



### **Domestic-to-Domestic Transactions—A Gap in China’s Merger Control Regime?**

On the heels of the fifth anniversary of the Chinese Anti-monopoly Law, **Yuni Yan Sobel** analyzes the substantive fairness of the Chinese merger control regime, including whether Chinese companies make the same pre-merger notifications with MOFCOM as their foreign counterparts. The author finds that there is a gap between filings for domestic-to-domestic transactions compared to their foreign counterparts and suggests that MOFCOM can address this discrepancy by working towards procedural fairness.

### **Drawing the Battle Lines for Mandatory Arbitration Clauses: The Consumer Financial Protection Bureau Joins the Fight**

**John Villafranco, Christie Thompson, and Jalyce Mangum** review the preliminary results from the Consumer Financial Protection Bureau’s December 2013 Arbitration Study, which analyzes the inclusion and effect of pre-dispute arbitration clauses in contracts for consumer financial products and services to determine whether such clauses should be restricted or prohibited. The authors conclude that the CFPB’s findings to date, along with the scope of additional research that the Bureau plans to undertake, foreshadow a rocky future for the use of these arbitration clauses.

### **Antitrust Counsel Beware: Divergent Disqualification Decisions Raise Questions About Positional Conflicts**

In the world of antitrust class-action defense, one day you’re in, and the next day you may be out—if one of your clients opts out of the class to bring its own action for damages. **Lee Berger, Panteha Abdollahi, and Andrew Booth** reflect on how two courts came to the opposite conclusion on attorney disqualification and how to deal with the resulting uncertainties.

### **Repatching the Quilt: An Update on State RPM Laws**

**Michael Lindsay** reviews the most recent developments in the “patchwork quilt” of state RPM cases and legislation post-*Leegin* and updates his invaluable chart tracking recent changes in the law. For starters, the rule of per se illegality endures in California.

### **Paper Trail: Working Papers and Recent Scholarship**

Editor **Bill Page** reviews two forthcoming articles that examine whether licensing boards and other regulators should qualify for antitrust immunity if controlled by members of the professions or industries they regulate. **Alexander Volokh**’s article looks beyond antitrust to explore how constitutional law, particularly the nondelegation doctrine and the due process guarantee, constrain the permissible roles of such entities. **Aaron Edlin** and **Rebecca Haw**’s article recommends testing all board-adopted licensing standards by a version of the rule of reason.

## Domestic-to-Domestic Transactions— A Gap in China’s Merger Control Regime?

**Yuni Yan Sobel**

China recently celebrated the fifth anniversary of its landmark enactment and implementation of the Anti-monopoly Law (AML) in August.<sup>1</sup> In the past five years, Chinese antitrust agencies carefully but steadily have expanded the scope of their enforcement activities and increased the sophistication of their enforcement. The State Council appointed three antitrust enforcement agencies: the Ministry of Commerce (MOFCOM), which handles mergers; the National Development and Reform Commission (NDRC), which has retained its responsibilities for price-related offenses, including cartels; and the State Administration for Industry and Commerce (SAIC), which regulates non-price-related abuse of dominance and monopoly agreements. To date, MOFCOM’s merger review remains the most prominent part of China’s AML enforcement, receiving over 700 notifications.<sup>2</sup> With a fast-growing record, MOFCOM has become a very significant antitrust regulator that cross-border M&A counsel cannot overlook.

As of December 31, 2013, MOFCOM cleared a total of 728 cases unconditionally.<sup>3</sup> To date, it has imposed restrictive conditions in 21 transactions and prohibited one transaction.<sup>4</sup> These transactions include InBev/Anheuser-Busch, Coca-Cola/Huiyuan (the only MOFCOM decision blocking a transaction), Mitsubishi/Lucite, GM/Delphi, Pfizer/Wyeth, Panasonic/Sanyo, Novartis/Alcon, Uralkali/Silvinit, Alpha V/Savio, GE (China)/Shenhua, Seagate Technology/Samsung Electronics, Henkel (Hong Kong)/Tiande Chemical, Western-Digital/Hitachi, Google Inc./Motorola Mobility, United Technologies/Goodrich, Wal-Mart/Yihaodian, ARM/Giesecke & Devrient/Gemalto, Glencore/Xstrata, Marubeni/Gavilon, Baxter/Gambro, MStar Semiconductor/MediaTek, and Thermo Fisher Scientific/Life Technologies.<sup>5</sup> All of the transactions involve at least one “foreign” party, i.e., a company with its holding parent headquartered outside Mainland China.<sup>6</sup> Further, other than the proposed Coca-

<sup>1</sup> See The Anti-monopoly Law of the People’s Republic of China [hereinafter AML] (promulgated by the Standing Comm. Nat’l People’s Cong., Aug. 30, 2007, effective Aug. 1, 2008), arts. 9 and 10, [http://www.gov.cn/flfg/2007-08/30/content\\_732591.htm](http://www.gov.cn/flfg/2007-08/30/content_732591.htm) (China), translated in Nathan Bush, *The PRC Antimonopoly Law: Unanswered Questions and Challenges Ahead*, THE ANTITRUST SOURCE, Oct. 2007, appendix.

<sup>2</sup> See MOFCOM, *MOFCOM Spokesman Yao Jian Answered Questions from the Media Regarding the Anti-monopoly Review of Concentration of Undertakings* [hereinafter May 2013 MOFCOM Spokesman’s Remarks] (May 27, 2013) (stating that MOFCOM had received 698 filings by March 21, 2013).

<sup>3</sup> See MOFCOM, Government Affairs, available at <http://fldj.mofcom.gov.cn/article/zcfb/> (providing links to past MOFCOM unconditional clearances on a quarterly basis).

<sup>4</sup> MOFCOM, Public Announcements, available at <http://fldj.mofcom.gov.cn/article/ztbx>.

<sup>5</sup> *Id.* No. 95 (2008); Nos. 22, 28, 76, 77 & 82 (2009); Nos. 53 (2010); Nos. 33, 73, 74 & 90 (2011); Nos. 6, 9, 25, 35, 49 & 87 (2012); Nos. 20, 22, 58 & 61 (2013); and No. 3 (2014).

<sup>6</sup> Mainland China excludes Hong Kong, Macau, and Taiwan, which are generally considered to be outside the territory of the People’s Republic of China. See Norton Rose Group, *Antimonopoly Law in China 7* (Mar. 2012) [hereinafter Norton Rose Guide], available at <http://www.nortonrosefulbright.com/files/download-antimonopoly-law-in-china-63824.pdf>.

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Cola/Huiyuan merger, the GE (China)/Shenhua joint venture, and Wal-Mart's acquisition of control over Yihao dian, all transactions are among foreign companies.

These transactions' cross-border nature resulted in extensive coverage of each MOFCOM decision by many international antitrust practitioners and scholars. Especially in the aftermath of the first prohibited Coca-Cola/Huiyuan transaction in 2009, many commentators questioned the fairness of MOFCOM's application of the AML to foreign enterprises and domestic enterprises.<sup>7</sup> Many suggested that the AML would be used to promote a protectionist agenda, shielding Chinese domestic industry from foreign competition or investment. Although the United States officially has been reluctant to confront China over antitrust rules, in an unusually direct speech in Beijing at a conference celebrating the fifth anniversary of the AML, FTC Commissioner Maureen Ohlhausen urged that "political decisions" should have no place in antitrust reviews.<sup>8</sup>

Rather than reviewing whether these MOFCOM decisions are substantively correct, this article examines the procedural fairness of the Chinese merger control regime by investigating whether Chinese domestic companies, including powerful state-owned enterprises (SOEs), are subject to the merger control regime and whether they routinely make pre-merger notifications with MOFCOM, as do their foreign counterparts. For the purpose of this article, "domestic" companies, i.e., those that are not "foreign," are those with holding parents that are headquartered in Mainland China.<sup>9</sup> The article then explores possible reasons why foreign and domestic companies may receive different procedural treatment.

### The Intention: To Apply the AML Equally to All

Largely following the model of the European Union and German competition laws, the AML includes merger rules to regulate significant M&A activities and prevent transactions that restrict competition, as well as rules that prohibit restrictive agreements and the abuse of administrative power that leads to restrictions of competition.

The AML applies to all "business operators" or "undertakings," which are defined to include any natural person, legal person, or any other organization that produces goods or provides services. Article 7 of the AML contains somewhat ambiguous language concerning the AML's application to SOEs, but the majority view is that the AML is intended to apply equally to all undertakings.<sup>10</sup> The three antitrust enforcement agencies—NDRC, SAIC, and MOFCOM—all have stated publicly that they do not afford any preferential treatment to SOEs in the application of the AML.

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<sup>7</sup> See MOFCOM, MOFCOM Held Anti-monopoly Work Status Special Press Conference on the 12th (Aug. 12, 2010) [hereinafter MOFCOM 2010 Press Conference], available at [http://www.gov.cn/gzdt/2010-08/12/content\\_1678211.htm](http://www.gov.cn/gzdt/2010-08/12/content_1678211.htm); MOFCOM Held "2011 Anti-monopoly Work Main Status" (Dec. 27, 2011) [hereinafter MOFCOM 2011 Press Conference], available at <http://www.mofcom.gov.cn/article/ae/slfw/201112/20111207901483.shtml>; Britton Davis, *China's Anti-Monopoly Law: Protectionism or a Great Leap Forward?*, 33 B.C. INT'L & COMPARATIVE L. REV. 305 (2010).

<sup>8</sup> Maureen K. Ohlhausen, Commissioner, Fed. Trade Comm'n, Nurturing Competition Regimes: Evaluation and Evolution, Remarks at the Competition Policy in Transition China Competition Policy Forum, Beijing (July 31, 2013), available at [http://www.ftc.gov/sites/default/files/documents/public\\_statements/nurturing-competition-regimes-evaluation-and-evolution/130731compolicychina.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/nurturing-competition-regimes-evaluation-and-evolution/130731compolicychina.pdf).

<sup>9</sup> If an entity is a 50/50 joint venture between a domestic company and a foreign company, the entity is considered foreign.

<sup>10</sup> See Norton Rose Guide, *supra* note 6, at 6.

Indeed, NDRC investigated several SOEs regarding their practices within China and MOFCOM imposed restrictive conditions on a cross-border joint venture involving an SOE.<sup>11</sup>

Article 2 of the AML adopts the principle of extraterritorial jurisdiction, which is the ability of a government to exercise authority beyond its national boundaries, and states that the AML not only applies to monopolistic conduct inside the territory, but also to conduct outside the territory of the People's Republic of China if it eliminates or has a restrictive effect on competition in the domestic market. MOFCOM's imposition of regulation on foreign parties discussed herein shows that the principle of extraterritorial jurisdiction has been put in practice.

Although the international reaction toward the AML's enactment generally has been positive, there also has never been a shortage of skepticism over its fair application, and such skepticism becomes especially heightened each time the Chinese antitrust agencies flex their regulatory muscle against foreign enterprises.<sup>12</sup> MOFCOM has been quite sensitive to such skepticism and has consistently emphasized through many public statements that China does not discriminate against foreign companies in its application of the AML.

For example, the Director General of MOFCOM's Anti-monopoly Bureau held a press conference in August 2010, which, in part, specifically emphasized the non-discriminatory application of the merger control regime.<sup>13</sup> In answering questions from an Associated Press reporter on the possible bias behind the phenomenon that MOFCOM's decisions to impose conditions seem to focus principally on foreign-to-foreign deals, the Director General emphasized that MOFCOM does not discriminate between concentrations that involve foreign enterprises and those that involve only domestic Chinese enterprises, though he acknowledged that he lacked concrete statistics in this respect. Moreover, he explained that foreign companies typically had a much higher probability of triggering the notification thresholds because of their significant capital and because they tend to be more active in making acquisitions.<sup>14</sup>

Similarly, at its annual press conference in December 2011, in answering an almost identical question posed by a *China Journal* reporter, MOFCOM re-emphasized that it does not discriminate among concentrations that involve foreign enterprises, SOEs, and domestic private enterprises—MOFCOM only takes into account the concentration's impact on competition.<sup>15</sup> Then again, in May 2013, a spokesman remarked that MOFCOM would apply the AML equally to “all Chinese and overseas enterprises.”<sup>16</sup> Thus, based on both the text of the AML and MOFCOM's

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<sup>11</sup> See, e.g., Susan Xuanfeng Ning et al., *What Constitutes Anticompetitive Tying in China? The Wuchang Salt Company Case* (Nov. 30, 2010), available at <http://www.chinalawinsight.com/2010/11/articles/corporate/antitrust-competition/what-constitutes-anticompetitive-tying-in-china-the-wuchang-salt-company-case/>; Mayer Brown, *China Antitrust Moves Up a Gear* (Nov. 14, 2011), available at <http://www.mayerbrown.com/files/Publication/bc5aedc7-36ef-4a91-97dc-165dbc97984e/Presentation/PublicationAttachment/a2231f25-ee96-405e-81fa-30e363a6ab29/11808.pdf>; MOFCOM, Public Announcement No. 74 (2011), available at <http://fldj.mofcom.gov.cn/aarticle/zcfb/201111/20111107824342.html>.

<sup>12</sup> See, e.g., Qingxiu Bu, *Coca-Cola v. Huiyuan—Market-Economy Driven or Protectionism?*, 41 INT'L REV. INTELL. PROP. & COMPETITION L. 202–10 (2010); Grace Ng, *China Flexing Its Anti-Monopoly Law Muscle: Revenge or Self-Defense?* (July 10, 2013), available at <http://medcitynews.com/2013/07/china-flexing-its-anti-monopoly-law-muscle-revenge-or-self-defense>.

<sup>13</sup> Yee Wah Chin, *M&A Under China's Anti-Monopoly Law, Emerging Patterns*, BUS. L. TODAY (NewsL. ABA Section of Business Law), Sept. 2010, available at [http://www.americanbar.org/publications/blt/2010/09/05\\_chin.html](http://www.americanbar.org/publications/blt/2010/09/05_chin.html).

<sup>14</sup> MOFCOM 2010 Press Conference, *supra* note 7.

<sup>15</sup> MOFCOM 2011 Press Conference, *supra* note 7.

<sup>16</sup> MOFCOM Spokesman Yao Jian Answered Questions from the Media Regarding the Anti-Monopoly Review of Concentration of Undertakings (May 27, 2013), available at <http://english.mofcom.gov.cn/article/newsrelease/policyreleasing/201306/20130600150074.shtml>.

various public statements, it seems clear that MOFCOM intends to treat concentrating parties equally in all respects, including notification thresholds, notification procedures, and substantive evaluation criteria.

### The Track Record: Clearance Decisions Reveal Limited Procedural Fairness

Although MOFCOM has made its intention to apply the AML equally to all undertakings abundantly clear, until recently there have been no statistics available to test whether such equality exists in practice. Until late 2012, MOFCOM had made public only its decisions to impose restrictive conditions on, or to prohibit, a notified concentration. Each of the 22 published decisions involved at least one foreign party; none of the decisions involved transactions with only domestic parties (domestic-to-domestic transactions). It therefore was not possible to determine whether MOFCOM cleared any domestic-to-domestic transactions or whether M&A counsel in China advised their clients to make notifications to MOFCOM in domestic-to-domestic transactions that triggered filing thresholds. Such procedural equality is a threshold issue in assessing whether merger control under the AML is indeed applied equally to all undertakings.

In a much-welcomed effort to enhance its transparency, in September 2012 MOFCOM went beyond the disclosure requirements under the AML and began regularly identifying all cases approved without conditions.<sup>17</sup> Although these quarterly announcements reveal only limited information, such as the parties' names and the clearance date, they shed light on how often, if at all, parties involved in domestic-to-domestic transactions notified MOFCOM. This is an important piece of information in assessing the procedural fairness of the merger control regime under the AML. A review of all of MOFCOM's unconditional clearances from August 2008 until the end of 2013 shows that a very small number of notifications are domestic-to-domestic transactions. Out of 750 notifications, only approximately 8 percent, or 57 transactions, are domestic-to-domestic.<sup>18</sup> (Each domestic-to-domestic transaction is listed in the Appendix.)

As shown by the five-year clearance records, at least some parties involved in domestic-to-domestic transactions filed pre-merger notifications with MOFCOM and received clearance like their foreign counterparts. Notably, at least 26 of the 57 domestic-to-domestic transactions involve at least one party that is an SOE, showing that even the all-powerful SOEs in major strategic sectors (such as steel, energy, civil aviation, and minerals) follow the AML's notification procedures. On the other hand, given their financial size and the relatively frequent major reorganizations and consolidations SOEs have gone through,<sup>19</sup> it is not surprising that transactions involving SOEs tend to trigger filing thresholds. The clearance records, however, also reveal that on average, parties involved in domestic-to-domestic transactions filed approximately 10 to 11 notifications with MOF-

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<sup>17</sup> MOFCOM, MOFCOM Held Special Press Conference on "Anti-Monopoly Work Progress in 2012" (Jan. 5, 2013), available at <http://english.mofcom.gov.cn/article/newsrelease/press/201301/20130108513014.shtml>.

<sup>18</sup> According to a 2013 study, which based the nationality of the company on the location of its headquarters, among all transactions reviewed by MOFCOM from August 2008 through June 2013, approximately 18% of acquisitions involved a domestic acquirer and domestic seller and 10% of non-acquisitions (typically joint ventures) involved a domestic acquirer and domestic seller. The nationality of each firm in this study is defined based on the location of its headquarters and the study includes as "domestic" companies those with headquarters in Mainland China, Hong Kong, Macau, and Taiwan. See Fei Deng & Cunzhen Huang, *A Five Year Review of Merger Enforcement in China*, ANTITRUST SOURCE, Oct. 2013, available at [http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/oct13\\_deng\\_10\\_29f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/oct13_deng_10_29f.authcheckdam.pdf).

<sup>19</sup> The State-Owned Assets Supervision and Administration Commission [hereinafter SASAC] announced in 2006 that it would be China's goal to foster 30 to 50 large "internationally competitive" SOEs in seven strategic industries by 2010. See Xinhua News, *SOEs to Maintain Overwhelming Control in Seven Sectors* (Dec. 19, 2006), available at [http://news.xinhuanet.com/fortune/2006-12/19/content\\_5504591.htm](http://news.xinhuanet.com/fortune/2006-12/19/content_5504591.htm).

COM every year, while parties involved in transactions with at least one foreign party filed well over 100 such notifications each year. This contrast casts doubt over whether notifying domestic-to-domestic mergers is a routine practice in China.

Could the 8 percent low filing rate be merely due to a lack of domestic-to-domestic transactions in China? Several third-party M&A data sources appear to call that proposition into question. Using Thomson Reuters data from August 1, 2008 through December 31, 2013, there were a total of 19,480 M&A transactions involving a target whose primary business was located in Mainland China, of which 15,177 deals, or approximately 78 percent, involved an acquirer whose primary business was also located in Mainland China.<sup>20</sup> Data from Dealogic appear to be consistent in suggesting that domestic M&A deals accounted for approximately 81 percent of China-targeted deals from the same period in terms of number of deals.<sup>21</sup> Both sets of M&A data are based only on announced deals and only act as references to give some perspective on how frequently domestic companies acquire domestic targets compared to foreign companies.

Furthermore, one cannot directly compare the 8 percent domestic-to-domestic filing rate based on MOFCOM's quarterly announcements with the high 70–80 percent figures from the third-party data providers. The Thomson Reuters and Dealogic data do not capture many foreign-to-foreign deals that trigger MOFCOM notifications, such as Google's acquisition of Motorola in 2012, because those companies' primary businesses or headquarters are not in Mainland China. However, these M&A data do suggest that domestic-to-domestic transactions comprise a large share of M&A activities targeting Chinese companies.

Could the low number of domestic-to-domestic notifications result from the fact that such transactions typically do not reach the AML's relatively high notification thresholds?<sup>22</sup> Third-party data do not appear to support this proposition. From August 1, 2008 through December 31, 2013, Thomson Reuters reports 606 M&A transactions (1) that exceed US\$200 million in value<sup>23</sup> and (2) in which both the target and buyer have their primary business in Mainland China; and a subset of 214 transactions with deal values over US\$500 million. Similarly, Dealogic reports 737 domestic M&A transactions valued<sup>24</sup> at over US\$200 million and 219 such transactions valued at over US\$500 million. Both numbers exclude deals with undisclosed deal values.

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<sup>20</sup> Thomson Reuters (SDC Platinum), International Mergers database [hereinafter IMA database]. The IMA database includes all announced deals, but excludes withdrawn deals between August 1, 2008 through December 31, 2013.

<sup>21</sup> Dealogic Analytics database [hereinafter Dealogic database]. The Dealogic database includes all announced deals, but excludes withdrawn deals between August 1, 2008 through December 31, 2013. Domestic M&A deals as reported by Dealogic include deals in which both parties are headquartered in Mainland China. China-targeted deals include all deals in which the target is headquartered in Mainland China.

<sup>22</sup> The AML revenue thresholds include: (1) the global sales of the undertakings involved exceed RMB10 billion (approximately US\$1.7 billion) and each of at least two undertakings involved have sales exceeding RMB400 million (approximately US\$66.0 million) in Mainland China in the previous accounting year; or (2) the sales in Mainland China of all undertakings involved exceeds RMB2 billion (approximately US\$330.0 million) and each of at least two undertakings involved have sales exceeding RMB400 million (approximately US\$66.0 million) in Mainland China in the previous accounting year. See Regulation on Notification Thresholds for Concentrations of Undertakings (promulgated by the 20th General Meeting of the State Council, Aug 1, 2008, effective Aug. 3, 2008), available at [http://www.gov.cn/zwjg/2008-08/04/content\\_1063769.htm](http://www.gov.cn/zwjg/2008-08/04/content_1063769.htm), translated in <http://www.lawinfochina.com/display.aspx?id=7024&lib=law>.

<sup>23</sup> This value is calculated by subtracting the value of any liabilities assumed in a transaction from the transaction consideration and by adding the target's net debt.

<sup>24</sup> Deal value is either directly disclosed by one of the parties (total consideration given in press release) or, for public companies, calculated based on the offer price per share on a fully diluted basis. In general, deal value is being defined as a cost to the acquirer for the stake/company/assets acquired. Net debt is included in full once the 50% threshold has been breached. See Dealogic database, *supra* note 21.

One cannot directly compare the number of domestic-to-domestic transaction notifications disclosed by MOFCOM's quarterly announcements (57) with the numbers of domestic M&A transactions valued over US\$200 million or US\$500 million reported by Thomson Reuters or Dealogic, as the transaction value is, at best, a very rough proxy of the filing thresholds, which are measured by the global and domestic revenues of both parties involved in the transaction. However, third-party data do appear to suggest that there is no dearth of large domestic-to-domestic M&A transactions in China, contrary to what the small number of domestic-to-domestic MOFCOM notifications may have suggested.

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Thus, although the equal application of the AML to all undertakings has been repeatedly emphasized by MOFCOM, the small number of domestic-to-domestic transactions cleared by MOFCOM seems to suggest that many such transactions may not in fact be notified to MOFCOM. It is difficult to attribute a single reason for the potential differentiated treatment of domestic and foreign mergers in China, and one should not simply assume protectionism. Merger control is better understood in the context of the history of the AML and MOFCOM, as well as MOFCOM's administrative status.

### The Potential Reasons Behind the Limited Procedural Fairness

**The History of Merger Control in China.** Article 1 of the AML explains its purpose—to prevent and restrain monopolistic conduct, protect fair competition in the market, enhance economic efficiency, safeguard the interests of consumers and social public interest, and promote the healthy development of the socialist market economy. Nevertheless, it appears clear that an unstated but important goal of the AML is to address issues associated with foreign investors acquiring domestic companies through M&A transactions.<sup>25</sup>

As part of economic reform efforts beginning in 1978, China experimented with opening up to foreign investment in selected coastal cities and in special economic zones and industrial parks with a focus on attracting export-oriented manufacturing investment.<sup>26</sup> To join the World Trade Organization (WTO) in 2001, China made a strong commitment to open up its economy to foreign competition and agreed to drastically reduce tariff levels.<sup>27</sup> In the following years, foreign investors increasingly shifted their investment in China toward acquiring domestic companies, which led to heightened concerns that foreign companies might begin to dominate China's industries. China responded by taking measures to protect and nurture domestic industries, including setting ad hoc limitations on M&A transactions by foreign companies, revoking some of the preferential treatments previously accorded to foreign investors, and imposing new restrictions to increase foreign investors' cost of doing business in China.<sup>28</sup>

With this historical backdrop, China introduced a pre-merger anti-monopoly review of M&A transactions in 2003 with the issuance of the Provisional Rules on the Takeover of Domestic Enter-

<sup>25</sup> See Bruce M. Owen et al., *China's Competition Policy Reforms: The Antimonopoly Law and Beyond*, 75 ANTITRUST L.J. 230, 252 (2008).

<sup>26</sup> The World Bank, *Foreign Direct Investment—the China Story* (July 16, 2010), available at <http://www.worldbank.org/en/news/feature/2010/07/16/foreign-direct-investment-china-story>.

<sup>27</sup> See Owen et al., *supra* note 25, at 252.

<sup>28</sup> See *id.* at 252–53 & n.63; see also Peter Wang & Yizhe Zhang, *Chinese Merger Control*, ASIA-PACIFIC ANTITRUST REV., 2007, at 1, available at <http://www.jonesday.com/files/Publication/039e0b51-6bbc-4e4a-affe-12337096e670/Presentation/PublicationAttachment/b0e8ba1a-8734-42ff-8704-31176aa0bd1f/China%20merger%20control.pdf> (providing examples that antitrust policy and enforcement in China may face increasing pressure to target foreign multinational corporations in order to protect domestic Chinese industry).

prises by Foreign Investors (2003 Provisional M&A Rules).<sup>29</sup> The Interim Rules on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (2006 M&A Rules) subsequently replaced the 2003 Provisional M&A Rules in 2006.<sup>30</sup> Many saw this change as the first step toward using competition policy as an additional tool to limit foreign investment in certain sectors. The 2006 M&A Rules followed the pre-merger notification thresholds in the 2003 Provisional M&A Rules and applied only to transactions involving foreign purchasers acquiring control in certain key economic sectors. Although the AML's implementation in 2008 superseded the competition review provisions in the 2006 M&A Rules, and the final text of the AML does not single out foreign companies, there remains some concerns that the AML merger control regime is a remnant from the 2006 M&A Rules and could be primarily used to target foreign companies.<sup>31</sup>

**The History of MOFCOM.** While the 2006 M&A Rules may partially explain why the new merger control enforcement under the AML is potentially biased against foreign investors, MOFCOM's history sheds light on why the merger control regime may not be enforced against domestic-to-domestic transactions. A careful examination of that history reveals that for over 50 years, MOFCOM's predecessors had been "foreign-facing" agencies in charge of foreign trade and economic activities outside the territory of China, with little jurisdictional or enforcement power over purely domestic activities.

On November 2, 1949, one month after the founding of the People's Republic of China, the Ministry of Trade (MOT) of the Central People's Government was established.<sup>32</sup> MOT was in charge of trade management in China, such as approving business and financial plans of businesses, managing the funds and inventories of state trading, and setting the wholesale goods price of state trading companies.<sup>33</sup> As China had just started to recover from World War II and the Chinese Civil War, the trading activities were very limited. In order to strengthen foreign trade and more effectively carry out domestic trade work by reducing the MOT workload, the 17th Session of the Central People's Government Committee passed a resolution on August 7, 1952, that dissolved MOT and established the Ministry of Foreign Trade (MOFT), which would oversee foreign trade. The former MOT head was appointed to run MOFT, and the Central People's Government Department of Commerce was assigned responsibility for domestic trade. As MOFT was established to unify the management of foreign trade in China, the nine enumerated functions all focused on matters relating to foreign trade.<sup>34</sup>

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<sup>29</sup> Provisional Regulations Regarding Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (promulgated by the Ministry of Foreign Trade and Economic Cooperation, State Administration of Taxation, SAIC, and State Administration of Foreign Exchange, Mar. 13, 2003, effective Apr. 12, 2003), available at <http://tfs.mofcom.gov.cn/aarticle/date/i/s/200509/20050900366385.html>.

<sup>30</sup> Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (Aug. 10, 2006), available at <http://english.mofcom.gov.cn/article/policyrelease/Businessregulations/201303/20130300045825.shtml>.

<sup>31</sup> See Owen et al., *supra* note 25, at 252–54.

<sup>32</sup> See The Ministry of Trade under the Central People's Government 1949.11-1952.8 (Dec. 7, 2010), available at <http://english.mofcom.gov.cn/history.shtml> (outlining that the MOT was established pursuant to Article 18 of the Organic Law of the Central People's Government and the Circular of the Government Administration Council on November 1, 1949).

<sup>33</sup> The MOT's functions included managing the funds and inventories of state trading; overseeing the business plan of professional companies; determining the wholesale goods price of state trading companies; and guiding private businesses, among others. See *id.*

<sup>34</sup> The enumerated functions of MOFT included overseeing China's import and export plans and the foreign exchange expenditure plans; drafting and implementing plans and regulations on foreign trade, customs, and economic cooperation; supervising import, export, and transport and packaging of state foreign trading companies; and issuing licenses for import, export, and transit trade, among others. See *id.*

In March 1982, pursuant to a resolution passed at the 22nd Session of the Standing Committee of the Fifth National People's Congress, MOFT was merged with the Ministry of Economic Relations with Foreign Countries, the State Import and Export Administration Commission, and the State Foreign Investment Administration Commission,<sup>35</sup> and became the Ministry of Foreign Economic Relations and Trade (MOFERT), the new administrative agency in charge of foreign trade, foreign economic and technological cooperation, and foreign exchange-related issues in China.<sup>36</sup> On March 16, 1993, MOFERT was renamed the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), pursuant to a resolution passed at the first Session of the Eighth National People's Congress. MOFTEC's main responsibilities mirrored those of MOFERT in regulating China's foreign trade and international economic relations.<sup>37</sup>

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As China entered the WTO in November 2001 and the Chinese economy sped up its integration with the global economy, the line between domestic trade and foreign trade was blurred. To streamline its bureaucracy and keep pace with its post-WTO economic developments, China reorganized several major government ministries and agencies in 2003. In connection with the reorganization and pursuant to a plan and notice passed at the first Session of the Tenth National People's Congress, MOFTEC was renamed MOFCOM, which assumed MOFTEC's responsibilities over foreign trade and foreign economic cooperation.

At the same time, MOFCOM assumed parts of the State Economic and Trade Commission's functions relating to domestic trade, foreign economic coordination, and organization and implementation of plans for the import and export of major industrial products, and parts of the State Development and Planning Commission's functions relating to implementation of state planning for the import and export of agricultural products.<sup>38</sup> Thus, about 51 years after MOT's dissolution, its much-evolved successor, MOFCOM, gained some responsibilities over domestic trade.

Before MOFCOM's establishment in 2003, all of its predecessors, with the exception of MOT for a brief three-year period, had assumed the foreign-facing responsibilities associated with foreign trade and international economic cooperation for over 50 years. Only in 2003 was MOFCOM put in charge of the integrated functions of domestic and foreign trade. As a result, there is still a strong perception in China that MOFCOM is largely a foreign-facing ministry. Given its predecessors' long history of managing foreign trade, investment, and economic relations related

<sup>35</sup> The State Import and Export Administration Commission and the State Foreign Investment Administration Commission were established in August 1979. The main functions of the two commissions are, among others, to formulate the guidelines, policies, statutes and regulations on, and together with the National Economic Planning Commission (currently the National Development and Reform Commission), China's long-term planning and annual planning of, import and export, technology import, foreign capital utilization and foreign economic cooperation; to organize departments, provinces and municipalities to adopt forceful measures on enlarging export and increasing foreign exchange income; and to formulate and enforce the statutes and relevant measures regarding joint ventures; and to review the long-term economic cooperation and long-term trade agreements and treaties between Chinese and foreign governments. *See id.*

<sup>36</sup> The main functions of this new ministry are, among others, to implement the planning and policies on developing foreign economic relations and trade, to regulate and coordinate the foreign economic and trade activities, to improve multilateral and bilateral economic and technological cooperation, to utilize foreign capital, to administer technological import and export foreign project contract and labor service overseas, and to serve socialist modernization and development of international relations. *See id.*

<sup>37</sup> Among the many enumerated functions of the MOFTEC are: to formulate and implement laws, regulations, policies, and reform plans of foreign trade, foreign economic cooperation, and foreign investment; to formulate and execute medium- and long-term programs and development strategies of foreign trade; to formulate and execute policies and manage technology import and export; and to formulate policies and manage China's foreign aid. *See id.*

<sup>38</sup> Susan Munro & Sherry Yan, *Recent Government Reorganization in China, China Law and Policy Newsflash* (O'Melveny & Myers) (July 30, 2003), available at <http://omm.com/files/Publication/0917ead3-7fb1-4a9f-bc47-56f85252183b/Presentation/PublicationAttachment/cca1351c-d4f4-4e37-a04c-5a3781b30cbc/clp030730.pdf>.

issues, it became a natural candidate for the enforcement of the merger control regime under the 2003 Provisional M&A Rules and 2006 M&A Rules, where the pre-merger notification requirement was only imposed on foreign acquirers specifically. Although the AML imposes pre-merger filing obligations on all undertakings, parties involved in purely domestic-to-domestic transactions may not consider notifying MOFCOM, a traditionally foreign-facing agency, as a necessary step in consummating such transactions.

Furthermore, in regulating domestic-to-domestic transactions, MOFCOM could potentially run into turf battles with NDRC or SAIC. Both have a much longer history of regulating domestic activities than MOFCOM, and MOFCOM consults both in connection with merger review. Specifically, with its broad administrative and planning control over the Chinese economy, NDRC and its predecessors have been responsible for formulating and implementing strategies for national economic and social development, including price policies, since 1952.<sup>39</sup> SAIC and its predecessors have been responsible for regulating the Chinese industry and commerce through administrative enforcement and regulations since 1953.<sup>40</sup> Under the AML, NDRC primarily regulates pricing practices and MOFCOM administers the merger control regime. They supervise competition in their respective areas, in addition to their other administrative authority in the fields of domestic economic development and international trade, respectively.<sup>41</sup> By contrast, SAIC takes a more holistic view of competition law and looks at it within the larger framework of consumer protection, including fraud and unfair trading.<sup>42</sup>

The distribution of antitrust enforcement power among three institutions inevitably creates conflict and friction. Large domestic-to-domestic transactions may be where the fragmentation of antitrust authority is most salient. While such transactions may fall within the merger control enforcement of MOFCOM, given that the parties are large domestic companies traditionally regulated by NDRC and SAIC, MOFCOM, acting in what is for China still fairly uncharted territory, may take a more conservative approach in exerting its enforcement power in relations to NDRC and SAIC.

***The Administrative Status of MOFCOM.*** In addition to the Chinese merger regime and MOFCOM's historical foreign focus, the Chinese administrative structure may also impose unique constraints on MOFCOM's ability to enforce the merger control regime over domestic companies. To provide clear identification of the administrative hierarchy and the power of the administrative decisions among institutions, the State Commission for Public Sector Reform categorizes the status of Chinese governmental institutions and agencies into five administrative levels, in descending order: state level, ministry (province) level, department/bureau level, county (section) level, and

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<sup>39</sup> The NDRC is a successor of the State Planning Commission, which had managed the country's centrally planned economy from 1952 through 1998, and then, through several restructuring and reorganizations, became NDRC in 2003. The State Planning Commission was renamed the State Development Planning Commission (SDPC) in 1998. After merging with the State Council Office for Restructuring the Economic System and part of SETC in 2003, the SDPC was restructured into the NDRC. See NDRC, Brief Introduction of the NDRC, available at <http://en.ndrc.gov.cn/brief/default.htm>.

<sup>40</sup> *History and Functions of SAIC*, XINHUA NEWS, available at [http://news.xinhuanet.com/zhengfu/2003-02/26/content\\_746623.htm](http://news.xinhuanet.com/zhengfu/2003-02/26/content_746623.htm).

<sup>41</sup> Salil K. Mehra & Yanbei Meng, *Against Antitrust Functionalism: Reconsidering China's Antimonopoly Law*, 42 VA. J. INT'L L. 380, 407 (2008).

<sup>42</sup> See Office of the State Council's Notice on the Major Duties of the Internal Structure and Staffing Requirements of SAIC (July 11, 2008), available at [http://www.law-lib.com/law/law\\_view.asp?id=261207](http://www.law-lib.com/law/law_view.asp?id=261207).

township (sub-division) level. Each of these five levels also has a chief level and deputy level.<sup>43</sup> Civil servants in China are ranked on the same five levels.<sup>44</sup>

Falling under the direct supervision of the State Council, which is a state-level agency, MOFCOM, NDRC, and SAIC are all ministry-level agencies. Many SOEs in China also fall directly within the State Council's supervision and are ministry-level agencies. The antitrust enforcement agencies—the Anti-monopoly Bureau of MOFCOM, the Price Supervision and Anti-monopoly Bureau of NDRC, and the Anti-monopoly and Unfair Competition Enforcement Bureau of SAIC—are bureau-level agencies, ranked lower in administrative status than many powerful SOEs. Although many such SOEs undergo major reorganizations or carry out domestic M&A transactions that could potentially trigger the notification thresholds, this disparity in administrative level may constrain MOFCOM's ability to enforce the merger control regime against SOEs.<sup>45</sup>

Relatedly, the heads of the antitrust enforcement bureaus are bureau-level civil servants, who typically rank lower than the Chief Executive Officers of many powerful SOEs. This status disparity among the head civil servants may further complicate the enforceability of the merger regime over the SOEs. Thus, the hierarchical nature of the Chinese governmental institutions and civil service, deeply rooted in the Chinese political system, may present difficulties in the independence and enforcement practices of the antitrust enforcement agencies.

Many foreign commentators have assumed that because of the SOEs' ties to the central government, major SOEs are largely exempt from antitrust enforcement efforts, as no government agency would subject these companies to investigations or public criticism by the antitrust authorities.<sup>46</sup> However, MOFCOM has emphasized in public statements that its antitrust enforcement powers came from the AML and the administrative status does not constrain MOFCOM in any way.<sup>47</sup>

Further, recent NDRC enforcement actions suggest that the Chinese antitrust agency is prepared to take action against powerful SOEs and is starting to take significant actions using powers granted under the AML. In early 2011, NDRC launched an investigation into the practices of two telecom giants—China Telecom and China Unicom—for charging rivals higher fees for broadband access while failing to optimize network speed.<sup>48</sup> The investigation was suspended after the two companies announced that they would substantially raise their broadband speeds while further lowering broadband costs over the next five years. While it is unclear whether the power and status of the telecom giants affected NDRC's decision not to impose any fines over monopolistic conduct, this case, as China's first one involving large SOEs since the implementation of the AML, is significant. It remains to be seen whether MOFCOM will impose any conditions, or even block, any domestic-to-domestic transactions, such as major reorganizations by SOEs.

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<sup>43</sup> State Commission Office for Public Sector Reform, Institutional Classification, [http://www.scoprs.gov.cn/once/bzcs/201008/t20100830\\_14516.htm](http://www.scoprs.gov.cn/once/bzcs/201008/t20100830_14516.htm).

<sup>44</sup> Civil Servant Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 27, 2005, effective Jan. 1, 2006), art. 16, translated in <http://www.asianlii.org/cn/legis/cen/laws/tcsolproc462/>.

<sup>45</sup> Du Qiang, *The AML, These Past Four Years*, S. METROPOLIS DAILY, May 11, 2012, available at <http://gcontent.oeeee.com/e/0e/e0e9ac104fdeb345/Blog/7fa/b5bc2d.html>.

<sup>46</sup> See Henry (Litong) Chen et al., *China Cracks Down on Anti-Competitive Practices of Major State-Owned Enterprises* (Nov. 10, 2011), available at <http://www.mwe.com/publications/uniEntity.aspx?xPST=PublicationDetail&pub=6611&PublicationTypes=80ca8ee8-02a5-4d6c-bb51-fe2194cf5ea2>.

<sup>47</sup> MOFCOM 2010 Press Conference, *supra* note 7.

<sup>48</sup> Loretta Chao, *China Telecom, China Unicom Face Monopoly Probe*, WALL ST. J. (Nov. 9, 2011), available at <http://online.wsj.com/article/SB10001424052970204358004577027283900972206.html>.

## The Future: The “Failure-To-Notify” Statutes and More Transparency

Although for a variety of reasons the Chinese merger control regime may not be applied to domestic and foreign entities equally, the young regime is showing promising signs of moving toward more equality, especially in light of the recent adoption of certain transparency measures and failure-to-notify statutes.

In its 2011 end-of-year press conference, MOFCOM's Anti-monopoly Bureau warned companies that one of its priorities for 2012 will be to investigate and sanction parties who do not notify the transactions to MOFCOM.<sup>49</sup> To that end, MOFCOM promulgated the new Interim Measures for Investigating and Handling of Failure to Notify Business Operator Concentration (Failure-to-Notify Statutes), effective on February 1, 2012,<sup>50</sup> signaling increased efforts to ensure compliance with the AML. The procedures established under the Failure-to-Notify Statutes allow any member of the public or an entity to report a “suspicious” transaction. It is noteworthy that MOFCOM is obligated to keep the informant's identity secret and even must initiate an investigation if the complaint is in writing and is complete in terms of facts and evidence.

Additionally, as previously noted, about half a year after the Failure-to-Notify Statutes became effective, in an effort to increase transparency, MOFCOM began to release all unconditional approval cases to the public on a quarterly basis.<sup>51</sup> Although the releases only give limited information about the names of the notifying parties, such releases allow anyone to verify whether a consummated transaction, especially a high-profile one, has been notified. The new transparency measure coupled with the Failure-to-Notify Statutes essentially opened the door for whistleblowers to come forward to expose unnotified transactions. By August 2013, MOFCOM had given warning or imposed fines on eight cases, and several of the cases had been instigated by whistleblowers' reports.<sup>52</sup> It is unclear if any of the investigations involved domestic-to-domestic transactions.

## Conclusion

Since the AML's implementation, Chinese antitrust agencies have made major progress on many aspects of their work. They have demonstrated an increasing willingness to strengthen China's antitrust enforcement regime and exact monetary, structural, and behavioral relief from parties who have violated or could violate the AML. In particular, MOFCOM has demonstrated its willingness to impose both structural and behavioral remedies to cross-border transactions that have generated antitrust concerns in China.

While recognizing the progress MOFCOM has made in the last five years, some members of the international legal and business community have questioned the impartiality of MOFCOM's

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<sup>49</sup> See MOFCOM 2011 Press Conference, *supra* note 7.

<sup>50</sup> Interim Measures for Investigating and Handling of Failure to Notify Business Operator Concentration (promulgated by MOFCOM, Dec. 30, 2011, effective Feb. 2, 2012), available at <http://www.mofcom.gov.cn/aarticle/b/c/201201/20120107914884.html>, translated in <http://www.blankrome.com/siteFiles/EnglishTranslation.pdf>.

<sup>51</sup> On a related note, both SAIC and NAIC are also implementing transparency measures. On July 29, 2013, SAIC set up a new online platform to publish its antitrust investigations. Zhang Xiaosong, *SAIC Publishes 12 Investigations through “Antimonopoly Investigations Publishing Platform,”* XINHUA PRESS, July 29, 2013, available at [http://www.gov.cn/jrzq/2013-07/29/content\\_2457563.htm](http://www.gov.cn/jrzq/2013-07/29/content_2457563.htm). NDRC is also contemplating a platform for releasing decisions. See Yasue Nao Koblitiz, *Antitrust Investigations in China: Putting Things in Perspective* (Sheppard Mullin) (Aug. 29, 2013), available at <http://www.antitrustlawblog.com/2013/08/articles/article/antitrust-investigations-in-china-putting-things-in-perspective/>.

<sup>52</sup> See MOFCOM, *Positive Progress Made in Enforcement of the Anti-Monopoly Law*, Aug. 6, 2013, available at <http://english.mofcom.gov.cn/article/newsrelease/significantnews/201308/20130800231761.shtml>.

merger enforcement, equating its Anti-monopoly Bureau to a “Great Wall of 35 persons” that creates a blockage to global M&A activities, and have persistently called for increased predictability, transparency, and fairness in its enforcement.<sup>53</sup> This impartiality may be further questioned by this article’s analysis of MOFCOM’s five-year clearance records, which show a potential gap between filings for domestic-to-domestic transactions compared to their foreign counterparts. However, as this article has discussed, historical and administrative factors may have contributed to this gap.

In the coming years, MOFCOM may find that it can better achieve its stated goal of equality for all before the AML by pursuing additional procedural fairness, such as ensuring that domestic companies and foreign companies equally comply with the notification requirements. To that end, the new transparency measures, coupled with the regulations on failure-to-notify, set the stage for MOFCOM to narrow the gap by investigating all transactions that fail to file the proper notifications, especially domestic-to-domestic transactions. As the Great Wall of China has transformed from a means of border control against foreign invasion, MOFCOM’s merger control enforcement has the potential to continue enhancing its transparency and fairness. ●

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<sup>53</sup> See *Global Acquisitions Meet a “Great Wall of 35 Persons,”* NIKKEI CHINA, May 20, 2013, available at <http://cn.nikkei.com/china/economy/5568-20130520.html>; Ohlhausen, *supra* note 8.

## APPENDIX

### Unconditionally Cleared Domestic-to-Domestic Transactions

(August 31, 2008–December 31, 2013)<sup>54</sup>

NO.	PARTIES TO THE CONCENTRATION	CLEARANCE DATE	INDUSTRY
1	Chongqing Department Store; New Century Department Store	August 2008– September 2012	Retail Stores
2	Nanjing First Pesticide Group Co.; Nanjing Red Sun Co., Ltd.	August 2008– September 2012	Agriculture
3	Sanyuan Group (an SOE); Sanlu Group (an SOE)	August 2008– September 2012	Dairy
4	Chongqing Department Store; New Century Department Store	August 2008– September 2012	Retail Stores
5	Shanghai Sugar Cigarette & Wine (Group) Co., Ltd. (an SOE); China Yinmore Sugar Co. Ltd.	August 2008– September 2012	Retail
6	Qinghai Salt Lake Potash Co., Ltd. (an SOE); Qinghai Salt Lake Industry Group Co. (an SOE)	August 2008– September 2012	Steel
7	Tangshan Iron and Steel Co., Ltd. (an SOE); Handan Iron and Steel Group Co., Ltd. (a Key SOE); Chengde Xinxin Vanadium and Titanium Co., Ltd. (an SOE)	August 2008– September 2012	Steel
8	China Eastern Airlines (a Key SOE); Shanghai Airlines	August 2008– September 2012	Airline
9	Ping An of China; Shenzhen Development Bank	August 2008– September 2012	Insurance/Bank
10	Sichuan New Hope Agribusiness Co., Ltd.; Shandong Liuhe Group Co., Ltd.; Sichuan New Hope Farming Co., Ltd.	August 2008– September 2012	Agriculture
11	Jinan Iron and Steel Co., Ltd. (a Key SOE); Laiwu Steel Corporation (a Key SOE) et al.	August 2008– September 2012	Mining

<sup>54</sup> MOFCOM, *2008.8.1–2012.9.30 List of Unconditional Clearance for Concentrations of Undertakings*, items 17, 34, 46/70, 52, 61, 62, 69, 78, 84, 100, 113, 124, 135, 138, 151, 154, 188, 189, 192, 206, 235, 236, 237, 247, 325, 347, 349, 383, 398, 399, 431 & 458 (Nov. 16, 2012), available at <http://images.mofcom.gov.cn/fldj/accessory/201211/1353031118730.pdf>; MOFCOM, *List of Unconditional Clearance for Concentrations of Undertakings in Q4 2012* (Jan. 6, 2013), items 21, 22, 37, 40, and 53, available at <http://fldj.mofcom.gov.cn/article/zcfb/201301/20130108512781.shtml>; MOFCOM, *List of Unconditional Clearance for Concentrations of Undertakings in Q1 2013*, items 9, 10, 17, 18, 20 & 45 (Apr. 2, 2013), available at <http://fldj.mofcom.gov.cn/article/zcfb/201304/20130400075697.shtml>; MOFCOM, *2013 List of Unconditional Clearance for Concentrations of Undertakings in Q2 2013*, items 10, 16, 27, 35, and 43 (July 3, 2013), available at <http://fldj.mofcom.gov.cn/article/zcfb/201307/20130700184718.shtml>; *2013 List of Unconditional Clearance for Concentrations of Undertakings in Q3 2013*, items 4, 5, 28 & 51 (Oct. 8, 2013), available at <http://fldj.mofcom.gov.cn/article/zcfb/201310/20131000336357.shtml>; MOFCOM, *List of Unconditional Clearance for Concentrations of Undertakings in Q4 2013*, items 1, 13, 16, 26, and 50 (Jan. 11, 2014), available at <http://fldj.mofcom.gov.cn/article/zcfb/201401/20140100457358.shtml>. Lists of Key SOEs and Central SOEs are available at the websites of State-Owned Assets Supervision and Administration Commission of the State Council [hereinafter SASAC]. See SASAC, *Key SOEs by Provinces*, available at [http://www.sasac.gov.cn/wzlj/wzlj\\_zdqy.htm](http://www.sasac.gov.cn/wzlj/wzlj_zdqy.htm); SASAC, *Central SOEs*, available at <http://www.sasac.gov.cn/n2963340/n2971121/n4956567/index.html>. Other SOEs are identified based on publicly available information to the extent known.

NO.	PARTIES TO THE CONCENTRATION	CLEARANCE DATE	INDUSTRY
12	Air China Co., Ltd. (a wholly owned subsidiary of China National Aviation Holding Company, a Key and Central SOE); Shenzhen Airlines	August 2008– September 2012	Airline
13	China State Construction Engineering Corporation (a Central SOE); Xinjiang Construction Engineering Group	August 2008– September 2012	Construction
14	Beijing Building Materials Group Corporation; Hebei Taihang Cement Co., Ltd.	August 2008– September 2012	Building Materials
15	China Minmetals Corporation (a Central SOE); Hunan Nonferrous Metals Holdings Group Co., Ltd.	August 2008– September 2012	Minerals/Metals
16	Shanghai Friendship Group Inc.; Shanghai Bailian Group Co., Ltd.	August 2008– September 2012	Retail Stores
17	China National Medical Equipment Industry Co. (a wholly owned subsidiary of China National Pharmaceutical Group Corporation, a Central SOE)	August 2008– September 2012	Healthcare
18	Anshan Iron and Steel Group Company (a Central SOE); Panzhihua Iron and Steel Group Co., Ltd. (used to be an SOE)	August 2008– September 2012	Steel
19	China Grand Automotive Services Co.; Xian Qinchuan Tangdu Machinery Auto Parts Sales Co., Ltd.; Shanxi Tangxing Auto Sales Services Ltd. Co.	August 2008– September 2012	Automotive Services
20	China Grand Automotive Services Co.; Shandong Sunhover Industry Group Co., Ltd.	August 2008– September 2012	Automotive Services
21	Home Inns & Hotels Management Inc.; Motel168	August 2008– September 2012	Hotel
22	China Grand Automotive Services Co.; Inner Mongolia Yiyan Huizhong Auto Sales Co., Ltd. et al.	August 2008– September 2012	Automotive Services
23	China Grand Automotive Services Co.; Tangshan Guangrun Hetian Auto Parts Sales Co., Ltd. et al.	August 2008– September 2012	Automotive Services
24	China Zhengtong Auto Services Holdings Limited; Tongfang Ltd. Co.	August 2008– September 2012	Automotive Services
25	Jiangsu Rongsheng Heavy Industries Group Co., Ltd.; Anhui Quanchai Group Co., Ltd. (a Key SOE)	August 2008– September 2012	Industrial
26	Shanghai Pharmaceutical Holding Co., Ltd. (a SOE) China Health System Ltd.	August 2008– September 2012	Pharmaceutical
27	GAC Group (an SOE); GAC Changfeng Motor Co.	August 2008– September 2012	Automotive Services
28	China Grand Automotive Services Co.; Jilin Ruifu Investment Ltd. Co. et al.	August 2008– September 2012	Automotive Services
29	China Zhengtong Auto Services Holdings Limited; Tongfang Ltd. Co.	August 2008– September 2012	Automotive Services
30	China Zhengtong Auto Services Holdings Limited; Lasa Hong Jin Auto Trading Ltd. Co.	August 2008– September 2012	Automotive Services

NO.	PARTIES TO THE CONCENTRATION	CLEARANCE DATE	INDUSTRY
31	Air China Ltd. (a wholly owned subsidiary of China National Aviation Holding Company, a Key and Central SOE); Tibet Airlines	August 2008– September 2012	Airline
32	State Grid Electric Power Research Institute (a research institute of the State Grid Corporation of China and a Central SOE); Shanghai Zhixin Electric Ltd. Co.	August 2008– September 2012	Energy
33	China Grand Automotive Services Co.; Daqing Yeqin Rongxin Auto Sales & Services Ltd. Co. et al.	November 26, 2012	Automotive Services
34	China Grand Automotive Services Co.; Ningxia Shangling Mailun Auto Sales and Services Ltd. Co.; Ningxia Yinchuan Shangling Fengtian Auto Sales and Services Ltd. Co.	November 26, 2012	Automotive Services
35	China National Pharmaceutical Group Corporation (a Central SOE); Winteam Pharmaceutical Group Co., Ltd.	December 14, 2012	Pharmaceutical
36	Jiangling Motors Co. (a Key SOE); Taiyuan Changan Heavy Vehicle Co. (an indirect subsidiary jointly controlled by Aviation Industry Corporation of China and China South Industries Group Corporation, two Central SOEs)	December 17, 2012	Automobile
37	Datong Coal Mining Group's (a Key SOE); Shanxi Zhangze Electric Power Co., Ltd.	December 28, 2012	Energy
38	Yunnan Yuntianhua Co., Ltd. (a Key SOE)	January 18, 2013	Agriculture/ Chemicals
39	Zhejiang Provincial Energy Group Co., Ltd. (an SOE); Ningbo Marine Group Co., Ltd.	January 18, 2013	Energy/ Transportation
40	Suning Appliance Co., Ltd.; Beijing Red Baby Internet Technologies Co., Ltd. and four affiliates et al.	January 31, 2013	Household Appliances
41	Shenhua Group Co., Ltd (a Central SOE); State Grid Energy Development Co., Ltd. (a subsidiary of State Grid Corporation of China, a Central SOE)	January 31, 2013	Energy
42	Baoxin Auto Group Ltd.; Ruian Baolong Automobile Service Co., Ltd.; Shanghai Chenlong Auto Sales Co., Ltd.	February 5, 2013	Automobile
43	iSoftStone; Huawei Telecommunications Co.	March 25, 2013	Information Technology
44	Tongfang Co., Ltd.; Beijing Ereneben Information Technology Co., Ltd.	April 10, 2013	Internet
45	Anhui Shanying Paper Industry Co., Ltd.; Maanshan Paper Industry Group; Fujian Taisheng Industrial Co., Ltd.	April 25, 2013	Paper
46	Beijing Wangfujing International; PCD Stores (Group) Limited	May 16, 2013	Retail Stores
47	Xinjiang Longze Automobile Services; Harbin Meitong Automobile Sales and Services Co., Ltd.	May 30, 2013	Automobile

NO.	PARTIES TO THE CONCENTRATION	CLEARANCE DATE	INDUSTRY
48	Midea Group; Midea Appliances	June 8, 2013	Household Appliances
49	Anlong Air Rental Co. Ltd; Fuguo Air Co., Ltd.	July 3, 2013	Air Services
50	Xiamen Port Holding Group (an SOE); Xiamen ITG Holding Co., Ltd. et al.	July 3, 2013	Transportation
51	China National Corp. of Traditional & Herbal Medicine (an SOE); Guizhou Tongjitang Pharmaceutical Co., Ltd.	August 21, 2013	Medicine
52	NARI Technology Development Co., Ltd.; Beijing Kedong Electrical Control Systems Co., Ltd.	September 25, 2013	Electrical
53	Dongfeng Motor Co., Ltd. (a central SOE); Sanjiang Renault Motor Co., Ltd.	October 10, 2013	Automobile
54	Tsinghua Unigroup Ltd. (an SOE); Spreadtrum Communications, Inc.	November 4, 2013	Technologies/ Semiconductor
55	Heilan Group; Rongji International Co., Ltd.; Sancanal Technology Co., Ltd.	November 8, 2013	Garment Manufacturing
56	Inner Mongolia Erdos Energy Electric Services; Qinghai Baitong High Pure Materials Development Co., Ltd.	November 20, 2013	Energy
57	Beijing Jiangho Curtain Wall Co., Ltd.; Guangyuan Architectural Decoration Co., Ltd.	December 17, 2013	Construction

# Drawing The Battle Lines for Mandatory Arbitration Clauses: The Consumer Financial Protection Bureau Joins the Fight

**John E. Villafranco, Christie Thompson and Jalyce Mangum**

The Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>1</sup> (Dodd-Frank Act) requires the Consumer Financial Protection Bureau (CFPB) to provide Congress with a report on the inclusion and effect of pre-dispute arbitration clauses in contracts for consumer financial products and services to determine whether such clauses should be restricted or prohibited. On December 12, 2013, more than a year-and-a-half after initiating its public inquiry for the report,<sup>2</sup> the CFPB released its Arbitration Study Preliminary Results: Section 1028(a) Study Results to Date (Preliminary Report).<sup>3</sup> While the Preliminary Report is not the final version the Bureau will present to Congress, its findings on pre-dispute arbitration clauses, or as CFPB Director Richard Cordray calls them, “take it or leave it clauses,”<sup>4</sup> support the general position that these clauses suppress the legal rights of consumers. While the CFPB cautions that it still has much work to do,<sup>5</sup> the data presented in the report, the scope of additional research that the Bureau plans to undertake, and the political trend against mandatory arbitration foreshadow a rocky future for the use of such arbitration clauses.

Before the CFPB issued its Preliminary Report, the Federal Trade Commission weighed in on September 13, 2013, filing an amicus brief in a consumer class action challenging a tribal payday lender’s practice of requiring consumers to submit to arbitration proceedings at a Native American Reservation.<sup>6</sup> In supporting the putative class of Illinois consumers, the FTC argued that the lender’s arbitration clause was unfair and unconscionable.<sup>7</sup> The FTC’s amicus brief followed its 2010 report that endorsed debt collection litigation and arbitration reforms “to fix a broken system.”<sup>8</sup>

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<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, tit. X, 124 Stat. 1376, 1955 (2010) [hereinafter Dodd-Frank Act], available at <http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf>.

<sup>2</sup> See CONSUMER FIN. PROT. BUREAU, REQUEST FOR INFORMATION REGARDING SCOPE, METHODS, AND DATA SOURCES FOR CONDUCTING STUDY OF PRE-DISPUTE ARBITRATION AGREEMENTS 4 (Apr. 2012) (Dkt. No. CFPB-2012-0017) [hereinafter RFI]. [http://files.consumerfinance.gov/f/201204\\_cfpb\\_rfi\\_predispute-arbitration-agreements.pdf](http://files.consumerfinance.gov/f/201204_cfpb_rfi_predispute-arbitration-agreements.pdf).

<sup>3</sup> CONSUMER FIN. PROT. BUREAU, CFPB, ARBITRATION STUDY PRELIMINARY RESULTS: SECTION 1028(A) STUDY RESULTS TO DATE (Dec. 12, 2013) [hereinafter PRELIMINARY REPORT], [http://files.consumerfinance.gov/f/201312\\_cfpb\\_arbitration-study-preliminary-results.pdf](http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf).

<sup>4</sup> Press Release, Consumer Financial Protection Bureau, Prepared Remarks of Director Richard Cordray at the Field Hearing on Arbitration (Dec. 12, 2013) [hereinafter Field Hearing], <http://www.consumerfinance.gov/newsroom/prepared-remarks-of-director-richard-cordray-at-the-field-hearing-on-arbitration/>.

<sup>5</sup> *Id.*

<sup>6</sup> Brief for the Federal Trade Commission as Amici Curiae Supporting Petitioner, Jackson v. Payday Fin., LLC, No. 12-2617 (7th Cir. July 10, 2012).

<sup>7</sup> *Id.* at 18, 24.

<sup>8</sup> FED. TRADE COMM’N, REPAIRING A BROKEN SYSTEM: PROTECTING CONSUMERS IN DEBT COLLECTION LITIGATION AND ARBITRATION (2010) available at <http://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-bureau-consumer-protection-staff-report-repairing-broken-system-protecting/debtcollectionreport.pdf>.

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These concerns are not unique to the FTC. For example, the Senate Judiciary Committee held a December 17, 2013 hearing entitled “The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?” to discuss two Supreme Court cases that rejected arguments against the enforcement of class waivers in arbitration clauses.<sup>9</sup> Presiding over the hearing, Senator Al Franken reintroduced the Arbitration Fairness Act, which would void such clauses in consumer disputes, stating, “It’s clear from today’s hearing that we’re at a point where big corporations can write their own rules and insulate themselves from liability for wrongdoing—this can’t continue.”<sup>10</sup>

This article summarizes the findings that led to the CFPB’s Preliminary Report and the outlook for the CFPB’s future work. The article also discusses efforts by the business community to redirect the discourse on pre-dispute arbitration clauses.

## Background

Arbitration clauses in agreements for financial products and services have been on the rise since as early as 1925, when Congress enacted the Federal Arbitration Act<sup>11</sup> (FAA) to honor arbitration agreements between assenting parties. Congress passed the FAA in response to judicial hostility towards arbitration agreements<sup>12</sup> and “require[d] courts to enforce privately negotiated agreements to arbitration, like other contracts, in accordance with their terms.”<sup>13</sup> In general, the FAA prohibits courts from reviewing or overturning arbitration awards, except in very limited circumstances.<sup>14</sup>

The FAA ushered in a policy generally favoring arbitration as an alternative means to resolve disputes. The Dodd-Frank Act is one of a few statutes in which Congress has departed from this policy.<sup>15</sup> The Act aims “to protect consumers from abusive financial services practices” and to promote “the financial stability of the United States” by increasing “accountability and transparency in the financial system.”<sup>16</sup> Having endured backlash from the 2008 recession and several bank bailouts, members of Congress likely saw mandatory, private arbitration as a possible abusive practice and palpable stain on the transparent financial system that it favored. The Act’s provisions confirm this view. For example, Section 1414 prohibits the inclusion of arbitration clauses in most residential mortgage loan contracts<sup>17</sup> and Section 921 gives the Securities and Exchange Commission authority to prohibit or restrict the enforcement of arbitration clauses for certain dis-

<sup>9</sup> *The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?*, 113th Cong. (2013) [hereinafter *FAA Hearing*]; *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011); *Am. Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013).

<sup>10</sup> *FAA Hearing*, *supra* note 9 (statement of Sen. Al Franken, Member, S. Comm. on the Judiciary).

<sup>11</sup> Federal Arbitration Act (FAA), Pub. L. No. 68-401, tit. IX, 43 Stat. 883 (1925), available at [http://www.constitution.org/uslaw/sal/043\\_statutes\\_at\\_large.pdf](http://www.constitution.org/uslaw/sal/043_statutes_at_large.pdf).

<sup>12</sup> The House and Senate Report accompanying the FAA legislation identify judicial hostility as a motivation for passing the legislation. H.R. REP. NO. 68-96, at 1–2 (1924) (discussing the “jealousy of the courts and the rejection of arbitration agreements”); S. REP. NO. 68-536, at 2–3 (1924) (discussing reasons courts refuse to enforce arbitration agreements).

<sup>13</sup> *Voit Info. Scis., Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989).

<sup>14</sup> *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995) (noting that under the FAA, courts may vacate an arbitrator’s decision “only in very unusual circumstances.” *Id.* at 942).

<sup>15</sup> *Field Hearing*, *supra* note 4.

<sup>16</sup> Dodd-Frank Act.

<sup>17</sup> *See* Dodd-Frank Act § 1414, 15 U.S.C. § 1639.

putes.<sup>18</sup> Finally, Section 1028 addresses the application of arbitration clauses “in connection with the offering or providing of consumer financial products or services.”<sup>19</sup> Taken together, these clauses mark a legislative turning of the tide against pre-dispute arbitration clauses.

Section 1028 requires the CFPB to conduct a study and provide a report to Congress concerning the use of pre-dispute arbitration agreements “in connection with the offering or providing of consumer financial products or services.”<sup>20</sup> Section 1028 provides that the CFPB may adopt regulations to “prohibit or impose conditions or limitations on the use of [pre-dispute arbitration agreements]” if it “finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers.”<sup>21</sup>

### The Preliminary Report

The CFPB’s initial inquiry focused on three types of consumer financial services contracts: cardholder agreements for credit cards, deposit account agreements for checking accounts, and cardholder agreements for general purpose reloadable (GPR) prepaid cards.<sup>22</sup> The Preliminary Report includes findings with respect to the incidence of arbitration provisions, the substance of the arbitration provisions, and the incidence and types of consumer disputes filed with the American Arbitration Association and in small claims courts.

#### **Clause Incidence, Complexity, and Features.**

**INCIDENCE.** The CFPB studied samples of three categories of agreements: credit card agreements on file with the CFPB from 2010 to 2012;<sup>23</sup> checking account agreements from 300 banks and credit unions;<sup>24</sup> and GPR prepaid card agreements from the web pages of five issuers.<sup>25</sup> In evaluating these agreements, the CFPB noted a stark contrast in the types of institutions that use mandatory arbitration clauses. Larger institutions are more likely to include an arbitration clause in consumer contracts than community banks or credit unions.<sup>26</sup> For example, in the credit card market 29 of the 50 largest bank issuers included arbitration clauses in their agreements. Thus, while most issuers exclude such clauses in their consumer credit card contracts, over 50 percent

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<sup>18</sup> See Dodd-Frank Act § 921, 15 U.S.C. § 780.

<sup>19</sup> See Dodd-Frank Act § 1028, 12 U.S.C. § 5518.

<sup>20</sup> 12 U.S.C. § 5518(a).

<sup>21</sup> § 5518(b).

<sup>22</sup> The CFPB defines a general purpose reloadable (GPR) prepaid card as a card that “a consumer can use anywhere that accepts payment from a retail electronic payments network, such as Visa, MasterCard, American Express, or Discover” and to which the “consumer, or authorized party, can add money to the card after the card is issued.” Consumer Fin. Prot. Bureau, Advance Notice of Proposed Rulemaking, 77 Fed. Reg. 30,923 (May 24, 2012) (Dkt. No. CFPB-2012-0019).

<sup>23</sup> The Credit Card Act of 2009 requires credit card issuers above a certain size to submit their credit card agreements to the appropriate regulator. The Dodd-Frank Act authorizes the CFPB to collect credit card agreements under the Credit Card Act. Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1746, § 204(a) (May 22, 2009); see 15 C.F.R. § 226.58(c)(5) (de minimis exception); see 15 U.S.C. § 1632(d).

<sup>24</sup> Using insured deposits as a proxy for consumer accounts, the CFPB’s sample set of checking account agreements include agreements from: “the 100 largest banks based on consolidated deposits less than \$250,000 (i.e., the deposit insurance threshold); a random sample of 150 banks not among the 100 largest (referred to as small and mid-sized banks); and the 50 largest credit unions based on the amount of insured deposits.” PRELIMINARY REPORT, *supra* note 3, at 133.

<sup>25</sup> The CFPB noted that the market data is much less comprehensive for GPR prepaid cards than for either credit cards or checking accounts. The CFPB included agreements (1) posted on the Visa, MasterCard, or NerdWallet web pages; (2) examined in key studies on the terms of prepaid cards; and (3) posted on the web pages of two leading credit union GPR card programs, by PSCU and CUNA. *Id.* at 134.

<sup>26</sup> *Id.* at 19.

of outstanding credit card loans on file are subject to arbitration clauses. The CFPB noted, however, that the percentage of outstanding credit card loans subject to arbitration clauses could have been much higher. In 2009 and 2010, a number of large issuers entered into private settlements in which they agreed to delete the arbitration clauses from their credit card consumer agreements for a certain period of time. But for the settlement agreements, nearly 94 percent of outstanding credit card loans would now be subject to arbitration.<sup>27</sup>

Similar to the credit card market, larger banks tend to include arbitration clauses in their consumer checking contracts, while mid-sized and smaller banks and credit unions do not. The CFPB estimates that about 8 percent of banks, covering 44 percent of insured deposits, include arbitration clauses in their checking account contracts.<sup>28</sup> Finally, in its sample for GPR prepaid cards, the CFPB reports widespread use of arbitration clauses. Four out of five contracts reviewed for GPR prepaid cards include arbitration clauses.<sup>29</sup> The prevalence of arbitration clauses in prepaid card agreements indicates the growing preference for arbitration clauses among emerging financial products and services.

**COMPLEXITY.** The Preliminary Report also evaluated the relative complexity of these clauses in the credit card market.<sup>30</sup> In credit card agreements, the study found that arbitration provisions were almost always more complex and written at a more challenging level of readability than the other provisions in the contract.<sup>31</sup> Indeed, the Report observes that in every credit card agreement studied, the non-arbitration provisions achieved a better score in terms of readability than the arbitration clause. The study used the Flesch readability score and the Flesch-Kincaid grade level to assess readability. Scores between 0 and 49 are considered easily understood by college graduates, while scores between 60 and 100 are considered easily understood by average students in grades five through nine.<sup>32</sup> The lower the readability score, the harder it is to comprehend the text. The goal for most standard documents is a score between 60 and 70.<sup>33</sup> The study reported that the mean Flesch readability score for arbitration provisions in credit card contracts was 34.5 and the median was 33.7. The mean readability score for the remaining provisions in the contract was 52.2 and the median was 51.6.<sup>34</sup> Tracking the Flesch readability data, both mean and median Flesch-Kincaid grade levels for credit card arbitration clauses were three grades higher than mean and median grade level for the remainder of the credit card contract.<sup>35</sup>

**FEATURES.** In addition to examining their complexity, the CFPB also analyzed various terms that appeared in or with arbitration clauses. Most notably, the Bureau examined whether the clause (1) provides consumers with a period to reject the arbitration clause; (2) contains a small

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<sup>27</sup> *Id.* at 22–23.

<sup>28</sup> *Id.* 25–26.

<sup>29</sup> *Id.* 27.

<sup>30</sup> The CFPB did not examine the complexity of arbitration clauses in consumer checking account and GPR prepaid card agreements. PRELIMINARY REPORT, *supra* note 3, at 28.

<sup>31</sup> *Id.* 28.

<sup>32</sup> *The Flesch Readability Formula*, READABILITY FORMULAS, <http://www.readabilityformulas.com/flesch-reading-ease-readability-formula.php> (last visited Jan. 9, 2014).

<sup>33</sup> *Test Your Document's Readability*, MICROSOFT OFFICE, <http://office.microsoft.com/en-us/word-help/test-your-document-s-readability-HP010148506.aspx> (last visited Jan. 9, 2014); Cheryl Stephens, *All About Readability*, PLAIN LANGUAGE, <http://plainlanguage.com/new-readability.html> (last visited Jan. 9, 2014).

<sup>34</sup> PRELIMINARY REPORT, *supra* note 3, at 29.

<sup>35</sup> *Id.*

claims carve-out excusing consumers with disputes eligible for small claims court from the obligation to arbitrate; (3) delegates enforceability decisions to the arbitrator; (4) precludes class proceedings; or (5) limits the recovery of punitive or other damages.<sup>36</sup>

For both credit card and checking accounts, just over a quarter of the arbitration clauses included a provision that provided consumers with a defined period of time to opt out of, or reject, the arbitration clause.<sup>37</sup> Just 17 percent of prepaid card arbitration clauses included an opt-out.<sup>38</sup> In the checking account and prepaid card markets, larger institutions were slightly more likely to permit consumers to opt out of the arbitration clause than smaller institutions.<sup>39</sup> Taken separately, and stated as a percentage of account values, about 38.3 percent of arbitration-subject insured deposits had an opt-out term, as did 26.5 percent of dollar amounts of arbitration-subject prepaid card values. In the credit card market, 26.0 percent of arbitration-subject loans outstanding in the sample had an opt-out.<sup>40</sup> The CFPB did not discuss the percentage of consumers that took advantage of an opt-out clause.

Most of the agreements studied excluded certain claims or disputes from arbitration. The most common carve-out was for claims that were eligible for small claims court. For the credit card, checking account, and prepaid card markets, about two-thirds of arbitration clauses included carve-outs for small claims court.<sup>41</sup>

The CFPB also studied clauses that delegated to the arbitrator exclusive authority to make decisions about the enforceability of the arbitration clause. Under the FAA, arbitrators generally decide challenges to the legal validity of a contract that includes an arbitration clause while courts decide challenges to the enforceability of the arbitration clause itself. Courts can also decide whether a party assented to the contract. In 2010, however, the Supreme Court affirmed the use of delegation clauses whereby parties delegate to the arbitrator issues that otherwise would be reserved to the court.<sup>42</sup>

Overall, the CFPB found that most of the arbitration clauses within its sample included terms that delegate to the arbitrator exclusive authority to make decisions about the arbitration clause's enforceability. Considered individually, the data regarding clauses that included such terms ranged from 39.3 percent of clauses in the checking account sample, to 51.5 percent of credit card clauses, to 60.8 percent of prepaid card clauses.<sup>43</sup> According to the Preliminary Report, however, these statistics understate the degree of delegation to the arbitrator in two respects. First,

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<sup>36</sup> The CFPB also examined which entity or entities may administer the arbitration and how the arbitrator or arbitrators are to be selected; whether the clause delimits the time period in which a claim must be brought; whether the clause precludes the disclosure of information about any arbitration; where any in-person hearing is to take place; what the clause provides about the costs of arbitration to the consumer and the company; whether the clause provides for a contingent minimum recovery; and what the clauses disclose about various core characteristics of the arbitration process. *Id.* at 29–30.

<sup>37</sup> *Id.* at 31.

<sup>38</sup> *Id.* Generally, the time allotted for opting out was 30 to 60 days.

<sup>39</sup> *Id.* at 32.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* Some 59% (checking), 62.7% (prepaid card), and 66.7% (credit card) of arbitration clauses in the samples included carve-outs for small claims court, with large institutions more likely to use such carve-outs than small institutions.

<sup>42</sup> *Rent-A-Center West, Inc. v. Jackson*, 130 S. Ct. 2772 (2010) (finding that based on the terms of the parties' agreement to arbitrate their disputes, the arbitrator—not the courts—should decide whether the clause was unconscionable).

<sup>43</sup> PRELIMINARY REPORT, *supra* note 3, at 36. A number of clauses, however, reserved such authority to the court through an "anti-delegation clause." For the checking account market, 26.2% of the clauses in the sample have this feature. The shares that include these clauses for the credit card and prepaid card markets are 13.6% and 7.8%, respectively. *Id.*

the data does not account for terms that delegate most enforceability issues to the arbitrator but expressly reserve to the court the exclusive authority to decide the enforceability of contractual limitations on class proceedings.<sup>44</sup> Such terms appeared in over a quarter of the credit card clauses. Second, when parties agree to an arbitration clause designating an administrator for future disputes, the parties also submit themselves to the administrator's rules of procedure. Courts have consistently determined that the incorporation of AAA arbitration rules demonstrates that the parties "agreed to arbitrate arbitrability."<sup>45</sup> Therefore, even clauses that excluded traditional delegation clauses typically delegated additional authority to arbitrators because almost all of the arbitration clauses selected an administrator. In the CFPB's view, "[T]he effect of such delegation clauses is to reduce substantially the role of courts in policing the fairness of arbitration clauses when they are included in a contract."<sup>46</sup>

*In the CFPB's view, "[T]he effect of such delegation clauses is to reduce substantially the role of courts in policing the fairness of arbitration clauses when they are included in a contract."*

The CFPB also reported that nine out of ten contracts with arbitration clauses bar consumers from initiating or participating in class proceedings, further reducing the courts' role. As a practical matter, the 90 percent of clauses barring class proceedings covered almost 100 percent of arbitration-subject outstanding credit card loans, insured deposits, and dollar amounts loaded on prepaid card. Thus, in the CFPB's samples, almost all of the consumers who were subject to arbitration provisions were effectively precluded from participating in class proceedings.<sup>47</sup>

Finally, the CFPB saw a wide variety of other terms in arbitration clauses, including ones limiting punitive and consequential damages and imposing confidentiality and non-disclosure obligations. Damages-limitation terms were most prevalent in checking account contracts. Almost two-thirds of checking account contracts with arbitration clauses in the sample included some damages limitation. These terms covered almost 80 percent of arbitration-subject insured deposits.<sup>48</sup> Conversely, most of the arbitration clauses in the sample did not impose confidentiality or non-disclosure obligations on the parties. Non-disclosure provisions appeared most in checking account arbitration clauses. According to the CFPB, 11.5 percent of checking account arbitration clauses, covering 28 percent of arbitration-subject insured deposits, precluded the parties from making disclosures about the arbitration proceedings. By comparison, only one prepaid card arbitration clause, and two credit card arbitration clauses included such a term.<sup>49</sup>

### Arbitration Filings

Relative to the number of consumers using products subject to arbitration clauses, the number of consumer-initiated arbitration actions was low. The Preliminary Report reviewed three product markets: the credit card, checking account, and payday loans market. The CFPB obtained records on all consumer arbitration cases filed with the American Arbitration Association (AAA) between 2010 and 2012<sup>50</sup> and identified 1,241 credit card, checking, and payday loan disputes

<sup>44</sup> PRELIMINARY REPORT, *supra* note 3, at 37.

<sup>45</sup> See *Oracle Am., Inc. v. Myriad Group A.G.*, 724 F.3d 1069, 1074 (9th Cir. 2013) (noting that every circuit that has considered this issue has held the same position).

<sup>46</sup> PRELIMINARY REPORT, *supra* note 3, at 36.

<sup>47</sup> *Id.* at 37. Some arbitration clauses preclude all class proceedings, others expressly waive the consumer's ability to participate in class actions in court.

<sup>48</sup> *Id.* at 40.

<sup>49</sup> *Id.* at 42.

<sup>50</sup> The AAA was the predominant administrator for consumer arbitration concerning credit cards, checking accounts, and GPR prepaid cards in the CFPB's sample. The Preliminary Report did not provide data regarding AAA prepaid card disputes because the CFPB only identified four cases specific to the prepaid market. PRELIMINARY REPORT, *supra* note 3, at 10 n.20.

between consumers and businesses. Broken down by product market, there were 1,033 credit card disputes, 71 checking account disputes, and 137 payday loan disputes.<sup>51</sup> Included in these filings, however, were disputes in which companies initiated proceedings to collect debt from consumers. In comparison, the CFPB has already identified 3,000 federal court cases filed by consumers from 2010 to 2012 concerning credit card disputes alone, including 400 class actions. Juxtaposed with these findings, the CFPB estimated that 80 million credit cardholders were subject to arbitration clauses by the end of 2012. As reported, the number of arbitration claims filed concerning credit card, checking account, and payday loan disputes is dwarfed by the estimated number of consumers using these products.

For those consumers who did use arbitration, hardly any of them filed arbitration claims for small-dollar amounts. Very few AAA arbitration filings for the credit card, checking account, and GPR prepaid card markets involved amounts under \$1,000. The average debt amount in a dispute was \$13,418. In cases without a disputed debt amount, the average claim amount at issue was \$38,726 and the median was \$11,805.<sup>52</sup>

One could speculate that this is because consumers initiated smaller disputes in small claims court. Indeed, as noted above, most arbitration clauses contained small claims court carve-outs. Yet, the Preliminary Report casts doubt on that hypothesis. The CFPB found that cases filed in small claims court are much more likely to be brought by banks than by consumers. Furthermore, the CFPB emphasized that in 2012, considering that there were 85 million consumers in 31 jurisdictions, fewer than 870 small claims court credit card were filed against issuers, representing nearly 80 percent of outstanding credit card loans.<sup>53</sup> Moreover, the CFPB believes the data regarding the amounts at issue suggest that the small claims carve-out is meaningless in this area, as the average amount at issue in the sample of arbitration filings exceeds the jurisdiction for most small claims courts. Furthermore, since most arbitration clauses included small claims carve-outs, the amount at issue in most of the sampled filings exceeds the cutoff amount for most small claims courts by default.

Finally, the study examined whether counsel represented consumers in these disputes.<sup>54</sup> A slight majority (53 percent) of consumers were represented by counsel in the AAA arbitrations studied. In non-debt collection disputes, 61 percent of consumers had a lawyer at some point in the arbitration. In debt collection disputes, 42 percent of consumers had legal representation at some point in the arbitration. Companies, however, were almost always represented by counsel, both in debt collection and non-debt collection arbitrations.

### The CFPB's Future Work

The CFPB cautioned readers not to interpret the report as indicative of what conclusions might be reached or recommendations made in the statutory report to Congress and made three observations as to how the Report was intentionally limited in scope. First, the CFPB observed that the Preliminary Report focused on the “front-end” of formal disputes involving consumers, namely who files the disputes, in what numbers, and against whom. The CFPB intends to address the “back-end” of formal arbitration disputes—what happens after the suit is filed and at what cost—in later

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<sup>51</sup> *Id.* at 64.

<sup>52</sup> *Id.* at 80.

<sup>53</sup> *Id.* at 14–15.

<sup>54</sup> *Id.* at 73–74.

work. Second, the Preliminary Report also focused on filings in arbitration and in small claims court. The CFPB plans to address consumer cases filed in federal courts and in state courts in a later work. Third, the results concentrated on individual disputes. As part of a comprehensive report to Congress the Bureau is also studying class action proceedings to assess the extent to which they are limited by arbitration clauses.

Although only a Preliminary Report, the stage is perhaps set for adverse rulemaking to restrict or prohibit mandatory arbitration clauses in certain settings. In the CFPB's December 12, 2013, field hearing to discuss the Preliminary Report, Director Cordray emphasized the CFPB's mission to ensure that consumers are well-informed and educated about their financial affairs. He announced that the CFPB will survey consumers in the credit card market to determine "whether they are aware of the terms in arbitration clauses; whether they make assumptions about their legal rights under the terms of these clauses; and whether they factor the existence of these clauses into their decision-making process about obtaining or using particular consumer financial products and services."<sup>55</sup> Because most consumers do not read all the terms of many of the contracts they sign,<sup>56</sup> the conclusion that will be shaped from this survey is not likely to differ from the conclusion formed from the Preliminary Report.

*Although only a Preliminary Report, the stage is perhaps set for adverse rulemaking to restrict or prohibit mandatory arbitration clauses in certain settings.*

Additionally, the Bureau is comparing the benefits to consumers from arbitration versus class action litigation. The CFPB has identified a number of class actions involving credit cards, deposit accounts, or payday loans that were settled since July 2009 where the contract at issue allowed for arbitration before the AAA.<sup>57</sup> Consumers who were members of the classes in these cases could opt out of the class settlement and bring their own case through arbitration. In the cases that the Bureau has identified, more than 13 million class members have made claims or received payments under subsequent settlements.<sup>58</sup> Only 3,605 individuals opted out. Exclusive of attorney's fees and the value of injunctive relief, total payments or debt relief to the classes were over \$350 million. Moreover, the CFPB found that only a handful of the individuals who opted out chose instead to file an arbitration claim.<sup>59</sup>

So far, the CFPB's findings in relation to class action proceedings suggest that the Bureau favors class actions over arbitration as a means for providing redress to consumers. Anticipating the CFPB's stance, members of the financial services industry have released a report of their own entitled, "Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions."<sup>60</sup> Focusing on the "back-end" of formal class action disputes, the study—described in more detail in the following section—found that class actions "provide far less benefit" to individual consumers than consumer advocates allege.

<sup>55</sup> FIELD HEARING, *supra* note 4.

<sup>56</sup> See Jessica M. Choplin & Debra Pogrud Stark, *A License to Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, 5 N.Y.U. J.L. & Bus. 617 (2009). In a survey of consumers, researchers found that, on average, 67% of consumers fail to read all of the terms of the contracts they sign for goods and services relating to computer software, rolling contracts, car rentals, apartment leases, home purchase, and home loans.

<sup>57</sup> FIELD HEARING, *supra* note 4.

<sup>58</sup> PRELIMINARY REPORT, *supra* note 3, at 104.

<sup>59</sup> *Id.* at 104.

<sup>60</sup> Mayer Brown LLP, *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* (Dec. 11, 2013), <http://www.classdefenseblog.com/files/2013/12/Mayer-Brown-Class-Action-Study.pdf>.

### Class Action Study

At the request of the U.S. Chamber of Commerce Institute for Legal Reform, Mayer Brown LLP conducted an empirical analysis of a sample set of putative consumer and employee class action lawsuits filed in or removed to federal court in 2009. Lawyers at Mayer Brown identified a set of 148 putative consumer and employee class actions using the *BNA Class Action Litigation Reporter* and the *Mealey's Litigation Class Action Reporter*. The sample consisted of consumer and employee claims resembling those that will be addressed in the CFPB's final report to Congress.<sup>61</sup> The report purports to provide strong evidence that class actions do not provide class members with the benefits claimed by their proponents.

Of the 148 reviewed cases that were initiated in 2009, zero cases had gone to trial by September 1, 2013, and resulted in a judgment on the merits. The study found that 14 percent of the class actions studied remained pending without resolution or a determination of whether the case could go forward on a class-wide basis. Moreover, in nearly two-thirds of the resolved cases, class members obtained no relief. The study found that plaintiffs had voluntarily dismissed 35 percent of these cases while another 31 percent had been dismissed on the merits. The remaining approximately 20 percent had settled.<sup>62</sup>

Based on the Mayer Brown study, it is possible to conclude that, in class action litigation, as a practical matter, settlement is the only resolution that produces the possibility of a benefit to class members. But obtaining a benefit through settlement is unlikely. The study found that class actions are significantly less likely to produce settlements, particularly settlements that provide any benefit to class members, than other forms of dispute resolution. The study divided class action settlements into three categories: (1) *cy pres* settlements and injunctive relief in which an amount is paid to a charitable organization and/or relief is injunctive, respectively; (2) "claims-made" settlements in which class members only obtain recoveries if they affirmatively request to do so; and (3) "automatic distribution" settlements in which each class member's settlement is distributed automatically to class members whose eligibility and alleged damages could be ascertained and calculated.<sup>63</sup>

Regarding *cy pres* settlements, the study found that the benefit went to third parties with little or no ties to the putative class. The study also indicated that *cy pres* provides individual consumers with no redress. Asserting that injunctive relief has little to no real-world benefit to class members, the study argued that injunctive relief is used to justify an award of attorney's fees to class counsel. Moreover, where consumers do obtain some benefit, it is usually very small.<sup>64</sup> Finally, the study notes that automatic distribution is difficult to achieve in consumer class actions because parties must have the personal information of every class member and the ability to calculate each member's alleged damages. The researchers only identified one consumer class action settlement that was resolved through automatic distribution. This study may play a key role in shaping the debate as the CFPB moves forward with its analysis and report to Congress.

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<sup>61</sup> *Id.* at 25–26.

<sup>62</sup> *Id.* at 1.

<sup>63</sup> *Id.* at 8–9.

<sup>64</sup> In the data set, 18 cases were resolved by "claims-made" settlements. The researchers were able to obtain data regarding the distribution of settlement proceeds in 6 of the 18 cases. Five of the 6 cases resulted in minuscule claims rates: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.

### Looking Ahead

The CFPB is only midway through conducting the arbitration study mandated by Congress. It has a number of research projects under consideration that will further inform whether the Bureau decides to prohibit, restrict, or limit arbitration clauses in contracts for financial services and products. The Preliminary Report, however, appears to have focused on statistics that support the conclusion that arbitration clauses prevent consumers from being fully engaged in disputing their claims and asserting their rights in a court of law.

Although the CFPB cautioned against reading too much into the Preliminary Report, a battle is shaping up between the financial services industry, the CFPB, and Congress over such clauses. In the meantime, industry members may consider collecting and sharing data demonstrating the fairness of pre-dispute arbitration clauses. They may also consider reviewing their clauses for clarity and ease of understanding as the Bureau emphasizes consumer awareness. ●

# Antitrust Counsel Beware: Divergent Disqualification Decisions Raise Questions About Positional Conflicts

By Lee F. Berger, Panteha Abdollahi, and Andrew R. Booth

Modern antitrust litigation typically involves a web of parties: named class representatives, unnamed class members, opt-out or “direct action” plaintiffs (usually large corporations), state attorneys general, third parties (subpoena targets and amici) and defendants (also usually large corporations). Antitrust attorneys entering the fray usually are careful to address standard conflicts issues: ensuring that no directly adverse party is a client of the firm, getting waivers and establishing ethical walls when a conflict can be resolved, and helping the client to find alternative, unconflicted counsel when it cannot. But increasingly, large corporate litigants are opting out of class actions and filing their own separate direct action lawsuits, creating an additional layer of potential conflicts questions. Such opt-out cases bring to the fore the issue of whether a “positional conflict” constitutes an ethical rules violation and supports disqualification of counsel.

A positional conflict question may arise in the following situation: (1) a law firm represents Client A in an action; (2) another of the law firm’s clients (Client B) is adverse to Client A in a separate but related action, for example, in the same multidistrict litigation; and (3) the law firm does not represent Client A or Client B in the related action. Nonetheless, the positions and arguments the law firm advances on behalf of Client A may be used against Client B in the related action. If the positional conflict is determined to violate the ethical rules and warrant disqualification, it may hinder many large law firm antitrust litigation practices and clients may face limitations in their choice of counsel. Conversely, if there is no ethical violation it may provide current clients more comfort that their attorneys will not take positions in any related litigation that may disadvantage them and may enhance their (and the public’s) perception of attorney loyalty.

Antitrust counsel face a convoluted and unpredictable task in assessing whether positional conflicts may be grounds for disqualification, especially in light of differing jurisdictions’ conflict rules coupled with the absence of clear guidance from courts or ethics rules. Two recent cases address this potential positional conflict situation and highlight the ambiguities: *In re Rail Freight Fuel Surcharge Antitrust Litigation* and *Arrowpac Inc. v. Sea Star Line, LLC*.<sup>1</sup> The *In re Rail Freight* court found no conflict because the matters were separate, even though related. In contrast, the *Arrowpac* court found the related nature of the cases did create a conflict and disqualified the defense firm. The cases turned on their unique factual scenarios and the courts’ analyses of a variety of policy factors, thereby leading to different outcomes. But there was a similarity between the two decisions in that both courts emphasized the issue of loyalty and its interplay with positional conflicts.

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<sup>1</sup> *In re Rail Freight Fuel Surcharge Antitrust Litig.*, MDL Dkt. No. 1869, 2013 WL 4714334 (D.D.C. Sept. 3, 2013); *Arrowpac Inc. v. Sea Star Line, LLC*, Nos. 3:12-cv-1180-J-32, 3:12-cv-1181-J-32, 3:12-cv-1182-J-32, 3:12-cv-1183-J-32, 2013 WL 5460027 (M.D. Fla. Apr. 30, 2013).

The divergent conclusions reached by the courts on when a positional conflict sufficiently hinders counsels' loyalties so as to warrant disqualification create uncertainty for practitioners and clients alike. This is further exacerbated by the often multidistrict nature of antitrust proceedings and the differences in jurisdictions' conflict laws. It is essential that parties and counsel be aware of these decisions and ambiguities in making their conflicts determinations.

To help resolve the uncertainty, we believe the American Bar Association and state bar associations should consider providing additional comments on their ethical rules regarding whether the types of positional conflicts at issue in those cases violate the various rules of professional conduct, particularly in multidistrict or related antitrust proceedings. While their comments would not bind courts, they would serve as persuasive authority for judges confronting the issue as a matter of first impression. They also would provide greater guidance to practitioners and clients facing a positional conflict question. Until the bar associations promulgate that guidance or new court decisions further resolve these conflicting opinions, antitrust lawyers should be aware of these developments and consider taking measures to minimize the risk of disqualification arising from positional conflicts.

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### **Conflict of Interest Rules and Disqualification**

There are a variety of sources of conflict-of-interest rules, which differ from state to state and also between state and federal courts within the same state.<sup>2</sup> Generally, a state's conflict-of-interest rules govern cases in a federal court in that state, including when the federal court presides over multidistrict litigation with cases originating around the country.<sup>3</sup>

But state rules are not the sole authority governing conflicts of interest in federal court, and federal courts may look to ABA model rules and ethical canons—in addition to the applicable state law—in deciding whether a conflict exists.<sup>4</sup> Assessing conflicts becomes, necessarily, an unpredictable exercise that varies based on the court and the jurisdiction, a problem exacerbated by the multijurisdictional practices prevailing in antitrust class actions. Furthermore, once courts conclude that a conflict exists and move to considering disqualification, they often assess an array of factors, including the prejudicial impact of granting or denying disqualification, any tactical reasons prompting the motion, and public policy considerations.<sup>5</sup>

### **Rail Freight Finds No Conflict and Denies Disqualification**

In *In re Rail Freight Fuel Surcharge Antitrust Litigation (Rail Freight)*,<sup>6</sup> District Judge Paul L. Friedman found that counsel should not be disqualified for an alleged positional conflict of interest. At issue in *Rail Freight* was Latham & Watkins LLP's representation of two parties on opposite sides of related litigations. Latham represented Union Pacific Railroad Company in dozens of matters.<sup>7</sup> Latham

<sup>2</sup> See, e.g., *In re American Airlines, Inc.*, 972 F.2d 605, 609–10 (5th Cir. 1992).

<sup>3</sup> See, e.g., *In re Cnty. of Los Angeles*, 223 F.3d 990, 995 (9th Cir. 2000).

<sup>4</sup> *In re American Airlines*, 972 F.2d at 610.

<sup>5</sup> RONALD E. MALLIN & JEFFREY M. SMITH, *LEGAL MALPRACTICE* § 17:15 (ed. 2011); *Kevlik v. Goldstein*, 724 F.2d 844, 848 (1st Cir. 1984); *Copantitla v. Fiskardo Estiatorio, Inc.*, 788 F. Supp. 2d 253, 281 (S.D.N.Y. 2011). Some courts, in certain situations, apply a per se rule of disqualification. See, e.g., *Zylstra v. Safeway Stores, Inc.*, 578 F.2d 102, 104 (5th Cir. 1978).

<sup>6</sup> *In re Rail Freight*, 2013 WL 4714334.

<sup>7</sup> *Id.* at \*1.

also represented Oxbow Carbon & Minerals LLC in transactional matters, though none related to Oxbow's relationship with Union Pacific or its rail freight needs.<sup>8</sup>

In 2007, direct purchasers of rail freight services launched class actions alleging a price-fixing conspiracy by the four largest rail freight carriers, including Union Pacific.<sup>9</sup> These class actions were centralized in the *Rail Freight* multidistrict litigation. Oxbow later filed a separate action against Union Pacific, making the same price-fixing allegations (the *Oxbow* case).<sup>10</sup> Latham served as Union Pacific's counsel in the *Rail Freight* class cases but not in the *Oxbow* case.<sup>11</sup> When Latham refused Oxbow's request to withdraw as counsel for Union Pacific in the class cases, Oxbow fired Latham in other matters and filed a motion to disqualify Latham from representing Union Pacific in the class cases, even though Oxbow was not a named party to the class cases.<sup>12</sup>

Oxbow argued that Latham's representation of Union Pacific in the class cases violated Rule 1.7(b) of the D.C. Rules of Professional Conduct. Rule 1.7(b)(1), which provides:

[A] lawyer shall not represent a client with respect to a matter if: (1) That matter involves a specific party or parties and a position to be taken by that client in that matter is adverse to a position taken or to be taken by another client in the same matter even though that client is unrepresented or represented by a different lawyer.<sup>13</sup>

Oxbow contended that the class cases and the *Oxbow* case are the "same matter" and thus Latham's representation of Union Pacific in the class cases would be directly adverse to Oxbow in the *Oxbow* case: Latham might make motions for Union Pacific in the class cases that, if successful, Union Pacific would use as precedent against Oxbow in the *Oxbow* case, and Union Pacific would use work product that Latham developed for Union Pacific in the class cases against Oxbow in the *Oxbow* case.<sup>14</sup>

The court rejected Oxbow's argument, and found no conflict existed. In so doing, the *Rail Freight* court relied on *Sumitomo Corp. v. J.P. Morgan & Co.*<sup>15</sup> In *Sumitomo*, Paul Weiss represented plaintiff Sumitomo against J.P. Morgan in one case but declined to represent Sumitomo in a separate but related case against Chase Manhattan Bank because Chase was Paul Weiss's client.<sup>16</sup> At Chase's request, the court consolidated the two cases filed by Sumitomo for pretrial purposes.<sup>17</sup>

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at \*1–2.

<sup>10</sup> *Id.* at \*2.

<sup>11</sup> *Id.* at \*3. Union Pacific had asked Latham to defend it in the *Oxbow* case, but Latham declined, stating it "did not want to be adverse to a valued client." *Id.*

<sup>12</sup> *Id.* at \*4.

<sup>13</sup> Paragraph (c) of Rule 1.7 provides that conflicts can be waived if all potentially affected clients provide informed consent.

<sup>14</sup> *In re Rail Freight*, 2013 WL 4714334, at \*8; Oxbow Reply to Opp. to Mot. to Disqualify, MDL 1869, Dkt. 642.

<sup>15</sup> Nos. 99 Civ. 8780, 99 Civ. 4004, 2000 WL 145747, at \*4 (S.D.N.Y. Feb. 8, 2000).

<sup>16</sup> *Sumitomo*, 2000 WL 145747, at \*1–2. During its investigation of the matter for Sumitomo, Paul Weiss discovered that several of its current clients, including Chase, were among Sumitomo's potential adversaries. Paul Weiss immediately informed Sumitomo that it could not evaluate potential claims against those clients (including Chase) or otherwise represent Sumitomo in connection with any future litigation against those clients. *Id.* at \*1. Sumitomo asked Paul Weiss to seek a waiver from Chase permitting Paul Weiss to evaluate potential claims against Chase. Pursuant to this request, Paul Weiss sought a waiver from Chase and, when that request was denied, Paul Weiss advised Sumitomo to retain other counsel for any claims against Chase. *Id.* at \*1–2.

<sup>17</sup> *Id.* at \*1, \*5.

Chase then moved to disqualify Paul Weiss because Paul Weiss's representation of Sumitomo against J.P. Morgan "would adversely affect Chase."<sup>18</sup>

Applying the Second Circuit's rules that "disqualification is appropriate only if there is a significant risk that an attorney's conduct will taint the trial" and "that a lawyer owes a duty of undivided loyalty to his client that precludes him from doing anything adverse to a client's interests," the *Sumitomo* court found the per se rule against simultaneous representation inapplicable.<sup>19</sup> The court reasoned that Paul Weiss did not represent one client in litigation against another current client, nor would Paul Weiss try to establish Chase's wrongdoing or seek a judgment against its current client. The fact that Paul Weiss could potentially advance positions that "if adopted, would prejudice an argument that Chase was advancing in a separate case" did not create direct adversity.<sup>20</sup> The court rejected the notion that consolidation of the two cases would alter this conclusion: "no conflict arises because consolidation does not merge separate lawsuits into a single action and does not make parties in one suit parties in another."<sup>21</sup>

The court further explained there was no danger that Paul Weiss's representation of Sumitomo would adversely impact its representation of Chase in completely unrelated matters or impugn the court's confidence in the vigor of client representation.<sup>22</sup> As the court stated:

[W]e are not dealing with an individual client who has placed his trust in an individual lawyer for a substantial period of time. Chase is a huge financial institution and Paul Weiss is but one of many law firms with which it does business. Moreover, the amount of business is not substantial given the size of the two institutions.<sup>23</sup>

The court's finding of a lack of positional conflict sufficient to warrant disqualification was thus driven, at least in part, by its analysis of client loyalty considerations.

Following *Sumitomo's* holding, the *Rail Freight* court noted that while "Latham's defense of [Union Pacific] in the [class cases] may involve the development of arguments or the taking of positions that ultimately establish negative precedent for Oxbow in" the *Oxbow* case, they are nevertheless distinct matters for purposes of Rule 1.7(b)(1). It also found no evidence that Oxbow had shared confidential information with Latham that Latham could use in its representation of Union Pacific, and therefore, Latham's representation of Union Pacific in the class cases provided "no reason to doubt Latham's loyalty to either [Union Pacific] or Oxbow in the matters in which Latham represents those clients."<sup>24</sup> Because the class cases and the *Oxbow* case were separate, and there was no reason to believe that Latham had breached the ethical rules regarding loyalty or confidentiality, the *Rail Freight* court refused to disqualify Latham. Additionally, and consistent with virtually all courts that have considered this issue, the court rejected Oxbow's argument that Latham could not represent Union Pacific in the class cases because Oxbow was an unnamed class member, as unnamed class members are not "parties" for conflicts purposes.<sup>25</sup>

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<sup>18</sup> *Id.* at \*2.

<sup>19</sup> *Id.* at \*3–4.

<sup>20</sup> *Id.* at \*4.

<sup>21</sup> *Id.* at \*5.

<sup>22</sup> *Id.* at \*4.

<sup>23</sup> *Id.*

<sup>24</sup> *In re Rail Freight*, 2013 WL 4714334, at \*10.

<sup>25</sup> *Id.* at \*9–12 (collecting cases); see Model Rules of Prof'l Conduct R. 1.7(a)(1) cmt. 25.

### The *Arrowpac* Court Concludes Conflicts Justify Disqualification

In contrast to *Rail Freight*, Magistrate Judge James R. Klindt in *Arrowpac Inc. v. Sea Star Line, LLC* disqualified counsel based on a positional conflict existing in separate but related actions.<sup>26</sup> The court focused on the practical implications that would arise from allowing simultaneous representation of clients with adverse positional interests, relying heavily on the purpose of the disqualification rules in safeguarding loyalty as a feature of the attorney-client relationship.

In October 2012, after opting out of a class action, Nestlé USA, Inc. and YRC Worldwide filed a price-fixing suit against Sea Star Line, LLC, alleging a price-fixing conspiracy related to the prices of ocean transportation shipping services. Nestlé and YRC filed that action, known as *Arrowpac*, simultaneously with three other direct-action plaintiffs' antitrust cases against Sea Star in the Middle District of Florida.<sup>27</sup>

Sea Star selected Baker & Hostetler LLP to represent it in the three non-*Arrowpac* cases. Baker did not represent Sea Star in *Arrowpac* because Baker simultaneously represented Nestlé and YRC in unrelated environmental and labor law matters, and Nestlé and YRC did not grant Baker a conflict waiver.<sup>28</sup> On January 25, 2013, Nestlé and YRC, although not plaintiffs in the non-*Arrowpac* cases, filed motions to disqualify Baker from representing Sea Star in any of the four pending antitrust suits.<sup>29</sup>

Nestlé and YRC argued that Baker's representation of Sea Star in the non-*Arrowpac* cases violated Florida Rule of Professional Conduct 4-1.7, which states, in pertinent part: "[A] lawyer shall not represent a client if . . . the representation of 1 client will be directly adverse to another client."<sup>30</sup> According to Nestlé and YRC, Baker could not defend Sea Star in the non-*Arrowpac* cases "without taking positions that are directly and materially adverse to Nestlé and YRC."<sup>31</sup> Sea Star countered that disqualification was not warranted because Baker did not appear in the *Arrowpac* case—the only case in which Nestlé and YRC were parties—and thus there could be no direct adversity. Rather, at most, there was a positional conflict, which Sea Star contended would not create a conflict under the ethical rules. Sea Star also asserted it would be prejudiced

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<sup>26</sup> *Arrowpac*, 2013 WL 5460027.

<sup>27</sup> U.S. District Court, Middle District of Florida, Case Nos. 3:12-cv-1180-J-32JBT, 3:12-cv-1181-J-32JBT, 3:12-cv-1182-J-32JRK, 3:12-cv-1183-J-32MCR. The cases all were assigned to Judge Timothy Corrigan. Case No. 1180 (Dkt. 43), Case No. 1181 (Dkt. 12), Case No. 1182 (Dkt. 5), Case No. 1183 (Dkt. 13).

<sup>28</sup> *Arrowpac*, 2013 WL 5460027, at \*2, \*5–6. The opt-out plaintiffs originally had filed suit against Sea Star in South Carolina. *Id.* at \*3. Sea Star, with some assistance from Baker, filed two motions to dismiss while the cases were pending in South Carolina. *Id.* at \*4–5. Before a decision was rendered, on October 29, 2012, the plaintiffs voluntarily dismissed their claims and re-filed their actions in Florida. *Id.* at \*6. In their briefing related to disqualification, Nestlé and YRC highlighted that Baker's involvement in the motions to dismiss showed a lack of loyalty to its existing clients. Mot. to Disqualify Baker & Hostetler, LLP as Counsel for Sea Star Line, LLC, Case No. 12-1180, Dkt. 71. Sea Star disputed this characterization. Opp. to Mot. to Disqualify Baker & Hostetler, LLP as Counsel for Sea Star Line, LLC, Case No. 12-1180, Dkt. 81. But it was undisputed that Baker did some research related to the dismissal motions. *Arrowpac*, 2013 WL 5460027, at \*5.

<sup>29</sup> Motion to Disqualify Baker & Hostetler, LLP as Counsel for Sea Star Line, LLC, Case No. 12-1180, Dkt. 71.

<sup>30</sup> *Arrowpac*, 2013 WL 5460027, at \*2, \*8. Florida's Rule 4-1.7 is modeled after the ABA Model Rules of Professional Conduct 1.7(a). *See* Model Rules of Prof'l Conduct R. 1.7(a)(1). Florida maintains an exception to the rule against simultaneous representation if the lawyer reasonably believes he/she can provide competent and diligent representation, the representation is not prohibited by law, the representation does not involve the assertion of a position adverse to another client when the lawyer represents both clients in the same proceeding before a tribunal, and each client gives informed written consent. Fla. R. Prof. C. 4-1.7(b).

<sup>31</sup> Motion to Disqualify Baker & Hostetler, LLP as Counsel for Sea Star Line, LLC, Case No. 12-1180, Dkt. 71, at 6.

without the right to choose its counsel, who had defended Sea Star in its antitrust litigations for over 20 years and had special knowledge of the ocean transport litigation.<sup>32</sup>

The *Arrowpac* court granted the motion for disqualification “[g]iven the unique facts present- ed” and the litigation’s history.<sup>33</sup> Like the *Rail Freight* court, the *Arrowpac* court considered *Sumitomo*, but here the court distinguished *Sumitomo*, despite acknowledging the case’s “factu- al similarities.”<sup>34</sup> Instead, the court interpreted Rule 4-1.7 as encompassing “any representation directly adverse to the interests of a current client.”<sup>35</sup> It reasoned that Sea Star’s next move in the cases would be to file a joint motion to dismiss, and “the arguments formulated and advanced by Baker’s lawyers [in the non-*Arrowpac* cases] could result in the dismissal of the case brought by Nestlé and YRC.”<sup>36</sup> Accordingly, the practical effect of this would be adversity that is “direct and it is material,” as Rule 4-1.7 prohibits.<sup>37</sup> The court further reasoned that even if separate motions to dismiss were filed in the four cases, Baker (or Sea Star’s general counsel) inevitably would share research and analysis with Sea Star’s counsel in *Arrowpac*, thereby acting against Nestlé’s and YRC’s interests.<sup>38</sup> The conflicts complications that would arise in the course of combined dis- covery also concerned the court.<sup>39</sup>

Applying a different standard than the *Sumitomo* court used,<sup>40</sup> the *Arrowpac* court ruled dis- qualification warranted based on the purposes of Florida’s disqualification rules: protecting client confidences and “to safeguard loyalty as a feature of the attorney-client relationship.”<sup>41</sup> While not- ing it was satisfied there was no risk of Baker’s improperly using client confidences in the litiga- tion, the court concluded “Baker’s loyalty to Nestlé and YRC[] would be seriously questioned if Baker were allowed to proceed as proposed.”<sup>42</sup> Similarly, the court doubted Baker’s ability to vig- orously represent Sea Star in the case while maintaining all client loyalties. The court found the prejudice of disqualification to Sea Star “minimal” given that the cases were in their infancy and “Sea Star has other counsel who are well familiar with the [ocean transport] litigation.”<sup>43</sup>

### Counsel Should Tread Carefully

The inconsistency between *Arrowpac* on the one hand, and *Rail Freight* and *Sumitomo* on the other, creates concern for antitrust litigants and their counsel. The complexity arises here due to differing interpretations of how far an attorney’s duty of loyalty goes, an almost metaphysical question that is influenced both by a particular judge’s and practitioner’s philosophy on the nature

*The complexity arises here due to differing interpretations of how far an attorney’s duty of loyalty goes, an almost metaphysical question that is influenced both by a particular judge’s and practitioner’s philosophy on the nature of the attorney-client relationship and the specific facts of any case.*

<sup>32</sup> Opp. to Mot. to Disqualify Baker & Hostetler, LLP as Counsel for Sea Star Line, LLC, Case No. 12-1180, Dkt. 81, at 7–19.

<sup>33</sup> *Arrowpac*, 2013 WL 5460027, \*2.

<sup>34</sup> Compare *Arrowpac*, 2013 WL 5460027, at \*8, with *In re Rail Freight*, 2013 WL 4714334, at \*7–8. The *Arrowpac* court believed the proce- dural scenario in *Sumitomo* differed, in that the *Sumitomo* court made its decision without a “rich [case] history” and absent a “future pic- ture of the practical implications” of allowing Paul Weiss to represent *Sumitomo*. *Arrowpac*, 2013 WL 5460027, at \*9–10.

<sup>35</sup> *Id.* at \*10.

<sup>36</sup> *Id.* Despite relying on this analysis for disqualification, the court nonetheless asserted it was not basing its disqualification order on the ground that Baker was “simply taking antagonistic legal positions.” *Id.* at \*10 n.17.

<sup>37</sup> *Id.* at \*10.

<sup>38</sup> *Id.* at \*11.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at \*12 n.19.

<sup>41</sup> *Id.* at \*12.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

of the attorney-client relationship and the specific facts of any case. Although we do not take a position on which court's interpretation of the duty of loyalty may be correct under the specific facts of each case, we believe the uncertainty creates a minefield for antitrust attorneys engaged in complex antitrust litigation. As one court noted, "Modern litigation . . . often involves multinational companies and multinational law firms among whom conflicts occasionally arise due to the broad reach of their respective businesses."<sup>44</sup>

Thus, some attorneys, especially those at large law firms with multiple offices and practice areas, may find a positional conflict rule under *Arrowpac* difficult to manage: even if an attorney clears conflicts at the outset of an antitrust litigation, opt-out plaintiffs filing separate but related suits years later could create a positional conflict that could then potentially disqualify counsel from the original lawsuit. From the perspective of the client whose counsel is disqualified, the positional conflict reduces its choice in counsel, as many large firms representing plaintiffs and defendants alike would face the risk of having a separate client file a related case in the multiyear path that many antitrust cases follow. Parties may also face significant prejudice from the inherent delay incurred in securing new counsel; and the longer the delay, the higher the prejudice. Adoption of the *Rail Freight* ruling, however, may lead to clients questioning their counsel's loyalties in light of their willingness to take on adverse positions. The *Arrowpac* approach may enhance a current client's confidence in its attorney's loyalty, as it will have security that its attorney will not take adverse positions in any matters.

### Clarity from the ABA and State Bar Associations Would Be Helpful

Given the inconsistent precedent on positional conflicts, as well as the lack of guidance given by legislatures and the courts, the ABA and state bar associations should supply further clarity.<sup>45</sup> As courts have recognized, conflict-of-interest rules developed in the context of traditional, single attorney-client relationships—not large firm-client relationships in complex class actions (including antitrust matters).<sup>46</sup> In particular, practitioners and their clients would benefit from further clarification of how the existing rules apply to antitrust class actions, which almost invariably include a combination of class plaintiffs and opt-out plaintiffs and a large number of defendants—all of which are typically corporate entities—and any given law firm will likely represent (in *some* fashion) entities on both the plaintiff and defense sides.

One specific area where guidance from the ABA would be helpful is the precise scope of the exclusion against representing concurrent clients with conflicts of interest under Model Rule 1.7. The rule permits concurrent representation notwithstanding a conflict if "the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal."<sup>47</sup> This language is ambiguous: attorneys wishing to rely on the *Arrowpac* ruling could interpret Rule 1.7 to encompass consolidated or related proceedings if they are all before one tribunal, but those relying on the *Rail Freight* decision would interpret the "same litigation or proceeding" to be limited to a single action.

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<sup>44</sup> *Wyeth v. Abbott Labs.*, 692 F. Supp. 2d 453, 458 (D.N.J. 2010).

<sup>45</sup> The ABA has addressed positional conflict in other contexts (such as when a lawyer is taking inconsistent positions on behalf of different clients in different cases), but not in the context of representing one client in one case and having another client who is in a related case but not represented by the attorney, as discussed in this article. See Annotated Model Rules of Prof'l Conduct, "Overview of Rule 1.7(A)(2): Material-Limitation Conflicts"; ABA Formal Ethics Op. 93-377 (1993).

<sup>46</sup> See, e.g., *In re Rail Freight*, 2013 WL 4714334, at \*9; *Lazy Oil Co. v. Witco Corp.*, 166 F.3d 581, 589–90 (3d Cir. 1999).

<sup>47</sup> Model Rules of Prof'l Conduct R. 1.7(b)(3)–(4).

### Avoiding Disqualification Scenarios

**Check conflicts broadly to best avoid disqualification issues/concerns.** While the inconsistency between *Rail Freight* and *Arrowpac* remains, practitioners may want to consider the possibility of conflicts under both cases. A risk-adverse attorney then could consider not only conducting a conflicts check for actual conflicts, but also a broader check for positional conflicts—if practicable—when taking on an antitrust litigation. That conflicts check would thus include not only the adverse parties in the precise case in which the attorney will represent her client, but also named parties in any related litigation and any other potential opt-outs or other unnamed class members who might play a role in a related litigation in the future. If a positional conflict is identified, the risk-adverse attorney would then either seek waivers or decline representation.

This kind of conflict check may not always be practicable, though, considering that conflict-identification systems generally do not include information that would flag a positional conflict. This is another area where further guidance from the ABA and the state bar associations would be helpful.

**Have a solid advance waiver in place.** Conflicts of interest can sometimes be resolved through advance conflict waivers. At the time a client retains the law firm, if permissible under the applicable ethics rules, the firm could include in the retention agreement an express recognition that positional conflicts do not rise to the level of a conflict under the applicable ethics rules, and to the extent that a court would find otherwise, the client waives those conflicts. An advance conflict waiver like that may protect the attorney against a future disqualification motion based on a positional conflict. Because an attorney is unlikely to know which jurisdictions may be relevant to any future positional conflicts, attorneys may wish to err on the side of caution and include this kind of advance conflict waiver in the event that it is enforceable under the rules of the relevant jurisdiction.

**Be transparent with clients.** It is critical to be open and fully candid with clients and communicate potential conflicts immediately. In both *In re Rail Freight* and *Arrowpac*, defense counsel did not immediately inform the plaintiff-clients of the potential conflict, and, in both instances, the clients declined to grant waivers. Even where the attorney does not believe that a true conflict exists, it can be imperative to raise the issue to defuse any concern that the client nevertheless perceives a conflict. Trust and loyalty are driving forces behind conflict-of-interest rules, and being transparent with clients will help preserve that trust and loyalty.

**Have ethical walls in place.** Also related to transparency and waivers is the importance of ethical walls. In situations where a law firm represents one client that is adverse to another client in an unrelated case, an effective program for implementing ethical walls may provide both clients with confidence that there will neither be limitations in representation nor unfair advantages gained from prior representations. Ethical walls will not be sufficient to prevent a conflict under the ethics rules of some jurisdictions, but even in those jurisdictions, ethical walls can provide some additional assurance that client confidences are maintained, which may tip the balance in favor of a finding that no conflict exists.

Implementing these recommendations may assist attorneys in avoiding some of the uncertainty arising from the conflict between the *Rail Freight* and *Arrowpac* decisions. But without further guidance, the bounds of rules governing positional conflicts likely will remain uncertain into the foreseeable future. ●

# Repatching the Quilt: An Update on State RPM Laws

**Michael A. Lindsay**

At the beginning of 2013, state laws on resale price maintenance (RPM) agreements were a patchwork quilt. Some of the patches in that quilt have changed in the past year, and others have been cleaned up, but overall, the quilt looks the same. Lower court decisions in California and Illinois have provided judicial guidance where previously practitioners' only post-*Leegin*<sup>1</sup> resource was state attorney general consent orders. Meanwhile in Kansas, the legislature overturned a state supreme court decision and reinstated the *Leegin* rule for Kansas state-law cases. The case law also underscores two substantive points: the *Colgate*<sup>2</sup> doctrine is alive and well (when a supplier actually follows it), and an RPM agreement with resellers is judged under the rule of reason (in *Leegin*-following states) even if the supplier engages in dual distribution.

Since the U.S. Supreme Court's 2007 decision in *Leegin*, *The Antitrust Source* has periodically updated and maintained on its website a chart providing relevant state-law authorities for each of the 50 states. The 50-state chart has been further updated to reflect the developments discussed here.<sup>3</sup>

## California: The Per Se Rule and the *Colgate* Doctrine

In 2013, both a federal district court and a California appellate court stated that, under controlling precedent from the state's supreme court, a vertical RPM agreement remains illegal per se under California's Cartwright Act.

**Darush v. Revision.** In *Darush MD APC v. Revision LP*, the federal court for the Central District of California considered the consequences of a not uncommon fact pattern: a unilateral pricing policy (protected under the *Colgate* doctrine) that did not immediately achieve the supplier's desired result.<sup>4</sup> In April 2013, the court dismissed the complaint (primarily for failure to plead an

<sup>1</sup> *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (retail price maintenance agreement subject to rule of reason), *overruling* *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911) (retail price maintenance per se unlawful).

<sup>2</sup> *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

<sup>3</sup> The chart is directly accessible from the Supplementary Materials section of the ANTITRUST SOURCE homepage at [https://www.americanbar.org/publications/the\\_antitrust\\_source.html](https://www.americanbar.org/publications/the_antitrust_source.html). For articles explaining the chart and describing key developments since its original publication, see Michael A. Lindsay, *Resale Price Maintenance and the World After Leegin*, ANTITRUST SOURCE, Fall 2007, at 1, 32, available at [http://www.dorsey.com/files/upload/Antitrust\\_Lindsay\\_Fall07.pdf](http://www.dorsey.com/files/upload/Antitrust_Lindsay_Fall07.pdf); Michael A. Lindsay, *From the Prairie to the Ocean: More Developments in State RPM Law*, ANTITRUST SOURCE, Aug. 2012 [hereinafter Lindsay, *From the Prairie*], [http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/aug12\\_full\\_source.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/aug12_full_source.authcheckdam.pdf); Michael A. Lindsay, *A Tale of Two Coasts: Recent RPM Enforcement in New York and California*, ANTITRUST SOURCE, Apr. 2011 [hereinafter Lindsay, *A Tale of Two Coasts*], [http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/apr11-lindsay\\_4-20f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/apr11-lindsay_4-20f.authcheckdam.pdf); Michael A. Lindsay, *An Update on State RPM Laws Since Leegin*, ANTITRUST SOURCE, Dec. 2010, [http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/Dec10\\_Lindsay12\\_21f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Dec10_Lindsay12_21f.authcheckdam.pdf); Michael A. Lindsay, *State Resale Price Maintenance Laws After Leegin*, ANTITRUST SOURCE, Oct. 2009 [hereinafter Lindsay, *State Laws After Leegin*], [http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/Oct09\\_Lindsay10\\_23f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Oct09_Lindsay10_23f.authcheckdam.pdf).

<sup>4</sup> *Darush MD APC v. Revision LP*, No. 12-cv-10296, 2013 WL 1749539 (C.D. Cal. Apr. 10, 2013).

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agreement that injured plaintiff),<sup>5</sup> but in July the court denied a motion to dismiss the amended complaint.<sup>6</sup> The plaintiff, medical doctor Alan Darush, bought and resold skin care products supplied by Revision.<sup>7</sup> Revision adopted a “manufacturer’s suggested retail price” (MSRP) policy.<sup>8</sup> Darush claimed that his retail competitors were not abiding by the policy, so he had to sell below the MSRP to remain competitive.<sup>9</sup> Revision representatives “allegedly contacted [Darush] multiple times in person and over the phone in an attempt to get [Darush] to raise his prices”<sup>10</sup> and “threatened to terminate the supply of Revision products to [Darush] if it did not expressly agree to fix prices.”<sup>11</sup> Darush declined to raise his prices, and Revision stopped supplying him.<sup>12</sup>

Darush filed suit against Revision and one of Darush’s competitors (Lovely Skin, Inc.) under California’s antitrust statute, the Cartwright Act, alleging that Revision and Lovely Skin engaged in vertical price fixing. In its April decision, the court recognized and applied two key legal principles from state court precedent. First, the court stated that a mere unilateral policy, coupled with a subsequent unilateral refusal to deal, is not actionable under the Cartwright Act. Like the Sherman Act, the Cartwright Act requires a combination of at least two persons.<sup>13</sup> In other words, California accepts a state-law equivalent of the *Colgate* doctrine.

Second, the court explained that a vertical RPM agreement remains illegal per se under California law.<sup>14</sup> The court acknowledged *Leegin*’s effect on federal law, but noted that the California Supreme Court has held that “vertical price restraints are per se unlawful under the Cartwright Act”<sup>15</sup> and found no indication that California precedent was changing (although the court pointed only to cases that pre-dated *Leegin*). The court was thus unwilling to disregard pre-*Leegin* state supreme court precedent.<sup>16</sup>

In its July decision upholding the amended complaint, the court found that Darush had alleged “sufficient factual support to make plausible an agreement between Revision and Lovely Skin to vertically fix prices and eliminate retailers selling at a discount.”<sup>17</sup> In other words, the agreement that the court found actionable was an agreement between Revision and one of Darush’s competitors. The court made clear that its decision was based only on the sufficiency of the pleadings and, even so, that the question was close,<sup>18</sup> but it was enough to keep the litigation alive. Although the allegations of Revision’s multiple efforts to persuade Darush to raise his prices were informa-

**[A] vertical RPM  
agreement remains  
illegal per se under  
California law.**

<sup>5</sup> *Id.* at \*7.

<sup>6</sup> *Darush MD APC v. Revision LP (Darush II)*, No. 12-cv-10296 (C.D. Cal. July 16, 2013).

<sup>7</sup> *Darush*, 2013 WL 1749539, at \*1.

<sup>8</sup> *Id.* (internal quotation marks omitted).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Darush II*, No. 12-cv-10296, at 2.

<sup>12</sup> *Darush*, 2013 WL 1749539, at \*1.

<sup>13</sup> *Id.* at \*4–5. The court also noted the possibility that an agreement may be found where a supplier “coerces” a reseller into acquiescence. The court noted that while the Ninth Circuit accepts this theory, it requires plaintiffs to show that “the supplier’s conduct rose to the level of coercion sufficient to deprive the dealers of their free choice.” *Id.* at \*4 (quoting *Hanson v. Shell Oil Co.*, 541 F.2d 1352, 1357 & n.4 (9th Cir. 1976)).

<sup>14</sup> *Darush*, 2013 WL 1749539, at \*6.

<sup>15</sup> *Id.* (citing *Mailand v. Burckle*, 572 P.2d 1142, 1147 (Cal. 1978)).

<sup>16</sup> *Id.* (citing *Chavez v. Whirlpool Corp.*, 113 Cal. Rptr. 2d 175, 180 (Cal. Dist. Ct. App. 2001)).

<sup>17</sup> *Darush II*, No. 12-cv-10296, at 6.

<sup>18</sup> *Id.* at 5.

tive, what seemed most important to the court was evidence of communications between Revision and Darush's competitor, Lovely Skin, which the court described as dealing with "the termination of certain discount [s]ites with the objective of raising retail prices" on the product at issue.<sup>19</sup> In particular, the court noted an email from Revision to Lovely Skin in which Revision offered to share information on its actions regarding accounts other than Lovely Skin: "If you . . . would like specific actions on our internet accounts, I will be happy to forward you that information."<sup>20</sup>

**Sara Lee.** The fact pattern in *Alsheikh v. Superior Court*<sup>21</sup> is less common than the fact pattern in *Darush*. The *Alsheikh* plaintiff was an individual, title-taking distributor of Sara Lee products to California groceries and chain stores.<sup>22</sup> The distribution agreement appointed plaintiff as a reseller, but it also appointed Sara Lee as the plaintiff distributor's agent "to obtain from Chains authorization to sell Products in the Chains and information regarding the prices and terms at which the Chains would be willing to purchase Products for their Outlets," which Sara Lee was to communicate back to the distributor. The distribution agreement acknowledged the distributor's right "to negotiate prices and terms directly" with any customer and to sell "at whatever prices and terms DISTRIBUTOR can negotiate."<sup>23</sup> The plaintiff distributor could terminate Sara Lee's appointment on 30 days' notice.<sup>24</sup>

The plaintiff alleged that notwithstanding these contract provisions, Sara Lee negotiated price agreements with chains and required plaintiff to comply with them (including by providing her with computerized devices that were "preprogrammed with the prices fixed between [Sara Lee] and the chain stores") in violation of the Cartwright Act's prohibition of vertical resale price agreements.<sup>25</sup> The trial court dismissed the claim without leave to amend.

The appellate court agreed that the complaint as pleaded did not state a claim under the Cartwright Act because the complaint's allegations directly contradicted the terms of the distribution agreement that the plaintiff had attached to her complaint. Nevertheless, the appellate court remanded with instructions to permit the plaintiff to amend. The appellate court observed that if the distribution agreement "operated in such a way as to 'limit[ ] the distributor's freedom to sell the supplier's product at a price independently selected by the distributor'. . . then a Cartwright Act violation might be stated."<sup>26</sup> Moreover, the court expressly stated "if there were vertical price fixing, that would . . . be a per se violation under the Cartwright Act."<sup>27</sup> The court noted that despite the "change of law" that *Leegin* had wrought under the Sherman Act, the per se rule stated in the California Supreme Court's *Mailand* decision remains good law, and "[w]e are bound to follow the law set forth by our Supreme Court applying state law."<sup>28</sup>

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<sup>19</sup> *Id.* at 1.

<sup>20</sup> *Id.* (internal quotation marks omitted).

<sup>21</sup> No. B249822, 2013 WL 5530508 (Cal. App. 2 Dist. Oct. 7, 2013), *review denied* (Jan. 15, 2014).

<sup>22</sup> Her suit against Sara Lee alleged alternative theories of liability: either she was an employee that Sara Lee denied wage and hour benefits under state law or she was an independent contractor on whom Sara Lee had imposed a vertical price-fixing agreement.

<sup>23</sup> *Alsheikh*, 2013 WL 5530508, at \*2.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* (quoting *Kunert v. Mission Financial Services Corp.*, 110 Cal. App. 4th 242, 263 (2003)).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* (citing *Mailand v. Burckle*, 20 Cal. 3d 367 (1978)).

### Illinois: The Rule of Reason and Dual Distribution

Just barely into 2014, a federal district court in Illinois in *House of Brides, Inc. v. Alfred Angelo, Inc.* dismissed without prejudice both federal and Illinois state-law claims arising from an RPM policy.<sup>29</sup> Alfred Angelo designed and manufactured bridal gowns and related products.<sup>30</sup> One of its resellers was House of Brides, which operated brick-and-mortar stores but made most of its sales online.<sup>31</sup> House of Brides claimed to be one of the first companies of its kind to publish retail prices for its products online, allowing consumers to comparison shop.<sup>32</sup> In addition to its design and supply business, Angelo had also opened its own retail stores and thus competed with its independent resellers.<sup>33</sup>

In 2004, Angelo adopted a mandatory minimum RPM policy. It is not clear how effectively Angelo either communicated or enforced the policy. House of Brides claimed not to have been aware of it until three years later.<sup>34</sup> In any event, when House of Brides learned of the policy (including a statement that noncompliance would result in termination) in 2007, it declined to comply, saying that other retailers were selling at discounted prices and that House of Brides needed to remain competitive.<sup>35</sup> According to the complaint, other resellers complained to Angelo regarding the refusal of House of Brides “to abide by the minimum resale price” and threatened to stop buying Angelo products if House of Brides continued selling at discount prices and Angelo kept supplying it.<sup>36</sup> In 2010, Angelo reinvigorated its efforts with a new set of marketing policies, including minimum resale prices for both online sales and brick-and-mortar store sales.<sup>37</sup> House of Brides claimed that the minimum online price was higher than the minimum brick-and-mortar resale price, which impeded its competition with bricks-and-mortar stores.<sup>38</sup> As a result, House of Brides again declined to comply. This time, however, Angelo sent a notice of termination.<sup>39</sup>

The court viewed the complaint as alleging a vertical agreement, and accordingly it applied *Leegin* to the federal law claims.<sup>40</sup> House of Brides had sought per se treatment because of Angelo’s dual distribution system, but the court found that restraints in dual distribution systems are analyzed under the rule of reason.<sup>41</sup> The court concluded that it did not need to determine whether House of Brides had sufficiently pleaded an “agreement,” however, because the complaint utterly failed to allege a plausible market in which to apply the rule of reason.<sup>42</sup>

*[R]estrains in dual distribution systems are analyzed under the rule of reason.*

<sup>29</sup> *House of Brides, Inc. v. Alfred Angelo, Inc.*, No. 11 C 07834, 2014 WL 64657, at \*11 (N.D. Ill. Jan. 08, 2014).

<sup>30</sup> *Id.* at \*1.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at \*2.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* (internal quotation marks omitted).

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at \*4–7.

<sup>41</sup> *Id.* at \*5.

<sup>42</sup> *Id.* at \*7.

The court held that its reasoning applied to the Illinois state-law claims as well. It noted the state statute's instruction that where the language of the state statute is identical or similar to the language in the federal antitrust law, courts should look to federal courts' constructions of the federal law as a guide when construing the state statute.<sup>43</sup> The court also found that the relevant section of the state statute (prohibiting contracts that unreasonably restrain trade) closely resembles Section 1 of the Sherman Act and should be interpreted accordingly.<sup>44</sup> This court ruling is particularly noteworthy in view of the Illinois attorney general's participation in a 2008 multi-state complaint and consent order that appeared to invoke a per se theory for a state-law challenge to an RPM agreement.<sup>45</sup>

### State Legislation

In April 2009, the Maryland legislature adopted the first and thus far only post-*Leegin* statute expressly rejecting the rule of reason for minimum RPM agreements.<sup>46</sup> In 2013, Kansas became the second state to adopt a post-*Leegin* statute, but it came out the other way. Another state legislative effort—a Pennsylvania bill that has not yet passed—is also worth noting.

**A *Leegin* Reinstater in Kansas.** In April 2013, Kansas became the second state to address the applicability of *Leegin* through legislation—and adopted the opposite of the Maryland rule. The legislation was passed in response to a 2012 Kansas Supreme Court case, in which it found that the rule of *Leegin* did not apply under the Kansas restraint of trade act.<sup>47</sup> The court recognized that “federal precedents interpreting . . . federal statutes have little or no precedential weight when the task is interpretation and application of a clear and dissimilar Kansas statute.”<sup>48</sup> The court explicitly rejected a reasonableness approach for vertical RPM agreements: “The clear statutory language . . . leaves no room” for considering the reasonableness of a vertical RPM agreement; instead, such an agreement was prohibited under a “simple, per se rule.”<sup>49</sup>

The new statute addresses both of the Kansas Supreme Court's points.<sup>50</sup> First, the statute expressly adopts a federal harmonization rule (although it does not affect the state's *Illinois Brick* repealer):<sup>51</sup> “the Kansas restraint of trade act shall be construed in harmony with ruling judicial interpretations of federal antitrust law by the United States supreme court.”<sup>52</sup> Second, the statute

<sup>43</sup> *Id.* at \*8 (citing 740 Ill. Comp. Stat. 10/11).

<sup>44</sup> *Id.* House of Brides offered the court no reason why it should not follow federal law in construing the Illinois statute; it only reiterated its arguments for liability under the Sherman Act. *Id.*

<sup>45</sup> See Complaint, *State v. Herman Miller, Inc.*, No. 08-2977 (S.D.N.Y. filed Mar. 21, 2008); Stipulated Final Judgment and Consent Decree, *Herman Miller, Inc.*, No. 08-2977 (filed Mar. 25, 2008). For discussion of this case, see Lindsay, *State Laws After Leegin*, *supra* note 3, at 4 (explaining that while the complaint alleges some anticompetitive effects, it “does not allege that Herman Miller had market power or that anticompetitive effects outweigh whatever procompetitive benefits the practice may have”).

<sup>46</sup> MD. CODE ANN., Com. Law. § 11-204(a)(1), (b) (2013) (“[A] contract, combination, or conspiracy that establishes a minimum price below which a retailer, wholesaler, or distributor may not sell a commodity or service is an unreasonable restraint of trade or commerce.”).

<sup>47</sup> *O'Brien v. Leegin Creative Leather Prods., Inc.*, 277 P.3d 1062, 1083 (Kan. 2012).

<sup>48</sup> *Id.* at 1079.

<sup>49</sup> *Id.* at 1083 (citations omitted).

<sup>50</sup> The Kansas legislature considered a “*Leegin* reinstater” bill in the immediate aftermath of *O'Brien* but failed to pass it. Lindsay, *From the Prairie*, *supra* note 3.

<sup>51</sup> KAN. STAT. ANN. § 50-161; *Ill. Brick Co. v. Ill.*, 431 U.S. 720 (1977).

<sup>52</sup> KAN. STAT. ANN. § 50-163(b). Notably, the statute preserves the right of action under KAN. STAT. ANN. § 50-161 “regardless of whether such injured person dealt directly or indirectly with the defendant.”

makes clear that it does not prohibit an agreement that “is a reasonable restraint of trade or commerce,” which the statute defines as a restraint that is “reasonable in view of all of the facts and circumstances of the particular case and does not contravene public welfare.”<sup>53</sup>

***A Leegin Repealer in Pennsylvania?*** Pennsylvania is the only U.S. state that does not have an antitrust statute, and in each of the last two legislative sessions, Pennsylvania State Senator Stewart Greenleaf has introduced legislation to adopt such a law.<sup>54</sup> The proposed legislation includes a federal harmonization clause (providing generally that the state law would be interpreted consistent with interpretations of federal law),<sup>55</sup> but it also includes an explicit prohibition on minimum resale price agreements.<sup>56</sup> The 2012 bill died in committee at the end of the 2011–2012 assembly.<sup>57</sup> The reintroduced bill likewise has not yet been acted on.<sup>58</sup>

## Conclusion

Companies considering RPM programs (or minimum advertised price programs that might evolve into RPM programs) should continue to consider carefully both the business benefits and the legal risks. If the business benefits are significant, then the company should ensure that its program is well designed and that its sales personnel receive training on appropriate communications (especially on topics that should be off-limits). Finally, a company should periodically review its program contents, administration, and training to ensure that safeguards remain adequate both in theory and in practice. ●

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<sup>53</sup> KAN. STAT. ANN. § 50-163(c).

<sup>54</sup> See S.B. 848, Gen. Assembly, Reg. Sess. 2013–2014 (Pa. 2013), available at <http://www.legis.state.pa.us/CFDOCS/Legis/PN/Public/btCheck.cfm?txtType=HTM&sessYr=2013&sessInd=0&billBody=S&billTyp=B&billNbr=0848&pn=0901>, S.B. 1565, Gen. Assembly, Reg. Sess. 2011–2012 (Pa. 2012), available at <http://www.legis.state.pa.us/CFDOCS/Legis/PN/Public/btCheck.cfm?txtType=HTM&sessYr=2011&sessInd=0&billBody=S&billTyp=B&billNbr=1565&pn=2296>.

<sup>55</sup> S.B. 848, sec. 3, § 911 (adding title 12, chapter 9, section 911 to provide that “If any provision of this chapter is identical to or similar to that of a Federal antitrust statute, it shall be interpreted in a manner consistent with comparable Federal antitrust law as decided by the Federal courts whose jurisdiction includes this Commonwealth.”).

<sup>56</sup> *Id.* sec. 3, § 904(2) (adding title 12, chapter 9, section 904(2) to prohibit any contract, combination, or conspiracy “to establish a minimum price below which a retailer, wholesaler or distributor may not sell a commodity or service”).

<sup>57</sup> See *Bill Information—Votes, Senate Bill 1565; Regular Session 2011–2012*, Pa. Gen. Assembly, [http://www.legis.state.pa.us/cfdocs/billinfo/bill\\_votes.cfm?year=2011&sind=0&body=S&type=B&bn=1565](http://www.legis.state.pa.us/cfdocs/billinfo/bill_votes.cfm?year=2011&sind=0&body=S&type=B&bn=1565).

<sup>58</sup> See *Bill Information—Votes, Senate Bill 848; Regular Session 2013–2014*, Pa. Gen. Assembly, [http://www.legis.state.pa.us/cfdocs/billinfo/bill\\_votes.cfm?year=2013&sind=0&body=S&type=B&bn=848](http://www.legis.state.pa.us/cfdocs/billinfo/bill_votes.cfm?year=2013&sind=0&body=S&type=B&bn=848).

# Paper Trail: Working Papers and Recent Scholarship

**Editor's Note:** In this edition, we consider two papers by young scholars that examine the applicability of the state action doctrine to state-sanctioned regulatory bodies composed, at least in part, of members of the industries they regulate.

Send suggestions for papers to review to: [page@law.ufl.edu](mailto:page@law.ufl.edu) or [jwoodbury@crai.com](mailto:jwoodbury@crai.com).

—WILLIAM H. PAGE & JOHN R. WOODBURY

## Recent Papers

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**Alexander Volokh, The New Private-Regulation Skepticism: Nondelegation, Due Process, and Antitrust Challenges**, HARV. J.L. & PUBLIC POL'Y (forthcoming)

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2335659](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2335659)

**Aaron Edlin & Rebecca Haw, Cartels by Another Name: Should Licensed Occupations Face Antitrust Scrutiny?** U. PA. L. REV. (forthcoming), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2384948](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2384948)

The state action doctrine has long recognized and tried to account for the influence of private actors in state regulation. In *Parker v. Brown*<sup>1</sup> itself, as Dave McGowan and Mark Lemley explained 20 years ago, the California statute

allowed producers in a given region to request the formation of a government committee—composed, not incidentally, of the raisin producers and packers themselves—which would propose a plan for reducing output (and therefore increasing prices). Once devised, a committee's plan was presented to the California Agricultural Prorate Advisory Commission, which could modify or reject it. Whatever the Commission did was then sent out to the producers themselves, who voted on it. The producers thus had the final say on whether a restriction would be adopted by the state of California. Not surprisingly, the result in Raisin Proration Zone No. 1 was that 70% of the raisin crop was taken off the market.<sup>2</sup>

The Supreme Court nevertheless upheld the program. It assumed that “the California prorate program would violate the Sherman Act if it were organized and made effective solely by virtue of a contract, combination or conspiracy of private persons”<sup>3</sup> because “a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful.”<sup>4</sup> Despite the role of producers, however, the Court held California's scheme immune because the Prorate Advisory Commission, a body appointed by the governor and confirmed by the state senate, assured that any restraints implemented statutory policy:

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<sup>1</sup> 317 U.S. 341 (1943).

<sup>2</sup> David McGowan & Mark A. Lemley, *Antitrust Immunity: State Action and Federalism, Petitioning and the First Amendment*, 17 HARV. J.L. & PUB. POL'Y 293, 302 (1994).

<sup>3</sup> *Parker*, 317 U.S. at 350.

<sup>4</sup> *Id.* at 351.

Although the organization of a prorate zone is proposed by producers, and a prorate program, approved by the Commission, must also be approved by referendum of producers, it is the state, acting through the Commission, which adopts the program and which enforces it with penal sanctions, in the execution of a governmental policy. The prerequisite approval of the program upon referendum by a prescribed number of producers is not the imposition by them of their will upon the minority by force of agreement or combination which the Sherman Act prohibits. The state itself exercises its legislative authority in making the regulation and in prescribing the conditions of its application. The required vote on the referendum is one of these conditions.<sup>5</sup>

The role of producers in regulating themselves is especially controversial now because of *North Carolina State Board of Dental Examiners v. FTC*.<sup>6</sup> In that case, the Fourth Circuit affirmed the FTC's finding that a state dental board both composed of and elected by members of the profession was essentially a private entity unworthy of *Parker* immunity. Consequently, its issuance of cease-and-desist letters to non-dentist providers of teeth whitening services violated the antitrust laws. The board has petitioned for certiorari, with the support of many other occupational licensing boards.

Both of the interesting papers we consider in this *Paper Trail* critically reexamine economic regulation by entities controlled by members of the professions or industries they regulate. The Volokh paper takes the broader approach, considering the applicability of constitutional law, particularly nondelegation and due process, as well as antitrust law, to a range of state regulatory schemes with varying degrees of private involvement. Edlin and Haw focus on occupational licensing and make an explicit policy proposal: to subject state licensing boards, virtually all of which are dominated by members of their occupations, to antitrust liability under a version of the rule of reason.

Volokh shows that constitutional standards like procedural due process and the nondelegation doctrine impose constraints on delegations to private groups. His parallel discussion of constitutional and antitrust doctrines recognizes that the Supreme Court has shaped the antitrust state action doctrine in ways that are consistent with the Court's treatment of similar federalism issues in constitutional law. In deciding *Parker v. Brown*, for example, the Court having recently abandoned substantive due process review of state regulation was disinclined to undertake similar inquiries under the Sherman Act.

In the latter part of his paper, Volokh lucidly describes antitrust constraints on private delegations. As he explains, the requirements for state action immunity depend upon the relationship of the actor to the state as sovereign. The actions of a state legislature or a state supreme court are considered actions of the sovereign and thus fully immune from antitrust scrutiny. Municipalities and probably most state administrative agencies are immune if they act pursuant to a policy clearly articulated by a sovereign body like the legislature. Private entities are immune only if they are acting pursuant to a clearly articulated state policy<sup>7</sup> and are actively supervised by a state agency.<sup>8</sup>

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<sup>5</sup> *Id.* at 352.

<sup>6</sup> 717 F.3d 359 (4th Cir. 2013), *petition for cert. filed*, 82 U.S.L.W. 3260 (Oct. 25, 2013) (No. 13-534).

<sup>7</sup> See, e.g., *FTC v. Phoebe Putney Health Sys.*, 133 S. Ct. 1003, 1011 (2013) (holding that a state hospital authority's acquisition of a hospital was not immune to antitrust review, because there was "no evidence the State affirmatively contemplated that hospital authorities would displace competition by consolidating hospital ownership").

<sup>8</sup> The active supervision requirement is designed "to determine whether the State has exercised sufficient independent judgment and control so that the details of the rates or prices have been established as a product of deliberate state intervention, not simply by agreement among private parties." *FTC v. Tico Title Ins. Co.*, 504 U.S. 621, 634-35 (1992).

Private entities may also escape liability if their actions within a state's statutory scheme do not conflict with the antitrust laws. A state regulatory scheme conflicts with antitrust if it authorizes private entities to form anticompetitive agreements or it imposes a restraint at the discretion of private economic actor—a so-called hybrid restraint. But a state's anticompetitive market intervention does not conflict with antitrust if, for example, it simply mandates private conduct like maximum rents, without any agreement or implementation of private discretion.<sup>9</sup>

Volokh's paper focuses on a crucial aspect of these institutional issues: when does regulation by a state agency constitute regulation by private interests because members of the industry control the agency? If the agency is public, it may be immune without active supervision and its actions may be viewed as unilateral. If it is private, however, then its actions would have to be actively supervised by the state to warrant immunity; without active supervision, its actions would involve an agreement of rivals subject to some level of antitrust scrutiny. Volokh considers how different answers to these questions would affect some well-chosen examples of actual state regulation that prominently involve members of regulated industries. One of those examples is drawn from the *Dental Examiners* case mentioned earlier.

Volokh identifies three levels of scrutiny the courts of appeals have used to address the immunity issue. Under the cursory view, the court views a regulatory board's actions as public, regardless of its membership;<sup>10</sup> under the intermediate view, the court evaluates whether the composition and actions of a board may, in some circumstances, make it private and thus require active state supervision;<sup>11</sup> and under the strictest view, typified by the FTC's position in *Dental Examiners*, the court examines whether the regulated industry or profession controls the board. (The Fourth Circuit affirmed the FTC's position, but rested its holding on the peculiar fact that the members of the board not only were dentists, but were *elected* by dentists rather than selected by public officials.) Volokh shows how these different approaches might determine immunity for the illustrative state entities he describes at the beginning of the article. His discussion in this part of the paper makes clear that a circuit split has emerged over decades concerning the required level of scrutiny of private involvement to secure immunity.

Volokh also considers how dominance by members of the industry affects whether anticompetitive actions of an entity involve a Section 1 agreement. Here again, his main focus is on the Fourth Circuit's *Dental Examiners* opinion, which found that the board's members were private actors and had illegally conspired by pursuing their own financial interests through what amounted to a joint venture of the profession. Moreover, although a board of dentistry presumably should consider health concerns, these board members, because they were private horizontal actors, could not invoke health justifications for their actions.

In a final section, Volokh considers possible public and private remedies against boards found to have violated antitrust laws without state action immunity. He concludes that state officials "would be wrong to presume that entities with governmental powers are public" for all purposes and that it behooves state regulators to be "extremely careful" to avoid being sued and held liable for damages.

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<sup>9</sup> See, e.g., *Fisher v. City of Berkeley*, 475 U.S. 260, 266 (1986) ("[T]he rent ceilings imposed by the Ordinance and maintained by the Rent Stabilization Board have been unilaterally imposed by government upon landlords to the exclusion of private control.").

<sup>10</sup> See, e.g., *Earles v. State Bd. of CPAs of La.*, 139 F.3d 1033, 1041 (5th Cir. 1998); *Porter Testing Lab. v. Bd. of Regents for Okla. Ag. & Mech. Colleges*, 993 F.2d 768, 772 (10th Cir. 1993); *Cine 42nd St. Theater Corp. v. Nederlander Org., Inc.*, 790 F.2d 1032, 1047 (2d Cir. 1986).

<sup>11</sup> See, e.g., *Bankers Ins. Co. v. Fla. Res. Pty. & Cas. Joint Underwriting Ass'n*, 137 F.3d 1293, 1297 (11th Cir. 1998); *Hass v. Or. State Bar*, 883 F.2d 1453, 1455–57 (9th Cir. 1989); *FTC v. Monahan*, 832 F.2d 688, 688–90 (1st Cir. 1987) (Breyer, J.); *Interface Group, Inc. v. Mass. Port Auth.*, 816 F.2d 9, 13 (1st Cir. 1987).

Edlin and Haw address many of the same issues as Volokh, including constitutional ones, but they make a much more explicit policy proposal—to extend antitrust liability to most of the thousands of occupational licensing boards around the country, unless they are subjected to active supervision.<sup>12</sup> They cite studies showing that these licensing requirements increase prices substantially by limiting entry. They recognize that market failures like the lemon problem and harmful externalities justify some forms of occupational regulation, but argue that in most cases the empirical support for these justifications is weak. They cite a study showing that almost 29 percent of American workers are licensed, even in occupations like floral design and casket retailing, for which a public interest rationale is not apparent. In other instances, the law requires that limited tasks be performed only by members of an occupation that requires extensive, unrelated training. Other rules may require unnecessary supervision and apprenticeships.

The authors argue that these sorts of regulations are similar to cartel mechanisms limiting entry and price competition, but with the added power of state enforcement. Moreover, they do not satisfy the requirements of state action immunity because they lack meaningful accountability. The authors endorse both public and private remedies, including damage liability for members of licensing boards. They suggest states might respond to such a step by indemnifying board members, as they do for § 1983 liability.

Edlin and Haw, like Volokh, explain the nuances of antitrust's state action immunity, and note the circuit split created by the Fourth Circuit's *Dental Examiners* case, which subjected a state licensing board to the active supervision requirement. They note, however, that the case limited its holding severely by making it contingent on the peculiar feature of the state scheme that dentists elected the members of the dental board. Because virtually all other occupational licensing boards are appointed by governors in one way or another, the narrow Fourth Circuit holding will do little to increase occupational competition.

Edlin and Haw review three theories of state action in the scholarly literature—one focusing on clear articulation,<sup>13</sup> one on regulatory capture,<sup>14</sup> and one on the financial interest of the regulator<sup>15</sup>—and argue that occupational licensing boards fail all of them. They criticize courts that casually characterize boards as “public” based on procedural requirements, arguing that “these features cannot meaningfully check self-dealing in the way that elections and public visibility check municipal officers from self-dealing at the expense of their citizens.” Instead, they endorse the position taken by the FTC's State Action Task Force, and advocated by the FTC in the *Dental Examiners* case, that liability should apply when there is “an appreciable risk that the challenged conduct may be the product of parties pursuing their own interests rather than state policy,”<sup>16</sup> a condition always present when the board is composed mostly of members of the profession. They also argue that, if the board is really private, it is not a single entity but a joint venture of its members, who are separate economic actors pursuing their self interest. Consequently, the agreement requirement of Section 1 is satisfied.

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<sup>12</sup> For a contrary argument, see Ingram Weber, Comment, *The Antitrust State Action Doctrine and State Licensing Boards*, 79 U. CHI. L. REV. 736 (2012).

<sup>13</sup> William H. Page, *Antitrust, Federalism, and the Regulatory Process: A Reconstruction and Critique of the State Action Exemption After Midcal Aluminum*, 61 B.U. L. REV. 1099 (1981).

<sup>14</sup> John Shepard Wiley Jr., *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713 (1986).

<sup>15</sup> Einer Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 667, 693–96 (1991).

<sup>16</sup> FED. TRADE COMM'N OFFICE OF POLICY PLANNING, REPORT OF THE STATE ACTION TASK FORCE 15 (2003), available at [http://www.ftc.gov/sites/default/files/documents/advocacy\\_documents/report-state-action-task-force/stateactionreport.pdf](http://www.ftc.gov/sites/default/files/documents/advocacy_documents/report-state-action-task-force/stateactionreport.pdf).

Edlin and Haw consider how antitrust liability would apply to restraints by occupational licensing boards under their proposal. First, they would modify the standard rule of reason to “allow public safety and quality enhancement justifications to be argued on behalf of licensing boards even when these alleged benefits flow directly from the elimination or limitation of competition.” Boards should be permitted, in other words, to explain how their restrictions address a known market failure associated with the occupation, particularly as negative externalities and informational asymmetries. Second, any restrictions should be narrowly tailored to the assigned market failure. And third, restrictions should operate in the least restrictive manner available and constitute the least anticompetitive of the practical alternatives.

Using these standards, they argue that a state could justify licensure of nurses, but not requirements that they be supervised by doctors in all contexts. A state might require licensing of African hair-braiding, but not by requiring training irrelevant to that occupation. Even if restrictions pass these standards, courts should consider whether other approaches, like state certification, might sufficiently protect the public interest. It is not clear how these changes would affect the *Dental Examiners* case: a concurring judge volunteered that “the record supports the Board’s argument that there is a safety risk inherent in allowing certain individuals who are not licensed dentists, particularly mall-kiosk employees, to perform teeth-whitening services,” but a “private consortium of dentists” could not invoke it.<sup>17</sup> If the rule of reason were to allow public health considerations even by self-interested board members, perhaps these health concerns might provide a defense.

In a final section, Edlin and Haw suggest three responses states might make to preserve state action immunity. First, they could provide for active supervision. Edlin and Haw do not describe institutional frameworks that would satisfy the active supervision requirement, but they might include a state appointed occupational licensing advisory commission, comparable to the Agricultural Prorate Advisory Commission in *Parker*, that would review proposed regulations of licensing boards. Alternatively, the state might require a board to sue those allegedly engaged in the unlawful practice of a profession in state court, rather than issuing their own orders or “cease and desist letters,” as the North Carolina Board of Dental Examiners did. States could also change the composition of boards so that members of the profession do not dominate them. Edlin and Haw suggest that a board might include one member of the profession along with consumer representatives and academics.

Last, they suggest that a state might “do more regulation directly through the sovereign branches of the state itself,” for example, by more specific state statutory definitions of lawful practice. Such an approach would require states legislatures to take more direct political responsibility for the imposition of any anticompetitive occupational criteria. Thus, unlike John Wiley’s capture theory of state action immunity, Edlin and Haw’s approach is consistent with present law in immunizing even “rubber stamps” by legislatures of anticompetitive lobbying proposals. Although they do not discuss it, the *Dental Examiners* case itself raises a version of this issue because a North Carolina state statute defines the practice of dentistry to include removal of stains, a term might well include the sort of chemical teeth whitening the board challenged.<sup>18</sup> ●

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<sup>17</sup> 717 F.3d at 377 (Keenan, J. dissenting).

<sup>18</sup> See Weber, *supra* note 12, at 775 (“The Board exercised its judgment, as contemplated by the legislature, and implemented the legislature’s rule by prohibiting nondentists from removing such stains in the form of teeth whitening.”).