect and recrosses in my court than anybody else's because I don't know enough yet. Testimony is great. So I allow a lot of latitude in questioning because the lawyers will be punished if they're wasting time since we do have time limits.

I have not yet had jurors ask questions. I never did it when I was in practice or had experience with it, and so far nobody has asked for it. I am open to it.

JUDGE SNYDER: I agree with what both of them said. I do permit jurors to ask questions in writing and discuss the questions with the attorneys to see if they are questions that should be asked to clarify things. They also can tell lawyers sometimes they are veering off-course because the questions really are not particularly good questions.

As far as videos, I think I agree with Judge Orrick, and I think if someone made a motion to preclude the use of videos in cross-examination, I would not have a hearing, I would just deny that out of hand.

JUDGE TIGAR: I might adopt that ruling, and I don't need to have a hearing.

***Moderator**: The next topic is documents. Antitrust cases are notoriously document heavy. The management of the documents is always a big issue in these cases. What do you allow in terms of sharing written documents with the jurors, showing excerpts on the screen, notebooks, binders, key documents, what has been the most or least effective ways of handling written documents in cases where the lawyers have put in hundreds of pages of documents into the record, and I don't know if anyone ever reads them, but what's your thoughts on documents and the use of documents?*

JUDGE ORRICK: I think you just answered the question. If you care about an exhibit, you have to show it to the jury. You have to focus them on the thing that you care about. And if you're just wholesale putting documents in, there may be a reason for you to do it for your record, but you are not persuading anybody, so you need to show them on a screen.

I personally am agnostic to giving many documents to the jurors and a notebook. If everybody agrees, I will go ahead and do it if you would like to do it. But the more paper you give the jury, the less they'll focus on you—when I am talking, I want you to focus on me or I want you to focus on the screen if I'm showing you something that's short.

But if I am listening to you and have a notebook with a bunch of documents and my mind starts to wander, I start looking at it and I am not paying attention to you. So I would be very cautious. I always warn lawyers about this. Sometimes they listen, sometimes they don't. I always warn lawyers about giving the jurors the opportunity to do other stuff than paying attention to the lawyers.

JUDGE SNYDER: I use the video screen, obviously, to focus documents. I think it is worth mentioning, although I don't have it because we don't have the resources, there are many practitioners who are working on jury trials who advocate having iPads for the jurors so they can have the document on their own iPad and read it as they go along.

I think we are going to see more of that because it is a way to let a juror who doesn't see as well see something up close. You can expand it on the screen if you want to do something. Many of the younger judges in my court seem to think that's the way to go.

JUDGE TIGAR: I have a courtroom at the moment that doesn't even have a home movie screen. So in terms of the technology for documents, the lawyers have to bring that in. I think that as an institution, we are a little bit—we are not on the edge of how people are receiving information. There's so much research now about divided attention skills or disabilities, depending on how you look at it, that the younger part of our jury audience now has because that's how you are processing information.

I don't think I have any tips about how you give information to jurors in a way that's consistent with the way they are absorbing information. I think that's a subject I need to learn more about. I'm not a teacher on that topic.

With regard to Judge Orrick's comment about notebooks, the only situation I have used notebooks is patent trials, and there aren't a lot of things in the notebooks, but there's some anchors in there, and a lot of time it has been helpful.

***Moderator**: The next topic I would like to cover is the use of guilty pleas. Particularly in the Northern District of California, there are many antitrust cases involving criminal price-fixing investigations that lead to guilty pleas by the company or senior executives and those executives testify in criminal and/or civil trials. What's your general approach with the use of guilty pleas and how they are brought into evidence?*

JUDGE SNYDER: This is a subject that can probably take the entire hour, but let me try to be brief. Obviously a guilty plea can be admitted against a party who has entered the guilty plea. The more interesting question is: What can you do with that guilty plea with regard to the alleged co-conspirators, what can you do with the guilty plea regarding other parties and so forth?

For example, if an employee of a company enters a guilty plea, it is most probably admissible against the corporation itself, assuming he performed whatever he did illegally in the course of his employment.

Likewise, you have the question of what do you do when you have a guilty plea by one defendant and there are alleged co-conspirators who have not entered guilty pleas? Does that guilty plea come in against them? I think perhaps it does as an admission against interest under Rule 804(b)(3), particularly if the witness is unavailable.

And there are, you know, many arguments either way on this subject, but I think that that is a question to be considered in the process of trying the case.

There are other situations where you have a guilty plea, let's say, by several codefendants with regard to one product and the plaintiff wants to use the guilty plea to show that they most likely conspired to fix prices as to another product, and that creates another set of problems.

The cases are somewhat split, but I think on balance, I think more courts are saying if these three people met someplace and agreed to fix the price of Product A and they were together at the time of Product B, it is at least some evidence that they conspired regarding Product B.

I think the most humorous example, there was a case many years ago that my antitrust-lawyer husband was involved in. He was involved in a case relating to a conspiracy to fix the price of vitamins. And all of the price-fixers met in the Black Forest on a particular day, they all went to Germany, and, of course, the question there is if three of the four had entered

guilty pleas and the fourth one just happened to be in the same hotel in the Black Forest and that person didn't fix prices also, was it a reasonable inference that Defendant Number Four was part of the conspiracy? And I submit that the answer is yes in the minds of both plaintiff and defense lawyers, but that's the rare case.

Usually you have a situation where nothing is really clear. You have parallel conduct, but not necessarily concerted action. So it is a very interesting area. I could go on for hours, but we don't have hours. So I just raise those issues.

They have been seen by many of the judges in this district, but you are going to be presented with them increasingly because there are so many guilty pleas that precede the filing of civil litigation that one has to figure out what they are admissible for, what the circumstances are. And I think it will be an increasingly interesting issue.

JUDGE TIGAR: I think on just this one issue I can speak for [Judge Orrick]. We have not had this come up, so we are just going to call [Judge Snyder] when it happens.

JUDGE ORRICK: I do have something wise to tell you all that will give you great insight into my judicial temperament. I have a question that I ask when I get an issue like this. I think: "What would Judge Illston do?" And then I usually go and ask her.

***Moderator**: The next topic relates to the use of deposition transcripts. How do you manage the endless objections to deposition testimony, what do you find the most effective way to present deposition testimony, video versus Q and A, stand in for the witness or just reading in by the lawyer, and do you permit narrative summary background testimony, and if you do, what have you found effective?*

JUDGE TIGAR: Let me do objections last. Video is clear, that's what the jurors want, that's what you want, that's what I want. Video, if you have it, is always the best way of presenting deposition testimony. I have gone both ways on whether I will require all the video to be shown at one time. There are good arguments to be made both ways.

Defendants always say, "Why shouldn't I be able to put in the good parts of my case," and the plaintiff says, "Why do I have to let their junky stuff that I hate in my case?" Really that's case-specific. Video, in terms of media, video is the best.

If you don't have the video and you want to get the testimony and you don't have the witness, I like to have somebody pretend to be the witness on the stand. I don't like to have some lawyer standing there reading the transcript. That is super boring. That's not a very judicial way of putting it, I know. But it is super boring.

It is boring even for the person reading it, because you can hear in their voice they wish they were somewhere else. So just imagine how the jury feels.

If you have someone playing the witness, sometimes the other side will object and say, "The witness is going to play games, they are going to put someone in the witness stand and do something that's unfair." You know what, the jury is smart. So if they do that, the jury will know. And the other way of presenting testimony is so boring we can't do it.

No one has asked me to do a narrative summary of trial testimony. I might allow that by stipulation. Otherwise someone summarizing ad hoc, I don't think I'd allow that. Photos, anything the lawyers agree on, I would probably allow, including summary of background.

Let me talk about objections. This goes back to what I said earlier, putting the junior associate in the room and locking the door and asking them to gin something up. I require, as almost all my colleagues do, process of cross-designations, they exchange, then meet and confer and then the lawyers file objections. Most the time the lawyers are reasonable in the objections they make.

Whether they're reasonable or not, I'm going to read all of them myself. I don't delegate that work to a law clerk. And usually I'm doing that work on the weekend before trial.

So if I had to spend an entire day going through unreasonable objections on the weekend before trial, we'll talk about that on Monday morning. For example, the effect of having to read the word "relevant" 412 times. For one thing, it forced me to learn a lot about the case. I have an electronic copy of the deposition, and because of all the objections, I just read it. I read the parts that have been objected to, but I end up reading a lot of the material around the objections too. And most relevance objections are overruled.

So the advantage for me is I have to do the objection rulings, but I also want to learn your case so when we do the trial, I am coming at it from a place of knowledge. So I am able to kill two birds with one stone. And on Monday I come in and have a table that sets out my rulings on each of my objections. You are going to get a lot of credit if you're reasonable on this.

JUDGE ORRICK: I generally have the same response as Judge Tigar.

But it brings something up in another context that I said at the beginning, which is we read these depositions and we see these stupid objections that people make to try to obstruct what's going on, and it gives us context that you really don't want to have.

It is like my view of trials: some of what matters comes out of a witness's mouth, but a lot of what matters is everything else, the way that people interact, the way that you interact with your witness or my courtroom deputy or how polite people are. You get to know a lot from everything, not just testimony and documents.

Usually when you're reading deposition transcripts, it's not very flattering. So I would be paying attention to how you behave all the way through your case.

JUDGE SNYDER: I think, first of all, under our local rules, if you plan to read a deposition in the course of the trial, you have to submit the objections in advance in the transcripts. So I obviously rule on those objections before we ever get into the courtroom.

I agree that the video depositions are far more interesting, but you have to give counsel enough notice so they know what testimony you are going to exclude and what testimony you aren't going to exclude. You can't really do it on the fly. I try to do it the day before so they have a chance to get their technical stuff in order so that they are not disclosing testimony that I have excluded.

Same thing with written, reading deposition transcripts, I agree with Judge Tigar, nothing is more boring than one lawyer reading the whole thing, so I really encourage there to be someone posing as the attorney and someone posing as the witness sitting in the witness box so that the jury can understand the exchange.

And, finally, as far as letting the opposite side put on its deposition testimony in the course of the defense case, I often do that because under the rule of completeness it seems appropriate to do it then, and it is probably more useful to the jury. I decide all this based on what I think is going to help the jury.

Moderator:*The next topic is expert testimony. Expert testimony is a crucial aspect of any antitrust case. I would like to get your thoughts on the use of expert witnesses. How closely do you hold experts to the reports on direct, to what extent can experts go beyond the report on cross, redirect, do you permit the use of bullet summaries to be shown while the experts are testifying, are those admitted into evidence, and do you require foundation for them and just any other general thoughts on expert testimony?*

JUDGE ORRICK: My specific expert thought is if you're able to hire Carl Shapiro as your expert, he's over at Berkeley, he used to work in the Antitrust Division, then you've done a really smart thing. He was the expert for the government in the *Bazaarvoice.* And while the defendant had a fine expert, Shapiro was really quite something and helped walk me in the direction that the government wanted me to go.

I hold experts very closely to their reports on direct. I don't let them go beyond in cross unless the cross-examiner opens the door in some fashion. I do permit bullet summaries. They are experts. I hope they know what they are going to be talking about, and the bullet summaries are helpful, again, as a way of explaining the testimony and keeping the expert corralled. I think they are just useful. And I'd only strike them if there was no foundation for them, and that's an issue that would get raised by objection.

JUDGE TIGAR: I agree with that. All I would add is that's one of the hardest things we do, this part about keeping experts to their report, because you all know your case. We have a difficult time doing that in real time. Maybe [Judge Snyder] and [Judge Orrick] don't. I do.

Judges make decisions and juries make decisions based on imperfect data. If you wanted to know why your credibility is so important, that's why, because we don't have all the information. We would love to be able to trust you because if we do trust you, we don't have to audit. Versus if we don't trust you, we have to audit and we don't have enough time, and so we feel acutely that you are making us do something that we don't feel we should be doing.

This is one of those areas where it is very difficult for a judge in the middle of an examination of an expert to opine with certainty whether someone is or is not faithful to her 67-page report. Your demonstrated credibility leading up to that is going to be very useful to you.

Conversely, as judges, we have to be sharper with people in an area like that, where it is harder for us to be all the way there on the information and you broke the rules. I think where it's been shown that an expert has not been faithful to the report, I am going to try to do as much as I can to try to make sure I have made the playing field level.

JUDGE SNYDER: I agree with everything that's been said. The one thing I would add is that when you retain and work with your expert, you really have to be careful that the expert is not opining as to ultimate facts and invading the province of the jury. I am constantly amazed with the expert reports I see that do that, and that's a place where I draw the line.

Moderator*: We have a couple more issues on our outline, but we are running low on time, and I do want to have an opportunity for two or three questions from the audience.*

AUDIENCE MEMBER: Do you give any special treatment to young lawyers when they face you at trial?

JUDGE SNYDER: I try to treat young lawyers like any other lawyer in the courtroom. And I think it is a tremendous thing when law firms let their younger lawyers get that sort of trial experience.

I think most judges are thrilled when young lawyers come into the program, assuming they are well-prepared, and they usually are, because the ones that want to step up to the line early in their career are budding superstars who really want to be good in court and learn. I don't know if it is special treatment, but we are always happy.

JUDGE TIGAR: I will give you my most clearly undivided attention. I will let you talk longer than I otherwise would. I am trying to do everything in my power, without saying it explicitly to the firm that allowed you to come to the microphone, that they made a good choice.

I had been only months out of my own clerkship for a federal judge and working at Morrison & Foerster, and I got pulled into this big commercial arbitration. I got to cross-examine witnesses, and I will never forget what it felt like as a young lawyer to have that opportunity. I agree with [Judge Snyder], we don't see enough young lawyers. I can't do anything beyond what I just said, but I do everything in my power to make that young lawyer know how glad I am she's at the microphone.

JUDGE ORRICK: I think not only that, but we always appreciate having the person that's done the work make the argument; just sayin'.

AUDIENCE MEMBER: Your Honor just said that you would exclude an opinion that embraced the ultimate fact, and I would think that 704 would allow that.

JUDGE SNYDER: Well, there are some ultimate facts that may be arguably allowed, but when you start telling the jury that the defendant is guilty—that's what I am talking about.

AUDIENCE MEMBER: Very good. Thank you.

Moderator*: I want to thank the three judges who have appeared today. The room here is full, and I think that's a testament to how much we enjoyed your comments today and how appreciative everyone is that the three of you took time off of your busy schedules to talk with us about complex trials. Thank you very much.*

THE *NEXIUM* TRIAL PIONEERS *ACTAVIS*' ACTIVATION: A ROUNDTABLE OF *NEXIUM*'S COUNSEL REFLECT ON THEIR SIX-WEEK TRIAL

By Moderator and Editor: Cheryl Lee Johnson;[1] *Panelists: Kristen Johnson, Steve Shadowen, John Schmidtlein, and Doug Baldridge*

I. BACKGROUND

A. The Reverse Payment Agreement Issue and the *F.T.C. v. Actavis* Decision

1. The Rise of Reverse Payments and Developments in Federal Law on Reverse Payments Pre-*Actavis*[2]

Robust generic competition to a branded drug significantly reduces drug prices for the consumer.[3] However, generic competition can be delayed by reverse payment agreements under which a branded drug company pays, either in cash or side deal incentives, rival generic companies in exchange for their agreement to delay their competition. These payments are made in the context of settling patent litigation between the brand and generic over the validity and enforceability of the branded company's patents relating to that drug.[4] The resulting settlement can facilitate a combination between pharmaceutical rivals that restricts the output of generic drugs and extends the monopoly pricing of the branded drug's sales by avoiding the legal challenge to the patents that might end that monopoly.[5]

Before 2006, drug manufacturers generally considered these agreements unlawful, and settled their patent lawsuits based in principle upon the perceived strength of the patent in question.[6] These agreements generally did not raise antitrust concerns, as they were not drawn to preserve the patent-holder's monopoly nor paid for by sharing monopoly profits between the two competitors.[7]

---

1 Cheryl Lee Johnson is in the Antitrust Section of the California Attorney General's Office, the Editor-in Chief of California Antitrust & Unfair Competition Law, and a former Chair of the California State Antitrust & Unfair Competition Section. Any views represented here are the author's own, and in no way represent the views of the Antitrust Section or the California Attorney General's Office.

2 The following two subsections are drawn, in part, from the author's earlier article regarding pay-for-delay. *See* Cheryl Lee Johnson, *Cipro's $400 Million Pay for Delay: How California Law and Courts Can Make a Difference in Reverse Payment Challenges,* 67 Rutgers U.L. Rev. 721 (2015).

3 FTC, Pay-for-Delay: How Drug Companies Pay-Offs Cost Consumers Billions 8 (2010) [hereinafter FTC, Pay-for-Delay] (noting that in a mature generic market, generic prices are on the average 85% lower than the pre-entry branded drug price); Alison Masson & Robert L. Steiner, FTC, Generic Substitution and Prescription Drug Prices: Economic Effects of State Drug Product Selection Laws 1(1985).

4 For a detailed discussion of the regulatory framework in which reverse payment agreements are concluded, *see* F.T.C. v. Actavis, Inc., 133 S. Ct. 2223, 2228 (2013); *In re* K-Dur Antitrust Litig., 686 F.3d 197, 203-04 (3d Cir. 2012); C. Scott Hemphill, *An Aggregate Approach to Antitrust: Using New Data and Rulemaking to Preserve Drug Competition,* 109 Colum. L. Rev. 629, 635 (2009).

5 *In re* Nexium (Esomeprazole) Antitrust Litig., 42 F. Supp. 3d 231, 240 (D. Mass. 2014).

6 *Cf.* FTC, Pay-for-Delay, *supra* note 3, at 1 ("The Federal Trade Commission's (FTC) investigations and enforcement actions against pay-for-delay agreements deterred their use from April 1999 through 2004. . . . Since 2005, however, a few appellate courts have misapplied the antitrust law to uphold these agreements. Following those court decisions, patent settlements that combine restrictions on generic entry with compensation from the brand to the generic have reemerged." (footnotes omitted)).

7 *See Actavis*, 133 S. Ct. at 2234-35, 2237 (suggesting parties can settle without payments that suggest monopoly sharing); *In re K-Dur*, 686 F.3d at 216, 218; Hemphill, *supra* note 4, at 635.

However, a body of law developed in which these agreements were increasingly insulated from legal challenge, culminating in the Second Circuit's decision in *In re Tamoxifen Citrate Antitrust Litigation*.[8] Under this precedent, the agreements were subject to antitrust scrutiny only with evidence that the underlying patent was procured by fraud or that the branded company's patent litigation was a "sham."[9] Ironically, this standard became known as the "scope of the patent" test, though it effectively foreclosed inquiry into the scope, validity, or enforceability of the patent except in very limited exceptions.[10] In the wake of the institution of this permissive standard came a surge of these agreements, with many, if not most, adopting highly-disguised forms given lingering concerns about their ultimate legality.[11] Introducing payments[12] into the settlement process raises antitrust concerns as the payment provides an incentive for resolving the patent litigation beyond the perceived strength of the patent. This skews the decision of the generic firm of when to enter the market and induces the generic firm to accept a later date to enter competition than would be accepted without the payment. Many reverse payment agreements offer generics greater

---

8 466 F.3d 187 (2d Cir. 2005).

9 Valley Drug Co. v. Geneva Pharms., Inc., 344 F.3d 1294, 1308-09 (11th Cir. 2003); Schering-Plough Corp. v. F.T.C., 402 F.3d 1056, 1068 (11th Cir. 2005); *In re* Ciprofloxacin Hydrochloride Antitrust Litig., 363 F. Supp. 2d 514 (E.D.N.Y. 2005); *Tamoxifen*, 466 F.3d at 208-09.

10 This misnomer was particularly inapt given that this is the term the United States Supreme Court has used to define the intersection between antitrust and patent law in assessing such issues as whether patent licensing agreements were unduly restrictive, and is a standard that involves an actual inquiry into the scope of the patent. *See, e.g.,* Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 136 (1969).

11 Press Release, FTC, FTC Study: In FY 2012, Branded Drug Firms Significantly Increased the Use of Potential Pay-for-Delay Settlements to Keep Generic Competitions off the Market (Jan. 17, 2013), *available at* http://www.ftc.gov/news-events/press-releases/2013/01/ftc-study-fy-2012-branded-drug-firms-significantly-increased. In a 2014 report, the Bureau of Competition found that of the twenty-nine actual or potential pay-for-delay agreements entered into in 2013, which covered more than twenty-one drugs with combined annual sales in the United States of $4.3 billion, fourteen had compensation in the form of cash purporting to reimburse the generic's fees; four included promises not to launch an authorized generic; ten restricted generic entry with declining royalty rates and other possible forms of compensation not readily discernible; and that most of the agreements included side business deals between the branded company and the generic manufacturer. Bureau of Competition, Agreements Filed with the Federal Trade Commission Under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003: Overview of Agreements Filed in FY 2013: A Report by the Bureau of Competition 1-2 (2014) [hereinafter Agreements Filed in FY 2013]. In its most recent 2016 report, another twenty-one reverse payment agreements were inked post *Actavis,* shielding $6.2 billion in annual drug sales from competition in addition to several other agreements that the FTC could not parse. Bureau of Competition, Agreements Filed with the Federal Trade Commission Under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003: Overview of Agreements Filed in FY 2014: A Report by the Bureau of Competition 1 (2016).

12 Use of the term "payments" here is not limited to cash payments, but rather denotes any form of consideration or value given in exchange for an agreement to delay competition. Most recent agreements eschew straight cash payments and instead include promises not to launch an authorized generic or other non-cash forms. *See* Agreements Filed in FY 2013, *supra* note 11, at 1-2; Michael A. Carrier*, Payment After Actavis,* 100 Iowa L. Rev. 7, 42 (2014). While there has been considerable litigation concerning the application of *Actavis* to non-cash settlement agreements, the two Federal Circuit cases addressing the issue, *In re* Loestrin 24 Fe Antitrust Litig., 2016 WL 698077 (1st Cir. Feb. 22, 2016) and King Drug Co. of Florence, Inc. v. SmithKline Beecham Corp., 791 F.3d 388, 403 (3d Cir. 2015), followed some eight district court decisions in rejecting such a limitation as contrary to the spirit and letter of the *Actavis* decision. *Loestrin*, 2016 WL 698077, at *10.

value than that available from successful competition with the branded drug.[13] Conversely, these agreements enable the branded company to buy a greater degree of market exclusion and monopoly than it could get based upon the strength of its patent alone.

Erosion of the virtual antitrust immunity these agreements enjoyed under the *Tamoxifen* standard was slow, though the standard was arguably at odds with the law in some courts, and denounced by the Federal Trade Commission ("FTC"), Solicitor General, academics, regulators, and even some of the judges that decided *Tamoxifen*.[14] Prior to the Supreme Court's ruling in *F.T.C. v. Actavis*, the federal courts—with the exception of the Third Circuit in *In re K-Dur Antitrust Litigation*[15]—largely continued to embrace the criticized *Tamoxifen* standard.[16]

2. The Supreme Court's Decision in *F.T.C. v. Actavis*

Having rejected certiorari in six previous reverse payment agreement challenges,[17] the United States Supreme Court granted certiorari in the Eleventh Circuit decision in *F.T.C. v. Watson*[18] that had also followed the controversial *Tamoxifen* decision. Two months after the Eleventh Circuit's *Watson* decision, the Third Circuit in *In re K-Dur* rejected *Tamoxifen* as "bad policy" that neglected the broad public interests in freeing competition from price-fixing agreements stemming from narrow or invalid patents.[19] Rather, *K-Dur* concluded that reverse payments should be considered presumptively unlawful as they "permit the sharing of monopoly rents between would-be competitors without any assurance that the underlying patent is valid."[20]

The split was resolved by a five-to-three United States Supreme Court decision in *F.T.C. v. Actavis,* which rejected *Tamoxifen* as an erroneous interpretation of federal antitrust and patent law.[21] The Court found that reverse payment agreements could be anticompetitive and that their presumptive immunity from antitrust under *Tamoxifen*'s "scope of the patent" test could not be justified under either patent or antitrust law.[22]

---

13 *See* F.T.C. v. Actavis, Inc., 133 S. Ct. 2223, 2235 (2013).

14 *See, e.g.,* Ark. Carpenters Health & Welfare Fund v. Bayer AG, 604 F.3d 98, 109-10 (2d Cir. 2010); *In re* K-Dur Antitrust Litig., 686 F. 3d 197, 213 (3d Cir. 2012).

15 686 F. 3d at 197.

16 *See In re* Ciprofloxacin Hydrochloride Antitrust Litig., 544 F.3d 1323 (Fed. Cir. 2008); F.T.C. v. Watson Pharms., Inc., 677 F.3d 1298 (11th Cir. 2012).

17 The United States Supreme Court earlier denied certiorari in the following cases: La. Wholesale Drug Co., Inc. v. Bayer AG, 562 U.S. 1280 (2011); Ark. Carpenters Health & Welfare Fund v. Bayer AG, 557 U.S. 920 (2009); Joblove v. Barr Labs, Inc., 551 U.S. 1144 (2007); F.T.C. v. Schering-Plough Corp., 548 U.S. 919 (2006); Valley Drug Co. v. Geneva Pharms., Inc., 543 U.S. 939 (2004); and Andrx Pharms., Inc. v. Kroger Co., 543 U.S. 939 (2004).

18 F.T.C. v. Watson Pharms., Inc., 133 S. Ct. 787 (2012). Watson Pharmaceuticals, Inc. became Actavis, Inc. *See Actavis*, 133 S. Ct. at 2229.

19 *K-Dur,* 686 F.3d at 216-17.

20 *Id.* at 215-16, 218.

21 *Actavis,* 133 S. Ct. at 2234-35 (noting that payments by patentee in return for staying out of the market simply keeps prices at patentee-set monopoly levels while dividing those monopoly returns with its rivals all at the expense of the consumer); *id.* at 2237 (noting that large unjustified payments can bring the risk of significant anticompetitive effects).

22 *Id.* at 2232-33.

Examining the extent to which patent law protected these agreements, the Supreme Court concluded that patent law provided no support for patentees to pay their drug company rivals to stay out of their markets.[23] Rather, the patentee's statutory rights—"whether expressly or by fair implication"—could not be viewed as extending any right to pay one's rivals not to compete.[24] Both history and experience with these agreements further convinced the *Actavis* Court that paying one's rivals was not necessary to settle pharmaceutical patent litigation.[25]

Similarly, the Court found that the Hatch-Waxman Act did not protect reverse payments; quite to the contrary, it condemned such payments both in its letter and spirit.[26] Finally, the *Actavis* court also declined to justify reverse payment agreements with any pro-settlement policy.[27]

While *Actavis* restored antitrust scrutiny of these agreements, it fell short of adopting the approaches urged by the FTC, the states' attorneys general, and private plaintiffs. They had urged the Court to treat the agreements as per se illegal, presumptively illegal, subject to a quick-look test, or some other variant thereof.[28] However, the Court disagreed, ruling that the agreements were to be evaluated under a rule of reason, using "traditional antitrust factors."[29] But the Court left it to the trial courts to further flesh out that standard, vaguely instructing trial courts that they can:

> [A]void, on the one hand, the use of antitrust theories too abbreviated to permit proper analysis, and, on the other, consideration of every possible fact or theory irrespective of the minimal light it may shed on the basic question—that of the presence of significant unjustified anticompetitive consequences.[30]

---

23 *Id.* at 2231 (reasoning that it would be "incongruous to determine antitrust legality by measuring the settlement's anticompetitive effects solely against patent law"); *id.* at 2230 (finding that even if the agreements' anticompetitive effects are within the scope of the exclusionary potential of the patent, they are not immunized from antitrust attack); *id.* at 2234 ("[P]ayment in effect amounts to a purchase by the patentee of the exclusive right to sell its product . . . .").

24 *Id.* at 2233 (dismissing the dissent because it identifies no patent statute that grants a patentee the right to pay its competitors, whether expressly or by fair implication, and noting that such a right would be irreconcilable with the patent policy of eliminating unwarranted patent grants); *id.* at 2232 (emphasizing that patent related settlement agreements can violate the antitrust laws though the patents were valid because the Sherman Act strictly limits concerted action by patent owners); *id.* at 2231 (noting that the Court must balance whether the patent statute specifically gives a right to restrain competition in the manner challenged against available lesser restraints and the prohibitions against monopolies).

25 *Id.* at 2237.

26 *Id.* at 2234.

27 *Id.* at 2231, 2234.

28 *Id.* at 2237.

29 *Id.* at 2231.

30 *Id.* at 2238.

Predictably, this "instruction" has generated a surfeit of commentary,[31] while courts overseeing the bountiful post-*Actavis* lawsuits struggle to divine the intended boundaries of *Actavis.*[32]

B. *In Re Nexium* Antitrust Litigation

1. The *Nexium* Reverse Payment Agreements

Nexium, a branded drug manufactured by AstraZeneca ("AZ") whose active ingredient is esomeprazole magnesium, is widely used to treat heart burn, and enjoys annual sales of a billion dollars a year. It was launched to replace AZ's earlier heart burn medication, Prilosec (which largely has the same active ingredient as Nexium), as it faced the end of its marketing exclusivity. AZ claimed that Nexium sales were entitled to market exclusivity due to several patents related to a process for manufacturing and method for using Nexium.[33]

However, AZ's Nexium patent claims were considered by some would-be rivals as dubious, and thus were challenged under the controlling Drug Price Competition and Term Restoration Act of 1984 (known as the "Hatch-Waxman Act").[34] Recognizing that questionable patent claims could be used to chill generic competition, Congress adopted the Hatch-Waxman Act for the "express purpose of expediting the entry of non-infringing generic competitors into pharmaceutical drug markets in order to decrease healthcare costs for consumers."[35] The Act incentivizes would-be generics to challenge branded drug patents, and provides them a means to certify around the claimed patents[36] and seek approval of their generic launches from the Food and Drug Administration ("FDA").

In August 2005, generic manufacturer Ranbaxy applied for FDA approval to launch generic Nexium, certifying that the Nexium patents were either invalid as obvious, or were not infringed. AZ's responsive suit against Ranbaxy for infringement of the Nexium patents, under the Hatch Waxman Act, automatically stayed any FDA approval of Ranbaxy's

---

31 See, for example, the Fall 2013 issue of Antitrust Magazine, which is dedicated to this commentary and contains some nine articles on the topic. *See also* Carrier, *supra* note 12, at 10 (citing numerous articles on the topic); Allison A. Schmitt, *Competition Ahead? The Legal Landscape for Reverse Payment Agreements After* Federal Trade Commission v. Actavis Inc., 29 Berkeley Tech. L.J. 493 (2014); Seth Silber, Jonathan Lutinski & Ryan Maddock, "*Good Luck" Post-*Actavis*: Current State of Play on "Pay-for-Delay" Settlements,* Competition Pol'y Int'l Antitrust Chron. (Nov. 2014). Some of those same issues were parsed out by the California Supreme Court, which addressed the standard of review and burden of proof in challenges to reverse payment agreements under California state antitrust law in *In re* Cipro Cases I & II, 61 Cal. 4th 116 (2015).

32 *See, e.g.,* Brief of F.T.C. as Amicus Curiae in Support of No Party, *In re* Wellbutrin XL Antitrust Litig., No. 15-3559 (3rd Cir. Mar. 11, 2016) (arguing that *Actavis* applies to any reverse payments even if the underlying patent litigation continues, that proof of actual delayed entry is not required, and that defendants must prove any pro-competitive benefits); Silber, *supra* note 31 (citing numerous cases on the topic).

33 *In re* Nexium Antitrust Litig., 777 F.3d 9, 12 (1st Cir. 2015).

34 Pub. L. No. 98-417, 98 Stat. 1585 (codified at 21 U.S.C. § 355 (1984)).

35 HR Rep. No. 98-857, pt 2, at 4 (1984); *see also In re* Nexium (Esomeprazole) Antitrust Litig., 968 F. Supp. 2d 367, 378 (D. Mass. 2013).

36 Under the Hatch-Waxman Act, an applicant may certify (1) that the associated branded drug is not patented, (2) that the patent for the branded drug is expired, (3) that the generic will not be marketed until the patent covering the branded drug has expired, or (4) that the applicant believes the patent covering the branded drug is either not valid or not infringed. *See* 21 U.S.C. § 355(b)(2)(A).

application for thirty months without regard to the merits of the litigation. Subsequently, Teva and DRL, two other generic companies, also sought FDA approval to launch generic Nexium and were sued by AZ.[37]

In April 2008 as the thirty-month stay was about to expire, AZ settled with Ranbaxy, the first sued and the first-to-file, with Ranbaxy agreeing to delay a generic version of Nexium until May 27, 2014[38] and drop its challenge to the patents. In exchange, Ranbaxy received from AZ an agreement not to launch an authorized generic as well as "lucrative manufacturing and distribution agreements and prospective future revenue under an exclusive marketing agreement."[39]

Because the AZ/Ranbaxy agreement precluded any FDA approvals before the agreed May 27, 2014 date, Teva and DRL sought to uncork this "bottleneck" with their own actions against AZ. However, they, too, settled with AZ by agreeing to delay generic competition until May 27, 2014 unless another generic legally entered the market earlier.[40] In exchange, Teva received AZ's agreement to drop damage claims for Teva's at-risk launch of Prilosec, and DRL received a release of damage claims for its generic sales of another drug, Accolate.[41]

Following these agreements, direct and indirect purchasers of Nexium filed numerous class actions under federal and state laws, challenging the agreements as unlawful restraints on competition for generic Nexium. The Nexium patents were alleged to be invalid, as the European and Canadian patent offices had already held.[42] The plaintiffs further contended that in light of the dubious scope of the patents, the size and amount of consideration flowing to the settling generics, and the fact that the generics provided only an agreement not to compete, the agreements were unlawful agreements not to compete.[43] But for these agreements, the plaintiffs alleged generic Nexium would have been available by April 2008, and thus would have ended Nexium's monopoly pricing of Nexium from April 2008 through at least May 27, 2014.[44]

2. Pretrial, the "Rip-Roaring Six-Week Trial," the Jury Verdict, and the Appeal in *Nexium*

While the *Nexium* case was the first post-*Actavis* case to be tried, the protracted pretrial proceedings consumed several years, and followed what the trial judge, District Court Judge Young in Boston, confessed was his imperfect and changing understanding of the contours of both the case and the dictates of *Actavis.*[45] Along the way, the court dismissed all the

---

37 *In re* Nexium (Esomeprazole) Antitrust Litigation, 42 F. Supp. 3d 231, 247, 249 (D. Mass. 2014).

38 *Id.* at 247.

39 *Id.*

40 *Id.* at 249, 256.

41 *Id.* at 247.

42 *In re* Nexium Antitrust Litig., 777 F.3d 9, 13 (1st Cir. 2015).

43 *Id.* at 14.

44 *Id.* at 13-14.

45 *Id.* at 14; *see also In re* Nexium (Esomeprazole) Antitrust Litig., 309 F.R.D. 107, 114-24 (D. Mass. 2015).

plaintiffs' claims on twelve summary judgments, and then reversed two grants of judgment.[46] The judge limited the parties to a single theory of liability after concluding that the Ranbaxy agreement could not be a source of competitive injury.[47] He also issued a series of rulings limiting the introduction of various expert testimony and FTC studies and bifurcating the trial with the first phase to be the existence of an antitrust violation and the period of delay to commence on October 20, 2014.[48]

The first phase trial focused on the Teva agreement and the conspiracy claim. On the seventeenth day of the trial, the court confessed it had a "fairly fundamental misconception" and now understood that the Ranbaxy agreement could create a blocking position and create delay.[49] This, the judge further confessed, was his "sockdolager" and he "promptly corrected course," allowing the plaintiffs to proceed on their theory that the Ranbaxy agreement was anticompetitive.[50] The defendants, faced in mid-trial with new theories to defend, moved for a mistrial but were rebuffed by the court.[51] According to the judge: "Thereafter, the case went swimmingly (in the sense that I understood what the lawyers were doing and why)."[52]

The trial concluded on December 2, 2014 with the jury returning its findings that (1) AZ exercised market power within the relevant market, (2) the settlement of the AZ-Ranbaxy patent litigation included a large and unjustified payment by AZ to Ranbaxy, and (3) AZ's Nexium settlement with Ranbaxy was unreasonably anticompetitive, i.e. the anticompetitive effects of that settlement outweighed any procompetitive justifications.[53] Despite being convinced that the anticompetitive effects of the AZ-Ranbaxy agreement outweighed any procompetitive benefits, the jury answered "no" to Jury Question Number Four, which read, "Had it not been for the unreasonably anticompetitive settlement, would AstraZeneca have agreed with Ranbaxy that Ranbaxy might launch a generic version of Nexium before May 27, 2014?"[54] By answering "no" to that question, the jury could not conclude that Ranbaxy would have agreed to a new earlier date of entry, and while there may have been the "intent to violate the antitrust laws" the jury could not establish that the agreement caused delay and overcharges.[55]

The direct purchasers and the end-payors timely moved for a new trial, which was denied on August 7, 2015 in a lengthy memorandum opinion opening with the court's

---

46 *Nexium,* 42 F. Supp. 3d at 243-44 (D. Mass. 2014).

47 *Nexium,* 309 F.R.D. at 117-18.

48 The protracted pretrial history of the case is set out in the court's lengthy decision denying a motion for a new trial, s*ee id.* at 114-18, as well as the plaintiffs opening brief on appeal, *see* Consolidated Brief of Direct Purchaser and End-Payor Class Plaintiffs-Appellants at 51-54, *In re* Nexium (Esomeprazole) Antitrust Litig., No. 15-2005 (1st Cir. Feb. 5, 2016).

49 Consolidated Brief of Direct Purchaser and End-Payor Class Plaintiffs-Appellants, *supra* note 48, at 57 (internal quotation marks omitted) (footnote omitted).

50 *Nexium,* 309 F.R.D. at 119-20.

51 *Id.* at 120 (the defendants "howled" but the court denied the motions for mistrial).

52 *Id.*

53 *Id.* at 124-25.

54 *Id.* at 125.

55 *Id.*

telling summation: "I did not try the case very well. I did try it fairly."[56] Following entry of final judgment for the defendants, the plaintiffs filed an appeal with the First Circuit, which appeal is currently being briefed by the parties.[57]

II. PANEL INTRODUCTION

On this panel, we are honored to have the lead trial team from the six-week Nexium trial in Massachusetts. Nexium, the purple pill used by Larry the Cable Guy and millions of other Americans suffering heartburn, has annual United States sales of almost a billion dollars.

Some ten years ago, several drug companies sought to sell generic versions of Nexium and were sued by Nexium's manufacturer, AstraZeneca for patent infringement. The patent suits were settled with the parties agreeing that they would not compete for any Nexium sales before May 2014, and Ranbaxy, the first-filing generic company, was alleged by plaintiffs to have received valuable side agreements and promises.

These agreements are fairly typical of the hundreds of reverse payment agreements executed over the last few years. In 2013, the United States Supreme Court in the landmark ruling in *F.T.C. v. Actavis* held that these agreements could be anticompetitive, and were to be evaluated under a rule of reason. Beyond that, as you will see, there is little agreement between the litigants as to what the Supreme Court meant or said in *Actavis.*

In *Nexium*, add to this a judge trying to figure out the issues at the intersection of antitrust, patent, and the Hatch-Waxman regimes, in the first case to go to trial post-*Actavis.* Not until the parties were seventeen days into the trial, did the judge, by his own account, have his "sockdolager," or "aha moment," as to what the case involved, and changed his directions to counsel. A mistrial motion was denied and the case continued for several more weeks. The jury found that there was a "large and unjustified payment" by AstraZeneca to Ranbaxy that was "unreasonably anticompetitive," but that there was no harm caused by the agreement. The matter is on appeal, and the appeal is off-limits for this discussion.

Now let me introduce our illustrious trial panel.

- Representing the direct purchasing class action plaintiffs is **Kristen Johnson,** a partner at Hagens, Berman, Sobol and Shapiro; she was a key member of the plaintiff's *Nexium* trial team as well as the *Neurontin* trial team that secured a $142 million judgment against Pfizer for off-label marketing. She is also the lead on numerous other key pharma class actions.
- Also for plaintiffs is **Steve Shadowen**, founding partner of Hilliard and Shadowen; he has secured some of the key pay-for-delay rulings, including those in *K-Dur* and *Cardizem*. He has tried too many significant antitrust cases to list, and received the American Antitrust Institute award for "Outstanding Antitrust Litigation Achievement in Private Practice."
- Representing AstraZeneca is **John Schmidtlein**, co-Chair of Williams and Connolly's Antitrust Practice; he has been lead trial counsel in numerous class action suits, and represented Google, Archer Daniels Midland, and many pharma

56 *Id*. at 110.

57 *In re* Nexium (Esomeprazole) Antitrust Litig., No 15-2006 (3d Cir. Sept. 11, 2015).

and pharmacy benefit managers in high profile government investigations, and also represented the states against Microsoft.

- Representing Ranbaxy, the generic, is **Doug Baldridge**, Chair of Venable's litigation group; he has tried numerous complex antitrust and other cases to verdict, and while he loves a good trial, he is also devoted to social justice cases, including a suit for blind voters in Florida. In February, he will be trying *Provigil*, the second post-*Actavis* case to go to trial.[58]

III. DISCUSSION

Moderator: *First, we will ask each side to take three minutes to briefly discuss its strategy or the major themes it sought to establish at trial, starting with the plaintiffs.*

Shadowen: It took me seventeen days to explain all this to Judge Young, so I will try to do it for you in a little less than that. The major themes for the plaintiffs were this:

- That AstraZeneca's patents on Nexium were weak. We never intended to prove that they were invalid or not infringed; rather that the patents were weak and subject to a significant challenge.
- Secondly, in light of the weakness of the patents, that AstraZeneca had a risk of losing the patent litigation, and, therefore, having generic competition to Nexium launched.
- Thirdly, to avoid that risk of competition, that AstraZeneca made a payoff to Ranbaxy and others to withdraw their challenges to the patent and to delay entry into the market.
- So far, we have weak patents, a risk of loss of the litigation and competition, and a payoff to avoid that risk.
- Lastly, absent the payoff, that, in fact, there would have been generic entry into the market sooner than was.

Key for us was not to take on more of a burden than we thought that we legitimately had under the law. We didn't want to prove that the patents were invalid or not infringed, just that they were weak. We didn't want to have to prove that because we didn't think we had to prove it under the law. We did not need to show that absent the payment, that the generics would have won the litigation, just that there was a risk of AstraZeneca losing. So part of the delicate balancing act for the plaintiffs was not taking on more of a burden than we thought we legitimately had under the law. I think overall we were fairly successful on that. Obviously, in terms of the jury's verdict, which was on special interrogatories, we lost on a causation question.

The plaintiffs believe those causation issues are the result of errors made by Judge Young at trial, that are now the subject of appeal, so we are not going to talk about those today. But that's sort of in a nutshell, the big picture, from where we saw the case.

Moderator*: Now, the defense high level strategy.*

Schmidtlein: I am going to address a number of the issues from the defense perspective.

---

58 The *Provigil* trial was subsequently stayed by order of the appellate court.

Just to be clear here, everything I am saying here it can be found by searching through the openings, closings, and some of the other transcripts from the trial. We obviously had a very different view of the patents from that of the plaintiffs, and we will talk a little bit about that later in the panel.

In this case what you had was a license entry date that was tied to the expiration of the key compound patents for AstraZeneca. Our position was that those patents were very, very strong. There were other patents we also thought were strong that went out further than the license entry date. But one of the key issues for AstraZeneca was demonstrating that, absent a settlement agreement here, we weren't going to give an earlier entry date. And the evidence in the case and the settlement discussions that took place were consistent with that. So one of our key issues and themes was that we had very strong patents. We were going to win the patent case at least as to those patents, if not other patents, that would go and keep the generics out longer.

So, therefore, the settlement agreement provided for early entry, in our view. In other words, there were patents covering Nexium that extended much longer than the license entry date. And we think that bolstered both an antitrust competition angle and also a causation angle.

There also was in this case an extraordinary amount of evidence regarding causation in the FDA approval context. This case was fraught with, as Doug can attest to, this case had some very, very difficult causation issues for the plaintiffs. By the time this case had come to trial, the license entry date had already come and gone through the settlements. The license entry date was May of 2014. We tried this case from October until December of 2014. And at the time of the trial, none of the generics who had settled had obtained final FDA approval. Indeed, the key generic, the only generic that the judge was focused on in terms of would they have gotten to market, had not even obtained tentative approval as of the date of the trial. So this was a very, very significant causation issue that the defense pressed very hard on at trial.

There was another sort of tricky issue for purposes of this case. Because the judge found that Ranbaxy, the first filer, could never have come to market, the plaintiffs were pursuing a theory whereby they had to demonstrate that somehow Ranbaxy would have waived their first filer exclusivity to Teva, the second generic who had settled. We also believed we had very, very strong arguments that there was no evidence of that, that they could not demonstrate not only that they had to get approval, but that somehow Ranbaxy would have gotten out of the way and allowed Teva to come to the market earlier than them.

Baldridge: Briefly, Cheryl noted, there was the—I can't pronounce the word (sockdolager)—the moment of truth in the seventeen days of trial. So our feeling during the first seventeen days of trial is, "Why the hell are we here?" We did the Admiral Stockdale-Ross Perot, "We can't figure out why we're here." And Judge Young says, "You are here seventeen days in the trial because I have now decided your agreement with AstraZeneca is the focus." So we had to shift on the fly, and we really went full-in causation. And I don't need to repeat what John said, but there are enormous issues with plaintiff's case on causation, with FDA approval and Ranbaxy's ability to launch. The but-for fantasy world set up by the plaintiffs simply had no factual support for it. It was, in my view, a fantasy.

Moderator*: We will get to that later when we talk about causation. I think at this point, we are now going to proceed to a kind of a "mini trial" on one of the key liability issues in this case, and that is—was there a "large and unjustified" payment from AstraZeneca to Ranbaxy in exchange for their agreement to delay competition? We are giving each side nine minutes to give you their best evidence and arguments to show you the enormous complexity of this key issue.*

Shadowen: So, as you all know, one of the problems with a highly complex antitrust trial or commercial litigation of any kind, is how do you take all this complexity and boil it down, and teach it to a jury of eight people pulled off the streets of Boston? I am going to show you at least how we tried to do it in this trial.

We wanted to show that an agreement is anticompetitive under the antitrust laws if it results in less competition that would have resulted absent the agreement. To understand why the plaintiffs are here telling you that there's an antitrust violation, you need to understand four concepts, and here they are: Reduced competition, the expected outcome of patent litigation, pay-for-delay, and a large payment. I am going to walk you through very quickly each of those four key concepts.

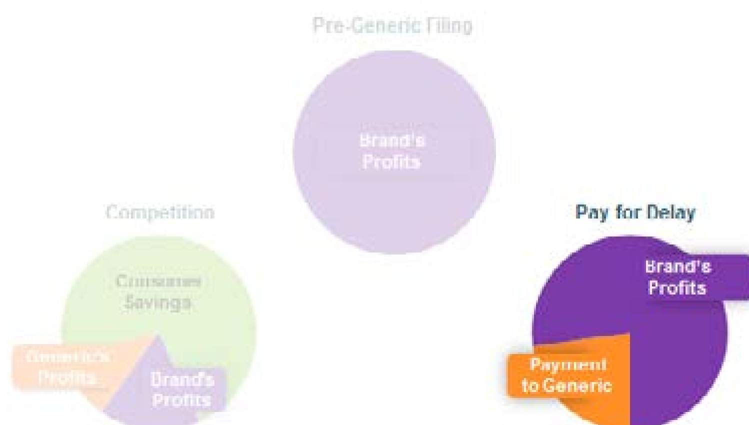
Four Key Concepts

1. **Reduced Competition**
2. **"Expected" Outcome**
3. **Pay for Delay**
4. **Large Payment**

Let's start with reduced competition. When AstraZeneca is the only manufacturer of this product on the market, it has one-hundred percent of all the profits flowing from the sales of Nexium. Last thing in the world it wants is a generic manufacturer to come into the market, because when a generic comes into the market, this is what happens: All those brand profits from Nexium sales decrease to about a quarter of where they were before, because some people will still buy the brand product even when the generic is available. The generics come into the market and they take a little bit of the profits, but not a lot of the profits. This is because there's not just one generic on the market after a period of time, there are three or four, and they compete like cats and dogs. And with this generic competition, the price goes way down, as we all know, that's what causes generic prices to be so affordable for all of us.

What happened to the rest of those profits that AstraZeneca had when it was the only player in the market?

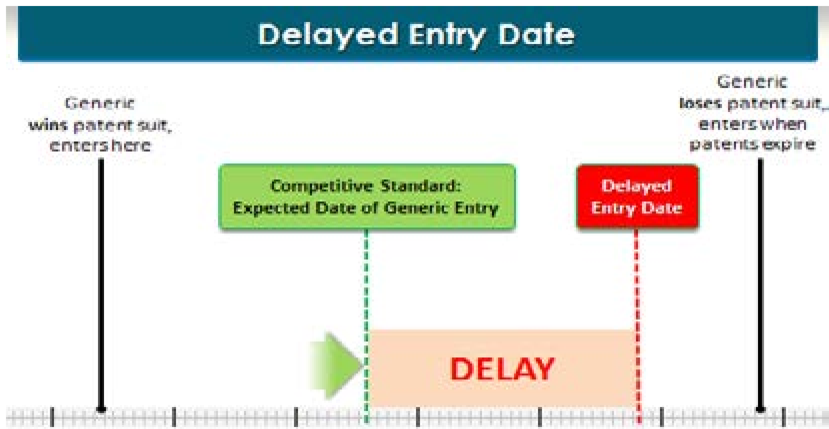
Incentives to Pay for Delay



They are here in the green—in the form of savings to consumers. The consumers, you and I, get all those savings that used to go into AstraZeneca's pockets. Now, when you look at this chart, if you were a generic manufacturer or a brand manufacturer, a light might come on in your head and say, "Gee, we are competing with each other, and there are all these profits that were available before that are going to consumers. Here's an idea—why don't we cut out the consumers and split those consumer profits between ourselves?"

And that's the point of the pay-for-delay payment. The brand manufacturer says to the generic, "Let's not compete with one another. I will pay you some of my profits directly. We'll share the part that would have gone to consumers and share it between ourselves." And that's, in essence, reduced competition, the elimination of competition in order for the brand and the generic to share those consumer savings that should have gone to you and me, to share them between ourselves.

But, you may say, "Wasn't there patent litigation and what happened if the generic had lost the patent litigation? There wouldn't be any competition then. There's no guarantee that the generic would have won the underlying patent litigation." That's where the economic concept of expected outcome of litigation comes into play.



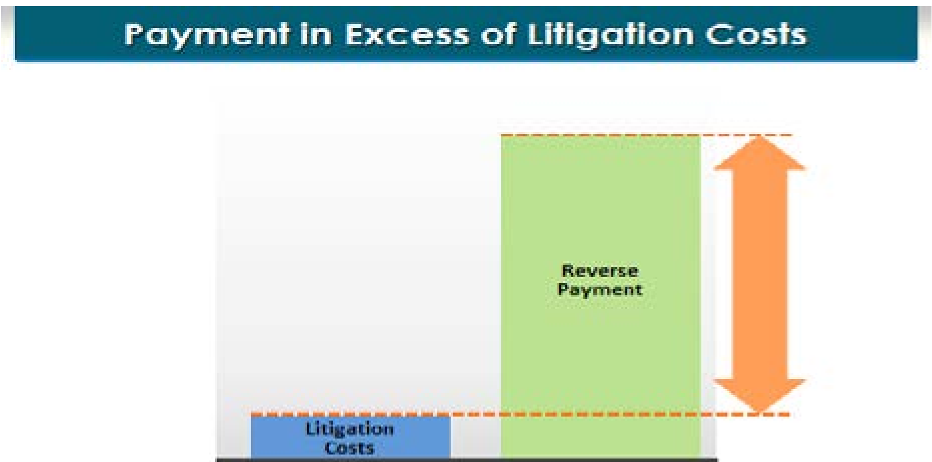
What's the expected outcome? It is the probability-adjusted outcome—what's the chances that that would happen. This is a timeline with the beginning of the patent litigation here on the left, going over to the end of the patent term on the right. Without a payment, here's what would happen in the litigation, one of two things: either the generic would win the patent litigation and enter the market way over here on the left, or the generic would lose the patent litigation and generic entry wouldn't occur until the end of the patent term, way over here on the right. But economists have a concept that says "What's the expected date of entry?" The expected date of entry is the probability-adjusted entry. One way to think of it is: without any payments or payoffs of any kind from the brand manufacturer to the generic manufacturer, what's the date they would have agreed on as a compromise? They are both highly intelligent. They have all the information about the underlying litigation. They know the chances of winning and losing. And the compromise date that they would agree upon is what's called the expected date of generic entry.

Why is the date of expected generic entry important? Because it ties into our concept of paying for delay. Delay compared to what? Delay compared to the date of expected entry. That's what happens here. So let's take ourselves back in time to AstraZeneca and Ranbaxy in a room negotiating without any payments between them. This is hypothetical, they would have agreed on a date that is here marked by our green line. That's without a payment.

But then AstraZeneca says, "Hey, wait a minute. Rather than you entering on that date and making your profits by selling generic Nexium, why don't I give you a payment?" As my co-counsel will explain, this payment was on the order of magnitude of a billion dollars. "I'll pay you a billion dollars, and we'll move that date, the entry date from the date of expected outcome, the date we would have agreed upon without a payment, way over here to the right." And that's the delayed entry date. That's pay-for-delay.

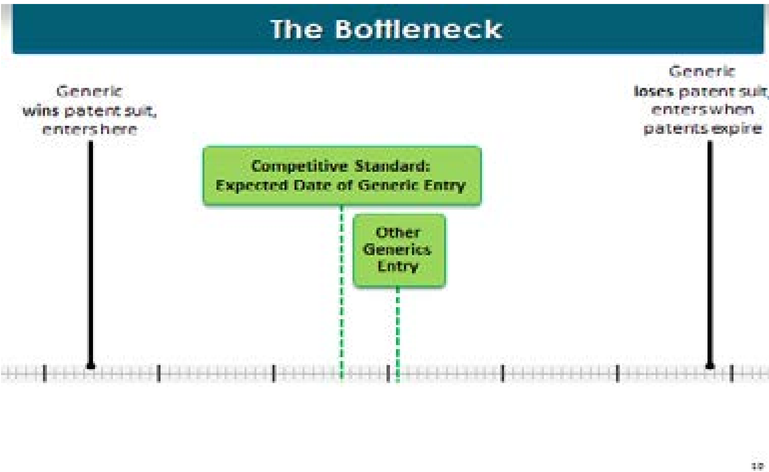
By the way, this same concept works in reverse. If you see that there's an agreed entry date between the brand manufacturer and the generic manufacturer, and you see that there was a payment from the brand manufacturer to the generic manufacturer, you know that the expected date of entry was further over to the left. Otherwise, why is the brand paying the generic? There's no reason to pay the generic unless the brand manufacturer is getting something in return. The something that AstraZeneca got in return was the movement of this entry date from the left-hand side over to the right.

What's a "large" payment? Judge Young is going to instruct you that a large payment is a payment in excess of the saved litigation costs. And we can illustrate that very easily.



The payment here was on the order of magnitude of a billion dollars. The testimony is going to be that the litigation costs that AstraZeneca saved by settling the litigation were on the order of magnitude of $10 to $15 million. So it is very clear that these—the payment here was far in excess of the saved litigation costs.

One final concept I want to go over very quickly, and that's what we call the bottleneck.



Ranbaxy was the first generic manufacturer to challenge these patents. Under the Hatch-Waxman Act, the first manufacturer to file its application with the FDA for approval to sell the generic—which was Ranbaxy in this case—is entitled to one-hundred eighty days of market exclusivity, as the only generic manufacturer on the market. The FDA cannot approve any other generic manufacturer to come into the market until Ranbaxy has been in the market for one-hundred eighty days.

So here's the problem: Here's our competitive entry, in the middle of the time frame, one-hundred eighty days later, we can expect all kinds of other generic manufacturers to enter the market. But when AstraZeneca makes that enormous payment to Ranbaxy to get Ranbaxy to move its entry date over to the right, as a matter of law, by the Hatch-Waxman Act, the others cannot enter for one-hundred eighty days later. So that payoff from AstraZeneca to Ranbaxy had the effect of not only moving Ranbaxy's entry date, but all the other manufacturers to the way end of the right.

K. Johnson: So let's talk about the evidence of the payment from AstraZeneca to Ranbaxy, and let's be concrete about it.

We learned in the summer of 2007 that AstraZeneca and Ranbaxy sat down and had a settlement conference. And what did the parties do afterwards? Ranbaxy goes back to its offices and starts modeling how much additional money it will make if AstraZeneca agrees not to compete with Ranbaxy during its one-hundred eighty day exclusivity period, which AstraZeneca could do by launching an authorized generic ("AG") in that period. And Ranbaxy calculates that it will make an additional $679 million as a result of AstraZeneca's agreement not to compete in that one-hundred eighty day period.

Ranbaxy Internal Document

SOURCE: RAN-ESM0252274

What does AstraZeneca do after this? AstraZeneca goes back to its offices. And its outside lawyer, Mr. Hester, the chairman of Covington & Burling, sends a note to AstraZeneca's inside counsel, Mr. Pott, that says we think we can get a "relatively late entry date" if we agree not to compete with an authorized generic. A "relatively late entry date."[59]

Nexium Settlement Considerations

1. Ranbaxy has recently settled a number of Hatch-Waxman cases and appears to be interested in settling rather than litigating such cases.

2. Ranbaxy likely will want a settlement that preserves its 180-day period of exclusivity against other generics and also guarantees that exclusivity against authorized generic competition, and it may be willing to agree to a relatively late entry date in a settlement that provides it with sole exclusivity. While yielding a right to license authorized generics may limit AZ's ability to settle with other ANDA applicants, the benefits of settlement with Ranbaxy may more than overcome that disadvantage.

So AstraZeneca's lawyers now tell you, the jury, because you are the jury today, this is an "early entry date," before the expiration of all the patents. But have they shown you one document or elicited testimony that says it was an early entry date? We don't have that. We have one contemporaneous document that says, this is a "relatively late entry date."

So why is this a large and unjustified payment? First, it is large because it gave $679 million in value to Ranbaxy; Ranbaxy's internal employee calculated it was worth at least $300 million. We know it was going to cost AstraZeneca, in terms of lost sales, about $500 million. And we also know, that this amount is significantly higher than the $10 to $15 million in attorneys' costs that AstraZeneca estimated it was saving by settling this litigation.

59 The graphic below is shown with emphasis added.

Finally, there were three different deals in addition to the no-AG promise that provided value to Ranbaxy.

AstraZeneca-Ranbaxy Agreement

Ranbaxy

- ✓ No-AG commitment $697 million
- ✓ Deal to make Nexium API
- ✓ Deal to make Nexium product
- ✓ Two distribution deals at 2X profit
- ✓ Coordinated entry

AstraZeneca

- ✓ Years of first filer delay
- ✓ Bottleneck for other generics
- ✓ Over $8.8 billion net sales
- ✓ Coordinated entry

Ranbaxy went from being a would-be competitor of AstraZeneca to being a partner with AstraZeneca in making Nexium. Ranbaxy was paid money to manufacture Nexium active pharmaceutical ingredient ("API") as well as to literally make Nexium capsules for AstraZeneca themselves. Secondly, Ranbaxy was paid by AstraZeneca to sell Prilosec and Plendil. And we know Ranbaxy internally thought they got a good deal there, because rather than providing the ten percent profit—which is the industry average—Ranbaxy got a twenty percent profit on the API agreement with AstraZeneca. So they got twice the profits out of that deal alone.

So between these side deals and the promise of no authorized generic competition, this was a massively organized and negotiated settlement that was intended to take value from AstraZeneca and move it to Ranbaxy in order to push generic entry off by many years, just what Judge Young told you the law prohibits.

Moderator*: And now we will hear the defense perspective on whether the agreements included a "large and unjustified" payment.*

Schmidtlein: Everything they said is wrong. I am going to talk about the alleged large and unjustified payment. I am not going to address everything that Steve said, but I am going to talk about the payment. So the alleged payment was three things supposedly, and Kristen was talking about those: The authorized generic distribution agreement, an API and tolling agreement, and what we refer to as the exclusive license, or what the plaintiffs refer to as the no-authorized generic agreement.

Now, with respect to the authorized generic distribution agreement, this is an agreement. It is not unusual. In some instances you'll have a situation where a branded company will license a generic to distribute its own branded capsules as a generic. The deal here was an eighty-twenty profit split, AstraZeneca kept eighty percent, and Ranbaxy got twenty percent. The testimony at trial was that Ranbaxy had done agreements that went from fifty-fifty up to ninety-ten. AstraZeneca had done agreements that range from ninety-ten to sixty-forty. There was no expert testimony. Nobody was brought in on the plaintiff's side to say, "I have studied this industry, I have concluded that eighty-twenty is an unreasonable, non-fair-market-value deal," and I emphasize the words "fair value." You probably remember those words from the *Actavis* decision, because if deals were of fair value, it is not a payment. So from our perspective, there was no way this authorized generic distribution agreement was going to ever be a large payment.

Second, as to the API supply and tolling agreements that were introduced at trial, it was the same story. There was no expert testimony from the plaintiffs, nobody stood up and said, "The price that AstraZeneca paid to Ranbaxy for either the API or for the finished capsules was not a market price." You remember the allegations in *Actavis* were that the marketing deals were sort of bogus deals, that in that case, the brand company was paying exorbitant fees and getting very, very little in the way of actual services from the generic company. No testimony to that effect in this case. The testimony was the deals were negotiated at arm's length. They were negotiated over a long period of time between the business executives who were experts in these areas. They went back and forth, back and forth. They settled on a price that was either at or lower than the price that AstraZeneca was currently paying and consistent with an outsourcing strategy that AstraZeneca had employed.

So, again, were these agreements for fair value? We obviously said absolutely they were for fair value and, therefore, they should be immune from attack under *Actavis.*

As to the exclusive license or no-AG agreement. Kristen made note of the fact of some internal Ranbaxy documents that purported to estimate what the value to Ranbaxy would have been. I would submit to you that under *Actavis*, you have to look at this not from the perspective of the generic, but from the perspective of the branded company. Because the whole point of *Actavis* was: Can you glean something from this payment to tell you something about the strength or weaknesses of the patents? What did the brand think about the strength or weakness of the patents? The testimony in this case was AstraZeneca had done authorized generic—or done a "no-AG deal"—once in its entire history before this settlement provision. It had been in a slightly different factual situation that made it different. But without getting into those details, it was a disaster for AstraZeneca.

AstraZeneca had entered into a situation where it was just a complete mess, and what happened was the CEO of the company was very, very strongly against authorized generic types of deals. AstraZeneca had introduced its own authorized generics, but the generic companies actually had their products pulled from the market, and so AstraZeneca was actually left with its own generic in the market by itself, taking sales away from the brand. So the CEO is like, "I'm not a big fan of these authorized generic deals."

The other factor was that this type of a product was not a good candidate for an authorized generic during the exclusive license which was for one-hundred-eighty days. It was only during the one-hundred eighty-day exclusivity period that AstraZeneca agreed to

give the exclusive license. As some of you may remember during the wars on generic drugs, there were actually generic manufacturers who were complaining, threatening litigation and going to Congress and saying, "When these branded companies launch authorized generics during the one-hundred-eighty-day period, that's dirty pool. That's undermining the Hatch-Waxman Act. We are supposed to get the one-hundred-eighty days of generic sales. What are these branded companies doing, launching authorized generics?"

They went to Capitol Hill, the FTC, they complained to everybody.

The testimony we submitted in the case was that AstraZeneca wasn't going to launch an authorized generic during the six-month period that would increase the erosion of the sales of the brand. While that would have made AstraZeneca a little bit of money, it would have caused AstraZeneca to lose a lot more money in its branded sales. So in the end this "no-AG deal" was worth zero or next to zero to AstraZeneca, and when combined with the fact that they were going to insist upon an entry date of 2014 with the patents, it really had no impact. And Steve's argument that in the absence of this, AstraZeneca would have moved that license date back earlier, wasn't going to happen.

Baldridge: I have the unenviable task of trying to cram a closing after eight weeks of trial into, what, three minutes? Here we go, here's an attempt to truncate.

Ladies and gentlemen of the jury, we thank you for your patience. We thank you for your patience because we have wasted a large part of your last forty days in this trial. This isn't about cross-elasticity of demand, not about probability-adjusted outcomes, and it is not about imaginary predictions of what might have happened in a fantasy world where there was no agreement. Because in this case, the real world answers every question you need to answer to decide this case.

The question, as counsel has already posed to you, is whether AstraZeneca made a large and unjustified payment to my client, Ranbaxy, that caused a delay in Ranbaxy entering the market with a generic alternative for Nexium. And the answer is clearly no. How do we get to that answer? Well, for those of you who perhaps did time in the United States Marine Corps, you may know the concept of absolute truths. Absolute truths is the clarity provided in chaos, the simple answers that no one disagrees with and concepts that allow you to reach the answer to a more complicated question. And there are five absolute truths in this case that no one disputes and no one will dispute.

The first one is the truth about AstraZeneca's patent monopoly. It is an undisputable truth that AstraZeneca's valid and enforceable patent did not expire until 2019. It is a perfectly legal right provided by the United States Constitution and the patent laws to exclude all competition. That's the real world, not the fantasy world. That was AstraZeneca's right.

The second absolute truth is the truth about the AstraZeneca-Ranbaxy settlement. That settlement agreement allowed Ranbaxy to enter the market with a generic alternative on May 27, 2014. You don't need an economist to do the math and tell you that is five years before expiration of the AstraZeneca patent, which makes me wonder why the plaintiffs' lawyers call this pay-for-delay. There was no delay. It was early entry. That's the real world.

Absolute Truth Number Three, the truth about FDA approval. Without final approval from the FDA, every witness has testified that no generic can enter the market. There

are thirteen different generic companies that filed to enter the market for Nexium. As of today, none has approval. So as a matter of law, there's no one who can enter the market with a Nexium alternative. Today, incidentally, the day of this trial, is five months after the early entry date under the AstraZeneca-Ranbaxy settlement agreement, and there still is no generic alternative.

Absolute Truth Number Four, Hatch-Waxman Act: The bottleneck was given to generics by being the first filers by Congress. That bottleneck status has taken on a bad term with plaintiffs' lawyers, but, in fact, it was something that is a perfectly legal right created by Congress that is given to the first filer under Hatch-Waxman.

Absolute Truth Number Five, instructed by Judge Young, there was no chance Ranbaxy could enter the market with a generic alternative.

Where does this get us with the existence of a "large and unexplained" payment? Well, you take these five undisputed truths, these absolute truths, and you apply them to the facts of what is a large and unexplained payment.

The first alternative, as counsel has referenced, is the so-called "no-AG" provision. Well, that's an exclusive license. If Ranbaxy is afforded rights but then can face competition directly from the brand in the form of an AG, that would not be an exclusive license. Exclusive licenses are granted every single day by patent holders, and you will be instructed that an exclusive license, if that's what you find this is, is perfectly legal, and fully explained this settlement. The second payment would be the so-called side agreements. Well, as counsel has pointed out, there's not a shred of evidence that Ranbaxy did not do exactly what it was required to do under its agreements in the form of providing API, in the form of distributing the product and that they were paid fair value for those services. There is no evidence to the contrary, and you have been instructed by Judge Young that that's the case, you must find for defendants.

***Moderator**: Great. As you see, the issues in these cases are quite complex and these deals are usually structured or negotiated by attorneys. As a result, the deal documents often present a lot of thorny attorney-client privilege issues. You heard Kristen refer to some of the communications to counsel that proved pivotal to the judge's understanding of the case. So I'd like the plaintiffs to explain their strategy about getting the privileged documents into this case.*

K. Johnson: So I am just going to tell you what happened in this case, because I think that's fascinating and a lesson in itself. In early discovery in the case, plaintiffs asked defendants individually whether they intended to assert an advice of counsel defense. We were told by each no, they were not going to.

We then asked for documents in discovery, we asked questions about their affirmative defenses, and defendants indicated that they intended to assert defenses of reasonableness, of legitimate business justifications, and I am trying to remember the phrasing, but something about merits-based settlement considerations. At the same time, during depositions and in response to discovery requests, defendants lodged attorney-client objections to many requests for evidence relating to their affirmative defenses. As an example, six of the defendants' deposition witnesses were actually attorneys who had negotiated or worked on the deals, and they were all instructed not to answer questions involving discussions with or communications to clients about the settlement, and that held for the lead settlement negotiators as well.

So pretrial, it became clear from the pretrial memos that the defendants intended to continue asserting a reasonableness and a business justification defense. You wound up with cross-motions in limine with both the defendants and plaintiffs trying to tee up this issue of attorney-client privilege for the court. The plaintiffs took the position that defendants were improperly using privileges as both a sword and shield, because they prevented plaintiffs from discovering reasons they thought these agreements had legitimate business justifications or satisfied the reasonableness asserted defense, but they continued to maintain those defenses. The defense opposed and asked the court to prevent allowing questions that would draw attorney-client objections. The court did not rule, but he said he was vigorously disposed to prevent the sword/shield issues. But he indicated he would wait and see what actually happened at trial and see how it played out.

At trial, on October 27th and 28th, AstraZeneca's general counsel, Mr. Pott, testified. A few days later, on the 4th of November, the chairman of Covington & Burling, Mr. Hester, testified. On November 5th, based on Mr. Hester and Mr. Pott's testimony, plaintiffs filed an emergency motion. Anything that I am stating here is either straight quotations or paraphrased from pleadings already filed. None of this is new. Plaintiffs took the position that Mr. Hester's testimony about communications with Mr. Pott meant that previously withheld documents should be produced to plaintiffs so we could test the assertions that Mr. Hester had made on the stand. To give a couple examples of questions that defense counsel asked Mr. Hester: "Did you have discussions with Mr. Pott about the Nexium settlement? What did you tell him? Did he provide you any documents?" In that motion, plaintiffs identified twenty-one entries on the privilege log that reflected communications between Mr. Hester and Mr. Pott.

The court ordered the parties to produce those communications in camera. And he reviewed them in chambers and ultimately required AstraZeneca to produce eight documents based on the statements that Mr. Hester and Mr. Pott's testimony had skirted around the edges of those issues. Once those documents were produced, there were some tantalizing documents as slide three of my earlier presentation.

From: Hester, Timothy
Sent: Friday, August 03, 2007 7:06 PM
To: jeffrey.pott@astrazeneca.com
Cc: Bowman, Terri; Heifetz, Marcus
Subject: Settlement Considerations

Privileged & Confidential
Attorney Work Product

Jeff – As we discussed today, here is a rough outline of considerations related to the Nexium settlement issues. This reflects input from Chris Sipes. We'd be happy to kick these points around with you if that would be helpful.

Best regards,

Tim.

Timothy C. Hester
Covington & Burling LLP
202.662.5324
thester@cov.com

It is pretty juicy. In any event, one of those documents ended up being a major part of plaintiffs' closing statements, certainly the statement that a no-AG promise might get AstraZeneca a relatively late entry date we thought pretty juicy. The jury agreed with us. Following the production of that document, we re-called Mr. Pott and asked Mr. Pott questions about it. Just to give you a sense of the timing on that, Mr. Pott took the stand on day twenty-three of trial, which was December 1st, and the jury was charged two days later, on December 3rd.

Moderator*: And now let us learn the defense view on these privilege issues?*

Schmidtlein: The privilege issues in these cases are very, very tricky. You are, not surprisingly, going to oftentimes have either in-house or, in some cases, outside lawyers involved in the negotiations of the settlement agreements. So the negotiations themselves are not privileged.

In this case, the defendants were very, very committed to calling those witnesses and laying bare for the jury the process and what happened during the settlement negotiations. We felt like we were going to put those before the jury. We thought the settlement negotiations, actually, and the settlement conference that the judge in the underlying patent case had with some of these same lawyers, was very, very persuasive evidence in defendants' favor that they were not going to agree and negotiate an earlier settlement date or an earlier license to entry date. So it is impossible not to defend these cases without calling these witnesses. The plaintiffs— candidly, I am not so sure they wanted to hear the answers. They wanted us to invoke privilege in front of the jury. So that's one of the tough issues you confront. You try to get some direction on that early in the trial. I will say this, though: Most of the questions that purportedly led to the documents were actually questions elicited by plaintiffs' counsel.

And I would suggest to you, one of the things that is very, very difficult for any lawyer is case law on what's a privileged communication and what's a waiver and what's the scope of the waiver. Once you start researching those issues, you will find as many outcomes as there are cases. The cases are very, very fact-specific, and you are doing this on the fly at trial, making decisions about: Is the answer to that question going to be privileged or not? If I allow the witness to answer it, am I waiving privilege? What's the scope of that waiver going to be?

It is a very, very tricky thing to do, and you have to be very careful in how you prepare your witnesses.

Moderator*: The Supreme Court in* Actavis *says, "Our Federal patent laws do not give the patent holder the right to pay its competitors not to compete." And* Actavis *also said that "You don't necessarily need to relitigate the patent merits in use cases." What does that mean? Are the patent merits still at issue, and how are they relevant? And aside from the patent merits, what are the procompetitive justifications for these agreements?*

Baldridge: The question you asked actually goes right into the heart of this privilege issue, because it generally—or often—involves in-house counsel assessing the patent merits and inquiry by the lawyers as to whether that assessment of the strength of that patent had some bearing on the decision to settle. From the generic standpoint, and stated very quickly, we took the position that the strength of the patents at issue had absolutely nothing to do with our decision to settle. The unique fact to this case that allowed us to do that, was what

you have already heard, that my client was experiencing some regulatory concerns. The judge had already instructed the jury we could not enter the market. So there were all kinds of reasons why a reasonable businessperson, wholly divorced from any legal analysis, could make a reasonable and justified decision to settle. That was the generic perspective in this trial.

Schmidtlein: On the brand side, again, this goes back to several of the critical elements that the plaintiffs needed to prove in the case, and the jury found against them on causation. In a private plaintiff damage case, to say that the patent merits don't matter makes no sense, notwithstanding whatever Justice Breyer says in *Actavis.* And this is why: You have to show that absent the settlement agreement, there would have been earlier generic entry. How are you going to prove that? You have to show that you would have either won the patent case and gotten to market before the license date. Well, that obviously implicates the patent holders. You have to show that somehow you would have launched at risk after the thirty-month stay expired, and, subsequently, you would have won the patent case. This is because a launch at risk that is later deemed unlawful, you can't get damages for that unlawful entry.

Finally, this goes to Steve's slide, you have to somehow show, absent the settlement agreement, you would have agreed to a different settlement agreement. And that different settlement agreement would have had the brand giving you earlier entry that would have sacrificed a great deal of brand profits. Again, you cannot delve into answering any of those questions while ignoring the merits of the patent case. That was our position.

Moderator*: And now let's hear the plaintiff's perspective?*

K. Johnson: We started out this case expecting we would spend time showing that the patents were weak. Our first witness we called to the stand, which was more for scheduling, more than any other reason, was a former FDA commissioner who explained that the FDA review of Nexium showed that it was not superior to Prilosec, which had direct bearing on the patents that were the subject of the settlement agreement. Testimony was then elicited from AstraZeneca and Ranbaxy witnesses that said the settlement merits played no role in our decision to settle, no role, zero role.

The testimony was that not one of the documents on the privilege log reflected any sort of internal assessment of what the patents actually looked like, the odds of prevailing at trial either from Ranbaxy or AstraZeneca. So faced with that testimony, frankly, it is a head-scratcher, right?

What do you do in a situation where you want to show that the patents are weak in order to show that generic entry by somebody else was possible, but you have actual testimony from the general counsel saying we never once thought about it in the context of actually negotiating the settlement?

Plaintiffs took the position that because the testimony was so emphatic, right, that only shows how the payment infected the settlement process from the very beginning, because from the start you had this no-AG promise embedded in the deal and no one ever talked about the patent merits. So, of course, there was no evidence you could show the jury of what a AstraZeneca and Ranbaxy proposed settlement without a payment would look like. There was no evidence showing what those parties thought the earlier date, without a payment, would be. Because from the very beginning of the negotiation, no one ever thought about the patent merits. It was all about the payoff.

But, as we will get into, the relevant question isn't what AstraZeneca and Ranbaxy actually talked about, it's what reasonable pharmaceutical companies in AstraZeneca and Ranbaxy's respective positions would have agreed to given competitive market conditions, i.e. in the absence of a payment.

***Moderator**: As we indicated earlier, the jury found that the agreements were unreasonably anticompetitive, but found no harm. We talked a lot about the causation element. In wrapping up, we would like each of the parties to take a minute or two to discuss the causation element.*

Baldridge: You have heard it earlier from me, we were focusing on causation in our case. One thing that I thought was critical from a trial standpoint is the plaintiffs did create their but-for world, and they put an expert on the stand. That was unusual, let's just say. That in and of itself isn't that unusual, but at the same time, as Kristen did mention, they had the head of the FDA on the stand. And the head of the FDA on the stand was never asked the question, "Could there have been an earlier approval by the FDA, could there have been an earlier entry date?" Instead, the plaintiffs went with this other expert. From my standpoint, from the causation standpoint, that said it all. You had the head of the FDA and didn't get the answer, but you asked this expert over here, who had significant problems in the cross-examination. From the but-for standpoint, no one could get on with the FDA and why that approval wasn't honed in more directly with someone qualified to answer that question.

Schmidtlein: Just one little tweak on that defense. The jury didn't even reach that question of the sort of "no FDA approval" defense. The jury found for the defendants before they even got to that series of questions. So this was always going to be a major problem. One last point is these cases really do sort of cry out for sort of special verdict forms. I have tried cases where I think antitrust cases oftentimes are good for those, and this was, I think, useful.

***Moderator**: We'd like to hear the plaintiffs' perspective on causation.*

Shadowen: I am going to keep it very general because this is one of the thrusts of the ongoing appeal. Let me talk about these sets of cases generally, rather than this case in particular. As John mentioned, plaintiffs have the burden of saying what would have happened in the but-for world. In the but-for world, you have three avenues to earlier generic entry.

One, you prove the generic would have won the underlying patent litigation. Two, you prove that the generic manufacturer would have waited out the thirty-month stay and launched at risk. And then there's going to be a hell of a legal issue one day whether, if you go that path, you have to prove that the generic would have ultimately won the underlying patent litigation. Because, as John asks, is there antitrust injury if consumers were deprived of an interim set of sales that turned out to be infringing sales? That's going to be an interesting legal issue someday.

Third avenue is to say that, but for the payment, the manufacturers would have agreed to an earlier entry date. And it is on that one, I think that the plaintiffs in the future are going to focus very, very heavily on saying it's not a subjective test—would these manufacturers have agreed to an earlier entry date—but rather, would reasonable manufacturers in that position have agreed to an earlier entry date? Otherwise it is just too easy for John to put his witness on the stand and say, "Oh, no, absolutely not. I made that payment out of the goodness of my heart. Absent that payment, I still would have insisted on exactly the same entry date." So

we are going to be better off in the future, rather than cross-examining heavily, which we'll do, but rather than relying solely on cross-examination of the subjective views and intentions of the defendants' executives, to have economists with very solid studies come in and say, "Reasonable manufacturers in this position would have found it in their mutual economic interests to agree on a payment-free earlier entry date."

K. Johnson: If you think about it in a hypothetical context where a jury finds that there is a "large and unjustified payment" and the jury finds that the anticompetitive consequences outweigh the procompetitive benefits—take that as a starting point. The law then requires that a jury decides what would have happened in the absence of that payment. It has to be done, right. I am not making it up. It is not a fantasy world; it has to be done. You can't say, "It is too hard." You can't get in your Tardis time machine and go see what some other universe looks like. But what you can do is look at the economics, stupid. You look at what would have actually happened with competitive consequences. And that is what Steve is saying. I think you'll see in future trials, you'll see a lot more economic testimony about what logically would have flown from those competitive circumstances.

Schmidtlein: With that, I say unleash the *Daubert* hounds.

***Moderator**: All the economic experts should perk up with that comment. We have only a minute or two; would any of our panel members want to give a Tweet-length tip from the lessons you learned from this trial?*

Baldridge: I'll say the same one I say every time: I am not an antitrust lawyer, although I have tried a bunch of antitrust trials. We all have a tendency to look down on juries, that's a huge mistake. Juries usually get it right. And talking to them like they are something of low ilk or can't understand these issues is a huge mistake. If you don't believe that, don't try cases, sit back and write white papers and send them to the FDA.

K. Johnson: I have one serious and one funny. Serious: if this trial taught me anything, is that you have to adapt at a moment's notice, everything changes so quickly that you have to turn on a penny. Funny: don't wear slingbacks when examining witnesses, because it is very embarrassing later when someone says, "Oh, I remember you. You are the one with the loud shoes."

Schmidtlein: I will agree. You have to expect the unexpected. The judges are doing and will continue to do their very best to try to navigate through all of these very difficult issues. You need to be flexible. The last thing I will say that was sort of taught to me years ago is try to convince, put your trial strategy together to play to things that juries believe. Trial lawyers by definition have enormous egos, and sometimes we think we can convince anybody of anything. And one of the things I try not to forget is that is completely nonsense. People who have a firm understanding or a belief system in certain things, you are not likely going to be able to change their views. You are just not that good, and their understanding of the truth is that firmly held. But what you can do is to try to focus on things and frame issues and put your case on so that it plays to things that people already naturally understand and believe.

Shadowen: I will reiterate what Doug said. This was a very attentive jury. We have complaints, obviously, that the trial judge improperly prevented us from putting compelling facts in front of them and gave them confusing and erroneous instructions, but we will see on round two what happens.

BIG STAKES ANTITRUST TRIALS: *O'BANNON V. NATIONAL COLLEGIATE ATHLETIC ASSOCIATION*

By David W. Kesselman[1]

I. INTRODUCTION

In June 2014, U.S. District Judge Claudia Wilken presided over a three-week bench trial in the high-profile antitrust class action filed by former and present Division I college basketball and football players against the National Collegiate Athletic Association ("NCAA").[2] In this rare rule of reason trial, Judge Wilken was asked to determine whether the NCAA rules that prohibit basketball and football players from receiving compensation for the use of their names, images and likeness ("NIL"), constituted an unreasonable restraint of trade under Section 1 of the Sherman Act.

In a case of first impression, Judge Wilken ruled in late September 2014 that the NCAA's so-called amateurism rules banning compensation beyond the value of a full grant-in-aid scholarship were anticompetitive. Rejecting the NCAA's position that prior Supreme Court precedent should be read to afford it immunity from antitrust scrutiny in this context, Judge Wilken balanced the student-athletes' evidence of anticompetitive effects with the NCAA's proffer of procompetitive justifications, and determined that the NCAA's rules were more restrictive than necessary. In a decision spanning almost 100 pages, Judge Wilken fashioned an injunction requiring the NCAA to refrain from: (1) agreeing to set a cap on payment to student athletes below the cost of attendance; and (2) prohibiting NCAA member schools from depositing a limited share of licensing revenue in trust up to $5,000 per year for each year the student-athlete remained academically eligible to compete.[3] The NCAA appealed Judge Wilken's ruling in full.

On September 30, 2015, the Ninth Circuit Court of Appeal ("Ninth Circuit") issued its ruling, affirming in part and denying in part Judge Wilken's ruling.[4] The Ninth Circuit affirmed that: the NCAA's amateurism rules were not entitled to blanket antitrust immunity, and that the District Court had properly balanced the anticompetitive effects and procompetitive justifications and determined that the NCAA's rules on student aid were overly restrictive and violated the Sherman Act. However, while the Ninth Circuit endorsed that portion of the injunction that limited caps on the cost of attendance, the panel, in a split decision, reversed that portion of the order allowing schools to set aside up to $5,000 per year beyond the cost of attendance.[5]

---

1 David W. Kesselman is a founding partner of Kesselman Brantly Stockinger LLP in Los Angeles, where he specializes in antitrust and unfair competition law. He also serves as an adjunct professor of antitrust law at Loyola Law School. He introduced the panelists for the discussion that took place at the State Bar of California Antitrust, UCL and Privacy Section's 25th Annual Golden State Antitrust and Unfair Competition Law Institute on October 29, 2015. The following excerpts of the panel discussion have been edited for publication.

2 *O'Bannon v. NCAA*, 7 F. Supp. 3d 955 (N.D. Cal. 2014).

3 *Id.*

4 *O'Bannon v. NCAA*, 802 F.3d 1049 (9th Cir. 2015).

5 After the panel discussion, which took place on October 29, 2015, the Ninth Circuit denied the student-athletes' petition for *en banc* review. The plaintiff student-athletes filed a petition for certiorari to the Supreme Court of the United States on March 14, 2016.

We are fortunate to have two outstanding antitrust lawyers who serve as counsel for the parties in this litigation:

- **Michael P. Lehmann** of Hausfeld LLP. Mr. Lehmann is a business litigation partner with particular expertise in antitrust law. He has worked on numerous class action antitrust cases, and he has particular expertise briefing complex legal issues. He is consistently listed as one of the Best Lawyers in America. He is counsel for the plaintiff student-athlete class members in the *O'Bannon v. NCAA litigation*.
- **Gregory L. Curtner** of Schiff Hardin LLP. Mr. Curtner is a partner and practice leader of the firm's antitrust and trade regulation department. He frequently serves as lead counsel in nationwide antitrust disputes and class actions for clients in a wide range of industries. He is consistently listed as one of the Best Lawyers in America. He is counsel for the defendant NCAA in the *O'Bannon v. NCAA* litigation.

Because the litigation remains active, counsel for the parties are constrained in certain aspects of their comments. To that end, the panelists have decided to separately present their views of the case and trial proceedings, rather than participate in a "back and forth" debate on the merits of the District Court's rulings. It was agreed that Mr. Lehmann would provide the background and overview of the lawsuit. Mr. Lehmann would then present the plaintiffs' view of the trial. Mr. Curtner would then follow with his own view on the trial proceedings. The actual transcript has been edited for purposes of this article.

MR. LEHMANN:

The Facts Giving Rise to the Lawsuit

The case originated in 2008 when Ed O'Bannon, who was a power forward at UCLA and one of the greatest players in UCLA basketball history, visited a friend's house. His friend's child showed Mr. O'Bannon his image in a college basketball video game produced by Electronic Arts ("EA"). Mr. O'Bannon was shocked to see that in the video game he was wearing his jersey which had been retired by UCLA, Number 31, and the avatar was his image. He said, "I hadn't authorized that. I am not getting paid for that. That's wrong."

The Early Stages of the Lawsuit

Mr. O'Bannon approached us, and we filed an antitrust suit for him and others similarly situated in July 2009, raising claims under Section 1 of the Sherman Act. His case was preceded by a second case called *Keller v. NCAA*,[6] filed in May 2009. The *Keller* case included allegations of right of publicity violations on behalf of student athletes.

As our case developed, we alleged that the NCAA, through its member schools and conferences, conspired to deny student athletes any payment for what we call their NIL, as those were used in broadcasts, rebroadcasts and video games.

Initially there was widespread pessimism that this was a case that had any legs. The NCAA relied, as it had in the past, on *dicta* from the U.S. Supreme Court decision in *NCAA*

---

6 The formal title of the case is *Keller v. Electronic Arts, et al.*, No. 09-1967, 2010 WL 530108 (N.D. Cal. Feb. 8, 2010).

v. Board of Regents,[7] which in connection with discussing the rule of reason, referenced the connection between product and the prohibition on paying student athletes. Nonetheless, Judge Wilken rejected the NCAA's motions to dismiss over the first two years of the case and again in 2013. Discovery proceeded and the case evolved to include current students as class representatives as well.

We alleged two relevant markets: (1) the college education market in which Division I ("D1") schools competed to recruit men's football and basketball players; and (2) a group licensing market where the players would sell their group licenses to the schools for their NILs, much as athletes do in professional leagues. The District Court found both markets existed, but ruled with respect to the second market that there wasn't enough harm to competition because the student athletes didn't compete with each other across the groups.

Class Certification

In November 2013, Judge Wilken certified a class of all D1 men's basketball and football players whose NILs have been included (or could have been included by virtue of appearing on a roster) in a broadcast or video game. However, she only certified a class for injunctive relief pursuant to Federal Rule of Civil Procedure 23(b)(2). Judge Wilken denied certification of a damages class. She held that there were ascertainability issues. We did not appeal her ruling on damages.

Summary Judgment

Under the Ninth Circuit's standard in rule of reason cases, there is a three-part analysis. First, the plaintiff has the burden of identifying the relevant market and showing that there were anticompetitive effects caused by the alleged restraint in the market. Second, the burden shifts to the defense to show that there were procompetitive justifications for those restraints. Finally, if the defense meets that burden, the burden shifts back to the plaintiff to show that the concerns addressed by those justifications could be satisfied through less restrictive alternatives.

The NCAA largely conceded the anticompetitive restraint, which the court held it would review under the rule of reason. Instead, the NCAA offered a whole slew of procompetitive justifications in its motion for summary judgment, including: (1) protection of "amateurism," (2) safeguarding the education of college athletes, (3) maintaining competitive balance, (4) increasing output of college football and basketball, and (5) the need to maintain viability of other collegiate sports. The court determined that there was sufficient conflicting evidence in the record to support a trial on the first four justifications. However, the court rejected the NCAA's argument on the need to maintain viability of other sports and instead granted Plaintiffs' motion for summary judgment on that issue. The NCAA requested that the District Court certify the summary judgment ruling for interlocutory review under 28 U.S.C. § 1292(b), but the request was denied.

---

7 465 U.S. 85 (1984).

The Trial: Plaintiffs' Perspective

The trial, which commenced in June 2014, was a highly unusual event. There are virtually no antitrust class action cases against the NCAA that have reached trial on the merits. They are typically dealt with on the pleadings or settled. Only two cases in the last 30 years have reached trial–*NCAA v. Board of Regents*[8] and *Law v. NCAA*[9]–but those were very different situations. It was fairly unique in taking to trial a case involving the rule of reason claims presented here.

We decided shortly before the trial to waive a jury. I am not going to get into the details of that, but I think an obvious factor was that this was no longer a class action for damages. The only damages claims left were for the individual named plaintiffs. And you're talking about older players like Bill Russell, Oscar Robertson, or Ed O'Bannon, many of whom were in the sport at the time when there were no lucrative TV contracts. Their damages would be fairly minor. It was also going to be a complex case, unlike say a case involving a cartel with respect to capacitors or resistors. And people have strong attitudes towards paying athletes, and paying student athletes in general, so we would have to divorce those attitudes from the merits in any case in front of the jury. Finally, we thought that Judge Wilken would provide a full and fair hearing; not that she would rule in our favor on everything—which she didn't as reflected in the class certification decision and some of her decisions in trial—but that she would give a thoughtful reading of the evidence. So we decided to move forward with a bench trial in front of her.

The NCAA raised numerous concerns about proceeding to trial. The *Keller* case was due to go to a jury trial in 2016, and the NCAA filed motions seeking to sever the claims on video games for inclusion in the trial with *Keller*. But those efforts failed.

The trial lasted 15 days. Because it was a bench trial there were no opening statements or closing arguments. Instead, Judge Wilken asked legal questions of counsel after the close of evidence. There were 23 witnesses and 287 exhibits used at trial. Three student athletes testified.[10] An EA executive testified about the market for video games. And the parties called five expert witnesses. Judge Wilken ran an extremely tight ship. She was very involved and asked a lot of questions of the witnesses herself. For example, the Judge asked the plaintiffs' expert, Professor Roger Noll, whether the college education market was a monopoly or a monopsony—and that point was addressed in her ruling.

The trial was expert intensive. But Judge Wilken refused to allow videotape testimony. And she limited expert testimony to opinions expressed in previous written initial briefs; the parties could not rely on opinions expressed in reply briefs or deposition testimony. She declined to accept proposed findings of fact and conclusions of law from the parties—she wanted to write those herself. But the Judge did ask that the parties submit stipulated facts prior to the commencement of the trial. That did limit certain issues. For example, the NCAA conceded that its rules prohibited paying student athletes for their performance.

---

8 468 U.S. 85 (1984).

9 134 F.3d 1010 (10th Cir. 1998).

10 The three athletes were Ed O'Bannon, Chase Garnham, who was a linebacker at Vanderbilt, and Tyrone Prothro, who was a wide receiver at the University of Alabama and made probably the most famous catch in the history of the NCAA football program. A month after the catch Mr. Prothro broke his leg in two places and he never played again.

Interestingly, Dr. Dan Rubinfeld, one of the defense expert witnesses, had written a textbook on microeconomics in which he conceded that the NCAA was a cartel, and that it restrained competition in a number of important ways. One of those ways was reducing bargaining power by student athletes by enforcing rules regarding eligibility in terms of compensation. We were able to use the words of their own witness on that point.

In addressing the NCAA's extensive defense of amateurism, we cited to the NCAA's own statements. For example, Myles Brand, the former president of the NCAA, said in a 2006 speech regarding the state of the association that it was necessary for the members to forget the romantic notion of amateurism and respect the fact that the athletic programs of the D1 schools had to be run in accordance with a business model. He said that, "Amateur defines the participants, not the enterprise." We were also able to introduce documents at trial where Mr. Brand raised whether it might not be a bad idea to share some royalties on jerseys and other products that use the amateur athlete's NIL with the student. We were also able to point to the statements of David Berst, vice president of the NCAA, who said in 2008 that the notion of amateurism was not steeped in some revered tradition and it had changed over time. Similarly, a 2010 memo written by an advisor to the NCAA president had noted that college sports were as thoroughly commercialized as professional sports, and all the money that is obtained is done at the expense of the student athletes, whose participation is exploited to make another buck for a bigger stadium, the coaches, or the administrators. He called this the great hypocrisy of intercollegiate athletics.

The NCAA presented survey evidence that if student athletes were paid it would impact consumer demand. We put on an expert witness who testified that the survey was entirely flawed, asked the wrong questions, and didn't deal with the issue of compensation for use of NIL, especially on a deferred basis.

The Liability Ruling

In the end, Judge Wilken found that the NCAA's restrictions did not promote competitive balance. She based this upon internal NCAA memos that contradicted their defense, and noted that schools were spending money on other recruiting incentives, including coaches (Nick Saban received an annual salary of $7 million at Alabama) and opulent training facilities. And while there was some suggestion that certain colleges might drop out of fielding D1 football or basketball teams if the rules were set aside, the NCAA's own witnesses said that was not likely to happen.

The Remedy

It was interesting how the remedy developed. We had initially proposed a form of injunction prohibiting the NCAA members from agreeing to any rule not to pay class members. We didn't put a number on it. We said the market would decide that. But the court wanted more alternatives, so on June 27, near the end of the trial, we proposed (1) a payment of an undefined amount to an escrow account that the athlete could access after graduation, and (2) payments that they could obtain up to the full amount of attendance. Those were the two options that Judge Wilken adopted, with modifications.

As discussed earlier, the Judge allowed, as one less restrictive alternative, the payment of up to a full cost of attendance for each year of attendance by student athletes. She also ruled that a capped amount of money could be held in trust for the athlete to access after college.

She set the cap on deferred money at $5,000 based upon testimony of some of the NCAA's own witnesses.

The Ninth Circuit's recent ruling reversed the remedy allowing payment of $5,000 because it held that those cash payments were untethered to education expenses. Chief Judge Thomas dissented and said that the Ninth Circuit should not have second guessed Judge Wilken in this respect.

MR. GREG CURTNER:

I should note at the outset that I was lead defense counsel in *O'Bannon* for the first five years but was not lead counsel at trial. I am not here today representing the NCAA, and I am not speaking on behalf of the NCAA.

The Rule of Reason

I want to talk about the rule of reason because that's the interesting aspect of this. We are all interested in *O'Bannon* for the concept of paying student athletes, but I am going to try to stay away from the newspaper version of the case.

There is a jury instruction on the rule of reason. There's also a standard instruction in the Eleventh Circuit. It is basically a balancing test, weigh all the factors, including the history, and it is taken from a number of Supreme Court decisions trying to discuss what the rule of reason means. I think we can all agree that it is a bunch of soft concepts that would be very hard for judges or juries to apply. Over the years, various commentators have tried to make it a little more understandable and a little more applicable in a more or less objective way. But while everybody agrees that there is a balancing test or a weighing of the alternatives, I don't think there's much agreement to what that means.

I think Judge Wilken and the Ninth Circuit more or less applied the rule of reason as a burden shifting test: Was there a restraint in a proper market? Did it have anticompetitive effects? If yes, then was there a justification or justifications for the restraint, and what were the competitive effects of the justifications? Having answered yes to both of those questions, the District Court and the Ninth Circuit went to the third question: Was there a less restrictive alternative identified? And having answered yes, they proceeded to a remedy.

It seems to me that in applying the rule of reason you should apply a balancing test. Were the adverse effects, netted out, greater than or worse for competition as a whole than the competitive effects of the justifications, if netted out. I say "netted out" because both the restraint and the justifications may have both positive and negative effects on competition, so it seems to me you need to net them out and then you have to weigh them. And only if the substantial anticompetitive effects outweigh the procompetitive effects, should you then proceed to the less restrictive alternative test.

Application of the Rule of Reason to *O'Bannon*

Let's look at the *O'Bannon* case. What were the constraints in question? Let's try to apply the rule of reason as it was applied by the court, and then as I think it should be applied.

Really the case boiled down to two different restraints. One was the way the case started out. And, as Michael alluded, the case evolved considerably over its five years before trial and

continued to evolve even up to the end of trial. The original version of the case brought by Mr. O'Bannon and some other notables was that they were restrained by NCAA rules from being able to sell and license their NIL in output markets and licensing endorsements. It turned out that wasn't true. Judge Wilken found it wasn't true. Student athletes are not restrained from selling their images and asserting their rights for publicity after they leave school. Many of them do successfully, including Mr. O'Bannon.

Over time the case evolved. And originally the plaintiffs said they were not challenging the amateurism rules of the NCAA, which were upheld by the Supreme Court in what they argued was *dicta* in the *Board of Regents* case. By the time they got to trial, they were challenging the amateurism rules.

Judge Wilken allowed the addition of new plaintiffs who were current student athletes so they would have standing to challenge the rules relating to compensation of current student athletes. The rules about restraints after people are out of school really fell by the wayside. As it went to trial, the restraint of trade issue evolved to whether student athletes be paid as a group for their NIL while they were in school participating under NCAA rules as amateurs. Judge Wilken found it made no sense to talk about individual NIL licenses but only group licenses.

So that is the restraint. There is no doubt the rules did not allow that kind of licensing. It did not allow them to be paid while they were in school—even though there was no such rule expressly on the books.

The allowable forms of aid were limited to a grant-in-aid, which was defined as tuition, room and board, books, and necessary expenses. Over the course of the case this was amended—and that led to the second restraint, which was the limitation on compensation or support to student athletes while they were in school to a grant-in-aid, which was later modified to cost of attendance. And the cost of attendance rule was considered actually before this case came along, and it is now the rule that schools are free to offer cost of attendance if they want.

In short, the anticompetitive effects from the NCAA rules at issue were identified as: (1) no payments due to the inability to enter into group NIL licenses; and (2) no payments due to the failure to pay greater than grant-in-aid allowances. Being smart antitrust lawyers, you know that the restraint and the effects of those restraints look remarkably the same. In fact, that's largely what was found by the trial judge and by the Ninth Circuit: that the rules were anticompetitive, that the student athletes were not allowed to get paid for their NIL and it was anticompetitive for them not to get full cost of attendance or anything more. Those were the anticompetitive effects. But there was no finding of anticompetitive effects other than the lack of compensation.

And this led to one of the issues at trial. Dr. Lauren Stiroh, an NCAA expert from NERA, testified that the plaintiff needed to prove substantial anticompetitive effects, and in order to do so, they had to show some output or other price effects in a downstream market and that simply showing that some money didn't get paid to a student athlete or a group of student athletes kind of begged the question. You didn't know if that was an anticompetitive effect or not without examining its effects on the market. But Judge Wilken rejected that argument.

The NCAA argued that you needed to show some adverse effects in downstream markets or at least in input markets, and that Plaintiffs failed to do so. That the plaintiffs, in effect, were applying a form of a *per se* rule rather than a rule of reason. That issue remains an interesting one. I am not sure we're going to get an answer out of this case, but I think it is going to get litigated further. The issue is really whether the failure to pay more money to a group—to a labor input in this case—is itself anticompetitive and whether you have to look at the actual competitive effects on the market.

Moving on to the procompetitive effects, the NCAA asserted that the rules at issue were needed to preserve amateurism and the integration of athletics into education. Judge Wilken found that there was evidence to support those justifications. The Judge allowed the NCAA to address competitive balance at trial, but decided that the NCAA had not established it as a procompetitive justification. The NCAA also argued that the rules in question expanded output in both the input and output downstream markets and also allowed the maintenance of other sports, including Olympic sports and women's sports. Judge Wilken ruled that the other sports justification was not cognizable at all under the Supreme Court's decision in *Professional Engineers*[11] and other cases, and she wouldn't consider that, but would consider output in general.

The weigh and balancing aspect of the rule of reason is well-established in the case law. I want to speak to some of the broad trends because *O'Bannon* is not on its own. In particular, I want to draw your attention to the *Marshall v. ESPN* case,[12] which came out of Tennessee and is now pending in the Sixth Circuit. It is almost a carbon copy of *O'Bannon*, although the NCAA itself was not named as a defendant. The NCAA conferences and the networks were named. The District Court in *Marshall* reached the opposite conclusion from what Judge Wilken decided, and held that these rights of publicity were not valid under any law, certainly not under Tennessee law, and that he didn't think they had much value. The *Marshall* judge gave the Supreme Court's decision in *Board of Regents* greater weight, and he gave amateurism greater weight. So it is possible, after the Sixth Circuit considers the case, we may have a split of authority on these issues. Stay tuned.[13]

The Use of Experts at Trial

Rule of reason antitrust cases are, of course, expert specific. The NCAA put up at least four experts. I want to talk about them a bit.

Dr. Dennis did a survey. He's very reputable in his field and his survey was very well done. Judge Wilken gave it very little weight and found it not credible because he asked about paying student athletes in amounts of $20,000, $50,000 or $100,000, and the Judge thought he should have asked about $5,000. So she concluded that since he did not ask that

---

11 *Nat'l Soc'y of Prof'l Eng'rs v. U.S.*, 435 U.S. 679 (1978).

12 *Marshall v. ESPN Inc.*, No. 3:14-019945, 2015 WL 3606645 (M.D. Tenn. June 8, 2015).

13 One other interesting issue that is making its way through the courts is the role of copyright law on these claims for right of publicity or NIL rights. This is an issue because with live sporting events that are broadcast on TV, somebody has a copyright, sometimes there are several copyrights, and those copyrights in many cases arguably trump these rights of publicity. The Ninth Circuit did not think it needed to reach the issue in *O'Bannon*. Judge Wilken didn't reach that issue. But I think it is a trend in the case law that will have to get resolved at some point.

question, it would have meant that $5,000 would not adversely impact consumer views or demand. But Dr. Dennis found that people were consistently opposed to paying student athletes. And his results were completely consistent with at least five other public opinion polls done by a variety of folks over the years. And there are others out there, and all of them come to the same conclusion: about two-thirds of Americans are opposed to paying student-athletes. He also tried to examine effects of paying different amounts to different student-athletes based upon whether the stars did better than the bench players, if some schools could pay a lot more than other schools, and what the effects of that might be on demand for the product. Those are very, very difficult things to measure and to examine. Judge Wilken found the evidence to be less than persuasive on that, even though the plaintiffs did not have a competing expert.

Dr. Rubinfeld, who is a well-known economist, examined the question of amateurism and found that while the NCAA's definition had not been the same over 50 or 70 years, it had varied a little bit, that its definition was very similar to other sporting organizations. He found the same survey evidence was that the public opposed paying student athletes, which translates into demand for the product. Of course, if people don't like the way your product is produced and the character of your product, they are going to stay at home. He also tried to look at the question of competitive balance. Commentators in a number of cases have found that competitive balance is a legitimate goal in sports to some degree. Dr. Rubinfeld tried to show that the results on the field did not correlate very well with the amount of money the school had.

Dr. Jim Heckman, who won a Nobel Prize in economics, also testified as to data showing the effects of being an athlete and outcomes in life across a wide variety of groups. He found very persuasively that being a student-athlete: got you into college earlier, kept you in longer, graduated at a higher rate, gave you a better job out of college, and made you earn more money five years later. That was true across demographic groups. Nobody quibbled with that. Judge Wilken considered it and concluded that it was not sufficiently tied to the question of paying this incremental amount between grant-in-aid and the cost of attendance, or the incremental amount for NIL, and therefore it was irrelevant.

The NCAA In Perspective

I do want to try to put some of this into perspective. Everyone who talks about these issues from the plaintiffs' side always refers to the multibillion dollar revenue streams of the NCAA or the conferences or the schools, but what they don't talk about is where the money goes. The big picture is that the NCAA and its over 1,200 member institutions spend about $13 billion a year on their athletic programs. A significant portion of that is on education for student athletes. Their net revenue is less than $7 million a year. They spend almost $7 billion a year to put on these athletic programs. It is true that a few of the schools make some money on it. But all in, they are losing a lot of money. You can ask yourself why they do that. The answer is they think it is good for education.

SETTLEMENT NEGOTIATION TACTICS, CONSIDERATIONS AND SETTLEMENT AGREEMENT PROVISIONS IN ANTITRUST AND UCL CASES: A ROUNDTABLE

Moderated by Paul Riehle[1]

INTRODUCTION

While trial lawyers love to talk about trying cases—hence the Golden State Institute's successful long-running panels on Big States Antitrust Trials,—the reality is that many cases settle. Why antitrust cases and Unfair Competition Law ("UCL") class actions settle, how they settle, when they settle, what they settle for, settlement agreement provisions and other settlement considerations are rarely the subject of frank public discussion involving leading lawyers with plaintiff, defense and government. We are fortunate to have such an accomplished panel of counsel discuss those topics and other intractable issues in settling antitrust cases and UCL class actions.

Our illustrious panel consists of:

- Joseph R. Saveri, the founder of the Joseph Saveri Law Firm in San Francisco, specializes in antitrust law, as well as complex civil and class action litigation, in state, federal and international arenas. He earned his B.A. from UC Berkeley and his law degree from the University of Virginia. Mr. Saveri started practicing law with McCutchen, Doyle, Brown & Enersen, LLP. In 1992, he joined Lieff, Cabraser, Heimann & Bernstein, LLP where he founded, developed and chaired the firm's antitrust and intellectual property practice. During his 20 years at Lieff, Cabraser, he handled numerous groundbreaking and landmark cases. Most recently, he played a prominent role in *In re Cipro Cases I & II* and *In re High Technology Employee Antitrust Litigation*.
- Holly House is an Antitrust and Competition partner in the Litigation Department of Paul Hastings in San Francisco. She is a graduate of Smith College and Harvard Law School. She worked for many years at McCutchen, Doyle where she spent a part of her life representing Eastman Kodak in all stages of the *Image Technical Services, Inc. v. Eastman Kodak Co.* case, including in its trip to the Supreme Court and a jury trial. Ms. House has received numerous accolades and recognitions, including one of the "Top 250 Women in Litigation" nationwide in the last two years and one of the "Top 100 California Women Lawyers" for each of the last five years. Perhaps most notably, she is a past Chair of the Antitrust & UCL section and a past Chair of the Golden State Institute.
- Heather Tewksbury is a partner with WilmerHale in Palo Alto and leads the firm's California cartel practice. She is a UC Berkeley graduate, both undergrad and the School of Law. While working for the Department of Justice, she handled some of

---

1 Paul Riehle is a partner in the San Francisco office of Sedgwick LLP, where he serves as the Chair of the firm's Antitrust & UCL Practice Group and the Co-chair of its Class Action Task Force. Mr. Riehle is the 2015-16 Chair of the Executive Committee of the California State Bar's Antitrust, Unfair Competition Law and Privacy Section, and was the Chair of the 25th Annual Golden State Institute in 2015. He was Student Body President at the University of Notre Dame and Editor-in-Chief of the *Hastings Constitutional Law Quarterly*.

the most significant investigations and criminal prosecutions brought in recent years: she served as one of the lead trial lawyers in *United States v. AU Optronics*; and she was lead trial counsel in the jury trials of two AU Optronics executives. Ms. Tewksbury has received numerous awards and accolades, including Attorney of the Year by the *Recorder.* She has served on the Antitrust, UCL & Privacy Executive Committee since 2013, and for the last two years has been the Editor-in-Chief of *Competition*.

Paul Riehle, chair of Sedgwick LLP's Antitrust & Unfair Competition Practice Group, moderated this discussion, which builds upon the recent panel at the Antitrust, UCL & Privacy Law Section's 2015 Golden State Institute. Mr. Riehle moderated the combined panel discussion and was joined by Ms. House, Mr. Saveri and Ms. Tewksbury.

Settlement Panel Discussion

Moderator: Our general approach for this panel will be to discuss settlement issues in a chronologic life-of-the-case format. Our first topic is the consideration of settlement at the outset. Assume that direct and indirect class actions and state attorney general actions have been filed after a government criminal probe has been announced. What is the role of the government enforcer and view of the government enforcer regarding early resolution of private civil litigation?

Ms. Tewksbury: Let me start with a disclaimer. Although I worked as a prosecutor in the Department of Justice ("DOJ") Antitrust Division in San Francisco for eight out of the past ten years, the views that I am about to express are not those of the Antitrust Division. My views are drawn from my perspective as defense counsel.

Part of the mandate of the Antitrust Division is to help and assist victims of price-fixing to get restitution for rightful claims. The Department of Justice's advocacy with respect to getting ACPERA[2] passed through Congress is a real indicator of that. On the one hand, it was in an effort to incentivize leniency applicants to bring cartel cases to the DOJ in order to get leniency for the corporation and its executives. But ACPERA also was about incentives for civil follow-on litigation; if the leniency applicant satisfies the requirements of ACPERA, they receive the benefit of de-trebling and single damages in the civil litigation. It is another incentive to get not only the ACPERA applicant into a settlement posture with plaintiffs, but to allow plaintiffs to garner evidence more quickly through cooperation in order to leverage settlement with others. So clearly the DOJ has recognized and demonstrated its support for settlements and early settlement.

However, there is tension as sophisticated plaintiffs' attorneys bring cases almost immediately after a grand jury investigation is made public and a search warrant is executed. Typically, the DOJ has a window where it can use the secrecy of the grand jury as leverage against non-cooperating defendants by holding information close to the vest as to who the informants are and what the key documents are.

As plaintiffs' class action cases are being filed more quickly, ACPERA is becoming immediately utilized by plaintiffs and the ACPERA applicant to leverage cooperation. Thus,

2 Antitrust Criminal Penalty Enhancement and Reform Act of 2004, tit. II, Pub. L. No. 108-237, 118 Stat. 661.

the DOJ may not be able to as effectively use the tools they typically have had available to them in the past to investigate and prosecute these cases. Discovery is potentially opening up more quickly and causing defendants—who maybe would have been in a position where the leverage was so great and the concern about what the DOJ had against them was high—to perhaps decide to settle. It is possible now that defendants might just hold out for the immediate discovery they could get to determine whether or not they face a real problem. Currently, the only thing the government has as a tool to deal with this issue is the use of a stay, which in this district has been widely utilized in an effort to allow the DOJ to continue with its historical approach to investigating these cases.

While this tension has been developing and might continue to expand in the future, I don't think that there's anything the DOJ would do to impinge upon an early settlement, which I think is still a significant goal.

Moderator: Does the strategy of plaintiffs include typically an effort toward early resolution with one or more defendants? If so, what factors do you consider?

Mr. Saveri: Absolutely, the plaintiffs' strategy does entail and focus early in the case on efforts to resolve the case with one or more of the defendants.

In terms of criteria or considerations, there are a number of them. First, if we are talking about cartel cases, is trying to identify who the ACPERA applicant is because of the obligations under ACPERA to help the civil plaintiffs. Sometimes it is difficult to actually identify with certainty who the ACPERA applicant is because there's really no clear disclosure obligation. Of course, moving forward, there also is frequently some disagreement between the private plaintiffs and the ACPERA applicant about what sufficient cooperation is—qualitatively and also in terms of timing.

Another consideration that is important to keep in mind is that there may be parties to criminal proceedings who have substantially advanced their efforts to resolve the case with the DOJ and who have come to the conclusion that, whatever the problem is, it is something to be resolved—life is too short. They want global peace and resolution of the civil damage claims. So identifying defendants that are interested in resolution is also important.

An additional issue is to identify defendants who have a financial condition which provides an incentive for early resolution. The economic situation of a defendant may be poor, such that its financial resources will be exhausted by the civil litigation—and those resources might be better used to resolve claims for those that have been injured. So it is important to try to figure out which defendants are in a bad financial condition, which might be facing some form of bankruptcy, or for which ones there might be some inability to pay.

Those are the general kinds of things or considerations we have when we are trying to figure out where to focus our settlement efforts. And then sometimes you just have to answer the phone and call people back because people have all sorts of reasons to resolve cases.

Moderator: When does it make sense strategically to settle as a defendant, and what are the impediments of doing so?

Ms. House: One place to start is to look at your key customer base. As we all know, some of these cases turn into opt-out cases. You may not be able to get rid of the classes early,

but you might be able to settle early with some of the customers. You also may have a better point of leverage because perhaps there has not yet been a plea deal. That depends on the case itself, as uncertainty can be a positive and negative. Early on, before the case develops, there is the possibility of a lower settlement; there is no plea—nothing has developed yet. But by the same token, that uncertainty makes it that much harder to deal with, particularly the larger customers, or the class counsel, because the expert work has not been done. We do not know what the scope of the volume of commerce is, or what the defendant shares are. No plaintiff wants to feel like they are leaving money on the table, or from defendants' point of view, overpaying. So that means that early resolution can be very difficult.

A lot of times, too, it depends on the sophistication of your defendant client and whether they understand how this is going to play out, how long it is going to take. Sometimes it really does make sense to try to deal with these settlements early because it is going to be a very long and expensive process otherwise. But, again, the uncertainty makes it somewhat difficult to settle early on.

Moderator: One of the early decisions for defendants is whether or not to enter into a judgment-sharing agreement. What drives a judgment-sharing agreement is that antitrust laws provide for treble damages, joint and several liability, no right of contribution and trebling before offsets. So if you are one defendant and you are found liable, at the end of the day, you can be found liable for the whole kit and caboodle—or at least a large portion of it. A judgment-sharing agreement seeks to neutralize these aspects of the remedial scheme by creating a contractual right of contribution among the defendants. A judgment-sharing agreement diminishes the downside risk by a formula, typically market shares, based on which a settling defendant must require plaintiffs to agree to take out the settling defendant's share of damages from the amount of the ultimate verdict. Judgment-sharing agreements repeatedly have been upheld by the courts in antitrust cases.[3] From a defense point of view, it would seem that a rational defendant would want to ink a judgment-sharing agreement. And there is a lot of buzz that judgment-sharing agreements are prevalent, yet a review of settlement agreements in recent antitrust cases—*DRAM, SRAM, LCDs, High-Tech Employment,* and *CRTs*—reflects no judgment-sharing agreements were entered into those cases. In fact, the settlement agreements in those cases specifically said otherwise.[4] So the questions for our panelists: what has been your experience with judgment-sharing agreements, do they

---

3 *Cimarron Pipeline Construction, Inc. v. Nat'l Council on Compensation. Ins.*, No. CIV-89-1886-T, 1992 WL 350612, at *3 (W.D. Okla. Apr. 10, 1992); *In re Brand Name Prescription Drugs Antitrust Litig.*, No. MDL 997, 1995 WL 221853, at *1-*4 (N.D. Ill. Apr. 11, 1995); *California v. Infineon Techs. AG*, No. C 06-4333 PJH, 2007 WL 6197288, at *2-*3 (N.D. Cal. Nov. 29, 2007). *But see In re San Juan Dupont Plaza Hotel Fire Litig.*, No. MDL-721, 1989 WL 996278, at *2 (D.P.R. Sept. 14, 1989) (judgment-sharing agreement invalidated where the purpose behind the agreement was to "prevent resolution of plaintiffs' claims using the armor of a defense cooperation" agreement and the judgment-sharing agreement required signatories to decline all admissions of liability and aid to the plaintiffs or otherwise supporting plaintiffs).

4 *See, e.g.*, Settlement Agreement between Cypress Semiconductor and SRAM Direct Purchaser Class at 17, *In re Static Random Access Memory (SRAM) Antitrust Litig.*, No. 4:07-md-01819-CW (N.D. Cal. Mar. 11, 2011), ECF No. 1331-1 ("This Agreement does not settle or compromise any claim by Plaintiff or any Class Member asserted in the complaint against any defendant or alleged co-conspirator other than the Cypress Releases. All rights against such other defendants or alleged co-conspirators are specifically reserved by Plaintiff and the Class, including the right to seek damages from such other defendants or alleged co-conspirators based on Cypress's sales to the Class, and Cypress's sales to the Class shall not be removed from the Action.").

promote settlement, and why aren't they entered into in every price-fixing case?

Ms. House: Perhaps the best analogy is judgment-sharing agreements, like cartel agreements themselves, are rife for cheating. Different defendants with different shares typically have different incentives and different desires to settle earlier. Even where a company has a financial situation causing it to be more likely to settle, it is really difficult to get a group to agree on what the shares are going to be, what the formula is going to be and how long the agreement is going to last. It is like herding cats. So it is not at all surprising to me that you do not see as many judgment-sharing agreements as you might anticipate.

Obviously there are some benefits to judgment-sharing agreements. And there may be some judgment-sharing agreements that have a limited shelf life that provide the opportunity to conduct collective negotiations. They can allow the defense group to stay on message, because everyone knows with certainty what your share is going to be. Obviously clients like that and just as obviously the plaintiffs do not like it. But, like feral cats, some defendants do not want to be part of the herd.

Moderator: What is the plaintiffs' view about the propriety of judgment-sharing agreements and whether they promote or detract from settlement?

Mr. Saveri: Let's start with this basic premise, which I think is noncontroversial, that the purpose and effect of a judgment-sharing agreement is to alter some of the core principles underlying private enforcement antitrust law in the United States. You have identified the key one, joint and several liability with treble damages. If you start from the premise that those features of the antitrust law are key to private enforcement, something that undercuts that or prevents those principles from operating is flatly inconsistent with the purposes of private enforcement of the antitrust law. There is academic literature that shows, both using economic tools and empirical evidence, that judgment-sharing agreements reduce settlement values, lead to the suppression of incriminating evidence, reduce the likelihood of successful meritorious price-fixing cases and make price-fixing cost-beneficial in the end. So if you put that all together, I think there is a very, very strong public policy argument that judgment-sharing agreements are against public policy, should be limited or should not be enforceable at all.

Unfortunately, the clear weight of authority is completely the other way. And the only case stating otherwise is the *San Juan Dupont Plaza Hotel Fire* case.[5] Since then, the courts have been pretty clear that they disagree with what I just said. I do not think those cases were correctly decided, but I am on the losing end of that argument.

Having said that, if a judgment-sharing agreement does exist, it should be disclosed. One of the issues we frequently have in a case, from plaintiffs' side, is that we do not know that they exist. They are not disclosed to us. Sometimes even when they are subject to clear discovery requests along the lines of insurance agreements, which usually don't exist in the antitrust context, they are withheld on privilege or joint defense grounds. I think to the extent a judgment-sharing agreement does exist, it is important that it be disclosed. And then we can have a fight about whether it is enforceable and its impact.

---

5 *See In re San Juan Dupont Plaza Hotel Fire Litig.*, *supra* note 3.

Ms. House: Will you provide your sharing arrangements from the plaintiffs' bar side as well?

Mr. Saveri: There is a difference to me, in my mind, between agreements that create a common alliance and allow for joint prosecution or joint defense of a case. To me those are conceptually distinct. I recognize common interest agreements exist on both sides of the bar, and I think they are consistent with the attorney-client privilege and work-product doctrine and the doctrines that support the confidential protection of legal rights. As such, they should be protected.

But judgment-sharing agreements are different because they qualitatively change the dynamic of what we are dealing with in an antitrust case. It is very problematic in the settlement context to be negotiating in a traditional manner and to not be aware that there is a judgment-sharing agreement. The unwillingness to disclose a judgment-sharing agreement frequently frustrates the ability of the parties to resolve the case, as it presents an impediment because a judgment-sharing agreement changes the traditional settlement dynamic.

I'll stop there, but I could go on for a while about this.

Moderator: Have government enforcers taken a public position on judgment-sharing agreements and have they sought the production by defendants of judgment-sharing agreements?

Ms. Tewksbury: I have never heard of any public announcements expressing views by any of the authorities on judgment-sharing agreements. I also would be surprised if the DOJ would ever be interested in getting discovery on those agreements. In any large cartel case, there likely will be in any plea agreement, and the accompanying sentencing memoranda, an acknowledgement of the defendant's obligation to provide restitution. In those cases, where there is a robust class action follow-on litigation system, particularly here in the Northern District, the DOJ has by and large concluded that restitution can very capably be handled by the plaintiffs in the follow-on litigation. In effect, they have ceded that territory to the plaintiffs' bar and, in many ways, washed their hands of it. When looking at the civil litigation, the focus is on what are the DOJ's prosecutorial interests and whether there is anything going on in the civil litigation that might impinge upon those interests.

For example, in the *LCDs* case, there were in the six or seven years of prosecution and investigation of that case, anywhere from five to ten DOJ staff attorneys on that case. Looking at this room, about two-thirds of you, I think, were involved in that case in the civil litigation and many more outside of this room. So the ability for staff to really understand, appreciate and get their hands dirty on what's happening in the civil litigations—for example, whether there are judgment-sharing agreements or whether that even matters to the DOJ—I imagine, is quite low. I think the view is that the DOJ does not want to frustrate the process that is happening on the civil side, which, again, is very capably being handled by both sides of the v.

Moderator: Next, our hypothetical case has gotten past the pleadings, and class certification motion practice is underway. From the plaintiffs' view, is this an attractive settlement window and, if so, what characteristics in the case posture or the profile of a defendant make it more or less attractive?

Mr. Saveri: I do think this is a significant window where the case can and should be resolved. Especially with the advent of *Twombly*[6] and higher pleading standards, I think that defendants want to wait and see the extent to which plaintiffs are successful or not in satisfying their pleadings burden. It has been my view for a long time, particularly in cartel cases, that the burdens of *Twombly* will be overcome by the plaintiffs eventually to a great or almost a complete degree. Nonetheless, we are put through our paces and we meet our obligations, and so at that point the case actually becomes ripe for settlement. It is game on at that point; that is the beginning of it.

The other end of this window is class certification. Again, with heightened class certification standards, it is generally the view that once the plaintiffs are able to satisfy their Rule 23 obligations and the class is certified, then the risk profile of the case has changed substantially both in terms of the plaintiffs and the defendants. Obviously it's less risky for the plaintiffs and, at the same time, I think it is fair to say that exposure to the defendants is greater. Particularly, if you view the burdens as having been increased by recent jurisprudence, if the plaintiffs get a class certified, they have really gone a long way toward what they need to do to be successful in the case.

With those bookends, the class certification motion is the point at which both sides really have skin in the game and after class certification, things are liable to happen which will substantially change the expectations of the parties. Those are circumstances which make settlement more likely. And for that reason, that is a time that some cases settle. However, settlement usually occurs much more toward the end of that process, typically after the class certification briefs are filed, after the expert work has been done, and after both sides have had an opportunity to kick each other's experts around a little bit. At that point the landscape is pretty clear, and people who are serious about the case can figure out what it's worth and whether they can resolve it.

Moderator: If settlement is discussed in this time frame, as the defendant first out, what conditions would you require and what demands would you expect?

Ms.Tewksbury: Obviously a defendant would like a broad release, which would include a release of all claims spanning all aspects of commerce. Implicit in that is a contradiction in that defendants will have been arguing that the FTAIA[7] bars most of plaintiffs' claims. But in settlement negotiations, that is what a defendant would expect and require.

Settling first increases your chances of limiting opt-outs as well, and that's obviously a good reason to settle early. Later in the panel discussion, we will consider aspects of that that can be put into a settlement agreement to address the risk if too many plaintiffs opt-out.

On the other hand, in terms of what I would expect plaintiffs to require of a first-out operator is substantial cooperation, and that is particularly true if they are really trading dollars for cooperation. A first-out settler in follow-on litigation can expect to provide the same documents and information as has been provided to the Department of Justice, so that plaintiffs are in the same posture as the DOJ.

---

6 *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007).

7 Foreign Trade Antitrust Improvements Act of 1982, 15 U.S.C. § 6a.

Moderator: Do plaintiffs' attorneys put a numeric value on a cooperation clause?

Mr. Saveri: It depends what you mean. Do we have a rule that says if you cooperate, you get 10 percent off or something like that? The answer to that is no. But certainly conceptually I think Heather is right; at a certain level, as part of the settlement negotiation, you are exchanging strict financial consideration, which is dollars or yen or something else, for cooperation. But I can't say if it is 10 percent, 20 percent, 50 percent, 75 percent. Depending on the cooperation and depending on some of the other things we were talking about, like the ability to pay, cooperation can be really the most valuable part of an early settlement.

Moderator: To that end, we pulled out some cooperation clauses in the *LCD* cases. In the Epson settlement in 2010, there is a one-paragraph clause that required the defendants to produce all the documents that they had provided to the DOJ during its investigation and also provide aggregated sales data.[8] A year later, the Hitachi defendants settled out and there were those requirements, plus, plus, plus which ran over a page in length.[9] Then when LG settled out two years later, the cooperation clause was over four pages.[10]

Mr. Saveri: I think LG had a lot of cooperating to do.

Moderator: The court grants plaintiffs' certification motion and one of the most difficult aspects of an antitrust case becomes more intractable: the competing interests by direct and indirect purchasers, as well as opt-outs and state AGs, for a limited pot of money. Holly, from a practical point of view, what is a defendant to do when confronted with what would amount to a duplicative recovery?

Ms. House: If you think of it conceptually, the issue is one of a limited amount of damage. In an ideal justice system, the damage should be apportioned by all the plaintiffs, by how much they actually absorbed. But unfortunately our federal direct purchaser system is expressly blind to the fact of whether or not the direct purchaser absorbed the damage. That is just the way the system is set up. So inherently you are going to have some duplicative recovery, just by virtue of the fact that there's a direct purchaser system that does not care whether the direct purchaser absorbed the damage, and then all the follow-on indirect actions.

First of all, what do you do as defense lawyers, especially when you have foreign companies facing our antitrust damages system for the first time, in effect saying, "What—I am going pay everybody, multiple people in this chain of distribution, multiple amounts for the same damage, every one of which is saying the damage stopped with me, it stopped with me, it stopped with me? What can you lawyers do to help?" And after listening to the screaming for a while, you say, "Let's be creative."

---

8 *See* Epson Defendants Settlement Agreement with Direct Purchaser Class at 15, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. July 12, 2010), ECF No. 1851-1 ("Within five (5) business days of the execution of this Agreement, Epson Defendants will, to the extent they have not already done so, produce (i) all documents kept by Epson Defendants in the ordinary course of their business that were provided to the Department of Justice during the course of its investigation; and (ii) data reflecting aggregate sales or purchases of TFT-LCD Products by Epson Defendants . . .").

9 *See* Hitachi Defendants Settlement Agreement with Direct Purchaser Class, Appendix 1, at 17-18, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. Aug. 30, 2011), ECF No. 3407-4.

10 *See* LG Defendants Settlement Agreement with Direct Purchaser Class, Appendix 2, at 40-44, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. July, 12, 2012), ECF No. 6141-3.

We tried to be creative with Judge Illston in the *TFT-LCD* case. One of the things we briefed fairly extensively is trying to get some procedural relief based on our claim that duplicative recovery was something that she had to wrestle with as a matter of law, citing both the U.S. Constitution and also various state court statutes that literally say you have to do everything you can to curb duplicative recovery. In the first instance we were addressing that when there was the question of how the trial was going to be structured, with the direct and indirect classes. In the accompanying materials, you will see that we created a list of options of how to deal with duplicative recovery[11] and what the judge decided to do.[12]

Judge Illston decided there was going to be a single trial with the direct and indirect classes, and she came up with some procedural ways to try to deal with the screaming from the plaintiffs' side—both direct purchaser and indirect purchaser classes did not want this to happen. But she came up with procedural ways so that the jury was not going to hear about the pass-on in the first instance, in the first phase. If the jury decided that there was liability and damages for the direct purchasers, then there would be a second phase where there was going to be the pass-on evidence and the damages for the indirect purchasers. But not surprisingly, the defendants did see that as a victory because there was at least some hope that the same jury would at least get that paying twice at least does not feel right. And, not surprisingly, there were some settlements that occurred after that.

Another way to do it practically is in the indirect purchaser cases, the follow-on cases. The more indirect purchasers you can get into one trial, particularly if they are at different points in the distribution chain, the better it is going to be to try to at least eliminate some of the duplicative recovery problem because you are going to have a jury hearing the inconsistency between somebody higher up in the chain saying, "Hey, the harm stopped here," and then somebody lower down say, "No, it all came down to me and stopped here." That is hopefully something that you can exploit as a defendant.

Practically, make sure your experts are all over this. This should be in their expert reports. And then use every opportunity, creative or otherwise in motion practice, both before the MDL judge and then, if you get remanded, before the remand courts, to try to talk about the problem of duplicative recovery and the legal ways that you can try to argue that the judge has to grapple with this and deal with this. Kicking it down the road is an option, but it is not a really good answer for defendants.

Ms. Tewksbury: The problem is obviously not just residing in this follow-on civil litigation where there's the real concern about duplicative recovery. You have the criminal litigation, where not only do you have the Antitrust Division who might be going after you, you might have other components of the DOJ who are also looking at that same conduct

---

11 *See* Notice of Motion and Motion of Defendants Regarding Trial Structure and for Relief to Avoid Duplicative Recovery, Appendix 3, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. Mar. 21, 2012), ECF No. 5258.

12 *See* Order on Trial Structure, Appendix 4, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. Apr. 20, 2012), ECF No. 5518; *see* Order Denying Motion for Leave to Amend to add additional defenses and a counterclaim for declaratory relief to address the risk of duplicative liability caused by multiple plaintiffs seeking to recover for the same alleged overcharge, Appendix 5, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. May 25, 2012), ECF No. 5795. *See also In Re Vitamins Antitrust Litig.*, 259 F.Supp.2d 1 (D.D.C. 2003) (order denying motion *in limine* to preclude the evidence that plaintiffs passed on any indirect-purchaser overcharges).

and trying to get fines with respect to that. The likelihood in those areas of having follow-on civil litigation is low, but still, again, they are not looking at the damages aspect of this.

In some respects it really is one pot of money because you have one company that has a finite amount of resources. The goal of the antitrust laws and of the enforcers, and hopefully civil plaintiffs, is not to put that company out of business. That does not help competition.

Not only do we have criminal penalties here in the U.S., but you have enforcers around the world, as Judge Illston mentioned, and others in the last panel. There are over 100 competition authorities. There are now somewhere around 40 or 50 who actually have robust competition programs, and that is really due to the proliferation of leniency. It used to be five to ten years ago you were going into only a few jurisdictions to deal with this. Now companies are going into China to seek leniency. And that a complete unknown.

There has been a lot of criticism of the DOJ with respect to what is called double-counting, the concept that the same commerce is getting counted in the volume of commerce in the U.S. and Japan and other places. I believe that the Antitrust Division has tried to work hard to avoid double-counting. I do not think it has been perfected, but certainly they have the discretion to do that. But the problem is that other jurisdictions do not. The JFTC[13] has no discretion. They have to count a certain amount of turnover, and that is it, there's nothing they can do, although it was just announced that they are considering through their legislature to modify that and give them discretion. Even in the European Union, they similarly are held to strict assessment on commerce.

Now that we are seeing more active enforcement authorities, the danger of double-counting is becoming more of a reality. Overall, it is becoming a fairly difficult problem for companies.

Moderator: Joe, you have worn both the indirect purchaser hat and the direct purchaser hat. Does how you approach this conundrum vary based on which class you represent?

Mr. Saveri: It depends what question you are asking. If you are talking about a trial perspective, I am thinking it does, because we struggle with the other side with a lot of the issues that Holly discussed. From a settlement context, in large measure the way the direct purchaser class and the indirect purchaser class address settlements with defendants is largely the same, although we have slightly different complications.

The indirect purchasers have to deal with the presence of the fact that there are a number of State Attorneys General who represent indirect purchaser consumers. That presents real issues in a settlement context of how to structure a settlement, how to figure out who gets what dollars.

---

13 Japan Fair Trade Commission.

With respect to the direct purchasers, the settlement issue really involves the opt-out plaintiffs. Frequently, at least in my experience, the opt-out plaintiffs are not part of a settlement process. They are sitting in the same room with the class lawyers, but certainly when we sit down with defendants to discuss settlement and we are talking about how much is going to be paid, obviously one of the issues that we have to grapple with is how much of the direct purchaser settlement money is being siphoned off to the opt-out plaintiffs, and how you deal with that in a settlement context.

Moderator: Traditionally antitrust cases have been settled without the help of third parties, but mediation is certainly becoming more frequent. What do you see with respect to mediation in the future of antitrust and UCL class actions?

Mr. Saveri: Let me say a couple things. First of all, I think it is definitely the case, historically, that antitrust class actions have been a place where there's been relatively low involvement of third parties to help mediate disputes. With the passage of time, that has changed somewhat and now there are a number of very significant antitrust cases that have been resolved in large part through the aid of third-party neutrals. The *LCD* case is one of them. Same with the *In re High-Tech Employee Antitrust Litigation*, which I recently handled. The *CRT* indirect purchaser class case was largely settled through a mediation process. So it is definitely the case that the use of third-party neutrals has increased over time. But having said that, I still think at the end of the day most of the resolutions in class-action antitrust cases are really reached as a result of negotiations, lawyer-to-lawyer.

Ms. House: I believe that mediation is definitely here to stay in the big antitrust cases. However, there is a time when it is going to be the most effective. You have to have the case gelled to a certain degree in order to have mediation be able to be meaningful for settlement. You have to have enough information about what the scope of the case is, what the size of the case is, before everybody is ripe for the opportunity to settle the case. If it is appropriately gelled and you do have enough understanding of what the court's likes are, some rulings that give you some direction, enough expert work to get at least a reasonable idea of what you are talking about in terms of sales at the end, then I do think there is an opportunity.

For all the reasons that mediation makes sense in all cases, mediation makes sense in antitrust cases. There can be client control issues that mediation can help address. Maybe the client is more receptive to what a neutral judicial officer says about where the client is blind about aspects of the case. So let's bring them to Jesus and tell them what's good and what's bad.

It also can be a good opportunity if you have plaintiffs that have a bunch of different counsel and they have a different idea of what the case is worth, as well as whether to settle now or later. Again, it is an opportunity to get people onto the same page.

There comes a certain momentum, particularly if it looks like it is going to happen and certain blocks are going to fall, that you can actually push things through. So I think mediation can be extremely helpful if it comes at the right time.

Moderator: One controversial settlement agreement term in the antitrust context is the most favored nation ("MFN") clause, which is where an early settling defendant essentially says, "I will pay, but I don't want to overpay. And if you settle with other defendants on better terms, I want the same terms." If that occurs, the early settling defendant gets back money

initially paid if the plaintiffs settle with somebody else for less.[14] Joe, have you ever agreed to a most favored nation clause and under what circumstances?

Mr. Saveri: Let me say one thing about this: I hate them, I resist them, and I give them.

I think MFN clauses are a fact of life—and that they are frequently more trouble than they are worth. Let me just say briefly one of the ways they are more trouble than they are worth. It kind of goes back to one of the things that Holly touched on a few minutes ago. They are really hard to structure in ways in which there are reliable and objective criteria for measuring them—how do you determine whether you have given someone else a better deal? Is it measured by some measure of sales? Is it measured by some volume of commerce? Even if you agree on what the measure is, there is wide disagreement about how that's measured. If you sit down all the defendants in a room and you ask them, each one of them, what their market shares are and you add that up, you end up with about 86 percent. So there are always incentives for undercounting and they are difficult to enforce.

Having said that, I think they happen in almost every case.

Ms. House: I am in agreement with Joe: MFN clauses are more trouble than they are worth. A lot of this is, frankly, about client control. Many of the defendants are intensely competitive rivals. So a lot of this is about the client wanting to make sure that they are not going to be disadvantaged in the market by paying more than their intense rival. The clients are where much of this push is coming from.

Also, the reality is that things cost money. The plaintiffs are going to demand something for a most favored nation clause. Moreover, I have never had a situation where the plaintiff ever ended up paying under a MFN clause. Given all the headaches and the cost related to a MFN clause, I personally do not think it is worth it. But I also understand why clients insist on one.

Moderator: At some point, through mediation or direct negotiations between counsel, a settlement has been achieved, and you are now seeking the court's final approval. Out of the woodwork come objectors. Is there a general approach you have when dealing with objectors or is it idiosyncratic?

Mr. Saveri: In general, objectors are idiosyncratic, but there are a couple of important caveats. There are a group of objectors who many acknowledge as professional objectors. These are repeat players. They appear in cases of all types, all over the country. I think that these repeat objectors make up one of the big scandals in class action practice in the country. With respect to that group of objectors, I do think there are common ways of trying to protect your client in the case from them, such as a quick-pay agreement in the settlement agreement or trying to secure a court order requiring an appellate bond from the objector. While there are pretty common ways of dealing with them, I do not think that those solutions are very effective.

Now, on the other hand, if you have folks who are really interested in a particular case that come forward for one reason or another and basically say, "Look, you haven't got enough money." With those you just have to deal with them directly, and it is a *sui generis* exercise.

---

14 *See* Appendix 6 for an example of a most favored nation clause.

Ms. House: It does depend on the basis for the objection. If it is the standard objection, then defendants typically sit back and let the plaintiffs take care of it. The objection oftentimes is an attack on plaintiffs' attorney's fees or class representative payments. If so, it is not the defendants' problem. Obviously, we look at the papers and decide if a response is appropriate.

If you can anticipate something, where you know there's going to be very serious objectors, you have to have a strategy to address that and then you are going to be more involved. In the *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*[15] last August, for instance, a proposed class settlement of claims against American Express was scuttled, and the previously approved $7.25B settlement with Visa and MasterCard threatened, because of improper communications between a lawyer for the merchants and a lawyer for MasterCard, who were friends. That is very unusual, and there has been a lot of involvement from the defendants in that case. Again, the involvement of defendants in dealing with objectors is going to depend on what the objection is.

Mr. Saveri: When we are talking about cartel cases, it is really not much of an issue. The settlements usually involve the payment of money. I cannot think of a Section 1 cartel case where there was a structural relief as part of a settlement. To the extent there is structural relief in a class action settlement, you are changing the way people do business and changing the way stakeholders relate to one another, there is potential for objections from them.

Moderator: The case has been settled, but there are many opt-outs, particularly large purchasers. What explains the trend of more and more opt-outs and what does the defendant do to limit the risk of overpayment?

Ms. Tewksbury: One aspect of that is there are distinct customers that can effectively trace their actual damages, and they want their own advocates to handle that. Another aspect of it relates to cartel cases involving electronic components, in particular, where a customer no longer potentially engages in that business line, but still uses the technology either because it is a legacy or there's nothing to replace it or they completely exited that business line and there is no opportunity for a business resolution. It is a way for companies to turn their legal departments into potential profit centers where they can pursue damage claims and potentially provide revenue to the company.

In terms of ways to limit overpayment to opt-outs, one we have already talked about is to settle early with the class in hopes of people not opting out at that point. Seeking business resolution is another avenue. Taking advantage of any arbitration clause is another option—and companies are becoming more sophisticated with their major purchasers by engaging in contracts that have very explicit arbitration clauses. Another is crafting a settlement that allows a defendant to essentially exit its resolution with plaintiffs if the opt-outs become too overwhelming. I think you have some examples of that.

---

15 986 F. Supp. 2d 207 (E.D.N.Y. 2013).

Moderator: Correct. In the Sharp *LCDs* settlement, the settling defendants had the right to void the settlement if 25% of the remaining commerce opted out.[16] In the *Samsung* settlement, the right to reject the settlement was based on opt-outs representing $150 million or more in a defined line of commerce.[17]

With respect to commerce, a significant issue in international cartel litigation is what sales abroad are included in the volume of commerce within the reach of the United States antitrust laws. What are the implications for settling antitrust cases in light of that issue?

Ms. House: Obviously, the larger the amount of foreign sales that are going to be included for the settlement calculations, the larger the payout, the larger the exposure. Overreaching by plaintiffs on foreign sales can make early settlement very difficult to achieve. Until the court rules on what is in and out, which generally comes fairly late in the process, there is going to be such a delta between what foreign sales are in or out that it becomes impossible to settle until you know what the true scope of the case is going to be.

Mr. Saveri: Here is the problem. Defendants want to have it both ways. Defendants want the broadest possible release, releasing claims as far across the globe as is possible. At the same time, they don't want to pay for the broad release. That incongruity presents difficulties for the parties to the settlement and courts charged with supervising class action litigation and approving class action settlements. If foreign commerce is to be included in a settlement, and thereby released, and it should be because foreign commerce is not excluded by the FTAIA, then there should be some consideration paid.[18]

---

16 Sharp Defendants Settlement Agreement with Direct Purchaser Class at 11-12, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. Aug. 30, 2011), ECF No. 3407-9 ("If the Court permits class members to opt out of this settlement, Co-Lead Counsel will cause copies of requests for exclusion from the Class to be provided to counsel for Sharp no later than ten (10) Court days before the commencement of the hearing regarding final approval of this Settlement. *Sharp shall not have the right to rescind the settlement unless purchasers responsible for 25% of the remaining relevant commerce are granted exclusion*. Such purchasers do not include persons and entities that opted out of the Litigation Panel Class and/or Litigation Product Class by January 4, 2011, as reflected in the list of opt-outs filed January 31, 2011 (Docket No. 2384), and also do not include the Apple, Inc. entities noted in the Court's February 18, 2011 Order (Docket No. 2477).") (emphasis added).

17 Samsung Defendants Settlement Agreement with Direct Purchaser Class at 13, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. Aug. 30, 2011), ECF No. 3407-7 ("Exclusions. If, contrary to Plaintiffs' and Samsung's expectations, the Court permits class members an opportunity to opt out of the Settlement, *Samsung will have an option to terminate the Settlement if new opt outs who exclude themselves from the Settlement account for more than $150 million of commerce as measured by panel value (as opposed to finished product value).* Samsung may exercise the option to terminate conferred by this paragraph within 14 days after Samsung receives notice of the identity of any new opt outs who exclude themselves from the Settlement, if after such exclusion the threshold specified in this Paragraph 19 is exceeded.") (emphasis added).

18 As an example of how this tension is resolved, in the Hynix direct purchaser settlement in the DRAM litigation, foreign purchaser sales were not released. *See* Hynix Defendants Settlement Agreement with Direct Purchaser Class, *In re Dynamic Random Access Memory (DRAM) Antitrust Litig.*, No. 4:02-md-01486-PJH (N.D. Cal. Apr. 28, 2006), ECF No. 829-1 ("This Agreement shall not affect whatever rights Releasors or any of them may have (i) to seek damages or other relief from any person with respect to any DRAM purchased directly from the manufacturer (or any subsidiary or affiliate thereof) outside the United States . . .").

Moderator: In *California v. Intelligender,*[19] a nationwide class settlement was approved by the federal district court, after the Class Action Fairness Act notice was sent out, but lo and behold, a civil government enforcer filed another lawsuit seeking restitution, essentially the same restitution that had already been settled. The Ninth Circuit reversed the district court's refusal to enjoin the restitution claims, but not the enforcer's request for penalties. Heather, what is your view about whether this decision will have any impact on the position the government enforcers will take in connection with motions for approval of class settlements?

Ms. Tewksbury: I do not see any real impact for antitrust cases, particularly cartel cases where there is follow-on litigation. The reason is that the DOJ, in those types of cases, articulates in their sentencing memoranda that it is to be left to the follow-on litigation to deal with restitution. I do not see a situation where this decision would impact the current approach and the policies of the Antitrust Division with respect to how to treat restitution.

The decision upholds the right for the government to recover penalties and the criminal fines placed on perpetrators serves the goal of deterrence, which is the paramount, hallmark aspect of the DOJ's mission. I believe the DOJ's view is that this is also achieved by putting executives in jail and requiring actual jail time for those executives. In negotiated resolution with individuals, we have seen a 24-month average jail time. That is a substantial uptick from many years ago when executives could plead and receive custodial time of around three months. I think that is where the DOJ Antitrust Division is going to focus, as opposed to going back to the well on restitution where that is dealt with otherwise.

19 *California v. Intelligender, LLC*, 771 F.3d 1169 (9th Cir. 2014).

Appendix 1

Hitachi Displays Defendants Settlement Agreement with Direct Purchaser Class, pp. 1, 17 – 18, *In re TFTLCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. Aug. 30, 2011), ECF No. 3407

TFT-LCD DIRECT PURCHASER CLASS SETTLEMENT AGREEMENT

This Settlement Agreement ("Agreement") is made and entered into as of this 3rd day o August, 2011 (the "Execution Date"), by and between Hitachi Displays, Ltd., 3300, Hayano, Mobara-shi, Chiba-ken, 297-8622, Japan (referred to herein as "Hitachi Displays"), subject to th approval thereafter by the Hitachi Displays, Ltd. Board of Directors (the "Effective Date"), on behalf of itself, Hitachi, Ltd., 6-6, Marunouchi 1-chome, Chiyoda-ku, Tokyo, 100-8280, Japan, and Hitachi Electronic Devices (USA), Inc., 208 Fairforest Way, Greenville, South Carolina (Hitachi Displays and Hitachi Electronic Devices (USA), Inc. are collectively referred to herein a the "Hitachi Displays Defendants" and Hitachi, Ltd. is herein referred to as the "Parent"), on the one hand, and the plaintiff class representatives ("Plaintiffs"), both individually and on behalf of certified class of direct purchasers of TFT-LCD Products (the "Class") that purchased TFT-LCI Products in the United States at any time during the period beginning January 1, 1999 and continuing through December 31, 2006 (the "Class Period"), as more particularly defined in Paragraph A.1 below, on the other hand. The Hitachi Displays Defendants, Parent, and Plaintiff are each referred to individually as a "Party" and collectively as the "Parties."

WHEREAS, Plaintiffs are prosecuting the Direct Purchaser Class Action, Master File No. 3:07-md-1827 SI (the "Action") in *In re TFT-LCD (Flat Panel) Antitrust Litigation*, MDL No. 1827 (N.D. Cal.) on their own behalf and on behalf of the Class against, among others, Hitach Displays Defendants and Parent;

WHEREAS, Plaintiffs allege that Hitachi Displays Defendants and Parent participated ir an unlawful conspiracy to raise, fix, maintain, or stabilize the price of TFT-LCD Products at artificially high levels in violation of Section 1 of the Sherman Act;

WHEREAS, Hitachi Displays Defendants and Parent deny Plaintiffs' allegations and hav asserted defenses to Plaintiffs' claims;

any order or proceeding relating to the Fee and Expense Application, or any appeal from any such order shall not operate to terminate or cancel this Agreement, or affect or delay the finality of the judgment approving settlement.

(d) Neither Hitachi Displays Defendants and Parent nor any other Hitachi Releasee under this Agreement shall have any responsibility for, or interest in, or liability whatsoever with respect to any payment to Class Counsel of any Fee and Expense Award in the Action.

(e) Neither Hitachi Displays Defendants and Parent nor any other Hitachi Releasee under this Agreement shall have any responsibility for, or interest in, or liability whatsoever with respect to allocation among Class Counsel, and/or any other person who may assert some claim thereto, of any Fee and Expense Award that the Court may make in the Action.

F. Outstanding Discovery and Future Cooperation.

25. Hitachi Displays Defendants will reasonably cooperate with Plaintiffs through the trial of the Action and any appeal and post-appellate proceedings. Such cooperation shall include authenticating and admitting documents, providing testimony, and producing live witnesses for deposition and trial as set forth in Paragraphs 27.

26. Within ten (10) days of the Effective Date, Hitachi Displays Defendants will, to the extent it has not already done so, either identify the documents already produced or produce all non-privileged, non-work product protected, pre-existing business documents kept by Hitachi Displays Defendants and Parent in the ordinary course of their businesses that (i) were provided to the Department of Justice or the U.S. grand jury during the course of their investigation of antitrust violations in the TFT-LCD Industry during the Class Period, including any such pre-existing translations into English; (ii) reflect aggregate sales or purchases of TFT-LCD Products by Hitachi Displays Defendants and Parent during the Class Period, and

(iii) reflect any agreements between Hitachi Displays Defendants or Parent and any competitors regarding the price, supply, production, or distribution of TFT-LCD Products during the Class Period. Plaintiffs may, for use in the Action, serve on Hitachi Displays Defendants' counsel of record requests to admit the authenticity of documents, and Hitachi Displays Defendants shall respond in good faith.

27. Within ten (10) days of the Effective Date, Hitachi Displays Defendants will, to the extent it has no already done so, provide a list of current executives, officers, or employees of Hitachi Displays Defendants who are most knowledgeable about the conspiracy alleged by Plaintiffs. Plaintiffs may reasonably pursue depositions (including cross-noticing of depositions) of a reasonable number of such persons. Hitachi Displays Defendants' counsel of record will accept service of any such deposition notice(s) on behalf of Hitachi Displays Defendants. The deposition(s) shall be taken at a mutually agreed upon location.

28. Within twenty (20) days of the Effective Date, Hitachi Displays Defendants will provide to Plaintiffs, non-privileged, non-work product protected, pre-existing translations from foreign languages into English of documents, as that term is defined in the Federal Rules of Civil Procedure, including ESI, that are in the possession, custody or control of Hitachi Displays Defendants, whether certified or not.

29.

(a) Except as specifically provided in Paragraphs 25-28, Hitachi Displays Defendants and Parent need not respond to any other formal discovery from Plaintiffs or otherwise participate in the Action during the pendency of the Agreement.

(b) A material factor influencing Hitachi Displays Defendants' and Parent's decision to settle this action is their desire to limit the burden and expense of this

Appendix 2

LG Display Defendants Settlement Agreement with Direct Purchaser Class, pp. 2, 41 – 45, *In re TFTLCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI N.D. Cal. July, 12, 2012), ECF No. 6141-3

SETTLEMENT AGREEMENT

This Settlement Agreement ("Agreement") is made and entered into this 5th day of July, 2012 (the "Effective Date") among:

(1) Defendants LG Display Co., Ltd. f/k/a LG Phillips LCD Co., Ltd. and LG Display America, Inc. f/k/a LGD LCD America, Inc. (collectively "LG Display Defendants");

(2) The Indirect Purchaser Plaintiffs (the "IPPs") class representatives, both individually and on behalf of the classes certified by orders of the United States District Court for the Northern District of California (the "Court"), Judge Illston, on March 28, 2010 and July 28, 2011;

(3) The following states, by and through their Attorneys General: Arkansas, California, Florida, Michigan, Missouri, New York, West Virginia and Wisconsin, each of which has been pursuing its own litigation (collectively the "Settling States," which, together with the IPPs and members of the IPP Classes shall hereafter be referred to as the "Settling Plaintiffs").

WHEREAS, the IPPs are prosecuting claims in *In re TFT-LCD (Flat Panel) Antitrust Litigation*, MDL No. 1827 (N.D. Cal.) on their own behalf and on behalf of (i) a nationwide federal injunctive-relief class under Federal Rules of Civil Procedure 23(a) and (b)(2) and Section 16 of the Clayton Act (15 U.S.C. § 26) for violations of Section 1 of the Sherman Act (15 U.S.C. § 1) and (ii) separate damages classes on behalf of twenty-four (24) states and the District of Columbia that seek monetary relief for alleged violations of state antitrust, consumer protection, unjust enrichment and other laws; and

WHEREAS, the Settling States are prosecuting separate cases in *In re TFT-LCD (Flat Panel) Antitrust Litigation*, MDL No. 1827 (N.D. Cal.), including *State of Missouri ex rel. Koster, et al. v. AU Optronics Corporation, et al.* (Plaintiff States of Missouri, Arkansas,

N. Cooperation.

46. LG Display Defendants, including its subsidiaries and affiliates, agrees to fully cooperate with the Settling Plaintiffs, until the conclusion of the Actions and only to the extent reasonably necessary for the continued prosecution of the Settling Plaintiffs' claims in the Action against any other Defendant, if any, that has not settled by:

(a) Promptly providing a detailed account to the Settling Plaintiffs of the material facts known to LG Display Defendants that are relevant to the Settling Plaintiffs' allegations in the Actions, which account shall include, but not be limited to, the identification of non-privileged and non-work product-protected documents reflecting the known facts;

(b) Producing in the United States, with copies for both Co-Lead Counsel for the IPP Classes and Co-Liaison Counsel for the Settling States (2 copies), all non-privileged and non-work product-protected documents (including any such available non-work product-protected English translations) that evidence any meetings or communications among TFT-LCD Panel makers, or plans for such meetings, or results of such meetings, and all documents evidencing how any TFT-LCD Panel or product-related conspiracy was formed, implemented, and enforced, to the extent known by LG Display Defendants, including, but not limited to, reasonably requested, non-privileged and non-work product-protected documents relating to sales, pricing, capacity, production, damages and liability and communications regarding the same, and to the extent such production already has been made, facilitating access to and identification of the same;

(c) Producing in the United States, with copies for both Co-Lead Counsel for the IPP Classes and Co-Liaison Counsel for the Settling States (2 copies), copies of any transcripts of depositions taken in these Actions, and all exhibits thereto, provided by LG

Display Defendants or otherwise in the possession of LG Display Defendants, or their counsel, as reasonably requested, to the extent allowed by the Protective Order;

(d) As reasonably requested by Settling Plaintiffs, making inquiries of officers or employees and ex-employees and reasonable examination of documents to provide confirmatory information or to "fill in gaps" in existing production or testimony previously provided to the States and Indirect Purchaser Plaintiffs (including, for purposes of this term, examination by counsel for LG Display Defendants of documents which may be classified as work product);

(e) Providing the Indirect Purchaser Plaintiffs and the States all reasonably requested data and reasonable access to LG Display Defendants' employees for additional explanations relating to the Settling Plaintiffs' efforts.

i. to demonstrate the intent, purpose, and/or expectation of LG Display Defendants or other co-conspirators (as identified in any of the Settling Plaintiffs' complaints) that TFT-LCD Panels subject to any price-fixing or other anticompetitive agreements, or the finished products in which they were installed, were likely to be sold to end-users in the United States;

ii. to analyze the impact of the cost of a TFT-LCD Panel on the total costs of a finished product and/or on their sale price at any level in the chain of commerce; and

iii. to identify contracts and evaluate the terms of sale by LG Display Defendants of their TFT-LCD Panels to its customers, including other manufacturers.

(f) Using best efforts to make available in or around San Francisco, California, or at such other location in the United States as agreed by the Settling Plaintiffs, at a mutually agreed upon time and place for deposition at least two (2) to four (4) officers or employees as are identified by the Settling Plaintiffs. Alternatively, if travel to the United States by the witness is not practicable, LG Display Defendants agree to make such witnesses available to the States and/or Indirect Purchaser Plaintiffs in Seoul, South Korea, and will pay all reasonable costs of travel and accommodations for at least two (2) representatives of both the Plaintiff States and the IPPs to travel to said place for the purpose of conducting said depositions and/or interviews;

(g) Using best efforts to make available any officers or employees and others over whom LG Display Defendants have control, whether in the United States or elsewhere, for interviews in person, if practicable, or by video conference, if practicable, or teleconference, as reasonably requested by the Settling Plaintiffs. In addition, LG Display Defendants shall use best efforts to provide affidavits on their behalf or on the behalf of other persons it controls as officers, employees or agents, or for the purpose of authenticating business records, as reasonably required by the Settling Plaintiffs; and

(h) Using best efforts to produce at trial in person at least two (2) to four (4) officers, employees, or others over whom LG Display Defendants have control ("representatives") to testify as reasonably required by the IPPs, with the IPPs bearing the reasonable travel expenses of such witnesses; producing at trial in person at least two (2) to four (4) representatives to testify as reasonably required by the Settling States in the MDL, and producing at trial in person at least four (4) representatives to testify as reasonably required by the State of California in its separate state court trial in the State of California Action and

producing at trial in person at least four (4) representatives to testify as reasonably required by the State of New York in its separate federal court trial;

(i) In the event that the Indirect Purchaser Plaintiffs and/or the Settling States determine that they want access to additional LG Display Defendants' officers and/or employees beyond the numerical limits set forth in subparagraphs (f) and (h) above, LG Display Defendants agree to work in good faith to provide such assistance as may reasonably be required;

(j) Continuing to agree to abide by the May 5, 2011 Order of the Special Master and the agreement of Defendants' Liaison Counsel that documents (and testimony) that were improperly designated as either "Highly Confidential" or "Confidential" shall be de-designated as non-confidential through a prompt meet and confer process. Upon request, from Co-Lead Counsel for the IPP Classes or Co-Liaison Counsel for the Settling States, LG Display Defendants shall promptly review any such request for de-designation of specific deposition testimony or documents produced (whether or not subject to the Special Master Order) and provide written notice that the materials are or are not confidential. In the event that request is made and LG Display Defendants fails to respond within twenty (20) days, said materials shall be deemed to be non-confidential. In the event of a dispute, LG Display Defendants shall promptly submit the materials to the Special Master for adjudication of the breadth of any confidentiality claim.

(k) For purposes of each of the following cooperation terms, requests shall be deemed "reasonable" if the person's name appears on any communications reflecting communications with or about competitor panel manufacturers, relating to pricing or supplies of LG Display Defendants or their competitors' panels, and/or relating to information relevant to

establishing damages flowing from the conspiracy, or the information described by sub-paragraph (c) above; likewise, requests for documents or information shall be deemed reasonable if the documents or information subject to the request reflect or relate to any of the foregoing.

(l) Nothing in this section shall be construed or interpreted to be inconsistent with any continuing obligations that LG Display Defendants may have to the United States Department of Justice. LG Display Defendants shall cooperate with the Settling Plaintiffs in any effort to address any purported inconsistency with the requirements of the United States Department of Justice or the Court. Nothing in this section shall be construed or interpreted to be inconsistent with any court order in the MDL. LG Display Defendants shall also cooperate with the Settling Plaintiffs in any effort to address any purported inconsistency between this agreement and any court order in the MDL or other related LCD antitrust litigation.

47. This Agreement constitutes the entire, complete and integrated agreement among Settling Plaintiffs and LG Display Defendants pertaining to the settlement of the Actions (including the California State Court Action) against LG Display Defendants, and supersedes all prior and contemporaneous undertakings of Settling Plaintiffs and LG Display Defendants in connection herewith, with the only exception being the Agreement as to Claims for Civil Penalties executed with the Settling States concurrently herewith. This Agreement may not be modified or amended except in writing executed by Settling Plaintiffs and LG Display Defendants, and approved by the Court.

48. This Agreement shall be binding upon, and inure to the benefit of, the successors and assigns of Settling Plaintiffs and LG Display Defendants and the other LG Display Defendant Releasees. Without limiting the generality of the foregoing, each and every covenant and agreement made herein by Settling Plaintiffs shall be binding upon all Members of

Appendix 3

Notice of Motion and Motion of Defendants Regarding Trial Structure and for Relief to Avoid Duplicative Recovery, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. Mar. 21, 2012), ECF No. 5258

Brad D. Brian (State Bar No. 079001)
Stuart N. Senator (State Bar No. 148009)
Jonathan E. Altman (State Bar No. 170607)
Truc T. Do (State Bar No. 191845)
Hailyn J. Chen (State Bar No. 237436)
MUNGER, TOLLES & OLSON LLP
355 South Grand Avenue
Los Angeles, CA 90071-1560
Telephone: (213) 683-9100
Facsimile: (213) 687-3702
Brad.Brian@mto.com

Jerome C. Roth (State Bar No. 159483)
Hojoon Hwang (State Bar No. 184950)
MUNGER, TOLLES & OLSON LLP
560 Mission Street, 27th Floor
San Francisco, CA 94105-2907
Telephone: (415) 512-4000
Facsimile: (415) 512-4077
Hojoon.Hwang@mto.com

Holly A. House (State Bar No. 136045)
PAUL HASTINGS LLP
55 Second Street
Twenty-Fourth Floor
San Francisco, CA 94105
Telephone: (415) 856-7000
Facsimile: (415) 856-7100
hollyhouse@paulhastings.com

Lee F. Berger (State Bar No. 222756)
PAUL HASTINGS LLP
875 15th Street, N.W.
Washington, DC 20005
Telephone: (202) 551-1700
Facsimile: (202) 551-1705
leeberger@paulhastings.com

Attorneys for Defendants
LG DISPLAY AMERICA, INC. AND LG DISPLAY CO., LTD.

[additional parties and counsel listed in signature block]

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

IN RE: TFT-LCD (FLAT PANEL) ANTITRUST LITIGATION	CASE NO. 3:07-MD-1827 SI MDL No. 1827
THIS DOCUMENT RELATES TO: *Direct Purchaser Class Action and Indirect Purchaser Class Action*	**NOTICE OF MOTION AND MOTION OF DEFENDANTS REGARDING TRIAL STRUCTURE AND FOR RELIEF TO AVOID DUPLICATIVE RECOVERY** Date: April 20, 2012 Time: 9:00 a.m. Courtroom: 10 Judge: Honorable Susan Illston

TABLE OF CONTENTS

Page

I. INTRODUCTION ... 1

II. SUMMARY OF PENDING ACTIONS AND POTENTIAL FOR DUPLICATIVE AWARDS ... 4

III. ARGUMENT ... 8

A. Allowing Duplicative Recovery Would Violate Defendants' Due Process Rights ... 8

B. Allowing Duplicative Treble Recovery Would Run Afoul of the Supreme Court's Punitive Damages Jurisprudence ... 12

C. The Court Has a Duty To Avoid Duplicative Recovery under State Laws Invoked by Plaintiffs ... 13

D. Various Plaintiffs' Sherman Act Claims Are Also Subject To Allocation ... 15

E. The Court Should Employ One or More of the Following Case Management Devices to Avoid Multiple Recovery ... 16

IV. CONCLUSION ... 24

TABLE OF AUTHORITIES

Page(s)

CASES

Bains LLC v. Arco Prods. Co.,
405 F.3d 764 (9th Cir. 2005) 12

Barr Labs., Inc. v. Abbott Labs.,
978 F.2d 98 (3d Cir. 1992) 18

Bateman v. Am. Multi-Cinema, Inc.,
623 F.3d 708 (9th Cir. 2010) 10

BMW of N. Am., Inc. v. Gore,
517 U.S. 559 (1996) 10, 11, 12

Bunker's Glass Co. v. Pilkington PLC,
75 P.3d 99 (Ariz. 2003) 14

Cal. v. ARC Am. Corp.,
490 U.S. 93 (1989) 16

Cities Serv. Co. v. McGrath,
342 U.S. 330 (1952) 8, 9

Clayworth v. Pfizer, Inc.,
49 Cal. 4th 758 (2010) 2, 14, 15

Cory v. White,
457 U.S. 85 (1982) 20

Crane-McNab, LLC v. County of Merced,
2010 WL 4024936 (E.D. Cal. Oct. 13, 2010) 22

Exxon Shipping Co. v. Baker,
554 U.S. 471 (2008) 12

Gardner v. N.J.,
329 U.S. 565 (1947) 20, 21

Griffin v. Burns,
570 F.2d 1065 (1st Cir. 1978) 23

Hanover Shoe, Inc. v. U.S. Mach. Corp.,
392 U.S. 481 (1968) 2, 15, 16

Harris v. Balk,
198 U.S. 215 (1905) 10

TABLE OF AUTHORITIES

Page(s)

Ill. Brick Co. v. Ill.,
431 U.S. 720 (1977) 15, 16

In re Ampicillin Antitrust Litig.,
88 F.R.D. 174 (D.D.C. 1980) 18

In re Digital Music Antitrust Litig.,
812 F. Supp. 2d 390 (S.D.N.Y. 2011) 15

In re Master Key Antitrust Litig.,
70 F.R.D. 23 (D. Conn. 1975), *appeal dismissed*, 528 F.2d 5 (2d Cir. 1975) 18

In re N. Dist. of Cal. "Dalkon Shield" IUD Prods. Liab. Litig.,
526 F. Supp. 887 (N.D. Cal. 1981) 11

In re W. Liquid Asphalt Cases,
487 F.2d 191 (9th Cir. 1973) 10

Johnson v. Ford Motor Co.,
35 Cal. 4th 1191 (2005) 11

Kourtis v. Cameron,
419 F.3d 989 (9th Cir. 2005) *overruled on other grounds by Taylor*, 553 U.S. 23

Little v. V & G Welding Supply, Inc.,
704 So. 2d 1336 (Miss. 1997) 21, 22

Magnolia Marine Trans. Co. v. Okla.,
366 F.3d 1153 (10th Cir. 2004) 20

Martin v. Wilks,
490 U.S. 755 (1989) 23

MCI Commc'ns Corp. v. Am. Tel. & Tel. Co.,
708 F.2d 1081 (7th Cir. 1983) 18

McShan v. Sherrill,
283 F.2d 462 (9th Cir. 1960) 19

Nat'l Wildlife Fed'n v. Gorsuch,
744 F.2d 963 (3d Cir. 1984) 23

Provident Tradesmens Bank & Trust Co. v. Patterson,
390 U.S. 102 (1968) 19

TABLE OF AUTHORITIES

Page(s)

S. Union Co. v. Irvin,
563 F.3d 788 (9th Cir. 2009) ... 12

State Farm Mut. Auto. Ins. Co. v. Campbell,
538 U.S. 408 (2003) ... 10, 11, 12

Taylor v. Sturgell,
553 U.S. 880 (2008) ... 21, 22

Tex. Indus., Inc. v. Radcliff Materials, Inc.,
451 U.S. 630 (1981) ... 10

Tex. v. Fla.,
306 U.S. 398 (1939) ... 19

Thompson v. Karastan Rug Mills,
323 A.2d 341 (Pa. Super. Ct. 1974) ... 22

Union Carbide Corp. v. Superior Ct.,
36 Cal. 3d 15 (1984) ... 3

Universal Am. Barge Corp. v. J-Chem, Inc.,
946 F.2d 1131 (5th Cir. 1991) ... 23

W. Union Tel. Co. v. Commonwealth of Penn.,
368 U.S. 71 (1961) ... 2, 8, 9, 17

Wash. v. Chimei Innolux Corp.,
659 F.3d 842 (9th Cir. 2011) ... 20

STATUTES

740 Ill. Comp. Stat. 10/7(2) ... 14

15 U.S.C. § 15c(a)(1) ... 13

28 U.S.C. § 1335 ... 18

28 U.S.C. § 1404(a) ... 17

Ark. Stat. Code Ann. § 4-75-212(b)(1)(B) ... 13

Cal. Bus. & Prof. Code § 16760(a)(1) ... 13

D.C. Code § 28-4509(b) ... 13

D.C. Code § 28-4509(c) ... 14, 18

TABLE OF AUTHORITIES

Page(s)

Fla. Stat. Ann. § 542.22 (2) 13

Haw. Rev. Stat. § 480-13(c)(2) 13

Haw. Rev. Stat. § 480-13(c)(5) 14

Minn. Stat. Ann. § 325D.57 14

Miss. Code Ann. § 75-21-9 14

N.D. Cent. Code Ann §§ 51-08.1-08(4) 13

N.M. Stat. Ann. § 57-1-3(C) 13

N.Y. Gen. Bus. Law § 340(6) 2, 13, 14

Or. Rev. Stat. § 646.775(1)(b)(A) 13

R.I. Gen. Laws § 6-36-12(g) 13

S.D. Codified Laws § 37-1-25 13

Vt. Stat. Ann. tit. 9 § 2465(b) 14

RULES

Fed. R. Civ. P. 19(a)(1)(B)(ii) 19

Fed. R. Civ. P. 19(a)(2) 19

Fed. R. Civ. P. 22 18

Fed. R. Civ. P. 42(a) 17

OTHER AUTHORITIES

Restatement (Second) of Judgments § 43 22

Sen. Rep. No. 94-803 (1976) 14

Wright & Miller, *18A Federal Practice & Procedure* § 4452 (3d ed. 2011) 22, 23

NOTICE OF MOTION

TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

PLEASE TAKE NOTICE THAT on April 20, 2012 at 9:00 a.m., or as soon thereafter as the matter may be heard, in Courtroom 10, 19th Floor, 450 Golden Gate Avenue, San Francisco, CA 94102, before the Honorable Susan Illston, defendants LG Display, Co. Ltd. and LG Display America, Inc. ("LG Display") as well as all parties reflected in the signature block below ("Defendants"), will move the Court for an order providing relief to avoid duplicative recovery.

This motion is based on this Notice of Motion and Motion, the following Memorandum of Points and Authorities, the concurrently-filed declaration of Hojoon Hwang, any reply memorandum as may be filed, the arguments of counsel, and such other material as the Court may consider. Across the multiple cases in this TFT-LCD flat panel multi-district litigation, many plaintiffs seek the same damages from the same alleged overcharge. For the reasons stated below, the Court should — indeed must — fashion appropriate relief to protect Defendants against the threat of duplicative recovery. Among the many options discussed, Defendants suggest consolidation of the damage-phase trial of all known cases for the purpose of allocating any damage award among the plaintiffs at various points on the chain of distribution for TFT-LCD products.

STATEMENT OF ISSUES TO BE DECIDED

Issue 1(a): Whether allowing duplicative recovery across the claims brought by the direct purchaser class action, the indirect purchaser class action, the direct action plaintiffs, and the state Attorneys General violates Defendants' due process rights and/or statutory mandates.

Issue 1(b): Whether the current risk of duplicative recovery across the claims brought by the direct purchaser class action, the indirect purchaser class action, the direct action plaintiffs, and the state Attorneys General requires the Court now to adopt affirmative steps to avoid duplicative recovery.

Issue 2: What affirmative steps the Court will take to eliminate the risk of duplicative recovery, including but not limited to, altering the structure of the upcoming trial of the direct and indirect purchaser class actions.

I. INTRODUCTION

Defendants bring this motion because of the enormous competing and duplicative damages claims of individuals and businesses along the distribution chain for TFT-LCD panels.

Take the example of indirect purchaser end user plaintiff ("IPP") class representative Allen Kelley, track two direct action plaintiff ("DAP") Hewlett-Packard, and track one DAP plaintiff Costco. IPP plaintiff Kelley purchased a Hewlett Packard monitor from Costco that contained a TFT-LCD panel. The TFT-LCD panel that underlies his claim is the same panel that underlies the separate and independent claims of both Hewlett-Packard and Costco. Each of these plaintiffs claims that Defendants and others entered into a conspiracy to fix the price of TFT-LCD panels, and each plaintiff claims it suffered injury in the form of an overcharge on the same TFT-LCD panel and seeks recovery of damages for that purported injury. The problem is that each of these plaintiffs claims that it absorbed the alleged overcharge: the upstream plaintiffs claim they did not pass it down the distribution chain, the downstream plaintiffs claim to the contrary that the entirety was passed down to them. As a matter of logic, they cannot all be correct. Yet, each seeks to recover the entire overcharge in separate trials before separate juries.

This conundrum is repeated across this vast litigation with potentially devastating results. In the IPP case, for example, the IPP's expert asserts $2.662 billion dollars as the end user consumers' untrebled damages and asserts that 100% of the overcharge was passed on to them. *See* accompanying Declaration of Hojoon Hwang ("Hwang Decl."), ¶ 3, Ex. B (at 121). The upstream DAPs in the first wave of opt out litigation disagree; despite their varying positions on the distribution chain, they each claim that *they* absorbed the overcharge, and identify $4.66 billion in alleged overcharges.[1] Dozens more DAPs have filed suit and more are expected. While

[1] AT&T identifies upwards of $335 million, *see* Hwang Decl. ¶ 32, Ex. EE (at 4-5), Hwang Decl. ¶ 33, Ex. FF (at 2). Best Buy identifies upwards of $841 million, *see* Hwang Decl. ¶ 34, Ex. GG (at 4-5), Hwang Decl. ¶ 35, Ex. HH (at 5-6). Costco identifies upwards of $120 million, *see* Hwang Decl. ¶ 10, Ex. I (at 4-5). Dell identifies upwards of $1.27 billion, *see* Hwang Decl. ¶ 36, Ex. II (at 5-6). Electrograph identifies upwards of $143 million, *see* Hwang Decl. ¶ 37, Ex. JJ (at 4-5), Hwang Decl. ¶ 38, Ex. KK (at 1-3). Kodak identifies upwards of $20.6 million, *see* Hwang Decl. ¶ 39, Ex. LL (at 10). Motorola identifies upwards of $1.18 billion, *see* Hwang Decl. ¶ 40, Ex. MM (at 4-5). Nokia identifies upwards of $354 million, *see* Hwang Decl. ¶ 41, Ex. NN (at 2-3), and the Target plaintiffs identify upwards of $643 million, *see* Hwang Decl. ¶ 29, Ex. BB (at 4-5), Hwang Decl. ¶ 42, Ex. OO (at 3-4).

they have not submitted their expert damages reports, their complaints assert they absorbed the overcharges. *See, e.g.*, P.C. Richard Am. Compl. ¶ 251 (D.I. 4075) ("Plaintiffs were not able to pass on to its [sic] customers the overcharges caused by the Conspiracy."); Schultze Agency Services, LLC First Am. Compl. ¶ 250 (D.I. 4283). While admittedly there is not a complete identity of panels implicated in each case, the reality, evident on its face, is that there is substantial overlap. Be it between the DPP and IPP cases, the IPP and DAP and Attorneys General ("AG") cases, or across the whole, many of the panels are the same. Without some mechanism to harmonize the results in each of these cases, Defendants face crippling liability that, after trebling, will be many multiples of the purported initial overcharges.

By this Motion, Defendants urge the Court to fulfill its constitutional and statutory duties to prevent duplicative treble damage awards for the same alleged overcharges on TFT-LCD panels. The Supreme Court has long held that due process protects a defendant from being "compelled to relinquish . . . [property] without assurance that he will not be held liable again in another . . . suit brought by a claimant who is not bound by the first judgment." *W. Union Tel. Co. v. Commonwealth of Penn.*, 368 U.S. 71, 75 (1961). The impending trial of the DPP and IPP claims threaten to do exactly that by subjecting Defendants to enormous and repeated treble damages claims with no assurance that they will not have to pay for the same overcharge again and again in the DAP and AG trials to follow. Moreover, because treble damage awards under the antitrust laws are punitive in nature, multiple awards for the same overcharge violate the constitutional protection against excessive punitive damages. Further still, many of the state statutes that plaintiffs across these cases invoke for indirect purchaser standing places the affirmative burden on this Court to manage the competing claims in order to avoid duplicative recovery. *See e.g.*, N.Y. Gen. Bus. Law § 340(6) ("the court *shall take all steps necessary* to avoid duplicative recovery, including but not limited to the transfer and consolidation of all related actions") (emphasis added). Any contrary rule of law, including the restrictions on the pass-on defense established in *Hanover Shoe, Inc. v. U.S. Mach. Corp.*, 392 U.S. 481, 489-94 (1968), must yield to the dictates of due process. *See Clayworth v. Pfizer, Inc.*, 49 Cal. 4th 758, 787 (2010) (adopting *Hanover Shoe* as a matter of state law but holding that "the bar on

consideration of pass-on evidence must necessarily be lifted" when faced with the prospect of duplicative recovery).

Now is the time to act. While Defendants have every intention of defending their case at trial and believe they will prevail, their constitutional rights will not be protected without the Court ruling on this motion *prior* to trial. Put differently, this motion does not present the liability question (which Defendants believe will be resolved in their favor). It presents the risk question. Here, both the law and practicality call for action in response to that risk and call for action now. Not only does due process require assurance that there will be no double liability *before* any judgment in the upcoming class trial is entered, but acting now gives the Court the widest array of options to address the issue. For example, consolidation of damages phases across claims is often identified as a tool to avoid this due process violation. Here, should any, some or all of the various plaintiffs' claims survive liability determinations, the damages issues in the competing cases can and should be brought before a single trier of fact to allocate the alleged damages among plaintiffs at various levels of distribution. That device is most effectively invoked before there is a judgment in favor of one plaintiff or group of plaintiffs among the many claimants. There are other procedures that the Court may choose, such as binding subsequent plaintiffs to the jury's finding in the DPP/IPP trial, if any, regarding the pass-through of the overcharge, as further explained below. It is critical, however, that the Court announce *now* the procedure it intends to employ to avoid duplicative recovery, so that all parties can have certainty as to how their rights may be affected by the claims of others and have the opportunity to protect their interests.

Defendants suspect that the DPPs and the IPPs will argue opposite sides of the coin in contesting this motion. They will contend that Defendants are either too late or too early. Neither view is correct. Setting aside that a court is not free to turn a blind eye to a potential constitutional violation, and that many states place the burden on the court to raise this issue, cases suggest that the issue of duplicative recovery is properly raised when the cases are at a stage that the evidence confirms the risk but also when a court has the ability to respond. *See, e.g.*, *Union Carbide Corp. v. Superior Ct.*, 36 Cal. 3d 15, 24 (1984). Here, both are true. As shown

below, the evidence across the IPP, DPP, DAP, and AG cases confirms the threat of duplicative recovery. And, as the joint pre-trial statement confirms, with the first trial looming, the time is ripe for this Court to act. Indeed, with an IPP motion before this Court already raising the structure of these cases going forward, there is an open acknowledgement that now is the time for court intervention. *See* D.I. 5068. Separate and apart from what the Court does on the IPPs' motion to sever (which Defendants will oppose), this Court must act now to address the issue of duplicative recovery. The law compels it.

II. SUMMARY OF PENDING ACTIONS AND POTENTIAL FOR DUPLICATIVE AWARDS

A mere description of the cases before this Court demonstrates why the risk of duplicative recovery is more than real. Now pending before just this Court are (a) a class action which includes two sub-classes of direct purchase plaintiffs, (b) a class action that includes 24 sub-classes of indirect purchasers, (c) 26 individual suits, brought on behalf of 49 companies, alleging a mix of direct and indirect purchase claims, and (d) five suits brought by state Attorneys General. That description does not include the three state Attorneys General actions asserting *parens patriae* claims proceedings in state courts in Washington, Illinois, and California, nor the two state attorney general actions that are currently proceeding in federal courts in Mississippi and South Carolina (with motions to remand pending). While the various cases target different groups of defendants, all of the claims allege the same core theory — that a group of companies formed a cartel to fix the prices of TFT-LCD panels. The suits span the entirety of the distribution chain with each alleged level claiming that all, or nearly all, of the same alleged overcharge — the product of the alleged conspiracy — was borne by them.

With the IPP and DPP cases proceeding quickly to trial, the risk of duplicative recovery has become manifest. To understand why that is so, it is easiest to focus on the panel and work backwards from the claims of the IPPs. While the conspiracy alleged across these cases was to fix the prices of the alleged input (the TFT-LCD panel) not just panel purchasers have sued. Instead, the IPP class members who bought computer monitors, notebook computers, and televisions containing TFT-LCD panels over an eight-year period in 23 states and the District of

Columbia are the final link in a complicated and elongated distribution chain that brings the TFT-LCD panels from manufacturers (including the defendants in these cases) to consumers. *See, e.g.*, Order Denying Defs.' Dispositive Mot. (Oct. 5, 2011) (D.I. 3833). The chain involves anywhere from one to six intermediaries, many of which are themselves suing for the same violation and seek to recover the same overcharge. *See* Hwang Decl. ¶ 4, Ex. C (Expert Report of Edward A. Snyder ¶ 131 (Aug. 10, 2009) (D.I. 1159) ("Snyder Report")).

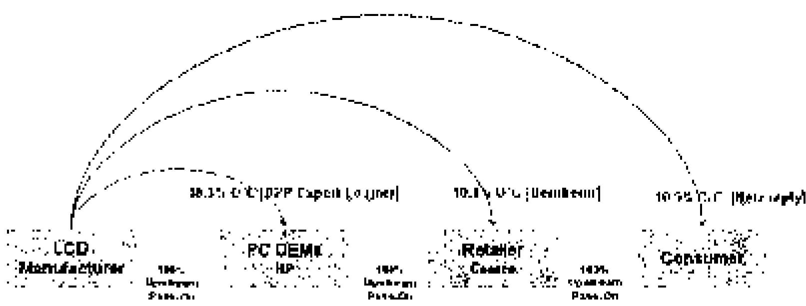
Adding to the risk of duplicative recovery, there is no one path that panels took in becoming the finished products the class members bought, as the chart below shows. *See id.* at ¶ 109; Hwang Decl. ¶ 5, Ex. D (Declaration of Janet S. Netz at 26 (June 2, 2009) (D.I. 1023-5) ("Netz Declaration")). The many intermediaries in the distribution chain structured their purchasing and sales operations in different ways and changed their purchasing and sales operations over time. *See* Snyder Report ¶ 109; Netz Decl. at 26-27. In most cases, the panel is first sold as a panel, usually (but not always) to a company that will incorporate it into a finished product. *See* Snyder Report ¶ 112 & Exh. 20.1-3; Netz Decl. at 26. That company might be the business under whose brand the product is sold (Dell, for example) or it may be a company operating under contract with the branded manufacturer. *See* Snyder Decl. ¶ 112 & Exh. 20.1-3; Netz Decl. at 26. In the latter case, the contracting company (variously called an "Original Design Manufacturer," "contract manufacturer," or "systems integrator") will assemble some or all of the finished product before selling it (or sometimes reselling it) to the branded company or "Original Equipment Manufacturer." *See* Snyder Decl. ¶¶ 113-14; Netz Decl. at 26-30.

With the television, notebook, or monitor assembled, the OEM has many potential sales channels. *See* Snyder Report ¶ 113; Netz Decl. at 30-31. OEMs sell some products to electronic products distributors such as DAP Tech Data, which then resell the products, often to small- and medium-sized retailers. *See* Snyder Report ¶¶ 113-14; Netz Decl. at 30-31. The OEMs sell other products to retailers such as DAPs Costco, Best Buy, and Office Depot. *Id.* They may also sell to consumers through websites or through their own retail stores. *See* Snyder Report ¶¶ 113-14; Netz Decl. at 30-31. Tech Data, Costco, Best Buy, and Office Depot have all asserted claims against Defendants. These distributors and retailers then sell their products to consumers or

businesses for their own use, many of whom are now members of the IPP classes.

No single path can stand in for the wide variation in distribution channels. Nonetheless, consider the example of IPP class representative Allen Kelley, discussed in the introduction. Mr. Kelley bought a HP monitor from Costco. Hwang Decl. ¶ 2, Ex. A (at 54:22-55:4). Hewlett-Packard may have been the direct purchaser of that panel or it may have bought from a systems integrator or ODM. Hwang Decl. ¶ 5, Ex. E (at 20:5-22:12). Similarly, IPP Mulvey bought a Sony monitor from DAP CompUSA (now Old Comp.). Hwang Decl. ¶ 7, Ex. F (at 61:18-23). In both examples, at least three separate plaintiffs in this MDL are claiming an overcharge on the same panel. As Figure 1 shows, these claims can quickly add up to more than the price of the original panel—for the panel in Mr. Kelley's monitor, the trebled damages exceed 140 percent of the price of the panel. As an expert for the first wave of DAPs has admitted, if all are allowed to collect there will be substantial duplication. Assuming that defendants hypothetically caused a $2 overcharge in panel prices for Mr. Kelley's or Ms. Mulvey's claim, that $2 overcharge results in $6 of awards if each level of the distribution chain is allowed to claim the entirety of the overcharge without allocation, and $18 when trebled. *See* Hwang Decl. ¶ 8, Ex. G (at 290-93).

Figure 1[7]



[7] HP has not yet submitted a report, so the alleged overcharge estimate provided here borrows from the direct purchaser class. *See* Hwang Decl. ¶ 9, Ex. H (at 64). The overcharge estimate for Costco is from Costco's proposed expert. Hwang Decl. ¶ 10, Ex. I (at 81). The overcharge at the consumer level is that offered by Dr. Netz. Hwang Decl. ¶ 3, Ex. B at 122.

Mr. Kelley and Ms. Mulvey are not unique. Of the 51 products the class representatives claim to have purchased, 23 of them were made by DAPs Dell, Sony, or HP (or HP's predecessor company Compaq). Hwang Decl. ¶ 11, Ex. J (Nos. 1 & 3, at 4-10); Hwang Decl. ¶ 12, Ex. K (at 4). Of the remaining 28 products, at least 11 were from a retailer already suing in the MDL. IPP representative Kou Srimoungchanh, for example, purchased his Toshiba notebook from DAP CompUSA. Hwang Decl. ¶ 13, Ex. L (at PLF-SRIMOUNGCHANH 00009).[3] Three other products were sold downstream of claims proceeding in the direct purchaser class action. Representative Chris Ferencsik, for example, purchased his Sharp television from direct purchaser class member Two Guys. Hwang Decl. ¶ 24, Ex. W (at 63:10-14).[4] Summing the duplication, the overlap is stark: more than 70% of the IPP class representatives' claims present at least one level of duplication with other upstream direct or indirect purchaser plaintiffs.

The duplication adds up to billions of dollars. The "Track One" retailer plaintiffs accounted for more than $10 billion worth of the classes' purchases of notebooks, monitors, and televisions. *See* Hwang Decl. ¶ 27, Ex. Z (Ex. 21 describing the percentage of Track 1 plaintiffs' sales that overlap with downstream plaintiffs); *id.* (Ex. 19 identifying the volume of sales of Track 1 plaintiffs)). While the IPPs' and DAPs' experts differ slightly about the magnitude of the initial overcharge, both agree that their clients are entitled to the entirety of that overcharge.[5] For

---

[3] Plaintiff Mortel purchased his Sharp television from plaintiff Good Guys. Hwang Decl. ¶ 14, Ex. M (at 75:1-2). Plaintiff Ho purchased his Hyundai monitor from plaintiff Office Depot. Hwang Decl. ¶ 15, Ex. N (at 109:18-20). Plaintiff Kerson purchased his Sharp television from plaintiff Good Guys. Hwang Decl. ¶ 16, Ex. O (at 46:7-8). Plaintiff Solo purchased his Sharp television from plaintiff Good Guys. Hwang Decl. ¶ 17, Ex. P (at 67:5-7). Plaintiff Ferns purchased *both* his Sharp televisions from plaintiff Brandsmart. Hwang Decl. ¶ 18, Ex. Q (at 91:7-8, 108:19-25). Plaintiff Murphy purchased his Samsung television from plaintiff Circuit City. Hwang Decl. ¶ 19, Ex. R (at 57:18-58:20). Plaintiff Ling-Hung Jou purchased her Maxent television from plaintiff Costco. Hwang Decl. ¶ 20, Ex. S (at 31:19-21). Plaintiff Tom DiMatteo purchased his Apple monitor from plaintiff CompUSA. Hwang Decl. ¶ 21, Ex. T (at 60:7-9). Plaintiff Beall bought his Samsung monitor at Circuit City. Hwang Decl. ¶ 22, Ex. U (at 53:11-18, 54:6-9). Plaintiff Blackwell bought one of her two Apple computers from Apple and the second from a "big store[]" that may have been plaintiffs Best Buy or CompUSA. Hwang Decl. ¶ 23, Ex. V (at 54:20-59:22).

[4] Plaintiff Hensen purchased his LG Electronics television from direct purchaser class member Karl's. Hwang Decl. ¶ 25, Ex. X (at 94:25-95:1). Plaintiff Eisler purchased his Acer television from direct purchaser class member Buy.com. Hwang Decl. ¶ 26, Ex. Y (at 58:17-19).

[5] *Compare* Hwang Decl. ¶ 28, Ex. AA (Netz at 110 ("These results verify that all class members suffer common harm in the amount of at least 100% of the overcharge imposed by Defendants at the top of the distribution chain.")), *with, e.g.*, Hwang Decl. ¶ 29, Ex. BB (Bernheim at 78) ("I computed damages for individual plaintiffs by applying a 100% pass-through rate to the dollar-

every product that a IPP class member purchased from one of the DAPs, then, at least the DAP and the IPPs are claiming an entitlement to the same 100 percent of the overcharge, and even were the numbers otherwise (the DAP retailer claims 75 percent; the indirect purchaser claims 90 per cent), any situation where the combined, alleged overcharge is greater than 100 percent, there is a risk of duplicative recovery.

III. ARGUMENT

A. Allowing Duplicative Recovery Would Violate Defendants' Due Process Rights

The Supreme Court has long recognized that potential for double liability raises serious due process concerns that *must* be mitigated by providing assurance against subsequent repetitive claims. In *Western Union*, 368 U.S. 71, the Supreme Court considered whether the State of Pennsylvania could lawfully compel a telephone company to escheat to the state certain money orders that were unclaimed and unpaid. Western Union objected on the ground that it could be subject to multiple liability in subsequent actions, either from senders of money orders who would not be bound by the escheat judgment or from other states seeking to escheat the same funds. 368 U.S. at 73-74. The Court agreed and held that the escheat action could not proceed absent assurance of protection against double recovery.

The Court first noted that, under its precedents "the holder of . . . property is deprived of due process of law if he is compelled to relinquish it without assurance that he will not be held liable again in another jurisdiction or in another suit brought by a claimant who is not bound by the first judgment." *Id.* at 75. Applying that principle, the Court held that "there can be *no doubt* that Western Union has been denied due process by the Pennsylvania judgment here *unless* the Pennsylvania courts had power to protect Western Union from any other claim." *Id.* (emphasis added). Due process required, the Court stressed, that "all interested States – along with all other claimants – can be afforded a full hearing and a final, authoritative determination." *Id.* at 80. Because the Pennsylvania court "cannot give such hearings" to all interested parties, the Court held, it "should have dismissed the case 'at the outset.'" *Id.* *See also Cities Serv. Co. v. McGrath*,

---

value overcharges for LCD panels.")

1 342 U.S. 330, 334-35 (1952) (holding that the Fifth Amendment required that defendant be
2 allowed to recoup property seized by the U.S. government if future claims from foreign
3 governments "would effect a double recovery against" the defendant).

4 Likewise here, Defendants face multiple claims to recover the same pot of money, th
5 alleged overcharge on TFT-LCD panels. Most prominent among these claims is that of the II
6 who claim over $2.86 billion in damages on the theory that, despite their position at the end c
7 multi-layered distribution chain, and despite the contrary claims and expert opinions of the D
8 DAPs and AGs, they absorbed 100 percent of the alleged overcharge. Due process requires
9 "assurance" – *before* the IPP case is permitted to go to judgment – that Defendants "will not
10 held liable again in another jurisdiction or in a suit brought by a claimant who is not bou
11 the first judgment," *i.e.*, in the pending actions by the DPPs, DAPs and AGs. *Western Union*
12 U.S. at 75. If the IPPs paid 100% of the alleged overcharge, then an upstream retailer or an
13 upstream distributor absorbed 0% of the alleged overcharge; it was all passed on. Conversel
14 an upstream distributor absorbed 100% of the alleged overcharge, then any downstream purc
15 paid 0% of the alleged overcharge. What cannot happen is for *both* the upstream distributor
16 have absorbed 100% of the alleged overcharge and the downstream purchaser to have paid 1
17 of the alleged overcharge. Yet, those are the very type of inconsistent and duplicative claims
18 Defendants now face.

19 While this Court may be the first to have to resolve this issue, it is not the first to hav
20 considered it. In the *SRAM* litigation, as here, there were both direct and indirect purchaser
21 claims, brought variously on behalf of a direct purchaser class, an indirect purchaser class, st
22 Attorneys General, and a number of direct action plaintiffs. Claims were brought on behalf c
23 OEMs of finished products, including computers and consumer electronics devices, distribut
24 of such finished products, and end consumers of devices containing SRAM chips. Faced wi
25 these competing claims, Judge Wilken posed the following thought hypothetical in advance c
26 trial: "Let's say there's a big verdict for the [direct purchasers] and then a verdict for the [ind
27 purchasers]." Hwang Decl. ¶ 30, Ex. CC (at 8). Having posed the question, she explained th
28 result – "We have a double recovery" – and then the legal effect: "It seems to me that would

be allowed. There has to be some sort of method of allocating. ... But in the end, when we come down to actually writing checks, you don't get it twice, I don't think, or the defendants don't have to pay it twice." *Id.* That same reasoning controls here, as the Supreme Court long ago recognized: "It ought to be and it is the object of courts to prevent the payment of any debt twice over." *Harris v. Balk*, 198 U.S. 215, 226 (1905). As a matter of due process, Defendants cannot be forced to write a check for the same claimed overcharge twice (or many times more). Putting them to that risk is a constitutional violation.

B. <u>Allowing Duplicative *Treble* Recovery Would Run Afoul of the Supreme Court's Punitive Damages Jurisprudence</u>

The risk of duplicative recovery in this case violates Defendants' due process rights for the additional reason that Defendants face not only a prospect of double liability but of *multiple treble-damages* awards for the same alleged overcharge. That prospect implicates the constitutional prohibition against excessive punitive damage awards, as the Supreme Court has described in cases such as *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003) and *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559 (1996). Courts have long recognized that treble antitrust damages serve the same punishment and deterrence goals as punitive damages. *E.g.*, *Tex. Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 639 (1981) ("The very idea of treble damages [in antitrust] reveals an intent to punish past, and to deter future, unlawful conduct, not to ameliorate the liability of wrongdoers."); *Bowman v. Am. Multi-Cinema, Inc.*, 623 F.3d 708, 715 (9th Cir. 2010) ("[T]he treble damages provisions in the Clayton and Sherman Acts act as statutory punitive measures in which two-thirds of the recovery is not remedial and inevitably presupposes a punitive purpose." (internal quotation marks omitted)); *In re W. Liquid Asphalt Cases*, 487 F.2d 191, 201 (9th Cir. 1973) (trebling of damages "is similar to punitive damages paid by a tortfeasor whose act injures several people"). Treble damage awards are therefore subject to the same due process constraints as traditional punitive damage awards.

Multiple payments of treble damages awards for the same injury clearly would violate these constraints. The Supreme Court has identified three "guideposts" for reviewing punitive awards: "(1) the degree of reprehensibility of the defendant's conduct; (2) the disparity between

1 the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the
2 difference between the punitive damages awarded by the jury and the civil penalties authorized or
3 imposed in comparable cases." *State Farm*, 538 U.S. at 418; *accord Gore*, 517 U.S. at 575.
4 Allowing every company and individual in the distribution chain to recover a treble damage
5 award based on the full overcharge cannot withstand scrutiny under *State Farm* and *Gore*. Put
6 directly, "[c]ommon sense dictates that a defendant should not be subjected to multiple civil
7 punishment for a single act or unified course of conduct which causes injury to multiple
8 plaintiffs." *In re N. Dist. of Cal. "Dalkon Shield" IUD Prods. Liab. Litig.*, 526 F. Supp. 887, 900
9 (N.D. Cal. 1981), *rev'd on other grounds*, 693 F.2d 847 (9th Cir. 1982); *Johnson v. Ford Motor*
10 *Co.*, 35 Cal. 4th 1191, 1209 (2005) ("repeatedly imposing punitive damages on the same
11 defendant for the same course of wrongful conduct may implicate substantive due process
12 constraints") (quoting *Owens-Corning Fiber. Corp. v. Malone*, 972 S.W.2d 35, 50 (Tex. 1998)).
13 The third *State Farm* factor weighs dispositively in favor of finding a due process
14 violation here. Congress and state legislatures have already determined that treble damages
15 provide the appropriate sanction in antitrust cases, a determination that the Supreme Court has
16 held deserves "substantial deference." *Gore*, 517 U.S. at 583 ("[A] reviewing court engaged in
17 determining whether an award of punitive damages is excessive should 'accord "substantial
18 deference" to legislative judgments concerning appropriate sanctions for the conduct at issue.'"
19 (quoting *Browning-Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 301
20 (O'Connor, J., concurring in part and dissenting in part))). Subjecting Defendants to paying
21 repeated treble damage awards to purchasers at every level of the distribution chain for the same
22 underlying conduct would thwart these legislative determinations.
23 Duplicative treble damage awards also violate the first two *State Farm* guideposts. First,
24 any finding of liability here would not involve the sort of reprehensibility that the Supreme Court
25 has indicated supports punitive damages. *State Farm*, 538 U.S. at 419 (reprehensibility evaluated
26 by considering whether "the harm caused was physical as opposed to economic; the tortious
27 conduct evinced an indifference to or a reckless disregard of the health or safety of others; the
28 target of the conduct had financial vulnerability; the conduct involved repeated actions or was an

isolated incident, and the harm was the result of intentional malice, trickery, or deceit, or mere accident"). Any harm is economic, not physical; nothing about Defendants' alleged conduct evinces any indifference to or disregard of the health or safety of others; and many of the plaintiffs are large corporations, not financially vulnerable individuals. All of these factors militate against a punitive award *greater* than one payment of treble damages. *See S. Union Co. v. Irvin*, 563 F.3d 788, 791-92 (9th Cir. 2009) (concluding "most of the indicia of reprehensibility do not appear" and reversing punitive damage award against public official for tortious interference when harm was economic, involved no disregard of safety, and victim was a large company); *Bains LLC v. Arco Prods. Co.*, 405 F.3d 764, 775 (9th Cir. 2005) (that harm from unlawful race discrimination "was economic and did not evince reckless disregard of health or safety ... reduces reprehensibility").

Second, although the Supreme Court has never set a "bright-line ratio which a punitive damages award cannot exceed," it has held that "[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee." *State Farm*, 538 U.S. at 425. The Court relied on this principle when, as a matter of federal admiralty law, it imposed a punitive-to-compensatory ratio of 1:1 for the $500 million compensatory award in the Exxon Valdez litigation. *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 515 (2008). Moreover, when considering an appropriate punitive-to-compensatory ratio, the Court has found "instructive" legislative decisions to impose "double, treble, or quadruple damages to deter and punish," including the treble damages remedy in antitrust law. *State Farm*, 538 U.S. at 425; *Gore*, 517 U.S. at 581 & n.33. Here, where any compensatory award may be substantial, and where Congress and state legislatures have mandated trebling that award, multiplying that already trebled award as will happen here if plaintiffs' competing demands are left unchecked would violate due process. *See also Irvin*, 563 F.3d at 792 (imposing a 3:1 punitive-to-compensatory ratio for economic tort where compensatory damages totaled nearly $400,000).

To avoid these serious due process problems, this Court must take steps now to ensure any treble damage award is allocated among prevailing plaintiffs according to their respective losses

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

C. **The Court Has a Duty To Avoid Duplicative Recovery under State Laws Invoked by Plaintiffs**

Even apart from the constitutional mandate, avoidance of duplicative liability is required as a matter of state law. Among the states that allow indirect purchaser standing in antitrust cases, many state legislatures have prohibited duplicative recovery and suggested to their courts to take steps to avoid it.

First, numerous state legislatures have expressly authorized defendants to assert a "pass-on" defense to ensure that any damages for an overcharge are properly allocated among plaintiffs along the distribution chain. *See* D.C. Code § 28-4509(b) ("a defendant shall be entitled to prove as a partial or complete defense to a claim for damages that the illegal overcharge has been passed on to others who are themselves entitled to recover so as to avoid duplication of recovery of damages."); Haw. Rev. Stat. § 480-13(c)(2) (same); N.Y. Gen. Bus. Law § 340(6) (same); N.M. Stat. Ann. § 57-1-3(C) ("any defendant, as a partial or complete defense against a damage claim, may, in order to avoid duplicative liability, be entitled to prove that the plaintiff purchaser or seller in the chain of manufacture, production, or distribution who paid any overcharge . . . passed on all or any part of such overcharge"); N.D. Cent. Code Ann. § 51-08.1-08(4); *see also* S.D. Codified Laws § 37-1-35 (generally prohibiting duplicative recovery in antitrust actions: "The court shall exclude from the amount of monetary relief awarded for such action any amount of monetary relief which duplicates amounts which have been awarded for the same injury.").[6]

[6] In addition, several states have specific statutes that prohibit duplicative recovery in suits by the state Attorneys General suing as *parens patriae*. *See* Ark. Stat. Code Ann. § 4-75-212(b)(1)(B) ("The court shall exclude from the amount of monetary relief awarded in the action any amount which duplicates amounts that have been awarded for the same injury already"); Cal. Bus. & Prof. Code § 16760(a)(1) ("The court shall exclude from the amount of monetary relief awarded in the action any amount of monetary relief (A) which duplicates amounts which have been awarded for the same injury, or (B) which is properly allocable to (i) natural persons who have excluded their claims . . . , and (ii) any business entity"); Fla. Stat. Ann. § 542.22(2) (in parens patriae action, "[t]he court shall exclude from the amount of monetary relief awarded in such action any amount of monetary relief which: (a) [d]uplicates amounts which have been awarded for the same injury"); Or. Rev. Stat. § 646.775(1)(b)(A) (similar); R.I. Gen. Laws § 6-36-12(g) (similar). So too does the federal government under the Hart-Scott-Rodino Act (HSRA), which, among other things, allows state Attorney Generals to pursue *parens patriae* claims on behalf of indirect purchasers under the Clayton Act. Originally, the draft HSRA said nothing about duplicative recovery. Before enactment, however, the Senate changed the bill, so that it now provides that "[t]he court shall exclude from the amount of monetary relief awarded in such action any amount of monetary relief . . . which duplicates amounts which have been awarded for the same injury[.]" 15 U.S.C. § 15c(a)(1). As the accompanying report to the HSRA explained,

1 Next, in order to effectuate the requirement to allocate damages, states have expressly
2 authorized or required their courts to exercise their case management powers to avoid duplicate
3 liability for the same antitrust injury. For example, the New York antitrust statute, the Donnelly
4 Act, mandates that "the court shall take all steps necessary" to avoid duplicative liability
5 including consolidation. N.Y. Gen. Bus. Law § 340(6); *see also* 740 Ill. Comp. Stat. 10/7(2)
6 ("[I]n any case in which claims are asserted against a defendant by both direct and indirect
7 purchasers, the court shall take all steps necessary to avoid duplicate liability for the same injury
8 including transfer and consolidation of all actions."). Other statutes authorize consolidation,
9 apportionment and a "delay [sic] disbursement of damages to avoid multiplicity of suits and
10 duplication of recovery of damages." D.C. Code § 28-4509(c); *see also* Haw. Rev. Stat. § 480-
11 13(c)(5); Minn. Stat. Ann. § 325D.57 (authorizing court to "take any steps necessary to avoid
12 duplicative recovery against a defendant"); Miss. Code Ann. § 75-21-9 (authorizing antitrust suits
13 for direct and indirect injury and providing "All recoveries herein provided for may be sued for in
14 one suit"); Vt. Stat. Ann. tit. 9 § 2465(b) ("The court shall take all necessary steps to avoid
15 duplicate liability, including but not limited to the transfer or consolidation of all related
16 actions.").

17 State courts have consistently explained that duplicative recovery in indirect purchaser
18 suits should be avoided, and have endorsed various case management devices, including
19 consolidation, interpleader, and mandatory joinder, to bring the claimants together and apportion
20 damages. For example, the California Supreme Court, while holding that the pass-on defense is
21 ordinarily inapplicable to direct or indirect purchaser claims under California's antitrust statute,
22 the Cartwright Act, nonetheless ruled that the "bar on consideration of pass-on evidence *must*
23 *necessarily be lifted*" where, as here, "multiple levels of purchasers have sued, or where a risk
24 remains they may sue" in order to avoid duplicative recovery. *Clayworth v. Pfizer, Inc.*, 49 Cal.
25 4th 758, 787 (2010) (emphasis added); *see also Bunker's Glass Co. v. Pilkington PLC*, 75 P.3d
26 99, 108 (Ariz. 2003) (noting "legitimate and important concern" of duplicative recovery). The
27
28 Congress thought it important to "assure that defendants are not subjected to duplicative liability[.]" Sen. Rep. No. 94-803, 2d Sess. (1976), p. 44

1 California Supreme Court further stated that "joinder, interpleader, consolidation, and like
2 procedural devices" should be used to "bring all claimants before the court" to allocate damages
3 among the "various levels of injured purchasers." 49 Cal. 4th at 787. Thus, as a matter of state
4 law, the claims of the IPPs and the DAPs under state law must be adjudicated in a way that avoids
5 duplication of recovery. *See e.g., In re Digital Music Antitrust Litig.*, 812 F. Supp. 2d 390
6 (S.D.N.Y. 2011) (holding that procedural considerations in state antitrust laws apply in federal
7 court sitting in diversity where they are bound up in the underlying right).

8 **D. Various Plaintiffs' Sherman Act Claims Are Also Subject To Allocation**

9 In *Hanover Shoe, Inc. v. U.S. Mach. Corp.*, 392 U.S. 481, 489-94 (1968), the Court
10 restricted the use of a pass-on defense for federal direct-purchaser antitrust claims. The Court
11 reasoned that allowing pass-on defenses (1) would require "long and complicated proceedings"
12 and (2) individual consumers to whom overcharges were passed would have little incentive to
13 sue, allowing antitrust violators to "retain the fruits of their illegality." *Id.* at 494; *see Ill. Brick*
14 *Co. v. Ill.*, 431 U.S. 720, 725-26 (1977) (describing dual rationale of *Hanover Shoe*).
15 Nevertheless, the Court expressly held that the bar on pass-on defenses was not absolute: "We
16 recognize that there might be situations – for instance, when an overcharged buyer has a pre-
17 existing 'cost-plus' contract, thus making it easy to prove that he has not been damaged – where
18 the considerations requiring that the passing-on defense not be permitted in this case would not be
19 present." 392 U.S. at 494. These cases present a situation where pass-on evidence must be
20 permitted to permit allocation of damages.

21 Neither of the Supreme Court's two rationales for precluding consideration of pass-on
22 exist here. The complexity that the Court sought to avoid by excluding a pass-on theory is
23 already part of this case. Both the IPPs' damages and the indirect damages claims of certain
24 direct action plaintiffs necessarily rise or fall on their proof of pass through. Therefore, there is
25 no risk that, if pass-on evidence is allowed and Defendants are found liable, they will "retain the
26 fruits" of their illegality. The risk is the opposite. Without the right to assert a pass through
27 defense against *all* plaintiffs, many plaintiffs could get windfall damages while Defendants could
28 pay not just once but multiple times, in contravention of their due process rights.

1 That *Hanover Shoe* does not establish an absolute bar to a pass-on defense is further
2 confirmed by *Cal. v. ARC Am. Corp.*, 490 U.S. 93 (1989), in which the Supreme Court held that
3 state *Illinois Brick* repealer statutes were not preempted. The Court rejected the argument that
4 federal direct purchaser plaintiffs might have to share damages with indirect purchaser plaintiffs,
5 explaining "*Illinois Brick* was not concerned with the risk that a plaintiff might not be able to
6 recover its entire damages award." *Id.* at 104. Therefore, the fact that a pass-on theory might
7 reduce the direct purchaser damages is no reason to bar it. The basis of *Hanover Shoe* is not to
8 guarantee that direct purchasers collect the full overcharge even when they recouped some or all
9 of it by passing it on; rather, the Court was concerned with avoiding a situation where a liable
10 defendant was able to avoid paying damages *at all* by arguing that overcharges were passed on to
11 absent parties with no claim. This concern is plainly not implicated here.

12 *ARC* confirms that *Hanover Shoe*'s approach must give way when both direct and indirect
13 purchasers have sued. As *Illinois Brick* makes clear, a bar on pass-on defenses makes sense only
14 in a world where *only* direct purchasers have an injury. *Illinois Brick*, 431 U.S. at 736, 746-47.
15 Once indirect purchasers may bring suit, as they have done here under state law, the proscription
16 on pass-on arguments and evidence envisioned in *Hanover Shoe* and *Illinois Brick* is untenable.

17
18 F. **<u>The Court Should Employ One or More of the Following Case Management Devices to Avoid Multiple Recovery</u>**

19 Having shown that the Court is obligated to assure that duplicative recovery does not
20 occur, the question becomes what is the Court to do. While recognizing that the law places the
21 burden on the Court to resolve this question, Defendants nevertheless offer the following
22 procedural mechanisms the Court may employ. Rising to constitutional proportions, the threat of
23 duplicative recovery requires an aggressive response, which Defendants' list reflects. The list is
24 not meant to be exhaustive, nor is any one suggestion meant to be exclusive or sufficient by itself.
25 Instead, the offered list recognizes the tools the Court has at its disposal, offers suggestions as to
26 how those tools may be used (and at times interconnect), and finally offers proposed solutions to
27 anticipated hurdles. The duplicative recovery problem presented here is massive and requires
28 creative thought to solve. Defendants offer their list in an effort to help the Court fulfill its

obligation to address and to resolve this significant issue.

<u>Bifurcate the damage issues in Class Trials and consolidate for trial with all DAP and AG actions</u>. As discussed above, consolidation of the competing claims for the purpose of allocating damages is the most straightforward means of ensuring that duplicative recovery will not occur. This is precisely what the U.S. Supreme Court held was required to protect the defendant's due process rights in *Western Union*. *See Western Union*, 368 U.S. at 79 (it is "imperative" that competing claims "be settled in a forum where all [interested parties] . . . can present their claims for consideration and final authoritative determination"). For those claims that were initially filed in the Northern District of California, consolidation is available under Federal Rules of Civil Procedure 42(a), which this Court can invoke *sua sponte*. For the cases that are before this Court only for pre-trial purposes (*e.g.*, *Tech Data Corp. v. AU Optronics Corp.*, No. 8:11-cv-05765 (M.D. Fla.)), the Court could order defendants, with its consent, to file motions seeking to transfer those actions to this Court under 28 U.S.C. § 1404(a) for subsequent consolidation and trial. Additionally, for the same cases, the Court could contact the originating courts and request that *they* exercise their authority to transfer those cases and issue § 1404(a) transfer orders after notice to the parties.

That said, consolidation will take some time. If the Court believes that it is important to try the DPP and IPP actions in the near term or under the current schedule, the Court could bifurcate the class actions between liability and damages phases so that the liability phase could proceed promptly. The liability phase will identify those plaintiffs, if any, who have a right to recover without determining how much they are entitled to receive. Defendants again believe that will be a null set and that they will prevail at trial. Should the trial prove otherwise, a similar process could be implemented in the DAP and AG cases, and, should there be a need to award damages to any party after that process has run, the Court could then consolidate all damages phases for trial. The benefits of this process are self-evident. It allows the cases to continue to progress, it may promote settlement if there are findings of liability, it works to ensure that multiple claims brought by plaintiffs along the distribution chain will not result in the duplicative recovery described above, and it gives all parties a better sense of how the Court intends to

address this important issue.

The law fully supports this approach. Bifurcating between liability and damages phases is not uncommon in complex cases like this one. *See, e.g.*, *Barr Labs., Inc. v. Abbott Labs.*, 978 F.2d 98, 115 (3d Cir. 1992) ("bifurcation would prove beneficial by enhancing juror comprehension of the complex issues presented"); *MCI Commc'ns Corp. v. Am. Tel. & Tel. Co.*, 708 F.2d 1081, 1167-68 (7th Cir. 1983). Indeed, some of the very state statutes referenced above contemplate a phased approach to damages. *See, e.g.*, D.C. Code § 28-4509(c) ("In any case in which claims are asserted by both direct purchasers and indirect purchasers, the court may delay disbursement of damages to avoid multiplicity of suits and duplication of recovery of damages . . . ."). Structured the right way, the process can be consistent with the Seventh Amendment. *See, e.g.*, *In re Ampicillin Antitrust Litig.*, 88 F.R.D. 174, 179 (D.D.C. 1980); *In re Master Key Antitrust Litig.*, 70 F.R.D. 23, 29 (D.Conn. 1975), *appeal dismissed*, 528 F.2d 5 (2d Cir. 1975) ("I find the defendants' constitutional objections unpersuasive and order that separate trials be held on the issues of liability and damages"). Moreover, bifurcation serves the end of judicial efficiency by having a single damages trial across many claimants. In short, using this Court's trial management authority, bifurcation and consolidation are recognized and powerful tools this Court could use to meet its obligation to avoid duplicative recovery.[7]

Join All Parties For Interpleader: A related approach may again be to bifurcate liability and damages and then order class defendants, with their consent, to join the parties in the DAP and AG cases (or known possible other parties) for interpleader under Federal Rule of Civil Procedure 22 and/or 28 U.S.C. § 1335. If the class defendants prevail in the liability phase, there will not be a need for interpleader, but, as a procedural tool, interpleader is well suited for this type of situation. In addition to protecting against multiple lawsuits and possibly inconsistent or multiple determinations of liability, interpleader promotes judicial economy by requiring the "rival claimants to litigate . . . the decisive issue" before a single court. *See, e.g.*, *Tex. v. Fla.*, 306

---

[7] Defendants suggest bifurcation only if the Court orders consolidation of the damages phase of all actions to avoid duplicative recovery. Defendants do not believe that bifurcation would be appropriate otherwise and would oppose bifurcating liability and damage phases in any particular case.

U.S. 398, 405-07 (1939). Confirming the point, states, the laws of which are invoked in the IPP case, and the Ninth Circuit recognize that interpleader may be an appropriate mechanism to protect against the risks of duplicative liability, as noted above.

<u>Declare the parties not before the Court in the class cases indispensible parties under Rule 19 and require the class plaintiffs to propose a resolution</u>: Separately, given that parties not before the Court and parties before the Court have identical or overlapping claims for damages, Rule of Civil Procedure 19 is implicated and the Court should consider whether absent parties are necessary. Indeed, the Court has the authority, if not the duty, to raise the issue *sua sponte*. *See McShan v. Sherrill*, 283 F.2d 462, 464 (9th Cir. 1960) ("The absence of indispensable parties can be raised at any time, however, even by the appellate court on its own motion."). Once raised, an iterative process begins. First, the Court must determine whether the absent parties are necessary, meaning in this case, that defendants face "a substantial risk of incurring double, multiple, or otherwise inconsistent obligations." Fed. R. Civ. P. 19(a)(1)(B)(ii). That step is easily satisfied here, and indeed drives this discussion. Next, the Court must determine whether those parties can be joined, *see* Fed. R. Civ. P. 19(a)(2), an analysis that repeats much of the analysis above. If the absent parties cannot be joined to the pending class actions, the Court then would consider, among other things, whether any steps may be taken to eliminate the prejudice to the defendants from pursuing the class actions without those absent parties. *Provident Tradesmens Bank & Trust Co. v. Patterson*, 390 U.S. 102, 111-12 (1968). If the Court determines that the prejudice to the defendants cannot be eliminated, the Court may consider dismissing the action. *Id.*

<u>Consistent with consolidation, or interpleader, this Court could reach out to the state courts where claims are pending and coordinate the proceedings to avoid duplicative recovery</u>: Bifurcation, consolidation, and interpleader will get this Court far down the road of avoiding duplicative recovery, but it will not get the Court all of the way. Some direct, indirect, and *parens patriae* claims brought by state Attorneys General are now pending in state courts throughout the country, *see, e.g.*, *People of the State of California, ex rel. Kamala D. Harris v. AU Optronics Corporation, et al.*, No. CGC-10-504651 (Cal. Superior Ct.), and, at least if

brought in state courts in this Circuit, cannot currently be removed to federal court. *See, e.g.*, *Wash. v. Chimei Innolux Corp.*, 659 F.3d 842 (9th Cir. 2011). Similarly, the Eleventh Amendment may stand as a bar to defendants interpleading certain states. *See, e.g.*, *Cory v. White*, 457 U.S. 85, 89-90 (1982).

These obstacles presented by the state court actions do not eliminate or lessen this Court's obligation to avoid duplicative recovery. Instead, folding in the state Attorneys General actions into a comprehensive resolution plan again invites creativity. The California action, for example, is now pending before the Superior Court of California for the County of San Francisco, Judge Richard A. Kramer presiding, Case No. 10-504651. Judge Kramer has already suggested that he has experience coordinating his cases with MDL proceedings. Hwang Decl. ¶ 31, Ex. DD (at 11:15-12:3) ("I had something called the automobile antitrust cases with an MDL action in the state of Maine. . . . [T]he federal judge [and I] . . . [w]e crafted an order that basically had the federal action go forward with very little activity here, but still the possibility to have things happen. [B]asically, we both just kept on top of what was going on with the idea being that the federal court, because of the supremacy clause and because he had a much bigger situation than I had, was the dog and I was the tail. That worked pretty well."). He indicated that it already was his plan to reach out to this Court in an effort to coordinate his case with the MDL. *Id.* at 21:12-21. This Court could do the converse for those cases that are now proceeding outside the MDL in state court, reaching out to those courts to jointly devise a plan that ensures the avoidance of duplicative recovery.

Such solutions are not unprecedented. For example, while interpleader may raise Eleventh Amendment immunity questions *before* liability is determined, federal courts hearing admiralty claims have found that concern eliminated *after* resolving liability, allowing "limitation" claims against states to proceed to ensure a just allocation of the *res*. *See, e.g.*, *Magnolia Marine Trans. Co. v. Okla.*, 366 F.3d 1153, 1160 (10th Cir. 2004) ("the State's invocation of sovereign immunity stands the relationship between the parties on its head"). The same has been found true in the bankruptcy setting. *See, e.g.*, *Gardner v. N.J.*, 329 U.S. 565, 574 (1947) ("When the State becomes the actor and files a claim against the fund it waives any

immunity which it otherwise might have had respecting the adjudication of the claim.").
Assuming the affected state courts are amenable, this Court could suggest a timed approach that allows all cases, state and federal, to be merged at the right time. Thus, with careful coordination and creative thought, it may be possible to bring all parties with claims before the Court at the right moment if the staging is done correctly.

<u>Either issue an order that the direct action plaintiffs and state Attorneys General will be estopped in their damage claims from taking any position inconsistent with any award made in the class trial, or issue an order that "vouches in" anyone who has a related claim, alerting all interested parties that their claims may be waived if they do not seek to intervene in the class trial</u>. As creativity may help solve jurisdictional hurdles, so too may creativity solve the problem of various cases proceeding in different jurisdictions and/or at different times. Across the DPP, IPP, DAP, and AG cases, certain common damages questions will be litigated perhaps to differing and inconsistent results if tried separately. As discussed above, the indirect end user plaintiffs claim that the alleged amount of overcharge that was passed on to them for their TFT-LCD products was high – near 100%. The DAP retailer plaintiffs who sold to those IPPs disagree. If all the parties in the same distribution line are not before the Court when the pass-on issues are resolved, some mechanism must be put in place that nevertheless ensures that those issues are resolved only once. This Court's inherent equitable powers afford it various mechanisms to achieve this.

For example, the Supreme Court has recognized that a nonparty may still be precluded – and here both issue and claim preclusion are implicated – based on "'substantive legal relationship[s]' between the person to be bound and a party to the judgment[,]" or where a "'special statutory scheme'" "expressly foreclos[es] successive litigation by nonlitigants." *Taylor v. Sturgell*, 553 U.S. 880, 894, 895 (2008). Although normally applied when real property is involved, "[q]ualifying relationships include, but are not limited to preceding and succeeding owners of property, bailee and bailor, and assignee and assignor." *Id.* at 894. Certain states have held that parties within the "'chain of sale'" "are in privity," *see Little v. V & G Welding Supply, Inc.*, 704 So.2d 1336, 1339 (Miss. 1997), while others have noted that "a manufacturer-supplier

of goods stands in 'vertical privity' in the 'chain of sale' to the retailer and purchaser." *Thompson v. Karastan Rug Mills*, 323 A.2d 341, 345 (Pa. Super. Ct. 1974). This Court has recently reiterated its view that as to the claims for *injunctive* relief, these class cases will not have preclusive effect on certain claims proceeding elsewhere. Order re: States of Illinois and Washington's Administrative Motion to Clarify January 30 Order (Feb. 27, 2012) (D.I. 4885). As to the *damages* claims, however, this Court could apply general equitable principles to preclude claims or conclusively establish certain facts (alleged pass through, *etc.*) by parties within the same distribution chain.

Defendants acknowledge that there is secondary authority that suggests that this form of non-party preclusion only works down the distribution chain (a predecessor binds a successor), not up (a successor cannot bind a predecessor). *See, e.g.*, Restatement (Second) of Judgments § 43 cmt. e. Yet, given the overlay of the unique federal and state antitrust statutory schemes here, that concern may well be inapposite. Regardless, even only working down the distribution scheme, the Court could conclude that the damages claims of downstream buyers – IPPs and DAPs alike – are precluded to the degree that the upstream claims of the DPPs have been resolved, any overcharge is awarded to those upstream DPPs, and the underlying TFT-LCD panel is the same. While no court has been presented with application of this approach in the antitrust direct/indirect purchaser context post *Taylor*, courts in this Circuit have applied *Taylor* to bar claims brought by a downstream predecessor in interest where an upstream claim has been adjudicated. *See, e.g.*, *Crane-McNab, LLC v. County of Merced*, 2010 WL 4024936, at *4 (E.D. Cal. Oct. 13, 2010) ("Plaintiffs claims are barred by the prior litigation even if they were not the named-parties, because Plaintiffs are succeeding owners of the property at issue in the prior litigation.")

A related option might be to pursue an extended form of the common law "vouching in" process. The concept recognizes that "[p]reclusion may extend to a nonparty who did not participate in an action on the ground that the nonparty should have participated." Wright & Miller, 18A Federal Practice & Procedure § 4452 (2d ed. 2011). There is not an insignificant question whether the doctrine remains alive, *see id.*; *Martin v. Wilks*, 490 U.S. 755 (1989)

1 *Kourtis v. Cameron*, 419 F.3d 989, 998 (9th Cir. 2005) *overruled on other grounds by Taylor*,
2 553 U.S. at 904, but "[a] few cases and some commentary . . . have raised the question whether
3 some circumstances may justify preclusion for failure to intervene[.]" and particularly in places
4 where "special remedial schemes" "are designed specifically to foreclose non participants." 18A
5 Federal Practice & Procedure § 4452. The analogy here is to bankruptcy law. There – given the
6 specialized nature of the law – courts have held that "a party may be barred from future litigation
7 by his mere failure to intervene" after notice. *Griffin v. Burns*, 570 F.2d 1065, 1071 n.7 (1st Cir.
8 1978). Similarly, courts have held that in unusual circumstances, where non-parties "were
9 aware" of the previous suits, "knew that their interests were at stake," and "monitored" the
10 litigation "closely," they could be deemed bound by the result of the earlier litigation where they
11 chose not to intervene. *Nat'l Wildlife Fed'n v. Gorsuch*, 744 F.2d 963, 971 (3d Cir. 1984).[9]
12 Related concepts would apply here. Like in bankruptcy, the underlying premise is that if there
13 has been a wrong that resulted in alleged overcharges, that universe is not unlimited. Instead it
14 would create a pool – the total found overcharge (if any) – against which claims could be drawn.
15 This Court could then give notice to all parties of its intent to invoke this option. Those who then
16 chose not intervene would be bound by the upcoming trial's outcome as to found facts concerning
17 damages. Given that at least some courts have concluded that some form of "vouching" remains
18 viable in a post-*Wilks* world, *see, e.g.*, *Universal Am. Barge Corp. v. J-Chem, Inc.*, 946 F.2d
19 1131, 1139 (5th Cir. 1991) ("This court recognizes vouching as a valid procedural device."), this
20 is a further option this Court could explore.

21 ***Summation:*** The above discussion demonstrates that the Court, all parties to the pending
22 class trials, and all other claimants have an obligation to and interest in developing a resolution to

23

[9] By virtue of the MDL procedures, all actual and potential claimants have long been on notice of
24 the competing demands along the TFT-LCD supply chain for the same overcharge damages. In
addition, in connection with this motion, Defendants are giving notice to all DAPs and AGs that
25 they intend to assert damages-related preclusion based on the results of the upcoming DPP/IPP
trial, which notice then affords them the option to weigh in on the appropriate procedures for
26 effecting this result. Before the resolution of this motion, LG Display (and likely other
defendants) will also seek leave to add declaratory relief counterclaims in all pending DAP and
27 AG cases on the duplicative recovery issue. The remaining IPP and DPP Defendants would also
be happy to amend their answers to add a declaratory relief claim in the IPP and DPP class
28 actions if the Court feels it would help.

1 avoid duplicative recovery and to do so in a fair and efficient manner. Most antitrust MDLs do
2 not get this far, and, as a result, there is not abundant authority explaining what the Court is to do.
3 One thing the laws makes clear, though, is that doing nothing is not an option. Duplicative
4 recovery must be avoided.

5 As the above analysis reflects, the remaining IPP and DPP Defendants have given
6 substantial thought to the options this Court has available to meet its burden to avoid the inequity
7 of duplicative recovery. Defendants, however, encourage the Court to invite the class plaintiffs
8 and other interested claimants to *also* propose meaningful solutions. Once the Court determines
9 what options it would like to explore, it may make sense to request further briefing.

10 IV. <u>CONCLUSION</u>

11 For the foregoing reasons, Defendants request an order adopting the procedural
12 mechanisms to avoid multiple recovery and/or further guidance from the Court on how it will
13 advance this important and necessary end result.

14

15 DATED: March 12, 2012

By: /s/ Hojoon Hwang
Brad D. Brian (State Bar No. 079001)
Jerome C. Roth (State Bar No. 159483)
Hojoon Hwang, Esq. (State Bar No. 184950)
Stuart N. Senator (State Bar No. 148009)
Jonathan E. Altman (State Bar No. 170607)
Truc T. Do (State Bar No. 191845)
Hailyn J. Chen (State Bar No. 237436)
MUNGER, TOLLES & OLSON LLP
355 South Grand Avenue
Los Angeles, CA 90071-1560
Telephone: (213) 683-9100
Facsimile: (213) 687-3702
Brad.Brian@mto.com

16
17
18
19
20
21
22
23
24
25
26
27
28

1 By /s/ Holly A. House
2 Holly A. House (State Bar No. 136045)
Lee F. Berger (State Bar No. 222756)
3 Paul Hastings LLP
55 Second Street
4 Twenty-Fourth Floor
San Francisco, CA 94105
5 Telephone: (415) 856-7000
Facsimile: (415) 856-7100
6 *hollyhouse@paulhastings.com*
leeberger@paulhastings.com
7
Attorneys for Defendants LG Display Co., Ltd.
8 *and LG Display America, Inc.*

9 By /s/ Christopher A. Nedeau
Christopher A. Nedeau (State Bar No. 81297)
10 Carl L. Blumenstein (State Bar No. 124158)
James A. Nickovich (State Bar No. 249959)
11 Chi Soo Kim (State Bar No. 232346)
NOSSAMAN LLP
12 50 California Street, 34th Floor
San Francisco, CA 94111
13 Telephone: 415.398.3600
Facsimile: 415.398.2438
14 cnedeau@nossaman.com
cblumenstein@nossaman.com
15 jnickovich@nossaman.com
ckim@nossaman.com
16
Attorneys for Defendants AU Optronics
17 *Corporation and AU Optronics Corporation*
America
18

19 By /s/ Christopher M. Curran
John H. Chung (Pro hac vice)
20 WHITE & CASE LLP
1155 Avenue of the Americas
21 New York, NY 10036
(212) 819-8200 (Phone)
22 (212) 354-8113 (Facsimile)
jchung@whitecase.com
23
Christopher M. Curran (Pro hac vice)
24 Kristen J. McAhren (Pro hac vice)
WHITE & CASE LLP
25 701 Thirteenth Street, NW
Washington, DC
26 (202) 626-3600 (Phone)
(202) 639-9355 (Facsimile)
27 ccurran@whitecase.com
kmcahren@whitecase.com
28

Counsel for Defendants Toshiba Corporation, Toshiba Matsushita Display Technology Co., Ltd., Toshiba America Electronic Components, Inc. and Toshiba America Information Systems, Inc.

Attestation: The filer of this document attests that the concurrence of the signatories thereto has been obtained.

[illegible]

Appendix 4

Order on Trial Structure app. 4, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. Apr. 20, 2012), ECF No. 5518

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

IN RE: TFT-LCD (FLAT PANEL) ANTITRUST LITIGATION	No. M 07-1827 SI MDL. No. 1827
This Order Relates To: All Direct- and Indirect-Purchaser Plaintiff Class Actions	**ORDER REGARDING TRIAL STRUCTURE**

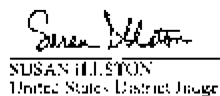
On April 20, 2012, the Court heard argument on separate motions[1] regarding how the May 21, 2012 trial should be structured in this MDL. Having considered the papers submitted, oral argument, and for good cause shown, the Court orders as follows.

The Court will bifurcate this jury trial into two phases. In the first phase, Direct- and Indirect-Purchaser Plaintiffs ("DPPs" and "IPPs") will present evidence of Defendants' price-fixing conspiracy. In addition, DPPs will present their evidence of increases in TFT-LCD panel prices and of their damages. The jury will be asked to make a finding on the existence of the alleged price-fixing conspiracy and, if that finding is positive, on liability to the DPPs and the amount of DPP damages. In the second phase, IPPs will present their evidence concerning their state law claims, including increases in TFT-LCD panel prices and pass-on, and the amount of damages. The jury will then be asked to make a finding on liability to the IPPs and the amount of IPP damages.

[1] Motion of Defendants Regarding Trial Structure and for Relief to Avoid Duplicative Recovery (Master Docket No. 5258), and Direct-Purchaser Plaintiffs' Motion to Bifurcate Trial into Two Phases (Master Docket No. 5455).

United States District Court
For the Northern District of California

1 The jury will be informed at the outset that the trial will proceed in these two phases, and will
2 be given a general statement as to the purpose of each of the phases.
3
4
5 IT IS SO ORDERED.
6
7
8 Dated: April 20, 2012



SUSAN ILLSTON
United States District Judge

9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

United States District Court
For the Northern District of California

Appendix 5

Order Denying Motion for Leave to Amend to add additional defenses and a counterclaim for declaratory relief to address the risk of duplicative liability caused by multiple plaintiffs seeking to recover for the same alleged overcharge, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, No. 3:07-md-01827-SI (N.D. Cal. May 25, 2012), ECF No. 5795

United States District Court
For the Northern District of California

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

IN RE: TFT-LCD (FLAT PANEL) ANTITRUST LITIGATION	No. M 07-1827 SI MDL. No. 1827
This Order Relates to Direct Action cases filed by Best Buy Co., Inc.; Electrograph Systems, Inc.; Target Corp.; Arthur R. Siegel, trustee of Circuit City, SB Liquidation Trust; Tracfone Wireless, Inc.; State of Missouri, et al. (Five States); State of Florida; State of Oregon; and Costco Wholesale Corp.	Case Nos.: C 10-4572 SI; C 10-117 SI; C 10-4945 SI; C 10-5625 SI; C 10-5458 SI; C 10-3205 SI; C 10-3619 SI; C 10-03517; C 10-4346 SI; C 11-0058 SI **ORDER DENYING LG DISPLAY AMERICA, INC. AND LG DISPLAY CO., LTD.'S MOTION FOR LEAVE TO AMEND**

Defendants LG Display America, Inc., and LG Display Co., LTD (collectively, "Defendants") have filed a motion in the above captioned direct purchaser actions for leave to amend their answers to add additional defenses and to file a counterclaim for declaratory relief. Master Docket No. 5271. Having considered the arguments presented in the moving papers, the Court hereby DENIES Defendants' motion.

Defendants seek leave to amend their answers to "add additional defenses and a counterclaim to address the risk of duplicative liability caused by multiple plaintiffs seeking to recover for the same alleged overcharge." Motion at 1. Defendants' moving papers set out arguments very similar to those made in Defendants' Motion Regarding Trial Structure and for Relief to Avoid Duplicative Damages. *See* Master Docket No. 5258. The Court found then and finds now that Defendants have not provided legal basis for their proposed "violation of laws of duplicative recovery" defense or for their proposed counterclaims for declaratory judgement regarding the same. *See e.g., In re Flash Memory Antitrust*

Litig., 643 F. Supp. 2d 1143, 1156 (N.D. Cal. 2009) ("Duplicative recovery is, in many if not all cases alleging a nationwide conspiracy with both direct and indirect purchaser classes, a necessary consequence that flows from indirect purchaser recovery.") (quoting *In re Dynamic Random Access Memory (DRAM) Antitrust Litig.*, 516 F. Supp. 2d 1072, 1089 (N.D. Cal. 2007)). Should Defendants wish to challenge any allocation of damages, they are free to do so post-trial.

Accordingly, the Court **DENIES** Defendants' Motion for Leave to Amend. (Master Docket No. 5271).

IT IS SO ORDERED.

Dated: May 25, 2012

SUSAN ILLSTON
United States District Judge

Appendix 6

Most Favored Nation Clause

Most Favored Nation Clause

4.2 Π shall not enter into a settlement with any defendant or, if applicable, Defendant Group in the Action other than the Releasees unless the settlement payment exceeds $$$ for each such defendant. If Π does enter into a settlement with any current or newly named defendant or, if applicable, Defendant Group in the Action other than the Releasees for an amount less than $$$, then Π shall pay back to Δ the difference between the lowest settlement reached by Π and $$$. For purposes of this paragraph, settlement payment or settlement amount means only cash payments paid in exchange for release, and does not include, among other things, coupons, discounts, rebates, products, and other in-kind compensations.

4.3 No later than seven (7) days after entering into a settlement with any current or newly named defendant or, if applicable, Defendant Group in the Π Action other than the Releasees, Π shall provide to Δ (i) notification of the existence of such settlement and the identity of the settling party; and (ii) confirmation in writing that the settlement was not on more favorable terms, as provided for in section 4.2. Releasees may then seek additional information, such as the settlement amount or any other information necessary to determine whether the Δ have been accorded the most favorable terms of settlement under the Agreement as provided for in section 4.2, and Π will provide that information in accordance with the terms and conditions of any confidentiality provision that may be contained within the subsequent settlement agreement. Any such subsequent settlement agreement must, at a minimum, permit Π to provide the requested information to Δ outside counsel for the sole purpose of confirming compliance with section 4.2.

CONSIDERATIONS, NOT LIMITATIONS: AN ARGUMENT AGAINST DEFINING THE ANTICOMPETITIVE HARM UNDER *F.T.C. V. ACTAVIS* AS THE "ELIMINATION OF THE RISK OF POTENTIAL COMPETITION"

By Anna M. Fabish[1]

I. INTRODUCTION

Litigants agree on little when it comes to reverse payment settlements and the interpretation of *F.T.C. v. Actavis*. Notably, neither litigants nor the courts have reached consensus on how to define the anticompetitive harm that underlies a reverse payment antitrust violation.

Plaintiffs and the Federal Trade Commission have attempted to convince courts to narrowly define the relevant anticompetitive harm as the mere "elimination of the risk of potential competition." Under this proposed definition, the harm to competition giving rise to an antitrust violation is complete at the time a reverse payment settlement is executed: executing the settlement either eliminates the risk of potential competition or it does not, regardless of actual outcomes later on.

This definition creates a misguided shortcut and reflects a misreading of *Actavis*. The Supreme Court considered risk elimination only in rejecting the scope-of-the-patent test, and never defined the harm from reverse payment settlements that establishes antitrust liability. Yet Plaintiffs have seized on a few select phrases regarding risk elimination in the *Actavis* opinion to suggest a result wholly contrary to the Court's larger holding.

Defining the anticompetitive harm as the FTC and plaintiffs suggest renders less relevant important factors in the rule-of-reason analysis, including actual injury evidence, hypothetical alternative outcomes, and procompetitive virtues. The definition truncates the net competitive effects inquiry that has hallmarked Supreme Court rule-of-reason precedent for over 100 years. It also directly contradicts *Actavis*'s explicit holding that the FTC, when challenging reverse payment settlements, must prove its case "as in other rule of reason cases."[2] Refusing to look more broadly to the net competitive effects of a settlement overall—potential and actual, at the time of the deal and thereafter—effectively rejects one portion of the Court's holding (full rule of reason) in blind service to another (elimination of the risk of potential competition).

This article does not undertake to offer an alternative definition for the relevant harm to competition under *Actavis*. Rather, it takes on the narrower task of rejecting plaintiffs' and the FTC's proposed shortcut to establishing anticompetitive harm, a shortcut that finds no support in the *Actavis* decision and, if embraced, would undermine the rule-of-reason.

---

1 Anna M. Fabish is a counsel in the Los Angeles office of O'Melveny & Myers LLP. The views expressed in this article are those of the author and not necessarily those of O'Melveny & Myers, its lawyers, or its clients.

2 *F.T.C. v. Actavis, Inc.*, 133 S. Ct. 2223, 2237 (2013).

As this article assumes general familiarity with *Actavis* and the rule of reason, **Part II** begins with a targeted background discussion of *Actavis*, as well as the FTC's and plaintiffs' efforts to secure acceptance for the anticompetitive harm shortcut.

Part III explains why defining the harm from a reverse payment settlement as the elimination of the risk of potential competition will frustrate proper rule-of-reason analysis in reverse payment cases.

Part IV discusses why language in the Court's opinion relating to risk elimination should not be taken out of context to define anticompetitive harm and limit the rule of reason. It explains why doing so finds no support in (and actually contradicts) both the *Actavis* decision and over a century of Supreme Court rule-of-reason precedent.

II. BACKGROUND

A. *Actavis* requires a traditional rule-of-reason analytical framework and does not define the relevant anticompetitive harm

1. The primary holding of *Actavis:* A change in analytical framework

In the opening paragraph of *Actavis*, the Court frames "the basic question" presented to it narrowly: whether a reverse payment agreement "can sometimes unreasonably diminish competition in violation of the antitrust laws."[3] The Court answers its question in this same paragraph, noting that, contrary to an analysis that considers only the scope of the patent, "reverse payment settlements such as the agreement alleged in the complaint before us can sometimes violate the antitrust laws."[4]

2. The Court's explanation for its analytical framework choice and the "five considerations"

The lion's share of the Majority's opinion explains why it is rejecting the scope-of-the-patent test and instead requiring a more traditional antitrust analysis.[5] The Court addresses this from numerous angles in the second section of the Majority opinion: it discusses the intersection of patent and antitrust law in its previous decisions,[6] highlights the unique incentives of the Hatch Waxman framework,[7] responds to the dissent and Court of Appeals' reasoning,[8] and provides the now much-discussed "five sets of considerations."[9]

The Court at no point presents the five considerations as prescriptive notes on the structure or substance of the analysis. In fact, the Court explicitly states that these five points are in further support of its decision to replace the scope-of-the-patent test with a

---

3 *Id.*

4 *Id.*

5 *See generally id.* at 2230–37 (Part II of Majority opinion).

6 *Id.* at 2231–33.

7 *Id.* at 2234 ("the Hatch–Waxman Act itself does not embody a statutory policy that supports the Eleventh Circuit's view").

8 *Id.* at 2233.

9 *See id.* at 2234–37.

more rigorous antitrust analysis: "five sets of considerations *lead us to conclude that the FTC should have been given the opportunity to prove its antitrust claim*."[10]

The opinion's second section concludes by noting that "these considerations, taken together, outweigh the single strong consideration—the desirability of settlements—that led the Eleventh Circuit to provide near-automatic antitrust immunity to reverse payment settlements."[11] This conclusion confirms what the overall structure of the opinion's second section suggests: that the section is clearly aimed at explaining the Court's analytical framework choice, its decision to require meaningful antitrust analysis for reverse payment settlements.

Plaintiffs and the FTC have cherry-picked language from the second section and taken it out of context to support what this article will refer to as their proposed anticompetitive harm shortcut, under which they define the relevant anticompetitive harm as the elimination of the risk of potential competition. Yet this portion of the Court's opinion at no point purports to define or limit the applicable antitrust analysis, let alone the applicable anticompetitive harm. That follows in the Majority opinion's third and final section.[12]

3. The applicable antitrust analysis

The Court discusses the antitrust analysis to be applied in place of the scope of the patent test in the Majority opinion's brief final section.[13]

There, the Court rejects the "quick look" approach the FTC had proposed, noting the many factors that render the competitive effects of reverse payment settlements too complex to be determined by such a cursory assessment. These "complexities" include those related to "large and unjustified" payments and "lead [the Court] to conclude that the FTC must prove its case as in other rule-of-reason cases."[14] The Court goes on to note that this framework requires a sliding scale of relevance that will vary with the circumstances.[15] Nowhere in this discussion does the Court suggest the rule of reason to be applied in reverse payment settlements should be *different* from that "in other rule-of-reason cases."[16] Nor does the Court suggest any definition of the anticompetitive harm at issue that would prevent a full rule of reason. To the contrary, it suggests that "the basic question" remains as it always has been under the rule of reason: "that of the presence of significant unjustified anticompetitive consequences."[17]

---

10 *Id.* at 2234 (emphasis added).

11 *Id.* at 2237.

12 *See generally id.* at 2237–38 (Part III of Majority opinion).

13 *See id.* at 2237.

14 *Id.* at 2237.

15 *Id.* at 2237–38.

16 *See id.* at 2237.

17 *Id.* at 2238.

A. FTC and plaintiffs' proposed anticompetitive harm shortcut

Plaintiffs and the FTC take certain portions of the *Actavis* opinion—namely, the Court's "five sets of considerations"—out of context and, based on those passages, prescribe an analytical framework for assessing anticompetitive effects and liability that focuses solely on whether a reverse payment settlement eliminated the risk of potential competition. Plaintiffs have succeeded in convincing some courts to adopt this erroneous interpretation of the High Court's decision, and the FTC recently formalized its view in two amicus briefs.

1. *In re Aggrenox Antitrust Litigation* Motion to Dismiss (D. Conn. 2015)

In *Aggrenox*, direct and indirect purchasers of Aggrenox, the stroke-prevention medication, sued Boehringer Ingelheim Pharmaceuticals based on an alleged $120 million payment Boehringer made to Barr Pharmaceuticals to keep Barr's generic version of the medication off the market.[18] Defendants' motion to dismiss argued that plaintiffs had insufficiently pleaded antitrust injury.[19] According to defendants' motion, because plaintiffs had not alleged that the patent was invalid or not infringed, they had not alleged delay in a generic Aggrenox product entering the market beyond what would have resulted from a valid and infringed patent preventing generic launch.[20] The district court disagreed on the basis that, where plaintiffs have sufficiently alleged a large unexplained payment, they need not plead a specific basis for patent invalidity to survive a motion to dismiss.[21]

In the context of responding to this patent-focused argument, the court offered its view of the relevant anticompetitive harm:

> The anticompetitive harm is not that the patent surely would have been invalidated if not for the settlement, and that a generic therefore surely would have entered the market sooner; if that were the anticompetitive harm, a determination of a patent settlement's lawfulness under antitrust law would require the very same patent litigation that the settlement avoided. The anticompetitive harm, under *Actavis*, is that the reverse-payment settlement "seeks to prevent the risk of competition."[22]

The *Aggrenox* decision supports this view with language from the Supreme Court's explanation for why it rejected the scope-of-the-patent test in favor of traditional antitrust factors.[23] The district court relied most heavily on the Court's "five considerations."[24] But, as will be discussed further *infra*, this language from *Actavis* does not seek to clarify the scope of the anticompetitive harm in a reverse payment antitrust challenge.

---

18 *In re Aggrenox Antitrust Litig.*, 94 F. Supp. 3d 224, 236–237 (D. Conn. 2015).

19 *Id.* at 239.

20 *Id.*

21 *Id.* at 240.

22 *Id.* This holding may be partially a function of the procedural posture of the case, in that the court was deciding the plaintiffs' initial pleading burden. *See id.* at 245-46 ("In the present context of a motion to dismiss, the plaintiffs need only allege plausible facts that, if true, raise a reasonable expectation that discovery will reveal sufficient evidence to prove their prima facie case. Under the treatment of reverse-payment settlements in Actavis, they have done so.")

23 *See id.* 240–41 (citing *Actavis*, 133 S. Ct. at 2230-31, 2235-37, to support a competitive harm definition).

24 *See id.* at 240–41.

2. *King Drug Co. of Florence et al. v. Smithkline Beecham Corp. et al.* (3d Cir. June 2015)

In *In re Lamictal Direct Purchaser Antitrust Litigation*, the District of New Jersey affirmed a pre-*Actavis* dismissal of plaintiffs' claims that GlaxoSmithKline LLC ("GSK") had paid several generic companies, including Ranbaxy, to delay marketing their generic versions of the stroke and epilepsy drug Lamictal.[25] The district court concluded that the alleged payments, including an agreement that GSK would not market an authorized generic for a certain amount of time (a "no-AG" clause), did not constitute payments under *Actavis*.[26] Plaintiffs appealed, and the Third Circuit ultimately reversed, offering the first post-*Actavis* federal appellate court decision on reverse payment settlements ("*Lamictal*").[27]

a. Dicta while addressing "no-AG" argument

While dealing primarily with the separate issue of whether a "no-AG" clause could constitute a payment, the Third Circuit offered views on the anticompetitive harm under *Actavis*. The panel noted that "it is the prevention of that risk to competition—eliminating 'the risk of patent invalidation or a finding of noninfringement' by 'paying the challenger to stay out' of the market (for longer than the patent's strength would otherwise allow)—that 'constitutes the relevant anticompetitive harm,' which must be analyzed under the rule of reason."[28] The panel read *Actavis* as "reiterat[ing]" this as the anticompetitive harm,[29] and cited the same Supreme Court language the *Aggrenox* court had cited for this proposition.[30]

b. Sufficiency of anticompetitive harm allegations

The *Lamictal* opinion also addressed defendants' argument that plaintiffs had insufficiently alleged anticompetitive harm under the rule of reason.[31] According to defendants, plaintiffs had not alleged that, absent the settlement, generic Lamictal would have come to market sooner, or that there would have otherwise been a more procompetitive result.[32]

The Third Circuit viewed the allegations regarding the alleged payment and the generics' behavior in related markets to be sufficient "at the pleading stage" to "allege[] that any procompetitive aspects of the … arrangement were outweighed by the anticompetitive harm from the no-AG agreement."[33] The panel "[did] not read *Actavis* to require allegations that defendants could in fact have reached another, more competitive settlement."[34] Here,

---

25 18 F. Supp. 3d 560, 561–62 (D.N.J. 2014).

26 *Id.* at 566, 570.

27 King Drug Co. of Florence, Inc., et al. v. Smithkline Beecham Corp. et al., 791 F.3d 388, 392-94, 413 (3d Cir. 2015)

28 *Id.* at 404 (quoting *Actavis*, 133 S. Ct. at 2236-37).

29 *Id.*

30 *Id.* at 404–05 (citing *Actavis*, 133 S. Ct. at 2236-37, to support anticompetitive harm); *see also id.* at 405 (citing *Actavis*, 133 S. Ct. at 2231, 2236, to support anticompetitive harm); *see supra*, section II.B.1.

31 *Id.* at 409.

32 *Id.*

33 *Id.* at 410.

34 *Id.*

the panel drew from the risk elimination concept, concluding that "under the substantive standard, the question is not whether the defendants have only possibly acted unlawfully… but whether they have acted unlawfully by seeking to prevent competition."[35] Again, to support these conclusions, the Third Circuit cited the "considerations" that led the Supreme Court to reject the scope-of-the-patent test.[36]

C. FTC's amicus briefs

The FTC formally weighed in on the anticompetitive harm under *Actavis* in two recent amicus briefs in support of no party: one filed on February 12, 2016 in the *In re Nexium (Esomaprazole) Antitrust Litigation* appeal pending in the First Circuit,[37] and one filed on March 11, 2016 in the *In re Wellbutrin XL Antitrust Litigation* appeal pending in the Third Circuit.[38] These briefs propose a risk elimination harm definition and, flowing from that proposed definition, a limited rule of reason analysis.

1. Amicus brief in *Nexium* appeal

The Commission's amicus brief in *Nexium* concerns itself primarily with whether actual injury is a necessary component of an *Actavis* violation (and the anticompetitive harm such a violation requires).

A substantial portion of the brief addresses the more general idea that, in an antitrust case, violation, causation, and antitrust injury, are distinct analyses.[39] This argument reacts to the district court's holding in *Nexium* that, because plaintiffs had not established causation/injury-in-fact, they had not established a necessary part of the antitrust *violation* under *Actavis*.[40] The FTC expressed concern that such an "erroneous analysis"[41] will imply that antitrust injury or injury-in-fact is required of a government plaintiff,[42] which would not be in line with the distinct public policies underlying government enforcement actions as

---

35 *Id.*; *see also id.* (noting that under *Actavis* "the anticompetitive harm is not certain consumer loss through higher prices, but rather the patentee's 'avoid[ance of] the risk of patent invalidation or a finding of noninfringement'—that is, 'prevent[ion of] the risk of competition,' beyond what the patent's strength would otherwise allow—and thus, consumer harm." (internal citations and emphasis omitted)).

36 *Id.* at 405 (citing *Actavis*, 133 S. Ct. at 2231, 2236, to support anticompetitive harm); *see supra* section II.A.2.

37 Brief for Federal Trade Commission as Amicus Curiae in Support of No Party, *In re* Nexium (Esomeprazole) Antitrust Litig., Nos. 15-2005, 15-2006, 15-2007 (1st Cir. Feb. 12, 2016) (on appeal from the U.S. Dist. Ct. D. Mass., Civil Action No. 12-md-02409-WGY) ("FTC Nexium Amicus Br.").

38 Brief of Federal Trade Commission as Amicus Curiae in Support of No Party, *In re* Wellbutrin XL Antitrust Litigat., Nos. 15-3559, 15-3591, 15-3681, 15-3682 (3d Cir. Mar. 11, 2016) (on appeal from the U.S. Dist. Ct. E.D. Pa., Civil Action Nos. 2-08-cv-2431, 2-08-cv-2433) ("FTC Wellbutrin Amicus Br.").

39 *See e.g.*, FTC Nexium Amicus Br. at 8-10; *see also id.* at 20-23.

40 *Id.* at 7–8 (quoting *In re* Nexium (Esomeprazole) Antitrust Litig., 309 F.R.D. 107, 125 (D. Mass. 2015)).

41 *Id.* at 4.

42 *Id.* at 9.

opposed to private civil actions.[43] When the concepts of violation, injury, and causation are separated, the FTC argues, actual injury is not necessary to establish anticompetitive effect.[44]

The FTC supports its argument with citations to various cases discussing the ability of the antitrust laws to condemn behavior *likely* to impede competition in the market, even absent proof of actual effects. They argue that "[r]ather than focusing on whether a challenged agreement has injured a specific party, the Court has focused on 'the principal tendency of a restriction' to interfere with competition."[45]

The Commission's brief further argues that the anticompetitive harm required to establish an antitrust violation under *Actavis* is the "elimination of the risk of potential competition."[46] To support this, the brief relies heavily on the same *Actavis* language as do *Lamictal* and *Aggrenox*, and cites these decisions as well.[47] The brief also indirectly relies on the Supreme Court's discussion of how a reverse payment may be anticompetitive regardless of whether the underlying patent is determined to be valid or infringed.[48] On this basis, the brief argues that "a reverse payment can violate the antitrust laws if it induces the generic to abandon its patent challenge and stay out of the market, regardless of whether the generic would actually have entered the market sooner than permitted by the agreement."[49]

The brief uses its proposed harm definition to bolster the conclusion that actual injury is not a necessary component of an *Actavis* antitrust violation. Actual injury is instead the stuff of antitrust injury and causation—elements that private plaintiffs, not government enforcers, need to prove.[50]

---

43 *See id.* at 20–23.

44 *See id.* at 10–11.

45 *Id.* at 11 (quoting Cal. Dental Ass'n v. F.T.C., 526 U.S. 756, 770 (1990)); *see also id.* at 10–11.

46 *Id.* at 16–20.

47 *See id.* at 1 (citing *Actavis* at 2236 ("prevents the risk of competition"); *id.* at 3 (citing *Actavis*, 133 S. Ct. at 2236); *id.* at 16 (citing *Actavis*, 133 S. Ct. at 2236); *id.* at 16–17 (citing *Lamictal*); *id.* at 17 (citing *Actavis*, 133 S. Ct. at 2237); *id.* at 20 (citing *Aggrenox* and *Lamictal*). The brief also cites *In re Niaspan Antitrust Litig.*, 42 F. Supp. 3d 735 (E.D. Pa. 2014). *See* FTC Nexium Amicus Br. at 17. However, that decision touched only briefly on this point in the context of antitrust injury and relied on the same portions of *Actavis* as did *Aggrenox* and *Lamictal*, without much further discussion:

> In Actavis, however, the Supreme Court identified "prevent[ion of] the risk of competition" as "the relevant anticompetitive harm." 133 S.Ct. at 2236; *see also id.* at 2236 (discussing the "concern that a patentee is using its monopoly profits to avoid the risk of patent invalidation or a finding of noninfringement"; *id.* (noting that the failure to "face what might have been a competitive market" is "the very anticompetitive consequence that underlies the claim of antitrust unlawfulness."); *id.* at 2244 (Roberts, J., dissenting) ("The majority seems to think that even if the patent is valid, a patent holder violates the antitrust laws merely because the settlement took away some chance that his patent would be declared invalid by a court."). *See In re Niaspan Antitrust Litig.*, 42 F. Supp. 3d at 755 ("That said, the Court need not delve into the merits of this debate at this time because plaintiffs' allegations are sufficient, even under defendants' definition of "antitrust injury," to survive the Motion to Dismiss.").

48 FTC Nexium Amicus Br. at 18 (citing *Actavis*, 133 S. Ct. at 2231, 2235, 2234).

49 *Id.* (citing *Actavis*, 133 S. Ct. at 2235).

50 *Id.* at 18–19, 20–22.

Defining the anticompetitive harm in this way leads the Commission to further conclude that the anticompetitive effects inquiry under *Actavis* should look *only* at the time the deal was entered into (since at that time, the "risk of potential competition" was either eliminated or it was not).[51]

2. Amicus brief in *Wellbutrin* appeal

In its *Wellbutrin* amicus brief, the FTC argued that the district court's approach to the rule of reason was legally erroneous under *Actavis*.[52] The district court first concluded that the Wellbutrin settlement did not present the type of anticompetitive potential at issue in *Actavis*, since the settlement did not end the underlying patent litigation.[53] The court viewed this as a basis for granting defendants' summary judgment motion, even without performing a rule of reason analysis, but went on to analyze the settlement under the "traditional rule of reason" as well.[54] The district court's rule of reason analysis concluded that, because the plaintiff had not established the settlement resulted in actual delay, the plaintiff had not satisfied its burden of showing anticompetitive harm.[55] It further concluded that, even if plaintiff *had* established anticompetitive harm, procompetitive justifications for and virtues of the settlement as a whole outweighed any anticompetitive effects.[56] Specifically, the court considered various provisions that could facilitate generic entry, and found that the agreement allowed generic entry earlier than otherwise might have been possible.[57]

The Commission's brief takes issue with all of these aspects of the lower court's analysis. It argues that risk elimination is the relevant anticompetitive harm, which may occur regardless of whether the underlying patent litigation continues, and/or regardless of whether there is actual delay in generic entry.[58] The FTC supports its suggested risk elimination harm definition in the *Wellbutrin* brief with many of the same arguments and citations it provides in its *Nexium* brief.[59]

But the *Wellbutrin* submission also suggests limitations on the rule-of-reason analysis that the Commission did not discuss in *Nexium*. Specifically, the FTC argues in *Wellbutrin* that the only procompetitive virtues a court may properly consider in a reverse payment rule-of-reason analysis are justifications *for the alleged reverse payment*—not any general

---

51 *Id.* at 18 ("The anticompetitive effect of an unlawful reverse payment therefore occurs at the moment the agreement is entered.").

52 FTC Wellbutrin Amicus Br. at 2.

53 *See id.* at 9 (citing *Wellbutrin* Op. 41-42.)

54 *Id.* at 10 (citing *Wellbutrin* Op. at 44-48, 50 n.32, 52).

55 *Id.* at 10 ("According to the [district] court, [the traditional rule of reason] required plaintiffs to 'show that the Wellbutrin Settlement actually resulted in the delayed entry of Wellbutrin XL—that absent the Wellbutrin Settlement, generic competition would have occurred earlier.'" (quoting Op. at 52-53).)

56 *Id.* at 10 (citing Op. at 5, 57-58.)

57 *Id.* at 10 (citing Op. at 57-62.)

58 *See, e.g., id.* at 11-12.

59 *See. e.g., id.* at 12-18. The brief also relies on the same portions of *Actavis* as did the FTC's *Nexium* brief and the courts in *Aggrenox* and *Lamictal.*

procompetitive effects of the settlement as a whole.[60] These and the other limitations the FTC suggests flow, at least in part, from the Commission's suggested harm definition.

III. THE PROPOSED ANTICOMPETITIVE HARM SHORTCUT LIMITS THE RULE-OF-REASON ANALYSIS TO BE APPLIED TO REVERSE PAYMENT CHALLENGES

Defining the relevant anticompetitive harm in the manner the FTC and plaintiffs suggest would significantly alter the rule-of-reason analysis applied to reverse payment cases.

The FTC's briefs explicitly suggest certain limitations on the rule of reason in connection with their anticompetitive harm definition. Specifically, they suggest (1) that the competitive effects inquiry should consider only effects at the time the settlement is executed (not actual or likely post-settlement effects), and (2) that the only relevant procompetitive virtues are justifications for the reverse payment (not procompetitive effects of the payment provision or procompetitive virtues of the settlement as a whole).

The anticompetitive harm definition *Aggrenox* and *Lamictal* employ, when taken to its logical conclusion, will necessarily limit the rule-of-reason analysis in the same way the FTC suggests.

First, if one defines the harm giving rise to liability as the elimination of the risk of potential competition, that harm concludes at the time the settlement is executed. As a result, any effects and circumstances after the agreement is executed bear little on the competitive effects analysis. This would limit the evidence weighed in a rule-of-reason analysis to conditions, effects, and intent present *at the time of the deal*, not after.

Second, a risk elimination harm definition also limits the procompetitive virtues that are relevant in the effects analysis. To begin, this harm definition limits the relevance of procompetitive effects *post-settlement*, because if the harm is complete upon execution of the settlement, it is relatively impervious to actual—even potentially great—consumer benefit down the road.

In addition, such a harm definition limits the *type* of procompetitive evidence that will be relevant. Under the proposed anticompetitive harm shortcut, a payment that is large and unjustified implies payment to prevent competition.[61] If preventing the risk of potential competition is the entirety of the antitrust harm, only a justification *for the payment*—that is, proof the payment was not to eliminate risk—can balance out that harm. The question becomes: can *the payment* be sufficiently justified, such that it did not actually eliminate the risk of potential

60 *See, e.g., id.* at 21-25.

61 *See* FTC Nexium Amicus Br. at 18; *Aggrenox*, 94 F. Supp. 3d at 241 ("The salient question is not whether the fully-litigated patent would ultimately be found valid or invalid--that may never be known--but whether the settlement included a large and unjustified reverse payment leading to the inference of profit-sharing to avoid the risk of competition."); *King Drug Co.*, 791 F.3d at 394 ("We believe this no-AG agreement falls under Actavis 's rule because it may represent an unusual, unexplained reverse transfer of considerable value from the patentee to the alleged infringer and may therefore give rise to the inference that it is a payment to eliminate the risk of competition.").

competition, but rather served some other legitimate purpose?[62] Absent such justifications *for the payment*, the brand company must have made the payment to remove the risk of potential competition, and liability has been established. Under this approach, no matter how great the consumer benefit from the settlement might be, if the payment remains unjustified, the harm to competition is complete and not offset. This prevents larger procompetitive virtues of the settlement as a whole from counterbalancing possible anticompetitive effects.

IV. THE SUPREME COURT'S FEW REFERENCES TO RISK ELIMINATION SHOULD NOT BE TAKEN OUT OF CONTEXT TO LIMIT THE FULL RULE-OF-REASON ANALYSIS *ACTAVIS* PRESCRIBED

While the *Actavis* Court clearly considered the possibility that reverse payment settlements could be used to eliminate risk, lower courts should not expand the concept to do more in their analyses than it did in the Supreme Court's analysis. The concept explains why reverse payment settlements should be subject to antitrust review, and informs that review where appropriate, but nothing more. Nowhere in the opinion does the Court suggest this concept should limit the rule of reason to be applied in these cases. Nor would it make sense to limit the full rule-of-reason analysis—which is central to the Court's holding—based on a few select phrases from the opinion. Doing so contradicts the larger holding of *Actavis*, not to mention the vast body of Supreme Court case law establishing the nature of a rule-of-reason inquiry.

A. The Court's references to risk elimination should be understood in the context of the Court's decision

Part of the anticompetitive *potential* the Court identified in reverse payment settlements stems from the possibility that a patent holder might pay to eliminate a competitor. The Court pointed to that potential while explaining why it rejected the scope-of-the-patent test. But merely acknowledging potential harm does not an antitrust violation make. Rather, it is the reason the Court applied an antitrust analysis in the first place—the harm "that justified antitrust scrutiny for reverse payment settlements."[63]

---

62 *See e.g.*, FTC Wellbutrin Amicus Br. at 23 (quoting *Actavis*, 133 S. Ct. at 2236) ("absent an explanation for the reverse payment, nothing contradicts the conclusion that 'the payment's objective is to maintain supracompetitive prices to be shared among the patentee and the challenger rather than face what might have been a competitive market—the very anticompetitive consequence that underlies the claim of antitrust unlawfulness.'"); *In re* Solodyn (Minocycline Hydrochloride) Antitrust Litig., 2015 WL 5458570, slip copy at *9 (D. Mass. 2015) ("The direct purchasers allege a payment to Sandoz significantly larger than Medicis' estimated saved litigation costs, so the burden shifts to Defendants to come forward with evidence that the *reverse payment* is justified by procompetitive considerations." (Emphasis added)); *see also In re* Nexium (Esomeprazole) Antitrust Litig., 42 F. Supp. 3d 231, 262 (D. Mass. 2014) ("Once this showing is made, the burden then shifts to the Defendants to show that a challenged payment was justified by some precompetitive objective.").

63 *See In re* Wellbutrin XL Antitrust Litig., ---F. Supp. ---, 2015 WL 5582289, at *14 (E.D. Pa. 2015) ("The Supreme Court in Actavis did outline a specific type of competitive harm *that justified antitrust scrutiny for reverse payment settlements:* that the defendant in the patent infringement lawsuit would abandon its patent claim, eliminating the risk of patent invalidation or a finding of invalidity.") (emphasis added). The First Circuit Court of Appeals recently reiterated this more limited purpose for the Court's five considerations. *In re* Loestrin 24 Fe Antitrust Litig., ---F.3d---, 2016 WL 698077, at *3 (1st Cir. Feb. 22, 2016) (noting that the Supreme Court "determined that 'five sets of considerations' weighed in favor of subjecting reverse payment settlements to antitrust scrutiny.").

To support its proposed anticompetitive harm shortcut, the FTC and some courts have relied most heavily on language in the Court's fourth "consideration." In its fourth consideration, the Court reacts to a concern that partially motivated the court below to apply the scope-of-the-patent test. Specifically, the Eleventh Circuit feared that an antitrust analysis would prove administratively unfeasible, since it would require a "mini-trial" on patent issues. By applying the scope-of-the-patent test, the Eleventh Circuit foreclosed that result. In the Supreme Court's view, however, determining patent validity and infringement will not normally be necessary, since an "unexplained large reverse payment itself would normally suggest that the patentee has serious doubts about the patent's survival." This, "in turn, suggests that the payment's objective is to maintain supracompetitive prices to be shared among the patentee and the challenger rather than face what might have been a competitive market—the very anticompetitive consequence that underlies the claim of antitrust unlawfulness."[64] Put another way, where there is a large unexplained payment, the patent holder "likely seeks to prevent the risk of competition. And, as we have said, that consequence constitutes the relevant anticompetitive harm."[65] Because a large and unexplained payment suggests that the patent holder "likely" intends to restrict competition beyond what a valid patent would allow, this anticompetitive intent provides a sufficient basis to proceed with the antitrust analysis, without initially analyzing patent validity or infringement questions.[66] Thus, when the Court references the possibility that a reverse payment might be designed to eliminate the risk of potential competition in this context, it does so for the purpose of demonstrating why a patent mini-trial is not necessary to assess a reverse payment settlement's anticompetitive potential. This is a far cry from defining the anticompetitive harm at issue in a way that would limit the competitive effects inquiry.

All other language in *Actavis* touching on risk elimination is also contained in the Majority's second section and similarly limited by its context. For example, while discussing its second "consideration"—the possibility that procompetitive virtues could offset the anticompetitive potential of a reverse payment settlement—the Court references a "concern that a patentee is using its monopoly profits to avoid the risk of patent invalidation or a finding of noninfringement."[67]

These references to risk elimination arise not only in the limited context of explaining the Court's analytical approach; they are accompanied by descriptions of *other* possible anticompetitive harms far broader than the risk of the elimination of potential competition. For example, while discussing the fourth consideration, the Court refers to "maintain[ing] supracompetitive prices to be shared among the patentee and the challenger rather than face what might have been a competitive market—*the very anticompetitive consequence that underlies the claim of antitrust unlawfulness*."[68] This anticompetitive harm concept goes beyond the mere elimination of risk at the time of the settlement, and instead involves actual effects

64 *Actavis*, 133 S. Ct. at 2236–37.

65 *Id*.

66 *Id*. at 2236.

67 *Id*.

68 *Id*. at 2235–36 (emphasis added).

on price, which would necessarily occur post-settlement.[69] Similarly, in its discussion of the first and second considerations, the Court references a "[p]ayment in return for staying out of the market [that] *simply keeps prices at patentee-set levels, potentially producing the full patent-related…monopoly return* while dividing that return between the challenged patentee and the patent challenger. The patentee and the challenger gain; the consumer loses."[70] This language also describes an anticompetitive harm concept that goes beyond the mere elimination of risk, and involves actual effects on price and actual consumer harm, which may or may not occur as a result of eliminating the risk of potential competition. Such references to other anticompetitive harm concepts no more define the anticompetitive harm underlying antitrust liability under *Actavis* than do the select risk elimination phrases on which the FTC and plaintiffs rely.

Finally, had the Court truly intended to so narrowly define the anticompetitive harm underlying a violation, selecting the rule of reason to determine where such a violation exists would have made little sense. As discussed *infra*, the rule of reason examines net competitive effects; it is not limited to considering only specific timeframes or certain types of evidence.[71] Yet defining the anticompetitive harm from a reverse payment settlement as mere risk elimination *does* limit the timeframe of the competitive effects analysis and the factors to be considered. The anticompetitive harm shortcut plaintiffs and the FTC propose thus fundamentally clashes with the Court's chosen analytical framework.

B. Using the risk elimination concept to truncate the full rule-of-reason analysis is inconsistent with the larger holding of *Actavis*

The reasoning behind the Court's decision to apply a traditional antitrust analysis should certainly inform lower courts applying the rule of reason to reverse payment settlements. But the concept should not limit that rule-of-reason analysis, and no language in the *Actavis* opinion is to the contrary.

1. The rule of reason is designed to consider *net* competitive impact and all aspects of the challenged conduct

Under longstanding Supreme Court precedent, a traditional rule-of-reason analysis assesses numerous relevant factors, including any evidence of actual post-restraint effects,

---

69 The First Circuit Court of Appeals recently described the potential anticompetitive harm from reverse payment settlements in a similar manner, focusing on price effects and consumer welfare: "These types of settlements led to concerns that a brand manufacturer may be paying the generic manufacturer to abandon its patent challenge, thereby insulating the brand's market from competition and preventing consumers from accessing a more affordable generic version of the brand-name drug." *In re* Loestrin 24 Fe Antitrust Litig--- F. Supp. 3d ---- , 2016 WL 698077, at *3 .

70 *Id.* at 2234–35 (emphasis added). Specifically, in the first line discussing this consideration, the Court notes that "these anticompetitive consequences will at least sometimes prove unjustified." *Id.* at 2235-36. Because the phrase "these anticompetitive consequences" appears in the opening line of the section, it is most logically understood as referring to the anticompetitive consequences discussed in the preceding paragraph. That paragraph discusses "keep[ing] prices at patentee-set levels, producing the full patent-related …monopoly return while dividing that return between the challenged patentee and the patent challenger." *Id.* at 2234.

71 *See infra*, section IV.B.1.

where available, to determine a restraint's net competitive effects.[72] Commission decisions describe Supreme Court law on the rule of reason in this manner as well.[73]

At no time has the Supreme Court limited the timeframe in which those effects are relevant to the analysis.[74] Indeed, given that the Supreme Court's overarching edict that rule-of-reason cases should focus on competitive effects, evidence of current actual effects speaks *most* directly to exactly what the rule of reason examines. Justice Brandeis's 1918 formulation of the rule of reason in *Chicago Board of Trade v. United States*—the "touchstone for [the] rule of reason analysis"[75]—is a prime example. In this formulation, Justice Brandeis aptly describes the rule-of-reason inquiry as focused on competitive effects, unrestricted by time:

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; ***its condition before and after the restraint was imposed;*** the nature of the restraint ***and its effect, actual or probable.***[76]

Similarly, under the first pronouncement of the test in *Standard Oil*, "the inquiry [was] confined to a consideration of impact on competitive conditions."[77] In discussing the common law on which the rule of reason is based, the Court in *Standard Oil* "noted that contracts which had been illegal on their face were later recognized as reasonable because they tended to promote competition."[78] This suggests that the timeframe for the inquiry is broader than just the time of the restraint, at least where data about actual post-restraint effects is available.

Thus, while the traditional rule of reason may not *require* evidence of actual adverse effects on competition, excluding evidence of actual effects from the analysis would be contrary to the nature of the inquiry.[79]

2. *Actavis* requires—and does not revise—the rule-of-reason analysis

When the *Actavis* Court spoke directly about the antitrust analysis to be applied—as opposed to *why* the Court was applying an antitrust analysis at all—it spoke *against* limiting the rule of reason in any way.[80]

---

72 *See, e.g.*, NCAA v. Bd. Regents Oklahoma, 468 US 85, 104 (1984) ("Under the Sherman Act the criterion to be used in judging the validity of a restraint on trade is its impact on competition."); *Actavis*, 133 S. Ct at 2238 (noting "the basic question" as "the presence of significant unjustified anticompetitive consequences.").

73 *See, e.g.*, Matter of Int'l Ass'n of Conference Interpreters, 123 F.T.C. 465, 639 (1997) ("The Supreme Court has made clear that the rule of reason contemplates a flexible enquiry, examining a challenged restraint in the detail necessary to understand its competitive effect.") (citing *NCAA*, 468 U.S. at 103–10).

74 *See infra* at pages 17–19, distinguishing cases the FTC Nexium Amicus Brief cites for this proposition.

75 Matter of California Dental Ass'n, 121 F.T.C. 190, 297 (1996).

76 Board of Trade Cty. of Chicago v. United States, 246 U.S. 231, 238 (1918) (emphasis added).

77 Nat'l Soc. of Prof'l Engineers v. United States, 435 U.S. 679, 690 (1978) (describing Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911)).

78 *Nat'l Soc. of Prof'l Engineers*, 435 U.S. at 690 n.16 (describing *Standard Oil*, 221 U.S. at 55.).

79 *See infra*, section IV.A.3.a.

80 *See* 133 S. Ct. at 2237 ("the FTC must prove its case as in other rule-of-reason cases").

The Court "conclude[d] that the FTC must prove its case as in other rule-of-reason cases."[81] It did not qualify or place any caveats on its prescription of the rule of reason as the appropriate mode of analysis. Nor did it describe a variation on the rule of reason different from that in the Court's previous decisions. To the contrary, the Court emphasized that "the basic question" in a reverse payment case is the same question at the heart of every rule-of-reason inquiry: whether "significant unjustified anticompetitive consequences" exist.[82] Even the FTC and the Third Circuit in *Lamictal* recognize this, at least in theory.[83] For example, the Third Circuit concluded that:

> The District Court mistook the "five sets of considerations" that persuaded the Actavis Court "to conclude that the FTC should have been given the opportunity to prove its antitrust claim" under the rule of reason, as a redefinition of the "rule of reason" itself. But the general contours of the rule of reason are well-mapped.[84]

3. Preventing the rule of reason from considering the full range of available actual effects evidence is inconsistent with *Actavis*

The potential for a reverse payment to eliminate the risk of potential competition was the basis for the Court turning its back on the scope-of-the-patent test in favor of a more robust antitrust analysis. But that antitrust analysis remains as it has been for over 100 years: focused on net effects on competition. As one district court explained, "*Actavis* does not provide a legal basis for restricting negotiated settlement terms ***where they do not restrain competition***."[85] Instead, *Actavis* requires an intensive rule-of-reason analysis to determine *whether* an agreement restrains competition. And under established Supreme Court precedent, that analysis includes an inquiry into actual competitive effects.[86] Any concept of anticompetitive harm that prevents the full rule-of-reason inquiry thus fundamentally contradicts *Actavis*.

a. The analysis should consider available contemporaneous *and* post-settlement evidence of actual effects on competition

Restricting the rule-of-reason inquiry to exclude evidence relevant to actual, post-settlement effects on competition is inconsistent with the Supreme Court's mandate that the plaintiff "prove its case as in other rule of reason cases." Yet this is exactly what defining the anticompetitive harm as risk elimination would ultimately require.

---

81 *Id.*

82 *Id.* at 2238 (emphasis added).

83 *See, e.g.*, FTC Wellbutrin Amicus Br. at 1.

84 *King Drug Co.*, 761 F.3d at 411 (citing to *Actavis*, 133 S. Ct. at 2234); *see id.* at 403 ("courts should apply the traditional rule-of-reason analysis"); *see also In re* Wellbutrin XL Antitrust Litig., 2015 WL 5582289, at *16 ("the Supreme Court instructed district courts to apply the traditional rule of reason analysis when evaluating reverse payment settlements.").

85 *In re* Actos End Payor Antitrust Litig., 2015 WL 5610752, at *16 (S.D.N.Y. Sept. 22, 2015) (emphasis added).

86 *See supra* section IV.B.1; *see also In re* Wellbutrin XL Antitrust Litig., 2015 WL 5582289, at *18 ("[i]t is in keeping with the traditional rule of reason analysis to require the plaintiffs to show that the Wellbutrin Settlement actually resulted in the delayed entry of Wellbutrin XL – that absent the Wellbutrin Settlement, generic competition would have occurred earlier.").

The traditional rule of reason considers both intended and actual effects of the challenged conduct as a whole, as discussed above.[87] The *Actavis* Court also referred to assessing a payment's intent *and likelihood of bringing about* anticompetitive effects.[88] The best evidence of the latter, if available, is information about the settlement's *actual* effects.

The FTC has argued that actual injury is not *necessary* in order to sustain a violation under the rule of reason. To be sure, the rule of reason does provide mechanisms for determining the likely anticompetitive effects of challenged conduct where actual effects are not yet known.[89] But where evidence of actual effects *is* available, it is highly relevant to whether a reverse payment settlement is an "arrangement[] that prevent[s] competition in the marketplace," and thus whether it constitutes an antitrust violation.[90] Similarly, while *Actavis* indicates that actual evidence of patent validity is *unnecessary* to assess the antitrust implications of a reverse payment settlement, this does not prevent patent validity evidence from being *relevant* to the rule-of-reason inquiry.[91]

The Commission does not (and could not) cite any authority truly supporting the proposition that actual injury—or actual benefit—resulting from the challenged agreement is somehow *irrelevant* to the antitrust violation inquiry under the rule of reason.

Instead, the Commission's brief in *Nexium* relies in part on *United States v. Microsoft* for the proposition that "the antitrust violation analysis does not 'turn on a plaintiff's ability or inability to reconstruct the hypothetical marketplace absent a defendant's anticompetitive conduct' because 'neither plaintiffs nor the court can confidently reconstruct a product's hypothetical …development in a world absent the defendant's exclusionary conduct.'"[92] First, this passage does not declare actual effects evidence *irrelevant*, but rather declines

---

87 *In re* Wellbutrin XL, 2015 WL 5582289, at *16:

> The Court will also evaluate the settlement as a whole, and not in a piecemeal, provision-by-provision approach. *See In re* Niaspan Antitrust Litig., 42 F. Supp. 3d 735, 752 (E.D. Pa. 2014); *see also In re* Lipitor Antitrust Litig., 46 F. Supp. 3d 523, 548–49 (E.D. Pa. 2014). The Wellbutrin Settlement was negotiated as a whole, agreed to as a whole, and went into effect as a whole, so failing to evaluate the agreement as a whole would overlook context essential to determining any possible anticompetitive effects.

88 *Actavis*, 133 S. Ct. at 2236 ("the parties may have provided for a reverse payment without having sought or brought about the anticompetitive consequences we mentioned above. But that possibility does not justify dismissing the FTC's complaint.").

89 Bd. of Trade of City of Chicago v. United States, 246 U.S. 231, 238 (1918) ("The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.").

90 *King Drug Co.*, 791 F.3d at 405 (citing Actavis, at 2234–35 and Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶2046c (2014 Supp.)).

91 Moreover, there are numerous types of post-settlement, actual effects evidence unrelated to patent validity that might still weigh heavily in a rule-of-reason analysis. *See infra*, section IV.B.3.b (discussing manufacturing and regulatory difficulties that could affect timing of entry, absent settlement).

92 FTC Nexium Amicus Br. at 11–12 (quoting United States v. Microsoft Corp., 253 F.3d 34, 79 (D.C. Cir. 2001)).

to require such evidence, where it is not available. Second, and more importantly, the "antitrust violation analysis" at issue in this discussion is a section 2 monopolization claim; *the court was not applying the rule of reason.*[93] Later in this same opinion, when the D.C. Circuit *does* have occasion to apply the rule of reason to the government's section 1 tying claim, the court describes actual effects as the touch stone of the analysis: "plaintiffs must show that Microsoft's conduct unreasonably restrained competition. Meeting that burden 'involves an inquiry into *the actual effect' of Microsoft's conduct on competition* in the tied good market, the putative market for browsers."[94]

The *Nexium* amicus brief also cites *Valley Drug v. Geneva Pharms., Inc.*, which considered the role of patent validity in a pre-*Actavis* challenge to an alleged market allocation agreement between a patent holder and a competing drug manufacturer.[95] The lower court had declared the agreement per se illegal, without considering the effect of the patent.[96] The appellate court disagreed, and rejected a per se analysis on this basis.[97] The Court did *not* conclude that patent validity was irrelevant to the antitrust analysis. In fact, it concluded the opposite: "the mere subsequent invalidity of the patent does not render the patent irrelevant to the appropriate antitrust analysis."[98] The policy concerns about undermining patent incentives that underlie the court's conclusion are also do not apply to reverse payment cases in a post-*Actavis* landscape.[99]

Finally, the FTC's submission in *Nexium* relies on two cases to support the idea that the rule of reason analysis should look only at the time the challenged settlement was executed: *Microbix Biosystems, Inc. v. Biowhittaker, Inc.*[100] and *Polk Bros., Inc. v. Forest City Enters., Inc.*[101] Yet neither of these support such a far-reaching exclusion of post-settlement evidence from the rule-of-reason inquiry. *Microbix* applies a *quick look* rule of reason analysis, not the full

---

93 *Microsoft*, 253 F.3d at 59 (acknowledging that the rule of reason analysis to be applied to section 1 claims is distinct from, though similar to, that analysis set forth for section 2 claims).

94 *Id.* at 95 (quoting Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 29 (1985) (emphasis added)).

95 344 F.3d 1294, 1300–1303 (11th Cir. 2003).

96 *Id.* at 1301–02.

97 *Id.* at 1308.

98 *Id.* at 1306–07.

99 *Id.* at 1308:

> [W]e conclude that exposing settling parties to antitrust liability for the exclusionary effects of a settlement reasonably within the scope of the patent merely because the patent is subsequently declared invalid would undermine the patent incentives. Patent litigation is too complex and the results too uncertain for parties to accurately forecast whether enforcing the exclusionary right through settlement will expose them to treble damages if the patent immunity were destroyed by the mere invalidity of the patent. This uncertainty, coupled with a treble damages penalty, would tend to discourage settlement of any validity challenges except those that the patentee is certain to win at trial and the infringer is certain to lose. By restricting settlement options, which would effectively increase the cost of patent enforcement, the proposed rule would impair the incentives for disclosure and innovation."

100 172 F. Supp. 2d 680 (D. Md. 2000).

101 776 F.2d 185 (7th Cir. 1985).

rule of reason the *Actavis* court required, in the context of which it provides the language on which the FTC relies.[102]

As to *Polk Bros.*, the Commission quotes the following as the case's holding: "A court must ask whether an agreement promoted enterprise and productivity at the time it was adopted."[103] However, the sentence in *Polk Bros.* that immediately follows this quoted language clarifies its limited meaning: "If it arguably did [promote enterprise and productivity at the time it was adopted], *then the court must apply the Rule of Reason to make a more discriminating assessment*."[104] *Polk Bros.* thus stands for the proposition that, in the context of determining *which* analysis to apply to a horizontal agreement—full rule or reason, quick look, or per se—a court should focus on the contemporaneous effects of conduct.

The Commission's brief in *Wellbutrin* likewise fails to provide support for the proposition that actual effects evidence—be it evidence regarding actual delay or actual procompetitive effects—should be excluded from a rule-of-reason analysis. Instead, the *Wellbutrin* brief continues to rely on case law supporting the proposition that actual effects are not *necessary* to establish an antitrust violation.[105] For example, the FTC notes that "the rule-of-reason inquiry considers whether the nature of the restraint is likely to harm competition."[106] But it does not follow from this non-controversial point that courts should ignore evidence regarding actual or likely effects on competition. Indeed, ignoring such evidence would be inconsistent with the very idea on which the FTC attempts to rely: the traditional rule-of-reason directive to analyze "harm to competition."

Similarly, the *Wellbutrin* brief recites case law establishing that the rule of reason should be guided by "the principal tendency of a restriction" to interfere with competition.[107] This does not support—indeed, it contradicts—the FTC's suggestion that the rule of reason should ignore evidence bearing on whether the restriction *actually did interfere with competition*, or likely will do so. Such an approach reflects a logical error of which the Commission accuses the district court in *Wellbutrin*: namely, "elevat[ing] nominal factual distinctions over economic reality" while "overlooking the underlying logic."[108] The FTC's approach would elevate economic *theory* about the potential of reverse payments *in the abstract* (the theoretical possibility of eliminating the risk of potential competition) over economic *reality* (evidence of actual competitive effects in the market, where available).

---

102 *See Microbix*, 172 F. Supp. 2d at 692, 694 n.50 (noting anticompetitive effects are measured at the time of the conduct when applying a quick look rule of reason, and citing non-rule of reason cases to support this proposition); FTC Nexium Amicus Br. at 19 (citing *Mirobix*, 172 F. Supp. 2d at 694).

103 FTC Nexium Amicus Br. at 19 (quoting *Polk*, 776 F.2d at 189).

104 776 F.2d at 189 (emphasis added).

105 *See, e.g.*, FTC Wellbutrin Amicus Br. at 17 (citing case law establishing that restraints not yet proven to have adversely affected competition may still violate the antitrust laws under the rule of reason, on the theory that such practices might "impede the ordinary give and take of the market place or might be "likely enough to disrupt the proper functioning of the price-setting mechanism of the market …even absent proof that [they] resulted in higher prices.") (quoting *Nat'l Soc. of Prof'l Engineers*, 435 U.S. at 692; *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 461-62 (1986).

106 FTC Wellbutrin Amicus Br. at 2-3.

107 *Id.* at 17 (quoting *Cal. Dental Ass'n v. FTC,* 526 U.S. 756, 781 (1999)).

108 *Id.* at 15.

Finally, the FTC's distinction between an antitrust violation and antitrust injury also does not support turning a blind eye to available evidence regarding actual effects. Actual effects are of course also relevant to antitrust injury and causation in private cases. But this does not prevent them from bearing directly on liability and on whether a given settlement really had the net effect on competition that the Court feared such settlements might. Consistent with this, when the Supreme Court analyzed the FTC's *Section 5* claim in *Actavis*—which implicated neither antitrust injury, nor causation, nor damages—the Court required a competitive effect balancing test that, as discussed, considers both "actual and probable effects."

In short, no case law supports ignoring relevant effects or post-settlement evidence in any rule-of-reason analysis.[109] Yet, as discussed above, a logical consequence of dogmatically defining the antitrust harm as an elimination of risk *at the time of the settlement* is to exclude actual effects evidence from the rule-of-reason inquiry.

b. Analysis should weigh procompetitive virtues of the settlement generally and as a whole, not just justifications for payments

A settlement containing a reverse payment that eliminates the risk of potential competition might, *if its net effects are anticompetitive*, violate the antitrust laws under the rule of reason and *Actavis*. But Supreme Court case law, including *Actavis,* does not support limiting the analysis to this one form of anticompetitive harm—and as a corollary, focusing the rule-of-reason inquiry solely on justifications for or benefits flowing directly from *the payment*.[110] Not only does the general rule-of-reason approach consider the challenged agreement as a whole (rather than in component parts),[111] *Actavis* explicitly invites consideration of procompetitive virtues *of the deal as a whole*. Specifically, when the Court discusses the ways in which reverse payment settlements may still be permissible under the antitrust laws, notwithstanding their "potential for genuine adverse effects," it generally notes that "offsetting or redeeming virtues are sometimes present."[112] The Court does not limit this comment to justifications for the

---

109 The FTC's Wellbutrin submission also claims the *Actavis* Court rejected the idea that a reverse payment settlement facilitating earlier generic entry might constitute a procompetitive virtue. The Commission cites the Court's conclusion that "[n]otwithstanding such 'early entry,'" risk of competition may still be eliminated. FTC Wellbutrin Amicus Br. at 24 (citing *King Drug Co.*, 761 F.3d at 408; *Actavis*, 133 S. Ct. at 2234-35). But the "early entry" to which the Court refers in the cited passage is *entry before patent expiration*. *See* Actavis, 133 S. Ct. at 2234-35 ("We concede that settlement on terms permitting the patent challenger to enter the market before the patent expires would also bring about competition, again to the consumer's benefit. But settlement on the terms said by the FTC to be at issue here—payment in return for staying out of the market—simply keeps prices at patentee-set levels, potentially producing the full patent-related $500 million monopoly return while dividing that return between the challenged patentee and the patent challenger."). This is just another way of phrasing the court's rejection of the scope-of-the-patent test. It does not speak to whether evidence of actual procompetitive effects, such as evidence suggesting that the settlement facilitated entry earlier than would have been possible without the settlement, might counterbalance any anticompetitive tendencies in a rule of reason analysis.

110 *See supra* section III.

111 *In re* Wellbutrin XL Antitrust Litig., 2015 WL 5582289, at *16 (E.D. Pa. 2015); *In re* Niaspan Antitrust Litig., 42 F. Supp. 3d 735, 752 (E.D. Pa.2014); *see also In re* Lipitor Antitrust Litig., 46 F. Supp. 3d 523, 548–49 (E.D.Pa. 2014).

112 *See* 133 S. Ct. at 2235–36.

payment or its size, though as an "example" of an "offsetting virtue," the Court notes that the reverse payment may be justified in myriad ways.[113]

In arguments to the contrary, the FTC cites the defendant's burden under the rule of reason to offer procompetitive justifications *for the challenged conduct*: "[T]he antitrust question is not whether there are benefits to certain provisions in the abstract. It is whether the benefits are attributable to the restraint—in this case the payment."[114] This argument is premised on the faulty assumption that the reverse payment term, not the larger settlement agreement containing that term, is the "challenged conduct." But the payment alone cannot constitute the challenged conduct, since the payment alone cannot cause the alleged anticompetitive harm, however defined. Without other aspects of the settlement that also restrict the generic's ability to enter, the payment alone creates neither the potential for delay, nor the potential for risk elimination. Put simply, the payment alone does not restrain trade; the settlement does. And when the settlement is properly analyzed as the challenged restraint, any procompetitive effects it may have are not "abstract," but rather fit squarely into the traditional rule-of-reason framework the FTC cites.

The Commission's logic regarding a causal connection between the claimed procompetitive benefits and the challenged conduct also would not support all the limitations the *Wellbutrin* amicus brief suggests for a rule-of-reason analysis under *Actavis*. That brief criticizes the district court's finding that the alleged reverse payment itself may have had procompetitive effects.[115] With this argument, the FTC appears to advocate limiting the procompetitive analysis *not just* to procompetitive effects flowing from what the FTC views as the challenged conduct (the payment), but to procompetitive *justifications for* the payment. The Commission offers no basis for ignoring consumer benefits clearly flowing from the payment in this manner. Nor is such a limitation consistent with the larger goal of a rule-of-reason competitive effects inquiry.

This issue has great practical significance for litigants. Evidence of overall post-settlement effects and outcomes may well provide strong procompetitive counterbalances to any anticompetitive effects of a reverse payment settlement—even a settlement involving a large and unexplained payment. For example, evidence may point to the generic challenger's ultimate inability to secure regulatory approval, or to overcome unforeseen manufacturing difficulties. If a supply agreement or authorized generic commitment in the larger settlement allows the generic to nevertheless enter the market, this would be a strong procompetitive effect to consider.[116] Defining the relevant harm as the elimination

---

113 *Id.* at 2236.

114 FTC Wellbutrin Br. at 23.

115 "[T]he district court's analysis irrationally turns proof of the plaintiff's case —the use of a reverse payment to induce an entry-restricting settlement —into a defense." FTC Wellbutrin Amicus Br. at 24.

116 See, e.g., *In re* Wellbutrin XL Antitrust Litig., 2015 WL 5582289, at *20-21. In *Wellbutrin*, the district court performed the kind of traditional rule-of-reason analysis the Court envisioned: it considered general procompetitive virtues and effects of the settlement as a whole, not just the payment. These included the scope of the license the generic received, the supply agreement covering the generic if manufacturing or regulatory difficulties prevented it from producing its own product on the licensed entry date. *See id.* The court also considered a broader potential menu of possible anticompetitive harms with which plaintiffs may have satisfied their initial burden under the rule of reason. *Id.* at *16–19.

of the risk of potential competition, and focusing the antitrust inquiry on the time of the settlement, would prevent courts from considering such a procompetitive virtue. This could result in courts condemning a settlement that actually facilitated generic entry that would not otherwise have been possible.

It is also possible that, on balance, the consideration received as a reverse payment benefits both the generic challenger *and* consumers, and may thus be procompetitive.[117] Such a larger procompetitive virtue would not "explain" or "justify" the payment, or disprove the payment's theoretical potential to eliminate risk. Yet it a court should undoubtedly consider it in the overall calculus of the rule of reason, as some lower courts have already concluded.[118]

Evidence of patent invalidity may also be relevant, and consideration of this evidence, if available, would not contradict the Supreme Court's view on the role of the patent. While the Court made clear that patent validity does not *end* the antitrust inquiry into a reverse payment settlement, that hardly means that available evidence of patent validity should be ignored. "[I]n some cases, the invalidity of the patent will be readily established and the Court need not rest its analysis on the settlement value."[119]

It makes no sense to exclude these kinds of potentially relevant procompetitive virtues from the net competitive effects calculus. Just as the Court concluded that "it would be incongruous to determine antitrust legality by measuring the settlement's anticompetitive effects solely against patent law policy, rather than by measuring them against procompetitive antitrust policies as well," it would be incongruous to limit which procompetitive virtues a court may consider.[120] Yet defining the relevant anticompetitive harm as "the elimination of the risk of potential competition" leads to just that.

V. CONCLUSION

For over 100 years, the rule of reason has balanced actual and intended pro- and anticompetitive effects to assess antitrust liability and harm to competition. The Supreme Court has not strayed from this approach during this century of case law. Nor does the *Actavis* decision suggest courts should so stray when it comes to reverse payment settlements. Yet plaintiffs' and the FTC's proposed anticompetitive harm shortcut *prevents*

---

117 See, e.g., *In re* Actos End Payor Antitrust Litig., 2015 WL 5610752, at *17 (S.D.N.Y. 2015) ("[A] ny benefits that [the defendant generics] received under the agreements were benefits shared by consumers."); *F.T.C. v. AbbVie Inc.*, 107 F. Supp. 3d 428, 436 (E.D. Pa. 2015) ("What the FTC does not seem to recognize is that the benefit flowing to Teva is also a benefit flowing to consumers who will now be able to purchase the generic form of TriCor at a reduced price.…In a word, the TriCor agreement, unlike those in *Actavis*, is procompetitive.").

118 *See supra* note 101.

119 *In re* Actos End Payor Antitrust Litig., 2015 WL 5610752, at *21 (S.D.N.Y. 2015) ("Of course, in some cases, the invalidity of the patent will be readily established and the Court need not rest its analysis on the settlement value. For example, following a bench trial in which the patent at issue was held to be invalid and procured by fraud, the court in *F.T.C. v. Cephalon, Inc.* concluded that the brand name manufacturer was collaterally estopped from asserting "the strength of its patent, or litigation uncertainty and business risk" as defenses against a reverse payment antitrust claim by the FTC." (citing *F.T.C. v. Cephalon*, 36 F. Supp. 3d 527, 537 (E.D. Pa. 2014)).

120 *Actavis*, 133 S. Ct. at 2231.

the competitive effects balancing that hallmarks the rule of reason. This harm shortcut thus finds no support in *Actavis*, and flies in the face of many years of High Court precedent. Rather than effectively inserting words and concepts into Justice Breyer's Majority opinion, we should apply the analysis the Court unambiguously required: a rule of reason competitive effects balancing analysis, "as in other rule of reason cases."

THE DECISION OF THE SUPREME PEOPLE'S COURT IN *QIHOO V. TENCENT* AND THE RULE OF LAW IN CHINA: SEEKING TRUTH FROM FACTS[1]

By Emilio Varanini[2] *and Feng Jiang*[3]

Abstract: The rule of law creates social order, enhances legitimacy, and promotes economic growth. To accomplish these goals, the rule of law requires the development of administrable principles, the use of a system of case precedent, and the implementation of due process. In the area of antitrust, there is an additional gloss on the rule of law in that the need for administrable rules must be balanced against the application of economic theories. However, at bottom, these notions all depend on a competent judiciary that can, in fact, carry out these tasks. The 2014 antitrust decision by the Supreme People's Court—Beijing Qihoo Technology Co., Ltd. v. Tencent Technology (Shenzhen) Co., Ltd.[4]—*is a thorough opinion demonstrating the judiciary in China is up to the job. However, this decision's ultimate significance will be determined by how China follows-up on it; in its receiving the quasi-precedential status under Chinese law known as a "Guiding Case"; in private litigants in China using all of the procedural and evidentiary tools entrusted to them to litigate antitrust cases going forward based on the lessons learned from this decision; and in the Chinese courts being now entrusted to exercise the administrative review power delegated to them vis-à-vis government agency actions. Given that China is the second largest economy in the world, China's fostering further the rule of law becomes particularly important not just for its own growth and reform but also for the rest of the world.*

I. INTRODUCTION

The rule of law is important not only to create order in society and enhance government legitimacy but also to promote economic growth.[5] However, the development of the rule of law is about process as much as it is about results.[6] The English Common Law, for example, developed as it did because King Henry II sought to impose a system of courts that would administer a law common to England so as to increase his power at the expense of local

---

1 *See, e.g.,* RONALD COASE & NINA WANG, HOW CHINA BECAME CAPITALIST loc. 121 (2011) (ebook) (explaining origins and ramifications of the saying, ascribed to Deng Xiaoping, of seeking truth from facts).

2 Emilio E. Varanini is a Deputy Attorney General in the Antitrust Section of the California Attorney General's Office and is the International Liaison for the National Association of Attorneys General's Antitrust Task Force. He served as Chair of the China Working Group for the American Bar Association's Section of Antitrust Law for two years. He is now a member of the International Task Force of the American Bar Association's Section of Antitrust Law as well as a member of the Executive Committee of the International Law Section of the State Bar of California.

3 Feng Jiang is a Director of the Guandong Balifu Law Firm in Shenzhen, China. He has written extensively on China's Anti-Monopoly Law. He is also Director of the Fair Trade Committee of the Shenzhen Lawyers' Association and Vice-Chairman of the Intellectual Property Lawyers' Association of Guangdong Province, China.

4 2013 CIV. JUDG. (Sup. People's Ct. Oct. 8, 2014) (China).

5 *See, e.g.*, Margaret Lewis, *Criminal Law Pays: Penal Law's Contribution to China's Economic Development*, 47 VAND. J. OF TRANSNAT'L LAW 371, 374-75 (2014).

6 *See, e.g.*, *id.* at 374 (quoting sources for the proposition that "the courts enable market actors to plan by resolving disputes predictably, efficiently, and in accordance with the legal rules" (internal quotation marks and citations omitted)).

customary feudal rights.[7] Such courts could offer litigants "better justice than they could have at the hands of their lords" via offering a fairer process.[8] For example, only royal judges could summon a jury.[9] And a jury came to be thought of as "a safeguard from arbitrary perversion of the law."[10] This encouraged the people to resort to royal courts that now had to be staffed with professional judges, removed from local prejudices, who would apply a law common to the entire country.[11] Even though antitrust principles are subject to revision based on the evolution of economic understanding,[12] antitrust is no more exempt from the rule of law than any other body of law.[13]

The process behind the rule of law has important aspects that deserve widespread attention. In the first instance, the rule of law involves the development of principles that can be applied or expanded to novel circumstances.[14] Those principles have to be administrable—capable of ready understanding and application—even though insofar as antitrust is concerned, concerns of administrability can be foreign to economics.[15] Nonetheless, even in antitrust, the gap between developing administrable principles and applying complex fact-dependent

---

7 *See* Winston Churchill, A History of the English-Speaking People, The Birth of Britain, The English Common Law, 215-17 (New York, Dodd, Mead & Co. 1969) [hereinafter English Common Law].

8 *Id.* at 217. This is not an analogy without salience in China in terms of improving governance, for example, in the provinces. Although the full exploration of that aspect of the rule of law is beyond the scope of this Article. *See, e.g.*, Stephen Breyer, The Court and the World: American Law and the New Global Realities loc. 5782 (2015) (ebook) ("Our Chinese counterparts . . . saw in administrative law a method of preventing arbitrary action by regional government authorities.").

9 English Common Law, *supra* note 7, at 218.

10 *Id.* at 219.

11 *See id.* at 220-22.

12 *See Kimble v. Marvel Entm't LLC*, 135 S. Ct. 2401, 2412-13 (2015).

13 *See e.g.*, OECD, OECD Policy Roundtable, Judicial Enforcement of Competition Law, 19 (1996) [hereinafter Judicial Enforcement of Competition Law] (on file with authors) (noting that "[i]n most countries, courts do play an important role in commerce" and then noting the importance of the role played by the courts in antitrust, especially because competition laws are written so broadly).

14 *See* English Common Law, *supra* note 7, at 224-25.

15 *See* Oliver Williamson, The Mechanisms of Governance, 282-83 (1996) [hereinafter The Mechanisms of Governance] (citing and quoting now U.S. Supreme Court Justice Breyer for the proposition that antitrust law cannot simply replicate economists' views, which may be conflicting, but in developing rules and precedent also follow administrative virtues of simplicity); *see also* Judicial Enforcement of Competition Law, *supra* note 13, at 10 ("The judiciary has two important functions in the implementation of competition policy: ensuring that procedural due process is observed, and applying the underlying substantive principles of the competition law in a correct and consistent manner. Thus, courts bring economic policy under rule of law.").

economic theory has been filled by the use of presumptions and structural factors.[16] Thus, antitrust can be seen as presenting cutting-edge issues for the application of the rule of law because of the desire to balance the need to apply economic principles to often complex factual circumstances while avoiding every antitrust case from degenerating into a "graduate economic seminar."[17]

The rule of law also involves the development of precedent, a body of published case law that judges could apply in similar cases and that commentators could reference to explain and comment on.[18] A system of precedent also involves lower courts standing by the decisions of higher courts and higher courts (generally) following their own prior precedent.[19] In this manner, the rule of law can "promote the evenhanded, predictable, and consistent development of legal principles" and ensure "the actual and perceived integrity of the judicial process."[20] Indeed, it is now common to the rule of law in East Asia and the West alike that it rests, in the end, on a system of court decisions that involve binding precedent from higher courts.[21] And in this respect, antitrust presents interesting challenges in the development of precedent because of the desire to apply the latest economic principles

---

16 *See, e.g.*, *Philadelphia National Bank at 50: An Interview with Judge Richard Posner*, 80 ANTITRUST L.J. 205, 207 (2015) [hereinafter *Interview with Judge Posner*]; *see also* Harry First & Eleanor Fox, *Philadelphia National Bank: Globalization and the Public Interest*, 80 ANTITRUST L.J. 307, 326 (2015) [hereinafter *Globalization*] (noting that the shift from eschewing tests for competitive effects to the market share presumptions in *Philadelphia National Bank* "made effective enforcement more likely" because of the focus on economics and administrability); THE MECHANISMS OF GOVERNANCE, *supra* note 15, at 283-84 (citing and quoting the underlying article that gave rise to the *Philadelphia National Bank* presumption with approval for the proposition that a gradualist approach to incorporating the latest economic theories into antitrust rules is "arguably" the "way antitrust enforcement should work"); *id.* at 284-85 (noting that legal rules should not, however, in the service of administrability disregard economics altogether because of the costs imposed, but rather should be flexible and open to refinement); *id.*at 287-88 (discussing the use of "filters" or "factors" to distinguish between "problematic and unproblematic cases"); JUDICIAL ENFORCEMENT OF COMPETITION LAW, *supra* note 13, at 13 (discussing the various presumptions of fact that may be employed in the civil sphere).

17 *See Interview with Judge Posner, supra* note 16, at 207; *see also* JUDICIAL ENFORCEMENT OF COMPETITION LAW, *supra* note 13, at 19 (noting that the task of courts' applying economic thinking in antitrust cases calls for the use of "shortcuts" or "legal presumptions" to make that task easier but also noting that for some tasks like market definition, such shortcuts are not possible and encouraging the exploration of how courts may better use economic evidence).

18 *See, e.g.,* ENGLISH COMMON LAW, *supra* note 7, at 224-25.

19 *See James v. Boise*, No. 15-493, slip. op. at 1-2 (U.S. Jan. 25, 2016) (per curiam); *see also Kimble v. Marvel Entm't LLC*, 135 S. Ct. 2401, 2409 (2015); BREYER, *supra* note 8, at loc. 5923-24.

20 *See e.g.*, *Kimble*, 135 S. Ct. at 2409.

21 *See* Toshiaki Iimura, Ryu Takabayashi & Christoph Rademacher, Commentary, *The Binding Nature of Court Decisions in Japan's Civil Law System*, CHINA GUIDING CASES PROJECT (2015), *available at* https://cgc.law.stanford.edu/commentaries/14-Iimura-Takabayashi-Rademacher; Yong Lim & Yunyu Shen, *A Tale of Two Courts: Handling Market Definition in Abuse of Dominance Cases under Market-Share Based Statutory Presumptions in China and Korea*, CPI ANTITRUST CHRONICLE, Feb. 12, 2015, at 7-8 (discussing Republic of Korea); Emilio Varanini, *Running Soft Convergence into the Ground: The Case for an International Antitrust Treaty*, 28 CHINESE (TAIWAN) Y.B. INT'L L. & AFF. 137, 143-45 (2013) (discussing Japan); *id.* at 142-43 (discussing European Union); Emilio Varanini, *American and European Antitrust Enforcement: Let One Hundred Flowers Bloom and One Hundred Schools of Thought Contend*, ANTITRUST BULLETIN 97, 100 nn.16, XX n.17, 101 n.26, 103-04 (Summer 2004) (discussing European Union).

without sacrificing the predictability of this system of precedent.[22] Finally, the rule of law also involves following a set process in which everyone has a chance to be heard and to respond in front of a neutral decision-maker where a litigant's legitimate interests, such as the protection of the confidentiality of business secrets, are taken into account.[23]

In the end, however, all of this presupposes a judiciary that can carry out these tasks—as evinced by the quality of their opinions.[24] And that point applies whether the judiciary is in a civil law country or a common law country.[25]

Since the Cultural Revolution, China embarked on its own course of developing a functioning legal system that would implement many features of the rule of law in the economic and commercial spheres: it passed legal codes and restored a functioning court system; it then steadily increased the power and reach of its courts as well as the tools available to civil litigants to pursue cases within that system. Eight years ago, it enacted the Anti-Monopoly Law, a civil antitrust law of such importance that a celebration of its five-year anniversary was televised on the premier, state-owned, television network CCTV.[26] This raises the dual questions of how China has addressed the challenges of applying the rule of law in the context of antitrust and what its efforts to date in the context of antitrust say about its commitment to the rule of law as a more general matter.

---

22 *See Interview with Judge Posner, supra* note 16, at 206-07 (discussing the "presumption of illegality," "plus a short list of possible rebuttal points that the defendant would be allowed to make" for mergers of a certain market share and whether the current state of economic learning suggests that this presumption should be revisited); *see also Kimble*, 135 S. Ct. at 2413 (noting that, by comparison to patent law, antitrust law turned over exceptional law-making authority to the courts); *Globalization, supra* note 16, at 326.

23 *See* Tad Lipsky & Randy Tritell, *Best Practices for Antitrust Law: The Sections Offers Its Model*, 15 The Antitrust Source 1, 17-20 (Dec. 2015) [hereinafter *Best Practices*], *available at* http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/dec15_full_source.authcheckdam.pdf; Judicial Enforcement of Competition Law, *supra* note 13, at 10; *see also* Breyer, *supra* note 8, at loc. 5827 (setting out minimum standards for due process); The Mechanisms of Governance, *supra* note 15, at 289-90 (discussing the need for plaintiffs' arguments to not be peremptorily dismissed on summary judgment); *id.* at 292 (disagreeing with the notion advanced by Judge Easterbrook that private lawsuits by competitors against mergers should not be allowed as being "too simplistic").

24 *See* Judicial Enforcement of Competition Law, *supra* note 13, at 10 ("Judges are uniquely qualified to perform this balancing of procedural and substantive principles in competition enforcement . . . . [J]udges are experienced in this process—in discerning the underlying purpose or purposes of a law and reconciling those fundamental goals with the need for fair and transparent application of the law."); *see also id.* ("The judiciary also brings a certain degree of flexibility to the implementation of the competition law, thus enhancing the development of law and the application of current economic thinking."); Breyer, *supra* note 8, at 5821, 5837 (discussing how judges need to have the right state of mind to be independent in dealing "honestly" with the facts of a case, "working through the details," and ruling "without regard for the press (for instance) would say").

25 *See Best Practices, supra* note 23, at 4 (in discussing best practices for the conduct of antitrust proceedings, the authors point out that "[n]o system of enforcement—adversarial or inquisitorial, common-law or civil-law, judicial or administrative—has been assumed superior in its relevant capacities."); Judicial Enforcement of Competition Law, *supra* note 13, at 10. Given that, for example, the common law has evolved in places such as the United States to become a system that is far more based on the enactment and application of statutes (*see, e.g.*, *Campbell-Ewald Co. v. Gomez*, No. 14-857, slip. op. at 4-5 (U.S. Jan. 20, 2016) (Thomas, J., concurring)), the experience of common law systems with the rule of law is salient for civil law systems (and vice versa).

26 One of the two authors of this Article participated in that event.

Those dual questions are worth study, not just through an analysis of the development of China's legal framework for addressing antitrust issues but also through a detailed examination of a 2014 antitrust decision by the Supreme People's Court—*Beijing Qihoo Technology Co., Ltd. v. Tencent Technology (Shenzhen) Co., Ltd.*[27] (*2014 QQ Decision*). That comparison is enlightening as to the question of whether China is truly now on the road to the rule of law, at least in the economic and commercial spheres. This Article answers that question in the affirmative based on an analysis of China's legal system, and the comparative analysis of the *2014 QQ Decision* with a 2015 decision of the California Supreme Court. However, this Article notes that there are still important milestones to meet flowing from the *2014 QQ Decision* and legal developments contemporaneous-in-time with that decision.

This Article is divided into six parts following this introduction. Part II provides background on the development of China's civil law system following the Cultural Revolution. Part III provides background on the scope of China's Anti-Monopoly Law eight years out. Part IV provides an overview of recent changes in Chinese law, close-in-time to the *2014 QQ Decision*, as well as the decision of the Chinese Communist Party's Central Committee on October 23, 2014 at the 4th Plenary Session of the 18th Central Committee on the rule of law (Fourth Plenum Decision)—all of which serves as an important backdrop that imparts further significance to that *2014 QQ Decision*. Part V discusses the *2014 QQ Decision* in extensive, but necessary, detail so that its significance may be readily understood in terms of how it provides careful guidance on a whole host of evidentiary, procedural, and substantive issues of great import for the Anti-Monopoly Law specifically and the rule of law generally. Part VI compares the *2014 QQ Decision* to a more recent decision in California to further explore the significance of the *2014 QQ Decision* for the rule of law in China. This part of the article also explores the milestones that we would want to see China surpass to confirm that China is indeed on the path to the rule of law as indicated by the *2014 QQ Decision*. Part VII provides some closing thoughts.

II. THE DEVELOPMENT OF CHINA'S CIVIL LAW AND PROCESSES AFTER THE CULTURAL REVOLUTION

Since 1979, China's lodestar has been economic development and social stability under Deng Xiaoping and his successors.[28] However, as the Cultural Revolution came to an end, China found itself without a legal system.[29] China's first task in addressing the renewal of economic development and social stability was thus to restore a legal system by enacting a Constitution in 1978 that restored the courts and procuratorates.[30] This was followed by the enactment of a new Constitution in 1982 that was revised four times through 2004 as well as over 229 national

---

27 2013 Civ. Judg. (Sup. People's Ct. Oct. 8, 2014) (China).

28 *See, e.g.*, Lewis, *supra* note 5, at 373, 394-99 (discussing the need for social stability in China).

29 *See* Ronald Coase & Nina Wang, How China Became Capitalist loc. 99 (2011) (ebook); *see also* Daniel Chow, The Legal System of the People's Republic of China in a Nutshell loc. 56-59 (2nd ed. 2009) (ebook).

30 *See* Coase & Wang, *supra* note 29, at loc. 99-100; *see also* Chow, *supra* note 29, at loc. 56-60; *id.* at loc. 80, 184, 198 (making this point in the context of the 1982 Constitution). The term procuratorates refers to the agencies in China that are responsible for prosecutions. *See, e.g.*, *Supreme People's Procuratorate*, Wikipedia, https://en.wikipedia.org/wiki/Supreme_People%27s_Procuratorate (last visited on June 20, 2015). Any discussion of the development of procuratorates is mostly beyond the scope of this article, though similar agencies exist within other civil law systems. *See id.*

laws through 2008 that spanned a wide variety of criminal, civil, economic, and administrative subjects.[31] The 1982 Constitution, for the first time, emphasized the rule of law.[32]

The 1980 Organic Law of the People's Courts and the 1982 Constitution established the general administrative structure of four court levels, with the Supreme People's Court located in Beijing as the apex.[33] In 1986, China enacted the General Principles of the Civil Code,[34] enabling civil cases to be heard in its courts as a substantive matter.[35] In 1989, China enacted the Administrative Litigation Law,[36] enabling cases challenging certain administrative actions to be heard in its courts.[37] And in 1991, China enacted the Civil Procedural Law, setting out the general process and rules by which civil actions would be heard and adjudicated in Chinese courts.[38]

China's court system allows for a civil plaintiff to receive up to two trials at different levels (e.g., the equivalent of the district or superior court level in the United States and then again at an intermediate appellate level) with the second trial being *de novo*.[39] The courts are split into four divisions: civil, criminal, economic, and administrative.[40] Many provinces have

---

31 Coase & Wang, *supra* note 29, at loc. 100; *see* Chow, *supra* note 29, at loc. 60-61 (noting that in the first decade of reform after 1979-1980, "over 3,000 laws and regulations were enacted, including over one hundred major legal codes," as well as the enactment of a new Constitution).

32 *See, e.g.*, Chow, *supra* note 29, at loc. 77-78, *see also id.* at loc. 184 (discussing importance of this commitment to rule of law to effectuate economic reform and social stability).

33 *See* Organic Law of the People's Courts of the People's Republic of China (promulgated by the Nat'l People's Cong., July 1, 1979, effective July 5, 1979) (amended 1983, 1986, & 2006), arts. 1, 2, 9-11, 13, 18, 20, 23-27, 29-32; *see also* Chow, *supra* note 29, at 202-04.

34 General Principles of the Civil Law of the People's Republic of China (promulgated by the Nat'l People's Cong., Apr. 12, 1986, effective Jan. 1, 1987).

35 *See* Chow, *supra* note 29, at loc. 330.

36 Administrative Litigation Law of the People's Republic of China (promulgated by the Nat'l People's Con., Apr. 29, 1999, effective Oct. 1, 1999).

37 *See generally* Jianlong Liu, *Administrative Litigation in China: Parties and their Rights and Obligations*, 4 NUJS L. Rev. 205 (2011) (discussing process of challenging administrative decisions in China); Chow, *supra* note 29, at loc. 298-99.

38 Civil Procedure Law of the People's Republic of China (promulgated by the Nat'l People's Cong., Apr. 9, 1991, effective Jan. 1, 2013) (amended 1991, 2007, & 2012), arts 1-7, 10, 12, 17-20, 39-43, 75-77, 79, 125, 133-34, 138-39, 141, 152, 156, 164, 168-71.

39 *See* Organic Law of the People's Courts of the People's Republic of China (promulgated by the Nat'l People's Cong., July 1, 1979, effective July 5, 1979) (amended 1983, 1986, & 2006), art. 11; Civil Procedure Law arts. 10, 17-20, 39-40, 153, 164, 168-71; *see also* Chow, *supra* note 29, at loc. 203-04. If the first trial is held in front of the Supreme People's Court in Beijing, then it is final. *See* Chow, *supra* note 29, at loc. 203-04; *see also* Organic Law art. 32; Civil Procedure Law arts. 10, 20.

40 *See* Chow, *supra* note 29, at loc. 204-05; *see also* Organic Law arts. 18, 23. Cases that involve such laws as the Anti-Monopoly Law fall within the civil area, rather than economic, as economic cases involve enterprises and industrial sectors, *see, e.g.*, *id.*, unless it is administrative in nature. *See id.*; Anti-Monopoly Law of the People's Republic of China (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug, 30, 2007, effective Aug. 1, 2008), art. 50; *see also Beijing Qihoo Technology Co., Ltd. v. Tencent Technology (Shenzhen) Co., Ltd.*, 2013 Civ. Judg. (Supreme People's Court Oct. 8, 2014) (China) [hereinafter *2014 QQ Decision*] (translated by Feng Jiang) (labelling opinion as a *civil* judgment).

established a separate division of one kind or another for intellectual property cases[41] and those divisions have become tasked with hearing cases involving the Anti-Monopoly Law (though not exclusively so as a theoretical matter).[42] Moreover, those intellectual property cases (and by extension Anti-Monopoly Law cases) may involve a trial in the first instance at the intermediate appellate court level, with a second-level Higher People's Court for the entire province that can retry the case and then the Supreme People's Court.[43] The Supreme People's Court is the court of final resort in Mainland China; though it has considerable room for the exercise of original jurisdiction, in practice it prefers to serve as an appellate court in hearing appeals from lower courts.[44]

At each level of a court system in a province, as well as at the Supreme People's Court, there will be a President, Vice-Presidents, a Chief Judge for each division within that system, deputy chief judges, and assistant judges—as well as People's Assessors or lay judges though such assessors are not included in second trials or appeals.[45] They are appointed for a term by the equivalent People's Congress for that level.[46]

---

41 *See* Wang Chuang, Deputy Chief Judge, Supreme People's Court of the People's Republic of China, Presentation Before the 20th U.S.-China Legal Exchange: China's Judicial Reform slides 2-3 (Feb. 29, 2016) (on file with author); Chow, *supra* note 29, at loc. 204.

42 *See* Susan Ning & Ding Liang, *Commentary on the Anti-Monopoly Judicial Interpretation*, China Law Insight (Aug. 29, 2012), http://www.chinalawinsight.com/2012/08/articles/corporate/commentary-on-the-antimonopoly-judicial-interpretation (analyzing Article 3 of 2012 Supreme People's Court rules on the Anti-Monopoly Law, discussed *infra*). As discussed *infra*, challenges to local government actions for abuse of dominance conduct under the Anti-Monopoly Law and to antitrust enforcement actions, e.g., the imposition of fines, are now allowed under amendments to the Administrative Litigation Law that took effect this year. Whether lawsuits based on those challenges would be heard in the administrative system, as might be expected, remains to be seen though they should be heard in the first instance at an intermediate appellate level. *Cf.* Chow, *supra* note 29, at loc. 300 (discussing how cases involving patent, grave, and complex cases, and cases involving an agency acting under direction of the State Council, are to be heard by such courts in the first instance); Organic Law arts. 18, 23 (intermediate courts can set up criminal, civil, economic, and other divisions whereas lower courts can only set up criminal, civil, and economic divisions).

43 *See generally, e.g.*, Chow, *supra* note 29, at loc. 209 (describing how the venue for patent cases and complex cases can end up in a first-level intermediate appellate court rather than a basic court); Civil Procedure Law arts.19-20. However, lower courts, colloquially referred to as district courts, have set up intellectual property panels in some areas such as in Beijing. These intellectual property panels may also hear antitrust cases. *See, e.g.*, Anjie Law Firm, 2015 China Anti-Monopoly Rpt. 46-48 (2016) [hereinafter 2015 China Anti-Monopoly Rpt.] (on file with authors) (discussing holding of Beijing High Court that such panels have jurisdiction over antitrust cases based on regulations of the Supreme People's Court and the Beijing High Court).

44 *See* Chow, *supra* note 29, at loc. 211-12; *see also* Organic Law art. 29; Civil Procedure Law art. 20.

45 *See* Organic Law arts. 9, 26, 30; Civil Procedure Law arts. 39-43; Chow, *supra* note 29, at loc. 205-06, 212; *see also* Wang, *supra*, note 41, at slides 8-9 (describing intellectual property panels). The People's Assessor not only ensures some public participation in judicial proceedings but also may even be an expert in an area pertinent to the case, thus bringing his or her expertise to bear in supporting the court's decision.

46 *See* Organic Law arts. 34-36; Chow, *supra* note 29, at loc. 205-06.

Judges are required to have advanced degrees specializing in law or a college degree plus one or two years of working experience and professional legal knowledge.[47] Though would-be judges can pass an examination to become judges, they may be directly appointed as assistant judges, even at the Supreme People's Court level. However, once appointed, judges must pass periodic examinations and evaluations like any other civil servant.[48] And judges at the higher levels, whom not uncommonly have scientific or engineering degrees of one kind or another, believe that those degrees help them in the performance of their judicial functions, e.g., by enabling those judges to ask court litigants the kind of questions necessary to address complex or technical matters, including those under the Anti-Monopoly Law.[49]

Judges decide cases by setting up a collegiate panel of an odd number of judges.[50] Civil cases will involve the questioning of civil litigants, the presentation of evidence—including witnesses and documents—and the presentation of argument before a judgment is reached.[51] Although pre-trial discovery is minimal as compared to the United States, the courts can, either on their own or in response to a request, order the gathering or preservation of

---

47 *See* Chow, *supra* note 29, at loc. 206-07; *see also* Organic Law art. 33. The expertise of the judges on the intellectual property panels in major cities such as Beijing is much greater. *See, e.g.,* Wang, *supra*, note 41, at slide 4 (noting judges on the intellectual property panels in Beijing, Shanghai, and Guangzhou have between 7-10 years of judicial experience). There were issues with the quality of judging in China, especially in the early years as China's set up its civil law court system. In response to such issues, China set up an administrative system of supervision in which decisions of lower courts could be reviewed by judges in higher courts and others to avoid mistakes being made. *See, e.g.*, Organic Law, *supra* arts. 10, 13 (discussing role of judicial committees, higher courts, people's congresses, and procuratores). Though there is less need for this system now on civil matters than has been true historically, it does continue to endure. This point is discussed in more detail at note 61, *infra.*

48 *See* Chow, *supra* note 29, at loc. 206-07; *see also* Organic Law art. 36.

49 Anonymous, Statements at the 2014 Antitrust Civil Litigation Forum, Beijing, China (May 24-25, 2014). Though one of the authors attended this forum, the authors of this article are following the Chatham House Rule in avoiding any more specific description of the statements or the individuals making those statements. *See Chatham House Rule*, Wikipedia, https://en.wikipedia.org/wiki/Chatham_House_Rule (last visited on June 20, 2015) (Chatham House Rule is designed to foster debate and discussions on controversial issues by enabling participants to use information from that debate or discussion but not identify who made what comment).

50 *See* Organic Law, *supra* arts. 9, 23; Civil Procedure Law arts. 39-43; Chow, *supra* note 29, at loc. 212; Wang, *supra*, note 41, slide 8 (intellectual property cases are decided collectively); *see also 2014* QQ *Decision, supra* note 40, at 83 (case was decided collectively by a panel of the Supreme People's Court composed of Presiding Judge Wang Chuang, Judge Wang Yangfang, Acting Judge Zhu Li, and two clerks). The courts will strenuously use mediation or conciliation to try to get cases to settle before they proceed to trial, *see generally, e.g.*, Chow, *supra* note 29, at loc. 212, 291-92, though the use of, and limitations on, such measures are beyond the scope of this article.

51 *See* Civil Procedure Law arts. 63-81; Chow, *supra* note 29, at loc. 212-13, 291; *see also 2014* QQ *Decision*, *supra* note 40, at 1-21 (describing the presentation of evidence in the Guangdong Higher People's Court as including such items as expert reports, market reports from companies and the government as well as other information available from government agencies such as the State Intellectual Property Office, Internet access demonstrations, Internet articles, and website posts).

evidence,[52] including in intellectual property cases[53] and anti-monopoly cases.[54] The courts can also allow civil litigants to present witnesses with professional knowledge that other civil litigants or the court can question,[55] or can, at least in an anti-monopoly case, designate their own independent economic experts to produce a report.[56] Taking into account which party has the burden of proof on an issue, judges can draw adverse inferences from the failure of civil litigants or their witnesses to be able to answer questions or provide information requested by them.[57] And reports by government agencies, presumably including decisions of government antitrust enforcers, have greater evidentiary weight than other forms of written evidence.[58]

---

52 *See* Civil Procedure Law art. 64, 67, 81; Chow, *supra* note 29, at loc. 288.

53 *See, e.g.*, Chow, *supra* note 29, at loc. 438.

54 Susan Ning, Kate Peng, Jia Liu & Rui Li, *The Dual System of Anti-Monopoly Law—The Interplay Between Administrative Enforcement and Civil Action*, China Law Insight (Sept. 12, 2013), http://www.chinalawinsight.com/2013/09/articles/corporate/antitrust-competition/the-dual-system-of-anti-monopoly-law-the-interplay-between-administrative-enforcement-and-civil-action/ (discussing the ability of civil plaintiffs filing claims under the Anti-Monopoly Law to use Article 64 of the Several Provisions of the Supreme People's Court on Evidence in Civil Proceedings to ask the court to investigate and gather evidence). Whether, and to what extent, that would apply to evidence submitted by an amnesty applicant to a government antitrust enforcement agency remains to be seen. *See id.* In that respect, the authors note that other jurisdictions have found mechanisms by which civil plaintiffs can secure evidence from amnesty applicants without discouraging companies from applying to antitrust enforcers for amnesty status in the first instance. *See, e.g.,* Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108-237, §213(b), 118 Stat. 665, 666 (codified as amended at 15 U.S.C. § 1 note); Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on Certain Rules Governing Actions for Damages under National Law for Infringements of the Competition Law Provisions of the Member States and the European Union, arts. 26-28, 2014 O.J. (L. 349) 5.

55 Ning et al., *Commentary on the Anti-Monopoly Judicial Interpretation, supra*, note 42 (discussing Article 12 of the Supreme People's Court Rules on the Anti-Monopoly Law—discussed *infra*—and Article 61 of the Several Provisions of the Supreme People's Court on Evidence in Civil Proceedings); *see also 2014 QQ Decision*, *supra* note 40, at 2 (both sides hired economic experts); Civil Procedure Law art. 79 ("The parties concerned may apply to the people's court to notify a person with professional knowledge to appear before court and issue opinions on the expert evaluation opinions issued by the experts on professional issues.").

56 *See* Ning et al., *Commentary on the Anti-Monopoly Judicial Interpretation, supra*, note 42 (discussing Article 13 of the Supreme People's Court Rules on the Anti-Monopoly Law); *see also, e.g.,* Civil Procedure Law art. 76 ("A party may apply to the people's court for expert evaluation of specific issues concerning the facts); *id.* ("Where the party has not applied for expert evaluation but the people's court deems it necessary with regard to certain specific issues, the court shall appoint a qualified expert to conduct expert evaluation.").

57 Anonymous, Statements to the 2014 Antitrust Civil Litigation Forum, Beijing, China (May 24-25, 2014).

58 *See* Ning et al., *The Dual System, supra*, note 54 (discussing Article 77 of Some Provisions of the Supreme People's Court on Evidence in Civil Procedures). However, there is a difference between a written government decision, with factual and legal findings, being admissible even if special evidentiary weight is placed on the decision, and the underlying findings in that decision having preclusive effect in follow-on civil litigation. *See generally* Stephen Freccero, *The Use and Effect of a Guilty Plea in Subsequent Civil Litigation*, 22 Competition: J. Anti. & Unfair Comp. L Sec. St. B. Cal. 136, 144-48, 151-56 (Spring 2013) (discussing U.S. antitrust law). While the draft rules of the Supreme People's Court discussed *infra* included a provision according such preclusive effect to government decisions, that provision was removed from the final promulgated version. *See* Ning et al., *The Dual System, supra*, note 54.

American courts must also interpret statutes; such cases have enhanced precedential value because Congress can amend the statute if it so chooses in response to a court decision.[59] The situation in China is more complex, though the courts have a greater role in that respect than it may appear at first glance.

As China has a system of legislative supremacy, interpretations of law are handed down by the Standing Committee of the National People's Congress (which is simultaneously a law-making body) while interpretations of administrative regulations are conducted by the State Council.[60] However, the Standing Committee's reported reluctance to give such interpretations has left a lot of room open for the Supreme People's Court to do so in a manner that can be so detailed and broad as to amount to supplemental legislation.[61]

In spite of the impressive steps made by China on the rule of law in the use of its courts,[62] much remains to be done on that subject to ensure continued economic reform and social stability.[63] To understand this point, as well as how the *2014 QQ Decision* is an important signpost of the continued development and use of law in China, this Article next turns to a description of China's Anti-Monopoly Law.

III. CHINA'S ANTI-MONOPOLY LAW EIGHT YEARS OUT

On April 1, 2008, China's antitrust law, known as the Anti-Monopoly Law, took effect.[64] The Anti-Monopoly Law was enacted as part of a systematic effort to establish a

---

59 *See, e.g.*, *Kimble v. Marvel Entm't LLC*, 135 S. Ct. 2401, 2409 (2015).

60 *See, e.g.*, Chow, *supra* note 29, at loc. 173-75, 207.

61 *See id.* at loc. 176-79, 180; *see also* Organic Law of the People's Courts of the People's Republic of China (promulgated by the Nat'l People's Cong., July 1, 1979, effective July 5, 1979) (amended 1983, 1986, & 2006), arts. 15, 33. The word "reported" is intentional; the Supreme People's Court can consult with the Standing Committee (whose role as a law-making body is referenced *infra* in note 88) to determine if the Court's interpretation of a law is accurate. *See* Mei Gechlik & Dai Di, Commentary, *Guiding Case No. 5: Monopoly in China's Salt Industry and Amendments to the Legislation Law and the Administrative Litigation Law*, China Guiding Cases Project, 4 (2015), *available at* https://cgc.law.stanford.edu/commentaries/13-gechlik-and-dai. As referenced in note 4, *supra*, there is a process of "adjudication supervision" by which otherwise final judgments can be corrected for errors (though parties have to abide by timelines). This process is thought to be important in a system where the competency of the courts, and the qualifications of their members, has required ongoing nourishing and development since their reestablishment following the Cultural Revolution. *See* Chow, *supra* note 29, at loc. 217-18. The re-opening, or correction, of final judgments, albeit on the satisfaction of strict standards, is not unknown in the United States. *See* Fed. R. Civ. Pro. 60(b). This process of administrative supervision is coupled by a more informal process of administrative guidance, however, in which lower courts will seek the opinions of higher courts on a legal issue before them in a case for the same reasons that motivate the administrative supervision process. A more detailed exploration of the adjudication supervision process, or the more informal variant of administrative guidance, is beyond the scope of this article except to note that this administrative review and feedback process as a whole provides some explanation as to how case decisions from a court below the Supreme People's Court in Beijing can be viewed as being sufficiently important to warrant administrative designation as a guiding case by the Supreme People's Court. *See* Gechlik & Di, *supra*.

62 *See* Wang, *supra*, note 41, at slides 6-7 (noting that the intellectual property panels in Beijing, Shanghai, and Guangzhou accepted 15,772 cases and decided 9,872 cases as of December 31, 2015).

63 *See* Coase & Wang, *supra* note 29, at loc. 181-83, 185 (making that point by reference to Chinese statements made during the Qin Dynasty).

64 *E.g.*, Zhenguo Wu, *Perspectives on the Chinese Anti-Monopoly Law*, 75 Antitrust L.J. 73 (2008).

comprehensive legal system to regulate the socialist market economy by 2010.[65] It embodies a desire to establish a market economy in China, combat abusive state power (as a second best measure to economic reform involving state power in the market), and protect the national interest.[66] The Anti-Monopoly Law has sections that address monopoly agreements (e.g., horizontal agreements among competitors to fix price or vertical agreements between manufacturers and distributors to fix price), abuse of dominant market position (e.g., tying or exclusive conduct by a company with certain levels of market power or abuse of intellectual property rights), mergers, abuse of administrative powers to eliminate or restrict competition, and supplemental provisions that include the power to block the conduct in question and assess civil penalties.[67]

The courts have an important role in carrying out the Anti-Monopoly Law in two ways. First, Article 50 of the Anti-Monopoly Law states that businesses can be held civilly liable for the damages that they inflict on others by engaging in practices that violate the law.[68] Analyzing Article 50 of that law in conjunction with the General Principles of the Civil Law means that the courts can, in a given case under this law, apply the following broad remedies: "(1) cessation of infringements; (2) removal of obstacles; (3) elimination of dangers; (4) return of property; (5) restoration of original condition; (6) repair, correction, or replacement; (7) compensation for losses; (8) payment of deposits or liquidation damages; (9) elimination of ill-effects and restoration of reputation; and (10) extension of apology."[69] Indeed, this interpretation of Article 50 has been confirmed by the Supreme People's Court.[70] Second, a business dissatisfied with a decision of a government antitrust enforcement agency can file an administrative litigation action with the courts.[71]

Though the courts have not, to date, heard administrative litigation cases involving specific decisions of government antitrust enforcers, Article 50 of the Anti-Monopoly Law has given rise to important activity by the courts over the eight years since its enactment,

---

65 Yong Huang, *Pursuing the Second Best: The History, Momentum, and Remaining Issues of China's Anti-Monopoly Law*, 75 Antitrust L.J. 117, 119 (2008).

66 *Id.* at 121-24.

67 *See, e.g.*, Wu, *supra* note 64, at 79-97, 103-12.

68 *See, e.g.*, *id.* at 112.

69 *See id.*; *see also 2014 QQ Decision*, *supra* note 40, at 3 (Qihoo as the civil plaintiff requested that the courts order the following: (1) Tencent stop its conduct constituting an abuse of market dominance; (2) Tencent pay Qihoo 150 million RMB for Qihoo's economic losses (3) Tencent apologize to Qihoo; (4) Tencent pay Qihoo's reasonable expenses, including investigation fees, notarization fees, and attorney's fees, all totaling 1 million RMB; and (5) Tencent pay other litigation fees); Ning et al., *Commentary on the Anti-Monopoly Judicial Interpretation*, *supra* note 42 (making these same points in analyzing the Supreme People's Court rules on the Anti-Monopoly Law and Article 134 of the General Principles of Civil Law).

70 Ning et al., *Commentary on the Anti-Monopoly Judicial Interpretation*, *supra* note 42 (analyzing Article 14 of the Supreme People's Court Rules on the Anti-Monopoly Law).

71 *See, e.g.*, Wu, *supra* note 64, at 109 (discussing civil penalties); *id.* at 113 (discussing decisions involving monopoly agreements and abuse of dominance). Because of the complexities involved with merger analysis, administrative review is required first insofar as a merger decision is concerned before a party may proceed to file suit under the Administrative Litigation Act. *Id.* at 113-14.

culminating in the *2014 QQ Decision*.[72] Most importantly, the Supreme People's Court issued rules in 2012 to govern civil trials by itself and by lower courts involving alleged violations of the Anti-Monopoly Law (Supreme People's Court Rules on the Anti-Monopoly Law).[73] Those rules provide in substantive part: (1) a court decision need not be stayed while a government investigation is pending, though civil law allows it to do so if it deems it necessary; (2) the statute of limitations is suspended if a plaintiff's report to a government agency has triggered an investigation for the duration of that investigation; (3) the burden of proof is placed on defendants to rebut the presumption of anti-competitive effects from horizontal monopolistic agreements though civil plaintiffs still carry the burden of showing such effects for vertical monopolistic agreements and abuse of dominance conduct; (4) the burden of proof is placed on defendants to rebut the presumption that it has a dominant market position if they have the requisite market shares spelled out in the Anti-Monopoly Law, if they have a dominant market position pursuant to the law, or if they are a public utility; (5) the burden of proof is placed on defendants to show the existence of justifications or excuses accepted under the Anti-Monopoly Law; (6) a defendant's statements of its market position in its documents (e.g., its stock market filings) may be accepted by the courts as conclusive proof of its market shares; and (7) the civil plaintiff bears the burden of showing injury, causation, and damages though compensation for losses may include the reasonable fees of a civil plaintiff in investigating and bringing the case.[74]

The courts have heard or are hearing cases that involve such areas as abuse of intellectual property, vertical price-fixing restraints, abuse of administrative monopoly to eliminate or restrict competition, tying, and abuse of market dominance, including two cases against state-owned companies.[75] It is predicted that private cases filed under the Anti-Monopoly Law will only continue to grow.[76]

---

72 *See, e.g.*, Vanessa Yanhua Zhang, *CPI Talks: Interview with Judge Chuang Wang*, CPI Antitrust Chronicle, Feb. 2016, at 1 (contrasting 2008-09 when the people's courts processed 10 cases of first instance and adjudicated 6 cases to 2015 when the people's courts processed 141 cases of first instance and adjudicated 98 cases, including backlogged cases).

73 Provisions of the Supreme People's Court on Several Issues Concerning the Application of Law in the Trial of Civil Dispute Cases Arising from Monopolistic Conduct (promulgated by the Supreme People's Court, May 3, 2012, effective June 1, 2012). The Supreme People's Court has administrative supervisory powers over lower courts that allow it to promulgate these rules. *See, e.g.*, Organic Law of the People's Courts of the People's Republic of China (promulgated by the Nat'l People's Cong., July 1, 1979, effective July 5, 1979) (amended 1983, 1986, & 2006), art. 32; Chow, *supra* note 29, at loc. 147, 211-12.

74 *See* Ning et al., *The Dual System, supra* note 54; Ning et al., *Commentary on the Anti-Monopoly Judicial Interpretation, supra* note 42.

75 *See* 2015 China Anti-Monopoly Rpt., *supra* note 43, at 40-50; Anjie Law Firm, 2014 China Anti-Monopoly Rpt. 36-48 (2015) [hereinafter 2014 China Anti-Monopoly Rpt.] (on file with authors); Susan Ning, Li Rui & Hazel Yin, *Chinese Consumer Wins Abuse of Dominance Civil Case against Tie-In Sales in Program Bundling*, China Law Insight (Apr. 6, 2013), http://www.chinalawinsight.com/2013/04/articles/corporate/antitrust-competition/chinese-consumer-wins-abuse-of-dominance-civil-action-against-tie-in-sales-in-program-bundling-2.

76 *See* Zhang, *supra* note 72, at 1-2; 2015 China Anti-Monopoly Rpt., *supra* note 43, at 50.

IV. COMMUNIST PARTY PRONOUNCEMENTS AND RECENT ENACTMENTS IN CHINESE LAW CONTEMPORANEOUS-IN-TIME WITH THE *2014 QQ DECISION*

To understand the importance of the *2014 QQ Decision* by the Supreme People's Court in Beijing, including its timing, it is important to look first at the Communist Party's relatively recent pronouncements on the rule of law before turning to recent legal reforms postdating that commitment. Those reforms enhance the potential application of the rule of law and their enactment impacts the assessment of the *2014 QQ Decision* for the continued development of China's Anti-Monopoly Law specifically and the rule of law generally.

A. The Fourth Plenum Decision of the Communist Party's Central Committee

On October 23, 2014, the Communist Party's Central Committee (CCP Central Committee), the highest-level policy-making arm of the Communist Party, addressed what it characterized as major questions in moving China forward according to the rule of law.[77] The CCP Central Committee first recognized the need to "give even better rein to the guiding and driving role of the rule of law."[78] In doing so, the CCP Central Committee called for reforms that would enhance the responsibilities of the judiciary in administrative review of government decisions, in holdings trials according to evidence admitted via standardized evidentiary rules and an otherwise fair process, in handing down authoritative judgments according to a unified body of law, in having the judgments of lower courts be reviewed for errors of law by higher courts (with a second trial on the facts being available in the next highest court), and in calling for a system of case precedent on which the courts could draw.[79] However, the CCP Central Committee was aware that an enhancement of the judiciary's responsibility meant that professionally trained judges were required (just as King Henry II needed professional judges to expand the common law in England) and so called for the resources, the training, and the merit selection and promotion process necessary to develop such a judiciary.[80]

As part of this decision, the CCP Central Committee urged the Communist Party, among other things, to take "Deng Xiaoping theory" as "guidance."[81] That statement is an important signal as to the potential importance of these objectives for the Communist Party; during his

---

77 *See* CCP Central Decision Concerning Some Major Questions in Comprehensively Moving Governing the Country According to the Law Forward (Oct. 30, 2014) (translated by Jeffrey Dawn) (on file with authors) [hereinafter Fourth Plenum Decision].

78 *Id.* at 1.

79 *Id.* at 11-15.

80 *Id.* at 19. The authors of this Article have been informed from a reliable source that the Communist Party is working on amendments to the Organic Law, Organic Law of the People's Courts of the People's Republic of China (promulgated by the Nat'l People's Cong., July 1, 1979, effective July 5, 1979) (amended 1983, 1986, & 2006), to effectuate its decision and that the first reading of any such amendments will be later this year.

81 Fourth Plenum Decision, *supra* note 77, at 2. Deng Xiaoping thought is one of the bases of China's 1982 Constitution, which is still in effect. *See, e.g.*, CHOW, *supra* note 29, at loc. 75-76. Deng Xiaoping's objectives have been followed by his successors. *See, e.g.*, Lewis, *supra* note 5, at 373 (collecting statements of China's leaders from Deng Xiaoping through Xi Jinping on China's goal being economic development).

lifetime, Deng Xiaoping understood well the need for the development and deepening of the rule of law to ensure continued economic development and social stability.[82]

B. The Increased Importance of Guiding Cases As Quasi-Precedent

A sign that the judiciary in China can meet the goals of the CCP Central Committee's Fourth Plenum Decision in furthering the rule of law in China is whether it has or would have a precedential system governing its decisions. The recent clarification of the role of so-called "Guiding Cases" in China sheds light on that question and provides a signpost against which one can evaluate the significance of the *2014 QQ Decision* for antitrust law in China and, more generally, for the rule of law there.

On November 26, 2010, the Supreme People's Court created an administrative process to synopsize important decisions by itself and by lower courts in which the synopses could be referred to by lower courts in a precedential fashion in adjudicating disputes before them as well as by commentaries; those synopses are referred to as "Guiding Cases."[83] It was open to debate then as to whether the Chinese court system had to follow these cases, though the most likely answer was yes, let alone whether they would evolve to becoming binding precedent in the Eastern Asian or Western sense.[84]

The Supreme People's Court provided at least a partial answer on May 13, 2015, when it issued its "Detailed Implementing Rules on the 'Provisions of the Supreme People's Court

---

82 *See* Coase & Wang, *supra* note 29, at loc. 98-103, 131-33; Ezra Vogel, Deng Xiaoping and the Transformation of China loc. 574-75, 589-90, 671, 673, 684, 698, 706 (2011) (ebook); *see also* Chow, *supra* note 29, at loc. 184 (discussing importance of the commitment to rule of law in the 1982 Constitution to effectuate economic reform and social stability); Lewis, *supra* note 5, at 398-400 (discussing Deng Xiaoping's commitment to the rule of law in the criminal context as a means of effectuating economic reform). Though the Fourth Plenum Decision discussed in this section of the Article involving the rule of law and the courts might be viewed by Westerners as a surprise given that they may view Chinese history as involving a lack of any accountability or review for the decisions by government agencies (except by petitioning very high-level officials); such a view would not be entirely accurate. *See, e.g.,* F.W. Mote, Imperial China 900-1800, 895-96 (Harv. Univ. Press 2nd ed. 2000) (discussing the use of the Chinese Censorate by the Qing Dynasty to ensure that "other offices of government were functioning honestly and effectively" and noting that Sun Zhongshan "decided to retain the Censorate (and the civil service examination system) as distinctly Chinese institutions worthy of being adapted to modern government, following the Revolution of 1911" (footnote omitted)). Nonetheless, throughout most of Chinese history, rule of law has been absent to a substantial extent in China, making recent advancements that much more striking even before the Fourth Plenum Decision. *See, e.g.*, Chow, *supra* note 29, at loc. 50-53.

83 *See Seminar Summary: Why China's Guiding Cases Matter?*, China Guiding Cases Project 2 (Apr. 22, 2015), https://cgc.law.stanford.edu/wp-content/uploads/sites/2/2015/08/GC-seminar-20150422-summary-English.pdf; *see also* Wang, *supra* note 41, at slides 11-12. The authority for the Supreme People's Court ability to set up a Guiding Cases system stems from Article 32 of the Organic Law. *See* Organic Law art. 32.

84 *See Seminar Summary*, *supra* note 83, at 2 ("Although formally the new rule states only that courts at all levels in China 'should refer to' . . . guiding cases released by the Supreme People's Court, senior judges of the highest court have observed that they expect these cases to be followed and that, if they are not, there may be severe repercussions. Such comments, together with the fact that guiding cases are selected by the adjudication committee of the Supreme People's Court (the members of which include the president, vice-presidents, and chief judges of different chambers in the court) make clear that these cases carry far more weight than the phrase 'should refer to' would otherwise suggest. While not formally constituting binding precedent in the Western sense, the guiding cases may evolve to have a similar effect.").

Concerning Work on Case Guidance.'"[85] Those rules set out the scope of those required synopses of the facts of, and law applied in, decisions that would be designated as Guiding Cases, encouraged the submission of candidate decisions by courts and others that can become Guiding Cases, set out the process by which notice of these cases can be distributed widely, encouraged the courts and court litigants to examine and refer to Guiding Cases, and set up the format in which Guiding Cases can be cited and quoted in subsequent decisions.[86] These detailed implementing rules specifically provided, for example, that whenever a civil litigant raises a guiding case as a ground for a position taken in litigation, the court handling that litigation "should" in providing the reasons for its decision, "respond [as to] whether [they] referred to the Guiding Case [in the course of their adjudication] and explain their reasons [for doing so]."[87]

The issuance of these detailed implementing rules has been viewed as "a clear step to achieve one of the goals stated by China's top leaders in their Fourth Plenum decision adopted in October 2014: 'to strengthen and standardize [the systems of] . . . case guidance to unify the applicable standards of law.'"[88] However, to implement those rules, and achieve this goal of furthering the rule of law, requires a competent judiciary, high-quality opinions that can serve as guidance, and an ongoing commitment to implement those rules in fact by designating high-quality opinions as Guiding Cases. All of these points provide milestones against which the *2014 QQ Decision*'s impact on antitrust law specifically, and the rule of law generally, can be properly assessed.

C. The Importance of Recent Administrative Review Reform as a Signpost to the Enhancement of the Judiciary's Role and China's Commitment to the Rule of Law

A competent judiciary is one that can be trusted to review government decisions, with or without some layer of deferential review be it heavy or light, to ensure that such decisions conform to the rule of law. The recently enacted statutory reform of China's administrative judicial review process, known as the Administrative Litigation Law,[89] provides yet another signpost against which the significance of the *2014 QQ Decision* can be assessed.

---

85 *See* Detailed Implementing Rules on the Provisions of the Supreme People's Court Concerning Work on Case Guidance (promulgated by Supreme People's Court, May 13, 2015), *translated in Detailed Implementing Rules on the Provisions of the Supreme People's Court Concerning Work on Case Guidance*, China Guiding Cases Project, http://cgc.law.stanford.edu/guiding-cases-rules/20150513-english [hereinafter Detailed Implementing Rules].

86 *See id.* arts. 3-6, 9-11, 13; *see also* Wang, *supra* note 41, at slides 13-15 (describing process).

87 Detailed Implementing Rules, *supra* note 85, art. 11.

88 The CGCP Team, *Breaking News: China's Supreme Court Explains How to Cite Guiding* Cases, China Guiding Cases Project (June 5, 2015), https://law.stanford.edu/2015/06/05/cgcp-2015-06-05-breaking-news-chinas-supreme-court-explains-how-to-cite-guiding-cases/; *see also* Wang, *supra* note 41, at slide 12 (effect of designation of an opinion as a guiding case is that it is to be applied as a "reference in trials," that it has "a strong binding force in similar cases," and that "for cases in which it is not applicable, the original sentence may be changed or retrial may be held").

89 For general background on China's Administrative Litigation Law and a civil plaintiff's rights under that law, *see, e.g.*, Liu, *supra* note 37, at 205-10, 215-19, 220-28 (2011) (on file with authors); Chow, *supra* note 29, at loc. 298-99; *see also* China Research Center, *New Trends in China's Administrative Reform*, 13 China Current, No. 2 (2014) (discussing background behind reform), *available at* http://www.chinacenter.net/2014/china_currents/13-2/new-trends-in-chinas-administrative-reform/.

The Standing Committee of the National People's Congress,[90] enacting this reform on November 1, 2014 to take effect on May 1, 2015, amended the Administrative Litigation Law to broaden it in significant ways: (1) it eliminated the "specific administrative act" requirement so as to broaden challenges to administrative actions;[91] (2) it provided that challenges may be made to administrative actions in twelve broad areas encompassing a very wide range of abuses of administrative powers, including the "[e]xecutive abuse of administrative power to eliminate or restrict competition," "administrative punishment [such as] fines," "administrative enforcement of administrative measures," and "[the] confiscat[ion] [of] . . . illegal income" could all serve as a basis for an administrative review action;[92] (3) it enhanced the authority of a court judgment over the administrative agency in question;[93] and (4) it increased the statute of limitations from three months to six months.[94]

In implementing these reforms, China left intact the ability of foreign citizens and organizations (as well as Chinese organizations and citizens) to resort to the courts to review administrative decisions.[95] China also left intact civil plaintiffs' rights to the facts and legal basis on which a decision was made by the administrative agency in question and also left in place a bar on the agency's ability to obtain evidence from those plaintiffs retroactively

---

90 Because it may not be immediately apparent to those readers from outside China, the Standing Committee of the National People's Congress has substantial law-making powers. *See, e.g.*, *Standing Committee of the National People's Congress*, Wikipedia, https://en.wikipedia.org/wiki/Standing_Committee_of_the_National_People%27s_Congress (last visited on June 20, 2015); *see also, e.g.*, Chow, *supra* note 29, at loc. 79, 91-97, 148-49, 163-64. (The Anti-Monopoly Law came into effect as well via an enactment of the Standing Committee of the National People's Congress.) Though a detailed discussion is beyond the scope of the Article, other government organs in China have law-making powers such as the National People's Congress itself, *see id.* at loc. 90-91, 148-49, 160-63, or the State Council, *see id.* at loc. 97-102, 149-56, 165-68.

91 Decision of the Standing Committee of the National People's Congress on Revising the Administrative Procedure Law, Order No. 15 of the President (promulgated Nov. 1, 2014) [hereinafter Administrative Procedure Decision] (setting out this principle as an amendment throughout the Administrative Litigation Act per Item 60); *see e.g.*, Laney Zhang, *China Administrative Procedure Law Revised*, Library of Congress (Apr. 2, 2015), http://www.loc.gov/lawweb/servlet/lloc_news?disp3_l205404366_text [hereinafter *China Administrative Procedure Law Revised*] (discussing this point more generally).

92 Administrative Procedure Decision, *supra* note 91 (setting out these bases for administrative litigation as an amendment to Articles 11 and 12); *see e.g.*, *China Administrative Procedure Law Revised*, *supra* note 91 (discussing this point more generally).

93 Administrative Procedure Decision, *supra* note 91 (setting out the various amendments designed to enhance the enforceability of court judgments on administrative actions as to administrative agencies as Item No. 58); *see e.g.*, *China Administrative Procedure Law Revised*, *supra* note 91 (discussing this point more generally).

94 Administrative Procedure Decision, *supra* note 91 (setting out the change in the statute of limitations as Item No. 48); *see* Susan Ning, Kate Peng, & Qiu Weiching, *China Toughens Up on Abuses of Administrative Powers*, China Law Insight (Dec. 12, 2014), http://www.chinalawinsight.com/2014/12/articles/corporate/antitrust-competition/china-toughens-up-on-abuses-of-administrative-powers-the-impact-of-reforms-to-chinas-administrative-procedure-law-in-respect-of-abuses-of-administrative-powers/ (last visited on June 21, 2015).

95 *See* Chow, *supra* note 29, at loc. 332-33; Liu, *supra* note 37, at 207.

to justify its decision.[96] And the courts retained the power to overturn the actions of a government agency if those actions were based on insufficient evidence, on substantive legal error, or on procedural legal error; if those actions ventured beyond the jurisdiction of the agency in question; if those actions constituted an abuse of power; or if those actions raised an appearance of impropriety.[97]

On its face, these reforms extend to the Central Government, as well as provincial and local government agencies, thus reinforcing the possibility that the decisions of the antitrust enforcers in Beijing may be subject to such review by the courts.[98] Though the courts may engage in the administrative review of the decisions of those enforcers in a deferential manner, even such a deferential review could still be meaningful.[99]

However, allowing such challenges in the area of antitrust will require competent courts that can issue high-quality opinions that thread the needle in properly taking account of the latest economic theories and in developing administrable rules against which antitrust enforcers can be held accountable without unduly chilling their efforts in policing anti-competitive conduct.[100] The *2014 QQ Decision* provides an important benchmark against which the readiness of the courts in China to undertake such a duty can be judged.[101]

---

96 *Compare, e.g.*, Liu, *supra* note 37, at 227-28 (discussing these principles in the context of the original law), *with* Administrative Procedure Decision, *supra* note 91 (setting out amendment to Article 19 of Administrative Litigation Law re-stating the principle that an administrative agency cannot collect more evidence from a civil plaintiff to justify its decision once that plaintiff has filed suit and an amendment to Articles 24 and 25 that leave any person or organization with the ability to bring suit under the Administrative Litigation Act).

97 *Compare* Administrative Procedure Decision, *supra* note 91 (setting out these principles as amendments to Article 70 of the Administrative Litigation Law pursuant to Item No. 70), *with* Chow, *supra* note 29, at loc. 302-03 (discussing the state of the law prior to these amendments).

98 *See* Anonymous, Statements at the 2014 Antitrust Civil Litigation Forum, Beijing, China (May 24-25, 2014).

99 *See* Anonymous, Statement to the 2014 Antitrust Civil Litigation Forum, Beijing, China (May 24-25, 2014) (speaking of the Chinese courts needing to be convinced that there was a clear mistake before they would consider overturning an administrative act of an antitrust enforcement agency). The European civil law system, which in the European Union requires courts to apply a certain measure of discretion in reviewing antitrust decisions of the European Commission, is discussed *infra*. In fact, the first such administration litigation case was filed by a defendant against a fine imposed by the regional bureau of a government antitrust enforcer in Jiangsu, although the complaint was dismissed before a decision was issued apparently due to statute of limitations problems. 2014 China Anti-Monopoly Rpt., *supra* note 75, at 46-47. Now that the statute of limitations problem has been rectified, there should be more challenges—though allowing challenges against local government entities may be a different kettle of fish than allowing challenges against central government agencies.

100 *See e.g.*, Judicial Enforcement of Competition Law, *supra* note 13, at 10 ("The judiciary also brings a certain degree of flexibility to the implementation of the competition law, thus enhancing the development of law and the application of current economic thinking.").

101 In fact, the *2014 QQ Decision*'s quality and thoroughness may also provide a measure as to whether the courts can also undertake the parallel, but important, duty of reviewing private challenges to local administrative monopolies. The amendment to the Administrative Litigation Act now allows for challenges by private parties to abusive administrative monopolies by government entities, thus potentially broadening the reach of Anti-Monopoly Law provisions that were important but had been thought to be modest in effect. *See* Huang, *supra* note 65, at 131.

V. THE *2014 QQ DECISION* OF THE SUPREME PEOPLE'S COURT

Abuse of dominance cases (or monopoly cases to invoke the rough, though not totally comparable, analog under U.S. law) can require courts to make complex judgments about the effects of single firm conduct.[102] While market share presumptions can be used as a proxy to avoid determining directly a single firm's market power[103]—otherwise known as a direct effects analysis—courts are still required to make what can be extensive factual determinations as to the scope of the relevant product and geographic markets.[104] And courts must then also determine whether the conduct in question has a tendency to cause anti-competitive effects, e.g., the conduct is exclusionary or predatory in nature, before analyzing any proffered pro-competitive effects or justifications for that conduct.[105]

The Anti-Monopoly Law follows this approach. Article 17 of that law sets out conduct that is illegal when committed by a firm with a dominant market position, including refusals to deal without justification; tying without justification; exclusive dealing without justification; predatory pricing, predatory bidding, and pricing discrimination; and other conduct determined by the Anti-Monopoly Committee under the State Council[106] to violate this provision.[107] Article 18, in turn, sets out a number of factors to determine when a firm has a dominant market position, including an assessment on whether other firms can enter the market, on market shares and the positions of competitors, on the degree of dependence of other firms on the firm in question, and on any other factors that may be germane to that

---

102 *See Am. Needle, Inc. v. Nat'l Football League*, 560 U.S. 183, 190-91 (2010).

103 *See Tops Market, Inc. v. Quality Market, Inc.*, 142 F.3d 90, 98 (2d Cir. 1998) (finding that market power "may be proven directly by evidence of the control of prices or the exclusion of competition, or it may be inferred from one large firm's percentage share of the relevant market"); *see also* Philip Areeda, Herbert Hovenkamp, & John Solow, Antitrust Law, ¶ 500 at 107 (3d. ed. 2007) ("And judgments about the 'reasonableness' of a particular restraint often depend upon the market power of the parties concerned."); *id.* ¶ 531 at 233 ("Because they so often lack such data [for a direct effects analysis], antitrust courts traditionally define a market and examine the firms' marker shares.").

104 *See, United States v. Microsoft,* 253 F.3d 34 (D.C. Cir. 2001); *United States v. Aluminum Co of America*, 148 F.2d 415 (2d Cir. 1945).

105 *See, e.g.*, *Realcomp II v. FTC*, 635 F.3d 815, 826-27 (6th Cir. 2011) (quoting *Cal Dental Ass'n v. FTC*, 526 U.S. 756, 775 n.12 (1999) ("[T]here must be some indication that the court making the decision has properly identified the theoretical basis for the anticompetitive effects and considered whether the effects actually are anticompetitive. Where . . . the circumstances of the restriction are somewhat complex, assumption alone will not do.")).

106 The Anti-Monopoly Committee of the State Council, provided for under the Anti-Monopoly Law, was constituted on July 28, 2008 to undertake a number of tasks, including researching and drafting competition policy and promulgating guidelines for enforcement of the law. Details regarding its members and activities can be found at *Anti-Monopoly Law of China*, Wikipedia, https://en.wikipedia.org/wiki/Anti_Monopoly_Law_of_China (last visited on June 23, 2015). As discussed in *supra* note 90, the State Council has substantial law-making powers even aside from those powers conferred specifically on its Anti-Monopoly Committee under the Anti-Monopoly Law.

107 Anti-Monopoly Law of the People's Republic of China (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug, 30, 2007, effective Aug. 1, 2008), art. 17. For the benefit of readers of this Article, a translation of this law into English, available on Chinese websites, has been accepted as authoritative in the United States. *Anti-Monopoly Law of the People's Republic of China (Chinese and English Text)*, Congressional-Executive Commission on China, http://www.cecc.gov/resources/legal-provisions/prc-anti-monopoly-law-chinese-and-english-text (last visited on June 23, 2015).

assessment.[108] Finally, Article 19 sets out market share presumptions applicable to a finding of a dominant position, including a market share of a single firm amounting to 50% or more of a relevant market.[109]

The Anti-Monopoly Law itself does not spell out how to define a relevant market. Beyond Article 18 discussed in the preceding paragraph, Article 12 only defines a relevant market as the scope of the product or geographic market within which firms compete against each other over a relevant period of time for products or services.[110] However, the Anti-Monopoly Committee of the State Council promulgated guidelines for market definition under the Anti-Monopoly Law in 2009.[111] Those guidelines provided that a relevant market must be defined by consumer demand as to product or geographic substitutability, meaning those products or geographic areas that consumers can consider to be close or strong substitutes for each other and will turn to in the event of a price increase as to a single product or geographic location.[112] The guidelines then defined the major factors to be considered in defining relevant product and geographic markets, including: product similarities and differences, shifts in consumer demand, price differentials, ease of entry, trade barriers (including local regulations), and changes in supply or production in response to price changes.[113] These guidelines also discussed the hypothetical monopolist test as the method for defining a market by measuring whether a hypothetical firm in a market can profitably raise the prices of the product in question 5-10%; however, and significantly for purposes of this article, those guidelines labelled the hypothetical monopolist test as the "usual[]" method for proving relevant markets.[114]

Courts in other jurisdictions have endorsed direct effects (e.g., directly measuring anti-competitive effects from a defendant's conduct often based on transactional data-crunching as supported by a defendant's internal documents) as an alternative means of measuring market power.[115] Nonetheless, the Anti-Monopoly Law itself is silent on whether direct effects suffice to demonstrate market power for purposes of applying the abuse of dominance

---

108 Anti-Monopoly Law of the People's Republic of China (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug, 30, 2007, effective Aug. 1, 2008), art. 17.

109 *Id.*

110 *See* Lim & Shen*, supra* note 21, at 4.

111 Guide of the Anti-Monopoly Committee of the State Council for the Definition of a Relevant Market (promulgated by Anti-Monopoly Comm. of the State Council, May 24, 2009), *translated in Standards and Anti-Monopoly Law, Beijing, China*, 2nd Conference of Intellectual Property (May 16-17, 2012) [hereinafter State Council Relevant Market Guidelines] (on file with the authors).

112 *Id.* arts. 3-9.

113 *See id.*

114 *Id.* art. 10.

115 *See FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 460-61 (1986) (direct effects evidence enough under rule of reason); *Toys-R-Us v. FTC*, 221 F.3d 928, 937 (7th Cir. 2000) (same); *NCAA v. Bd. of Regents,* 468 U.S. 85, 109-10 (1984); *cf.* Decision and Order*, In the Matter of Evanston Northwestern Healthcare Corporation*, Docket No. 9315 at 78 (F.T.C. Aug. 6, 2007), *available at* www.ftc.gov/sites/ default/ files/documents/cases/2007/08/070806opinion.pdf (actual price increase by merged entity in *post hoc* merger analysis enough to demonstrate anti-competitive analysis where regression analysis, pre- and post- merger documents of the merged entity, and testimony from insurers, all supported the conclusion that the price increase arose from the market power of the combined entity and not from any competitively-benign factors).

provisions. It is against this specific backdrop of antitrust legal principles that the background, holding, and significance of the *2014 QQ Decision* should first be assessed.

A. The Background and Holdings of the *2014 QQ Decision* on Evidentiary and Substantive Issues

This section of the Article will set out the background as to the parties involved, and the nature of the allegations made, pertaining to the *2014 QQ Decision*. It will then discuss the analysis and holding of the Guangzhou Higher People's Court before turning to a discussion of the analysis and holding of the Supreme People's Court on appeal from that lower court decision.

1. Background of the Parties and the Allegations

QQ is a very popular Internet social network in China developed by defendant Tencent that is equivalent in many respects to Facebook or similar services in other countries. Its primary focus is instant messaging software though it provides a number of services such as instant messaging, news, games, group chats/microblogging, voice/video chat, and its own security software.[116] It provides such services (mostly) for free, making money off of Internet ads as do many other such social networks and search engines on the web.[117]

360 is an anti-virus software and browser program developed by plaintiff Qihoo.[118] In September 2010, Qihoo had informed its users that it had analyzed QQ's software using its 360 product and had come to the conclusion that QQ was automatically scanning its users' computers and uploading those users' personal information without their consent.[119] Following those statements, Qihoo and Tencent engaged in tit-for-tat retaliation: Qihoo first released a product that would allow QQ users to block QQ advertisements (even as QQ users could otherwise continue to use QQ); and Tencent then responded by filing a lawsuit against Qihoo on November 3, 2010 under China's unfair competition law and, the same day, blocking the ability of Qihoo to interoperate with QQ and instructing its users to uninstall Qihoo.[120] The Chinese government soon stepped in and mediated an accord in which Qihoo ceased selling its software blocking QQ ads and Tencent ceased its actions blocking Qihoo software from interoperating with QQ although both companies were free to pursue lawsuits against each other—Tencent against Qihoo under China's unfair competition law and Qihoo against Tencent under the Anti-Monopoly Law.[121]

---

116 *Tencent QQ*, Wikipedia, https://en.wikipedia.org/wiki/Tencent_QQ (last visited on June 23, 2015); *see 2014 QQ Decision*, *supra* note 40, at 2-3; Lim & Shen*, supra* note 21, at 3-4.

117 *Tencent QQ*, *supra* note 116.

118 *Id.*; *see 2014 QQ Decision*, *supra* note 40, at 2, 53; Lim & Shen*, supra* note 21, at 3-4.

119 *Tencent QQ*, *supra* note 116; *Qihoo*, Wikipedia, https://en.wikipedia.org/wiki/Qihoo (last visited on June 23, 2015); *see 2014 QQ Decision*, *supra* note 40, at 16-17; Susan Ning, Ding Liang, & Angie Ng, *The QQ/360 Disputes: Who, What, Where, When and Preliminary Antirust Analysis,* China Law Insight (Nov. 12, 2010), http://www.chinalawinsight.com/2010/11/articles/corporate/antitrust-competition/the-qq-360-disputes-who-what-where-when-and-preliminary-antitrust-analysis/.

120 *See Tencent QQ*, *supra* note 116; *see also 2014 QQ Decision*, *supra* note 40, at 2, 75-76.

121 *See Tencent QQ*, *supra* note 116; *see also 2014 QQ Decision*, *supra* note 40, at 2, 19, 53; Ning et al., *The QQ/360 Disputes*, *supra*, note 119. Tencent's unfair competition lawsuit against Qihoo will not be discussed further in this article except to the extent that it bears on the *2014 QQ Decision* of the Supreme People's Court regarding Qihoo's lawsuit against Tencent under the Anti-Monopoly Law.

On November 15, 2011, Qihoo filed a case against Tencent under Article 17 of the Anti-Monopoly Law for abuse of dominance.[122] Qihoo contended as follows: (1) Tencent had market dominance in the relevant product and geographic markets—the relevant product market being instant communication services software involving integrated audio, video, and text, and the relevant geographic market being mainland China—with Tencent having a 76.2% share of that proposed market and a market penetration rate of 97%; (2) Tencent could effectively raise prices and hinder competition in that market and otherwise had a strong financial and technical position in that market; (3) Tencent had such a strong customer base that, due to network effects, other potential competitors would find it difficult to enter the market, let alone to be an effective competitor to Tencent; (4) Tencent's conduct itself violated the Anti-Monopoly Law (as an abuse of dominance) by barring the interoperability of QQ with Qihoo's software; and (5) Tencent's conduct alternatively violated the Anti-Monopoly Law when it bundled or tied its instant messaging software with its own security software (QQ Doctor).[123]

Qihoo based its contentions as to the scope of the relevant product and geographic markets on the following items of evidence: (1) stock market or securities filings by QQ; (2) an expert report analyzing the market, including the correlation if any between the use of various Internet products, the similarities and differences in Internet product characteristics, and the various parallels between this proposed market and the market analysis conducted by the European Commission in its report in the *Skype/Microsoft* merger case; (3) a 2009 report by the Chinese Internet Network Information Center (CNNIC) as to the lack of churn in the installed base of social network users; and (4) a 2009-10 iResearch report as to the importance of instant messaging for Chinese users.[124]

Qihoo next based its contentions as to Tencent's dominant position in its proposed market based on the following: (1) Tencent's market share continuing to grow even after the dispute it had with Qihoo in November of 2010—referencing Qihoo's expert report, from which Qihoo drew the inference of high barriers to entry; (2) Tencent's unique product portfolio that would involve an additional expense for its competitor to replicate in its entirety and that had induced network effects in a large installed base—as spelled out in Qihoo's expert report analyzing the attempts of a competitor to compete with QQ; (3) Tencent's own interim securities report in 2011 making statements as to the scope of its installed base; (4) a 2009-10 report from iReports making statements as to the lack of interoperability between differing instant messaging products, thereby creating barriers to entry in the market for QQ's instant messaging product; (5) a 2009 report from CNNIC making statements as to how virtual goods in online games essentially monetized instant messaging accounts, giving QQ's software a huge monetary value, and how QQ had a considerable advantage in user adoption due to its large installed base and the lack of interoperability between differing instant messaging software products; (6) a 2010 article in

---

122 *2014 QQ Decision*, *supra* note 40, at 3.

123 *Id.* at 2; *see also* Lim & Shen, *supra* note 21, at 5-6. Tying occurs when a monopolist bundles two distinct products for sale in such a way that the buyer is coerced into buying both products together. Under American and European Union law, tying is quasi-per se illegal when the monopolist has market power in the tying product market and forecloses a not insubstantial amount of sales in the tied product market. *See* Einer Elhauge, *Tying, Bundled Discounts and the Death of the Single Monopoly Profit Theory*, 123 Harv. L. Rev. 397, 420-422 (2009).

124 *2014 QQ Decision*, *supra* note 40, at 3-5.

Guangzhou Metro making statements as to Microsoft's inability to attract QQ users to its competing instant messaging software (MSN); (7) Tencent's statements in its 2011 annual forecast as to its leading position and the uniqueness of its products; (8) Tencent's providing virtual currency on its web site to induce continued use of its products (apparently provided to buttress the case for barriers to entry); and (9) a variety of reports from Tencent and third parties making statements as to Tencent's substantial revenues and gross profits, substantial market shares and user penetration (per iResearch and CNNIC reports for 2010-11 and 2009 respectively as well as reports from Analysys International), and disputes with other companies over blocking allegations.[125]

Finally, as to whether Tencent's conduct itself constituted abuse of dominance, Qihoo first contended that it constituted abuse of dominance by citing statements by Tencent (e.g., on its web site) that Tencent made a deliberate decision to stop running QQ software on any computer with 360 software to stop what it termed "malicious competition."[126] Second, Qihoo contended that Tencent had engaged in tying based on its software setup sequence and automatic updating, with no justification for such tying, based on analysis of user demand by CNNIC (2009 report), iResearch (2003 report), and the benefits 360 software gave a user who would wish to protect his or her privacy vis-à-vis QQ.[127]

Tencent denied these allegations.[128] It argued that other Internet products and services could achieve real-time communications, such that Qihoo's proposed market was unduly narrow, referencing a wide-variety of products that could be downloaded such as Baidu Hi (Baidu is a search engine of comparable scope and popularity to Google in the United States).[129] It further argued that the market proposed by Qihoo was characterized by high levels of competition, product substitution, and low barriers to entry based on: (1) an analysis by Analysys International as set out in a 2008 article about a launch of an instant messaging product by one of China's large telecom companies that gained a lot of users; (2) a CNNIC report on the fast growth of microblogging products that have a high degree of overlap with instant messaging products; (3) the fact that MSN shows up at the top of Baidu search lists as an alternative to QQ and according to news articles has been growing its user base; (4) the fact that 81% of QQ users would leave QQ if it charged for its services; and (5) the news announcements about the launch of new instant messaging products in China, including through Sina, a microblogging service, as well as the growth of Facebook and Google outside of China.[130] Finally, as to whether its conduct amounted to abuse of dominance, Tencent argued that its conduct was justified as a response to Qihoo's violation of China's unfair competition laws, citing two earlier civil judgments handed down in Beijing.[131]

---

125 *Id.* at 8-13.

126 *Id.* at 16-17.

127 *Id.* at 18-19.

128 *Id.* at 3.

129 *Id.* at 6-8.

130 *Id.* at 13-16.

131 *Id.* at 19-20. Tencent also argued that Qihoo did not suffer any economic losses based on Internet reports on downloads of Qihoo's programs as well as Qihoo's financial reports. *Id.* at 20-21.

2. The Analysis and Decision of the Guangdong Higher People's Court

In its decision, the Guangdong Higher People's Court defined the main issues as the following: (1) how to define the relevant market; (2) whether Tencent had a dominant position in the market in question; and (3) whether Tencent's conduct in the market amounted to abuse of dominance.[132]

For the first issue, the Guangdong Higher People's Court found Qihoo failed to meet its burden of proving the existence of its proposed relevant market. The court applied the State Council guidelines on market definition discussed in this Article *supra*.[133] It believed that the hypothetical monopolist test could be applied even though the market (however defined) was characterized by products offered at zero cost such that any price increase would cause users to switch to a free product.[134] Analyzing the market under this test, it found that not only real-time products such as QQ, MSN, China Mobile's instant-messaging product, and Skype should all be part of the relevant markets (which Qihoo and Tencent agreed on), but also text messaging, audio, and video calls should be so included (because any price increase by Tencent would cause users to flee to such alternatives).[135]

The court admitted that it was a more difficult question as to whether social networking services and microblogging services should be included in the relevant market as instant messaging communication. But it believed that these tools facilitated social communication in close enough a sense to instant messaging that these tools belonged in the same market given that a price increase by Tencent would cause its users to switch to these tools.[136] Rejecting the testimony of Qihoo's expert that the market analysis should be limited to a small slice of the year 2010 (when the conduct by QQ against Qihoo took place), the court alternatively found that the existence of these tools supported the notion of a broader dynamic market in Internet communication.[137]

Finally, the court found that building platforms, essentially product portfolios with a wide range of services, was the objective *sine qua non* of Internet competition. In that sense, offering free services or software was simply a device to drive users to a specific application platform and that dynamic meant that potential competition from such platforms in the instant messaging space (e.g., Apple) had to be taken into account.[138]

---

132 *Id.* at 21.

133 *Id.* at 21, 24.

134 *Id.* at 21.

135 *Id.* at 21-22.

136 *Id.* at 23.

137 *Id.* However, the court drew a line at traditional phone, fax, and text messaging services, refusing to include those services in the market because of technological differences and because those services charged money while instant messaging like QQ was free. *Id.* at 23-24. It also found e-mail to be in a different market because it lacked the real-time nature of instant messaging. *Id.* at 24.

138 *Id.* at 24.

The court then rejected Qihoo's proposed geographic market, finding that it should not be limited to mainland China but rather should be world-wide.[139] It found QQ was used overseas and that foreign operators could provide services in mainland China (e.g., MSN, Skype, or Yahoo Messenger). It also found no limits in terms of user demand, costs, or technical barriers to a world-wide market.[140]

Based on the court's view as to the scope of the relevant market, it found that Qihoo could not meet its burden of showing Tencent had a dominant position in the market.[141] It specifically observed that the iResearch year 2010 figure of 76.2% did not reflect Tencent's true position in the market. It also found a number of factors that supported a finding of lack of market power (which it correctly defined as being the ability to control prices, output, or other trading conditions):[142] (1) Tencent literally could not control price because users will not pay any money for instant messaging software; (2) given that users communicated with relatively few family and friends—only between four to six according to Facebook data and the findings of the European Commission in the *Skype/Microsoft* merger case—users were not locked into using only one type of instant message software; (3) entry into the market was easy with new and successful entrants in the market every year from large platforms and others (e.g., Baidu Hi, Ali Want, YY voice (from a games network), and China Mobile's instant messaging software); and (4) new competitive products, such as social networking sites which had impacted instant messaging services, were always emerging, disciplining companies like Tencent that provide instant messaging services.[143]

On the question of whether Tencent could justify its conduct, the court found that it was inappropriate for Tencent to engage in such "self-help" given that (1) it targeted Qihoo's users rather than Qihoo, (2) it could have simply issued a warning, and (3) it could have sought an injunction (even as an interim or emergency measure) based on the notion that Qihoo had infringed its intellectual property.[144] However, the court also found that Tencent's conduct did not amount to tying because the element of coercion was absent—users could uninstall QQ products that they do not want and could refuse to accept QQ updates they did not want—and because the bundling of these services was economically rational (e.g., QQ Doctor as a security program could help other components of QQ work better).[145]

3. The Analysis and Holding of the Supreme People's Court

a. Consideration of New Items of Evidence and Additional Fact-Finding

The Supreme People's Court, reviewing the decision of the Guangdong Higher People's Court in an appellate role—which could still reconsider facts and make new findings[146]—

---

139 *Id.* at 25.

140 *Id.*

141 *Id.* at 25-26.

142 *Id.* at 26.

143 *Id.* at 26-28.

144 *Id.* at 28-29.

145 *Id.* at 29-30. Tying is explained in passing in *supra* note 123.

146 *See, e.g.*, *id.* at 29-30, 61.

addressed at the threshold whether it could consider certain items of new evidence submitted by Qihoo. First, it ruled that it could consider two new expert reports submitted by experts for Qihoo, one of who had appeared in court to be examined, that set out the product and geographic market definition errors committed by the court below. The reports found that the product market should be limited to personal computer (PC) instant messaging services and the geographic market should be limited to mainland China.[147] In doing so, the Court rejected arguments that the expert who had appeared in court was not sufficiently qualified and that his report went to legal issues that were the province of the courts, pointedly noting that civil litigants should focus instead on the issues of sufficiency of facts to justify an expert's opinion, the reliability of an expert's methodology or analysis, and the consideration by that expert of alternative analyses or explanations.[148] It also rejected attacks that the expert reports lacked sufficient authenticity since they originated from outside China.[149]

Next, the Supreme People's Court considered whether it could accept screenshots into evidence that purported to show the function, or lack thereof, of various mobile and PC instant messaging services, microblogging services, and social network chat services, all for purposes of aiding the Court in defining the relevant market.[150] Rejecting attacks such as lack of authenticity and lack of notarization, the Court found that the public availability of the statements depicted in these screenshots demonstrated authenticity given the lack of any proffered evidence suggesting otherwise.[151]

The Supreme People's Court then followed up by finding admissible similar evidence offered by Tencent that went to market definition and abuse of dominance, including media reports, notarized information, and websites.[152] However, the Court also found admissible evidence that QQ software had similar functions to e-mail even though Tencent did not appeal its loss on that issue because, as it stated for apparently the first time in this case, market definition was a question of fact on which a court had to conduct a full and independent investigation.[153] It further found admissible citations to a market research firm's statistics report, even though background information about the data and statistics underlying the report was absent, because the report could be probative in conjunction with other items of

---

147 *Id.* at 36-39, 41.

148 *Compare id.* at 39, *with Apple v. Microsoft*, 757 F.3d 1286, 1318-19 (Fed. Cir. 2014) (focusing in patent case on whether expert's methodology was sound, i.e., the product of reliable principles and methods, whether the expert applied that methodology in a sound way and supported it with legally sound facts, and noting that disagreements as to the factual underpinnings of an expert's opinion go to weight and not admissibility), *and United States et al. v. Apple, Inc. et al.,* 791 F.3d 290, 335 n.24 (2nd Cir. 2015), *petition for cert. den.* (U.S. Mar. 7, 2016) (No. 15-8278) (noting same focus in antitrust context).

149 *2014 QQ Decision*, *supra* note 40, at 41.

150 *See id.* at 39-41.

151 *Id.*

152 *Id.* at 41-46.

153 *Id.* at 43. Other countries also look at market definition as being a question of fact. *See United States v. Microsoft,* 253 F.3d 34, 81-82 (D.C. Cir. 2001) (determination of a relevant market is a factual question to be resolved by the district court) (citations omitted); Decision and Order*, In the Matter of Evanston Northwestern Healthcare Corporation*, Docket No. 9315 at 57 n.67 (F.T.C. Aug. 6, 2007), *available at* www.ftc.gov/sites/default/files/documents/cases/2007/08/070806opinion.pdf ("However, market definition is a question of fact.").

evidence even if it was weak on its own.[154] And it also found admissible a global economic advisory paper issued by David Evans on the Internet commenting on the decision discussed *supra* of the Guangdong Higher People's Court.[155] Based on this evidence, the Supreme People's Court supplemented the factual record with evidence as to potentially alternative products such as the following: (1) the development of mobile instant messaging products (e.g., Apple's iMessage and Samsung's ChatOn) in 2011 and 2012; (2) the development of Sina microblogging services, Renren—a Chinese social networking service popular among college students,[156] and Netease mailbox; (3) the growth of smartphones generally per various reports as well as a 2012 usage study by CNNIC pertaining to the increased use of social network sites; (4) QQ's 2008 voice chat and file transfer products; (5) QQ's multi-lingual products from 2009 through 2012; (6) information regarding the worldwide market shares and growth of instant messaging products made by Facebook, Microsoft, and Twitter; and (7) feedback by Chinese users as to issues with the use of MSN vis-à-vis QQ.[157]

In sum, the Supreme People's Court erred on the side of admitting evidence and simply assessing its probative weight as part of its proceedings and its decision. That it eschewed a mechanical view of the evidentiary rules in China is supported by its denial at the end of its decision of a series of Qihoo's objections, including claims that the lower court failed to properly engage the parties on points that the lower court ended up referencing in its decision.[158]

The Supreme People's Court made a number of factual findings based on these supplemental facts, a cross-examination of the parties, and the evidence submitted to the Guangdong Higher People's Court.[159] The findings included the number of Internet users in China, the various uses of instant messaging software and social networking sites, the expectations of users as to instant messaging software being free, the features sought by instant messaging software users, the frequency by which users replace that instant messaging software, and the growth of mobile instant messaging software.[160] The Court also made findings as to changes in the use of QQ, MSN, Ali Wang, and China Mobile's instant messaging products in 2010, how QQ and 360 could fully interface with each other thanks to the intervention of the government, and as to another recent decision of the Supreme People's Court in a completely separate, though related, case involving China's Anti-Unfair Competition Law that found Qihoo had engaged in unfair competition in designing 360 to undermine QQ and in making various statements to the public about QQ.[161]

b. Defining Relevant Markets

After reviewing the decision of the Guangdong Higher People's Court and making a

---

154 *2014 QQ Decision*, *supra* note 40, at 44.

155 *Id.* at 46. It is also interesting (from the perspective of considering issues about barriers to entry) that it admitted aiResearch 2012-13 report on the instant messaging market, a report that post-dated the period in which Tencent committed the conduct in question. *See id.*

156 *Renren*, Wikipedia, https://en.wikipedia.org/wiki/Renren (last visited on June 24, 2015).

157 *2014 QQ Decision*, *supra* note 40, at 46-52.

158 *See id.* at 81-82.

159 *See id.* at 52-54.

160 *See id.*

161 *See id.* at 53-55.

number of supplemental factual findings, the Supreme People's Court first addressed the issue of defining relevant markets. It noted that while it was often important to engage in this analysis, it is only a tool to determine the market power of the firm or firms in question.[162] Market power could be independently determined by looking at barriers to entry or by looking at the potential anti-competitive effects of the firm's conduct coupled with direct evidence of such effects. In brief, a clear and explicit definition of a relevant market would not be required in every case.[163] However, as that Court explained, even when a court addresses such direct effects, it is the civil plaintiff that carries the burden of proving such effects even as the defendant retains the burden of proving the existence of any justifications.[164]

The Court then went on to address the issue of proving the product market's scope. It noted that the party claiming abuse of dominance had the burden of proving the relevant product market.[165] It further reasoned that if a party's definition of the relevant product market did not fit the specific circumstances of a case, that party had a duty to propose a market that fit those circumstances.[166]

The Court observed that there were circumstances in which limitations on evidence and data, or the complexity of a case, may make it difficult to define a relevant market.[167] However, that observation was not made in conjunction with a civil plaintiff's burden of proof but against the backdrop of Qihoo's complaint that the lower court had not clearly

---

162 *Id.* at 55.

163 *Id.* The reasoning and holdings of the *2014 QQ Decision* as to points like these were double-checked against a second, albeit partial, translation that will be cited in tandem with the author-translated version. *The Supreme People's Court of the People's Republic of China, Paper of Civil Judgment*, Global Economics Group, https://www.competitionpolicyinternational.com/assets/DecisionTranslation.pdf (last visited Mar. 14, 2016) [hereinafter Global Economics Group]. Various commentators have read this aspect of the *2014 QQ Decision* to be endorsing a direct effects analysis as an alternate means of showing market power. *See* Lim & Shen, *supra* note 21, at 11 n.66; Susan Ning et al., *The Supreme Court Goes Online with Anti-Monopoly Principles*: *A Review of Qihoo vs. Tencent Abuse of Market Dominance Case*, China Law Insight (Nov. 12, 2014), http://www.chinalawinsight.com/2014/11/articles/corporate/antitrust-competition/the-supreme-court-goes-online-with-anti-monopoly-law-principles%EF%BC%9Aa-review-of-qihoo-v-s-tencent-abuse-of-market-dominance-case/. This parallels the substantive law in other jurisdictions. *See* Herbert Hovenkamp, Federal Antitrust Policy § 12.8, 550 (3d ed. 2005); *see also FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 476 (1986) ("[T]he purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition. . . ."); *Tops Market, Inc. v. Quality Market, Inc.,* 142 F.3d 90, 98 (2d Cir. 1998) (finding that market power "may be proven directly by evidence of the control of prices or the exclusion of competition, or it may be inferred from one large firm's percentage share of the relevant market"); *K.M.B. Warehouse Distribs., Inc. v. Walker Mfg. Co.,* 61 F.3d 123, 129 (2d Cir. 1995) ("If a plaintiff can show an actual adverse effect on competition, such as reduced output[,] . . . we do not require a further showing of market power." (citation omitted)); *Capital Imaging Assoc. v. Mohawk Valley Med. Assocs.,* 996 F.3d 537, 546 (2d Cir. 1993) (explaining that plaintiffs may avoid a "'detailed market analysis' by offering 'proof of actual detrimental effects such as a reduction in output'" (citation omitted)).

164 *2014 QQ Decision*, *supra* note 40, at 79-80; Global Economics Group, *supra* note 163, at 34. The burden allocation is the same as in other jurisdictions, *see, e.g.*, the discussion *infra* Part VI.A of the California Supreme Court's *In re Cipro* decision.

165 *2014 QQ Decision*, *supra* note 40, at 55; Global Economics Group, *supra* note 163, at 2.

166 *2014 QQ Decision*, *supra* note 40, at 55; Global Economics Group, *supra* note 163, at 2.

167 *2014 QQ Decision*, *supra* note 40, at 55; Global Economics Group, *supra* note 163, at 2.

delineated the market.[168] Thus, while this statement would ordinarily be taken to mean that civil plaintiffs bear the burden of such shortcoming,[169] it is more likely—given the flexibility demonstrated by the Supreme People's Court on the admission of evidence in the first instance—that this statement was intended to encourage courts to reach conclusions as to the scope of a relevant market on less than perfect evidence.[170]

Based on these principles, the Supreme People's Court found that the lower court had clearly defined the relevant product market well enough with any ambiguities at the boundaries being tolerable.[171] In doing so, it eschewed form over substance in doing a careful analysis of the facts, an important principle in making the complex economic judgments necessary to the application of antitrust law.

For example, in addressing Qihoo's criticism of the lower court's application of the hypothetical monopolist test to an area in which competition did not occur on the basis of price,[172] the Court first began with the premise that the test has "general applicability."[173] However, as the Court further reasoned, if "non-price competition" were important in a market like the one at bar given that the products in that market are offered for free, then using this test would be particularly difficult.[174] Accordingly, it would not apply this test in this case because the facts as found by the Court demonstrated that users would not use instant messaging services unless they were free, and companies competed based on offering free products to attract users.[175]

A further example of eschewing form over substance can be seen in the Supreme People's Court analysis of whether non-integrated instant messaging services (like Apple's iMessage, which is text, as opposed to QQ, which is audio, text, and video) should be included within the scope of the relevant product market. The Court used as its baseline for addressing this question the principle that, as a "general approach," it would define the product market based on qualitative criteria to determine demand substitution for products and that such a qualitative analysis should focus on product characteristics such as use, quality, and ease of access.[176] The Court then found the product similarities between

---

168 *2014 QQ Decision*, *supra* note 40, at 55; Global Economics Group, *supra* note 163, at 2.

169 Ning et al., *The Supreme Court Goes Online with Anti-Monopoly Principles*, *supra* note 163.

170 *See* Lim & Shen*, supra* note 21, at 12-13, 15-16.

171 *2014 QQ Decision*, *supra* note 40, at 56; Global Economics Group, *supra* note 163, at 2-3.

172 The Supreme People's Court set out the definition of that test in terms of the small but significant and not transitory price increase or SSNIP method and the alternative small but significant and not transitory quality decrease method. *2014 QQ Decision*, *supra* note 40, at 56; Global Economics Group, *supra* note 163, at 3. Of course, the Court set out the correct test as set forth in the requisite guidelines. *See* State Council Relevant Market Guidelines, *supra* note 111, art. 10. But that the Court did not see itself bound to conduct a rote application of this test when faced with divergent market realities is yet one more example of the care with which this Court wrote this decision, a point that should not only factor into its designation as a guiding case but also into assessing China's progress towards its rule of law goals.

173 *2014 QQ Decision*, *supra* note 40, at 56; *cf.* Global Economics Group, *supra* note 163, at 3 (translating the relevant term as "universal" and not "general").

174 *See 2014 QQ Decision*, *supra* note 40, at 56-57; Global Economics Group, *supra* note 163, at 3.

175 *See 2014 QQ Decision*, *supra* note 40, at 57, 63-64; Global Economics Group, *supra* note 163, at 4-5, 12.

176 *2014 QQ Decision*, *supra* note 40, at 58; Global Economics Group, *supra* note 163, at 5.

non-integrated and integrated instant messaging services to be close enough (e.g., real-time communication, offered for free, and users' preferences for text as opposed to video and audio even in an integrated setting) to find non-integrated services fall within the relevant market.[177] The Court addressed and rejected the contentions of Qihoo's experts that there were quality differences between non-integrated and integrated instant messaging software that warranted them being placed in different markets: it observed that these contentions did not accord with user preferences, with partially overlapping functions of the various forms of instant messaging software, or with the ability of companies' providing non-integrated instant messaging software to reposition themselves to compete with more integrated instant messaging software products.[178]

Indeed, the Supreme People's Court also addressed whether mobile instant messaging services, social network sites, and microblogging sites should all be included in the relevant market. In reaching the conclusion that mobile instant messaging services were part of the relevant market, the Court found that around 2010-11, the functions were the same for mobile as for PCs regarding instant messaging communication, and that the use of mobile instant messaging services was growing fast at the time of the conduct and had already achieved considerable scale then (200 million users in 2010).[179] Although the Court recognized that this issue had not been addressed by the lower court, it found that it had the power to reach this issue not only because it had to have the power to examine all of the facts if there was a claim of error as to fact-finding in the court below but also because the question of what constitutes a relevant market was a factual one.[180]

Conversely, in reaching the conclusion that social networking and microblogging (aside from any instant messaging services that they provide) were not part of the relevant market, the Court emphasized the dissimilarities in product characteristics and user demand among these products.[181] The Court further observed that it could rely on a correlation analysis—whether the prices of commodities or services all change together as would be expected if they were in the same market—to support this result even if it could lead to false positives such that a court need be cautious in its use.[182] And the Court carefully found that the dynamic nature of the market did not alter this conclusion.[183]

---

177 *2014 QQ Decision*, *supra* note 40, at 58-59; Global Economics Group, *supra* note 163, at 5-7.

178 *2014 QQ Decision*, *supra* note 40, at 59; Global Economics Group, *supra* note 163, at 6-7.

179 *2014 QQ Decision*, *supra* note 40, at 61; Global Economics Group, *supra* note 163, at 7-8.

180 *2014 QQ Decision*, *supra* note 40, at 61; Global Economics Group, *supra* note 163, at 8. The Court used a similar analysis briefly addressing and rejecting Tencent's contention that e-mail and Short Message Service (SMS) were also part of the same market as instant messaging services although it also noted that SMS had another distinguishing characteristic in that it was fee-based. *See 2014 QQ Decision*, *supra* note 40, at 64-65; Global Economics Group, *supra* note 163, at 12-14.

181 *See 2014 QQ Decision*, *supra* note 40, at 61-62, 65; Global Economics Group, *supra* note 163, at 11-13.

182 *2014 QQ Decision*, *supra* note 40, at 62-63; Global Economics Group, *supra* note 163, at 11-12. The Court rejected Tencent's argument that it should accept a correlation analysis over a *longer* period of time that showed a positive relationship on demand between these disparate products. The Court observed that the 312% growth in Internet usage over the longer time-frame urged by Tencent, 2006-2012, meant that this positive correlation may not reflect a close product relationship, thus leading to a greater chance of error. *2014 QQ Decision*, *supra* note 40, at 63; Global Economics Group, *supra* note 163, at 11-12.

183 *2014 QQ Decision*, *supra* note 40, at 70; Global Economics Group, *supra* note 163, at 21.

The Supreme People's Court also painstakingly addressed the issue of whether the relevant product market should be determined on an Internet application platform basis. This would place firms that offer product portfolios on a platform, or a platform for a portfolio of services, in the relevant market.[184] As the Court observed, large Internet providers in mainland China had been increasingly building their own platforms that offered a range of services, such as e-mail, blogs, music, television programs, games, communication, and customer and/or business services. These services were gradually integrated into a single offering that would compete for advertisers who want to reach the users of such integrated platforms.[185]

On the one hand, the Court found that the scope of the relevant product market should not be expanded to include platform competition, even though it lacked definitive empirical data on this issue. The Court gave the following reasons: the focus of platform providers and advertisers in platform competition was on providing a secure Internet platform rather than on providing a single, integrated offering to compete with comparable, single integrated product offerings; different platform makers could offer a different mix of services with those services not all being substitutes for each other, e.g., an individual searching for information on a historical figure would need a search engine, not an instant messaging communication service; and those different platforms potentially competed for a different mix of users and advertisers rather than the inclusion of the same mix of users and advertisers.[186] Ultimately, the Court thought this issue of including platform competition was getting too far afield from those products and services actually provided by the parties to this case, on which a relevant product market analysis should be based.[187]

On the other hand, the Court ruled that this issue was still germane to whether there were additional constraints on Tencent that could prevent it from exercising market power.[188] Essentially, it found that this issue pertained to barriers to entry and the ability of companies outside the relevant market to re-position themselves and enter that market.[189] In fact, later in its decision, the Court returned to this point in agreeing with Tencent that Internet competition was dynamic, with foreseeable future changes in the market of being relevant to whether Tencent (or, for example, a firm committing alleged abuse of dominance misconduct for a year) faced competitive constraints.[190] This is one of the features of this thorough opinion thought to be salient by commentators.[191]

Finally, the Supreme People's Court also addressed the issue of the scope of the relevant geographic market. After noting that the test for determining the scope of the relevant geographic market focuses on both demand and supply substitution, the Court observed that it would start with mainland China being the baseline market with the lack of cost,

---

184 *2014 QQ Decision*, *supra* note 40, at 65-67; Global Economics Group, *supra* note 163, at 14-16.

185 *2014 QQ Decision*, *supra* note 40, at 65; Global Economics Group, *supra* note 163, at 15.

186 *2014 QQ Decision*, *supra* note 40, at 66; Global Economics Group, *supra* note 163, at 15-16.

187 *2014 QQ Decision*, *supra* note 40, at 66-67; Global Economics Group, *supra* note 163, at 16.

188 *2014 QQ Decision*, *supra* note 40, at 66-67; Global Economics Group, *supra* note 163, at 16.

189 *See* Lim & Shen, *supra* note 21, at 16.

190 *2014 QQ Decision*, *supra* note 40, at 70; Global Economics Group, *supra* note 163, at 21.

191 *See* Lim & Shen, *supra* note 21, at 6, 16; Ning et al., *The Supreme Court Goes Online with Anti-Monopoly Principles*, *supra*, note 163.

transportation, or technical barriers to worldwide distribution of software as being additional applicable factors (apparently because there was universal agreement as to all of those points). However, here too, it eschewed form over substance by conducting a deeper analysis of several important factors in applying this test: (1) the actual region in which demand for the products in question is most acute; (2) the laws and regulations that may bear on entry into mainland China; and (3) the experience of foreign competitors in trying to enter the market in mainland China as well as the timeliness for any such entry.[192]

Applying this test, the Court concluded that the relevant geographical market was mainland China as opposed to the entire world as the lower court had thought.[193] The conclusion relied on three important facts: (1) the demand of users in mainland China was overwhelmingly for instant messaging services provided by firms located in mainland China (97% according to a 2010 iResearch report); (2) firms providing such services in mainland China first had to comply with conditions set out in administrative rules and regulations, including obtaining a government telecommunications license, meeting minimum capital requirements, and (if a foreign company) also complying with special capital and corporate vehicle requirements;[194] (3) and foreign users of QQ had limited its use to keeping in touch with friends and family back home in mainland China.[195]

c. Whether Tencent Had a Dominant Market Position

The Supreme People's Court then turned to whether the lower court erred, as a matter of fact, in concluding that Tencent did not have a dominant market position.[196] Though it could be argued that a presumption of market power had to be applied to Tencent under Article 19 of the Anti-Monopoly Law given Tencent's market shares in the relevant market as defined by the Supreme People's Court,[197] the Supreme People's Court was not willing to do so without applying the factors set out in Article 18 of that law such as an assessment of the barriers to entry.[198] Indeed, in responding to Qihoo's claim that the lower court erred by failing to make an actual determination as to market share, the Court stressed that assessing a firm's dominant market position depended on a comprehensive assessment of all of the Article 18 factors, likely rendering the determination of market share an unnecessary step.[199]

---

192 *2014 QQ Decision*, *supra* note 40, at 67; Global Economics Group, *supra* note 163, at 17. Other jurisdictions have observed that, given antitrust law must be sensitive to economic context, it is warranted to pay attention to the significance of regulation in an industry. *See, e.g.*, *Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 411 (2003).

193 *2014 QQ Decision*, *supra* note 40, at 67-70; Global Economics Group, *supra* note 163, at 17-20.

194 While foreign companies had entered China and provided such services, they did so through joint ventures with Chinese companies. *2014 QQ Decision*, *supra* note 40, at 69; Global Economics Group, *supra* note 163, at 19-20.

195 *2014 QQ Decision*, *supra* note 40, at 67-70; Global Economics Group, *supra* note 163, at 17-20.

196 *See 2014 QQ Decision*, *supra* note 40, at 70-76; Global Economics Group, *supra* note 163, at 21-30.

197 Ning et al., *The Supreme Court Goes Online with Anti-Monopoly Principles*, *supra* note 163 (observing that, in the relevant market as defined by the Court, Tencent had an 80% market share).

198 *See 2014 QQ Decision*, *supra* note 40, at 71; Global Economics Group, *supra* note 163, at 23.

199 *2014 QQ Decision*, *supra* note 40, at 80; Global Economics Group, *supra* note 163, at 35.

This careful analysis does not constitute a sacrifice of the need for administrable rules much as it may seem otherwise to some commentators.[200] Certain factors listed in Article 18, such as barriers to entry, are germane to the calculation of market shares in the first instance and form part of a civil plaintiff's burden of proof for a monopoly or abuse of dominance case before market power can be presumed from those market shares.[201] Though certain factors listed in Article 18 are admittedly for a civil defendant to raise in the first instance, such as a defendant's technical or financial condition, a civil plaintiff still bears the ultimate burden of proof on market power even if presumptions from Article 19 would otherwise apply in the name of administrability.[202]

Applying the Article 18 factors assiduously, the Supreme People's Court reached the following conclusions: (1) other factors such as barriers to entry and Internet platform competition had to be examined before it could be concluded that Tencent had market power, even though the Court observed that Tencent had an approximate 80% market share in the relevant product and geographic markets during the relevant time based on expert analyses offered by Qihoo of usage frequency and number of users (a figure that climbed to approximately 90% in 2012);[203] (2) the barriers to entry in the relevant product and geographic market were low as witnessed by the plethora of products (such as Baidu Hi, Ali Want, Apple's iMessage or Samsung's ChatOn) that had entered the market as well as by competition from other Internet platforms, thus requiring continuous innovation to stay ahead;[204] (3) as to Tencent's ability to control price, output, or other axes of competition, the Court found this dynamic nature of the relevant market, as well as the free nature of the software involved, militated against any finding of control as users were not, in effect, locked in via network

200 *See* Lim & Shen, *supra* note 21, at 6, 10, 12, 17 & nn.29-30 (viewing the decision as using Article 18 to override Article 19 but noting that courts may become confused anyway in trying to reconcile seemingly different market power approaches in Article 18 versus those in Article 19); Ning et al., *The Supreme Court Goes Online with Anti-Monopoly Principles*, *supra* note 163 (viewing the decision on the one hand as being consistent with the original intent of Articles 18 and 19 but then stating that its override of Article 19 was a surprise that may be due to the dynamic nature of the Internet market).

201 *See United States v. Microsoft,* 253 F.3d 34, 82 (D.C. Cir. 2001); *Concord Boat Co. v. Brunswick*, 207 F.3d 1039, 1059 (8th Cir. 2000); *CDC Techs. v. Idexx Labs.,* 186 F.3d 74, 80 (2d Cir. 1999); *see also* J. Robert Robertson, *Editor's Note: Philadelphia National Bank at 50 Symposium*, 80 ANTITRUST L.J. 189, 196 (2015) (recasting presumption of market power from high market shares applicable to mergers as the higher the market shares and barriers to entry in the government's prima facie case, the higher the defendant's burden of producing rebuttal evidence); *but cf.* AREEDA ET AL., *supra* note 103, ¶ 420b at 75 (distinguishing between producing evidence that new entry into the market has not occurred within the past year or two, which should be plaintiff's burden, and producing evidence that likely, timely, and sufficient entry into the market will occur in the future, which should be defendant's burden, but noting that if a defendant were to produce such evidence, plaintiff should "generally" bear the burden of persuasion on the issue of new entry).

202 Regarding this point vis-à-vis the law of other jurisdictions, see discussion *infra* Part VI.A of the California Supreme Court's opinion in *In re Cipro* and Fed. R. Evid. 301 (in discussing presumptions, rule observes that while party against whom the presumption applies has the burden of producing evidence to rebut the presumptions, but that the party invoking the presumption still retains the burden of persuasion).

203 *2014 QQ Decision*, *supra* note 40, at 71-72; Global Economics Group, *supra* note 163, at 23-24.

204 *2014 QQ Decision*, *supra* note 40, at 72-73, 75; Global Economics Group, *supra* note 163, at 24-25, 27-28.

effects[205] (in discussing the lack of customer "stickiness," the Court discussed the rise and fall of MSN in China);[206] and (4) although the Court found that Tencent was in relatively strong financial and technical condition, it noted that so too were Tencent's competitors such as Baidu, China Mobile, Alibaba, and Microsoft.[207] Finally, in addressing Qihoo's contention that Tencent's actions against it forced customers to choose between Qihoo and Tencent, thereby demonstrating Tencent's market power, the Court found that Tencent had only engaged in this conduct for one day and that Tencent's competitors gained significant market share during the period, a result contrary to the idea that Tencent had market dominance.[208]

d. Whether Tencent's Conduct Was Otherwise Illegal

The Supreme People's Court observed that, "in principle," it was not required to address whether Tencent's conduct itself was illegal as an abuse of dominance under the Anti-Monopoly Law given its findings as to Tencent's lack of market power.[209] However, the Court observed that the more difficult it would be to determine the boundaries of a relevant market or the dominant position of a firm, the more a court should simply analyze directly the legality and competitive effects of conduct that is alleged to constitute an abuse of dominance.[210] Engaging in that direct analysis, the Court found that Tencent's conduct did not negatively impact consumers as they had alternatives to turn to, that Tencent's increased competition in the relevant market even though it lasted only one day, and that Tencent's actions could be explained as self-help in response to Qihoo's acts of unfair competition such that it was not "obvious" that Tencent's intent was anti-competitive.[211]

---

205 *2014 QQ Decision*, *supra* note 40, at 73-74; Global Economics Group, *supra* note 163, at 27. In particular, one report stated that more than 50% of users had two to three instant messaging software products with 8.7% changing the software they use within a half year while other reports had reported figures of 63.4% (CNNIC) and 90% (iResearch) for the number of users with two or more instant messaging software products. *2014 QQ Decision*, *supra* note 40, at 73-74; Global Economics Group, *supra* note 163, at 27.

206 *2014 QQ Decision*, *supra* note 40, at 73-74; Global Economics Group, *supra* note 163, at 27.

207 *2014 QQ Decision*, *supra* note 40, at 74; Global Economics Group, *supra* note 163, at 26.

208 *2014 QQ Decision*, *supra* note 40, at 75-76; Global Economics Group, *supra* note 163, at 27-29.

209 *2014 QQ Decision*, *supra* note 40, at 76-77; Global Economics Group, *supra* note 163, at 30.

210 *2014 QQ Decision*, *supra* note 40, at 76-77; Global Economics Group, *supra* note 163, at 30. This corresponds to the experience of other jurisdictions. *See, e.g.*, *FTC v. Actavis*, 133 S. Ct. 2223, 2237-38 (2013) (finding that courts can structure rule of reason analysis so that quality of proof required for elements can vary with circumstances and so that they need not consider every fact or theory no matter how minimal it is on the basic question of a restraint's significant and unjustified anti-competitive consequences); *Am. Needle, Inc. v. Nat'l Football League*, 560 U.S. 183, 203 (2010) (characterizing the Rule of Reason as being flexible and noting that concerted activity may not always require a detailed analysis under the Rule of Reason but "can sometimes be applied in the twinkling of an eye" in finding such activity to be justified (internal citation omitted)).

211 *2014 QQ Decision*, *supra* note 40, at 77-78; Global Economics Group, *supra* note 163, at 30-32.

Lastly, the Court addressed whether Tencent's conduct constituted the kind of tying (of one product with another) prohibited by the Anti-Monopoly Law.[212] This analysis is worth examination in assessing the ability of Chinese courts to properly apply legal concepts to the facts before them, not only in separating the wheat from the chaff but also in doing so in a manner that can be readily understood and applied by later courts. The Court first found that Tencent's conduct failed at the onset to meet the requirements for showing tying as that conduct did not appreciably shrink Qihoo's share of the tied product market—Internet security software—even as it did not increase by much Tencent's share of the tying product market—instant messaging software.[213] The Court then alternatively found both that the force required for tying was not obvious, as consumers could uninstall QQ programs that they did not like or refuse to accept upgrades, and that bundling instant messaging software with Internet security software was rational as users of instant messaging software were concerned about the security of their instant messaging software.[214] Finally, the Court determined that the lower court properly required Qihoo to show a net negative effect on competition arising from the tying, given that Qihoo had failed to meet its burden of showing a dominant market position in the tying product market such that it could avail itself of the presumption of anti-competitive effects arising from such a tie.[215]

B. The "Dog That Did Not Bark"[216]: What Was Apparently Not Done in the *2014 QQ Decision*

The *2014 QQ Decision* involved a vigorously litigated case at multiple levels of the Chinese court system that provides great insight into China's progress toward the rule of law as discussed *infra*. However, it is important to also consider what did *not* occur in that case.

First, Qihoo does not appear to have sought either an order requiring Tencent to produce evidence or an order requesting the appointment of a court expert, though both are permissible.[217] Qihoo may have adopted this strategy of refraining from using these tools because its case may have centered on the market share presumptions set out in Article 19 of the Anti-Monopoly Law, which it thought it could easily satisfy.[218] However, the ability to request the court to secure evidence from a defendant, or have the court conduct an independent analysis using its own expert, becomes that much more important given the willingness of the Supreme People's Court in its *2014 QQ Decision* to sanction courts looking more closely at direct effects, the analysis of which is inherently data-driven. And the same observations hold true as to the use of these tools as the Supreme People's Court stressed in its *2014 QQ Decision* the need for lower courts to be willing to use the evidence

---

212 *2014 QQ Decision*, *supra* note 40, at 78-80; Global Economics Group, *supra* note 163, at 32-34.

213 *2014 QQ Decision*, *supra* note 40, at 79; Global Economics Group, *supra* note 163, at 33.

214 *2014 QQ Decision*, *supra* note 40, at 79; Global Economics Group, *supra* note 163, at 34.

215 *2014 QQ Decision*, *supra* note 40, at 79-80; Global Economics Group, *supra* note 163, at 34.

216 Sir Arthur Conan Doyle, *Silver Blaze*, in The Memoirs of Sherlock Holmes (1892).

217 Civil Procedure Law of the People's Republic of China (promulgated by the Nat'l People's Cong., Apr. 9, 1991, effective Jan. 1, 2013) (amended 1991, 2007, & 2012), arts. 64, 67, 76, 79.

218 *Cf.* Ning et al., *The Supreme Court Goes Online with Anti-Monopoly Principles*, *supra* note 163 (setting out statements by attorneys in the law firm retained by Qihoo observing that, in the relevant market as defined by the Court, Tencent had a 80% market share).

before them to determine the scope of the relevant market, even if that evidence is less than perfect and even if the plaintiff is the one who has the burden of proof on market-definition issues.[219]

Second, the Supreme People's Court was very interested in admitting as much evidence as it could, and leaving as wide a scope as it could for the admission of economic expert testimony, so that it could reach the most informed decision possible. Yet the absence of any input from government antitrust authorities, or from informed third parties (such as economics professors), in an *amicus* capacity is quite striking when viewed against this apparent goal in comparing the proceedings before that Court in the *2014 QQ Decision* case with cases in other countries.[220]

The absence is striking because the lack of such input hinders the Court in reaching the most informed decision possible. For example, it has been claimed that the Court's decision fails to account sufficiently for the two-sided market phenomenon. This might have given Tencent market power as it could take advantage of the large installed base it has for its own differentiated platform to extend its market share over products that run on that platform to keep users from defecting to rival platforms.[221] The Court's opinion does address both platform competition and network effects (the latter of which is related to two-sided markets) based on the evidence before it. Nonetheless, allowing for the formal presentation of informed views on two-stage markets from third parties and government agencies in an *amicus curiae* capacity might have allowed it to draw even more on the latest scholarship regarding two-sided markets and how that should interface with the market definition test and market share presumptions of the Anti-Monopoly Law.[222]

---

219 Indeed, insofar as the Supreme People's Court appeared to be willing to infer that the intent behind Tencent's conduct was self-help—*see 2014 QQ Decision*, *supra* note 40, at 77-78; Global Economics Group, *supra* note 163, at 30-32—a court order allowing for a tailored production of Tencent's business documents surrounding the key date in question could have shed light on Tencent's actual motives. After all, antitrust defendants can claim *post hoc* justifications for their conduct that end up clashing with their actual intent or goal as expressed in contemporaneous business documents—a point that future antitrust plaintiffs in China should be mindful of given the holding of the *2014 QQ Decision*. *See United States et al. v. Apple, Inc. et al.,* 791 F.3d 230, 335 (2nd Cir. 2015). However, this observation is not to impugn Tencent's motives in this case or suggest that they were, in fact, other than what has been reported in the *2014 QQ Decision*.

220 *See* Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on Certain Rules Governing Actions for Damages under National Law for Infringements of the Competition Law Provisions of the Member States and the European Union, art. 30, 2014 O.J. (L. 349) 5 (competition authorities in Europe should be able to submit observations to national courts in private damage actions); Varanini, *American and European Antitrust Enforcement*, *supra* note 21, at 104 (discussing *amicus* procedure set up by European Commission for weighing in on issues of European Community competition law that are raised by cases and enforcement actions in a Member State's court); *see also* Judicial Enforcement of Competition Law, *supra* note 13, at 40 (noting judges in private antitrust actions in Italy can ask for information from government departments about the economic sector in question in a given case). For examples of what such amicus briefing can involve, *see, e.g.*, Brief for the United States and for the FTC as Amici Curiae in Support of Neither Party, *Motorola Mobility LLC v. AU Optronics Corp.*, 746 F.3d 842 (7th Cir. 2014) (No. 14-8003), 2014 WL 4447001.

221 *See* Ning et al., *The Supreme Court Goes Online with Anti-Monopoly Principles*, *supra* note 163.

222 For an example of such potentially informative scholarship, *see, e.g.*, David Evans, Attention Rivalry Among Online Platforms, Univ. Of Chi. Inst. Law & Economics, Research Paper No. 627, 4, 31-36 (2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2195340&utm_source=Copy+of+TencentWebinar&utm_campaign=April+30%2C+2013&utm_medium=email (discussing how differentiated platforms may be able to exercise market power); *id.* at 4 n.10, 40-42 (discussing the QQ decision of the Guangdong Higher People's Court). What makes this example particularly striking is that the views in this article may have been considered by the Supreme People's Court as part of its *2014 QQ Decision* as this article expressly mentioned and analyzed the lower court decision even though the Court did not cite to this article as support for its decision. *See 2014 QQ Decision*, *supra* note 40, at 46. And, in the context of formulating guidelines for lower courts, the Supreme People's Court has accepted comments on drafts from interested third parties. *See, e.g.*, Am. Bar Ass'n, Joint Comments of the American Bar Association Section of Antirust Law and Section of International Law on the Supreme People's Court Draft Provisions on the Trial Of Civil Monopoly Cases (June 2011) (on file with authors).

This case also does not involve a government decision following either an investigation with detailed factual findings and legal conclusions where it imposed fines and other relief, nor an investigation in which the government declined further action with a detailed statement of reasons. The review and treatment of such government decisions by the courts in the wake of the *2014 QQ Decision* will reveal much about China's commitment to the rule of law generally speaking as well as specifically in the context of antitrust.

VI. THE IMPORTANCE OF THE *2014 QQ DECISION* FOR THE GENERAL RULE OF LAW IN CHINA AS WELL AS THE SPECIFIC RULE OF LAW IN THE CONTEXT OF ANTITRUST

The detailed analysis of the *2014 QQ Decision* demonstrates that Chinese courts can, in fact, assume the role that is necessary for them to play if China is to stay on the path to the rule of law. First, it provides detailed guidance to lower courts on applying evidentiary and substantive rules in anti-monopoly cases and authoritatively addresses issues of market definition involving the assessment of economic evidence.[223] Further, it shows that private litigants in China can effectively use the court system to present facts and obtain a well-reasoned result that addresses the arguments they present in a neutral manner.[224] However, for observers to be convinced that the *2014 QQ Decision* is, as it appears to be, a welcome sign of China's commitment to the rule of law, further steps are needed.

Designating the *2014 QQ Decision* as a guiding case would be the most important next step that can be taken to demonstrate China's commitment to the rule of law, generally as well as specifically in the context of antitrust. Additional steps involve the tools available to private litigants in litigating these cases. Not only must private litigants in China use all of the tools currently available to them to bring and prosecute these cases but also those tools need to be expanded—at least in certain respects—so as to ensure that the judiciary's role in enforcing law in China will only continue to grow.[225] Finally, given that the *2014 QQ Decision* demonstrates the courts in China have the capacity to execute China's rule of law strategy, the proof of the pudding, as it were, will be whether China's courts can in fact review the decisions of government agencies under standards similar to those in other countries.[226]

---

223 *Cf., e.g.*, Judicial Enforcement of Competition Law, *supra* note 13, at 19 (noting that the task of courts applying economic thinking in antitrust cases calls for the use of "shortcuts" or "legal presumptions" to make that task easier but also noting that for some tasks like market definition, such shortcuts are not possible and encouraging the exploration of how courts may better use economic evidence).

224 *See id.* at 21 (noting the importance of "economic agents" themselves bringing cases for the rule of law in antitrust cases); *see also Best Practices, supra* note 23, at 9-10.

225 *Cf.* Council Directive 2014/104/EU, art 3, 2014 O.J. (L 349) 1 ("National courts thus have an equally essential part to play in applying the competition rules (private enforcement). While ruling on disputes between private individuals, they protect subjective rights under [European] Union law, for example by awarding damages to the victims of infringements. The full effectiveness of Articles 101 and 102 [of the Treaty on the Functioning of the European Union (TFFEU)], and in particular the practical effect of the prohibitions laid down therein, requires that anyone—be they an individual, including consumers and undertakings, or a public authority—can claim compensation before national courts for the harm caused to them by an infringement of these provisions.").

226 *See* Judicial Enforcement of Competition Law*, supra* note 13, at 21 (noting that part of the job of the courts in executing the rule of law in the antitrust context is reviewing the decisions of government antitrust enforcers); *see also* 2015 China Anti-Monopoly Rpt., *supra* note 43, at 50 ("In 2016, it is anticipated that there would be more antitrust litigations against the state-owned companies or the authorities in China.").

A. The *2014 QQ Decision*'s Being Worthy of Designation as Guiding Precedent

The Supreme People's Court's office responsible for the designation of an opinion as a guiding case will look to whether an opinion answers important questions as to the application of a law and can otherwise provide comprehensive guidance in the application of a law in a given area.[227] Looking to the interplay of economics with administrable rules, which lies at the heart of the rule of law in the antitrust context, the *2014 QQ Decision* sets out detailed guidance on how Chinese courts should substantively analyze abuse of dominance cases to separate the wheat from the chaff. By way of just one example, it encourages courts to look to direct effects as an alternative to the difficulties that can be encountered in the exercise of market-drawing. Such substantive holdings, which go beyond the Supreme People's Court prior guidelines on civil trials in anti-monopoly cases, alone suggest that the *2014 QQ Decision* should be designated as a guiding case.

However, the *2014 QQ Decision* also involves a host of procedural rulings involving the admission and consideration of evidence and the burden of proof in anti-monopoly cases. To ensure the effective application of a law such as the Anti-Monopoly Law for purposes of achieving the rule of law, there is a need for appropriate procedural rules that involve presumptions and burdens of proof as well as the admission of evidence.[228]

This point about delineating the burden of proof of a litigant as a necessary step on the path towards the rule of law can be seen by comparing the detailed *2014 QQ Decision* with an equally detailed 2015 antitrust decision from the California Supreme Court in the *In re Cipro* case.[229] This case discussed burden of proof questions in addressing the legality of reverse payments under state antitrust law (an issue with enormous consequences for the price of medicine in the United States). In particular, the California Supreme Court considered the question of whether a patent holder of a branded drug could pay a competitor issuing a generic equivalent of that branded drug with monetary and/or non-monetary compensation in exchange for a non-compete agreement from the generic competitor as part of a settlement of patent infringement claims.[230] Although the United States Supreme Court had answered that question in a general way by finding that such settlements were not categorically immune from antitrust liability,[231] it left a lot of questions unanswered, including which party carries which burden of proof as to what aspects of a so-called reverse payments claim.

As with the United States Supreme Court, the California Supreme Court found that such claims were not categorically barred if the settlement involved did not extend the patent past the expiration of its term.[232] Rather, applying a sliding scale flexible analysis

---

227 *See* Gechlik & Di, *supra* note 61, at 5 (discussing Guiding Case No. 5).

228 *Cf.* Council Directive 2014/104/EU, art. 4, 2014 O.J. (L 349) 2 ("The right in [European] Union law to compensation for harm resulting from infringements of Union and national competition law requires each Member State to have procedural rules ensuring the effective exercise of that right.").

229 *In re Cipro Cases I & II*, 61 Cal. 4th 116, 348 P.3d 845 (Cal. 2015).

230 *In re Cipro,* 61 Cal. 4th at 129-30, 132-33, 135; *see also id.* at 151 & n.11 (discussing non-cash compensation).

231 *Id.* at 130 (citing *Federal Trade Commission v. Actavis*, 133 S. Ct. 2223 (2013)).

232 *Id.* at 141-45.

(between *per se* or hard-core illegal on one end of the scale and full rule of reason with market definition et al. on the other),[233] the *In re Cipro* Court found that a civil plaintiff must show four elements, on which that plaintiff would bear the burden of proof, to make out a prima facie case that the reverse payments settlement is anti-competitive: (1) the settlement limits entry of the generic drug manufacturer; (2) the settlement includes cash or equivalent financial consideration; (3) the value of such consideration (minus any value originating from the delay itself) to the generic drug manufacturer exceeds whatever goods or services the generic drug manufacturer was providing to the brand; and (4) the value of the settlement exceeds the expected litigation cost absent settlement for the brand manufacturer.[234]

However, because evidence on the third and fourth element was more likely to be in the hands of defendant drug manufacturers, the Court found that those defendants must first meet their burden of producing evidence on those elements before the ultimate burden of proof as to those elements would shift back to the plaintiff.[235] Put another way, a plaintiff's showing of these four prima facie elements would allow for a presumption that the patent holder has market power without the need to delineate a relevant market and figure out market shares.[236] To reach these conclusions, the Court relied heavily on economic scholarship.[237]

In turn, the *In re Cipro* Court found that, if a civil plaintiff could make out such a prima facie case, the burden would shift back to defendants to offer evidence of pro-competitive justifications for the settlement.[238] Although the Court rejected the contention of the plaintiffs that the defendants should be barred from presenting any justifications, the Court also rejected, in following the lead of the United States Supreme Court, several potential justifications. These justifications included allowing competition at all earlier than patent expiration when the baseline should be the average period of competition that could be expected in the absence of settlement or re-litigating whether the patent was valid when the parties chose to settle without such a determination being made.[239] Moreover, as the last step here, the Court reiterated that "the ultimate burden throughout rests with the plaintiff to show that a challenged settlement agreement is anticompetitive,"[240] and that plaintiffs who have made the requisite prima facie showing need only show that any such justifications offered by a defendant are "unsupportable" to prevail.[241]

Ultimately, this kind of flexible and pragmatic burden of proof analysis in *In re Cipro* is redolent of the similar analysis performed by the Supreme People's Court in its *2014 QQ Decision*, both of which were based on economic thought. Just as the *In re Cipro* case has been important for demonstrating how the rule of law in the antitrust context can reconcile economic thought with administrative imperatives in devising the very burdens of production

---

233 *Id*. at 146-47.

234 *Id*. at 151-57.

235 *Id*. at 153 n.12, 153-54.

236 *Id*. at 157.

237 *Id*. at 154-55.

238 *Id*. at 157-58.

239 *Id*. at 158-59.

240 *Id*. at 159.

241 *Id*.

and proof that govern a case, so too could the *2014 QQ Decision* play a similar role in China if it were designated as a guiding case. Thus, the designation of the *2014 QQ Decision* as a guiding case would constitute an important milestone in demonstrating China's commitment to the rule of law, both as a general matter and as a specific matter with respect to antitrust.[242]

B. The Need for the Use, and Further Development, of Legal Tools in Anti-Monopoly Cases Handled by the Courts as Part of the Goal of Achieving Rule of Law

For the courts to do their part in the rule of law, civil litigants must be willing to fully use the tools granted to them by Chinese civil law, especially when, as in the *2014 QQ Decision*, that very law is found to require a pragmatic and flexible analysis and when the courts have indicated that they will eschew a technical approach to the consideration of evidence.

The use of existing tools could include, among other options, seeking court orders requiring defendants to produce documents and data,[243] and encouraging the courts to hire their own economic expert.[244] But it may include the development of other tools much along the lines of the European Union's 2014 Damages Directive setting out a range of evidentiary, procedural, liability, and damage standards for ensuring more effective private litigation.[245]

---

242 *Cf.* Zhang, *supra* note 72, at 4 (Deputy Chief Judge Wang of the Supreme People's Court stated that the courts should "provide guidance to the parties to ascertain their economic analysis on market definition, market power, and damages calculation, and improve the scientific nature of economic analysis. When identifying market power, the parties must fully understand that market share is just one of the many aspects used [to] determine market dominance, not the only one. Other methods should be given equal weight to avoid unjustified reliance on market share"). This set of recommendations by Deputy Chief Judge Wang would be achieved via designation of the *2014 QQ Decision* as a guiding case.

243 *See* Civil Procedure Law of the People's Republic of China (promulgated by the Nat'l People's Cong., Apr. 9, 1991, effective Jan. 1, 2013) (amended 1991, 2007, & 2012), art. 64; *cf.* Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on Certain Rules Governing Actions for Damages under National Law for Infringements of the Competition Law Provisions of the Member States and the European Union, arts. 15-18, 2014 O.J. (L. 349) 3-4 (directing that local courts in the European Union permit such orders); Zhang, *supra* note 72, at 4 (Deputy Chief Judge Wang is quoted as observing that "[f]rom the practice of civil antitrust cases, we have learned that the bottleneck in civil antitrust cases is the plaintiff's difficulty in collecting evidence and proving monopolistic behavior").

244 *See* Civil Procedure Law, art. 76; *cf. Interview with Judge Posner, supra* note 16, at 207 (Judge Posner sets out his practice of having the court retain its own expert as judges are "not well-equipped to deal with complex economic and statistical issues" and he is "skeptical about expert witnesses except those appointed by the judge"); Judicial Enforcement of Competition Law, *supra* note 13, at 41 (describing practice of Italian courts of appointing experts to assist them); *see generally* Zhang, *supra* note 72, at 4 (Deputy Chief Wang observed that the courts need to "improve the use, procurement[,] and examination of experts' opinions, economic analysis, and market survey reports to fully take advantage of the experts' function in evaluating professional and technical facts").

245 *See* Council Directive 2014/104/EU, arts. 2-4, 12-16, 18-19, 23, 25-45, 47-52, 2014 O.J. (L 349) 1-9; Zhang, *supra* note 72, at 4 (Deputy Chief Wang is quoted recommending the courts "standardize the ruling criteria at an appropriate time" and that the burden of proof on plaintiffs must be "moderated"); *see also* OECD, Relationship Between Public and Private Enforcement, Working Paper No. 3, DAF/COMP/WP3 14, 12-37 (2015) (on file with authors) [hereinafter *Relationship Between Public and Private Enforcement*] (setting out a multi-jurisdictional comparison on the subject); *cf. Clayworth v. Pfizer*, 233 P.2d 1066, 1070 (Cal. 2010) (holding "generally" pass-on should not be a defense under state antitrust law even in a case brought by indirect purchaser plaintiffs).

One important tool would be the ability of civil litigants to use government decisions in conducting follow-on actions if those decisions can first be subject to meaningful, if also deferential, review.[246]

Chinese law may permit the use of government decisions as evidence in subsequent litigation, though so far no such use has apparently occurred.[247] That is important as any private right, such as the right to compensation for violations of antitrust law, needs to have a meaningful path by which that right can be exercised.[248] As the European Union has recognized, rules allowing for the recovery of compensation, and the remediation of harm, "should not be formulated or applied in a way that makes it excessively difficult or practically impossible to exercise the right to compensation . . . ."[249] Accordingly the European Union has now provided that findings regarding the violation of European Commission law by a competition authority or a reviewing authority "should not be relitigated in subsequent actions for damages" and "should be deemed to be irrefutably established in actions for damages . . . ."[250]

However, government findings regarding antitrust liability do not emerge from a vacuum even in comparable civil law systems such as in Europe. Rather, those findings are scrutinized by the courts albeit with a measure of discretion[251]: "while the [European Union] Courts may scrutinize the Commission's factual analysis and are the ultimate arbiters with respect to matters of law, the Commission has traditionally enjoyed a 'margin of discretion' in relation to complex economic matters, which are often at the heart of merger control

---

246 *See Best Practices, supra* note 23, at 9-10 (discussing the need for government decisions to be reviewed by an independent tribunal and distinguishing between findings of fact, that should receive deference, and intertwined questions of fact and law, such as the drawing of inferences, that "implicate important economic and/or competition policy aspects" that should be reviewed); *see also* Douglas Ginsburg & Joshua Wright, *Philadelphia National Bank: Bad Economics, Bad Law, Good Riddance*, 80 ANTITRUST L.J. 377, 386-87 & nn.45-46, 388 n.57 (2015) (explaining that because "market definition is a question of fact," reviewing courts apply a highly deferential standard of review that, in the case of fact-finding by the FTC, is equivalent to the "substantial evidence" standard for reviewing agency determinations).

247 *See* Regulations on Open Government Information of the People's Republic of China (promulgated by the State Council, Jan. 17, 2007, effective May 1, 2008), arts. 6, 9, 13, 21, 23, *translated in Regulations on Open Government Information of the People's Republic of China*, CONGRESSIONAL-EXECUTIVE COMMISSION ON CHINA, http://www.cecc.gov/resources/legal-provisions/regulations-of-the-peoples-republic-of-china-on-open-government (last visited Mar. 26, 2016); *see also* Ning et al., *The Dual System, supra* note 54 (discussing Article 77 of Some Provisions of the Supreme People's Court on Evidence in Civil Procedures).

248 *See* Council Directive 2014/104/EU, arts. 3-6, 9, 11, 2014 O.J. (L 349) 1-3; *Relationship between Public and Private Enforcement*, *supra* note 245, at 3-4, 6-7, 8-10; *see also Clayworth*, 233 P.2d at 1070 (discussing the goals of state antitrust law in price-fixing cases as "maximizing effective deterrence of antitrust violations, enforcing the state's antitrust laws against those violations that do occur, and ensuring disgorgement of any ill-gotten proceeds"); *id.* at 1083 (discussing the need to select a damages rule that is "most consistent" with the "focus" on the importance of private litigation as a means of ensuring the enforcement of the antitrust law and deterring would-be violators even if such a rule results in "overcompensation").

249 Council Directive 2014/104/EU, art. 11, 2014 O.J. (L. 349) 33.

250 *Id.* art. 34, at 6.

251 *See, e.g.*, JUDICIAL ENFORCEMENT OF COMPETITION LAW*, supra* note 13, at 19.

decisions."[252] Moreover, these courts cannot engage in the *de novo* review of facts found by the Commission;[253] rather (on the factual side) the courts ensure that relevant procedural rules are complied with, that the statement of reasons for the decision are adequate, that the facts have been accurately stated, and that there has not been any "manifest" error or "misuse of powers." [254]

At first blush, it may appear that this standard is no standard at all. Nonetheless, the General Court (the court of first instance for antitrust cases) has been able to exercise meaningful review, annulling the following merger decisions: *Airtours/First Choice* (2002) (Commission decision was impermissibly based on "assertions," without "cogent evidence," that the merger would lead to collective dominance. Commission was required to follow legal test set out by General Court); *Schneider/Legrand* (2002) (Commission committed "substantive 'errors, omissions, and inconsistencies of undoubted gravity,'" using transactional data without doing a country-by-country analysis of markets outside of France and shifting its theory as to competitive effects within France without giving the defendants an opportunity to address that theory); and *Tetra Laval/Sidel* (2002) (Commission reached conclusion of "anticompetitive conglomerate effects" without conducting a "precise examination" supported by "'convincing evidence' that the transaction would in all likelihood create or strengthen a dominant position," thus creating "a 'manifest error of assessment'").[255] Regarding *Tetra Laval/Sidel*, the Commission appealed the General Court's decision to the Court of Justice (the European Union equivalent of the Supreme People's Court), claiming that the General Court disregarded the margin of discretion accorded to the Commission and exceeded its powers of review by substituting its own view of the facts for that of the Commission and by requiring a disproportionate standard of proof.[256] The Court of Justice rejected the Commission's arguments, particularly finding that the General Court had to review all of the evidence (even that of an economic nature) in determining whether the evidence relied on is "factually accurate, reliable, and consistent," whether the evidence "contains all of the information necessary to assess a complex situation," and whether the evidence "is capable of substantiating the conclusions drawn from it."[257]

The exercise of this review of Commission decisions by the courts in turn encouraged the Commission to take steps to ensure that its decisions are of the highest caliber in balancing economic thinking with concerns for the development of administrable rules.[258] The Commission handed down new merger guidelines that brought more analytical rigor to the theories of competitive harm by, for example, identifying more clearly the types of evidence relevant to different kinds of competitive harm, the hiring of a Chief Economist with a team of economists as a recognition of the need to place greater emphasis on detailed quantitative and economic evidence, the formation of industrial sectorial units to better understand conditions

---

252 Mark Leddy et al., *Transatlantic Merger Control: The Courts and the Agencies*, 43 CORNELL INT'L L.J. 25, 28 (2010) (internal citations and footnotes omitted).

253 *Id.* (internal citations and footnotes omitted).

254 *Id.* (internal citations and footnotes omitted).

255 *Id.* at 28, 30-33 (internal citations and footnotes omitted).

256 *Id.* at 33-34.

257 *Id.* at 34 (internal citations and footnotes omitted).

258 *See id.* at 41-45.

in specific markets, an extended timetable for investigations, and the formation of peer review panels (experienced officials from across DG-COMP—the antitrust authority of the European Union) to perform an effective internal check on investigators' preliminary theories.[259] As a result, "[m]ost observers believe that the Commission now grounds its decisions more firmly in facts and economics, a positive development for European merger control."[260]

The *2014 QQ Decision*'s thoroughness and quality of reasoning suggests that Chinese courts could play a similar role to their counterparts in Europe in reviewing decisions of government antitrust enforcers. This would set up a sort of virtuous feed-back loop in which court review of those decisions not only would foster a sense of compliance with the rule of law but also would result in government decisions that private litigants would be encouraged to use in bringing their own antitrust cases in court.[261]

VII. CONCLUSION

That the rule of law has been important to the effective functioning of a state and its market economy by promoting certainty and fairness is no accident. The original development of the rule of law accompanied the rapid administrative and economic development of a range of countries in Europe, including Prussia (later Germany), England, and France.[262] Even for fully developed countries in the economic first-rank, the rule of law requires ongoing nurturing, including in the field of antitrust.[263] In this sense, comparing cases such as the *2014 QQ Decision* and *In re Cipro* begin to inform us as to how the rule of law may be implemented world-wide in the field of antitrust in the 21st century.[264]

Moreover, as the second largest economy in terms of nominal gross domestic product with massive global reach,[265] China's ability to foster a strong civil and administrative court system through rule of law becomes particularly important,[266] not just for its own continuing

259 *Id.* at 42-43.

260 *Id.* at 50 (internal citations and footnotes omitted).

261 Except for decisions on mergers, China's Anti-Monopoly Law allows a party either to file an application for administrative reconsideration or to initiate an administrative lawsuit. Anti-Monopoly Law of the People's Republic of China (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug, 30, 2007, effective Aug. 1, 2008), art. 53. For decisions on mergers, a party must first file an application for administrative reconsideration before being able to initiate an administrative lawsuit. *Id.*

262 *See* Francis Fukuyama, Political Order and Political Decay: From the Industrial Revolution to the Globalization of Democracy loc. 49-52, 57, 180 (2014) (ebook).

263 *See, e.g.*, *Empowering the National Competition Authorities to be More Effective Enforcers*, European Commission (Nov. 4, 2015), http://ec.europa.eu/competition/consultations/2015_effective_enforcers/index_en.html (survey by European Commission as to whether the Member States of the European Union have the tools necessary to enforce European Community antitrust law); *see also supra* Part VI.A (discussion of the *In re Cipro* decision in California).

264 *See, e.g.*, Breyer, *supra* note 8, at loc. 5767, 5812, 5821, 5827.

265 *See, e.g.*, Lewis, *supra* note 5, at 373-74.

266 *See, e.g.*, *id.* at 376 (noting that China could rely on a strategy of using criminal law as an "alternate mechanism" to civil and administrative law but that such a mechanism was "incomplete and imperfect").

attempts at growth and reform,[267] but also for the rest of the world. China has recognized the importance of the rule of law to further reform and growth by setting 2020 as a target date for the implementation of the rule of law.[268] And in that sense antitrust law is the canary in the coal-mine, not just because it requires rule of law in the sense discussed in this Article,[269] but also because a well-functioning antitrust system of law is an important harbinger of market reform, equal market access for domestic and foreign firms, and economic growth.[270]

The *2014 QQ Decision* is an important sign of China's march to the rule of law in the development of a professional judiciary that can fairly assess evidence, competently apply economic principles as well as the law, and develop administrable rules in cases with precedential value. In the end, whether the *2014 QQ Decision* impacts the rule of law will depend on whether China hits certain signposts flowing from that decision. Nonetheless, this decision ultimately will prove in the end to be important, both in and of itself and as a catalyst, such that symposiums will be held 10 years in the future as to the decision's enormous impact on Chinese antitrust law and the rule of law in China.

---

267 *See, e.g.*, *id.* at 374 (discussing concerns that China's economy is slowing); *id.* at 448 (talking about not only how China's proactive reforms in the past have been the key to its success but also how the calls for reform in China still continue).

268 *See, e.g.*, *President Xi Stresses More Reform, Rule of Law in New Year Address*, XINHUA (Dec. 31, 2014), http://news.xinhuanet.com/english/china/2014-12/31/c_133890353.htm.

269 *See e.g.*, JUDICIAL ENFORCEMENT OF COMPETITION LAW, *supra* note 13, at 10.

270 *See, e.g.*, Trans-Pacific Partnership Agreement ch. 16, Austl.-Brunei-Can.-Chile-Japan-Malay-Mex.-N.Z.-Peru-Sing.-U.S.-Viet., Feb. 4, 2016, U.S. Trade Representative, https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text (2016) (as part of comprehensive trade treaty to reduce trade barriers, provide reciprocal market access, and harmonize laws, signatories are required to adopt or maintain competition laws, follow rule of law procedural fairness requirements, and provide for an independent right of private action for violation of a country's competition laws); Toshiaki Takigawa, *The Prospect of Antitrust Law and Policy in the Twenty-First Century in Reference to the Japanese Antimonopoly Law and Japan Fair Trade Commission*, 1 WASH. U. GLOBAL STUD. L. REV. 275, 276-77, 285-86 (2002) (due to the Structural Impediments Initiative negotiations between the U.S. and Japan, Japan strengthened its Antimonopoly Law and the Japanese Fair Trade Commission); Mitsuo Matsushita, *The Structural Impediments Initiative: An Example of Bilateral Trade Negotiation*, 12 MICH. J. INTL. LAW 436, 436-37, 443 (1991) (joint report of the Structural Impediments Initiative recommended, among other things, establishment of more formal procedures for enforcement of Japanese Antimonopoly Law, transparency in the enforcement process, more effective criminal prosecutions of cartels and bid rigging, and the establishment of a program to facilitate private damage suits by plaintiffs—all to facilitate market access and equal opportunity).

ROYAL PRINTING AND THE FTAIA

By Robert E. Freitas[1]

In *Royal Printing Company v. Kimberly-Clark Corporation,*[2] the Ninth Circuit created an exception to the *Illinois Brick*[3] direct purchaser rule that grants an indirect purchaser standing to sue participants in a price fixing conspiracy "when the direct purchaser is a subsidiary or division of a co-conspirator."[4] The Ninth Circuit now applies the *Royal Printing* exception "when a conspiring seller owns or controls the direct purchaser."[5] The Supreme Court has not approved or adopted the *Royal Printing* "owned or controlled" exception.

In addition to creating a new *Illinois Brick* exception, the *Royal Printing* court established a "full overcharge" rule that allows an indirect purchaser plaintiff to recover the full amount of the price fixing overcharge paid by its direct purchaser supplier. There is no requirement that the plaintiff prove that the overcharge was fully or partially passed on to the indirect purchaser. Further, the defendant is not allowed to defend with evidence that the overcharge was absorbed by the direct purchaser, or to reduce the amount of the plaintiff's recovery by proving that pass on of the overcharge was not complete. The *Royal Printing* court concluded that "[d]etermining what portion of the illegal overcharge was 'passed on' . . . and what part was absorbed by the middlemen would involve all the evidentiary and economic complexities that *Illinois Brick* clearly forbade."[6]

The *Royal Printing* full overcharge rule is not compelled by *Illinois Brick*, or by *Hanover Shoe,*[7] the case from which the limitation on the use of evidence of pass on in antitrust cases is derived. *Hanover Shoe* and *Illinois Brick* are based on an interpretation of Section 4 of the Clayton Act[8] making the direct purchaser the only party that is "injured in [its] business or property" within the meaning of Section 4 by the payment of an illegal overcharge. In both *Hanover Shoe* and *Illinois Brick,* the Supreme Court expressed concern about "evidentiary and economic complexities" associated with proof of pass on, but the basis for the Court's decisions was the determination that the direct purchaser is the injured party under Section 4. *Illinois Brick* did not simply "forbid" evidence of pass on based on "evidentiary and economic complexities." The *Royal Printing* full

---

1 Partner at Freitas Angell & Weinberg LLP (Redwood Shores, California). 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 or its clients.

2 621 F.2d 323 (9th Cir. 1980).

3 Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

4 621 F.2d at 326. The court recognized that "[i]f the plaintiff purchased a defendant's goods through the defendant's own wholesaling division, the plaintiff would qualify as a 'direct purchaser' from the corporate defendant and could sue for the entire amount of the overcharge, trebled." *Id.* at 326 n.6. *See* Motorola Mobility LLC v. AU Optronics Corp., 775 F.3d 816, 822 (9th Cir. 2015) ("In other words, Motorola is pretending that its foreign subsidiaries are divisions rather than subsidiaries. But Motorola can't just ignore its corporate structure whenever it's in its interests to do so.").

5 *In re* ATM Fee Antitrust Litig., 686 F.3d 741, 749 (9th Cir. 2012).

6 621 F.2d at 327.

7 Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968).

8 15 U.S.C. § 15.

overcharge rule—which allows indirect purchaser recovery without proof of injury—is a questionable application of *Illinois Brick,* and is arguably inconsistent with the *Hanover Shoe* interpretation of Section 4.

Regardless of how the full overcharge rule ultimately fares under Section 4, *Hanover Shoe,* and *Illinois Brick,* the requirements of the Foreign Trade Antitrust Improvements Act ("FTAIA")[9] present additional issues. Under the FTAIA, foreign anticompetitive conduct is not subject to the Sherman Act unless it "involves" import trade or commerce, or produces an effect on import or domestic commerce that is "direct, substantial, and reasonably foreseeable."[10] Without proof that a price fixing overcharge, or other anticompetitive harm, was passed on by the owned or controlled direct purchaser to the plaintiff, no "effect" on import or domestic commerce can be established. Nothing in *Hanover Shoe* or *Illinois Brick* allows a complexity-based disregard of the requirements of the FTAIA effects exception.

In *United States v. Hsiung,*[11] a criminal price fixing case involving TFT-LCD panels, the Ninth Circuit treated proof of pass on as a routine way to satisfy the effects exception. There is no reason why a similar approach should not be taken in civil cases. *Royal Printing*, a pre-FTAIA court of appeals decision, cannot justify a lessening of the proof requirements established by the FTAIA.

HANOVER SHOE AND THE ORIGINS OF THE DIRECT PURCHASER RULE

The direct purchaser rule has roots going back to *Hanover Shoe,* in which the Supreme Court barred the defensive use of pass on. As a matter of interpretation of Section 4 of the Clayton Act, the *Hanover Shoe* Court determined that the direct purchaser is the party "injured in [its] business or property" by the payment of an illegal overcharge,[12] and held that a defendant may not negate the plaintiff's proof of injury with evidence that the overcharge was passed on to the plaintiff's customers.[13] In *Illinois Brick*, the Supreme Court upheld the *Hanover Shoe* interpretation of Section 4, and refused to allow a plaintiff to demonstrate injury by proving that its direct-purchaser supplier passed on an overcharge.[14]

Illinois Brick also addressed an "owned or controlled" paradigm different from the one at issue in *Royal Printing.* In *Hanover Shoe*, the Supreme Court had "indicated the narrow scope it intended for any exception to its rule barring pass-on defenses" by mentioning only "a pre-existing cost-plus contract" as a possible justification for an exception.[15]

---

9 15 U.S.C. § 6a.

10 *Id*. See generally F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 161–62 (2004). Application of the effects exception can be based on an effect on domestic or import commerce. *See* 15 U.S.C. § 6a(1)(A). Under some circumstances, an effect on export commerce can also be sufficient. *See* 15 U.S.C. § 6a(1)(A). When an effect on export commerce is in issue, the final sentence of 15 U.S.C. § 6a limits the application of the effects exception to "injury to export business in the United States." This article primarily considers attempts to satisfy the FTAIA with proof of an effect on domestic commerce.

11 778 F.3d 738, 754 (9th Cir. 2015).

12 *Hanover Shoe*, 392 U.S. at 488-91.

13 *Id*. at 491-94. *See Illinois Brick*, 431 U.S. at 724–25.

14 *Illinois Brick*, 431 U.S. at 728–29.

15 *Id*. at 735-36.

When a direct purchaser resells price-fixed goods pursuant to a cost-plus contract, "[t]he effect of the overcharge is essentially determined in advance, without reference to the interaction of supply and demand that complicates the determination in the general case."[16] The *Illinois Brick* Court stated that "[a]nother situation in which market forces have been superseded and the pass-on defense might be permitted is where the direct purchaser is owned or controlled by its customer."[17]

THE *ROYAL PRINTING* EXCEPTION TO THE DIRECT PURCHASER RULE

The *Royal Printing* court did not rely on the idea that market forces are superseded when a "division or subsidiary" of a conspirator sells price-fixed goods to its customer, although it acknowledged the supersession of market forces as the basis for the potential "owned or controlled" exception mentioned in *Illinois Brick*.[18] Nor did the court suggest a parallel supersession of market forces that is relevant when a conspirator owns or controls the direct purchaser and a customer of the direct purchaser is a price fixing plaintiff. The court explicitly recognized that "the pricing decisions of such a subsidiary or division" might be "determined by market forces."[19] Indeed, the court concluded that "[a]lthough the wholesalers here are owned or controlled by appellees, the wholesalers' pricing decisions are determined by market forces."[20] The court therefore acknowledged that the idea behind the potential "owned or controlled" exception discussed in *Illinois Brick* was not applicable.

Royal Printing is based on an entirely different line of reasoning, that it is necessary to recognize a "subsidiary" or "owned or controlled" exception, lest private antitrust enforcement be unavailable when conspirators sell price-fixed goods through intermediaries. The court began its analysis with the idea that "[t]he threat of private treble-damages suits is vital to the enforcement of the antitrust laws," and stated that "[i]t was the purpose of *Hanover Shoe* and *Illinois Brick* to increase the effectiveness and deterrent power of such suits."[21] The court then observed that private enforcement was limited to direct purchasers "because of the twin rationales of danger of multiple liability and complexity of proof."[22] Finding neither a danger of multiple liability nor a complexity problem, the court created a new exception, holding "that *Illinois Brick* does not bar an indirect purchaser's suit where the direct purchaser is a division or subsidiary of a co-conspirator."[23]

Relying on the idea that the litigation decisions of subsidiaries "will usually be subject to parental control," the court concluded that a participant in a price fixing conspiracy has

---

16 *Id*. at 736. *See* California v. ARC Am. Corp., 490 U.S. 93, 97 n.2 (1989) ("The Court noted two possible exceptions: when the direct purchaser and the indirect purchaser have entered into pre-existing cost-plus contracts, and when the direct purchaser is owned or controlled by the indirect purchaser.") (citations omitted).

17 *Illinois Brick*, 431 U.S. at 736 n.16.

18 *Royal Printing*, 621 F.2d at 326 n.4.

19 *Id*. at 326.

20 *Id*. at 326 n.4.

21 *Id*. at 325–26.

22 *Id*. at 326.

23 *Id*.

"little reason . . . to fear a direct purchaser's suit when the direct purchaser is a subsidiary or division of a co-conspirator."[24] "The co-conspirator parent will forbid its subsidiary or division to bring a lawsuit that would only reveal the parent's own participation in the conspiracy," and the risk of multiple liability discussed in *Illinois Brick is therefore absent*.[25]

THE *ROYAL PRINTING* "FULL OVERCHARGE" RULE

The Ninth Circuit eliminated complexity concerns by the adoption of a rule that allows an indirect purchaser plaintiff to recover the "full overcharge" paid by the direct purchaser. "Determining what portion of the illegal overcharge was 'passed on' to Royal Printing and what part was absorbed by the middlemen would involve all the evidentiary and economic complexities that *Illinois Brick* clearly forbade."[26] The court understood that allowing Royal Printing to recover the full overcharge, despite the likelihood that the direct purchaser absorbed at least a part of the overcharge, created a risk of a windfall recovery, trebled.[27] The court considered this windfall "no more than was approved in *Hanover Shoe*, where the plaintiff was allowed to recover its 'full' damages even though it had 'mitigated' its damages by passing part of the excessive costs on to its customers."[28]

Because "[n]either of the rationales (multiple liability and complexity) underlying *Illinois Brick*"[29] was seen to apply, the court created its new exception, not based on an interpretation of Section 4, and allowed indirect purchasers to recover the full amount of the overcharge without proving that they were harmed in any amount. The Ninth Circuit took this step although, unlike in *Hanover Shoe* and *Illinois Brick,* the party whose standing was recognized had not necessarily been injured within the meaning of Section 4. The court did not address the *Hanover Shoe* interpretation of Section 4, which made the direct purchaser an injured party because it paid an overcharge, or offer an alternative theory by which it could be said, without proof of pass on, that Royal Printing was "injured in [its] business or property."

---

24 *Id*.

25 *Id*.

26 *Id*. at 327.

27 *Id*.

28 *Id*. As explained below, the situation presented in *Royal Printing* is different from that of *Hanover Shoe*, and the reasoning employed by the *Hanover Shoe* Court would not support the new claim established in *Royal Printing*. *Hanover Shoe* held a direct purchaser's payment of a price fixing overcharge to be Section 4 injury. The Supreme Court allowed full recovery of the overcharge by the direct purchaser, notwithstanding the possibility that all or part of the overcharge was passed on. An indirect purchaser seeking to recover price fixing damages cannot establish injury without proof of pass on.

29 *Id*.

THE *UTILICORP* APPROACH TO EXCEPTIONS TO *ILLINOIS BRICK*

The *Royal Printing* court was concerned that the strict application of *Illinois Brick* would eliminate private enforcement in situations in which price fixed goods are sold through intermediaries and, perhaps, by the thought that a price fixer could actively evade liability by structuring its business so that the only direct purchasers of price-fixed goods would be owned or controlled affiliates. The Supreme Court took a different approach in *Kansas v. Utilicorp United Inc.*[30] As the Court explained, "ample justification exists for our stated decision not to 'carve out exceptions to the [direct purchaser] rule for particular types of markets.'"[31] The Supreme Court concluded that, "even in rather meritorious circumstances," allowing exceptions "would undermine the rule."[32]

In *Utilicorp,* the Supreme Court frankly acknowledged that its "decisions in *Hanover Shoe* and *Illinois Brick* often deny relief to consumers who have paid inflated prices because of their status as indirect purchasers."[33] The Court nonetheless affirmed both the interpretation of Section 4 underlying the direct purchaser rule and declined to approve a process of case-by-case evaluation of the efficacy or appropriateness of the rule. As the Ninth Circuit later observed in *Delaware Valley Surgical Supply v. Johnson & Johnson,*[34] "[t]he Court refused to create an exception to the *Illinois Brick* rule, even where its previous concerns 'about the difficulties of apportionment, the risk of multiple recovery, and the diminution of incentives for private antitrust enforcement' would 'not apply with equal force.'"[35]

In *Delaware Valley Surgical Supply,* the Ninth Circuit concluded that that the "firm rule" of *Illinois Brick* "does not provide us the leeway to make a policy determination on a case-by-case basis as to whether standing should be recognized when there are special business arrangements."[36]

ROYAL PRINTING AND THE *HANOVER SHOE* INTERPRETATION OF SECTION 4

The Ninth Circuit's assumption that current subsidiaries are not likely to sue their parents or their parents' conspirators seems generally sound, but the court's recognition of indirect purchaser standing is not consistent with the foundation of the direct purchaser rule. *Hanover Shoe* held that only the direct purchaser is "injured in [its] business or property" within the meaning of Section 4. "We think it sound to hold that when a buyer shows that the price paid by him for materials purchased for use in his business is illegally high and also shows the amount of the overcharge, he has made out a prima facie case of

---

30 497 U.S. 199 (1990).

31 *Id*. at 216 (quoting *Illinois Brick*, 431 U.S. at 744).

32 *Id*.

33 *Id*. at 211-12.

34 523 F.3d 1116 (9th Cir. 2008).

35 *Id*. at 1121 (quoting *Utilicorp*, 497 U.S. at 208).

36 *Id*. at 1124.

injury and damage within the meaning of *§4.*"[37] Under the *Hanover Shoe* interpretation of Section 4 followed in *Illinois Brick*, when a plaintiff proves that it has paid an overcharge, injury and damage within the meaning of Section 4—and thus standing to sue—are established. It is a significant step from simple application of *Hanover Shoe* and *Illinois Brick* to a standing rule that dispenses with proof that the plaintiff paid an illegal overcharge.

If an overcharge paid by the direct purchaser is not passed on, an indirect purchaser allowed to recover the full overcharge under *Royal Printing* has not been injured at all, factually or as a matter of the application of the *Hanover Shoe* interpretation of Section 4. An indirect purchaser is also not injured in fact in the full amount of the overcharge paid by its supplier if pass on is not complete. *Illinois Brick* precludes the use of pass on to prove that an indirect purchaser plaintiff was harmed; *Royal Printing* provides the indirect purchaser a claim without proof that it was harmed.

The Ninth Circuit's assertion that *Illinois Brick* "forbade" the "evidentiary and economic complexities" involved in proof of pass on[38] does not capture the entire picture. A foundation for *Illinois Brick* is the conclusion in *Hanover Shoe* that only the direct purchaser is injured within the meaning of Section 4. In both *Hanover Shoe,* where a pass on defense to a direct purchaser's claim was not allowed, and *Illinois Brick,* in which an indirect purchaser was not allowed to create a claim by proving pass on, a predicate is that the direct purchaser paid an overcharge and suffered harm within the meaning of Section 4. *The Royal Printing* full overcharge rule produces a different result, allowing a party not injured in the sense recognized in *Hanover Shoe* and *Illinois Brick*—and perhaps not injured at all—to sue.

The Supreme Court was motivated in *Hanover Shoe* and *Illinois Brick* to adopt and

---

37 *Hanover Shoe*, 392 U.S. at 489. *See Utilicorp*, 497 U.S. at 204 ("we hold that only the utility has the cause of action because it alone has suffered injury within the meaning of § 4"); *id.* at 217 ("Having stated the rule in *Hanover Shoe*, and adhered to it in *Illinois Brick*, we stand by our interpretation of §4."); California v. ARC Am. Corp., 490 U.S. 93, 102-03 (1989) ("As we made clear in Illinois Brick, the issue before the Court in both that case and in *Hanover Shoe* was strictly a question of statutory interpretation – what was the proper construction of § 4 of the Clayton Act."); *id.* at 97 ("The [*Illinois Brick*] Court held that, with limited exceptions, only overcharged direct purchasers, and not subsequent indirect purchasers, were persons 'injured in [their] business or property' within the meaning of § 4, and that therefore the State of Illinois was not entitled to recover under federal law for the portion of the overcharge passed on to it.") (footnote omitted); *Illinois Brick*, 431 U.S. at 724–25 ("The [*Hanover Shoe*] Court held that except in certain limited circumstances, a direct purchaser suing for treble damages under § 4 of the Clayton Act is injured within the meaning of § 4 by the full amount of the overcharge paid by it and that the antitrust defendant is not permitted to introduce evidence that indirect purchasers were in fact injured by the illegal overcharge.") (footnote omitted); *id.* at 729 ("[W]e decline to abandon the construction given § 4 in *Hanover Shoe* that the overcharged direct purchaser, and not others in the chain of manufacture or distribution, is the party 'injured in his business or property' within the meaning of the section in the absence of a convincing demonstration that the Court was wrong in *Hanover Shoe* to think that the effectiveness of the antitrust treble-damages action would be substantially reduced by adopting a rule that any party in the chain may sue to recover the fraction of the overcharge allegedly absorbed by it."); Chattanooga Foundry & Pipe Works v. City of Atlanta, 203 U.S. 390, 396 (1906) ("A person whose property is diminished by a payment of money wrongfully induced is injured in his property."); *In re* ATM Fee Antitrust Litig., 686 F.3d 741, 748 (9th Cir. 2012) ("This rule (the *Illinois Brick* rule), that indirect purchasers suffer no injury under § 4, was reaffirmed in *Kansas v. Utilicorp United, Inc.*, 497 U.S. 199, 207(1990)."); *Delaware Valley Surgical Supply*, 523 F.3d at 1123–24.

38 *Royal Printing*, 621 F.2d at 327.

enforce the direct purchaser rule by the complexity considerations mentioned in *Royal Printing*, but the reasoning employed by the Supreme Court in *Hanover Sho*e and *Illinois Brick* does not necessarily call for a rule forbidding reliance on pass on in all circumstances. The Ninth Circuit's adoption of a rule allowing a party other than the party held to be injured in *Hanover Shoe* to sue should not have been seen as a simple matter of following the *Illinois Brick* teaching on the problems associated with proof of pass on.

THE FULL OVERCHARGE RULE AND THE FTAIA

This article is not, however, directed to the question of whether the *Royal Printing* full overcharge rule is ultimately justified by *Illinois Brick*, or to consideration of whether the Ninth Circuit's creation of a new exception to *Illinois Brick* in *Royal Printing* is consistent with the approach to exceptions to the direct purchaser rule taken by the Supreme Court in *Hanover Shoe*, *Illinois Brick*, and *Utilicorp*. Instead, the article looks at the *Royal Printing* full overcharge rule through the lens of the FTAIA. Under the FTAIA, the Sherman Act does not apply to foreign price fixing and other anticompetitive conduct taking place outside of the United States, and not "involving" import trade or commerce, unless the conduct has a "direct, substantial, and reasonably foreseeable" effect on domestic commerce (or import or export commerce).[39]

Hanover Shoe and *Illinois Brick* construe the injury requirement of Section 4 in a manner that makes consideration of pass on unnecessary (where a direct purchaser sues) or unavailing (where an indirect purchaser is the claimant). A different context is presented when the FTAIA "effects" exception is at issue. The Section 4 "injury" requirement remains, and an additional demand is placed on the plaintiff. It must prove injury, and it also must prove that its claim "arises out of" an effect on domestic commerce that is "direct, substantial, and reasonably foreseeable." In a price fixing case based on foreign conduct, with a foreign direct purchaser, proof of pass on is essential to proof of a direct effect, or any effect, on domestic commerce. There is no domestic "effect" when an overcharge paid by a foreign direct purchaser is fully absorbed by the direct purchaser.

The pre-FTAIA *Royal Printing* full overcharge rule allows a plaintiff to avoid proof of pass on. Thus, in a case in which a domestic indirect purchaser makes a claim based on foreign price fixing followed by a foreign direct purchase, the plaintiff avoids proof of a domestic effect. Is the *Royal Printing* full overcharge rule consistent with the FTAIA? Existing case law does not answer this critical question. In *United States v. Hsiung*,[40] however, the Ninth Circuit approved a methodology for proving a domestic effect that is dependent on proof that a price fixing overcharge was passed on by the direct purchaser. *Hsiung* helps explain why the *Royal Printing* full overcharge rule must yield to the FTAIA's specific statutory requirement of proof of a direct effect on domestic commerce.

---

39 *See generally Empagran*, 542 U.S. at 161–62.

40 778 F.3d 738, 754 (9th Cir. 2015).

FTAIA Basics

The FTAIA reads:

Sections 1 to 7 of this title shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless—

(1) such conduct has a direct, substantial, and reasonably foreseeable effect—

(A) on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations; or
(B) on export trade or export commerce with foreign nations, of a person engaged in such trade or commerce in the United States; and

(2) such effect gives rise to a claim under the provisions of sections 1 to 7 of this title, other than this section.

If sections 1 to 7 of this title apply to such conduct only because of the operation of paragraph (1)(B), then sections 1 to 7 of this title shall apply to such conduct only for injury to export business in the United States.

As the Supreme Court has explained, the "technical language [of the FTAIA] initially lays down a general rule placing *all* (nonimport) activity involving foreign commerce outside the Sherman Act's reach."[41] The reference to "nonimport" activity is necessary because of the "import commerce exclusion" contained in the parenthetical in the preamble of the statute. Conduct "involving" import trade or commerce falls within the exclusion, and thus outside the FTAIA.[42] The Sherman Act is fully applicable to foreign conduct when the conduct "involves" import commerce, but the situation is otherwise more complicated.[43]

After initially carving out all foreign conduct, the FTAIA "brings such conduct back within the Sherman Act's reach *provided that* the conduct *both* (1) sufficiently affects American commerce, *i.e.*, it has a 'direct, substantial, and reasonably foreseeable effect' on American domestic, import, or (certain) export commerce, *and* (2) has an effect of a kind that antitrust law considers harmful, *i.e.*, the 'effect' must 'giv[e] rise to a [Sherman Act] claim.'"[44]

---

41 *Empagran*, 542 U.S. at 142. *See id.* at 163 ("the FTAIA's general rule applies where the anticompetitive conduct at issue is foreign").

42 *See Hsiung*, 778 F.3d at 754 ("Under its plain terms, the FTAIA does not affect import trade."); Minn-Chem, Inc. v. Agrium Inc., 683 F.3d 845, 855 (7th Cir. 2012) (*en banc*) ("The FTAIA does not require any special showing in order to bring [import] transactions back into the Sherman Act, as *Empagran* put it, because they were never removed from the statute.").

43 *See Hsiung*, 778 F.3d at 754 ("[I]mport trade, as referenced in the parenthetical statement, does not fall within the FTAIA at all. It falls within the Sherman Act without further clarification or pleading."). The scope of the import commerce exclusion is not entirely settled. *See* Animal *Science Prods., Inc. v. China Minmetals Corp.*, 654 F.3d 462, 470 (3d Cir. 2011) (anticompetitive conduct "directed at an import market") (citing *Turicentro, S.S. v. Am. Airlines,* 303 F.3d 293, 303 (3d Cir. 2002)); *Hsiung*, 778 F.3d at 755 n.8 ("We need not determine the outer boundaries of import trade by considering whether commerce directed at, but not consummated within, an import market is also outside the scope of the FTAIA's import provisions because at least a portion of the transactions here involves the heartland situation of the direct importation of foreign goods into the United States.").

44 *Empagran*, 542 U.S. at 162. The effect must give rise to the plaintiff's claim, rather than generically to "a" claim. *Id.* at 174.

IDENTIFYING "DIRECT" EFFECTS

The courts of appeals are divided on the test to be applied under the FTAIA in the determination of whether an effect is "direct." The Ninth Circuit considers an effect "direct" if it "follows as an immediate consequence of the defendant's activity."[45] The Seventh Circuit, joined by the Second Circuit, applies a "reasonably proximate causal nexus" test.[46] Under either standard, proof in a price fixing case of a "direct" effect may consist of evidence that an overcharge paid by the direct purchaser of a price-fixed commodity was passed on to the direct purchaser's customers.

Royal Printing is commonly cited to support claims by domestic purchasers of finished products containing components that were the subject of foreign price fixing. When the direct purchasers of the price-fixed components are affiliates of conspirators, the finished product purchasers rely on the *Royal Printing* "owned or controlled" exception to expand the scope of their potential recovery.[47]

Royal Printing was not a component case, and component cases differ from resale cases in a manner that may distinguish them for purposes of the *Royal Printing* full overcharge rule. Finished product buyers nonetheless rely on *Royal Printing* to dispense with a need for proof of "upstream" pass on of the component overcharge, and situations that, as *Hsiung* did, involve components are addressed here. Regardless of whether a finished product sale or the resale of a price-fixed commodity is in issue, more than reliance on the *Royal Printing* full overcharge rule is required under the FTAIA.

PASS ON UNDER *HSIUNG*

As the *Hsiung* court explained, "the FTAIA is . . . a component of the merits of a Sherman Act claim involving nonimport trade or commerce with foreign nations."[48] "[I]f the government proceeds on a domestic effects theory, . . . the government must plead and prove the requirements for the domestic effects exception to the FTAIA, namely that the defendants' conduct had 'a direct, substantial, and reasonably foreseeable effect" on United States commerce."[49] A civil plaintiff must satisfy the same requirements to establish the FTAIA-related elements of its Sherman Act claim.

In a component price fixing case, the idea is that the "direct effect" on the domestic finished product buyer is an increase in the price of the finished product that is attributable

---

45 United States v. LSL Biotechnologies, 379 F.3d 672, 680 (9th Cir. 2004) (citing Republic of Argentina v. Weltover, Inc., 504 U.S. 607, 618 (1992)).

46 *Minn-Chem*, 683 F.3d at 857; Lotes Co. v. Hon Hai Precision Ind. Co., 753 F.3d 395, 398 (2d Cir. 2014).

47 Finished product purchases from affiliates of component price fixers are sometimes called "direct" purchases from the conspirators, but this is a misnomer. "*Royal Printing* merely permits suit under federal law by *indirect* purchasers notwithstanding *Illinois Brick*; it does not somehow transform indirect purchasers into direct purchasers." *In re* Optical Disk Drive Antitrust Litig., No. 3:10-md-2143, 2011 WL 3894376 *6 (N.D. Cal. Aug. 3, 2011).

48 *Hsiung*, 778 F.3d at 751. *See id.* at 753 ("The FTAIA . . . provides substantive elements under the Sherman Act in cases involving nonimport trade with foreign nations.") *See also Minn-Chem*, 683 F.3d at 852 ("the FTAIA sets forth an element of an antitrust claim, not a jurisdictional limit on the power of the federal courts"); *Lotes*, 753 F.3d at 395; *Animal Science Prods.*, 654 F.3d at 462.

49 *Hsiung*, 778 F.3d at 756.

to price fixing at the component level. An effect of this type is possible only if a price fixing overcharge paid by the finished product manufacturer is passed on when the finished products are sold. *Hsiung* provides an illustration.

In *Hsiung,* the indictment alleged that "'the substantial terms' of the conspiracy were an agreement 'to fix the prices of TFT-LCDs for use in notebook computers, desktop monitors, and televisions in the United States and elsewhere.'"[50] The "evidence under the domestic effects exception . . . was directed at foreign sales of panels that were incorporated into finished consumer products ultimately sold in the United States."[51] The indictment did not allege finished product price fixing. In its simplest sense, the evidence was directed to proof that "if the panel price goes up, then it will directly impact the monitor set price."[52] The court said "the practical upshot of the conspiracy would be and was increased prices to customers in the United States."[53] In summary, the court pointed to "the integrated, close and direct connection between the purchase of the price-fixed panels, the United States as the destination for the products, and the ultimate inflation of prices in finished products imported to the United States."[54]

Most of what the court said in its effects discussion explicitly refers to the pass on of a price fixing overcharge. The suggestion from the court's comments is that the trial evidence established that the overcharges resulting from the overseas fixing of the prices of the TFT-LCD panels were passed on by the finished product manufacturers and resulted in higher finished product prices in the United States. There is no indication in *Hsiung* that evidence of pass on is not admissible to show higher domestic prices attributable to the foreign price fixing, and no suggestion of another way to establish the existence of a "direct" effect on domestic commerce under the FTAIA. *Hsiung* recognizes proof of pass on as an acceptable way to satisfy the effects exception.

Hsiung is a sufficiency of the evidence case on the effects issue, and the opinion does not contain either an explicit proof roadmap, or a detailed discussion of the government's evidence of pass on.[55] While there is no mention of the use of the rigorous econometric analysis that is common in civil cases in which pass on is in issue under state law, there is no reason to believe that formal proof of this type would not be admissible. If the seemingly anecdotal evidence cited in *Hsiung* is sufficient, more detailed evidence must also suffice. The court's focus was on the evidence said to support a conviction,[56] but nothing in *Hsiung* suggests that a defendant could properly be forbidden from attempting to refute the existence of a direct effect with pass on-related evidence. If, as in *Hsiung,* evidence that finished product prices were increased as a result of component price fixing is admissible, evidence that domestic finished product prices were not affected (notwithstanding foreign component price fixing) must also be allowed.

---

50 *Id.* at 757. *See id.* at 757–58 ("the facts in the indictment necessarily supported the domestic effects claim, namely by allegations that AUO and AUOA sold price-fixed panels in the United States and abroad for use in finished consumer goods sold in or delivered to the United States").

51 *Id.* at 758.

52 *Id.* at 759.

53 *Id.*

54 *Id.*

55 *Id.* at 758-60.

56 *See* Jackson v. Virginia, 443 U.S. 307, 319 (1979).

DIRECT EFFECTS AND PASS ON

Evidence of pass on is necessary to establish a domestic effect, regardless of whether the price fixed good is resold or is a component of a finished product. Pass on evidence also has a role in determining whether any proven effect is "direct." The *Hsiung* defendants argued that the foreign conduct in issue was "too attenuated from the United States and that the intervening development, manufacture, and sale" of finished products throughout the world "resulted in a diffuse effect."[57] The Ninth Circuit found the evidence sufficient to support a jury finding that the domestic effect was "direct," even stating that the evidence "leads to one conclusion," but a contrary result is plausible in a given case under the Ninth Circuit "immediate consequence" test.[58]

"A wide range of factors influence a company's pricing policies,"[59] and it is not always a simple task to identify one factor as responsible for changes in a company's prices or pricing practices.[60] The *Hanover Shoe* Court considered it "normal" that "the impact of a single change in the relevant conditions cannot be measured after the fact," and expressed doubt that a seller would be able to say convincingly that a difference in one fact would have produced "a different price."[61] With evidence of pass on essential to the finding of an effect, doubt about whether a price fixing overcharge was passed on—and, if it was, the extent or frequency of pass on—are relevant in the assessment of whether the effect on domestic commerce resulting from pass on is "direct."

Evidence that pass on did not occur is plainly admissible to show the absence of an FTAIA "effect" on domestic commerce. When there is evidence that pass on occurred, but not always completely, the Ninth Circuit's "immediate consequence" standard should also allow the admission of evidence about the process by which pass on occurs and the extent, frequency, and variation of pass on. That pass on is not always complete, or does not always occur, shows that pass on is not an automatic or inevitable result of the underlying price fixing. Thus, the effect on domestic finished product commerce that results from pass on may not be an "immediate consequence" of foreign price fixing. The pricing aspect of the "intervening development, manufacture, and sale" of the price-fixed goods, or finished products in which they are incorporated, may provide evidence that an increase in the resale price of a price-fixed good or the price of a finished product is not the "immediate consequence" or the invariable consequence of the challenged conduct.

THE IMPACT OF THE FTAIA

The idea that intervening processes might negate the existence of a "direct" effect in resale cases, or finished product cases based on component price fixing, is consistent

---

57 *Id.* at 758.

58 In *Best Buy Co. v. HannStar Display Corp.*, Nos. 13-17408, 17618 (9th Cir. Jan. 7, 2016), which involved the TFT-LCD price fixing conspiracy in issue in *Hsiung*, "the jury . . . found that the conspiracy did not involve conduct with a 'direct, substantial and reasonably foreseeable effect on trade or commerce in the United States.'" *Id.* at 4 n.3. *Disclosure:* The author represented one of the defendants in the *Best Buy* trial.

59 *Hanover Shoe*, 392 U.S. at 492.

60 *See id.* at 492-23.

61 *Id.* at 493.

with the backdrop against which the FTAIA was enacted. The context in which the law was written presents little reason to fear an interpretation or application of the "direct" requirement that would more than occasionally bar indirect purchaser claims.

In 1982, when the FTAIA was enacted, *Illinois Brick* had been the law for five years, and *Hanover Shoe* for almost another decade. Given the approach to exceptions taken in both *Hanover Shoe* and *Illinois Brick*, Congress would have expected indirect purchaser claims to be infrequent at best. Congressional alarm at the thought that indirect purchaser claims under the Sherman Act might be severely limited by the requirement of a direct effect is not likely. A Congress that took no steps to eliminate the direct purchaser rule would not have expected indirect purchaser claims to be made in great numbers, and would not have gone out of its way to preserve them. For this reason, it is not necessary to seek to confine the impact of the "direct" requirement so that its impact on indirect purchaser claims is minimized.

There is also no reason to assume that *Royal Printing*, a court of appeals decision not squarely consistent with *Hanover Shoe* and *Illinois Brick*, would have been taken as a settled statement of the law. Even if *Royal Printing* were understood as a guiding statement of the law, it would not have been thought to require a conclusion that the effect of price fixing on indirect purchasers is always "direct," or even that an effect on indirect purchasers always occurs. The *Royal Printing* court found it probable that "market forces. . . . forced the middlemen to absorb part of the overcharge,"[62] and the interaction of those market forces and the internal factors driving direct purchaser pricing decisions can fairly be expected to lead in a given case to an effect that is not "direct." *Hsiung* treated the impact of component price fixing on finished product sales as a jury issue affected by "ambiguity," and the evidence presented in other cases will similarly "raise[] a question regarding whether the effects were sufficiently direct to uphold a verdict based on [a] domestic effects claim."[63]

The cases that established the direct purchaser rule and limited the use of pass on predate the FTAIA, and *Hanover Shoe* and *Illinois Brick* are based on an interpretation of Section 4 that does not preclude or limit the use of evidence of pass on in a case governed by the FTAIA. Because the direct purchaser is considered the party to have been injured within the meaning of Section 4, the offensive and defensive use of pass on cannot be used to prove or refute a claim of Section 4 injury to the direct purchaser's business or property. When the FTAIA effects exception is in issue, however, evidence of pass on has another role not addressed in *Hanover Shoe* or *Illinois Brick*.

As the government did in *Hsiung*, a civil claimant proceeding under the *Royal Printing* owned or controlled exception could offer evidence that a price fixing overcharge was passed on to demonstrate an effect on domestic commerce. (No other technique for proving a direct effect seems possible, and none appears to have been attempted by the government lawyers in *Hsiung*.) A defendant might offer evidence that pass on did not occur for the opposite purpose, or the defendant might present a detailed examination of the process by which pricing or pass on decisions are made to establish that any resulting impact was not an "immediate consequence" of the foreign price fixing in issue, and thus not a "direct" effect.

---

62 *Royal Printing*, 621 F.3d at 327.

63 *Hsiung*, 778 F.3d at 758.

Hanover Shoe and *Illinois Brick* did not consider the appropriateness of, or the necessity for, the presentation of evidence of pass on under the subsequently-enacted FTAIA.

The Supreme Court did, however, express concern about the complexity and difficulty associated with the use of economic evidence in antitrust cases. Much of what the Court said could also be applied to the evidence conventionally and without methodological controversy presented by plaintiffs to establish the existence and extent of an overcharge in price fixing cases. The typical overcharge evidence is just as complex, just as difficult to understand, and just as difficult to apply "in the real economic world rather than an economist's hypothetical model" as evidence of pass on.[64] The *Hanover Shoe* Court's observation that it is "normal" that "the impact of a single change in the relevant conditions cannot be measured after the fact" could be applied to the proof needed to construct the "but for world" and measure the alleged impact of price fixing.[65] Economic evidence of pass on has nonetheless received separate scrutiny in light of *Hanover Shoe* and *Illinois Brick*, and the additional issues that are presented when apportionment of an overcharge among multiple buyers is in issue.

The principal justification for the *Royal Printing* full overcharge rule is the *Illinois Brick* concern with the complexity associated with attention to proof of pass on. This, in turn, was the primary basis for the preclusion of the pass on defense under the Supreme Court's interpretation of Section 4 in *Hanover Shoe:*

> "The principal basis for the decision in *Hanover Shoe* was the Court's perception of the uncertainties and difficulties in analyzing price and out-put decisions 'in the real economic world rather than an economist's hypothetical model,' and of the costs to the judicial system and the efficient enforcement of the antitrust laws of attempting to reconstruct those decisions in the courtroom. This perception that the attempt to trace the complex economic adjustments to a change in the cost of a particular factor of production would greatly complicate and reduce the effectiveness of already protracted treble-damages proceedings applies with no less force to the assertion of pass-on theories by plaintiffs than it does to the assertion by defendants."[66]

Under the FTAIA, however, an indirect purchaser cannot prove a domestic effect from foreign price fixing without evidence of pass on. The complexity concerns that underlay the Supreme Court's unwillingness to construe Section 4 in a manner recognizing injury to any but the direct purchaser cannot be used to justify the exclusion of evidence of pass on under the FTAIA.

It is also worth mentioning that the practical significance of the complexity concerns noted by the Supreme Court has arguably changed in the years since *Hanover Shoe.* In the wake of *Illinois Brick*, many states adopted so-called *Illinois Brick* "repealer" statutes that authorize indirect purchaser claims. These statutes require evidence of "upstream" pass on to establish injury (much as the FTAIA requires proof of pass on to demonstrate a domestic effect) and some allow a "downstream" pass on defense. Thus, managing the complexity associated

---

64 *See Hanover Shoe*, 392 U.S. at 492–93.

65 *See id.* at 493.

66 *Illinois Brick*, 431 U.S. at 731–32 (citations and footnote omitted).

with the type of pass on evidence necessary to prove an effect on domestic commerce under the FTAIA does not necessarily add to the burdens on a district court in modern price fixing litigation. As a result of the Class Action Fairness Act, most state law price fixing class actions end up in federal court, typically in the multidistrict litigation court in which federal law direct purchaser class actions are litigated. When state law claims are tried, the court will often be required to wrestle with the issues presented by upstream pass on, and, when the plaintiff or plaintiff class is not at the ultimate consumer level, downstream pass on.

The Supreme Court was aware of the existence of statistical models by which economists assess pass on, but not convinced that they offer an efficient way to address the issues associated with the evaluation of pass on. "Under an array of simplifying assumptions, economic theory provides a precise formula for calculating how the overcharge is distributed between the overcharged party (passer) and its customers (passees). If the market for the passer's product is perfectly competitive, the overcharge is imposed equally on all of the passer's competitors, and the passer maximizes its profits, then the ratio of the shares of the overcharge borne by passee and passer will equal the ratio of the elasticities of supply and demand in the market for the passer's product."[67] The Court considered it "unrealistic to think that elasticity studies introduced by expert witnesses will resolve the pass-on issue,"[68] but it is often no more realistic to think that economic analysis will accurately replicate the "but for world" essential to proper measurement of the impact of price fixing on the price of the affected goods. Regardless of how difficult credible proof of pass on or its extent may be, or whether the economic evidence used to prove pass on can be distinguished from the economic evidence freely admitted on other issues, difficulties of this type cannot justify disregard of the explicit requirement of the FTAIA that a domestic effect be proved. *Hsiung* illustrates that proof of pass on is essential to this task.

FURTHER REASONS FOR LIMITING THE FULL OVERCHARGE RULE

When the effects exception is in issue, a price fixing plaintiff must present proof of pass on to establish a direct effect on domestic commerce. There is no justification for a rule that forbids a defendant from attempting to refute a claim of a direct effect with evidence that pass on did not occur, or with evidence directed to the nuance associated with pass on. In theory, this might lead to the admission of evidence of pass on with respect to FTAIA issues only, but that would not be a proper or sensible result. There is a "direct" link between the effects exception and proof of damages, and ample policy justification for rejecting the *Royal Printing* windfall once it is understood that pass on-related evidence must be admitted under the FTAIA.

---

67 *Illinois Brick*, 431 U.S. at 741–42 (footnote omitted).

68 *Id.* at 742. *See also id.* at 742–43 ("More important, as the *Hanover Shoe* Court observed, 'in the real economic world rather than an economist's hypothetical model,' the latter's drastic simplifications generally must be abandoned. Overcharged direct purchasers often sell in imperfectly competitive markets. They often compete with other sellers that have not been subject to the overcharge; and their pricing policies often cannot be explained solely by the convenient assumption of profit maximization. As we concluded in *Hanover* Shoe**,** attention to 'sound laws of economics' can only heighten the awareness of the difficulties and uncertainties involved in determining how the relevant market variables would have behaved had there been no overcharge.") (citations and footnote omitted).

DISREGARDING EVIDENCE OF PASS ON

What would be the point of disregarding evidence of the occurrence or extent of pass on for damages purposes if the evidence were admitted to establish or to refute the existence of a "direct" effect?

The essential basis for the full overcharge rule was the idea that a determination of the extent to which the overcharge was passed on "would involve all the evidentiary and economic complexities that *Illinois Brick* clearly forbade."[69] For this reason, the Ninth Circuit concluded, "*Royal Printing* cannot sue the appellees only for the portion of the overcharge that was passed on to it through the wholesaling subsidiary and division."[70] When "evidentiary and economic complexity" is injected into the case as a result of the requirement that a direct effect on domestic commerce be proven, there is no reason to ignore the evidence when damages are calculated.

"GIVES RISE TO"

The FTAIA also requires that the extent of pass on be considered as a part of the damages determination. The effects exception is satisfied when the anticompetitive foreign conduct "has a direct, substantial, and reasonably foreseeable effect" on domestic commerce, and the domestic effect "gives rise to" the plaintiff's claim.[71] The requirement that the domestic effect "give rise to" the plaintiff's claim calls for the rejection of the *Royal Printing* full overcharge rule. Price increases that are not passed on do not "give rise to" a claim.

Many pass on disputes are based on disagreement about the extent to which an overcharge was passed on. Even when the parties agree that pass on occurred to a significant extent, as economic theory suggests it will in certain market contexts, material disagreements commonly exist about the rate at which price fixing overcharges and other cost increases were passed on to the direct purchaser's customers. A plaintiff typically asserts an average upstream pass on rate of 100% (or more). Defense evidence, on the other hand, suggests a lower rate that reflects absorption of part of the overcharge by the direct purchaser. In some cases, the defendants may contend that any overcharge was fully absorbed by the direct purchaser.

When pass on does not occur—*i.e.*, when the full amount of the overcharge is absorbed by the direct purchaser—there is no "effect" on domestic commerce, and no basis on which the Sherman Act can be applied to foreign conduct. When pass on occurs, but is not complete, there is similarly no effect resulting from the part of the overcharge that is not passed on to the customers of the direct purchaser. If, for example, the jury determines that, on average, 60% of the proven overcharge was passed on by the direct purchaser, the 40% absorbed by the direct purchaser has no effect—and thus no "direct" effect—on domestic commerce. The absorbed overcharge does not produce an effect that can "give rise to" the plaintiff's claim. When pass on is partial, the plaintiff's recovery must be limited under the FTAIA to the part of the overcharge paid by the direct purchaser, as it plainly would be absent any restriction on the use of evidence of pass on. Having been absorbed by the direct purchaser, and not being paid by the indirect purchaser plaintiff, the 40% in this example cannot "give rise to" the plaintiff's claim.

---

69 *Royal Printing*, 621 F.2d at 327.

70 *Id.*

71 *Empagran*, 542 U.S. at 174.

ABSENCE OF APPORTIONMENT ISSUES

Proof of a direct effect under the FTAIA also does not include the full collection of issues that might be associated with the apportionment of damages across multiple levels of distribution, a concern the Supreme Court addressed in *Illinois Brick*. There is no likelihood that claimants at multiple levels will be present when the FTAIA effects exception is in issue in a resale or component price fixing case.

Illinois Brick generally precludes indirect purchaser recovery. The *Royal Printing* owned or controlled exception creates the potential for recovery by an indirect purchaser at one level. By definition, there will be no occasion for damages apportionment between the direct purchaser and the plaintiff, even though the existence and extent of pass on by the direct purchaser must be proved. The absence of a threat of suit by the direct purchaser was the basis for the *Royal Printing* court's conclusion that there is no substantial risk of multiple liability.[72] It must therefore be assumed that there will be no upstream claimants seeking a share of the overcharge.

Nor will apportionment issues involving downstream purchasers be present when the *Royal Printing* exception is invoked.[73] Subsequent buyers lack standing under *Illinois Brick,* and *Royal Printing* does not purport to change that. There is no reason to expect subsequent purchasers would consistently benefit from any other *Illinois Brick* exception. As a result, the complications the *Illinois Brick* court explained when it addressed the difficulty of apportioning damages among various levels of claimants are not likely to be present.[74]

These differences between the FTAIA effects context and the broader circumstances of concern in *Illinois Brick* do not, by themselves, justify disregard of the complexity concerns expressed by the *Illinois Brick* Court. The differences nonetheless show that allowing parties to present evidence necessary to satisfy the FTAIA will not be accompanied by all of the difficulties that contributed to the Supreme Court's interpretation of Section 4 in

---

72 *Royal Printing*, 621 F.2d at 326.

73 In theory, a price fixed good or a finished product containing a price fixed component could transit through multiple levels of owned or controlled purchasers before being purchased by a plaintiff. If the *Royal Printing* owned or controlled exception were applied in such a situation, and the remoteness of the plaintiff from the conduct in issue did not otherwise defeat its standing, consideration of pass on issues involving multiple levels of distribution could be necessary, although there would be a claimant at only one level of distribution.

74 *See Illinois Brick*, 431 U.S. at 732–33 ("Indeed, the evidentiary complexities and uncertainties involved in the defensive use of pass-on against a direct purchaser are multiplied in the offensive use of pass-on by a plaintiff several steps removed from the defendant in the chain of distribution. The demonstration of how much of the overcharge was passed on by the first purchaser must be repeated at each point at which the price-fixed goods changed hands before they reached the plaintiff.") (footnote omitted); *id.* at 737 ("Permitting the use of pass-on theories under § 4 essentially would transform treble-damages actions into massive efforts to apportion the recovery among all potential plaintiffs that could have absorbed part of the overcharge from direct purchasers to middlemen to ultimate consumers. However appealing this attempt to allocate the overcharge might seem in theory, it would add whole new dimensions of complexity to treble-damages suits and seriously undermine their effectiveness."); *id.* at 740–41 ("But allowing indirect purchasers to recover using pass-on theories, even under the optimistic assumption that joinder of potential plaintiffs will deal satisfactorily with problems of multiple litigation and liability, would transform treble-damages actions into massive multiparty litigations involving many levels of distribution and including large classes of ultimate consumers remote from the defendant. In treble-damages actions by ultimate consumers, the overcharge would have to be apportioned among the relevant wholesalers, retailers, and other middlemen, whose representatives presumably should be joined. And in suits by direct purchasers or middlemen, the interests of ultimate consumers are similarly implicated.") (footnote omitted).

Hanover Shoe and *Illinois Brick*.

ALTERNATIVE INTERPRETATION OF THE FTAIA

Plaintiffs might argue that, when pass on of a price fixing overcharge from a foreign direct purchaser to its domestic indirect purchaser customer occurs in any amount, there is an "effect" on domestic commerce, and the FTAIA is satisfied if the effect is "direct, substantial, and reasonably foreseeable." Pass on in any amount can result in a "direct, substantial, and reasonably foreseeable" domestic effect, but proof of an effect is not sufficient to establish that the effect "gives rise to" a civil plaintiff's damage claim for harm it did not suffer.

In the example in which 60% of the overcharge is passed on, the effect on domestic commerce is the price increase associated with the pass on of 60% of the overcharge. With a $10.00 overcharge, only $6.00 finds its way to the cost of the finished product. That effect gives rise to the plaintiff's claim.

The 40%, $4.00 in this example, absorbed by the direct purchaser does not produce a domestic effect. The effect associated with the $6.00 passed on overcharge does not give rise to a claim for $4.00 in impact that did not occur and $4.00 in damage that was not suffered. A plaintiff has no claim for harm it does not suffer.

Also significant is the fact that proof of a "direct, substantial, and reasonably foreseeable" effect is not a jurisdictional trigger automatically satisfying the FTAIA. As *Hsiung* and other cases show, prior conclusions that the FTAIA is "jurisdictional" are mistaken. It is now firmly settled that "the FTAIA is . . . a component of the merits of a Sherman Act claim involving nonimport trade or commerce with foreign nations."[75] It would be an odd "component of the merits" that allowed recovery of damages that were not suffered simply because the plaintiff suffered and claimed similar damages.

CONCLUSION

Hanover Shoe and *Illinois Brick* established firm rules forbidding evidence of pass on to demonstrate, or to disprove, injury under Section 4 of the Clayton Act, but neither case addresses the role of pass on when the existence of an effect on domestic commerce is in dispute under the FTAIA. The *Royal Printing* full overcharge rule, derived from *Illinois Brick* and adopted without consideration of the impact of the subsequently-enacted FTAIA, similarly does not bar the receipt of evidence of pass on that is admissible, or is required, under the FTAIA. *Hsiung* shows that proof of pass on is essential to the establishment of a domestic effect in a criminal case, and that is equally true in a civil case.

Evidence of pass on should be received under the FTAIA in civil cases, notwithstanding the *Royal Printing* full overcharge rule, in both of the following circumstances.

First, at least under the Ninth Circuit "immediate consequence" standard, evidence of the frequency and extent of pass on, and evaluation of the internal and external factors that influence pass on decisions, may assist the determination of whether an effect on

75 *Hsiung*, 778 F.3d at 751. *See also Minn-Chem*, 683 F.3d at 852 ("the FTAIA sets forth an element of an antitrust claim, not a jurisdictional limit on the power of the federal courts").

domestic commerce is "direct." Evidence of when and how pass on occurs is relevant to the assessment of whether pass on and the domestic effect it produces is an "immediate consequence" of foreign anticompetitive conduct. The "directness" issue is an all or nothing proposition, and pass on evidence considered for this purpose does not directly impact the *Royal Printing* full overcharge rule, or, when the domestic effect is found to be "direct," otherwise provide a basis for limiting the plaintiffs' damage recovery.

The FTAIA requirement that a domestic effect "give rise to" the plaintiff's claim also calls for the admission of evidence of pass on, and it requires rejection of the *Royal Printing* full overcharge rule when pass on is not complete. A price fixing overcharge fully or partly absorbed by the direct purchaser does not produce an effect on domestic commerce, and cannot "give rise to" a claim for damages. The FTAIA does not allow the recovery of damages that are not the result of a direct effect on domestic commerce.

THE UCL—NOW A MONEY BACK GUARANTEE?

By Michele Floyd[1]

I. INTRODUCTION

The Ninth Circuit issued its opinion in *Pulaski & Middleman, LLC v. Google, Inc.*[2] on September 21, 2015. After adopting an expansive definition of restitution under the California Unfair Competition Law ("UCL"), *Pulaski* reversed the district court's denial of certification on the ground that calculating restitution under the UCL posed no individualized questions. Underlying its reversal of the district court's decision were three findings: (1) California law creates a "conclusive presumption" that a consumer is entitled to restitution once liability is established under the UCL thus making individualized proof of entitlement to restitution unnecessary; (2) the value received post-purchase is irrelevant to a restitution calculation because the proper measure is the difference between the amount the class member paid and the amount the class member would have paid had he or she known the truth; and, in any event, (3) individualized damage calculations cannot defeat certification in the Ninth Circuit, even after *Comcast Corp. v. Behrend*.[3]

One week later, the California Court of Appeal affirmed the final judgment in *In re Tobacco Cases II*[4] and affirmed the trial court's refusal to award any restitution under the UCL. There, the court confirmed that UCL restitution must account for post-purchase value received, applying the definition formulated in *In re Vioxx Class Cases.*[5] *Tobacco II* further entrenched the developing weight of authority holding that a full refund is not available under the UCL except in the rare circumstance where the product at issue has no intrinsic value.

Pulaski is inconsistent with *Tobacco II* in at least two respects. First, as *Tobacco II* illustrates, California law does not create a conclusive presumption that a restitution award is proper once liability is established. Second, the *Pulaski* court applied the incorrect definition of restitution under the UCL—a definition that allowed it to sidestep *Comcast*. While it is true that there is no California Supreme Court authority conclusively defining restitution for purposes of the UCL, *Pulaski* is a clear departure from the body of law developed by the Courts of Appeal. *Pulaski* is also inconsistent with *Comcast*. Its bright-line refusal to consider the impact of damage calculations on the Rule 23(b) analysis flies in the face of *Comcast*'s now clear holding that plaintiffs must come forward at the certification stage with a damages methodology capable of class-wide application.

---

1 Michele Floyd is a partner at Sacks Ricketts & Case, a women-owned elite litigation boutique that focuses on competitive, consumer and employment class action defense across a number of industries, including video games, computer hardware and software, consumer retail sales, franchise, food/restaurant, manufacturing, and technology. Michele's practice focuses on antitrust and consumer class action defense, primarily for technology, online and retail clients.

2 802 F.3d 979 (9th Cir. 2015), *petition for cert. filed*, Mar. 1, 2016 (No. 15-1101).

3 133 S. Ct. 1426 (2013) (reversing the Third Circuit's decision and holding that there is a duty to conduct a "rigorous analysis" of whether the Rule 23 requirements have been met even if that means considering the merits of the claim at class certification).

4 192 Cal. Rptr. 3d 881 (Cal. Ct. App. 2015).

5 103 Cal. Rptr. 3d 83 (Cal. Ct. App. 2009).

This article will analyze the *Pulaski* opinion in light of existing California law defining restitution for purposes of the UCL and then look at the viability of the Ninth Circuit's ultimate conclusion in light of *Comcast*. We begin with a brief discussion of *Pulaski, Tobacco II* and *Vioxx*. We then turn to an examination of the evolution of the definition of UCL restitution. Then we will analyze the *Pulaski* holding in light of *Comcast,* reaching the conclusion that it was only the incorrect definition of restitution that allowed the Court to sidestep *Comcast*.

II. SUMMARY OF *PULASKI*: UCL RESTITUTION CAN'T DEFEAT PREDOMINANCE

Pulaski involved a challenge to Google's AdWords click advertising program. Specifically, plaintiffs, who were advertising agencies and businesses, alleged that Google uniformly failed to disclose in its AdWords documentation that it would place ads on low quality web pages such as parked domains (an undeveloped page consisting of nothing but links to ads) and error pages (reached when a user mistypes a domain or URL). At certification, plaintiffs proposed three alternative methods for calculating the amount of restitution owed to class members: (1) using Google's "Smart Pricing" algorithm, which would approximate the difference between what plaintiffs actually paid and what they would have paid had Google disclosed the ad placement; (2) a "Content Pricing" approach, which plaintiffs described as factoring in the lower bidding that would have occurred had advertisers been allowed to bid separately for parked domain and error page placement; and (3) a full refund.[6] The District Court, relying on the definition of restitution set forth in *Vioxx*, denied certification on the ground that determining not only who was entitled to restitution but in what amount, were necessarily individualized, and complicated, inquiries; the Court would essentially have to assess the intrinsic value of the advertising received, which would vary among class members.[7] Accordingly, the need to make individualized calculations defeated predominance under Rule 23.

The Ninth Circuit reversed, finding that the restitution calculations were irrelevant to the Rule 23 analysis. The Court's conclusion was premised on its findings that: (1) California has created a "conclusive presumption" of entitlement to restitution once liability under the UCL is established; and (2) liability under the UCL does not require individualized proof of deception, reliance or injury.[8] Therefore, the Court concluded, the amount of restitution is determined at the time of purchase and the proper measure is the difference between what the class members paid and what they would have paid absent the misrepresentation or omission.

Having adopted an expansive definition of restitution, the Court turned to predominance under Rule 23(b)(3), making it clear that *Comcast* did not change Ninth Circuit law holding that varying amounts of damage cannot defeat predominance.[9] It then expanded that familiar, and somewhat innocuous, proposition, however, to damage calculations, holding that the need

---

6 *Pulaski*, 802 F.3d at 983.

7 *Id.* at 982.

8 *Pulaski*, 802 F.3d at 986 (stating "'that when a defendant puts out tainted bait and a person sees it and bites, the defendant has caused an injury; restitution is the remedy'") (citing *Stearns v. Ticketmaster LLC*, 655 F.3d 1013, 1021 n.13 (9th Cir. 2013)).

9 The Court relied on *Yokoyama v. Midland Nat'l Life Ins. Co.*, 594 F.3d 1087 (9th Cir. 2010) (holding that damage calculations alone could not defeat class certification). This proposition is not new in the Ninth Circuit. *See Leyva v. Medline Indus., Inc.*, 716 F.3d 510 (9th Cir. 2013).

to individually calculate the amount of each class member's damage award can *never* defeat predominance. In the case before it, however, the statement was of little influence because pursuant to the Court's view of UCL restitution, individual calculations were unnecessary anyway. The Court formulated a measure of restitution that focused only on the point of purchase—the difference between the price paid and the price the plaintiff would have paid had she known the truth about the alleged misrepresented or omitted information. Under the Court's definition, then, post-purchase value, while undoubtedly individualized, was irrelevant to the calculation.[10] Taken to its logical extension, the Court's definition of restitution would allow a full refund if the consumer would not have purchased the product at all.

Ultimately, however, the Court did not endorse a full refund. Rather, it found that using the Smart Pricing algorithm would result in a nonspeculative approximation of the proper amount of restitution.[11] The algorithm essentially used a ratio from Google's data that adjusted the ad price for web page quality. Thus, it was both targeted to remedying the alleged harm (because it measured what the advertiser should have paid at the onset rather than accounting for what occurred post-purchase) and did not turn on individual circumstances.[12] Because damage calculations posed no impediment to certification, the Court reversed the District Court.

III. Summary of *Tobacco II*: Restitution is Individualized

The recent *Tobacco II* opinion was the result of an appeal after final judgment. The facts of *Tobacco II* are familiar: plaintiffs claimed that defendants falsely advertised Marlboro Lights as being less harmful than other "full-flavored" cigarettes. The trial court found that defendant's advertising was likely to mislead the general public but denied plaintiffs' request for restitution on the ground that plaintiffs' evidence of the difference between the price they paid for the cigarettes and the *value they actually received* was "incompetent and inadmissible."[13]

Plaintiffs made two contentions on appeal. First, they argued that the *Vioxx* measure of restitution (the difference between the amount paid and the actual value received) was not the only measure permitted under California law.[14] Second, they argued that California law did not require them to show any loss attributable to the false advertising because the court had the authority to order a full refund under the UCL exclusively for the purpose of deterrence.[15]

The Court of Appeal rejected both arguments and confirmed that *Vioxx* accurately represents California law. The Court further made it clear that under *Vioxx,* a full refund would be appropriate under the UCL only when the product in question has no intrinsic value. In so holding (and rejecting plaintiffs' arguments), the Court made three notable

---

10 *Pulaski*, 802 F.3d at 989-990 (citing *Kwikset Corp. v. Super. Ct.*, 246 P.3d 877, 890 (Cal. 2011)).

11 *Pulaski*, 802 F.3d at 989 (noting California law requires only that some reasonable basis for computation of damages be used and damages may be computed even if the result reached is an approximation) (citing *Marsu, B.V. v. Walt Disney Co.*, 185 F.3d 932, 938-39 (9th Cir. 1999)).

12 *Pulaski*, 802 F.3d at 990.

13 *Tobacco II*, 192 Cal. Rptr. 3d at 886.

14 *Id.* at 887.

15 *Id.*

observations. First, it noted that Sections 17203 (remedies) and 17204 (standing) have distinct requirements.[16] The Court discussed *Kwikset Corp. v. Super. Ct.*,[17] noting that it established the standard only for standing, a standard that was inapplicable to calculating restitution once liability was established. Second, the Court noted that there is no "entitlement" to restitution under section 17203.[18] Rather, injunctive relief is the primary remedy under the UCL and restitution is only ancillary.[19] Last, while section 17203 may be broad enough to allow recovery without proof of individual injury under certain circumstances, it is not so broad as to allow an actual monetary award with no evidence of the actual value of the product. On this last point, the Court confirmed that courts have no statutory authority to award restitution under the UCL as a deterrent.[20] Accordingly, a restitution award must account for the value each class member actually received in order to avoid a windfall. In short, restitution is an individualized calculation that cannot be avoided by awarding a full refund unless the product at issue has no intrinsic value.

Ultimately, the Court rejected plaintiffs' proposed methodology for calculating restitution. The Court also found plaintiffs' evidence to be inconsistent with a restitution award, specifically:

- Testimony from plaintiffs indicating that Marlboro Lights provided a reasonable value for the price paid notwithstanding the misrepresentations;
- Testimony from some class members establishing that they purchased cigarettes for reasons wholly unrelated to the health misrepresentations, such as taste and smoothness; and
- Testimony from some class members showing that they continued to buy the cigarettes for many years after they learned the truth.[21]

Accordingly, the Court awarded no restitution despite its liability finding.

IV. SUMMARY OF *VIOXX*: RESTITUTION REQUIRES SUBSTANTIAL EVIDENCE

Since *Vioxx* is credited with formulating the definition of restitution for purposes of the UCL, it warrants a brief discussion. *Vioxx* was a products liability action in which plaintiffs sued Merck for allegedly misrepresenting the safety and efficacy of the pain reliever Vioxx. Specifically, plaintiffs alleged that Merck represented that Vioxx was safe when it was actually less safe and no more effective than its generic competitors. Thus, plaintiffs alleged that they overpaid for Vioxx. On their motion for class certification, plaintiffs argued that they could establish the amount of restitution due to each class member by using the price of a generic drug, naproxen, as a comparator for calculating the amount of their overpayment (the difference between the price of Vioxx and the price of naproxen).

---

16 *Tobacco II*, 192 Cal. Rptr. 3d at 898 (citing *Kwikset Corp. v. Super. Ct.*, 246 P.3d 877, 894 (Cal. 2011)).

17 246 P.3d 877 (Cal. 2011). *Pulaski* relied on *Kwikset* as well, but as support for its point of purchase measure of restitution.

18 *Tobacco II*, 192 Cal. Rptr. 3d at 898 (citing *Kwikset*, 246 P.3d at 894).

19 *Id.* at 891.

20 *Id.* at 894.

21 *Id.* at 889.

Merck made a compelling argument that naproxen was an inappropriate comparator because not all Vioxx patients could safely switch to it. It supported its argument by submitting evidence showing a myriad of reasons why naproxen was inappropriate. For example:

- Plaintiffs did not contend that they would have purchased naproxen absent the misrepresentations and omissions, just that they would not have purchased Vioxx;
- Because naproxen was safer than Vioxx from a gastrointestinal perspective but not a cardiovascular perspective, only patients with gastrointestinal disorders might take naproxen rather than Vioxx;
- Many individuals would take Vioxx regardless of its risks because of its efficacy;
- Few patients switched to naproxen when Vioxx was taken off the market.[22]

The Court agreed with Merck and rejected naproxen as a valid comparator. On the issue of UCL restitution, the Court confirmed that restitution under the UCL is the difference between what the plaintiffs paid and the value of what they received.[23] Accordingly, plaintiffs must submit *substantial* evidence establishing the amount of restitution (i.e., evidence of the actual value they received).[24] Where, as there, the calculus was necessarily subjective, certification was inappropriate because the appropriate methodology was not subject to class-wide proof.[25] The Court denied certification on the ground that restitution could not be calculated on a class-wide basis.

V. THE PROBLEM(S) WITH *PULASKI*

A. The *Pulaski* Definition of Restitution is Inconsistent with *Vioxx*

In light of *Vioxx* and *Tobacco II*, it is clear that the *Pulaski* court misstepped. First, its expansive definition of restitution is not supportable. *Tobacco II* confirmed that *Vioxx* sets forth the correct definition—the difference between the amount paid and the value received.[26] True, *Pulaski* did not have the benefit of *Tobacco II* at the time it issued its holding, but it did have *Vioxx* and a number of lower court opinions (both federal and state) confirming that the calculation required deductions for value received.[27] Nonetheless, *Pulaski* relied on *Kwikset,* which discussed standing, in formulating the definition of restitution as: "what the purchaser would have paid at the time of purchase had the purchaser received all the information" with the focus being "on the value of the service at the time of purchase."[28]

---

22 *In re Vioxx Class Cases*, 103 Cal. Rptr. 3d 83, 91-92 (Cal. Ct. App. 2009).

23 *Vioxx*, 103 Cal. Rptr. 3d at 96 (citing *Cortez v. Purolator Air Filtration Products Co.*, 99 P.2d 706, 713 (Cal. 2000)).

24 *Vioxx*, 103 Cal. Rptr. 3d at 100-101 (citing *Colgan v. Leatherman Tool Group, Inc.*, 38 Cal. Rptr. 3d 36, 61 (Cal. Ct. App. 2006)).

25 *Vioxx*, 103 Cal. Rptr. 3d at 101 (holding that the issue of a proper comparator was a patient-specific issue incorporating the patient's medical history, treatment need and drug interactions).

26 *Tobacco II*, 192 Cal. Rptr. 3d 881, 895 (citing *Zhang v. Superior Court*, 304 P.3d 163 (Cal. 2013) and *Dunkin v. Boskey*, 98 Cal. Rptr. 2d 44 (Cal. Ct. App. 2000) (party seeking restitution must return value received)).

27 *See, e.g.*, *In re Pom Wonderful LLC Mktg and Sales Practices Litig.*, No. ML 10-02199 DDP, 2014 WL 1225184, at *3 (C. D. Cal. Mar. 25 2014) (citing *Vioxx*); *Ortega v. Natural Balance, Inc.*, 300 F.R.D. 422, 429 (C. D. Cal. 2014) (same).

28 *Pulaski*, 802 F.3d at 989.

Pulaski's definition is broad enough to encompass a full refund under circumstances where the plaintiff claims he or she would not have purchased the product at all but for the misrepresentation (or had she been aware of the omitted information). The problem here is that the UCL, however, is not exclusively deterrent. Accordingly, as *Tobacco II* explained, California law does not support a full refund under the UCL unless the product has no intrinsic value:

> We conclude that as a matter of law, restitution is not available here for the exclusive purpose of deterrence. Under plaintiff's theory, a full refund would be available on any product, even costly items such as cars, yachts, and planes, based on UCL violations that had little or no impact on value. That, of course, is not the law. "Section 17203 makes injunctive relief 'the primary form of relief available under the UCL,' while restitution is merely 'ancillary.'" Without any showing of loss to plaintiffs, there can be no restoration of money "which may have been acquired *by means of such unfair competition*."
>
> While a full refund may be proper when a product confers *no* benefit on consumers, such is not the scenario here. Plaintiffs do not dispute the court's finding that they obtained value from Marlboro Lights apart from the deceptive advertising. Indeed, it appears inherently implausible to show that a class of smokers received *no* value from a particular type of cigarette.[29]

There are circumstances where a full refund can be appropriate, and *Ortega v. Natural Balance, Inc.*,[30] provides an example. In *Ortega,* the plaintiffs challenged label representations indicating that the dietary supplements at issue had aphrodisiac properties, which, of course, was false. As it turned out, the evidence established that the supplements provided no health benefits at all, represented or not, and, in fact, contained illegal substances. Under those circumstances, the court determined that the *Vioxx* measure of restitution was actually zero because the product had no intrinsic value.[31] Thus, plaintiffs were entitled to a full refund.

So how did *Pulaski* stray so far afield in measuring restitution? Instead of relying on *Vioxx* and its progeny, it turned instead to standing cases and the Restatement of Restitution; based on them, the Court formulated a punitive definition: "[r]estitution has two purposes: 'to restore the defrauded party . . . and to deny the fraudulent party any benefits, whether or not foreseeable, which derive from his wrongful act.'"[32] *Pulaski* relied on *Nelson v. Serwold,* as an example of a punitive application, but *Nelson* was a securities fraud case and it did not involve violations of the UCL or California False Advertising Law ("FAL"). Thus, *Nelson* was defining restitution for entirely different purposes.

---

29 *Tobacco II*, 192 Cal. Rptr. 3d 881, 900-901 (citing *Clayworth v. Pfizer, Inc.*, 233 P.3d 1066, 1088 (Cal. 2010)) (emphasis in original).

30 300 F.R.D. 422 (C. D. Cal. 2014).

31 *Id*. at 430 (holding full refund may be available where dietary supplement had no value apart from the misrepresented health benefit).

32 *Pulaski*, 802 F.3d at 988 (citing *Nelson v. Serwold,* 687 F.2d 278, 281 (9th Cir. 1982) (citing the Restatement of Restitution)).

As referenced above, *Pulaski* also relied on *Kwikset* and *Colgan v. Leatherman Tool Group, Inc.*[33] While those are big names in UCL jurisprudence, neither were applicable because they addressed standing and liability standards under the UCL, not restitution calculations for purposes of class certification. Moreover, neither relied on the Restatement definition that *Pulaski* used. While *Colgan* made a reference to the Restatement, that part of the opinion was explaining simply that the amount of a restitution award has to be supported by evidence.[34] Thus, *Colgan* does not support *Pulaski's* adoption of the Restatement definition for purposes of calculating restitution under the UCL.

Pulaski similarly finds no support for the Restatement definition in *Kwikset*. In fact, *Pulaski's* reliance on *Kwikset* clearly conflated UCL standing requirements with the standards applicable to restitution calculations.[35] Pointing to language in *Kwikset, Pulaski* concluded that every consumer who is misled by a misrepresentation suffers the same harm—they paid more for the product than they otherwise would have.[36] Thus, the Court concluded that the measure of restitution is the same for all class members. *Kwikset*, however, does not support *Pulaski's* conclusion because *Kwikset* was addressing injury sufficient to support UCL standing requirements—it was not calculating the amount of restitution or analyzing the predominance requirement for class certification:

> For each consumer who relies on the truth and accuracy of a label and is deceived by misrepresentations into making a purchase, the economic harm is the same: the consumer has purchased a product that he or she *paid more for* than he or she otherwise might have been willing to pay if the product had been labeled accurately. This economic harm—the loss of real dollars from a consumer›s pocket—is the same whether or not a court might objectively view the products as functionally equivalent. A counterfeit Rolex might be proven to tell the time as accurately as a genuine Rolex and in other ways be functionally equivalent, but we do not doubt the consumer (as well as the company that was deprived of a sale) has been economically harmed by the substitution in a manner *sufficient to create standing to sue.* Two wines might to almost any palate taste indistinguishable—but to serious oenophiles, the difference between one year and the next, between grapes from one valley and another nearby, might be sufficient to carry with it real economic differences in how much they would pay. Nonkosher meat might taste and in every respect be nutritionally identical to kosher meat, but to an observant Jew who keeps kosher, the former would be worthless.[37]

The above examples illustrate *Pulaski's* flaw. The difference between the price paid and what a consumer would have been willing to pay had the product been accurately labeled demonstrates the existence of some injury for purposes of standing. But, calculating the *amount* of that injury for purposes of a monetary award is an entirely different story.

---

33 38 Cal. Rptr. 3d 36 (Cal. Ct. App. 2006).

34 *Id.* at 62. ("The Restatement contemplates restitution supported by evidence.").

35 *Pulaski*, 802 F.3d at 989.

36 This price premium measure has been rejected by lower courts. *See, e.g.*, *Pom Wonderful*, 2014 WL 1225184, at *5.

37 *Kwikset*, 246 P.3d at 890 (emphasis added).

Kwikset said nothing about placing a value on that amount for purposes of an award, nor did it excuse the plaintiff from ultimately quantifying the loss at the certification stage by resorting to admissible, nonspeculative proof of value. In fact, even in addressing standing only, *Kwikset* undermined *Pulaski* because it specifically called out the distinction between standing and calculating restitution:

> As we recently have noted, however, the standards for establishing standing under section 17204 and eligibility for restitution under section 17203 *are wholly distinct*. For the drafters of Proposition 64, which amended both sections 17203 and 17204, to make standing under section 17204 expressly dependent on eligibility for restitution under section 17203 would have been easy enough, but nothing in the text or history of Proposition 64 suggests this was intended. We thus rejected in *Clayworth* the argument that if the plaintiffs could demonstrate no compensable losses or entitlement to restitution under section 17203, they would lack standing under section 17204. As we explained, "this argument conflates the issue of standing with the issue of the remedies to which a party may be entitled. That a party may ultimately be unable to prove a right to damages (or, here, restitution) does not demonstrate that it lacks standing to argue for its entitlement to them."[38]

Colgan, also cited by *Pulaski*, actually confronted the distinction between liability and calculating restitution when that case reached the remedy phase.[39] The result there was no restitution award. *Colgan* was a challenge to an allegedly false "Made in the USA" label used in connection with marketing tools. The trial court found that the tools were not "Made in the USA" and thus found liability, but had difficulty quantifying the restitution. Accordingly, it awarded a flat amount of 25% of the gross sales receipts. Appellate court reversed noting that the amount was not supported by substantial evidence.[40] Because the plaintiffs' expert could not quantify the value of the "Made in the USA" label, plaintiffs failed in their proof.[41] Importantly, this did not leave the plaintiffs without remedy for the violation because the primary relief under the UCL is an injunction—in this case a labeling change. This outcome was entirely consistent with *Tobacco II*.

Thus, *Pulaski's* definition of restitution for purposes of remedy finds no support in California law. It has long been held that the UCL has no punitive component.[42] *Vioxx* supplied a definition of restitution for purposes of the UCL. And, *Tobacco II* confirmed it, noting "'[c]ourts ordering restitution under the UCL are not concerned with restoring the violator to the status quo ante. The focus instead is on the victim.' Obviously, restitution without proof of any actual loss to any plaintiff cannot be characterized as *restitutionary*."[43]

---

38 *Id*. at 894-895 (citing *Clayworth v. Pfizer, Inc.*, 233 P.3d 1066, 1087 (Cal. 2010)).

39 *Colgan v. Leatherman Tool Group, Inc.*, 38 Cal. Rptr. 3d 36 (Cal. Ct. App. 2006).

40 *Id*. at 63.

41 *Id*.

42 *Korea Supply Co. v. Lockheed Martin Co.* made it clear that restitution under the UCL is essentially limited to an out-of-pocket loss. 63 P.3d 937, 946-947 (Cal. 2003). The remedial sections of the statutory scheme do not provide for the recovery of compensatory or punitive damages. *Korea Supply* held clearly that disgorgement of profits was not "restitutionary" and therefore not recoverable under the UCL. *Id*. at 949. *Madrid v. Perot Sys. Corp.* later extended *Korea Supply* to class actions. 30 Cal. Rptr. 3d 210, 221-224 (Cal. Ct. App. 2005).

43 *Tobacco II*, 192 Cal. Rptr. 3d at 900 (citing *Madrid*, 30 Cal. Rptr. 3d 210 at 221).

B. CALIFORNIA LAW DOES NOT CREATE A "CONCLUSIVE PRESUMPTION" OF RESTITUTION

The second failing of *Pulaski* is its conclusion that California law imposes a "conclusive presumption" of restitution once liability under the UCL is established.[44] This conclusion is flatly contrary to *Colgan* and *Tobacco II*, both of which ended up awarding no restitution at all based on plaintiffs' failure of proof. *Pulaski* arrived at its contrary conclusion by relying on *Stearns*. The problem with its analysis, however, is that *Pulaski's* jump from liability standards under the UCL to standards applicable to quantifying restitution is legally unsupportable. In fact, *Pulaski* cites no authority to support its conclusion that entitlement to restitution never requires individualized inquiries because *Stearns* did not address restitution at all. *Stearns* addressed liability and standing standards after the first *Tobacco II* decision and, in fact, the footnote that *Pulaski* relied on was part of a discussion of Article III standing. Accordingly, *Stearns* does not support *Pulaski*.

C. DAMAGE CALCULATIONS DO MATTER: PULASKI'S RELIANCE ON *YOKOYAMA* IS INCONSISTENT WITH *COMCAST*

Relying on *Yokoyama v. Midland National Life Insurance Co.*, *Pulaski* concluded that damage calculations can never defeat predominance in the Ninth Circuit.[45] *Yokoyama*, decided well before *Comcast*, holds simply that "damage calculations *alone* cannot defeat certification."[46] *Comcast*, on the other hand, holds that plaintiffs' damage model must be capable of measuring damage resulting from the theory of liability advanced.[47] Underlying the *Comcast* opinion is another widely accepted rule: the inability to submit a class-wide methodology for establishing damages (or restitution in the context of the UCL) can defeat predominance.[48] In short, "[n]o damages model, no predominance, no class certification."[49] Despite the Ninth Circuit's attempt to state otherwise, *Yokoyama* is not inconsistent with *Comcast* because at bottom, it really stands for the same proposition. While the opinion speaks in terms of damage "calculations" when it says "damage calculations alone cannot defeat certification," the Court was clearly speaking in terms of one calculation that might yield varying amounts for different class members rather than a different methodology applicable to individual class members:

> [D]amage calculations *alone* cannot defeat certification. We have said that '[t]he *amount* of damages is invariably an individual question and does not defeat class action treatment.'[50]

44 *Pulaski*, 802 F.3d at 986 (citing *Stearns v. Ticketmaster Corp.*, 655 F.3d 1013, 1021 n.13 (9th Cir. 2011)).

45 *Id.* at 988 ("*Yokoyama* remains the law of this court, even after *Comcast*").

46 *Yokoyama v. Midland Nat'l Life Ins. Co.*, 594 F.3d 1087, 1094 (9th Cir. 2010) (emphasis added).

47 *Comcast*, 133 S. Ct. at 1433.

48 *See In re NJOY, Inc. Consumer Class Action Litig.*, 120 F. Supp.3d 1050, 1117 (C. D. Cal. 2015) (citing *Comcast*, 133 S. Ct. at 1433).

49 *In re Rail Freight Surcharge Antitrust Litig.*, 725 F.3d 244, 253 (D.C. Cir. 2013).

50 *Yokoyama*, 594 F.3d at 1094 (citing *Blackie v. Barrack,* 524 F.2d 891, 905 (9th Cir. 1975)) (emphasis added).

Yokoyama said nothing about the necessity of differing proof to establish entitlement to an award. It spoke only to a situation where the plaintiffs have established that the class is entitled to recover. There, the fact that a uniform calculation may yield differing amounts for individual members (even if the amount is zero for some) usually does not impede certification. Where, however, class-wide proof of entitlement is not possible, the issue is different and predominance is usually lacking.

The distinction is subtle and often conflated, but the facts of *Yokoyama* are helpful. There, the plaintiff claimed that uniformly distributed written information about variable annuity products were deceptive. Ironically, the issue in *Yokoyama* did not involve damage calculations but rather whether individual reliance was an element of liability under the Hawaii consumer protection statute.[51] With respect to damages, the Ninth Circuit concluded that because the lawsuit was premised only on uniform written statements (and not what any individual sales agent said) that all class members allegedly saw, entitlement to damage could be determined on a class-wide basis. It further dismissed the district court's finding that individualized inquiries might be necessary to calculate the *amount* of damage because calculations alone do not defeat certification. But, *Yokoyama* was a case where it appeared that the same general formula could be applied to all class members even though the inputs were variable and the calculations might yield different amounts for different class members. And, importantly, the variables were not so individualized that they would swamp common proof, and the formula was "mechanical." Despite the fact that it is widely cited, particularly as of late, *Yokoyama* really does not support the broad proposition that damage calculations can never defeat certification in the Ninth Circuit.

Blackie v. Barrack, also oft-cited (including by *Yokoyama)*, likewise illustrates the point.[52] *Blackie* was a securities fraud case. In recognizing that individual damage calculations usually do not defeat certification, the Court noted that before it was a case where "the amount of price inflation during the period can be charted and the process of computing individual damages will *be virtually a mechanical task*."[53] Again, *Blackie* was a case where one formula could be applied class-wide even though its application might result in different amounts for different class members.

Leyva v. Medline Industries, Inc.,[54] the last of the Ninth Circuit damage trifecta (and cited by *Pulaski)*, is also consistent with *Comcast*. *Levya* was a wage and hour case where plaintiffs proposed a "mechanical calculation" for restitution. Thus, the Court found that the damage calculations were not so individualized as to swamp common proof.[55]

There are plenty of examples, however, of cases where either entitlement to recover or the damage calculation itself is so individualized an inquiry that it swamps common proof and thus does defeat certification. In *Blades v. Monsanto Co.*, for example, the Eighth Circuit denied certification because the damages there were so individualized that attempting to

---

51 *Yokoyama*, 594 F.3d at 1092.

52 524 F.2d 891 (9th Cir. 1975).

53 *Id*. at 905.

54 716 F.3d 510 (9th Cir. 2013).

55 *Id*. at 514 (noting "Medline's computerized payroll and time-keeping database would enable the court to accurately calculate damages and related penalties for each claim.").

figure out who was entitled to recover, and in what amount, would swamp common proof.[56] The Sixth Circuit came to a similar conclusion in *Rodney v. Northwest Airlines, Inc.* and denied certification based on the individualized nature of the damage calculations presented there.[57] In *Heerwagen v. Clear Channel Communications,* the Second Circuit denied certification because the plaintiffs failed to submit a viable, class-wide methodology for proving damages.[58]

VI. CONCLUSION: RECONCILING *PULASKI, TOBACCO II* AND *COMCAST*

Pulaski, Tobacco II and *Comcast* may be reconcilable by limiting *Pulaski* to its facts. *Pulaski* was an omission case based on documentation that uniformly omitted information about ad placement on parked domains and error pages. Accordingly, the line of California cases holding that there must be some showing of reliance on misrepresentations in order to justify restitution did not come into play because *all* plaintiffs were subjected to the same omissions and the materiality of those omissions was not challenged. Thus, the appropriate measure of damage may have been calculable on a class-wide basis because Google actually had a methodology in place (the algorithm) that could calculate the value of the ads considering their placement. The Court itself seemed to suggest such was the case by using Google's algorithm, which resulted in a mechanical, formulaic approach consistent with Rule 23(b) and, incidentally, *Comcast*. But, this damage model, while uniform, still provided a windfall to those advertisers whose sales increased or who received some other benefit from the ads. Thus, this damage model is not supported by *Vioxx* and *Tobacco II.*

At bottom, though, California law does not support the reasoning underlying *Pulaski's* restitution definition and federal law does not support the manner in which it applied *Yokoyama* in light of *Comcast*. The defendant in *Pulaski* petitioned for certiorari, so it remains to be seen how the Ninth Circuit's positions will hold up. For now, however, there is at least an argument (albeit not a legally sound one) that the UCL can provide a money-back guarantee on a class-wide basis in Ninth Circuit courts.

---

56 400 F.3d 562 (8th Cir. 2005) (denying certification on ground that individualized damage calculations would defeat predominance).

57 146 Fed. App'x. 783 (6th Cir. 2005) (rejecting expert's proposed methodology for common proof of damages and denying certification). Lower courts within the Ninth Circuit have come to the same conclusion following *Comcast*. The Central District of California noted that "Rule 23(b)(3) is satisfied only if plaintiffs can show that damages are capable of measurement on a classwide basis." *In re NJOY, Inc. Consumer Class Action Litig.*, 120 F. Supp. 3d at 1117 (citing *Comcast*, 133 S. Ct. at 1433); *In re Con Agra Foods, Inc.*, 90 F. Supp. 3d at 1022-1023 (C.D. Cal. 2015) (citing *Comcast*, 133 S. Ct. at 1433). *McVicar v. Goodman Global, Inc.*, recently reached the same conclusion: "At the class certification stage, Plaintiffs must present a theory that can measure, *on a class-wide basis*, damages attributable to Plaintiffs' theory of liability." *McVicar*, No. SA CV 13-1223-DOC, 2015 WL 4945730, at *14 (C.D. Cal. Aug. 20, 2015) (citing *Comcast*, 133 S. Ct. at 1433) (emphasis added).

58 435 F.3d 219, 235 (2d. Cir. 2006).

FTC DATA SECURITY ENFORCEMENT: ANALYZING THE PAST, PRESENT, AND FUTURE

By Crystal N. Skelton[1]

The "Internet of Things" has recently come to dominate the consumer products market. Businesses are connecting nearly everything to the Internet – from homes and cars to clothing and even yoga mats. The shift from consumers using basic computers to interacting with mobile apps and other connected devices has continued to generate massive amounts of consumer data online. This trend is not expected to end anytime soon.

The U.S. Federal Trade Commission ("FTC") defines the Internet of Things as "the ability of everyday objects to connect to the Internet and to send and receive data," and includes both consumer- and non-consumer-facing devices.[2] Some analysts describe it as, the "third wave of the Internet," following the fixed Internet wave of the 1990s and the mobile wave in the 2000s.[3] DHL and Cisco report that there are 15 billion connected devices in the world today and predict that there will be 50 billion by 2020.[4] By that time, computers (including PCs, tablets, and smartphones) are expected to represent only 17 percent of all Internet connections, while the other 83 percent will result from the Internet of Things, including wearables and smart-home devices.[5] Intel's estimates are even more generous, forecasting that more than 200 billion devices will be connected by 2020.[6]

The collection of vast amounts of consumer data, however, often may not go hand-in-hand with increased efforts to protect the security of such data online. High profile data breaches and security lapses draw increased scrutiny from consumers, lawmakers, and federal and state regulators. The data security regulatory environment is in constant flux, with regulators and legislators alike proposing varying frameworks to protect personal information online. Nonetheless, there is currently no comprehensive federal privacy or data security law in the United States, as only sector-specific laws are present at the federal level. Simultaneously, forty-seven states and the District of Columbia have separate laws governing data security breach notification, while only a handful of

---

1 Crystal N. Skelton is an associate at Kelley Drye & Warren LLP, and a member of Kelley Drye's Privacy & Information Security and Advertising & Marketing groups. This article reflects the views of the author and not necessarily those of Kelley Drye, its attorneys, or its clients.

2 Fed. Trade Comm'n, Staff Report, Internet of Things: Privacy & Security in a Connected World (Jan. 2015), https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-staff-report-november-2013-workshop-entitled-internet-things-privacy/150127iotrpt.pdf.

3 The Goldman Sachs Group, Inc., The Internet of Things: Making Sense of the Next Mega-Trend 1 (Sept. 2014), http://www.goldmansachs.com/our-thinking/outlook/internet-of-things/iot-report.pdf.

4 DHL Trend Research & Cisco Consulting Servs., The Internet of Things in Logistics 4 (2015), http://www.dhl.com/content/dam/Local_Images/g0/New_aboutus/innovation/DHLTrendReport_Internet_of_things.pdf; *see also* Dave Evans, CISCO Internet Bus. Sols. Grp., The Internet of Things: How the Next Evolution of the Internet is Changing Everything, 3 (Apr. 2011) http://www.cisco.com/c/dam/en_us/about/ac79/docs/innov/IoT_IBSG_0411FINAL.pdf/.

5 DHL Trend Research, *supra* note 4, at 4 (citing David Mercer, Strategy Analytics, Connected World: The Internet of Things and Connected Devices in 2020 (Oct. 2014)).

6 Intel Corp., Intel IoT Gateway (2014), http://www.intel.com/content/dam/www/public/us/en/documents/product-briefs/gateway-solutions-iot-brief.pdf.

states have implemented data security requirements applicable to any entity collecting information about residents of their state.[7] Businesses are thus subject to a patchwork of statutory and regulatory data security-related requirements, which creates a complex environment for entities with a national or regional presence.

In an era where federal law appears to trail behind technology, the FTC's robust body of data security enforcement actions and business guidance can provide entities with a basic understanding of the types of minimum security controls that should be in place. This article will explore the current legal landscape on data security, the FTC's legal authority to regulate data security practices, efforts to increase enforcement, and predictions for the future.

I. FTC'S DATA SECURITY ENFORCEMENT AUTHORITY

The FTC is the most active government enforcer with respect to business compliance with data security obligations. Its primary authority comes from Section 5(a) of the Federal Trade Commission Act ("FTC Act"), which prohibits unfair or deceptive acts or practices in or affecting commerce.[8] Although the FTC Act does not expressly grant the FTC authority to regulate data security, the FTC has interpreted its Section 5(a) authority to regulate data security practices, which was affirmed by at least one federal appellate court.[9] To date, the FTC has brought more than 55 actions against entities for alleged data security lapses.

When the Commission has "reason to believe" that a statutory violation has occurred (usually as a result of an investigation into the company's practices), the FTC may issue a draft complaint setting forth its charges. If the parties are unable to resolve the matter through settlement, the FTC may pursue alleged Section 5(a) violations either in federal court pursuant to Section 13(b),[10] or in its administrative capacity under Section 5(b).[11] The processes differ, but the most significant difference is that the FTC cannot obtain monetary relief in an administrative proceeding (without further proceedings in a federal district court).[12] Under Section 13(b), the Commission is authorized to seek not only preliminary and permanent injunctions to halt unfair and deceptive practices, but may also freeze assets, appoint receivers, obtain disgorgement of profits associated with the challenged conduct, and seek restitution and other relief to redress injury. In both federal and administrative actions, the FTC may also assert violations of other consumer

---

7 *See e.g. 201* MASS. CODE REGS. § 17.00 *et seq.* (West 2016) (requires entities handling personal information to implement a written comprehensive information security program); MD. CODE ANN. COM. LAW § 14-3503 (West 2008) (requires a business that owns or licenses personal information of an individual residing in the state to implement and maintain reasonable security procedures and practices that are appropriate to the nature of the personal information owned or licensed and the nature and size of the business and its operations."); NEV. REV. STAT. § 603A.215(1) (2011) (requires businesses that accept payment cards to comply with the most current version of the Payment Card Industry Data Security Standard).

8 15 U.S.C § 45(a) (2012).

9 *Fed. Trade Comm'n v. Wyndham Worldwide Corp.*, 799 F.3d 236 (3d Cir. 2015).

10 15 U.S.C. § 53(b).

11 *Id. § 45(b).*

12 *Id. § 57b(a)(2).*

protection statutes enforced by the Commission. A respondent can either elect to settle or contest the charges brought by the FTC.[13]

A Commission order generally becomes final sixty days after it is served on a respondent, unless the order is stayed by the Commission or by a reviewing court.[14] If a respondent violates a term of its order, it can be liable for a civil penalty of up to $16,000 for each violation, which the FTC can construe as each day of noncompliance.[15] In that case, a court may also issue mandatory injunctions and further equitable relief as is deemed appropriate.[16]

A. Unfair and Deceptive Acts and Practices in Data Security

The FTC's primary focus under Section 5 relates to whether: (1) an entity misrepresented its privacy or security practices or the privacy or security controls of a product (a "deception" claim), or (2) failed to implement or maintain "reasonable" and "appropriate" controls to secure sensitive personal information in a way that causes or is likely to cause substantial consumer injury, and such injury is not (a) outweighed by benefits to consumers and (b) reasonably avoidable by consumers (an "unfairness" claim).[17]

The FTC will consider an act or practice to be deceptive "if there is a representation, omission, or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer's detriment."[18] Certain claims, such as express claims, are presumed to be material.[19] Even implied claims can be deceptive. In the data security context, the FTC generally finds an act deceptive if an entity makes materially misleading statements (*e.g.,* in a privacy policy, or other public-facing materials) or deceptive omissions of material facts concerning its security measures and how it would handle, protect, or otherwise treat personal information that is inconsistent with the entity's actions.[20]

Separately, the FTC will deem an act or practice to be "unfair" if it (1) causes or is likely to cause substantial consumer injury (2) which is not reasonably avoidable by consumers themselves and (3) not outweighed by countervailing benefits to consumers

---

13 A respondent electing to settle the charges will typically enter into a consent agreement without admitting liability, consent to entry of a final order, and waive all right to judicial review. A respondent electing to contest the charges will often result in the Commission adjudicating the complaint in federal court or before an administrative law judge, with an opportunity to appeal any final decision.

14 15 U.S.C. § 45(g)(2).

15 *Id.* § 45(l) (2012); *see also* 16 C.F.R. § 1.98(c) (2015) (increased liability for statutory violations to $16,000).

16 15 U.S.C. § 45(1).

17 *Id.* §§ 45(a)(1), 45(n); *see also* Complaint for Injunctive and Other Equitable Relief, *Fed. Trade Comm'n v. Wyndham Worldwide Corp.*, Civ. No. 2:13-cv-01887 (D. Ariz. Jun. 26, 2012).

18 *See* Letter from James C. Miller III, Chairman, Fed. Trade Comm'n, to the Honorable John D. Dingell, Chairman, Comm. on Energy & Commerce, U.S. House of Representatives (Oct. 14, 1983) (appended to *In re* Cliffdale Associates, Inc., 103 F.T.C. 110, 174 (1984)), http://www.ftc.gov/bcp/policystmt/ad-decept.htm [hereinafter Miller, Deception Statement].

19 *Id.* at 182.

20 *See e.g.,* Complaint, *In re Snapchat, Inc.,* Docket No. C-4501 (F.T.C. Dec. 23, 2014), https://www.ftc.gov/system/files/documents/cases/141231snapchatcmpt.pdf.

or to competition.[21] The FTC's evaluation for an unfairness claim will generally focus on whether the practices at issue were "reasonable" under the circumstances and in light of industry standards, the cost and ease of having various security controls in place, and the known vulnerabilities of not having such controls.[22]

B. Additional FTC Authority to Regulate Data Security Practices

Companies collecting and storing consumer information must also comply with a host of other federal laws targeting the use and collection of certain particularly sensitive information. Unlike the FTC Act, many of these laws provide the Commission with the authority to issue civil penalties for statutory violations.

For instance, the Children's Online Privacy Protection Act ("COPPA") and FTC's COPPA Rule are designed to protect online users under the age of 13.[23] COPPA applies to an operator of a website or online service directed to children under 13, or an operator that has actual knowledge that its website or online service is collecting personal information from a child. The COPPA Rule requires operators to, among other things, "establish and maintain reasonable procedures to protect the confidentiality, security, and integrity of personal information collected from children."[24] An operator may retain personal information collected from a child for only as long as is reasonably necessary to fulfill the purpose for which the information was collected, and must delete such information using reasonable measures to protect against unauthorized access or use of the data in connection with its deletion.[25] Violators of the COPPA Rule can face civil penalties of up to $16,000 per violation.[26]

The Gramm-Leach-Bliley Act ("GLBA") requires financial institutions to protect consumers' nonpublic personal information, including by preventing disclosure to unauthorized third parties.[27] As part of its implementation of the GLBA, the Commission promulgated the Safeguards Rule, which requires subject entities to develop and maintain a comprehensive written information security program that addresses administrative, technical, and physical safeguards appropriate to the business based on its size and complexity, nature and scope of activities, and sensitivity of the personal information collected.[28] The Safeguards Rule requires businesses to "[i]dentify reasonably foreseeable internal and external risks to the security, confidentiality and

---

21 15 U.S.C. § 45(n) (2012); *see* Fed. Trade Comm'n, Commission Statement of Policy on the Scope of the Consumer Unfairness Jurisdiction, 104 F.T.C. 1070 (1984) (appended to *In re Int'l Harvester Co.,* 104 F.T.C. 949 (1984)) [hereinafter Fed Trade Comm'n, Unfairness Policy Statement].

22 *See e.g.* Complaint at 3, *In re* CVS Caremark Corp., Docket No. C-4259 (F.T.C. June 18, 2009), https://www.ftc.gov/sites/default/files/documents/cases/2009/06/090623cvscmpt.pdf (alleging that failure to use reasonable and appropriate measure to prevent unauthorized access to personal information caused or was likely to cause substantial injury to consumers not offset by countervailing benefits to consumers or competition and thus was an unfair act or practice).

23 15 U.S.C. § 6501 *et seq.;* 16 C.F.R. § 312.2 (2015).

24 16 C.F.R. § 312.8.

25 *Id.* § 312.10.

26 15 U.S.C. § 45(m)(1); *see also* 16 C.F.R. § 1.98(d) (2015).

27 15 U.S.C. § 6801 et seq. (2012); 16 C.F.R. §§ 313–314 (2015).

28 FTC Standards for Safeguarding Customer Information, 16 C.F.R. § 314.1 *et seq.*

integrity of customer information that could result in [its] unauthorized disclosure," among other requirements.[29] A violation of the Safeguards Rule constitutes an unfair or deceptive act or practice in violation of Section 5(a) of the FTC Act.[30]

Entities that use or provide consumer reports must also comply with the Fair Credit Reporting Act ("FCRA").[31] The FCRA requires consumer reporting agencies to maintain reasonable procedures designed to avoid disclosing consumer information, and imposes safe disposal obligations on entities that maintain or otherwise possess information used in consumer reports.[32] Regulations implementing the safe disposal obligations provide that reasonable measures include, but are not limited to, "[i]mplementing and monitoring compliance with policies and procedures that require the destruction or erasure of electronic media containing consumer information so that the information cannot practicably be read or reconstructed."[33] The FCRA authorizes the Commission to commence a civil action to recover monetary civil penalties in a district court in the event of a knowing violation when it constitutes a pattern or practice of violations.[34]

II. CHALLENGING THE FTC'S AUTHORITY TO REGULATE DATA SECURITY PRACTICES

Although the FTC's statutory authority to prohibit unfair and deceptive acts and practices is quite broad, the FTC Act makes no specific reference to data security or liability for data breaches. Nonetheless, since at least 2002, the FTC has asserted its authority over inadequate data security practices as unfair and/or deceptive in violation of Section 5, whether or not these practices lead to a breach of customer information.[35]

Only recently has the FTC's authority to regulate data security practices under Section 5 been challenged. In separate actions filed against Wyndham Worldwide Corporation (in federal court) and LabMD Inc. (as an administrative proceeding), the FTC alleged that the companies' failures to employ reasonable and appropriate measures to prevent unauthorized access to consumers' personal information violated the FTC Act. Both Wyndham and LabMD challenged the FTC's authority to regulate data security practices as "unfair."

A. Wyndham Worldwide Corporation

In June 2012, the FTC filed suit against global hospitality company Wyndham Worldwide Corporation and three of its subsidiaries, Wyndham Hotel Group, LLC, Wyndham Hotels and Resorts, LLC, and Wyndham Hotel Management, Inc. (collectively, "Wyndham").[36] The Commission alleged that Wyndham failed to implement reasonable and appropriate data security safeguards for the personal information collected and

---

29 *Id.* § 314.3(a).

30 Similarly, the FTC cannot impose civil penalties for violations of GLBA's safeguarding provisions.

31 15 U.S.C. § 1681 *et seq.*; 16 C.F.R. § 602.1 *et seq.*

32 *See* 16 C.F.R. § 682.3(a) (2015).

33 *Id.* § 682.3(b)(2).

34 15 U.S.C. § 1681s(a)(2)(A) (2012).

35 *See, e.g.,* Decision and Order, *In re Eli Lilly & Co.,* Docket No. C-4047 (F.T.C. May 8, 2002), https://www.ftc.gov/sites/default/files/documents/cases/2002/05/elilillydo.htm.

36 *See* Complaint for Injunctive and Other Equitable Relief, *Fed. Trade Comm'n v. Wyndham Worldwide Corp.*, Civ. No. 2:13-cv-01887 (D. Ariz. Jun. 26, 2012).

maintained at its franchise locations. According to the Commission, this allowed computer hackers to breach franchise computer systems and the company's centralized property management center on three separate occasions between 2008 and 2010. The complaint further alleged that the breach resulted in more than 619,000 consumer payment card account numbers being compromised, many account numbers being exported to a domain registered in Russia, fraudulent charges on consumers' accounts, and more than $10.6 million in fraud loss.

The FTC alleged the following deficiencies in Wyndham's cybersecurity practices: (i) failure to use "readily available security measures" (such as firewalls) to limit access between the property management systems, the corporate network, and the Internet; (ii) failure to implement adequate information security policies and procedures prior to connecting their local computer networks to the broader Wyndham computer network; (iii) failure to require strong usernames and passcodes to access property management systems; (iv) failure to employ reasonable measures to detect and prevent unauthorized access or to conduct security investigations; (v) failure to follow proper incident response procedures; and (iv) failure to adequately restrict third-party vendor access to its network and company servers. Given the breadth of alleged deficiencies, the FTC also claimed Wyndham's privacy policy deceptively misrepresented the extent to which the company safeguarded consumer data.

In August 2012, Wyndham filed a motion to dismiss the FTC's complaint on four grounds.[37] First, Wyndham challenged the FTC's authority to assert an unfairness claim in the data-security context. Second, Wyndham asserted that the FTC must formally promulgate rules or regulations before bringing an unfairness claim and, by failing to do so, the FTC violated fair notice principles. Third, Wyndham argued that the FTC's allegations are plead insufficiently to support either an unfairness or deception claim. Lastly, Wyndham challenged the FTC's deception claim that Wyndham's privacy policy misrepresented measures taken by the company to protect consumers' personal information.

In April 2014, the district court denied the motion, but certified its decision for interlocutory appeal on two key questions: (1) whether the FTC had the authority to regulate data security under the unfairness prong of Section 5(a); and (2) whether Wyndham had fair notice that its specific practices could run afoul of that provision.[38] Prior to the decision, no federal court had adjudicated whether the FTC had authority under Section 5(a) to bring actions against companies for allegedly deficient cybersecurity practices.

The U.S. Court of Appeals for the Third Circuit granted interlocutory appeal. On August 24, 2015, the Third Circuit confirmed that the FTC has authority to bring an action focused on a company's data security practices under the "unfairness" prong, and that the FTC is not required to articulate a specific cybersecurity standard for companies to follow.[39]

---

37 Motion to Dismiss by Defendant Wyndham Hotels & Resorts LLC, *Fed. Trade Comm'n v. Wyndham Worldwide Corp.*, No. 12-cv-1365-PHX-PGR (D. Ariz. Aug. 27, 2012).

38 *See Fed. Trade Comm'n v. Wyndham Worldwide Corp.,* 10 F. Supp. 3d 602, 607 (D.N.J. 2014); *see also id.* at 636 (granting Defendant's motion to certify issues for interlocutory appeal).

39 *Fed. Trade Comm'n v. Wyndham Worldwide Corp.*, 799 F.3d 236 (3d Cir. 2015). Following the Third Circuit's decision, Wyndham agreed to settle the FTC's charges in December 2015. Stipulated Order for Injunction, *Fed. Trade Comm'n v. Wyndham Worldwide Corp.*, Civ. No. 2:13-CV-01887-ES-JAD (D.N.J. Dec. 9, 2015), https://www.ftc.gov/system/files/documents/cases/151209wyndhamstipulated.pdf.

1. FTC'S Authority to Regulate Data Security Practices as "Unfair"

In challenging the FTC's authority to bring an unfairness action for allegedly deficient cybersecurity practices, Wyndham advanced a novel theory: the three requirements of an unfairness claim that are codified at 15 U.S.C. § 45(n)—(i) substantial injury, (ii) that is not reasonably avoidable by consumers, and (iii) that is not outweighed by the benefits to consumers or to competition—were "necessary but insufficient conditions" of an unfair practice. Specifically, Wyndham argued that the plain meaning of the word "unfair" imposes independent requirements that were not met by the FTC.[40] For example, Wyndham argued that conduct could only be unfair when it injured consumers "through unscrupulous or unethical behavior" or was otherwise "marked by injustice, partiality, or deception."[41]

In rejecting Wyndham's arguments, the court opined that the FTC Act contemplated a theory of liability based on tortious negligence. In the court's view, the FTC Act "expressly contemplates the possibility that conduct could be unfair before actual injury occurs."[42] Even if a company's conduct is not *the most proximate* cause of an injury, this generally will not immunize the entity from liability if the harm was foreseeable or likely.[43] Thus, the Third Circuit confirmed that companies may be liable under an unfairness theory for a reasonably foreseeable data breach, even absent any evidence of actual injury or harm.

In the alternative, Wyndham argued that Congress intended to exclude cybersecurity from the FTC's unfairness authority by enacting more targeted federal privacy legislation (*i.e.,* FCRA, GLBA, and COPPA). The Third Circuit again rejected this novel theory finding that the various federal privacy laws were enacted to expand the FTC's authority over corporate cybersecurity, not merely to establish the FTC's authority in the first instance.

2. "Fair Notice" is Not Required

Wyndham claimed that, notwithstanding whether its conduct was unfair under Section 5(a), the Commission "failed to give fair notice of the specific cybersecurity standards that the company was required to follow."[44] Wyndham claimed that the court could not defer to the agency's interpretation of its own regulations unless private parties had "ascertainable certainty" as to those interpretations. Because the company was not made aware with "ascertainable certainty" of the specific cybersecurity standards on which it would be held accountable, Wyndham asserted that the FTC's interpretation of what constituted minimum security standards was not entitled to deference.

The court rejected this argument, noting that the Commission was not relying on an agency interpretation, rule, or adjudication of minimum cybersecurity standards under

---

40 *Wyndham,* 799 F.3d at 244.

41 *Id.* at 245.

42 *Id.* at 246 (citing 15 U.S.C. § 45(n) (2012) ("[An unfair act or practice] causes or is likely to cause substantial injury" (emphasis in original))); *see also id.* (holding unfairness claims could "be brought on the basis of likely rather than actual injury" (quoting *In re Int'l Harvester Co.,* 104 F.T.C. 949, 1061 (1984))).

43 *Id.*

44 *Id.* at 249.

Section 5 of the FTC Act. Rather, no such precedence exists because the FTC had not yet declared that cybersecurity practices could be unfair (*i.e.,* its numerous cybersecurity related administrative settlements could not be considered precedential). Thus, the Third Circuit found that the company was not entitled to "ascertainable certainty" of the FTC's interpretation of the specific cybersecurity practices required by the FTC Act. As a result, the relevant question was not "whether Wyndham had fair notice of the *FTC's interpretation* of the statute, but whether Wyndham had fair notice of what the *statute itself* requires."[45]

The Third Circuit concluded that the FTC's previous adjudication and interpretive guidance provided the requisite notice to Wyndham that its actions could be considered "unfair" under the FTC Act. The court reasoned that Wyndham was entitled to a comparatively low level of statutory notice because no constitutional rights were implicated, the statute was civil instead of criminal, and it regulated economic activity.[46] Moreover, the cost-benefit analysis provided in Section 5(n) informed Wyndham that it should consider the probability and magnitude of harms to consumers caused by its data security practices and whether these costs outweighed any savings from not employing more secure practices.[47] The court noted that Wyndham was hacked three times and, at least after the second attack, it "should have been painfully clear to Wyndham that a court could find its conduct failed the cost-benefit analysis."[48] Based on these factors, the court rejected Wyndham's fair notice claim.

B. LabMD

At the same time that *Wyndham* was being litigated in federal court, the action against LabMD, Inc., a clinical testing laboratory, proceeded on a parallel track as an administrative adjudication. The LabMD saga began in May 2008, after Tiversa Holding Company (a third-party cybersecurity consultant specializing in peer-to-peer network searches) informed LabMD that a company report containing patient information was publicly available on a peer-to-peer network called LimeWire. The report contained names, dates of birth, Social Security numbers, and health insurance information of approximately 9,300 patients. Tiversa claimed that it had linked this report to four IP addresses associated with known identity thieves.

The FTC commenced investigation in 2010, shortly after Tiversa informed the FTC of its findings. Following several years of public sparring between LabMD and the FTC, the Commission commenced an administrative enforcement action in August 2013, alleging that LabMD failed to reasonably protect the security of consumers' personal data.[49] The complaint contends that in two separate incidents, LabMD collectively exposed the personal information of approximately 10,000 consumers. The first breach related to the findings by Tiversa. Then, in October 2012, LabMD "day sheets" and a small number

---

45 *Id.* at 253–254.

46 *Wyndham,* 799 F.3d at 255 (citing *Vill. of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498–99 (1982)).

47 *Id.* at 255–256.

48 *Id.* at 256.

49 *See* Complaint at 5, *In re LabMD Inc.,* Docket No. 9357 (F.T.C. Aug. 28, 2013), https://www.ftc.gov/sites/default/files/documents/cases/2013/08/130829labmdpart3.pdf.

of copied checks containing sensitive personal information of at least 500 consumers were allegedly found in the possession of individuals determined to be identity thieves.

1. Procedural Background

Following the FTC's administrative complaint, LabMD contested the FTC's allegations through the administrative process while pursuing a parallel challenge in federal court.[50] Namely, LabMD asserted that the administrative action was an improper expansion of FTC jurisdiction, was retaliatory, and violated the Due Process Clause. Although the actions in federal court were eventually dismissed, LabMD continued to pursue its challenge through the administrative process.

LabMD filed a motion to dismiss the administrative complaint in November 2013. The motion alleged that: (1) the FTC lacks Section 5 "unfairness" authority to regulate patient-information data and data security practices; (2) the enforcement action violates LabMD's due process rights because the Commission has not provided fair notice of the data security standards that it believes Section 5 prohibits or requires; (3) the acts or practices alleged in the complaint do not affect interstate commerce; and (4) the alleged acts and practices have not caused, and are not likely to cause, substantial injury that is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.[51] Under the FTC's Rules of Practice, the motion was decided by the Commission. The Commission rejected LabMD's defenses, holding that the statutory prohibition against unfair trade practices in Section 5 could be applied to allegedly unreasonable and injurious data security practices, and declined to dismiss the complaint.[52]

The administrative proceeding proved lengthy and very contentious. With more than 200 entries on the administrative docket, including numerous discovery motions,

---

50 LabMD filed suit in the District Court for the District of Columbia, seeking an injunction to stay the administrative action from going forward on the grounds that it was an improper expansion of FTC jurisdiction, was retaliatory, and violated the Due Process Clause. *See LabMD Inc. v. F.T.C.,* No. 1:13-cv-01787-CKK (D.D.C. Nov. 14, 2013). LabMD filed a similar action in the United States Court of Appeals for the Eleventh Circuit, making the same allegations. *See LabMD Inc. v. F.T.C.,* No. 13-15267-F (11th Cir. Feb. 18, 2014). The Eleventh Circuit denied LabMD's claim, "citing [its] lack of jurisdiction over a non-final agency action, but declined to address whether the District Court could hear any of the claims." *LabMD, Inc. v. F.T.C.*, 776 F.3d 1275, 1277 (11th Cir. 2015). LabMD voluntarily dismissed its District of Columbia suit. On March 20, 2014, LabMD filed another suit in the Northern District of Georgia, alleging that: "(1) the FTC's administrative action against LabMD is arbitrary and capricious in violation of the [Administrative Procedure Act (APA)] because the FTC has no authority to regulate protected health information (PHI); (2) the action is ultra vires and exceeds its statutory authority; (3) the FTC's application of Section 5 to LabMD's security protocols violates the Due Process Clause of the U.S. Constitution because it did not provide fair notice or access to a fair tribunal and a hearing; and (4) the FTC violated LabMD's First Amendment right to free speech." *Id.* at 1277–78. The FTC filed a motion to dismiss, which the District Court granted, and LabMD appealed the decision, once again, to the Eleventh Circuit. The Eleventh Circuit eventually upheld the district court's dismissal of LabMD's complaint against the FTC, finding that the complaint did not stem from a "final" agency action as required under the APA. *See id.* at 1279.

51 *See e.g.,* Respondent LabMD, Inc.'s Motion to Dismiss Complaint with Prejudice and to Stay Administrative Proceedings, *In re LabMD Inc.,* Docket No. 9357 (F.T.C. Nov. 12, 2013), https://www.ftc.gov/sites/default/files/documents/cases/131112respondlabmdmodiscomplaintdatyadminproceed.pdf.

52 *See* Commission Order Denying LabMD's Motion to Dismiss at 2, *In re LabMD, Inc.,* Docket No. 9357 (F.T.C. Jan. 16, 2014), https://www.ftc.gov/sites/default/files/documents/cases/140117labmdorder.pdf.

motions for sanctions, and motions to dismiss, the three-year battle found itself at a full administrative trial before the Chief Administrative Law Judge D. Michael Chappell ("ALJ"). Days after the administrative trial began in May 2014, it was reported that the House Committee on Oversight and Government Reform ("OGR") had begun an investigation of Tiversa regarding the company's disclosures to the FTC. The OGR intended to call LabMD's key witness, former Tiversa employee Richard Wallace, in exchange for immunity. It was further disclosed that, if called to testify in the administrative proceedings, Wallace would invoke his constitutional privilege against self-incrimination, pending his effort to obtain a grant of prosecutorial immunity. The action was stayed to allow Wallace to seek prosecutorial immunity for the OGR testimony and for testimony in these administrative proceedings.[53]

On May 30, 2014, Wallace testified before OGR that Tiversa had fabricated evidence linking the LabMD report to identity thieves' IP addresses.[54] According to Wallace, Tiversa never found any evidence that anyone other than LabMD or Tiversa had accessed the report. Wallace testified that Tiversa's business model was to "monetize" documents that it downloaded from peer-to-peer networks, by using those documents to sell data security remediation services to affected entities, and by manipulating Tiversa's internal database of peer-to-peer network downloads to make it appear that a business' information had been found at IP addresses belonging to known identity thieves. Furthermore, Wallace testified that Tiversa allegedly fabricated this information and reported it to the FTC after it unsuccessfully solicited business from LabMD.

On December 29, 2014, on the Commission's motion, and pursuant to authority granted by the Attorney General of the United States on November 14, 2014, the ALJ issued an order granting Mr. Wallace immunity pursuant to Commission Rule 3.39 and directing Mr. Wallace to testify in these proceedings.[55] Proceedings reconvened for Mr. Wallace's testimony on May 5, 2015. Following the testimony, FTC staff chose not to cross-examine Wallace, indicated it would not rely on certain Tiversa-related testimony and evidence in its proposed findings of fact, and opted not to offer any rebuttal to Wallace's testimony.

2. FTC Failed to Demonstrate Likelihood of Consumer Injury

On November 13, 2015, the ALJ handed down the decision, dismissing the case in its entirety. The decision turned on whether the FTC had demonstrated that the alleged unreasonable conduct caused or is likely to cause substantial injury to consumers, as

---

53 *See* Order on Respondent's Unopposed Motion at 6, *In re LabMD, Inc.,* Docket No. 9357 (F.T.C. Oct. 9, 2014), https://www.ftc.gov/system/files/documents/cases/141009labmdaljorder.pdf.

54 *See* Letter from Rep. Darrell E. Issa, Chairman, House Oversight & Gov't Reform Comm., to The Honorable Edith Ramirez, Chairwoman, Fed. Trade Comm'n (June 11, 2014).

55 *See* Order Granting Respondent's Renewed Motion, *In re LabMD, Inc.,* Docket No. 9357 (F.T.C. Dec. 29, 2014), https://www.ftc.gov/system/files/documents/cases/141229labmdorder.pdf.

required by the first prong of the three-part "unfairness" test under Section 5(n).[56] The decision explains that the FTC's evidence failed to prove that the limited exposure of the report resulted or was likely to result in any identity theft-related harm. Moreover, the evidence failed to prove that embarrassment or similar emotional harm is likely to be suffered from the exposure of the report alone. The decision notes that, even if there were proof of such harm, this would constitute only subjective or emotional harm without further proof of other tangible injury. The ALJ determined that this does not amount to a "substantial injury" within the meaning of Section 5(n).

In addition, with respect to the exposure of "day sheets" and check copies, the decision notes that the FTC failed to prove that the exposure of these documents was causally connected to any failure of LabMD to reasonably protect data maintained on its computer network, because the evidence failed to show that these documents were maintained by, or taken from, LabMD. The decision further explains that FTC failed to prove that the exposure of day sheets and check copies caused, or was likely to cause, any consumer harm. Notably, the decision states that:

> *To impose liability for unfair conduct under Section 5(a) of the FTC Act, where there is no proof of actual injury to any consumer, based only on an unspecified and theoretical "risk" of a future data breach and identity theft injury, would require unacceptable speculation and would vitiate the statutory requirement of "likely" substantial consumer injury.*[57]

At best, the ALJ found that the FTC had proven the "possibility" of harm, but not any "probability" or likelihood of harm. Therefore, because the Commission failed to prove its case on the merits, the ALJ dismissed the case.

The ALJ's decision in *LabMD* is significant in that it clarifies the scope of the FTC's authority. By requiring some probability or likelihood of harm for unfairness claims, the decision presents a potentially restricting interpretation of Section 5(a)'s reach into data security practices. Regardless, the Third Circuit's decision in *Wyndham*, finding that the FTC has regulatory authority in this arena, is not disturbed.[58] Moreover, the FTC staff has appealed the ALJ's decision before the full Commission, so the *LabMD* saga likely will continue.[59]

III. FTC DATA SECURITY ENFORCEMENT AND TRENDS

The FTC is empowered under Section 5(a) to ensure that business representations and practices are not deceptive and/or unfair. In recent years, the FTC has focused its data security enforcement efforts in two primary areas. First, the FTC has reviewed the

---

56 Section 5(n) of the FTC Act states that "[t]he Commission shall have no authority to declare unlawful an act or practice on the grounds that such act or practice is unfair unless [1] the act or practice causes or is likely to cause substantial injury to consumers [2] which is not reasonably avoidable by consumers themselves and [3] not outweighed by countervailing benefits to consumers or to competition." Initial Decision at 13, *In re LabMD Inc.,* Docket No. 9357 (F.T.C. Nov. 13, 2015) (citing 15 U.S.C. § 45(n)), https://www.ftc.gov/system/files/documents/cases/151113labmd_decision.pdf.

57 *Id.* at 14.

58 Given that *LabMD* was an administrative proceeding, the ALJ's decision does not have binding precedential effect on federal or state courts.

59 Complaint Counsel's Appeal Brief, *In re LabMD, Inc.,* Docket No. 9357 (F.T.C. Dec. 22, 2015), https://www.ftc.gov/system/files/documents/cases/complaint_counsels_appeal_brief_-_labmd_580407.pdf.

extent to which a business protects the personal information collected and shared so that it is not misused by the business, third-party affiliates, service providers, or by hackers. Second, the FTC has scrutinized public statements made concerning how such personal information is protected.

The FTC has found fault with a number of common business practices for placing customer information at risk of misuse, including but not limited to:

- Permitting common or weak passwords to the company's systems and databases (including using a system administrative default log-in and password);
- Failing to implement internal measures appropriate under the circumstances to protect sensitive consumer information;
- Failing to sufficiently train employees on how to protect the confidentiality and privacy of customer information;
- Providing unrestricted retention of customer information (*i.e.,* keeping data longer than necessary) if there is no legitimate business reason to maintain the data;
- Allowing for inadequate data disposal practices for both electronic and hard copy data containing sensitive customer information;
- Failing to secure mobile and other devices with sensitive customer information, including laptops, PDAs, mobile phones, and flash drives;
- Failing to protect against "Structured Query Language" attacks to electronic databases;
- Storing sensitive information in clear, readable, unencrypted text that could be accessed through commonly-known log-ins and passwords (both during transmission and while the data is at rest);
- Failing to regularly monitor and control connections to the company's network, including via wireless connections;
- Failing to employ proper means to detect unauthorized access to sensitive personal information; and
- Failing to regularly perform security investigations or audits (or ignoring the results).

Data security settlements have not typically resulted in monetary penalties, unless the FTC can show that affected consumers were injured monetarily, that the business obtained a direct financial benefit from use of the consumers' personal information in a manner inconsistent with the relevant privacy policy (such as from a sale of such information), or the business violated another statute that contains civil penalty provisions, such as FCRA or COPPA. Although the FTC cannot assess monetary civil penalties directly for violations of Section 5(a), settling companies are typically under FTC order for 20 years. This means that if the company violates a term of its settlement agreement with the FTC, it can be liable for a civil penalty of up to $16,000 for each violation, which the FTC can construe as each day of noncompliance.

FTC data security settlements have typically been limited to robust injunctive provisions, third-party audits every two years during the term of the settlement, and even individual liability for company owners. The FTC also regularly requires businesses to have a comprehensive written information security program.[60] In general, an FTC

---

60 We note, additionally, that the FTC requires financial institutions subject to the GLBA Safeguards Rule to maintain a comprehensive written information security program that addresses administrative, technical, and physical safeguards appropriate to the business based on its size and complexity, nature and scope of activities, and sensitivity of the personal information collected. 16 C.F.R. § 314.3(a) (2015).

consent order will require that the company establish, implement, and thereafter maintain a written comprehensive information security program that is reasonably designed to protect the security, confidentiality, and integrity of personal information collected from or about consumers. Such programs are typically required to maintain administrative, technical, and physical safeguards appropriate to the entity's size and complexity, the nature and scope of the entity's activities, and the sensitivity of the personal information collected from or about consumers, including:

1. The designation of an employee or employees to coordinate and be accountable for the information security program;
2. The identification of reasonably foreseeable, material internal and external risks to the security, confidentiality, and integrity of personal information that could result in the unauthorized collection, use, disclosure, misuse, loss, alteration, destruction, or other compromise of such information, and assessment of the sufficiency of any safeguards in place to control these risks. At a minimum, this risk assessment should include consideration of risks in each area of relevant operation, including, but not limited to: (1) employee training and management, including secure engineering and defensive programming; (2) information systems, including network and software design, information processing, storage, transmission, and disposal; (3) product design development, and research; and/or (4) prevention, detection, and response to attacks, intrusions, or other systems failures;
3. The design and implementation of reasonable safeguards to control the risks identified through risk assessment;
4. Regular testing or monitoring of the effectiveness of the safeguards' key controls, systems, and procedures;
5. The development and use of reasonable steps to select and retain service providers capable of appropriately safeguarding personal information received from the company, and requiring service providers by contract to implement and maintain appropriate safeguards; and
6. The evaluation and adjustment of the information security program in light of the results relating to the testing and monitoring of the effectiveness of the safeguards, any material changes to any operations or business arrangements, or any other circumstances that may have an impact on the effectiveness of the information security program.[61]

The FTC's past enforcement in this area can provide entities with a basic understanding of the types of minimum security controls that should be in place. Moreover, these enforcement efforts identify four general categories of practices or products where FTC enforcement action has been and remains prevalent.

---

61 *See e.g.,* Decision and Order at 3, *In re Snapchat, Inc.,* Docket No. C-4501 (F.T.C. Dec. 23, 2014), https://www.ftc.gov/system/files/documents/cases/141231snapchatdo.pdf; Agreement Containing Consent Order, *In re ASUSTeK Computer, Inc.,* File No. 142-3156 (F.T.C. Feb. 23, 2016), https://www.ftc.gov/system/files/documents/cases/160222asusagree.pdf.

A. Corporate Data Security Practices

From its first data security action in 2002 against Eli Lilly involving the unauthorized disclosure of sensitive personal information by an employee,[62] the FTC has continued to necessitate that entities remain vigilant in safeguarding sensitive consumer information maintained on company servers, corporate and computer networks, and employee devices.

For instance, the FTC has brought several enforcement actions when unsecured corporate devices containing customers' personal information were misplaced or stolen. Notably, the FTC settled with Accretive Health, Inc. after an employee's laptop computer, containing sensitive information on 23,000 patients, was stolen from the passenger compartment of an employee's car.[63] Similarly, the operator of a cord blood bank, Cbr Systems, Inc., settled with the FTC after several backup tapes, a laptop, an external hard drive, and USB drive were allegedly stolen from an employee's personal vehicle.[64] The backup tapes were unencrypted and contained personal information from approximately 300,000 customers. The laptop and external hard drive were also unencrypted, and contained enterprise network information, including passwords and protocols, which could have facilitated an intruder's access to Cbr's network. In each case, the Commission alleged that the entities created unnecessary risks by transporting portable media containing consumer information in a manner that was vulnerable to theft or other misappropriation, and failed to employ reasonable procedures to ensure that consumers' personal information was removed or deleted when there was no longer a business purpose for retaining the data.

The Commission also settled with PLS Financial Services, Inc., a corporate manager of more than 300 payday loan and check cashing stores, and an affiliated owner and operator of several stores, following the unsecured disposal of consumer sensitive personal information. Specifically, the FTC's complaint alleged that the companies disposed of documents containing sensitive personal identifying information (including Social Security numbers, employment information, loan applications, bank account information, and credit reports) in unsecured dumpsters near several PLS Loan Stores or PLS Check Cashers locations. In addition to violations of Section 5, the FTC also alleged that the companies violated the Gramm-Leach-Bliley Safeguards Rule, which requires financial institutions to develop and use safeguards to protect consumer information.

The FTC has also kept a close watch over the data security practices of social networking sites. For example, in 2010, Twitter settled claims that it failed to protect users' personal information allowing hackers to obtain unauthorized administrative control of Twitter, including access to non-public user information, private tweets,

---

62 *See* Decision and Order, *In re Eli Lilly & Co.,* Docket No. C-4047 (F.T.C. May 8, 2002), https://www.ftc.gov/sites/default/files/documents/cases/2002/05/elililly do.htm.

63 *See* Decision and Order*, In re Accretive Health, Inc.,* Docket No. C-4432 (F.T.C. Feb. 24, 2014), https://www.ftc.gov/system/files/documents/cases/140224accretivehealthdo.pdf; *see also* Complaint at 2, *In re Accretive Health, Inc.*, Docket No. C-4432 (F.T.C. Feb. 5, 2014), https://www.ftc.gov/system/files/documents/cases/140224accretivehealthcmpt.pdf.

64 Decision and Order, *In re Cbr Systems, Inc.,* Docket No. C-4400 (F.T.C. Apr. 29, 2013), https://www.ftc.gov/sites/default/files/documents/cases/2013/05/130503cbrdo.pdf; *see also* Complaint at 3, *In re Cbr Systems, Inc.*, Docket No. C-4400 (F.T.C. Apr. 29, 2013).

and the ability to send out phony tweets from any account.[65] Specifically, the FTC's complaint asserted that an intruder used an automated password guessing tool to derive an employee's administrative password, after submitting thousands of guesses into Twitter's public login webpage. The password was a weak, lowercase, letter-only, common dictionary word. Using this password, the intruder reset user passwords, and publicly posted the information allowing other hackers to send unauthorized tweets from user accounts. This included one tweet, purportedly from President Barack Obama offering his more than 150,000 followers a chance to win $500 in free gasoline, in exchange for filling out a survey.

Although the FTC may investigate an entity's corporate data security practices when a breach occurs, it may not always mean the FTC will bring an enforcement action. For instance, in August 2015, the FTC sent a closing letter to Morgan Stanley Smith Barney LLC relating to the Commission's investigation over whether Morgan Stanley engaged in unfair or deceptive acts or practices by failing to secure certain account information related to its Wealth Management clients.[66] The investigation examined allegations that a Morgan Stanley employee misappropriated client information by transferring data from the Morgan Stanley computer network to a personal website accessed at work, and then onto other personal devices. The exported data subsequently appeared on multiple Internet websites, causing the potential for misuse of the data. The FTC decided to informally close the case without further action because Morgan Stanley had established and implemented comprehensive policies and access controls designed to protect against insider theft of personal information.

B. Software Providers

Both companies designing and using their own software, in addition to those using third party software in their business operations, have been subjected to FTC enforcement. Often times, the FTC will allege that the software itself, or the company's use of the software, either caused, or had the potential to cause, unauthorized third parties or hackers to access customer data. This can be due to vulnerabilities in the software design or the way in which the software was used. As discussed in *LabMD,* the FTC alleged that the company report was placed on a peer-to-peer file sharing network that was publicly accessible. The FTC has also brought similar actions against a number of other companies.

For instance, web analytics company, Compete Inc., settled FTC charges that it used its web-tracking software to collect personal data without disclosing the extent of the data collected through its software and third-party web tools, and failed to honor

---

65 Decision and Order, *In re Twitter, Inc.,* Docket No. C-4316 (F.T.C. Mar. 2, 2011), https://www.ftc.gov/sites/default/files/documents/cases/2011/03/110311twitterdo.pdf; *see also* Complaint at 3–4, *In re Twitter, Inc.*, Docket No. C-4316 (F.T.C. Mar. 2, 2011), https://www.ftc.gov/sites/default/files/documents/cases/2011/03/110311twittercmpt.pdf.

66 Letter from Maneesha Mithal, Assoc. Dir. of the FTC Div. of Privacy and Identity Prot., to Lisa J. Sotto, Counsel for Morgan Stanley Smith Barney LLC (August 10, 2015), https://www.ftc.gov/system/files/documents/closing_letters/nid/150810morganstanleycltr.pdf.

representations made about the extent to which it would protect the data.[67] Specifically, Compete's web-tracking software allegedly captured information consumers entered into websites, including usernames, passcodes, search terms, and sensitive information, such as credit card and financial account information, security codes and expiration dates, and SSNs. Compete made representations concerning the security of its software, including that all personal information is stripped before being sent to the company's servers. Despite these representations, the FTC's complaint alleged that Compete failed to remove personal data before transmitting it; failed to provide reasonable and appropriate data security; transmitted sensitive information from secure websites in readable text; failed to design and implement reasonable safeguards to protect consumers' data; and failed to use readily available measures to mitigate the risk to consumers' data.

In December 2015, Oracle agreed to settle charges that it deceived consumers about the security of Java software updates.[68] The FTC alleged that since acquiring Java in 2010, Oracle was aware of significant security issues affecting older versions of Java SE.[69] The security issues allowed hackers to create malware allowing access to consumers' usernames and passwords for financial accounts, and permitting hackers to acquire other sensitive personal information through phishing attacks. The FTC alleged that Oracle represented that by installing its updates to Java SE, the updates and the consumer's system would be "safe and secure" with the "latest… security updates." During the update process, however, the Java SE update removed only the most recent prior version of the software, but did not remove any earlier versions that might be installed. As a result, consumers could still have older, insecure versions of the software on their computers that were vulnerable to being hacked.

Most recently, Henry Schein Practice Solutions, Inc., a provider of office management software for dental practices, agreed to settle FTC charges that it falsely advertised the level of encryption provided to protect patient data.[70] The FTC's complaint alleged that Schein marketed its Dentrix G5 software to dental practices with deceptive claims that the software provided industry-standard encryption for sensitive patient information to ensure that practices using its software would protect patient data, as required by the Health Insurance Portability and Accountability Act (HIPAA). The software, however, used a proprietary algorithm that had not been tested publicly, and was less secure and more vulnerable than widely-used, industry-standard encryption algorithms.

---

67 Decision and Order, *In re Compete, Inc.,* Docket No. C-4384 (F.T.C. Feb. 20, 2013), https://www.ftc.gov/sites/default/files/documents/cases/2013/02/130222competedo.pdf; *see also* Complaint at 6, *In re Compete, Inc.*, Docket No. C-4383 (F.T.C. Feb. 20, 2013), https://www.ftc.gov/sites/default/files/documents/cases/2013/02/130222competecmpt.pdf.

68 Agreement Containing Consent Order, *In re Oracle Corp.,* File No. 132 3115 (F.T.C. Dec. 21, 2015), https://www.ftc.gov/enforcement/cases-proceedings/132-3115/oracle-corporation-matter.

69 *See* Complaint at 2–3, *In re Oracle Corp.*, File No. 132 3115 (F.T.C. Dec. 21, 2015), https://www.ftc.gov/system/files/documents/cases/151221oraclecmpt.pdf.

70 Agreement Containing Consent Order, *In re Henry Schein Practice Sols., Inc.*, File No. 142-3161 (F.T.C. Jan. 5, 2016), https://www.ftc.gov/system/files/documents/cases/160105scheinagreeorder.pdf; *see also* Complaint at 3, *In re Henry Schein Practice Sols., Inc.*, File No. 142-3161 (F.T.C. Jan. 5, 2016), https://www.ftc.gov/system/files/documents/cases/160105scheincmpt.pdf.

C. Mobile Apps and Mobile Devices

Since the FTC brought its first enforcement action involving a mobile app in 2011, the Commission has continued its active enforcement efforts, bringing more than 20 total cases involving mobile applications or mobile devices, including four relating to data security. In the data security context, the FTC has generally alleged that developers maintained inadequate security measures on their mobile apps or mobile devices.

The FTC kicked off its mobile app data security enforcement in 2011, settling with Frostwire LLC, a peer-to-peer (P2P) file-sharing app developer and its principal, over charges of unauthorized public disclosure of sensitive information and misrepresentation to its users concerning the sharing of downloaded user files.[71] Frostwire offered two free P2P file-sharing applications, which enabled users to share files—photos, videos, documents, and music—with other users on the same network. The FTC alleged that Frostwire had configured the default settings to allow the app to publicly share personal files that were stored on the users' mobile devices without proper notice or consent.

In June 2013, the FTC charged HTC America with failing to take reasonable steps to secure the software developed for the company's smartphones and tablets.[72] According to the complaint, the software's security flaws placed sensitive consumer information at risk of disclosure. The security vulnerabilities allowed the installation of malware onto devices without the consumer's knowledge or consent. Such malware could record and transmit information stored on the device, such as financial account and medical information. Due to the software flaws, the device user manuals and the interface for the company's Tell HTC app deceptively represented that HTC would notify users of third-party application access to device information and obtain their consent.

The FTC settled with two mobile app developers in March 2014 alleging that the companies failed to secure the transmission of consumers' sensitive personal information collected via their mobile apps and misrepresented the security precautions that the companies took for each app.[73] Specifically, the FTC asserted that Fandango and Credit Karma disabled the SSL (Secure Sockets Layer) certification validation procedure for each of their mobile apps. By doing so, the FTC claims that the apps were open to attackers positioning themselves between the app and the online service by presenting an invalid SSL certificate to the app—*i.e.,* "man-in-the-middle" attacks. The FTC contends that Fandango and Credit Karma engaged in a number of practices that, when taken together, failed to provide reasonable and appropriate security in the development and maintenance of its mobile app.

Most recently, the FTC announced a settlement with Snapchat resolving allegations that the app deceived consumers over the disappearing nature of users "snaps" and made

---

71 Complaint for Permanent Injunction and Other Equitable Relief, *Fed. Trade Comm'n v. Frostwire LLC*, Civ. No. 1:11-cv-23643-DLG (S.D. Fla. Oct. 7, 2011), https://www.ftc.gov/sites/default/files/documents/cases/2011/10/111011frostwirecmpt.pdf.

72 Complaint at 7, *In re HTC America, Inc.*, Docket No. C-4406 (F.T.C. June 25, 2013), https://www.ftc.gov/sites/default/files/documents/cases/2013/07/130702htccmpt.pdf.

73 *See* Decision and Order, *In re Fandango, LLC,* Docket No. C-4481 (F.T.C. Aug. 13, 2014), https://www.ftc.gov/system/files/documents/cases/140819fandangodo.pdf; Decision and Order, *In re Credit Karma, Inc.*, Docket No. C-4480 (F.T.C. Aug. 13, 2014), https://www.ftc.gov/system/files/documents/cases/1408creditkarmado.pdf.

false and misleading representations concerning its privacy and information security practices. The FTC took issue with several of Snapchat's practices and representations, including that Snapchat failed to securely design its "Find Friends" feature by failing to verify the phone number of the user upon registration. In such case, an individual could create an account using a phone number belonging to another consumer. In addition, Snapchat had represented in its privacy policy that it takes "reasonable steps" or "reasonable measures" to protect users' information. The FTC asserts, however, that Snapchat failed to implement any restrictions on serial and automated account creation, which allowed attackers to create multiple accounts and send millions of Find Friends requests using randomly generated phone numbers. According to the complaint, the attackers were able to compile a database of 4.6 million Snapchat usernames and associated mobile phone numbers.[74]

D. Internet-of-Things and Other Connected Devices

The FTC has expanded its enforcement efforts to cover the "Internet of Things" ("IoT") and other connected devices. In the FTC's first enforcement action regarding IoT, the FTC settled with TRENDnet, maker of Internet-connected home security cameras and baby monitors.[75] The FTC alleged that TRENDnet failed to employ reasonable and appropriate security in the design and testing of the software that it provided consumers for its IP cameras and failed to implement a process to actively monitor security vulnerability reports. The FTC alleged that, due to the company's failure to properly secure the cameras, hackers were able to access and then post online the private video and even audio feed of nearly 700 TRENDnet cameras, including live feeds displaying private areas of users' homes.[76]

The FTC followed up in February 2016 with its second IoT enforcement action charging that ASUSTeK Computer, Inc. failed to secure its connected routers and "cloud" services.[77] The FTC alleged that ASUS misrepresented the products' security through claims such as "the most complete, accessible, and secure cloud platform" and "safely secure and access your router." Nonetheless, the router and cloud services contained significant vulnerabilities and design flaws allegedly allowed unauthorized access to router login credentials and consumer files. For example, the complaint alleged that hackers could exploit pervasive security bugs in the consumer's web-based control panel to change the router's security settings, turn off the router's firewall, permit public access to the consumer's "cloud" storage, and configure the router to redirect consumers to malicious websites. Attackers could also access users' cloud storage without any login credentials and gain complete access to a consumer's connected storage device. This led to the compromise of thousands of consumers' connected storage devices, exposing consumers' personal files and sensitive information. At least one ASUS customer was the victim of identity theft.

---

74 Complaint at 8, *In re Snapchat, Inc.*, Docket No. C-4501 (F.T.C. May 8, 2014), https://www.ftc.gov/system/files/documents/cases/140508snapchatcmpt.pdf.

75 Decision and Order, *In re TRENDnet, Inc.*, Docket No. C-4426 (F.T.C. Feb. 7, 2014), https://www.ftc.gov/system/files/documents/cases/140207trendnetdo.pdf.

76 *See Complaint at 5, In re TRENDnet, Inc.*, Docket No. C-4426 (F.T.C. Jan. 16, 2014), https://www.ftc.gov/system/files/documents/cases/140207trendnetcmpt.pdf.

77 Complaint at 2–3, *In re ASUSTeK Computer, Inc.*, File No. 142-3156 (F.T.C. Feb. 23, 2016), https://www.ftc.gov/system/files/documents/cases/160222asuscmpt.pdf.

IV. PREDICTIONS FOR THE FUTURE

The FTC will continue its data security enforcement efforts for new and innovative products and connected devices when companies fail to enact reasonable data security policies and procedures to protect the security of users' personal or sensitive information. FTC investigations and enforcement activity often will follow on the heels of the Commission's workshops, reports, testimony before Congress, and other activities, and can provide insight for future trends. For instance, the FTC held a public workshop in November 2015 on cross-device tracking to examine privacy issues associated with tracking consumers' activities over time and across different devices for advertising and marketing purposes.[78] In March 2016, the FTC followed up on lessons learned in this area when it sent warning letters to a dozen mobile app developers alleging that audio monitoring software used in their apps had the potential to track consumers' activities for advertising purpose, but was not clearly disclosed to consumers.[79]

The FTC's pre-enforcement activities can provide a looking glass into issues that likely will emerge in the data security context. For example, the FTC has already announced that it will host a series seminars in fall 2016 to examine several new consumer protection issues.[80] Notably, one workshop will address the issue of ransomware, whereby hackers can gain access to consumer and business computers, encrypt files containing photos, documents, and other important data, and then demand a ransom in exchange for the encryption code. The FTC, through its prior workshops, reports, speeches, and Congressional testimony, has already revealed its interest in big data, connected cars, and consumer-generated and controlled health data (such as through health and fitness apps and devices). Although the Commission has yet to announce any enforcement actions in these areas, we should expect to see them in the near future.

Nonetheless, the fact that a company may suffer a data breach or data security lapse does not necessarily mean that the same company will face an FTC enforcement action. What the FTC requires is that entities implement *reasonable* data security measures, taking into account the sensitivity and volume of the consumer data collected, the size and complexity of the entity operations, and the cost of available tools to secure the data.[81] The Commission has reiterated that "reasonable security" does not necessarily mean perfect security.[82] It is only when a company deceives consumers about the data security practices or protections, or fails to provide reasonable security, that the FTC may intervene.

---

78 Fed. Trade Comm'n, Cross-Device Tracking, An FTC Workshop (Nov. 15, 2015), https://www.ftc.gov/news-events/events-calendar/2015/11/cross-device-tracking.

79 Fed. Trade Comm'n, Press Release, FTC Issues Warning Letters to App Developers Using 'Silverpush' Code (Mar. 17, 2016), https://www.ftc.gov/news-events/press-releases/2016/03/ftc-issues-warning-letters-app-developers-using-silverpush-code.

80 Fed. Trade Comm'n, Press Release, FTC to Host Fall Seminar Series on Emerging Consumer Technology Issues (Mar. 31, 2016), https://www.ftc.gov/news-events/press-releases/2016/03/ftc-host-fall-seminar-series-emerging-consumer-technology-issues.

81 *See e.g.,* Fed. Trade Comm'n, Statement Marking the FTC's 50th Data Security Settlement (Jan. 31, 2014), https://www.ftc.gov/system/files/documents/cases/140131gmrstatement.pdf.

82 *See* Julie Brill, Comm'r, Fed. Trade Comm'n, Keynote at FTC's Start with Security Event, Do Try This at Home: Starting Up with Security at 2 (Feb. 9, 2016), https://www.ftc.gov/system/files/documents/public_statements/915043/160208swsseattle.pdf.

The Third Circuit's *Wyndham* decision is significant when analyzing future trends for several reasons. First, the decision provides support that companies may be liable under an FTC unfairness theory for inadequate cybersecurity measures on the basis of likely (rather than actual) injury to consumers. Second, the decision underscores that companies have "fair notice" that a cybersecurity program may fall within the FTC's jurisdictional scope of Section 5(a), and whether such program is reasonable will turn on the extent to which the program survives a cost-benefit analysis. Lastly, the FTC's business guidance, administrative complaints, and consent decrees can guide entities as to what practices may give rise to unfairness claims based on inadequate corporate cybersecurity, and help to identify what security controls should be in place.

The general takeaway from FTC's data security enforcement actions is that a company's data security practices may be considered "reasonable" by the FTC (even if not perfect, and even within the context of a breach), if the company can demonstrate that it implemented comprehensive policies and access controls designed to protect consumer information; that the potential costs of more robust data security measures would offset any benefit to consumers in the aggregate and to competition; and that it did not misrepresent these practices in statements to consumers.

The FTC's deception and unfairness principles will continue to apply to Internet connected devices, web services, and mobile applications, just as they always applied to basic computers, corporate practices, and employee devices. As connected devices and the "Internet of Things" descends into new areas, so too will FTC enforcement.

CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW - REVISED EDITION

Cheryl Lee Johnson, Editor-in-Chief

Gain authoritative understanding of California antitrust and unfair competition statutes, policies and issues with one-volume convenience. This treatise brings you up to speed on everything from horizontal combinations and vertical restraints to public enforcement of California antitrust laws and trial considerations.

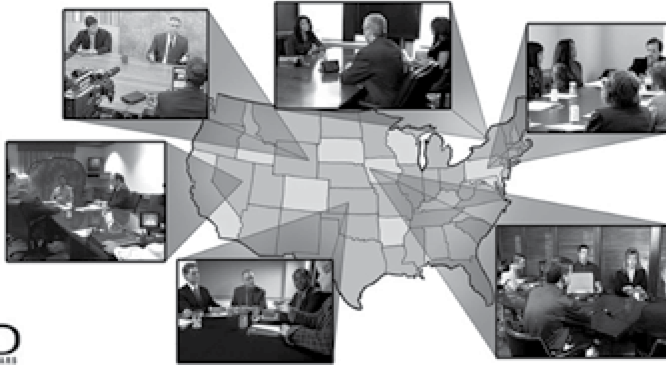
You get full coverage of The Cartwright Act along with related California consumer and unfair competition laws, and how they apply to the health industry, regulated industries, the labor market, electronic media, the internet and other fields. Additionally, there are chapters covering damages, defenses to liability including exemptions and immunities, injunctive relief, class actions, attorney's fees and costs, insurance issues, and much more. This publication includes contributions from over 120 highly experienced antitrust practitioners in both the private and government sectors, as well as the executive members of the Antitrust and Unfair Competition Law Section of the California State Bar.

$260, 1 volume, loose-leaf, updated annually, Pub. #01577,
ISBN 9780769856896

To order, call 800-223-1940 or visit the LexisNexis Store.

Wherever your deposition is in the U.S.

THE CONFERENCE ROOM IS ON US



40 YEARS

BARKLEY & Court Reporters

barkley.com

The Experts in Global Deposition Services

(800) 222-1231

YOUR INTERNATIONAL CONNECTION

BARKLEY & Court Reporters

barkley.com

40 YEARS

(800) 222-1231

The State Bar of California
Antitrust, UCL and Privacy Section
180 Howard Street
San Francisco, CA 94105-1639