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Employers Beware: The DOJ and FTC Confirm that Naked Wage-Fixing and “No-Poaching” Agreements Are Per Se Antitrust Violations

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Employers Beware: The DOJ and FTC Confirm that Naked Wage-Fixing and “No-Poaching” Agreements Are Per Se Antitrust Violations

Michael Lindsay, Jaime Stilson, and Rebecca Bernhard

Everyone knows that price fixing among competing sellers is illegal, but price fixing by buyers can also violate the antitrust laws. Every company with employees is a “buyer” of employees’ services, and human resources (HR) managers should understand that the antitrust laws apply to agreements relating to the buying of those services, whether or not the purchasing employers are competitors in their downstream markets. In other words, employers can be liable for antitrust violations that reduce competition in an employment market even if the employees do not make (and the employers do not sell) competing products.

In October, the nation’s two leading antitrust enforcers—the Federal Trade Commission and the U.S. Department of Justice’s Antitrust Division—published Antitrust Guidance for Human Resources Professionals reminding (or, in some cases, informing) employers and HR personnel that the antitrust laws apply.¹ The HR Guidance also puts employers and HR personnel on notice that the antitrust laws will be strictly enforced to prevent agreements that restrain competition in the employment market. Consistent with past enforcement actions and cases, the HR Guidance confirms that certain types of wage-fixing and no-poaching agreements² will be treated as per se violations. Moreover, the HR Guidance explicitly states that the DOJ will treat at least some cases of naked wage-fixing and no-poaching agreements as criminal antitrust violations.

To antitrust practitioners, the HR Guidance should come as no surprise. Price fixing and market allocation by buyers has never been immune from antitrust scrutiny. The HR Guidance provides antitrust practitioners with a useful tool for educating HR personnel about antitrust risks and for demonstrating that HR practices are now squarely in the crosshairs of antitrust enforcement. In this article, we review some of the substantive principles set forth in the HR Guidance, the key legal developments that led up to the issuance of the HR Guidance, the kinds of ancillary agreements that escape per se condemnation, and some practical tips for employers and HR professionals looking to steer clear of potential antitrust scrutiny.

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Background: Protecting Against Flight of Employees in Demand

Competition for skilled employees (and conversely, fear of attrition of skilled employees) is at an all-time high in many industries. A company’s investment in human capital may make its employees one of the company’s most important assets, yet employees are mobile. An employer will be

¹ U.S. Dep’t of Justice & Federal Trade Comm’n, Antitrust Guidance for Human Resources Professionals (2016), <https://www.justice.gov/atr/file/903511/download> [hereinafter HR Guidance].

² No-poaching agreements are also called no-hire, no-interference, non-solicitation, or no-switching agreements, depending on the circumstances. For convenience, we collectively refer to these as “no-poaching agreements” for the remainder of this article.

Employers traditionally have used a mix of incentives and disincentives to keep valuable employees from leaving. “Incentives” include compensation (salary, bonuses, benefits packages, and employee-specific perks) and working conditions that encourage employees to stay.

particularly concerned if its employee leaves to go work for a competitor. When that happens, the employer loses its investment in the employee and, worse, sees that investment used against it.³

Employers traditionally have used a mix of incentives and disincentives to keep valuable employees from leaving. “Incentives” include compensation (salary, bonuses, benefits packages, and employee-specific perks) and working conditions that encourage employees to stay. “Disincentives” include post-employment restrictions in an employment agreement that make it more difficult for the employee to leave. For example, an employment agreement might include a non-compete covenant (restricting the former employee’s ability to work for a competitor for a specified time in a specified territory), a non-solicitation covenant (restricting the former employee’s ability to solicit some or all of the former employer’s customers), a worker non-solicitation covenant (restricting the former employee’s ability to solicit former co-employees), or a confidentiality clause (prohibiting the former employee from taking, using, or disclosing the former employer’s confidential information).

Employment agreements, however, cannot fully protect a company’s investment in human capital. State law regulates the enforceability of post-employment restrictive covenants, and some states (notably California) place severe limitations on their use. So an employer may be tempted to consider other means to protect its interests, such as an agreement with its competitors in the employment market not to hire each other’s employees, or an agreement to set a cap on wages and other benefits. These agreements, however, are exactly what the law considers presumptively illegal—as the HR Guidance now confirms.

The HR Guidance: Stating the Obvious

The HR Guidance provides a good, reasonably plain-English guide for HR professionals regarding basic antitrust principles applied in the employment context, and it is a helpful tool for antitrust counsel to use in working with an HR team. The HR Guidance’s Q&As are particularly helpful in identifying some common fact patterns where HR professionals may need some training. The agencies have also prepared a listing of “red flags” for employment practices.⁴ This listing can provide useful material for a compliance presentation.⁵

From a substantive perspective, the HR Guidance focuses on three main antitrust violations:

- An agreement between two or more independent companies that does nothing more than fix wages, salaries, or other compensation (a naked wage-fixing agreement) is illegal per se.
- An agreement in which two or more independent companies agree not to solicit each other’s employees or otherwise agree to limit methods of competition (a naked no-poaching agreement) is also illegal per se, although there may be an exception if the agreement is closely and narrowly tied to a joint venture or other legitimate collaboration between the employers.
- An agreement between or among two or more independent companies to exchange current or prospective compensation information is problematic. The agreement may not be illegal

³ This is not to suggest that all value-enhancing investments are made by the employer (rather than the employee) or that the employer’s investment is independent of the employee’s efforts or natural talents.

⁴ U.S. DEP’T OF JUSTICE & FEDERAL TRADE COMM’N, ANTITRUST RED FLAGS FOR EMPLOYMENT PRACTICES (2016), <https://www.justice.gov/atr/file/903506/download>.

⁵ Circulating the “red flags” document in unedited form and without guidance from company counsel carries certain risks. The list of problematic activities is overly long and yet is “by no means exhaustive.” Moreover, the document acknowledges that it could generate false positives (“the presence of a red flag does not necessarily mean that there has been an antitrust violation”). It also encourages reporting directly to the DOJ or FTC, without mention of the employer’s in-house counsel or ethics/compliance hotline.

per se, but it can be evidence of a per se violation (i.e., a naked agreement not to compete). HR professionals should take appropriate precautions in exchanging this information.

These substantive principles are not themselves “new” news. Antitrust rules have been applied in purchasing markets for decades⁶ and, as suggested by the cases that the HR Guidance cites, in employment-related purchasing markets as well. Buyer-side agreements that fix wages and otherwise restrict competition for employees’ services are no different than supplier agreements that fix prices of products. Similarly, antitrust concerns about information exchanges—and the need for appropriate safeguards—date back to the *Hardwood Cases*,⁷ and information exchanges (including buyer-side information exchanges) continue to be an antitrust enforcement focus.⁸

What is new—or at least noteworthy—is the very clear statement that the DOJ intends to treat naked wage- or compensation-fixing agreements, no-poaching agreements, and other naked restraints in employment markets as *criminal* violations and may, where appropriate, bring felony charges against both the individuals responsible for the violation and their companies as well.⁹ The DOJ has previously made clear its view that these restraints are illegal per se, and naked agreements between competing sellers to fix prices have been the bread and butter of criminal antitrust enforcement for a century. Now the DOJ has forewarned employers and managers that they should expect this same basic approach in employment markets.

Enforcement Actions and Follow-on Litigation in Employment Markets

Buyer-side enforcement actions aimed at protecting employment markets are not new to the federal antitrust enforcement agencies, but the DOJ’s enforcement actions in the *High-Tech Employee Antitrust* cases¹⁰ focused more attention on the issue, particularly on per se condemnation of no-poaching agreements. The HR Guidance mentions some of the DOJ’s and FTC’s enforcement actions either in or at least tangential to employment markets, and these cases (along with a few others) warrant more discussion than the brevity of the HR Guidance permitted.

Debes. In the early 1990s, the FTC brought an enforcement action against several nursing homes in Illinois, alleging a buyers’ conspiracy to boycott a nurse registry that attempted to raise its prices for temporary nursing care services.¹¹ According to the FTC, nurse registries “compete among themselves to provide temporary nursing services at the price and quality nursing homes desire,” and “[c]ompetition among nursing homes for temporary nursing services ensures an ade-

⁶ *Mandeville Island Farms v. Am. Crystal Sugar*, 334 U.S. 219 (1948).

⁷ *Am. Column & Lumber Co. v. United States*, 257 U.S. 377 (1921); *Maple Flooring Mfrs. Ass’n v. United States*, 268 U.S. 563 (1925).

⁸ For example, the DOJ recently sued DirecTV for orchestrating an information-sharing arrangement with its competitors during the companies’ negotiations to carry the Dodgers Channel. The complaint alleged that the information exchange led to decisions by DirecTV and its competitors not to carry the channel, depriving consumers of almost all live telecasts of Dodgers games in the LA area. *See* Complaint, *United States v. DirectTV Group Holdings, LLC and AT&T Inc.*, No. 16-cv-8150 (C.D. Cal. Nov. 2, 2016), ECF No. 1.

⁹ Assistant Attorney General Renata Hesse reiterated this position at the ABA Section of Antitrust Law’s Fall Forum. Renata Hesse, Remarks Before the ABA Section of Antitrust Law Fall Forum (Nov. 17, 2016) (“going forward employers who conspire to hold down wages or restrict hiring of each other’s workers will be investigated criminally and, if appropriate, prosecuted criminally. Naked ‘no-poaching’ agreements or agreements to fix wages stamp out competition just like agreements to allocate customers or to fix product prices . . .”), <https://www.justice.gov/opa/speech/acting-assistant-attorney-general-renata-hesse-antitrust-division-delivers-remarks-0>.

¹⁰ *See e.g.*, Complaint, *United States v. Adobe Sys., Inc.*, No. 10-cv-01629, 2010 WL 11417874 (D.D.C. Sept. 24, 2010); Complaint, *United States v. Lucasfilm Ltd.*, No. 10-cv-02220, 2010 WL 5344347 (D.D.C. Dec. 21, 2010); Complaint, *United States v. eBay, Inc.*, No. 12-cv-5869, 2012 WL 5727488 (N.D. Cal. Nov. 16, 2012).

¹¹ *Debes Corp.*, 115 F.T.C. 701 (1991).

quate supply of quality nurses.”¹² In this case, however, the nursing homes subverted the competitive process by agreeing among themselves to collectively reject a price increase from one of the registries. Thus, the agreement at issue did not deal with the conspirators’ own respective employees or indeed with approaches to individual employees at all. Instead, it dealt with rates charged by temporary employment agencies for nursing services.¹³ The basic principle, however, remains—naked agreements among competing buyers to restrict their purchasing decisions are illegal. The nursing homes settled, agreeing to an injunction that prohibited repetition of the challenged behavior.¹⁴

Council of Fashion Designers of America. Another FTC enforcement action in the 1990s involved the purchase of modeling services in the fashion industry.¹⁵ Members of the Council of Fashion Designers of America (CFDA), a trade association of fashion designers, had formed a separate entity, “7th on Sixth, Inc.,” that had what the FTC recognized as “[a] legitimate purpose” of producing centralized fashion shows twice a year. The FTC did not challenge 7th on Sixth’s collective purchasing of services used in the production: tents, runway assembly, lighting design and installation, security, and architectural design. But 7th on Sixth did not purchase or resell modeling services for its shows. Instead, the Executive Director of 7th on Sixth met with fashion designers (who were also CFDA members) interested in participating in its shows to discuss modeling fees. During this meeting, 7th on Sixth and the fashion designers “agreed not to compete for modeling services and agreed to determine modeling fees collectively, rather than allow prices to be determined in a competitive market” in order to reduce the fees they paid for models.¹⁶ If the modeling agencies refused to agree to the fixed pricing, 7th on Sixth and the fashion designers threatened to boycott the modeling agencies and use “open call” to secure modeling services.

The FTC’s complaint alleged that the purchasers’ agreement on prices for modeling services “was not ancillary to the legitimate purpose of creating centralized fashion shows, and respondents did not purchase modeling services jointly.”¹⁷ This suggests that the FTC viewed the agreement as per se illegal, but the phrasing of these allegations was itself interesting.¹⁸ The FTC did not allege that 7th on Sixth and the fashion designers *could not* jointly purchase modeling services, just that they *did not* do so. In other words, the FTC took no position as to whether or not a joint venture or collaboration that collectively purchased the modeling services (at a lower price) might have passed muster. The CFDA and 7th on Sixth settled, consenting to an order requiring them to educate their members on the illegality of agreements to fix compensation for modeling or modeling agency services and prohibiting them from making such agreements in the future.

¹² *Id.* at 704–05.

¹³ Of course there may be some correlation between suppressed rates paid to nurse registries and lower wages paid to the temporary nurses working for the registries. Private litigants in the Arizona Hospital and Healthcare Association (AzHHA) follow-on case made that precise argument. *See infra* page 5.

¹⁴ *Debes*, 115 F.T.C. at 705.

¹⁵ Council of Fashion Designers of America, 120 F.T.C. 817 (1995). While the FTC and the DOJ are now touting this as an employment-related matter, the FTC’s contemporaneous press release described the matter as making clear “that antitrust laws prohibiting price fixing apply to the fashion industry just as they do to other products or services.” *See* Press Release, Fed. Trade Comm’n, Council of Fashion Designers of America (June 9, 1995), <https://www.ftc.gov/news-events/press-releases/1995/06/council-fashion-designers-america>.

¹⁶ *Fashion Designers*, 120 F.T.C. at 819.

¹⁷ *Id.* at 820.

¹⁸ Another interesting aspect of this case is the FTC’s repeated references to the presence and involvement of the fashion designers’ legal counsel in planning and drafting agreements. *See, e.g., id.* at 819–20. The case thus also serves as a reminder that transactional lawyers should always have an ear attuned for antitrust concerns.

Utah Society for Healthcare Human Resources. Rounding out the cases from the 1990s, the DOJ brought suit against the Utah Society for Healthcare Human Resources Administration, the Utah Hospital Association, and a group of hospitals. The case involved an agreement to exchange nonpublic information about current and prospective wages for entry-level nurses. The complaint alleged that the hospitals (which employed 75 percent of the registered nurses in the county) used the information to suppress nurses' entry wages during a critical shortage of nurses.¹⁹ The complaint did not allege that the hospitals actually agreed on entry-level wages, but it did allege that they "monitor . . . each other's registered-nurse entry wages."²⁰ The defendants consented to a final judgment prohibiting them from fixing nurses' compensation and from exchanging any current or prospective information about nurses' wages.²¹

AzHHA. In May 2007, the DOJ challenged the use of a group purchasing organization for the purchase of temporary nursing services.²² The Arizona Hospital and Healthcare Association (AzHHA) had created a "registry" of temporary nurses and set quality standards that the DOJ did not challenge. Ten years after starting operations, the AzHHA Registry began setting prices for nursing services purchased through the registry.²³ The complaint did not allege a per se violation. Rather, the complaint alleged that the defendants had market power in the purchasing market, that their agreement had a negative effect on compensation for nurses, and that the anticompetitive effects were not outweighed by any efficiencies. AzHHA settled the claims by consenting to a final judgment that prohibited use of the registry to set rates or other terms related to the provision of nurses' services.²⁴

Subsequent class action suits against AzHHA and a number of participating hospitals brought by temporary nurses seeking damages for suppressed wages not only alleged antitrust violations under the rule of reason (as the DOJ had done), they also alleged per se violations.²⁵ The class actions produced settlements totaling approximately \$24 million.²⁶

Detroit Nurses Antitrust Litigation. In December 2006, a group of registered nurses filed a class action suit alleging that Detroit-area hospitals conspired with one another to suppress nurses' wages and furthered that conspiracy by exchanging current compensation-related information in order to reduce competition.²⁷ Although this private litigation did not follow on the heels of any federal enforcement actions, the allegations are consistent with the principles set forth by the

¹⁹ *United States v. Utah Society for Healthcare Human Res. Admin.*, No. 94-C-282G, 1994 WL 750657 (D. Utah Sept. 9, 1994).

²⁰ Complaint ¶ 26(d), *Utah Society*, 1994 WL 750657 (No. 94-C-282G).

²¹ Final Judgment, *Utah Society*, 1994 WL 750657 (No. 94-C-282G).

²² The complaint alleged two markets: one for "per diem" nurses (who lived in the region) and one for "travel" nurses (who came into the region for temporary but consistent employment). Complaint ¶ 17, *United States v. Arizona Hosp. & Healthcare Ass'n*, No. CV07-1030-PHX, (D. Ariz. Sept. 12, 2007), <https://www.justice.gov/atr/case-document/complaint-28>.

²³ *Id.* ¶ 3.

²⁴ Final Judgment, *Arizona Hospital*, No. CV07-1030-PHX, <https://www.justice.gov/atr/case-document/final-judgment-17>, ECF No. 17.

²⁵ See e.g., Complaint, *Johnson v. Arizona Hosp. & Healthcare Ass'n*, No. CV-07-1292-PHX-SRB, 2009 WL 5031334 (D. Ariz. July 14, 2009), ECF No. 1.

²⁶ Final Judgment Approving Settlement with Certain Defendants, *Johnson*, 2009 WL 5031334 (No. CV-07-1292-PHX-SRB), ECF No. 660; Final Judgment Approving Settlement with Certain Defendants, *Johnson*, 2009 WL 5031334 (No. CV-07-1292-PHX-SRB), ECF No. 664; Final Judgment Approving Settlement with AzHHA Defendants, *Johnson*, 2009 WL 5031334 (No. CV-07-1292-PHX-SRB), ECF No. 665; Motion for Final Approval of Settlement with Abrazos Defendants, *Johnson*, 2009 WL 5031334 (No. CV-07-1292-PHX-SRB), ECF No. 721; Final Judgment Approving Settlement Against Abrazos Defendants, *Johnson*, 2009 WL 5031334 (No. CV-07-1292-PHX-SRB), ECF No. 724.

²⁷ Complaint, *Cason-Merenda v. VHS of Mich., Inc.*, 862 F. Supp. 2d 603 (E.D. Mich. 2012) (No. 06-cv-15061), ECF No. 1; Third Amended Complaint, *Cason-Merenda*, 862 F. Supp. 2d 603 (No. 06-cv-15061), ECF No. 67.

agencies in the HR Guidance. Plaintiffs alleged that the hospitals' conspiracy to suppress wages was per se illegal, but they also alleged that the agreement to exchange information was a separate antitrust violation under rule of reason analysis (as well as evidence of a per se violation). This hard-fought litigation lasted close to ten years—but with all defendants eventually settling with plaintiffs for over \$90 million in total.²⁸

High-Tech Employee Antitrust Litigation. In a series of cases beginning in September 2010, the DOJ filed complaints against several high-tech companies alleging that their agreements relating to hiring practices violated Section 1 of the Sherman Act. In *Adobe*, the six defendants entered into substantially similar agreements that restricted use of a particular recruiting tool: cold-calling each other's employees (one of the variations of a no-poaching agreement).²⁹ Both *eBay* and *Lucasfilm* featured restrictions on recruiting, but the complaints had additional components as well. In *eBay*, the parties' agreement included a no-hire component, preventing eBay from hiring anyone at all from Intuit for at least a year.³⁰ In *Lucasfilm*, the employers also agreed to give notice if they intended to make an offer to an employee of their competitor, and when making such an offer, agreed not to counteroffer above the initial offer.³¹

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In each case, the DOJ challenged the agreements as per se violations of Section 1 of the Sherman Act, and it is easy to see why. Each complaint focused on the direct restraint that the agreements imposed on the labor markets (rather than on any effects in downstream markets in which the firms may or may not have competed), because the real vice was the restraint's effect on competition for the services of highly trained technical employees, including access to better job opportunities. If the complaints had alleged the same kind of agreements among competing sellers—that is, agreements not to make sales calls on each other's customers, to give notice when offering to sell a product to each other's customers, and not to offer a lower price than what the new seller was offering—then no one would have any doubt that the allegations described a per se violation. Indeed, the DOJ advanced this argument in *Adobe*: "There is no basis for distinguishing allocation agreements based on whether they involve input or output markets. Anticompetitive agreements in both input and output markets create allocative inefficiencies."³² It reiterated the same principle in *Lucasfilm* and specifically tied it to employment markets: "Antitrust analysis of downstream customer-related restraints applies equally to upstream monopsony restraints on employment opportunities."³³

The DOJ acknowledged that in some instances the companies had "legitimate collaborative projects" and "extensive business relationships," such that some form or amount of recruiting restraints might have been justified. But as the DOJ observed, application of the rule of reason

²⁸ Motion for Final Approval of Settlements with St. John Health, Oakwood Healthcare Inc. and Bon Secours Cottage Health Servs. *Cason-Merenda*, 862 F. Supp. 2d (No. 06-cv-15061), ECF No. 691; Final Orders as to Defendants, *Cason-Merenda*, 862 F. Supp. 2d (No. 06-cv-15061), ECF Nos. 717–719; Motion for Final Approval of Settlements with Henry Ford Health Sys., Mount Clemens Gen. Hosp., Williams Beaumont Hosp., and Trinity Health, *Cason-Merenda*, 862 F. Supp. 2d (No. 06-cv-15061), ECF No. 812; Final Order Approving Settlement as to Defendants, *Cason-Merenda*, 862 F. Supp. 2d (No. 06-cv-15061), ECF No. 824; Motion for Final Approval of Settlement with VHS of Michigan, Inc., *Cason-Merenda*, 862 F. Supp. 2d (No. 06-cv-15061), ECF No. 964; Final Order Approving Settlement with VHS, *Cason-Merenda*, 862 F. Supp. 2d (No. 06-cv-15061), ECF No. 970.

²⁹ Complaint, *Adobe*, 2010 WL 11417874, at *1.

³⁰ Complaint, *eBay*, 2012 WL 5727488 at *1; see also *id.* at *3–5.

³¹ Complaint, *Lucasfilm*, 2010 WL 5334347, at *3.

³² Competitive Impact Statement at 8, *Adobe*, 2010 WL 11417874 (No. 10-cv-01629), ECF No. 2.

³³ Competitive Impact Statement at 5–6, *Lucasfilm*, 2011 WL 2636850 (No. 10-cv-02220), ECF No. 2.

requires that the restraint be designed to protect a legitimate business interest—and here the restraints were not limited in some way to such an interest.³⁴

Adobe and *Lucasfilm* were settled early with consent judgments that prohibited the challenged conduct,³⁵ but eBay chose to seek dismissal of the complaint—and lost.³⁶ The district court first rejected eBay's argument that the existence of an overlapping director between the two companies immunized the agreement under either *Copperweld* or Section 8 of the Clayton Act.³⁷ Next, the court expressly found that the agreement was a market allocation agreement, because "[a]ntitrust law does not treat employment markets differently from other markets in this respect."³⁸ The court held, however, that it could not determine on the pleadings whether the no-poaching agreement was ancillary to an agreement with a legitimate business purpose (namely, the service, on eBay's board of directors, of an Intuit executive and director). As the court explained, it "simply cannot determine with certainty the nature of the restraint, and by extension, the level of analysis to apply" without discovery. In other words, the court deferred decision on whether to apply the per se rule (or, for that matter, the DOJ's only other theory—a "quick look" violation). After the denial of the motion to dismiss, eBay, like the *Adobe* and *Lucasfilm* defendants, agreed to the entry of a consent judgment that prohibited the challenged agreements.³⁹

Private class action civil suits followed the DOJ enforcement actions, and the cases were consolidated in *In re High-Tech Employee Antitrust Litigation*.⁴⁰ The class plaintiffs, like the DOJ, alleged that the agreements were per se violations, but they added allegations that the bilateral actions challenged in the DOJ enforcement action were part of "an interconnected web of express bilateral agreements."⁴¹ The cases survived both a motion to dismiss and a motion for summary judgment. On the motion to dismiss, the court found that plaintiffs alleged "much more than parallel conduct" for an overarching conspiracy, including sufficient details regarding the "who, what, to whom, where, and when" of the collusion.⁴² The court expressly stated that in its view, the similarity of the six no cold-calling agreements, reached in secrecy over a two-year period, suggested collusion, rather than coincidence.⁴³ The court also held that determining whether to apply the per se rule or a rule of reason analysis was better left to summary judgment.⁴⁴ On summary judgment, the defendants again challenged proof of a conspiracy,⁴⁵ but the court found that plaintiffs presented sufficient disputed evidence that tended to exclude the possibility that the defendants

³⁴ Competitive Impact Statement at 9, *Adobe*, 2010 WL 11417874 (No. 10-cv-10629), ECF No. 2.

³⁵ Final Judgment, *Adobe*, 2010 WL 11417874 (No. 10-cv-01629), ECF No. 17; Final Judgment, *Lucasfilm*, 2011 WL 2636850 (No. 10-cv-02220), ECF No. 7.

³⁶ *United States v. eBay, Inc.*, 968 F. Supp. 2d 1030 (N.D. Cal. 2013).

³⁷ *Id.* at 1035–36; *see also* *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984) (parent and wholly owned subsidiary are same "person" for Section 1 purposes); 15 U.S.C. § 19 (prohibiting certain interlocking directorates).

³⁸ *eBay*, 968 F. Supp. 2d at 1039.

³⁹ Final Judgment, *eBay*, 2012 WL572748 (No. 12-cv-05869), ECF No. 66.

⁴⁰ *In re High-Tech Employee Antitrust Litig.*, 856 F. Supp. 2d 1103 (N.D. Cal. 2012).

⁴¹ *Id.* at 1110.

⁴² *Id.* at 1117–18.

⁴³ *Id.* at 1120.

⁴⁴ *Id.* at 1122.

⁴⁵ Orders Denying Motions for Summary Judgment, *High-Tech*, 856 F. Supp. 2d 1103 (No. 11-cv-02509), ECF Nos. 771, 788.

had acted independently in determining not to cold call the other defendants' employees.⁴⁶ The cases ultimately settled for close to \$435 million.⁴⁷

Au Pair Litigation. In November 2014, five au pairs brought a class action suit against the 15 sponsor agencies responsible for the exclusive administration of the J-1 Visa program for the U.S. Department of State. The complaint alleged that the agencies were illegally fixing the wages of the au pairs placed through their agencies, claiming a per se violation of the federal antitrust laws.⁴⁸ An amended complaint was filed in March 2015, and a year later the court largely denied the several motions to dismiss the complaint.⁴⁹ The court found that the complaint adequately alleged the existence of a direct agreement between the firms to suppress au pair wages.⁵⁰

After the Second Amended Complaint was filed in October 2016, one of the 15 defendant agencies moved to compel arbitration as to two newly added class representative plaintiffs under their agreement with the agency.⁵¹ Briefing on this motion is not yet completed, but this motion serves as a reminder both that a company may be able to channel antitrust claims into arbitration if its agreement includes an applicable and enforceable arbitration and class action waiver clause—and that class counsel should be wary of this issue when identifying potential class representatives.⁵²

Supplementing the HR Guidance

The HR Guidance reiterates the enforcement agencies' position that naked wage-fixing and no-poaching agreements between companies in an employment purchasing market are per se illegal. That does not mean that all restraints affecting employment markets are forbidden. The HR Guidance acknowledges that no-poaching agreements might be reasonably related to a legiti-

⁴⁶ See, e.g., Order Denying Motion for Summary Judgment at 3, *High-Tech*, 856 F. Supp. 2d 1103 (No. 11-cv-02509), ECF No. 771.

⁴⁷ Motion for Settlement Approval (claims against Intuit, Pixar/Lucasfilms), *High-Tech*, 856 F. Supp. 2d 1103 (No. 11-cv-02509), ECF No. 809; Order Granting Final Approval as to Settlement of Pixar/Lucasfilm Claims, *High-Tech*, 856 F. Supp. 2d 1103 (No. 11-cv-02509), ECF No. 936; Motion for Approval of Settlement of Claims of Remaining Defendants, *High-Tech*, 856 F. Supp. 2d 1103 (No. 11-cv-02509), ECF No. 1087; Order Granting Final Approval, *High-Tech*, 856 F. Supp. 2d 1103 (No. 11-cv-02509), ECF No. 1111. The plaintiffs had initially reached a \$324.5 million settlement with the majority of the defendants, but the court declined to approve that settlement because the proposed payment fell below the range of reasonableness given that the plaintiffs' case had survived summary judgment. Order Denying 920 Plaintiffs' Motion for Preliminary Approval of Settlements at 6–7, *High-Tech*, 856 F. Supp. 2d 1103 (No. 11-cv-02509), ECF No. 974.

⁴⁸ Complaint, *Beltran v. Noonan*, No. 14-cv-3074, 2014 WL 5904663 (D. Colo. Nov. 13, 2014), ECF No. 1. The complaint has been subsequently amended twice. See Amended Complaint, *Beltran*, 2014 WL 5904663 (No. 14-cv-3074), ECF No. 101; Second Amended Complaint, *Beltran*, 2014 WL 5904663 (No. 14-cv-3074), ECF No. 395.

⁴⁹ Amended Complaint, *Beltran*, 2014 WL 5904663 (No. 14-cv-3074), ECF No. 10; Order Adopting and Affirming in Part February 22, 2016 Recommendation of United States Magistrate Judge at 9, *Beltran*, 2014 WL 5904663 (No. 14-cv-3074), ECF No. 258.

⁵⁰ Order Adopting and Affirming in Part February 22, 2016 Recommendation of United States Magistrate Judge at 9, *Beltran*, 2014 WL 5904663 (No. 14-cv-3074), ECF No. 258 (the allegations of a direct agreement in this case “amount to what Judge Richard Posner has termed the ‘smoking gun in a price-fixing case’—namely, ‘direct evidence . . . [in] the form of an admission by an employee of one of the conspirators, that officials of the defendants had met and agreed explicitly on the terms of a conspiracy to [set] prices’”).

⁵¹ Second Amended Complaint, *Beltran*, 2014 WL 5904663 (No. 14-cv-3074), ECF No. 395; Defendant AuPairCare, Inc.'s Motion to Compel Arbitration and Dismiss or Alternatively, Stay Lawsuit, *Beltran*, 2014 WL 5904663 (No. 14-cv-3074), ECF No. 431.

⁵² Although mandatory arbitration clauses are useful for avoiding class actions in some types of controversies, at least two circuits—the Seventh and Ninth—have refused to enforce them for certain class action statutory employment claims, such as FLSA class actions. See *Ernst & Young, LLP v. Morris*, 2016 WL 4433080 (9th Cir. Aug. 22, 2016), *petition for cert. filed* (No. 16-300) (Sept. 8, 2016); *Lewis v. Epic Sys. Corp.*, 823 F.3d 1147 (7th Cir. 2016), *petition for cert. filed* (No. 16-285) (Sept. 2, 2016); see also *Patterson v. Raymours Furniture Co.*, 2016 WL 4598542 (2d Cir. Sept. 2, 2016), *petition for cert. filed* (No. 16-388) (Sept. 22, 2016); *Cellular Sales of Missouri, LLC v. NLRB*, 824 F.3d 772 (8th Cir. 2016); *Murphy Oil USA v. NLRB*, 808 F.3d 1013 (5th Cir. 2015), *petition for cert. filed* (No. 16-307) (Sept. 9, 2016).

mate procompetitive venture or collaboration between companies and reasonably necessary to protect that procompetitive venture (the ancillary restraints doctrine). Where parties can make a plausible case to that effect, then the agreement will be evaluated under the rule of reason, rather than be condemned as a per se violation.

Given the constraint imposed by brevity, the HR Guidance does not provide a complete play-book for the antitrust practitioner. Here are several areas that are not fully developed in the HR Guidance but that practitioners should understand.

Information Access in Mergers and Acquisitions. The HR Guidance generally refers to the risk of employment-related aspects of M&A agreements,⁵³ but it does not flesh out the principles that deal lawyers and HR professionals should understand. It is not enough to say that a diligence request for information on employee compensation and benefits “may be lawful.”⁵⁴ Generally speaking, parties will sign a confidentiality agreement that limits the persons who will have access to information and the uses to which that information can be put. As long as there is a bona fide proposed transaction, then it is highly probable that the seller’s disclosure of compensation and benefits information is lawful, because the buyer needs to evaluate the expected costs of employees. Furthermore, even with a strong confidentiality agreement, the seller is likely to be cautious about exposing its competitively sensitive information. This concern will usually act as a brake on when, how much, and to whom the seller’s sensitive information will be disclosed. Nevertheless, the HR Guidance can assist counsel on both sides of an M&A transaction by providing a tool to resist premature or overly aggressive information demands from the buyer’s HR department or undue squeamishness in the seller’s HR department.

No Poaching Agreements in M&A Transactions. No-poaching agreements in the M&A/divestiture context have been found to be permissible and not subject to per se illegal treatment. In *Eichorn*, the Third Circuit analyzed a no-poaching agreement between a company and several former affiliates that the company divested.⁵⁵ As part of the transaction, the company and its former affiliates agreed that for an eight-month period, they would not hire each other’s employees who made more than \$50,000 a year. The plaintiffs alleged that the defendants were “direct competitors for their labor” and challenged the agreement as “an illegal group boycott and a horizontal price fixing conspiracy under § 1 of the Sherman Act.”⁵⁶ The Third Circuit found that this restraint was ancillary to the company’s sale of the business to the affiliates and justifiable under a rule of reason analysis because the restraint was reasonable in scope and duration. Similarly, in the *High-Tech Employee Antitrust* cases, no-poaching agreements in the M&A context were expressly excepted from the per se prohibitions outlined in the final judgments.⁵⁷

⁵³ HR GUIDANCE, *supra* note 1, at 5 (“Even if participants in an agreement are parties to a proposed merger or acquisition . . . there is antitrust risk if they share information about terms and conditions of employment.”).

⁵⁴ *Id.* (“[I]n the course of determining whether to pursue a merger or acquisition, a buyer may need to obtain limited competitively sensitive information. Such information gathering may be lawful if it is in connection with a legitimate merger or acquisition proposal and appropriate precautions are taken.”).

⁵⁵ *See, e.g., Eichorn v. AT&T Corp.*, 248 F.3d 131 (3d Cir. 2001).

⁵⁶ *Id.* at 139, 142.

⁵⁷ *See, e.g., Final Judgment ¶ V.A.2, eBay*, 2012 WL 5727488 (No. 12-cv-05069), ECF No. 66 (“Nothing in Section IV shall prohibit the Defendant . . . from attempting to enter into, entering into, maintaining or enforcing a no direct solicitation provision, provided the no direct solicitation provision is . . . reasonably necessary for mergers or acquisitions, consummated or unconsummated, investments, or divestitures, including due diligence related thereto”).

Of course, even legitimate ancillary no-poaching agreements must still be reasonably tailored to the larger, legitimate business transaction.⁵⁸ A broad and vague no-poaching agreement without an end-date is very likely to present antitrust risk. The no-poaching agreement or other restraint should be limited in duration (during due diligence and for a reasonable period after the closing) and usually in scope (applicable to specific key employees or identifiable categories of employees).

Employers in a Single Corporate Family. The HR Guidance refers to agreements “among competing employers,” and clients have already asked whether this includes employers that are wholly owned by a common parent. The HR Guidance does not address this, but the answer is a clear “no.” Longstanding jurisprudence teaches that a parent and its wholly owned subsidiary are considered a single “person” for antitrust purposes—and therefore incapable of making an “agreement.”⁵⁹ The same principle has been extended to affiliates (with a common parent) and to subsidiaries that are less than wholly owned (but still majority-owned).⁶⁰ A no-poaching agreement within a corporate family would not be considered an agreement at all—it is an internal corporate policy.⁶¹

An interesting example relying on this general principle in an employment context arose in *Williams v. I.B. Fischer Nevada*,⁶² where the court considered an agreement under which management employees of a fast-food franchise could not move from one Jack-In-The-Box franchisee to a different franchisee without the first franchisee’s consent. The court said that the purpose of this no-poaching agreement was “to prevent the franchises from ‘raiding’ one another’s management employees after time and expense have been incurred in training them.”⁶³ The analysis focused on the fact that the agreement was within a single enterprise, the Jack-in-the-Box franchise system. Both the district court and the Ninth Circuit used the *Copperweld* single-entity analysis to conclude that the franchisor and franchisees were incapable of conspiring with one another.⁶⁴ The district court explained that “the franchisor does everything in its power to minimize competition and promote uniformity between franchises,” including uniformity of quality food and service, and does so to help both the franchisor itself and its franchisees achieve an “enhanced reputation” and increased business for both.⁶⁵ The Ninth Circuit affirmed, finding that despite the

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⁵⁸ *Eichorn*, 248 F.3d at 146 (“Because the no-hire agreement was a legitimate ancillary restraint on trade, we must determine whether the eight month restriction from employment at an AT&T affiliate was reasonable or whether it went further than necessary to ensure the successful transition of ownership.”). The court held that the restraint was reasonable. *Id.* at 146–47.

⁵⁹ See, e.g., *Copperweld*, 467 U.S. at 752.

⁶⁰ See, e.g., *Century Oil Tool, Inc. v. Production Specialties, Inc.*, 737 F.2d 1316 (5th Cir. 1984) (sister corporations with common parent were a single entity under *Copperweld*); *Novatel Commc’ns. v. Cellular Tel. Supply*, Civ. A. No. C85-2674A, 1986 WL 15507, at *6 (N.D. Ga. Dec. 23, 1986) (“The 51% ownership retained by Novatel-Canada assured it of full control over Carcom and assured it could intervene at any time that Carcom ceased to act in its best interests.”).

⁶¹ *Eichorn*, 248 F.3d at 139.

⁶² *Williams v. I.B. Fischer Nevada*, 794 F. Supp. 1026 (D. Nev. 1992), *aff’d*, 999 F.2d 445 (9th Cir. 1993).

⁶³ *Id.* at 1029.

⁶⁴ *Id.* at 1030–31; *Williams*, 999 F.2d at 447–48.

⁶⁵ *Williams*, 999 F.2d at 447.

fact that they did not share common “ownership,” the franchisor and franchisees had a sufficient unity of purpose to qualify as a single entity under *Copperweld*.⁶⁶

Vertical Restraints. Sometimes “competing employers” might also be in a supplier-customer relationship—for example, consulting firms and temporary employment agencies. The HR Guidance does not address vertical restraints in the employment market (such as a temp agency’s agreement that the customer will not hire away an individual who was originally supplied by the agency). The per se rule, however, is not appropriate in this context. Vertical restraints are generally judged under the rule of reason,⁶⁷ and that makes particular sense here. If the employer wants to convert the relationship from employment-supply to employee-recruiting, then the no-hire provision serves either as a pricing mechanism (if the agreement includes a liquidated damages provision) or as a trigger for negotiation over the value of the temp agency’s services for acting, in effect, as an employee-search firm. Even if the horizontal relationship (for example, between a consulting firm and its customer as competitors for the future services of the consulting firm’s employee) is considered important, the restraint would very likely be acceptable under the ancillary restraints doctrine because it is reasonably necessary for the provision of specialized services—a legitimate procompetitive business purpose.

Looking Ahead: Practical Tips for Employers and HR Departments

The HR Guidance provides an opportunity for law and HR departments to take stock of HR practices that may raise antitrust red flags and to take steps to manage effectively the legal and business risks. Employers should consider the following action steps:

- **Conduct leadership compliance training.** Include the topic of antitrust rules for recruiting and employment practices on the agenda for the next meeting of legal and HR leadership. HR personnel responsible for compensation and hiring decisions should be reminded that the antitrust laws apply in their field and that violations carry serious consequences for both the employer and the individual.
- **Consider a training program for the whole HR department.** Legal risks can arise from lower- or mid-level HR managers, and companies should consider compliance programs for the entire HR department, or at least a significant portion. The Q&A section of the HR Guidance can provide a useful foundation for the program. Expanding the company’s compliance program may also be appropriate if people outside the HR department participate in recruiting and hiring processes or if there is any reason to believe that there might be problematic recruiting-related agreements outside the HR department.
- **Rely on employment covenants (where possible).** An enforceable noncompete agreement—subject to reasonable geographic and time limitations—can keep employees from leaving for a competitor without raising the antitrust red flags that the HR Guidance is aimed at preventing. Just as it might do before entering into a joint venture or other collaboration with a

⁶⁶ The court’s analysis of *Copperweld*’s application to a franchise system predates the U.S. Supreme Court’s *American Needle* decision, which has made it more difficult for franchise systems to argue that they are immune from antitrust scrutiny under the single entity rule. See *Am. Needle, Inc. v. Nat’l Football League*, 560 U.S. 183 (2010) (finding no single entity for the NFL and its member teams because they did not possess either the unitary decision-making quality or aggregation of economic power typically present in a single entity); see also Barry M. Block & Matthew D. Ridings, *Antitrust Conspiracies in Franchise Systems After American Needle*, 30 *FRANCHISE L.J.* 216 (2011) (concluding that while *American Needle* does not completely foreclose the argument that a franchise system should be treated as a single economic enterprise, the analysis will differ based on facts and circumstances for each franchise).

⁶⁷ See *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

potential competitor, the employer should identify employees (by individual or by group) for whom noncompete agreements would be particularly important. Where a straight noncompete agreement is unenforceable or unobtainable, the employer might consider alternatives, such as requiring the employee to repay certain training and investment costs up to a set amount if the employee resigns or is fired for cause within a certain time period following his or her start date.⁶⁸ To help ensure enforceability, an employer should provide reasonable terms for the repayment amount and for the duration of employment that qualifies the employee for repayment forgiveness.⁶⁹ Similarly, an employer can link retention of a sign-on bonus with an agreed-upon length of employment. If the employee leaves before the end of the agreed-upon length of employment, a portion (or all) of the sign-on bonus must be repaid. With sufficient consideration, and as long as the sign-on bonus and time period are reasonable in amount, the contract would likely be enforceable.

- **Keep M&A due diligence on point.** When the company conducts employment-related due diligence in an M&A transaction, ensure that the due diligence is limited to what is reasonably necessary to evaluate the transaction and, where appropriate, ask M&A counsel whether other strategies (such as a clean room) can be used to facilitate due diligence of sensitive compensation-related information.
- **Use narrowly tailored agreements (both in scope and duration).** Before entering any kind of collaboration—with a competitor or anyone else—an employer should ask itself whether the collaborator might use the collaboration for recruiting and how the employer might protect itself. If that means contemplating no-poaching agreements in a legitimate business transaction, such as M&A deals, joint ventures, or customer agreements, make sure that the provision is appropriately tailored to enhance the overall purpose of the procompetitive business transaction and be prepared to explain why. Broad provisions are less likely to be considered ancillary to a legitimate transaction.
- **Audit the company's participation in surveys and information exchanges.** If the employer conducts or participates in compensation surveys, take the time to do an audit of how those surveys are drafted, compiled, and used, and seek outside counsel guidance when necessary to confirm that the company's practices do not raise red flags. Similarly, if the employer participates in information exchanges regarding employee compensation, make sure that the exchange has appropriate protections in place (such as the use of older data, management by an independent administrator, data masking and aggregation) to reduce risk of an antitrust violation. Pay attention as well to surveys conducted through trade associations.

Conclusion

The HR Guidance makes clear that restraints between competing buyers in the employment market are fully subject to the antitrust laws, including potential criminal liability. In an environment with increasing employee turnover and difficulties retaining top talent, companies must carefully navigate between business concerns about keeping employee talent and the laws that protect competition for those employees in employment markets. ●

⁶⁸ Some states prevent the reimbursement of certain employer costs. See, e.g., California Labor Code §§ 450, 2802, 2804 (West 2011).

⁶⁹ See, e.g., *USS-Posco Indus. v. Floyd Case*, 197 Cal. Rptr. 3d 791 (Cal. Ct. App. 2016) (enforcing agreement for employer to recoup cost of training); *Hassey v. City of Oakland*, 78 Cal. Rptr. 3d 621 (Cal. Ct. App. 2008) (upholding agreement requiring police officer to repay training costs after leaving position before end of five-year period, but holding that the debt could not be repaid by withholding final paycheck); see also Brandon S. Long, *Protecting Employer Investment in Training: Noncompetes vs. Repayment Agreements*, 54 DUKE L.J. 1295 (2005).

Emerging Issues in Third-Party Litigation Funding: What Antitrust Lawyers Need to Know

Anne Rodgers, Peter Scott, Arnaud Sanz, and D. Michael Brown

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Both antitrust litigation and third-party funding are increasing globally. Indeed, the two phenomena may feed off each other—more funders fund antitrust litigation because there is more of it, and there is more of it because there is more funding. Third-party litigation funding generally means that someone other than a party, the party's counsel, or other entity with a preexisting contractual relationship with the party (like an indemnitor or liability insurer) provides non-recourse funding for a dispute.¹ In its early days, funding involved a third-party investor's providing funds to prosecute a plaintiff's claim (often personal injury) in exchange for a portion of the settlement or judgment proceeds from the case. Today, the increasing prevalence of third-party funding has precipitated a number of related legal developments around the world. It looks like third-party funding is here to stay and we, as antitrust lawyers, need to know more about it.

In this article we discuss the basics of third-party litigation funding and various funding-related regulatory and legal developments. We interviewed a number of third-party litigation funders while preparing the article, and provide their perspectives and insights.² Our focus is on the United States, the European Union, the United Kingdom, and Canada because the funders we interviewed identified those jurisdictions as the most attractive prospects for litigation funding in our interviews (although Canada to a lesser extent).

Why Antitrust Is Appealing to Litigation Funders

Not surprisingly, the funders we interviewed all gave similar answers as to why antitrust cases are attractive. The reasons include:

- The cases are generally brought by experienced and highly specialized legal teams;
- The value of antitrust claims is sufficiently high to attract third-party funding, particularly where a cartel has operated for many years, and sometimes decades;
- The financial viability of a particular action may be improved if plaintiff law firms file class actions or assemble groups of claimants when there are a large number of victims of cartels;
- The claims often follow a decision of a national competition authority, where liability has been established and the dispute comes down to the extent of the claimant's loss;

¹ Am. Bar Ass'n Comm. on Ethics 20/20, Informational Report to the House of Delegates, 1 (2012), http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf.

² We interviewed the following funders on behalf of their organizations: Aviva Will, Managing Director, Burford Capital; Ashley C. Keller, Managing Director, Gerchen Keller Capital, LLC; Stephen O'Dowd, Senior Director of Litigation Funding, Harbour Litigation Funding; and Steven Friel, Chief Investment Officer, and Zachary Krug, Senior Investment Officer, Woodsford Litigation Funding. We also interviewed Selwyn Seidel, chair and CEO of Fulbrook Capital Management, LLC (and co-founder and former chair of Burford). Fulbrook says it occupies a different space, representing claimants and investors worldwide, linking claims with investors. Unless otherwise noted, all quotes from those companies in this article are from their interviews.

- Antitrust claims usually settle before a final judgment, further reducing the downside risks of funding;
- The significant up-front financial commitment and expense of litigating make sharing or shifting risk and expense an attractive proposition; and
- The defendants, importantly, are usually creditworthy.

Harbour Litigation commented that the majority of plaintiffs it funds in antitrust cases are large institutional investors. As a result, it is important to Harbour “to ensure they are seeking a monetary outcome from their case, rather than a more beneficial trading relationship with the defendants (e.g., discounted price list)” because “[w]hile it is possible to value future trading relationship benefits, it is less straightforward than a pure monetary outcome.”

In Europe, several high-profile court actions have been brought by well-known third-party funders that purchase the claims from buyers of the allegedly cartelized goods:

- Belgian firm Cartel Damage Claims (CDC) sought redress in various Member States against manufacturers sanctioned by competition authorities for their participation in price-fixing cartels regarding Hydrogen Peroxide in Germany and Finland, Sodium Chlorate in the Netherlands, Cement in Germany, and Paraffin Wax in the Netherlands;
- Irish firms Claims Funding International (CFI) and Claims Funding Europe (CFE) brought damages claims in the Air Cargo cartel case (Netherlands), and recently announced they would file an action in the Trucks cartel case in the Netherlands;
- East-West Debt, based in Belgium, the Netherlands, and the UK, brought an action for damages in the Elevator cartel case in the Netherlands;
- Dutch firm De Glazenlift also brought an action in the Elevator cartel case in the Netherlands; and
- U.S. firm Gerchen Keller is funding the MasterCard case in the UK.

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The Basics of Third-Party Litigation Funding

Litigation investments are attractive to investors because the returns in one case are largely uncorrelated to other cases, to the stock market, or to other asset classes, which can help diversify a portfolio. They also have the potential to generate large returns, though Gerchen Keller explained that funding-market fees are more akin to the contingency fee market than to venture-capital-style home-run returns.

The industry has grown exponentially in the last decade to fund virtually all types of commercial cases and portfolios of cases where multiple matters are used as collateral to secure capital. Some funders have provided capital for start-up law firms or branch offices of law firms that will be paid back from successful litigation.

The latest development in this area has seen certain funders moving on from funding a discrete claim to repositioning themselves as “financiers,” investing in portfolios of claims, and offering distinctive pricing models on this basis. For parties with adequate resources, litigation finance has evolved into corporate finance—funders can offer a more convenient financing structure, allowing capital that would otherwise be spent on legal fees to be allocated to other areas of their business during the life of the proceedings.

And the funders increasingly find ways to provide funding for defendants as well as plaintiffs. On the defense side, Gerchen Keller provides judgment indemnification to protect against an outsized judgment that could cripple an enterprise. It also sets benchmarks for defense success based on total exposure of a benchmark amount, in essence creating contingency-style incentives where a defendant may pay more in the event of a victory, but would pay only for a victory. An

added attraction to the defendant according to Burford is that a funder can help a defendant “take significant litigation expense off their balance sheets.” Woodsford believes that even without loser-pay rules, defense funding “can be attractive to both the funder and the defendant—similar to insurance, the defendant is able to mitigate a larger downside risk by paying the funder’s comparatively smaller upside.” Other funders would disagree, and suggest defense funding is uncommon because “a defendant has to pay a funder’s charges from its own funds” regardless of the outcome. Certainly, it remains the case that litigation funders are primarily used by claimants.

The nature of the funders is as varied as the funding they provide. Some are publicly traded companies or private firms; some are hedge funds or individuals seeking to invest in individual cases.³ The more traditional funders are considering different business models. Burford recently announced that it has launched a new law firm, Burford Law, using the UK Alternative Business Structure (ABS), which allows non-lawyers to own and invest in law firms.⁴ Woodsford is also considering an ABS for several reasons: first, to avoid the possibility of being “held liable for adverse costs” in the UK (a risk that funders face); second, to allow it “a more direct role in controlling the litigation”; and finally, to “minimize some transaction costs inherent in having both a funder and a law firm dealing with the same issues.” Woodsford acknowledges, however, that those “benefits may be outweighed by the managerial costs of running a full fledged law firm.”

The Pros and Cons of Litigation Funding

Critics of litigation funding point to the need to protect the purity of justice by preventing third parties from manipulating the litigation process. One of the more outspoken opponents—the U.S. Chamber Institute for Legal Reform (ILR), which is an advocacy group of the U.S. Chamber of Commerce—has identified “four negative public policy consequences” of third-party investments in litigation: (1) they can “increase the volume of abusive litigation” because the funders “can hedge any ‘investment’ against their entire portfolio of cases;” (2) they undercut the parties’ and lawyers’ “control over litigation” because the funders can “be expected to try to exert control over . . . strategic decisions;” (3) they can “prolong litigation” by making “reasonable settlement offers less attractive” because of the investor’s “extra demand” on a share of the proceeds; and (4) they “compromise the attorney-client relationship and diminish the professional independence of attorneys by injecting a third-party into disputes.”⁵ These potential consequences, according to the ILR, “represent a clear and present danger to the impartial and efficient administration of civil justice in the United States.”⁶

Proponents of litigation funding tout the industry’s ability to provide access to justice for under-resourced parties, enabling them to pursue proceedings that a lack of financing otherwise would have prevented. Or, as one U.S. court put it after noting that costs inherent in major litigation can be crippling to a plaintiff lacking resources to sustain a long fight, “Creative businessmen, ever

³ In 2015, *The American Lawyer* profiled six of the biggest litigation funding companies. See Julie Triedman, *The Big Players in the Litigation Funding Arena*, AM. LAW., Mar. 4, 2016. One of the more provocative examples of individual funding is Silicon Valley investor Peter Thiel’s funding of Hulk Hogan’s sex-tape lawsuit against Gawker, which resulted in a \$140 million jury verdict and led both Gawker and its founder, Nick Denton, to file for bankruptcy. (The parties subsequently entered into a confidential settlement agreement.)

⁴ Burford explained to us that “Burford Law exists to serve our law firm clients, not compete with them” and that “Burford Law’s current focus is on judgment enforcement matters, working closely with Burford Capital’s growing judgment enforcement business.”

⁵ John H. Beisner & Gary A. Rubin, *Stopping the Sale on Lawsuits: A Proposal to Regulate Third-party Investments in Litigation*, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM 1–2 (Oct. 2012), http://www.instituteforlegalreform.com/uploads/sites/1/TPLE_Solutions.pdf.

⁶ *Id.* at 1.

alert to new opportunities for profit, perceived in this economic inequality a chance to make money and devised what has come to be known as third-party litigation funding, where money is advanced to a plaintiff, and the funder takes an agreed upon cut of the winnings.”⁷

Funding advocates counter critics by noting that funders wanting to stay in business will not risk their investment in frivolous matters.⁸ The English Court of Appeal recently approved the view of a high court judge that funders did not aim “to finance hopeless cases but those with strong merits.”⁹ Additionally, Ashley Keller with Gerchen Keller explained that although funders do not have the same fiduciary duties as a lawyer has to the client, Gerchen Keller structures investments to align incentives, does not take control of a case or change strategy, and ensures that the client remains in the driver’s seat. Woodsford says its “level of involvement varies from case-to-case, depending on the needs and preferences of the claimants, lawyers, as well as the jurisdiction in which a case is pending,” but Woodsford echoed the other funders interviewed in adding that “[u]ltimate decisions regarding settlement and legal strategy are always in the hands of the claimant and lawyer.”

The funding, of course, comes at a cost. If a party is successful, most funders will expect to recoup the sum funded plus a substantial share of the proceeds. But if a party would otherwise be unable to pursue proceedings without funding, recovering a portion of its claim is better than nothing. There can also be significant upfront costs in putting third-party funding in place. A party’s legal team must conduct due diligence on funders and their credit worthiness, secure confidentiality agreements, and then agree to an appropriate funding agreement (the terms of which will vary depending on the parties and the case). Some or all of those costs may be wasted if an offer of funding is not made or where multiple funders have been approached.

Legality of Third-Party Funding

Historically, in many jurisdictions throughout the world, funding arrangements were prohibited by the doctrines of maintenance, champerty, and barratry. Those common law doctrines arose in Medieval Europe to prevent the wealthy from funding legal claims of the poor to attack personal or political enemies. They generally prohibit a third party from assisting in maintaining lawsuits, paying some or all of the litigation costs in return for a share of the proceeds, and stirring up lawsuits and disputes between others. Since the 1990s, however, there has been a general trend, frequently on a case-by-case basis, toward liberalizing or abolishing those doctrines, and considering instead whether the arrangements are contrary to public policy and unenforceable as a result. Some jurisdictions, however, still do not permit third-party funding arrangements.¹⁰

Still, the trend is not uniform and the status of the third-party funding industry remains somewhat in flux. And although third-party funding has been recognized and approved by courts in a number of jurisdictions, there is presently little mandatory regulation of third-party litigation fund-

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⁷ Miller UK Ltd. v. Caterpillar, Inc., 17 F. Supp. 3d 711, 718 (N.D. Ill. 2014).

⁸ Burford described to us the controversy over litigation finance as “a noisy swirl of imagined discord that often overshadows real dialogue about litigation finance, resulting in a false equivalence between a very small but vocal group of critics and the larger majority who support its use.”

⁹ Excalibur v. Texas Keystone Inc. and others [2016] EWCA Civ. 1144, 27 (Nov. 18, 2016).

¹⁰ For example, in Canada, third-party funding arrangements with contingency-based returns were thought to be prohibited under the common law doctrines of maintenance and champerty. See Dugal v. Manulife Fin. Corp., 2011 ONSC 1785, para 18, additional reasons 2011 ONSC 3147. Courts in Canada, however, now take the position that third-party funding is not champertous per se, but may be champertous if there is an improper motive. See, e.g., Metzler Inv. GmbH v. Gildan Activewear Inc., [2009] OJ No. 3315 (S.C.), para 63.

ing in most parts of the world. What little regulation there is reflects the differences in the political and legal systems in the various jurisdictions.

United States. The New York City Bar Association issued a formal opinion in 2011 addressing ethical issues that may arise when a lawyer represents a client who has entered into a non-recourse litigation financing agreement. The opinion identified two potential legal barriers. First, it advised that “lawyers should be aware that in certain circumstances, courts have found that non-recourse litigation financing agreements violate usury laws,” even where the financing companies “characterize non-recourse financing arrangements as a ‘purchase’ or ‘assignment of the anticipated proceeds of the lawsuit (and therefore not subject to usury laws).”¹¹ Second, the opinion advised lawyers to be mindful that although no New York courts appear to have found non-recourse funding arrangements unlawful under New York law, “courts in other jurisdictions have invalidated certain financing arrangements under applicable champerty laws.”¹²

More recently, New York’s highest court found a funding agreement champertous under a New York statute that “prohibits the purchase of notes, securities, or other instruments or claims with the intent and for the primary purpose of bringing a lawsuit,” despite a safe harbor that exists when the aggregate purchase price of the notes or other securities is at least \$500,000.¹³ The funder in that case, Justinian Capital, had taken an assignment of notes that had declined in value for a purchase price of \$1 million. The very essence of the assignment was to bring suit against the issuer of the notes. The court did not hesitate in finding the agreement champertous under New York’s statute. The court also found that the safe harbor did not apply because Justinian had not actually paid any portion of the purchase price and had no binding or bona fide obligation to pay it independent of the outcome of the lawsuit.¹⁴ The court described the agreement as a sham transaction between the owner of a claim that did not want to bring it and an undercapitalized assignee that did not want to assume the \$500,000 risk to qualify for the safe harbor.¹⁵

Although the decision involves a relatively narrow statutory provision not likely to apply in antitrust cases, it may have broader ramifications. In a press release immediately following the decision, Burford announced that it “reaffirms New York’s support of significant litigation finance,” and noted that the dissenting judge “would go even further and laud the role of litigation financiers as ‘fostering accountability in commercial dealings.’” Burford commented that “the narrow facts” that lead to a champerty finding in that case takes “nothing away from the broad endorsement of substantial litigation finance transactions by New York’s highest court.”¹⁶

A federal court in Illinois rejected a defense that a funding agreement was prohibited by an Illinois criminal statute prohibiting champerty and maintenance, aptly observing that “over the centuries, maintenance and champerty have been narrowed to a filament.”¹⁷ The court noted that “the

¹¹ The Ass’n of the Bar of the City of New York Comm. on Prof’l and Judicial Ethics, Formal Op. 2011-12 (June 2011), 2011 WL 6958790, at *2 [hereinafter NYC Ethics Opinion].

¹² *Id.* at *3.

¹³ Justinian Capital SPC v. WestLB AG, 2016 N.Y. Slip Op. 07047, 2016 WL 6270071, at *1 (NY Oct. 27, 2016).

¹⁴ *Id.* at *4.

¹⁵ *Id.* Along those lines, Woodsford noted that a well-regarded law firm’s “willingness to have some significant skin in the game is one meaningful indicator” of the probability of a claim’s success.

¹⁶ Press Release, Burford Capital, *New York Court of Appeals Affirms Burford-style litigation finance Transactions*, <http://www.burfordcapital.com/blog/new-york-court-appeals-affirms-burford-style-litigation-finance-transactions/>.

¹⁷ Miller UK Ltd., 17 F. Supp. 3d at 727.

few state courts that have held funding agreements champertous under their state statutes have only done so in the context of a suit by the parties to the contract seeking their enforcement.”¹⁸

A Delaware court considered litigation funding in deciding a motion to dismiss, and provided guidance regarding how to properly structure a litigation finance agreement.¹⁹ Specifically, the court suggested that a third-party litigation finance agreement could avoid champerty and maintenance claims where: (1) the agreement does not assign ownership of the legal claim to the funder; (2) the funder does not have any right to direct or control the litigation; and (3) the party bringing the claim retains the total and “unfettered” right to settle the litigation at any time and for any amount.²⁰

Legislation regulating the litigation finance industry in the U.S. is currently relegated to the states, some of which have been active recently in regulating consumer litigation finance.²¹ The ILR believes state regulation is not sufficient, and has advocated that federal regulation of the industry is essential. Its call has yet to succeed, but apparently has piqued some interest in the U.S. Senate. In 2015, Senate Judiciary Committee Chairman Chuck Grassley (R. Iowa) and Senate Majority Whip John Cornyn (R. Texas) expressed a concern that “[t]hird party litigation financing pumps millions of dollars into our justice system, and the current lack of oversight makes it difficult to track this money’s influence on the actions of litigants and the outcomes of litigation.”²²

Hoping to gain “insight into where this money is going” and to enable them to “craft effective protection to keep the civil justice system honorable and fair,” Senators Grassley and Cornyn sent letters to Burford Capital, Bentham IMF, and Juridica Investments Ltd. asking for “details regarding the cases they finance, the structure and terms of the agreements they’ve entered into and their returns on investment” as well as “information on firms’ general practices, such as whether the court or interested parties are made aware of any third-party agreement.”²³ To date, that inquiry has not resulted in legislation at the federal level.

Selvyn Seidel with Fulbrook acknowledges that “[m]any deep and opposing opinions are held” on the subject of regulating third-party litigation funding, but is pro-regulation as long as it is sensible. That can be achieved, he believes if “the industry, the market, the regulators, and the defendant community should, ideally, join hands to improve the situation.”²⁴

Europe. In much of Europe (outside of the UK), where class actions are more limited, the majority of third-party funders have adopted a business model of purchasing the claims from the victims. Under this model, which technically may not be considered financing, the funder acts in

¹⁸ *Id.* at 726 (citations omitted).

¹⁹ *Charge Injection Tech., Inc. v. E.I. DuPont de Nemours & Co.*, No. N07C-12-134, 2016 WL 937400 (Del. Super. Ct. Mar. 9, 2016). The motion involved a financing agreement with a subsidiary of Burford.

²⁰ *Id.* at *45.

²¹ For example in 2016, Indiana passed a consumer protection law that regulates loans made to consumer claimants. H.R. 1127, 119th Gen. Assemb., Second Reg. Sess. (Ind. 2016). Vermont and Arkansas also recently passed laws regulating the consumer litigation finance industry. *See* Vt. Stat. Ann. tit. 8, § 2251 et seq.; Ark. Code Ann. § 4-57-109 et seq. And in 2015, the Colorado Supreme Court ruled that consumer litigation funders who offer cash advances to plaintiffs in personal injury cases are making loans that are subject to payday lending rules. *Oasis Legal Fin. Group, LLC v. Coffman*, 361 P.3d 400 (Colo. 2015).

²² *See* Press Release, Grassley, Cornyn Seek Details on Obscure Third Party Litigation Financing Agreements (Aug. 27, 2015), <http://www.grassley.senate.gov/news/news-releases/grassley-cornyn-seek-details-obscure-third-party-litigation-financing-agreements>.

²³ *Id.* The letters, which are reprinted in full on Senator Grassley’s website, inquire into matters either being litigated or arbitrated in the United States.

²⁴ *See* Selvyn Seidel, *Fulbrook Primer on Third Party Dispute Finance* 49 (2016), <http://www.fulbrookmanagement.com/fulbrook-primer-on-third-party-dispute-finance/>.

its own name and on its own account (e.g., CDC, CFI/CFE). Though this model has been accepted in various Member States,²⁵ it is yet to be tested in others where the courts may be more timorous in the absence of a legal framework.

Indeed, after CFI's litigation vehicle, Equilib, brought a claim in the Netherlands against Air France, KLM, and Martinair, the three airlines brought a preemptory defensive action in French court to stave off a damages claim by Equilib in the Air Cargo cartel case.²⁶ The airlines argued that, according to French law, the very existence of Equilib should be deemed illegal as it was allegedly a fictitious company with unlawful purpose and cause. The French court rejected the airlines' action in 2012 for procedural reasons without reaching the merits and, in the end, Equilib never sued the airlines in France.

To date, no third-party funder has filed a cartel case for damages in France. The only local funder, Alter Litigation (which has not registered its company in France but in the UK), has remained inactive so far.

The most aggressive stance on third-party funding in Europe has been taken in the High Court of Ireland, which ruled in February 2016 that third-party funding of litigation is illegal even though the defense in that case argued that the claim could not have been prosecuted without third-party support.²⁷ This decision is to be appealed directly to the Irish Supreme Court and so it remains to be seen whether the decision will be upheld.

On the regulatory front, the EU is not authorized to regulate third-party funding generally; that responsibility lies with individual Member States. The European Commission nevertheless issued a non-binding recommendation in June 2013, which provides two sets of principles on third-party funding in antitrust class actions that can usefully guide national courts of the Member States.²⁸ First, the Commission encourages national courts to stay third-party funded proceedings where:

- (1) there is a conflict of interest between the third-party funder and the claimant party and its members;²⁹
- (2) the third-party funder has insufficient resources to meet its financial commitments to the claimant party initiating the collective redress procedure; or
- (3) the claimant party has insufficient resources to meet any adverse costs should the collective redress procedure fail.³⁰

Second, the Commission invites EU Member States to forbid third-party funders to:

- (1) influence procedural decisions of the claimant party, including on settlements;
- (2) provide financing for a collective action against a defendant who is a competitor of the fund provider, or against a defendant on whom the fund provider is dependent; or
- (3) charge excessive interest on the funds provided.³¹

²⁵ E.g., Germany, the Netherlands, and the UK.

²⁶ *Air France v. Equilib*, Paris Commercial Court, Jan. 31, 2012 (RG 2011030421).

²⁷ *Persona Digital Telephony Ltd & anor v. The Minister for Public Enterprise & ors* [2016] IEHC 187.

²⁸ European Comm'n, *Recommendation on Common Principles for Injunctive and Compensatory Collective Redress Mechanisms in the Member States Concerning Violations of Rights Granted Under Union Law*, 2013 O.J. (L 201) 60 (June 11, 2013), <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013H0396&from=EN>.

²⁹ The NYC Ethics Opinion identified a number of potential conflicts of interest that may arise in connection with referring a client to a litigation finance company, advising a client about financing, and extending financing to a client the lawyer represents in litigation. NYC Ethics Opinion, *supra* note 11, at *3.

³⁰ *Id.* ¶ 15.

³¹ *Id.* ¶ 16.

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funding generally;
that responsibility
lies with individual
Member States.*

It is yet to be seen if these principles will be adopted at the national level in the Member States.

In France, the national bar association has recently recommended the adoption of new legislation that would incorporate the European Commission's recommendations in the French Civil Code.³² The proposed reform may be decisive in the development of third-party funding there.

Many Member States, however, still lack a regulatory framework for third-party funding, including countries where it has been developing in practice (e.g., Germany).

In England and Wales, there has been a significant increase in third-party funded claims alleging a breach of competition law over the last decade. That can be attributed to various features of the English legal system that make it an attractive jurisdiction for bringing those claims (e.g., the ease with which claims can be issued, the permissive approach taken by the English courts to the rules that govern jurisdiction, wide and early disclosure of documents, and costs rules). Part of England's attraction, however, stems from the innovative fee arrangements that have been offered to potential claimants, including law firms offering "no-win, no or less-fee" conditional fee arrangements or "damages-based agreements" (the UK's equivalent of contingency fee agreements). When these fee arrangements are coupled with third-party funding, as well as after-the-event costs insurance, this can enable claimants to bring claims on effectively a "risk-free" basis. As Gerchen Keller noted, the defendants are the ones who should be worried about loser pay rules.

There is no binding funding regulatory regime in England. Instead, a voluntary Code of Conduct for Litigation Funders has been in existence since 2011 and covers capital adequacy requirements for funders as well as rights to terminate or control proceedings.³³ The Association of Litigation Funders is the body responsible for overseeing this self-regulation. Currently, however, only seven funders are members of that association, leaving a large proportion unregulated.³⁴ This poses real questions over the viability of self-regulation.

Canada. Third-party litigation funding is a relatively recent development in Canada. Other than class action and personal injury contexts, third-party funding of private litigation is still quite limited. Third-party funding arrangements in Canada will not be approved if they facilitate "officious intermeddling" by the third party.³⁵ Agreements should acknowledge that the plaintiffs instruct counsel and that counsel's duties are to the plaintiffs.³⁶ Agreements that allow the funder to attend settlement discussions and unilaterally withdraw from the litigation on short notice have been noted as improper.³⁷

Current Issues in Third-Party Funding

In addition to the ongoing debate as to what third-party funding is legal, to what extent, and under what general regulatory regime, there are some particular issues that courts are wrestling with. In each area, there are divergences of approach around the world, and the varying court-led approaches suggest that third-party litigation funding could benefit from a degree of regulation.

³² Conseil National des Barreaux, *Final Report on Third Party Funding* (Nov. 20–21, 2015).

³³ See <http://associationoflitigationfunders.com/code-of-conduct/>.

³⁴ *Id.* The seven member-funders are Burford Capital, Calunius Capital LLP, Harbour Litigation Funding Ltd., Redress Solutions PLC, Therium Capital Management Ltd., Vannin Capital PCC, and Woodsford Litigation Funding Ltd.

³⁵ *Metzler*, [2009] OJ No. 3315 (S.C.), para 60.

³⁶ *Dugal*, 2011 ONSC 1785, paras 6 and 33(c).

³⁷ *Metzler*, [2009] OJ No. 3315 (S.C.), paras 58 and 60.

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Class Actions. The primary issue relating to funding that has arisen in U.S. class actions is whether funding agreements and related documents may be relevant to class certification issues and should therefore be disclosed in discovery. For example, the court in *Kaplan v. S.A.C. Capital Advisors, L.P.*, declined to compel the production of funding documents because they were irrelevant to the case, despite a challenge to alleged adequacy of class counsel's financial resources.³⁸ But at least one case has held to the contrary. The court in *Gbarabe v. Chevron Corp.*³⁹ compelled a class action plaintiff to produce a confidential litigation funding agreement because it was relevant to determining the adequacy of class counsel who, according to the pleadings in the case, had no formal office or support staff and had missed deadlines due to lack of resources. However, *Gbarabe* may be an outlier because the plaintiff conceded two of the strongest arguments against producing third-party funding information—relevance and privilege. In addition, the confidentiality provision in the funding agreement explicitly allowed for production in case of a court order.

Although the U.S. has had class actions for more than 50 years, they are still in their relative infancy in other parts of the world. England and Wales have moved faster and further than the rest of the EU in relation to the availability of antitrust class action damages claims. Following the adoption of Chapter 2 of Part 3 of the Consumer Rights Act 2015 in England and Wales, it is now possible—for antitrust actions only—to claim on an “opt-out” basis, rather than an opt-in basis in which each member of the class has to expressly choose to join the class. There are currently two pending antitrust class action claims. One, in relation to mobility scooters,⁴⁰ does not feature third-party litigation funding. Instead, the lawyers involved are working on the basis of a conditional fee arrangement, and after-the-event insurance is in place to cover any costs payable to the defendant if the claim is unsuccessful.

The second antitrust class action claim is the well-publicized £14 billion claim issued in September 2016 by Walter Merricks, as a representative acting on behalf of 46 million consumers in the UK, against MasterCard in relation to interchange fees. This class action claim is being funded by Gerchen Keller, which has publicly stated that it is putting up to £40 million behind the claim. Gerchen Keller is not part of the Association of Litigation Funding, and so not bound by its Code of Conduct. In light of past practice, the English court will most likely enquire into the nature of the funding arrangement, and in particular, any impact it would have on the likelihood of settlement. Notably, Lord Justice Jackson had anticipated that all third-party funders would adhere to the voluntary code.⁴¹

In Canada, third-party funding is far more common in class actions than in other cases, primarily because of the availability of both private and public third-party funding in class cases. In some provinces, funding is available in class action cases through public funds or, more recently, through a court-approved private third-party funding arrangement. Public funding for class

³⁸ No. 12-CV-9350, 2015 WL 5730101, at *3–5 (S.D.N.Y. Sept. 10, 2015); see also *Miller UK Ltd.*, 17 F. Supp. 3d at 728 (after rejecting a defense of maintenance and champerty, holding that the “deal documents” evidencing the structure and terms of the financing transaction, were no longer relevant to the case.).

³⁹ 14-CV-00173, 2016 WL 4154849 (N.D. Cal. Aug. 5, 2016).

⁴⁰ *Gibson v. Pride Mobility Prods. Ltd.*, CAT Case No. 1257/7/7/16.

⁴¹ Review of Civil Litigation Costs: Final Report ¶ 2.4 (2009), <https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf>.

actions has been available in Ontario and Quebec for many years.⁴² Applications for public funding are rarely opposed by defendants.⁴³

Public funding in Canada has been provided in at least one antitrust class action. The claim there was based on alleged vertical price-fixing in the automotive resins market. The case settled and the Fund was awarded 10 percent of the net proceeds of the settlement claims process, as much as CDN\$1.1 million depending on the take-up rate on the settlement.⁴⁴

In English litigation, the

Court of Appeal recently

confirmed that a

third-party funder of

an unsuccessful litigant

may be liable to

contribute toward the

successful litigant's

costs, even on an

indemnity basis,

though currently that

contribution is limited

to the amount of

funding provided.

Private third-party funding arrangements in class actions in Canada must be approved by the court.⁴⁵ Recent cases have held that approval must be obtained before class certification, and the funding arrangement must be “promptly disclosed” to the court.⁴⁶ At least nine third-party funding arrangements have been approved, including four in Ontario. Courts, however, have held that the commission payable should be reasonable and consistent with the commission (10 percent) that would be payable to the Fund.⁴⁷ The commission received by the third party typically ranges between 5 percent and 10 percent in cases where the arrangement received court approval.

Costs Recovery. Costs recovery is another emerging issue. In English litigation, the Court of Appeal recently confirmed that a third-party funder of an unsuccessful litigant may be liable to contribute toward the successful litigant's costs, even on an indemnity basis,⁴⁸ though currently that contribution is limited to the amount of funding provided.⁴⁹ In contrast, an arbitration tribunal may not have jurisdiction to make a costs award against a funder, given that it is unlikely to be a party to the arbitration agreement.

The English High Court has also recently upheld a decision of an arbitrator who awarded the successful party not only its legal costs of the arbitration on an indemnity basis, but also its costs of obtaining third-party funding (i.e., 300 percent of the amount advanced or 35 percent of the damages awarded, whichever is the higher)—this amounted to an additional costs award of £1.9 million.⁵⁰

⁴² The Quebec Legislature created the Fonds d'aide aux recours collectifs (the Fonds), which provides financial support for counsel fees, notices to class members, costs, and disbursements. See An Act Respecting the Fonds d'aide aux actions collectives, CQLR c F-3.2.0.1.1, s. 29, https://releve.canlii.org/en/qc/laws/stat/cqlr-c-f-3.2.0.1.1/latest/cqlr-c-f-3.2.0.1.1.html#sec2_smooth. More than one third of the 776 applications for funding from the Fonds in the past decade have been successful. The Fonds is supported by provincial subsidies and recoveries made under legislation permitting the Fonds to recover a percentage of any amount awarded to class members in a Quebec class action on settlement or judgment, regardless whether they were supported by the Fonds. In Ontario, the legislature created the Class Proceedings Fund (the Fund) to provide financial support for disbursements and adverse costs awards. Law Society Act, RSO 1990, c. L.8, s 59.1, <https://www.ontario.ca/laws/statute/90l08>. The Class Proceedings Committee determines whether to fund a case by considering the merits of the case, fund raising efforts, use and control of funds, public interest, the likelihood of certification, and the amount of funding required. In return, the Fund may recover a 10 percent levy on any monetary award or settlement in the funded class action in addition to repayment of all amounts provided to the plaintiff. In 2014, the Fund provided \$1,329,046 in funding and approved 11 new applications.

⁴³ In *Stewart v. General Motors of Canada Ltd.*, [2008] OJ No. 4426 (S.C.), the defendant was prepared to oppose an application to the Fund, but the application was adjourned and later abandoned once a settlement was concluded.

⁴⁴ See *Axiom Plastics Inc. v. E.I. du Pont Canada Co.*, 2013 ONSC 2675.

⁴⁵ *Fehr v. Sun Life Assurance Co. of Canada*, 2012 ONSC 2715, para 90.

⁴⁶ *Id.* para 89.

⁴⁷ *Dugal*, 2011 ONSC 1785, para 33(d).

⁴⁸ When costs are assessed on the indemnity basis, any doubt as to the reasonableness of costs incurred is resolved in favor of the receiving party. This is the opposite of the approach from when costs are assessed on the standard basis.

⁴⁹ *Excalibur* [2016] EWCA Civ. 1144.

⁵⁰ *Essar Oilfields Serv. Ltd. v. Norscot Rig Mgmt. PVT Ltd.* [2016] EWHC 2361 (Comm).

This is the first time an English Court has considered a tribunal's power to award the costs of third-party funding. The outcome contrasts with the position in English litigation, where these costs are considered not to be recoverable.⁵¹ This decision is clearly good news for funded parties. The practical effect of prohibiting recovery of costs of third-party funding has meant that a funded party, if successful, will inevitably be out of pocket for the third-party funder's (often significant) fee.

But the decision raises serious concerns for parties facing a third-party funded opponent. There is generally no obligation in arbitration to disclose the existence of third-party funding arrangements, let alone the detailed terms of such funding. In many instances, parties might not even know that they are at risk of facing a very significantly inflated adverse costs award if they lose. Moreover, parties facing a third-party funded opponent encounter difficulties even if they win. If the third-party funded opponent is impecunious, a successful party is unlikely to be able to recover its costs from that party.

It is not clear whether the *Essar* decision represents the orthodoxy and the (new) rule or is simply an unusual exception and exercise of discretion due to the extreme facts of the case, where the arbitrator had been highly critical of the paying party's conduct. Either way it is increasingly likely that parties to London-seated arbitrations will now look to recover assorted other costs.

Proof of Ability to Fund. A number of actions in the EU have been dismissed because a litigation funder may not be able to fund the litigation. In the Cement case in Germany, CDC lost its lawsuit against cement manufacturers in 2013 because CDC, then acting as claimant, did not have sufficient funds to cover the litigation costs at the time the claims were assigned by victims of the cartel, although it was able to do so at a later stage when its action was dismissed by the lower court.⁵² Two years after learning that lesson, CDC provided security of \$2.5 million to the benefit of the defendant and the court cashier in a new claim it brought against HeidelbergCement in September 2015.⁵³

But challenging the funder's financial standing is not necessarily an easy card to play for alleged cartelists defending against damages actions. For instance, a court in The Hague (Netherlands) sided with CDC in 2014 in the Paraffin Wax case where the wax manufacturers had failed to demonstrate that "at the time of assignment, CDC would not be able to cover any order regarding the costs of proceedings."⁵⁴ According to the judges, it was not enough to refer to the fund's financial standing, the defendants should have put forward "more facts and circumstances" to argue that the fund would not be able to pay the costs.⁵⁵

The Ontario courts in Canada grappled with the ability of a third-party funder to provide sufficient financing.⁵⁶ The funding agreement in that case indemnified the plaintiff against exposure to adverse costs in return for a 7 percent share of the proceeds of any recovery subject to certain

⁵¹ The definition of "costs" in the Civil Procedure Rules is narrower than section 59 of the Arbitration Act which refers to "legal *or other* costs of the parties" (emphasis added). In similar vein, since April 2013, after-the-event insurance premiums and the success fee on a conditional fee agreement have ceased to be recoverable from the other side in litigation before the English courts.

⁵² Landgericht Düsseldorf, December 2013, 17 (37 O 200/09 (Kart) U, NZKart 2014, 75). Confirmed by the Düsseldorf Court of Appeals: Oberlandesgericht Düsseldorf, February 2015, 18 (VI-U (Kart) 3/14, NZKart 2015, 201).

⁵³ *CDC Files Cartel Damages Suit Against HeidelbergCement in Germany*, MLEX, Oct. 2015, at 29. Other funds have had to close down for failing to find investors, like Talionis after it tried to bring a damages claim against the Paper cartel in Germany in 2010.

⁵⁴ District Court of The Hague, December 2014, 17 (C/09/414499/HA ZA 12-293).

⁵⁵ *Id.*

⁵⁶ *Dugal*, 2011 ONSC 1785, para 33(d).

Recent U.S. case law shows a trend toward finding that the information shared during litigation finance negotiations is protected by the attorney work product privilege.

maximum amounts.⁵⁷ The funder had no assets in Canada. As a condition of approving the funding arrangement, the court required that the funder post security for the defendants' legal costs.⁵⁸

Confidentiality and Privileges. Recent U.S. case law shows a trend toward finding that the information shared during litigation finance negotiations is protected by the attorney work product privilege.⁵⁹ For instance, in *Carlyle Investment Management L.L.C. v. Moonmouth Company S.A.*, the Delaware Court of Chancery recently found that communications exchanged between a litigation funder and a claimant or the claimant's attorney are protected from discovery under the work product doctrine because the negotiations involved the exchange of documents that included "lawyers' mental impressions, theories, and strategies," the documents were only prepared because of the litigation, and "the terms of the final agreement—such as the financing premium or acceptable settlement conditions—could reflect an analysis of the merits of the case."⁶⁰ The court noted that only a handful of American courts have addressed the issue, four of which found communications with the third-party funder were privileged and one of which did not.⁶¹

The disclosure of the existence and terms of funding is also currently a contentious issue in the U.S. The ILR and other groups have advocated amending Rule 26(a) of the Federal Rules of Civil Procedure to require the disclosure of third-party litigation funding at the outset of a lawsuit.⁶² The funding industry has (so far, successfully) argued against a mandatory disclosure requirement.⁶³ Fulbrook, however, believes it can be helpful to disclose that a case has funding; disclosure can reduce satellite litigation (at least over disclosure issues), and the defense strategy may change when they know the plaintiffs have staying power.

In Canada, there are conflicting decisions among the superior courts of different Canadian provinces regarding the confidentiality or privilege attaching to third-party funding arrangements. In Ontario, the terms of the arrangement have been found not to be privileged. In Ontario, a motion to approve third-party funding must be made on notice to the defendant, and the motion should be open to the public.⁶⁴ In Alberta, Saskatchewan, and Nova Scotia, motions for third-party funding have been made ex parte, subject to a sealing order and without published reasons.⁶⁵

One court has provided guidance on privilege and confidentiality concerns arising from third-party funding arrangements, holding that defendants are normally entitled to participate in

⁵⁷ *Id.* para 6.

⁵⁸ *Id.* para 3.

⁵⁹ No. CV. 7841, 2015 WL 778846 (Del. Ch. Feb. 24, 2015).

⁶⁰ *Id.* at *9.

⁶¹ *Id.* at *7 n.48 (citing *Doe v. Soc'y of Missionaries of Sacred Heart*, 2014 WL 1715376, at *3–4 (N.D. Ill. May 1, 2014) (finding work product protection); *Miller UK Ltd.*, 17 F. Supp. 3d at 731–39 (finding work product protection, but rejecting common-interest doctrine and finding sharing documents with prospective funders waived attorney-client privilege); *Devon IT, Inc. v. IBM Corp.*, 2012 WL 4748160, at *1 (E.D. Pa. Sept. 27, 2012) (finding common interest and work product protection); *Mondis Tech., Ltd. v. LG Elecs., Inc.*, 2011 WL 1714304, at *2–3 (E.D. Tex. May 4, 2011) (finding privilege); *Leader Techs., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373, 376–77 (D. Del. 2010) (rejecting both common interest and work product protection)).

⁶² Press Release, U.S. Chamber Institute for Legal Reform, TPLF Transparency: A Proposed Amendment to the Federal Rules of Civil Procedure (July 6, 2014), <http://www.instituteforlegalreform.com/resource/tplf-transparency-a-proposed-amendment-to-the-federal-rules-of-civil-procedure>.

⁶³ See Response of Gerchen Keller Capital, LLC, Burford Capital LLC, and Benthams IMF to Proposed Amendment to Fed. R. Civ. P. 26(a)(1)(A) (Oct. 21, 2014), <http://www.uscourts.gov/file/17644/download>.

⁶⁴ *Fehr*, 2012 ONSC 2715, paras 103–112, 139–142, and 154–158.

⁶⁵ *Schneider v. Royal Crown Gold Reserve Inc.*, 2016 SKQB 278; *Stanway v. Wyeth Canada Inc.*, 2013 BCSC 1585, para 16.

motions for third-party funding because their interests are affected,⁶⁶ no privilege attaches to the terms of a third-party funding arrangement,⁶⁷ and the open court principle requires the motion for third-party funding to be open to the public.⁶⁸

Forum Shopping. Due to the lack of harmonization of legal systems in the EU, third-party funders tend to be expert forum shoppers when seeking to sue cartelists. Selecting the right jurisdiction may very well be the key for success in many situations, and the EU offers significant advantages in terms of forum shopping. The main advantage is probably the ability to sue all the cartel members in the same jurisdiction, relying on an anchor defendant which has its registered office in this jurisdiction.⁶⁹ This anchor defendant does not even need to remain in the proceedings until the end. In 2015, in a landmark judgement in the Hydrogen Peroxide case, the European Court of Justice (ECJ) has confirmed that CDC had validly sued all the defendants in Germany because one of them (Evonik Degussa) had its seat in Germany, even though CDC settled with Evonik Degussa at a later stage.⁷⁰ The ECJ stated that jurisdiction could only have been challenged if there had been firm evidence that the claimant had colluded with the anchor defendant to choose the court, at the time the proceedings were brought, which was not the case here.⁷¹

Another advantage, which has also been confirmed by the ECJ in the above judgment, is that jurisdiction clauses (often included in supply agreements) are generally found inapplicable to damages claims resulting from a cartel infringement, unless they explicitly covered such disputes and were clearly accepted by the victim—which is rarely (if ever) the case.⁷² For third-party funders, forum shopping will continue to be influenced by the favorability of national regimes to their funding arrangements.

Conclusion

Third-party litigation funding not only appears to be here to stay, it is a global growth industry. Despite its high costs and often protracted proceedings, the potential payouts of antitrust litigation make it a prime value proposition for well-capitalized funders. However, a key driver of litigation funder growth (in antitrust and other cases) will be the evolution of the regulatory environment. Funders may wish to operate in jurisdictions where rules on disclosure, privilege, and costs recovery are favorable. But the ease of bringing an antitrust claim, and the damages available to successful claimants, will likely still be a paramount consideration in the choice of jurisdiction. Among this complex matrix of choices, it may be in the funders' interests that rules on third-party funding are codified, so that jurisdictions can converge to a clear, global best practice standard. Until then, issues concerning the propriety of the many permutations of litigation funding, the variety of business models, and the underlying theoretical concerns will continue to percolate through the courts around the world. ●

See update on next page.

⁶⁶ *Fehr*, 2012 ONSC 2715, para 108.

⁶⁷ *Id.* para 141.

⁶⁸ *Id.* para 158.

⁶⁹ Article 6(1) EC Regulation 44/2001.

⁷⁰ Case C-352/13, CDC Hydrogen Peroxide SA v. Evonik Degussa GmbH, 2015 (Eur. Ct. Justice).

⁷¹ *Id.* ¶ 29.

⁷² *Id.* ¶¶ 57–72.

UPDATE: As this article went to press, Burford announced that it has entered into an agreement to acquire Gerchen Keller for \$160 million and a further potential performance-based \$15 million. See Press Release, Burford Capital Adds Scale and Significant Private Capital Management Business Through Acquisition of Gerchen Keller Capital (Dec. 14, 2016), <http://www.burfordcapital.com/newsroom/burford-capital-announces-gerchen-keller-capital-acquisition/>.

Biosimilars Enter the Courts: How Will Patent Infringement Settlements Be Tested for Validity Under Antitrust Laws?

Kirke M. Hasson and Maria Salgado

In the 30 years since the advent of generic drugs under the Hatch-Waxman Act, certain patterns of litigation and settlements have developed. We are now entering a stage where the courts are starting to deal with the entry into the market of “biosimilars”—biologic drugs that are highly similar to or interchangeable with biologic drugs that have already been approved by the FDA (“biologic reference products”). This relationship bears a number of similarities to the one between generics and branded drugs. However, the statutory procedures for, and economics applicable to, the advent of biosimilar products suggest there will potentially be some differences in the antitrust analysis of settlements between biologics and biosimilars for validity, as compared to the settlements between branded and generic drugs.

The Biologics Price Competition and Innovation Act of 2009 (BPCIA) established an abbreviated pathway for the FDA to use in approving biosimilars. In our analysis we have concluded that the differences in the relationship between biologics and the BPCIA, as compared to that of generic drugs and the Hatch-Waxman Act, may lead to different considerations when settlements between biologics and biosimilars are analyzed under the antitrust laws to determine whether they are unlawful anticompetitive agreements. In particular:

- (1) We may observe more frequent “at-risk” launches of biosimilar products, and any anti-competitive impact of reverse payments involving biologics may be less and more difficult to calculate;
- (2) The threshold for considering whether a payment is “large” under Actavis will likely be higher for biologics. Thus, it may be more difficult to find a reverse payment to be “large” in biologics because it will need to surpass a higher threshold;
- (3) It may not be profitable for biologic companies to launch brand-authorized biosimilars. As a result, reverse payment settlements with a promise not to launch a brand-authorized biosimilar may be viewed as less anticompetitive than with small-molecule drugs; and
- (4) Reverse payment settlements involving biologics will likely have early entry provisions (allowing the biosimilar to enter the market before patent expiration), similar to what is observed in Hatch-Waxman cases.

Key Legal Procedures Under Hatch-Waxman

The Drug Price Competition and Patent Term Restoration Act of 1984, known as the Hatch-Waxman Act, greatly simplified the process of obtaining FDA approval for a generic drug by allowing a generic company to file an Abbreviated New Drug Application (ANDA) to show that the

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generic drug is bioequivalent to the reference branded drug. This greatly reduced the costs of developing a generic, which have been estimated to be \$2–\$5 million.¹

Biologics were excluded from the Hatch-Waxman Act—except for insulin and hGH, which are regulated as drugs—because, as late as 2004, the FDA was expressing uncertainty whether available science allowed a determination of sameness of the proposed biosimilar.² Moreover, it was known that biosimilars could not be shown to be structurally identical to their biologic reference products, so guidelines for demonstrating biosimilarity needed to be developed.³

Regulatory Procedures Under the BPCIA as Compared to Hatch-Waxman

Certain features of the BPCIA may call for a somewhat different analysis of the patterns of settlements between biosimilar and biologic companies, and of the reasonableness of such settlements. These features may be summarized as:

- (1) **Lack of interchangeability for biosimilars:** The BPCIA created a distinction between biosimilars and interchangeable products. The FDA has stated that it will issue draft guidelines on the requirements for interchangeability for biosimilars by the end of 2016,⁴ but these requirements will likely be much higher than for biosimilarity alone.⁵ As a consequence, it could be some time until interchangeable products enter the market.⁶
- (2) **Exclusivity period for biologics:** The reference biologic is provided a 12-year period of exclusivity⁷ running from the date its product was first licensed,⁸ and this period does not depend on the existence of any patent or trade secret.⁹

¹ Henry G. Grabowski, Rahul Guha & Maria Salgado, *Regulatory and Cost Barriers Are Likely to Limit Biosimilar Development and Expected Savings in the Near Future*, 33 HEALTH AFF. 1048, 1050 (2014).

² For a small-molecule drug covered by a composition-of-matter patent, the chemical composition of the drug was, by definition, disclosed in the patent, and a proposed generic could be compared directly to the branded product. Biologics, however, were not necessarily comparable in this way. It was noted that the characteristics of a biologic pharmaceutical product were not always determinable from the finished product and that instead “the manufacturing process is unique to each biologic and is not generally disclosed as part of the published patent.” 155 CONG. REC. E688 (daily ed. Mar. 17, 2009) (remarks of Rep. Eshoo). Or, as some in the industry have put it, “the process is the product.” Accordingly, the intellectual property protection could involve a combination of narrowly drawn product composition disclosed in a patent with confidential trade secrets relating to the manufacturing process. See also *The Law of Biologic Medicine: Hearing Before the S. Comm. on the Judiciary*, 108th Cong. 9–10 (2004) (statement of Lester Crawford, Acting Commissioner, Food and Drug Administration).

³ Henry G. Grabowski, Genia Long & Richard Mortimer, *Implementation of the Biosimilar Pathway: Economic and Policy Issues*, 41 SETON HALL L. REV. 511, 512–13 (2011).

⁴ *FDA to Issue Draft Guidance on Interchangeability by End of Year*, BIG MOLECULE WATCH (Oct. 26, 2016), <http://www.bigmoleculewatch.com/2016/10/26/fda-to-issue-draft-guidance-on-interchangeability-by-end-of-year/>.

⁵ Steven Kozlowski et al., *Developing the Nation's Biosimilars Program*, 365 NEW ENG. J. MED. 385, 385–88 (2011).

⁶ Grabowski, Guha & Salgado, *supra* note 1, at 1048.

⁷ Regarding the reference product manufacturer's trade secrets concerning data provided to the FDA, the legislative history leading to the BPCIA sometimes references this as “a 12-year period of [data] exclusivity,” as compensation for “allow[ing] competitors access to their data and a shortcut into the market.” *Biologics and Biosimilars: Balancing Incentives for Innovation: Hearing Before the Subcomm. on Courts & Competition Policy of the H. Comm. on the Judiciary*, 111th Cong. 9 (2009) (testimony of Rep. Eshoo). This is an allusion to the fact that the 12-year period was said to be related to the 11-and-a-half-year period that was the “average length of time that drugs are marketed under patent.” *Id.* at 8. But in the BPCIA the 12-year period applies regardless of patents, and patents still come into play following the 12-year period.

⁸ 42 U.S.C. § 262(k)(7)(A). Unless otherwise specified, all subsection references herein are to subsections of 42 U.S.C. § 262. The statutory phrase “first licensed” does not refer to a particular indication.

⁹ Many of the blockbuster biologics are nearing or past those dates. Remicade was approved in 1998, Humira in 2002, Enbrel in 2000, Lantus in 2000, Neulasta in 2002, and Neupogen in 1998.

- (3) **Stay period for FDA approval of biosimilars:** There is no automatic 30-month stay or equivalent period for the FDA approval of biosimilars. However, this may not matter if the patent litigation is resolved before the end of the 12-year exclusivity period.
- (4) **Notice of intention to market biosimilars:** The Federal Circuit has held that “[t]he biosimilar applicant has to disclose its intention to market starting 180 days following the grant of approval by the FDA, regardless of whether the ‘patent dance’ is followed.”¹⁰ Following such a notice, the reference product sponsor may seek a preliminary injunction until a decision of patent validity, enforcement, and infringement is reached.¹¹
- (5) **Wait period for biosimilars’ applications:** The biosimilar application cannot be submitted until four years after the reference biologic was approved by the FDA.¹²
- (6) **Disclosure process of Subsections (l)(1)–(2):** The biosimilar applicant *may*, should it choose, avail itself of the procedures of Subsections (l)(1)(B) and (l)(2). Although Subsection (l)(1)(B) states the applicant “shall” provide this information, the Federal Circuit in *Amgen v. Sandoz* ruled that this pathway is essentially optional for the biosimilar applicant.¹³ Moreover, if the applicant chooses to follow this process, it can limit the immediate patent determination to a single patent (to be chosen by the reference sponsor).
- (7) **Lack of exclusivity period for first-approved biosimilars:** Unlike the 180-day exclusivity granted to first-approved generic drugs, there is no special preference accorded to the first approved noninterchangeable biosimilar. While the first *interchangeable* biological product receives a certain period of exclusivity,¹⁴ because interchangeable products are not expected in the near term,¹⁵ none of the biosimilars products that will launch in the short term will have a period of exclusivity.

The Settlement Patterns and Challenges Under the BPCIA May Be Substantially Different than Under Hatch-Waxman

Settlement Patterns and Challenges Under Hatch-Waxman. In *Actavis*, the first reverse payment case to reach the U.S. Supreme Court, the Court ruled that reverse payment settlements would be tested for antitrust validity by a rule-of-reason analysis, examining the terms of the settlement and the professed justifications.¹⁶ Although the Court expressly left it to the lower courts to struc-

¹⁰ *Amgen Inc. v. Apotex Inc.*, 827 F.3d 1052 (Fed. Cir. 2016), *petition for cert. filed* (U.S. Sept. 14, 2016) (No. 16-332). Apotex has petitioned the Supreme Court for certiorari on this issue. See Jeff Overley, *Apotex Takes Biosimilar Case to Supreme Court*, LAW360, Sept. 16, 2016. “Patent dance” is a name often given to the schedule by which the biosimilar applicant and the reference product sponsor exchange information regarding the patents that may be the subject of litigation.

¹¹ 42 U.S.C. § 262(l)(8)(B).

¹² 42 U.S.C. § 262(m)(2)(A).

¹³ 794 F.3d 1347, 1355–56 (Fed. Cir. 2015), *petition for cert. filed* (U.S. Mar. 23, 2016) (No. 15-1195).

¹⁴ 42 U.S.C. § 262(k)(6).

¹⁵ Substantial obstacles are being argued in opposition to findings of interchangeability. See, e.g., Citizen Petition from AbbVie Inc. to the FDA (Dec. 16, 2015), http://www.bigmoleculewatch.com/wp-content/uploads/2016/01/Citizen_Petition_from_AbbVie_Inc_.pdf.

¹⁶ *FTC v. Actavis, Inc.*, 133 S. Ct. 2223, 2237–38 (2013). In *Actavis*, Solvay Pharmaceuticals had obtained approval to market a branded drug called AndroGel in 2000. *Id.* at 2229. When two companies—Actavis Inc. and Paddock Laboratories—filed an ANDA to market a generic drug modeled after AndroGel, Solvay initiated Paragraph IV patent litigation to establish that Solvay’s patent barred their entry into the market until expiration of the patent in January 2021. That litigation then settled in 2006. *Id.* One term of the settlement was that Actavis would not bring its generic to market until August 31, 2015, unless someone else marketed a generic sooner; other terms included the payment for an estimated \$19–\$30 million per year to Actavis during those nine years. *Id.* The FTC sued the settling parties, claiming that the settlement violated Section 5 of the Federal Trade Commission Act of 1914, alleging that the payments to the proposed generic manufacturers were unlawful as agreements not to compete, and that competition would have substantially reduced the costs of the drug to consumers. *Id.* at 2229–30.

ture the antitrust analysis, it called out several factors bearing on the analysis, including the reverse payment's size, scale in relation to the payor's anticipated litigation costs, independence from other services, and lack of any other justification for the payment.¹⁷

A number of reverse payment cases have reached district and appeals courts after *Actavis*. These cases have addressed several issues, including whether parties could avoid rule-of-reason analysis if their settlements did not include cash payments.¹⁸ Reversing the district court's dismissal of one action, the U.S. Court of Appeals for the Third Circuit ruled that "[w]e do not believe *Actavis*'s holding can be limited to reverse payments of cash."¹⁹

Another issue faced by courts has been how to analyze complicated settlements, in which non-monetary values flow in different directions.²⁰ Where a transaction has numerous components, with hard-to-value consideration flowing in the direction of the branded manufacturer, the courts are presented with a difficult challenge in determining whether the net of the values is a large payment in favor of the generic challenger. Faced with this issue, the parties' arguments have focused on who had the burden of proof on justification. Most or all plaintiffs have accepted, and at least one court has held, that plaintiffs had the burden to prove the payment was "large."²¹

Expected Competition Between Biosimilars and Biologics. As of today, the FDA has only approved four biosimilars²² and only one of those, Zarxio,²³ is on the market. Thus, little is known

[L]ittle is known yet

about the actual levels

of competition between

biosimilars and

reference biologics in

the United States.

¹⁷ *Id.* at 2237.

¹⁸ *King Drug Co. of Florence, Inc. v. Smithkline Beecham Corp.*, 791 F.3d 388 (3d Cir. 2015), *cert. denied*, 84 U.S.L.W. 3482 (U.S. Nov. 7, 2016) (No. 15-1055). Note that the first generic is guaranteed a 180-day period of exclusivity as to generic competition except for such competition as the branded manufacturer might authorize. FTC studies in this area have suggested that in the Hatch-Waxman context the first generic version of a drug is priced on average nearly 15 percent lower than the brand name drug. FED. TRADE COMM'N, AUTHORIZED GENERIC DRUGS: SHORT-TERM EFFECTS AND LONG-TERM IMPACT (2011), <http://www.ftc.gov/os/2011/08/2011genericdrugreport.pdf>. But as more generics become available, the price may fall further: after additional generic competitors enter, generic prices ultimately end up 85 percent lower on average than the brand-name manufacturers' original prices. FED. TRADE COMM'N, PAY-FOR-DELAY: HOW DRUG COMPANY PAY-OFFS COST CONSUMERS BILLIONS (2010), <https://www.ftc.gov/reports/pay-delay-how-drug-company-pay-offs-cost-consumers-billions-federal-trade-commission-staff>. The brand-name drug ultimately loses on average about 90 percent of its market share by unit sales. *Id.*

¹⁹ *Smithkline*, 791 F.3d at 403. At least one former FTC Commissioner has described that question as "not even a close one." Joshua D. Wright, Commissioner, Fed. Trade Comm'n, Remarks at the Antitrust Masters Course VII: Antitrust Analysis of Reverse Payment Settlements after *Actavis*: Three Questions and Proposed Answers 5 (Oct. 10, 2014), https://www.ftc.gov/system/files/documents/public_statements/591131/141010actavisspeech.pdf. FTC Chairwoman Edith Ramirez went further earlier this year, stating that the FTC is committed to "stopping pay-for-delay agreements that inflate the prices of prescription drugs and harm competition, regardless of the form they take." Press Release, Fed. Trade Comm'n, FTC Sues Endo Pharmaceuticals Inc. and Others for Illegally Blocking Lower-Cost Generic Versions of the Branded Drugs Opana ER and Lidoderm (Mar. 31, 2016) (emphasis added), <https://www.ftc.gov/news-events/press-releases/2016/03/ftc-sues-endo-pharmaceuticals-inc-others-illegally-blocking-lower>.

²⁰ *King Drug Co. of Florence, Inc. v. Cephalon, Inc.*, 88 F. Supp. 3d 402 (E.D. Pa. 2015).

²¹ *Id.* at 414. As to how one proves "large," the court agreed with the plaintiffs "that a reverse payment is sufficiently large if it exceeds saved litigation costs and a reasonable jury could find that the payment was significant enough to induce a generic challenger to abandon its patent claim." *Id.* at 417. Later discussion clarified "large" as an amount "that comes close to or exceeds the expected profits to be earned by prevailing in the patent litigation." *Id.* That said, at least one former FTC Commissioner has made statements that suggest that the analysis should include procompetitive benefits to the settlement agreement considered as a whole, even if those benefits were connected only by the settlement agreement itself. Wright, *supra* note 19, at 16–20.

²² See John T. Aquino, *Second U.S. Biosimilar Approval Shows FDA's Confidence*, BLOOMBERG BNA (Apr. 6, 2016), <http://www.bna.com/second-us-biosimilar-n57982069574/>; Press Release, FDA, FDA Approves Erelzi, A Biosimilar to Enbrel (Aug. 30, 2016), <http://www.fda.gov/NewsEvents/Newsroom/PressAnnouncements/ucm518639.htm>; Ezequiel Minaya, *FDA Approves Amgen's Biosimilar Version of Humira*, WALL ST. J., Sept. 23, 2016.

²³ Ben Hirschler & Michael Shields, *Novartis Launches First U.S. "Biosimilar" Drug at 15 Percent Discount*, REUTERS (Sept. 3, 2015), <http://www.reuters.com/article/us-novartis-drug-idUSKCNOR30C220150903>. See also Press Release, Novartis, Sandoz Launches Zarxio™ (figrastim-sndz), the First Biosimilar in the United States (Sept. 3, 2015), <https://www.novartis.com/news/media-releases/sandoz-launches-zarxiotm-filgrastim-sndz-first-biosimilar-united-states>.

yet about the actual levels of competition between biosimilars and reference biologics in the United States. However, given the characteristics of biologics products and the regulatory process established by the BPCIA, competition between biologics and biosimilars is expected to be substantially different than competition between small-molecule drugs and their AB-rated generics.

Some of the expected differences in competition result from the inherent differences between biosimilars and generic drugs. Generics will only be automatically substituted by pharmacies if they are found to be bioequivalent. Since no known state has allowed the substitution of a noninterchangeable biosimilar, biosimilars are expected to take a substantially lower share away from the reference biologic as compared to AB-rated generics, which take most sales away from the brand within a few months of generic entry. As such, biosimilar companies will likely need to promote their products both to physicians and to payors in order to incentivize biosimilar sales. That is, competition between biosimilars and biologics will likely be similar to brand-to-brand competition of branded small-molecule drugs.

Moreover, the costs of developing complex biologics could be over \$100 million and take over five years.²⁴ These are considerably higher than the \$2–\$5 million of development costs and a time span of two to three years for generic drugs.²⁵ This—together with the lack of pharmacy substitution and with certain features of the BPCIA described below—will likely result in fewer biosimilar entrants for a given reference biologic.

Some of the expected differences in competition result from certain novel features of the BPCIA that limit the rewards for biosimilar entry. For example, because the reference biologic has 12 years of exclusivity, by the time the biosimilar is launched, improved follow-on versions of the reference biologic may be available with prescriptions switched to the follow-on product.²⁶ Additionally, the lack of exclusivity period for the first noninterchangeable biosimilar potentially limits the incentives for early biosimilar entry. Finally, the reimbursement rules for biologics and biosimilars under Medicare Part B as established by the BPCIA do not encourage biosimilar use.²⁷

The lack of interchangeability and pharmacy substitution, higher biosimilar development costs, the 12 years of exclusivity for the branded biologic, the lack of biosimilar exclusivity, and the reimbursement rules for biosimilars will likely result in fewer entrants into the market and smaller price discounts for biosimilars, compared to those observed for generic drugs. Therefore, the potential price benefit to consumers from biosimilar entry is likely smaller, such that any anticompetitive impact of reverse payment settlements will likely be lesser for biosimilars than for generics.

Reverse Payments May Be Less Likely Under the BPCIA. There are reasons to believe that reverse payment settlements between biologic and biosimilar companies will be less common than with brand and generic companies.

²⁴ See FED. TRADE COMM’N, EMERGING HEALTH CARE ISSUES: FOLLOW-ON BIOLOGIC DRUG COMPETITION 14 (2009), <https://www.ftc.gov/sites/default/files/documents/reports/emerging-health-care-issues-follow-biologic-drug-competition-federal-trade-commission-report/p083901biologicsreport.pdf>.

²⁵ Grabowski, Guha & Salgado, *supra* note 1, at 1050.

²⁶ See 42 U.S.C. § 262 (k)(7)(A). For further discussion of how the 12-year exclusivity period could affect competition, see Sara Champion, Rahul Guha & Maria Salgado, *Emerging Competition Issues in Biologics*, 26 ANTITRUST HEALTH CARE CHRON. (ABA Section of Antitrust Law Newsl.), July 2013, at 9, 10–11.

²⁷ Specifically, under the BPCIA, biologics are reimbursed at 106 percent of the biologic’s average sales price (ASP), while the biosimilar is reimbursed at 100 percent of the biosimilar’s ASP plus 6 percent of the reference biologic’s ASP. Patient Protection and Affordable Care Act § 3139, 42 U.S.C. § 1395w-3a (2012). Thus, the reimbursement beyond the ASP is the same whether the biosimilar or the biologic is used, which does not encourage providers to use biosimilars.

First, it will likely be more difficult for biosimilar and biologic companies to agree to the terms of a reverse payment settlement. As long as a biosimilar is noninterchangeable and not automatically substituted at the pharmacy, the branded biologic will generally not lose as much share to the biosimilar as a branded product loses to their generic equivalents. At the same time, because the biosimilar price is closer to the biologic price, the joint profits of the biologic and the biosimilar will be relatively close to the profits that the biologic company would earn on its own. This means that there is a narrower range of reverse payment settlement amounts that would be acceptable to both parties.

Second, it is possible that the reference biologic's patents will have expired by the end of the 12-year exclusivity period, in which case a patent settlement may not be necessary. This possible reduction of patent disputes may, however, be offset to some degree by the fact that a greater number of patents may be asserted against biosimilars, for reasons discussed below. Additionally, there is substantially more time between the start of the patent litigation (assuming biosimilars choose to enter into the "patent dance") and the end of the 12-year exclusivity period. Thus, it is possible that patent litigation is resolved through a trial by the time 12-year period is over, which may reduce the likelihood of a reverse payment settlement.

Third, because there is no exclusivity for the first noninterchangeable biosimilar, the incentives for patent challenges and therefore patent litigation may be less common with biologics than with small-molecule drugs. This would also reduce the likelihood of reverse payment settlements.

The Statutory Differences Between BPCIA and Hatch-Waxman May Lead to Different Considerations When Analyzing Settlements Between Biologics and Biosimilar Companies Under the Antitrust Laws. There are a number of reasons why patent settlements between biologic and biosimilar companies will be different than for small-molecule drugs²⁸ and, therefore, why the antitrust considerations may also be different. The issue posed in *King v. Cephalon*—"A reasonable jury could find that a reverse payment to a generic manufacturer that comes close to or exceeds the expected profits to be earned by prevailing in the patent litigation could induce a generic manufacturer to forfeit its claim"²⁹—would involve different analyses in the world of biosimilars.

One reason why antitrust considerations may be different for biosimilars is that—to the extent that patent litigation is still pending after the 12-year exclusivity period for the reference biologic—biosimilar companies are more likely to launch "at-risk" than small-molecule generic manufacturers. This is because the difference between the biologic and the biosimilar prices is relatively smaller than for small-molecule drugs, meaning that an eventual payment of damages by the biosimilar company will be closer to what it made as profits. As such, the risk of paying damages due to an "at-risk" launch will be smaller for biosimilar companies than for small-molecule generics. "At-risk" entry will likely be more common in the next few years, as biologic products are past their 12-year exclusivity period, but, because of the recency of the BPCIA, patent litigation did not begin with that 12-year period.

There are a number of reasons why patent settlements between biologic and biosimilar companies will be different than for small-molecule drugs and, therefore, why the antitrust considerations may also be different.

²⁸ Section 1112 of the Medicare Modernization Act of 2003 (MMA) requires that agreements between brand name companies and generic companies regarding the manufacture or sale of a generic be filed with the Assistant Attorney General and the FTC for review within ten days after the agreements are executed. Medicare Prescription Drug, Improvement, and Modernization Act of 2003 § 1112, 21 U.S.C. § 355 (2012). No such reporting is required for the BPCIA. See *Biosimilars*, HEALTH AFFAIRS: HEALTH POLICY BRIEFS (Oct. 10, 2013), http://www.healthaffairs.org/healthpolicybriefs/brief.php?brief_id=100.

²⁹ *Cephalon*, 88 F. Supp. 3d at 417.

A consequence of an increase in “at-risk” launches is that, in the event of a settlement, a feasible payment from the biologic to the biosimilar is the forgiveness of damages. And assuming that *Actavis* applies to biologic settlements, an important question will be whether such forgiveness of damages constitutes a payment. On this point, two observations should be made. First, we have found only one court ruling that, under *Actavis*, forgiveness of damages may be considered a reverse payment.³⁰ Accordingly, although the Court in *Actavis* noted that the courts reviewing settlement for antitrust compliance might not need to assess the strength of the underlying patents, it is hard to see how a court could avoid that exercise if it needed to determine whether there was a “large” forgiveness of damages.

Second, because competition between biologics and biosimilars is similar to brand-to-brand competition, estimating the branded sales lost due to the biosimilar entry may be difficult because the market definition could be broader than simply the biologic and the biosimilar drugs together. Specifically, because there is no automatic substitution with the reference biologic, and because the biosimilar company will likely promote its drug to some extent, sales of the biosimilar will likely come from (a) sales of the reference biologic; (b) sales of the follow-on reference biologic, if available; (c) sales of other non-reference biologics; and (d) patients who were not taking a biologic drug.³¹ Importantly, because sales of the biosimilars will not be directly tied to sales of the reference biologic (in contrast to many situations involving small-molecule drugs), estimating damages to the reference biologic is likely going to be a complex exercise, especially in therapeutic categories with more significant competition.

Another reason why antitrust considerations may be different is related to a critical question in *Actavis*, namely whether the reverse payment is “large.” This question will likely remain in any reverse payment case involving biologics. However, the determination of whether the payment is “large” and the kinds of payments are likely to be seen will be different for biologics. First, in *Actavis*, “large” is often compared to the amount of litigation costs, which according to the American Intellectual Property Law Association (AIPLA) are approximately \$5 million for disputes involving more than \$25 million at risk.³² For biologics, however, litigation costs are likely much larger because biologic disputes are expected to involve more patents, and more complex patents, as well as trade secret issues.³³ Thus, the threshold for considering whether a payment is “large” under *Actavis* will likely be higher for biologics.

³⁰ In *In re Nexium (Esomeprazole) Antitrust Litigation*, 42 F. Supp. 3d 231, 285–86 (D. Mass. 2014), the generic manufacturer paid \$9 million to settle the case, but the plaintiffs contended that this was over \$20 million less than the actual damages. The court denied summary judgment, ruling that the plaintiffs “sufficiently demonstrate[d] a significant forgiveness of debt [from a separate patent litigation] to support a reasonable inference that Teva received a reverse payment to delay its generic Nexium launch.” *Id.* at 286.

³¹ Category (d) includes people who were potentially taking a non-biologic drug, or they were not being treated with drugs at all. See generally SHASHANK UPADHYE, GENERIC PHARMACEUTICAL PATENT AND FDA LAW § 16 (2016) (discussing various factors in damages analysis for pharmaceutical patent infringement in a non-two-supplier market scenario).

³² Am. Intellectual Prop. Law Ass’n (AIPLA), *2015 Report of the Economic Survey* 37 (2015), <http://files.ctctcdn.com/e79ee274201/b6ced6c3-d1ee-4ee7-9873-352dbe08d8fd.pdf>.

³³ It is not clear how the fact that more patents may ultimately come into play for the reference product manufacturer will affect the analysis. On the one hand, one may expect that the inclusion of process patents may put additional arrows in the patentee’s quiver; but, on the other hand, the fears expressed in the legislative history (as discussed above) that the composition-of-matter patents may not be as easy to enforce as to biosimilars suggest a countervailing weakness of the patentee’s protection. Consistent with this suggestion, the patent whose potential infringement led to the settlement challenged by the FTC in *Actavis* was a composition-of-matter and a method-of-treatment patent, whereas the patent asserted in *Amgen v. Sandoz* was a method-of-treatment and “pharmaceutical kit” patent.

*(R)reverse payment
settlements with a
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Second, certain noncash payments are less likely to be seen in settlements between biologics and biosimilar companies. For example, in reverse payment cases between small-molecule brands and generics, one kind of payment that has been reviewed is a promise by the brand not to launch an authorized generic.³⁴ Brand-authorized generics are drugs that are sold by the branded company as a generic, but at a lower price than the brand. The brand-authorized generic typically competes with other generics on price. In the case of biologics, the incentives of the biologic company to launch a brand-authorized biosimilar will be different. Specifically, because a brand-authorized biosimilar would be interchangeable with the biologic, but would be priced lower than the biologic, it would take sales away from both the biosimilar (as brand-authorized generics take sales away from generics) and the biologic. Thus, when deciding whether to launch a brand-authorized biosimilar, the biologic company would need to consider the gain from obtaining some sales from the biosimilar versus the loss from cannibalizing biologic sales.³⁵ Whether this is viewed as anticompetitive will depend (among other factors) on the level of sales that the biosimilar would obtain. The higher the level of biosimilar sales, the more profitable it should be to launch a brand-authorized biosimilar. Taken together, this means that brand-authorized biosimilars should be less common than brand-authorized generics. As a result, reverse payment settlements with a promise not to launch a brand-authorized biosimilar may be less likely to be viewed as anticompetitive because such brand-authorized biosimilars would not have launched in the first place.

Moreover, the value of not having a brand-authorized biosimilar will be lower to biosimilar companies than to generic companies because there is no 180-day exclusivity for non-interchangeable biosimilars. This 180-day period is when generic companies obtain the vast majority of their profits and is a reason why no-brand-authorized generic clauses have raised antitrust concerns in reverse payment cases involving generic drugs. Such considerations will be different in reverse payment cases involving biologics.

Also important, as in Hatch-Waxman, is the fact that settlements often include early entry provisions that let the generic drug launch before the patent expires without liability. These provisions may be net procompetitive, as has been noted in defense of Hatch-Waxman reverse payment settlements.³⁶ Such provisions are likely expected as well under BPCIA because a biosimilar would not have an incentive to enter into a settlement without such early entry provisions. Moreover, like in Hatch-Waxman, early entry provisions can lead to more biosimilar competition, and not less, and thus be procompetitive. ●

³⁴ Press Release, Fed. Trade Comm'n, FTC Submits Proposed Amicus Brief Concerning "No-Authorized-Generic" Commitments in Drug Companies' Patent Settlements (Aug. 15, 2013), <https://www.ftc.gov/news-events/press-releases/2013/08/ftc-submits-proposed-amicus-brief-concerning-%E2%80%9Cno-authorized>.

³⁵ This is different than small-molecule drugs because with small-molecule drugs a brand-authorized generic mainly takes sales away from other generics but does not take additional sales from the brand.

³⁶ Diane E. Bieri, *Implications of FTC v. Actavis: A Reasonable Approach to Evaluating Reverse Payment Settlements*, 15 MINN. J.L. SCI. & TECH. 135, 145–46 (2014).

Paper Trail: Working Papers and Recent Scholarship

Editor's Note: John Woodbury reviews two papers addressing the role of consent decrees in particular in resolving anticompetitive concerns.

Send suggestions for papers to review, or comments, to page@law.ufl.edu or jwoodbury@crai.com.

—WILLIAM H. PAGE AND JOHN R. WOODBURY

Recent Papers

Steven C. Salop, *Modifying Merger Consent Decrees to Improve Merger Enforcement Policy*, ANTITRUST, Fall 2016, at 15

In this paper, Steven Salop, Professor of Economics and Law, Georgetown University Law Center, and Senior Consultant, Charles River Associates (with which I am affiliated), considers modifications to the merger remedy process (including consent decrees and merger challenges). As is well known, consent decrees in particular provide the antitrust agencies with flexibility in addressing mergers that might otherwise be challenged on the grounds that such mergers would harm consumers and could require extended litigation during which the harm may continue. Joshua Wright and Douglas Ginsburg note that the antitrust agencies “have increasingly moved from actively litigating antitrust cases to settling cases through consent decrees.”¹

But Salop observes that some decrees are robbed of their remedial value, notably (in the extreme) when the consent-mandated divested entities become bankrupt, as happened with the Advantage divestiture in the Hertz/Dollar Thrifty transaction (p. 16). As a result, consumers may well face higher prices with the unexpected reduction in competition. For example, Salop points to the evidence in John Kwoka’s recent tome on retrospective merger studies,² which (among other things) concluded that mergers allowed to proceed with divestitures have been associated with significant price increases of 6.1 percent on average and a substantial 12.8 percent with conduct remedies.³ (p. 16)

On balance, Salop argues that consumers likely are harmed within the universe of challenged mergers (which would include those resolved by consent decrees) *if* the agency’s expectations are correct.⁴ If the agencies succeed in winning an injunction against a perceived anticompetitive

¹ Joshua D. Wright & Douglas H. Ginsburg, *The Costs and Benefits of Antitrust Consents* (George Mason University Law and Economics Research Paper Series No. 16-42 (posted Oct. 2016)), <https://ssrn.com/abstract=2860174>. I discuss this paper below.

² JOHN W. KWOKA, JR., *MERGER CONTROL AND REMEDIES: A RETROSPECTIVE ANALYSIS OF U.S. POLICY* (2015).

³ Citing the review of the Kwoka book by Robert A. Skitol, *A Harsh Report Card on the Merger Enforcement Process*, ANTITRUST SOURCE (Feb. 2015), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/feb15_skitol_review_2_11f.pdf.

⁴ This obviously is an important “if.” If the increased reliance on consents leads to less economic analysis of anticompetitive concerns, one cost of increased reliance on consents could be a higher incidence of false positives. That the underlying economic analysis could be less than complete is a concern of Wright and Ginsburg, discussed below. Having said that, the Kwoka analyses might suggest that that increased incidence of false positives may not be substantial, given the post-merger price increases associated with mergers cleared via consent decrees.

merger, consumers are no better or worse off. If the courts deny the injunction, consumers are worse off. And, judging by the Kwoka study, allowing a merger to proceed via what is ex post an ineffective consent decree will also often harm consumers.

To cure what may be an ineffective remedy ex post, Salop proposes that the agencies should be willing to modify that remedy when its failure becomes evident as well as to revisit a consummated merger where necessary. In particular, he suggests that at least three distinct benefits can flow from a policy of revisiting failed consents. First, the policy will restore much of the competition lost as a result of the ineffective consent. This policy would allow the agencies to revisit consents that appeared effective at the time of the adoption of the consent but subsequently failed to satisfy the agency's expectations. Second, the prospect of a second review will create incentives for the merging parties to develop and propose an economically sound and viable consent to avoid any subsequent review as well as to discourage exaggerated efficiency claims.

Third, even if the consent is seemingly ineffective or the merger is erroneously cleared without remedial conditions (a false negative), the merged firm may nonetheless refrain from raising prices or otherwise harming competition to avoid another agency review. The possibility of ex post reviews "in principle . . . might permit the agencies to demand smaller divestitures or other relief in certain cases, knowing that there can be further adjustments later, if needed [or] allow the agencies to forgo challenging some very 'close-call' mergers that otherwise would be challenged." (p. 16) Nonetheless, Salop urges caution in concluding that in "close-call(s)," the agencies should forgo litigation "only in the most limited circumstances. . . . Post-consummation reviews may be imperfect and remedial choices will be more limited." (pp. 16–17)

Salop proceeds to outline a framework for the implementation of the consent review, and that framework includes the following (among others):

- Language in the consent that specifically provides for such a post-merger review.
- A non-exclusive list of the types of events that could trigger such a review.
- A requirement that the merging parties (and other competing firms) provide ordinary course of business documents to allow the agencies to track prices, margins, shares, and quantities on an annual basis.
- A sunset provision for the ex post review, possibly one that occurs within, e.g., 3 to 4 years after court approval of the decree or the clearance of the merger.⁵

Salop acknowledges that in considering ex post adjustments to remedy any consumer harm, "[i]t can be difficult to unscramble the eggs. However, analysis . . . suggests that there would be substantial benefits by restoring competition and increasing deterrence through alternative modifications." (p. 18)

Salop highlights other possible second-review remedies where divestitures are not practical, including (where appropriate) the licensing of intellectual property at zero or below market rates, reducing the length of customer contracts or allowing customers to renegotiate contracts (to reduce entry barriers), or requiring (where relevant) a set price differential between captive customers (who would experience the more substantial post-merger price increases) and others. If these remedies are not available, Salop suggests that the merged firm could be required to divest in other markets where the merged firm competes and has market power (but is unaffected by the merger), thereby tending to offset in part the market power resulting from an ineffective

⁵ However, Salop notes that "[i]f there is evidence that the merged firm subsequently raised prices as a result of market power flowing from or enhanced by the merger, the period may be lengthened somewhat or there might be a second review." (p. 17)

initial consent decree. Alternatively, monetary penalties could be imposed that reflect the value of current and/or expected profits as a deterrent to the exercise of market power.

If none of these remedies are viewed as possible, practical, or effective, Salop proposes that as a “remedy of last resort” (p. 18), the court (or some other agency) monitor and regulate the prices of the merged firm if the merger creates durable market power. Salop notes that “[w]hile ongoing oversight of prices may create great discomfort for antitrust practitioners, commentators, and the regulated firms, paying monopoly prices creates great discomfort for consumers, who are entitled to protection by the antitrust laws.” (p. 18)

Salop has no illusions that this would be a costless endeavor. He acknowledges that (among other costs) there may be false positives associated with the consent review. As one example, any observed post-merger price increases may be attributable to unrelated cost and demand factors rather than market power. Further, any price increases may reflect quality improvements. But he notes that comparing current with but-for (nominal or quality-adjusted) prices is within the expertise of the agencies. Given the fact that consumers currently bear the downside risk of challenged mergers, Salop notes that “[a]sking the merging firms to ‘put their money where their mouth is’ can both partially insure consumers against the downside risk and facilitate a more efficient merger enforcement process.” (p. 19)

I share Salop’s view that in principle, the merger enforcement process and consumers can benefit from an agency’s willingness to review consent decrees that appear ineffective and thus cause consumer harm. Importantly, the modifications would create incentives for the merging parties to develop an effective remedy. But the devil ultimately is in the details. As Salop recognizes, a second bite at the apple by the agencies should occur infrequently. It would be useful if the circumstances under which such a review would be triggered—and the degree of certainty one would have that in modifying the decree, consumers would be better off—were carefully specified.⁶ Otherwise, the risk that such modifications—particularly ones involving an ongoing review of pricing by the merged firm, divestitures in unrelated markets, or interfering in the firm’s contractual relationships—may have adverse effects on the very competition that the modifications seek to enhance.

As Salop recognizes, many antitrust practitioners would be at least somewhat concerned with some of the suggestions in his proposal.⁷ Such ex post remedies as the prospect of essentially regulating prices (using rate-of-return regulation, price caps, or even benchmark pricing) or requiring divestitures in unrelated markets, will surely give many antitrust practitioners pause, given, e.g., the extent to which price regulation has been associated with substantial market inefficiencies.

And there remains the practical question of costs to the agencies and firms of such a proposal. Salop argues that these increased costs would be limited because “not all mergers would be reviewed in detail and detection of remedial failure would necessarily be imperfect.” (p. 19) In addition, as noted above, a concern that the agencies may take a second bite at the apple will

⁶ For example, suppose that the agency were to find that there was a statistically significant increase in the post-merger price, but that the increase was quantitatively small. Putting litigation costs aside, would that small increase trigger a process to modify the consent decree? Or would the trigger depend on the total overcharge to consumers being above some threshold level? Put differently, would there be safe harbors for mergers or practices that require a second look?

⁷ In an earlier version of this paper, Salop notes that when presenting it at the 2016 ABA Antitrust Section’s Spring Meeting, his proposal “was (I hope) jokingly characterized as a ‘communist plot.’” Steven C. Salop, *Modifying Merger Consent Decrees: An Economist Plot to Implement Merger Enforcement Policy* 1 (Apr. 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2768143.

itself create incentives for the merging parties to fashion a consent decree that is realistic and effective. Still, if the scope of agency merger control broadens substantially, one would expect, as Salop notes, that additional agency resources would be required to better insure that the costs of any particular ex post intervention is worth the benefits. Regardless of whether one agrees with Salop, he has focused on an ex post issue worthy of consideration. For those looking for a thoughtful and provocative read, this paper is an ideal candidate.

Joshua D. Wright & Douglas H. Ginsburg, The Costs and Benefits of Antitrust Consents
(George Mason University Law and Economics Research Paper Series No. 16-42 (posted Oct. 2016),
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2860174)

In this paper, Joshua Wright and Douglas Ginsburg (WG) consider the costs and benefits of increased reliance on consent decrees rather than litigation to address perceived consumer harm from mergers or other anticompetitive practices.⁸ At the outset, WG observe that in the U.S., “over the last three decades the Agencies have resolved nearly their entire civil enforcement docket by consent decree” (p. 1), which has resulted in what they call a “culture of consent.” (p. 1) The goal of the paper is to “document the costs and benefits of a shift from a litigation-oriented regime to a regulatory regime.” (p. 2)

While acknowledging that any antitrust policy would include some optimal mix of consent decrees and litigation to address anticompetitive harms, WG highlight what they regard as the significant costs in moving from litigation to consents. First, WG argue that increased reliance on consent decrees “results in less litigation of important issues that would stimulate the healthy development of antitrust jurisprudence.” (p. 4) Among other effects, WG contend that the use of consent decrees diverts resources from gathering and evaluating evidence that a merger or a business practice is anticompetitive to designing and negotiating the consent.

WG argue that by contrast, litigation provides the opportunity for the agencies to reaffirm or develop new antitrust legal rules that “provide the parties with some degree of certainty about the boundaries of lawful business conduct As our understanding of economics evolves, repeated litigation allows courts to adapt to changes in our economic knowledge and empirical learning.” (p. 5) WG contend that increased reliance on consent decrees, implemented as they are on a case-by-case basis, provide guidance on only what kind of conduct is unlawful rather than conduct that is lawful. Further, whatever guidance consent decrees provide is further reduced, according to WG, because the nature of the decrees can vary with the changing composition of the agencies.

A second cost from a shift towards consents is the failure of the agencies to involve economists in the process of consent design and implementation. WG argue that the collateral damage from increased reliance on consents relative to litigation is that the agencies will fail “to collect the data and evidence required for economic analysis if it assumes that cases will typically be resolved by a negotiated consent decree.” (p. 7)

WG identify a third cost of increased consents as one that reduces “the cost to the agency of straying from its core antitrust mission.” (p. 8) As one example of a “misuse of agency power”

⁸ Joshua Wright is University Professor, Antonin Scalia Law School, George Mason University, and Senior of Counsel, Wilson, Sonsini, Goodrich & Rosati. Douglas Ginsburg is Senior Judge, U.S. Court of Appeals for the District of Columbia Circuit, and Professor of Law, Antonin Scalia Law School, George Mason University.

(p. 9), WG cite the FTC's consent decree with Intel that (among other things) prevented Intel from making design changes that, in the FTC's view, generate few consumer benefits but could be used to fortify Intel's market power.⁹ In another example cited by WG (n.17), the Nevada Attorney General conditioned its approval of a merger on the merged firm's dollar contributions to certain activities favored by the state, a condition exceeding the scope of what many would consider as appropriate antitrust policy.

Finally, WG point to a fourth cost of consents as how they affect the conduct of non-party firms: "Businesses make note of the consent decrees entered into by firms in their industry [but] generally have no way of knowing which facts or modes of economic analysis were influential in the settlement process." (p. 11) In other words, the consent decrees are not transparent, creating uncertainty in firms deciding whether to engage in conduct that could be procompetitive.¹⁰

Against those costs, WG consider the benefits from a consent. First, WG note that consents can be "convenient" to the agencies because "entering into consent decrees can substantially shorten the duration of an investigation [and] need not exhaust its resources preparing for litigation and instead can focus on a broader set of activities." (p. 14) In addition, "an agency may be able to narrow the theory of harm in a complex case without fully establishing a violation of the law." (p. 14) In doing so, WG urge the agencies to focus on only those consents that advance the welfare of consumers.

Second, and related to the first, a consent decree allows the agency to act more quickly than the courts when the market is dynamic. By the time the case winds its lengthy way through the court system, WG note that the conditions that led to the original anticompetitive concerns may no longer exist: "The ability of agencies to intervene more quickly through settlement may increase the chance of successful enforcement by restoring effective competition in the market faster." (pp. 16–17)

WG also note that despite the fact that consent decrees do not establish legal precedents, the consent decree "signal[s] an agency's enforcement goals [that] can help an industry quickly understand the prevailing logic and inner workings of the agency." (p. 17)

Third, WG note that consent decrees "have the ability to tailor remedies to the particular facts of individual cases and are thus able to address allegedly anticompetitive behavior more precisely." (p. 18) But WG again caution that such remedies can be "detrimental to consumer welfare or . . . could not lawfully be obtained in litigation." (p. 18)¹¹

WG conclude that when considering a consent decree as a remedy, the "agencies must be aware of the social costs associated with over reliance upon settlements rather than upon litigation to promote competition policy." (p. 20)

It does not take much of a leap to infer that WG regard the current use of consent decrees by the agencies as being excessive in that the incremental gains from consents are outweighed by the incremental costs. But some of the costs described by WG may be difficult to accept on faith.

⁹ Intel Corp, FTC Docket No. 9341 (2010), <https://www.ftc.gov/enforcement/cases-proceedings/061-0247/intel-corporation-matter>.

¹⁰ Concern about the lack of transparency seems, at least superficially, at odds with a benefit of consents highlighted by WG and noted below in the text, that consents can send a clear signal to market participants about the agency's enforcement policies. But, to be sure, the judicial system provides more durable guidance, one that does not depend on the changing composition of the agency heads or staff.

WG also express concern that if the "culture of consent" were to be adopted by other countries, antitrust policies internationally will fail to converge to a common framework. (pp. 12–13)

¹¹ Of course, it is quite possible that the remedy would advance consumer welfare and not be one that would be readily obtainable from the courts because, e.g., the court decisions do not yet reflect modern antitrust thinking.

As one example, WG claim, in effect, that if a consent decree is in the offing for a matter, both the investigation of the alleged harm and the underlying economic analyses will become a much more casual affair. Certainly, there may well be consent decrees that are ill-suited as remedies to address the alleged harm. But a general statement that a key cost of relying on consent decrees entails “less formality” (p. 14) in the analyses would seem to require greater substantiation (which I grant may be a mission impossible). Still, former Commissioner Wright is certainly in a better position than many others (including myself) to identify this as an important source of collateral damage. To the extent that economists in particular are not part of the process leading up to a decree, the remedy is for the agency itself to appreciate the risks of developing a decree that lacks a grounding in economics and so may harm consumers and competition.

As noted above, WG regard the consent decree addressing Intel's alleged anticompetitive behavior as an example of agency abuse of the consent decree process. While I offer no opinion on the decree itself or the underlying allegations, I certainly would be concerned if this remedy was fashioned with little or no economics input. And I suspect that some antitrust practitioners would regard that part of the decree addressing design changes as one that was tailored to the alleged anticompetitive harms. One may view the allegations against Intel as being unfounded or that the decree was too regulatory in nature (with costs not fully appreciated by the FTC), but that is a different issue from whether or not the consent was an effective remedy (meaning that it cured the anticompetitive conduct), assuming the FTC's views were correct.¹² Interestingly, I observe that this consent would seem to fit the general circumstances in which WG might think the consent decrees are more appropriate in that the “market” for computer chips is one that is dynamic.

While WG appreciate that consent decrees can be useful remedies, WG raise reasonable arguments in cautioning against an immediate resort to consent decrees to resolve anticompetitive harms, and those lessons should be taken to heart by the agencies. I certainly agree that any analyses in support of a consent should be complete and not the result of casual economics. Another paper worth reading.

—JRW

¹² I do agree that using consent decrees to extort conditions unrelated to the perceived harms (as in the Nevada matter cited above in the text) does not obviously advance the interests of consumers or serve to protect competition.