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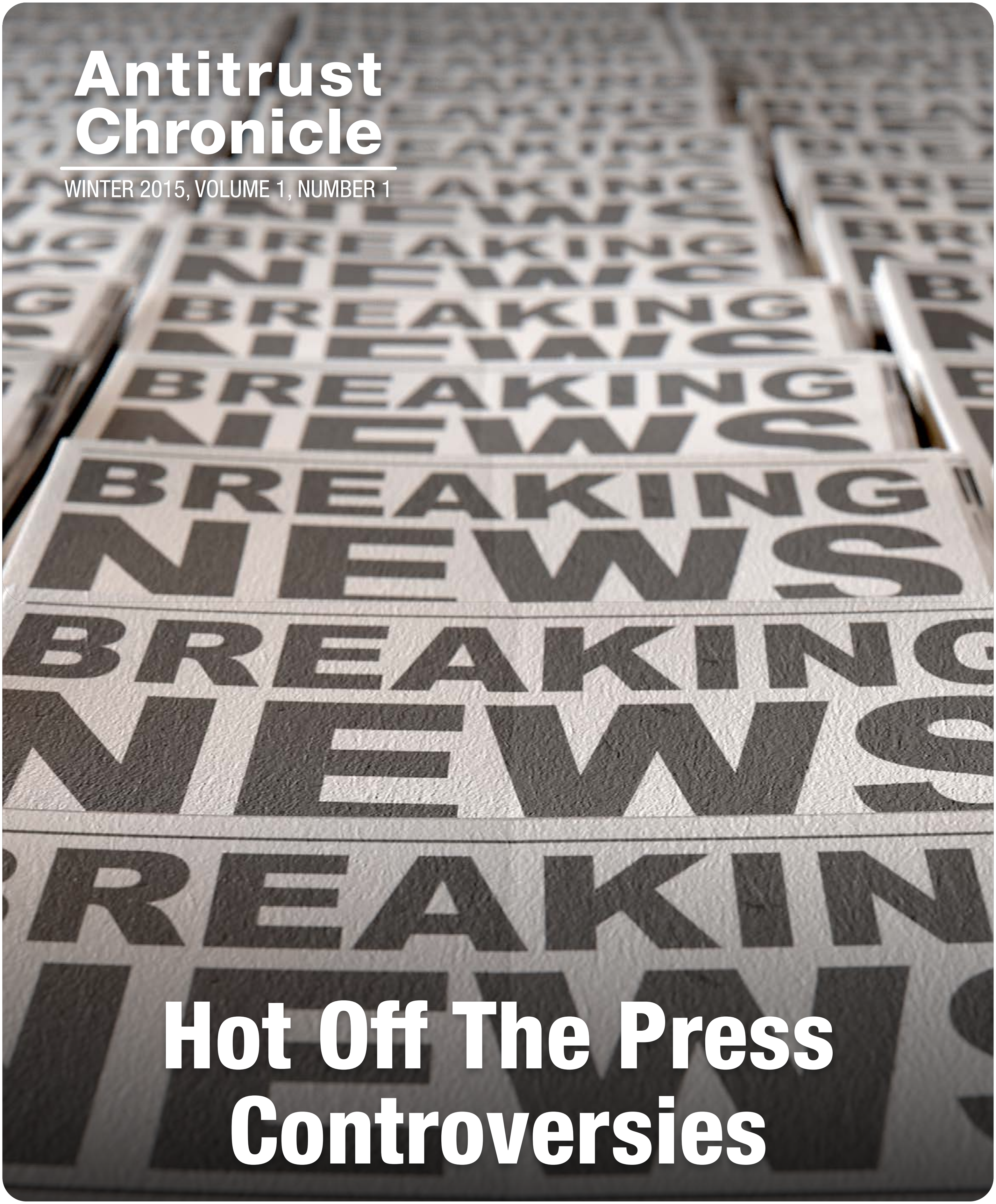

Hot Off The Press Controversies

CPI COMPETITION POLICY INTERNATIONAL

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January 2014 (1)

Litigating Change in College Sports

David Greenspan &
Joseph Litman

Winston & Strawn LLP

Litigating Change in College Sports

David Greenspan & Joseph Litman[1]

I. INTRODUCTION

The most important storyline in college sports this past fall had nothing to do with the Bowl Championship Series, conference realignment, or celebrity coaches. Nor did it play out on Saturdays, as one might expect. Rather, in an Oakland federal district court, Chief Judge Claudia Wilken of the Northern District of California issued two rulings in *In re NCAA Student-Athlete Name & Likeness Licensing Litigation*[2] ("*O'Bannon*") that may forever alter college athletics.

The *O'Bannon* case represents a frontal assault on the rules imposed by the National Collegiate Athletic Association ("NCAA") that prohibit student-athletes from receiving monetary compensation for the commercial use of their names, images, and likenesses as a condition of their eligibility. In orders issued just two weeks apart, Judge Wilken first denied the NCAA's latest motion to dismiss the case ("Motion to Dismiss Order") and then certified an injunction class seeking to stop the NCAA from enforcing its compensation ban ("Class Certification Order").[3]

This article analyzes Judge Wilken's recent rulings and what they may mean for the outcome of the *O'Bannon* case as well as future litigation against the NCAA. The litigation stakes are far higher than any contested on the field.

II. STUDENT-ATHLETES CHALLENGE THE NCAA'S CORE AMATEURISM RULES AS UNLAWFUL RESTRAINTS OF TRADE

The *O'Bannon* plaintiffs presently consist of five current and fifteen former student-athletes who play, or have played, Division I ("DI") football or basketball. The action was initiated in 2009. Plaintiffs' claims evolved over time, and, on July 19, 2013, they filed a Third Amended Complaint seeking to enjoin the NCAA from imposing and enforcing its ban on certain types of student-athlete compensation and seeking treble damages. One major distinction between the Third Amended Complaint and its prior iterations is that the *O'Bannon* plaintiffs augmented their claims to include revenue derived from *live* NCAA broadcasts and not just *historical* footage, in addition to video games.

[1] David Greenspan is a partner at Winston & Strawn in New York and co-chair of the firm's college sports practice group. He has litigated on behalf of a range of clients in various antitrust and sports matters, including the National Football League Players Association and the National Basketball Players Association. Joseph Litman is a litigation associate at Winston & Strawn and a member of the sports practice group.

[2] No. 09-cv-01967-CW (N.D. Cal.) The student-athlete litigation encompasses both antitrust claims brought by the *O'Bannon* plaintiffs and right of publicity claims brought by four former student-athletes led by one-time DI football player Sam Keller ("*Keller*"). This article focuses on the antitrust claims; discovery concerning the *Keller* right of publicity claims has been stayed.

[3] Order Den. Mots. to Dismiss, Docket No. 876, Oct. 25, 2013; Order Granting in Part and Denying in Part Mot. for Class Certification, Docket No. 893, Nov. 8, 2013.

In antitrust terms, the *O'Bannon* plaintiffs' claims are framed as attacking a group boycott and price-fixing conspiracy through which the NCAA and its member institutions restrain competition, and fix prices for student-athlete monetary compensation at zero. Plaintiffs allege that there are two relevant markets affected by this conduct. The first is an alleged "college education" market, in which colleges and universities would compete with one another to recruit student-athletes by promising them monetary compensation but for the NCAA prohibitions. The second is an alleged "group licensing" market in which, absent the NCAA restraints, licensors such as television broadcasters and video-game publishers would compete for group licenses to the names, images, and likenesses of DI student-athletes playing basketball and football.

Plaintiffs allege that the NCAA unlawfully restrains these markets by premising a student-athlete's eligibility upon remaining uncompensated and waiving rights to the commercial use of his image during college and after graduation.

III. THE NCAA'S RESTRAINTS MUST BE SCRUTINIZED UNDER THE RULE OF REASON

The NCAA moved for dismissal of this latest *O'Bannon* complaint on three principal grounds: i) the NCAA's right to regulate amateurism is effectively immune from antitrust scrutiny by virtue of the Supreme Court's decision in *NCAA v. Board of Regents*;[4] ii) neither federal nor state law confers protectable name, image, or likeness rights in sports broadcasts upon student-athletes; and iii) the Copyright Act preempts student-athletes' rights of publicity.

The court rejected all three of these arguments. Judge Wilken ruled that the oft-invoked language from *Board of Regents* that has traditionally provided a bulwark for the NCAA—"to preserve the character and quality of the [NCAA's] 'product,' athletes must not be paid"[5]—does not preclude plaintiffs from challenging whether the NCAA's ban on student-athlete competition is an illegal restraint of trade under the rule of reason. She further rejected the NCAA's contention that, regardless of the NCAA's restraints, there would be no demand for student-athlete group licensing rights for live television broadcasts because the First Amendment displaces any individual right of publicity for such live sporting events.

Judge Wilken instead concluded that further development of the evidentiary record as to whether live broadcasts of DI football and basketball games are "primarily commercial" would be required to decide this First Amendment question. Moreover, Judge Wilken held that even though the section of the California Civil Code cited by the NCAA excludes sports broadcasts from recognizable rights of publicity, the *O'Bannon* plaintiffs have alleged a national market, and thus California law alone cannot extinguish their rights of publicity. Finally, the court held that the Copyright Act was inapposite because plaintiffs are seeking to protect personae, not copyrights.

Focusing on the antitrust rulings, Judge Wilken rejected the NCAA's argument that it is entitled to *de facto* antitrust immunity in the name of amateurism under *Board of Regents*. She held that the decision "gives the NCAA 'ample latitude' to adopt rules preserving" amateurism,

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[4] 468 U.S. 85 (1984).

[5] *Bd. of Regents*, 468 U.S. at 102 (citation omitted).

but it does not stand for "the sweeping proposition that student-athletes must be barred…from receiving any monetary compensation for the commercial use of their names, images, and likenesses." Judge Wilken's Motion to Dismiss Order makes clear that the court intends to assess the NCAA's assertion that its restrictions are, on balance, pro-competitive as an evidentiary matter rather than trying to apply dicta from a Supreme Court decision that had little to do with amateurism.

Indeed, *Board of Regents* dealt with restraints in the market for college football broadcasts, not on the NCAA's policies prohibiting student-athletes from receiving compensation. And, as Judge Wilken held, antitrust law is concerned with protecting competition in particular markets for particular periods of time.

College sports, however, have changed dramatically in the nearly thirty years since *Board of Regents* was decided. Consider: the television broadcast plan at issue in *Board of Regents* provided that each of two network partners could broadcast a total of fourteen live football games *per season* and had to feature at least eighty-two different teams in a two-year period.[6] Today, at least a dozen football games are available on live television *week by week*. Further, each "power conference" has launched or will launch a proprietary television network, and certain schools have exclusive television networks of their own. As NCAA athletics have evolved into a commercial juggernaut, the competitive justifications and ramifications of prohibiting student-athletes from receiving monetary compensation have changed too.

On the heels of the Motion to Dismiss Order (and the Class Certification Order), the *O'Bannon* class and the NCAA cross-moved for summary judgment. Although the factual allegations of conspiracy—namely, the NCAA's rules concerning amateurism—are largely undisputed, the parties hotly contest the relevant market definitions and the pro- and anticompetitive effects of the NCAA's rules therein. It seems unlikely that Judge Wilken's eventual decision on summary judgment will resolve *O'Bannon*, although that decision will likely focus the issues for trial. No court (or jury) has ever considered amateurism through the lens of antitrust law, and it appears that *O'Bannon* is heading in that direction.

IV. CHANGE IS ON THE WAY

An *O'Bannon* trial could transform college athletics, as we know them, in large part because of the Class Certification Order, in which Judge Wilken certified an injunctive-relief class. The Order also declined to certify a damages class on the ground that plaintiffs failed to demonstrate a feasible way to determine which members of the putative damages class were actually harmed by the NCAA's restraints. For example, Judge Wilken concluded that it would be an overwhelmingly difficult and burdensome task to identify which class members' name, image, or likeness rights had actually been utilized in live or archived broadcasts or in video games.

[6] *Bd. of Regents*, 468 U.S. at 92-94. The networks could also broadcast "supplemental" and "exception" games after negotiating with various schools individually along narrow guidelines.

Though the NCAA was quick to declare this outcome a victory,[7] the reality is that the *O'Bannon* plaintiffs' pursuit of injunctive relief presents an existential threat to amateurism in college athletics—certification of a damages class and an award of money damages would have simply been the gravy for plaintiffs. There should be little doubt that if the NCAA had the opportunity to make *O'Bannon* go away merely by opening its checkbook—while leaving its current amateurism rules intact—the NCAA would have taken that result. Instead, the NCAA must defend against the very real threat of a permanent injunction that could indelibly transform college athletics by declaring as void and unenforceable the NCAA's most central amateurism rules.

With a potential trial looming, it has been reported that the NCAA and "power conference" members are exploring stipends and other compensation models within the prevailing structure.[8] The timing of such discussions is not coincidental; rather, it punctuates the significance of Judge Wilken's recent decisions and the leverage and momentum they have created for plaintiffs and student-athletes. It would not be surprising to see the NCAA liberalize its strict amateurism rules in the months ahead to begin "voluntarily" moving in the direction of a regime that Judge Wilken or a jury may very well force upon it.

Moreover, *O'Bannon* is not the first, and will not be the last, legal challenge against the NCAA's rules on amateurism. Already, courts have found plausible antitrust causes of action in cases in which plaintiffs have alleged that the NCAA's compensation rules restrict the market for DI talent by limiting the number and distribution of DI football scholarships[9] and forms of financial aid.[10]

And, with greater frequency, courts have been viewing NCAA athletics for what they are: big business. As the Seventh Circuit recently held: "No knowledgeable observer could earnestly assert that big-time college football programs competing for highly sought-after high-school football players do not anticipate economic gain from a successful recruiting program."[11]

It also bears mention that, even though Judge Wilken declined to certify a damages class in *O'Bannon*, that does not preclude the availability of treble damages in future actions brought against the NCAA on a non-class basis. Should the *O'Bannon* plaintiffs ultimately succeed in proving antitrust violations by the NCAA, then they might try to use that judgment as a springboard for damages trials by individual student-athletes (most likely, high-profile student-athletes whose notoriety would present the greatest upside for damages).

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[7] Statement, NCAA, Judge Denies Plaintiffs' Certification of Damages Class (Nov. 8, 2013) (*available at* http://www.ncaa.org/about/resources/media-center/press-releases/judge-denies-plaintiffs%E2%80%99-certification-damages-class).

[8] Rachel Cohen, *Power Conferences Seeking More Autonomy in NCAA*, ASSOCIATED PRESS, Dec. 12, 2013 (*available at* http://finance.yahoo.com/news/power-conferences-seeking-more-autonomy-121959979.html).

[9] *Rock v. NCAA*, 2013 WL 4479815 (S.D. Ind.); *In re NCAA 1-A Walk-On Football Players Litig.*, 398 F. Supp. 2d 1150 (W.D. Wash. 2005).

[10] *White v. NCAA*, No. 06-999, Docket No. 72, slip op. at 3 (C.D. Cal. Sept. 20, 2006).

[11] *Agnew v. NCAA*, 683 F.3d 328, 340 (7th Cir. 2012); MTD Order at 14.

V. COURTS (OF LAW) ARE PROVIDING THE VENUE FOR CHANGE

The *O'Bannon* Motion to Dismiss and Class Certification Orders simultaneously continue the trend and set the table for NCAA reform. They present an existential threat to the NCAA and an opportunity to remake the college sports landscape. The legal system appears primed to address this modern reality, even if the NCAA is not. Regardless of how *O'Bannon* ultimately resolves, it is *in* the courts, not on them, where student-athletes may earn their greatest victory.

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Sport and State Aid—Reining in the Populist Gesture

Ken Daly
Sidley Austin LLP

Sport and State Aid—Reining in the Populist Gesture

Ken Daly[1]

I. INTRODUCTION

Sport's ability to capture public attention and generate intense loyalties and rivalries is not overlooked by public representatives with budgets to spend. A recent focus by the European Commission on State Aid in sport has sought to reduce the risk of populist gestures causing controversy between Member States by clarifying how they may channel public money into their national sports teams and infrastructure without causing important distortions in economic (and ultimately sporting) competition.

However, at the very same time, as if to remind law-makers of sport's uniquely political nature, an unprecedented controversy has erupted in which the European Ombudsman has accused the EU's (Spanish) Commissioner for competition of maladministration for failing to initiate investigations into public support for some notable Spanish football clubs, including the club that the Commissioner is said to support.

II. EU STATE AID LAW AND SPORT

In light of sport's social, public health, and political dimensions, public spending plans across the European Union rightly allow for investment in sports facilities, teams, training, and infrastructure. EU law and policy not only recognize the value of this investment, but a special legal status has been afforded to sporting issues in the Treaty on the Functioning of the European Union (at Article 165), alongside other major public priorities.

EU State Aid law, on the other hand, is designed to serve another major EU priority: that of ensuring a level playing field among economic actors within the EU's internal market by limiting the ability of Member States to distort competition by selectively offering public money or any other support (including tax breaks, regulatory concessions, or anything which creates a more favorable trading environment), to particular undertakings.

Investment in purely public projects (such as building a motorway) will generally be exempt, but where a Member State wishes to invest public money or give any other benefit or support over certain thresholds that will give rise to purely private benefits, the Member State must notify the Commission. It can then block, approve, or add conditions to the aid, depending on the benefit's potential to distort competition within the European Union. The Commission has extensive powers to investigate complaints or conduct its own enquiries regarding potentially distortive aid. Aid that is not notified and approved is deemed invalid, and the Member State may be ordered to recover it.

The EU State Aid rules have always applied to sport, but the precise scope for public authorities to invest in and support sport-related activities without violating EU State Aid rules

[1] Ken Daly is a partner in the Brussels office of Sidley Austin LLP. The views expressed in this article are exclusively those of the author and do not necessarily reflect those of Sidley Austin LLP, its partners, or its clients.

has not been entirely clear. However, a series of recent cases, policy initiatives, and controversies have begun to shed (and will shed more) light on the Commission's policies in this area.

III. DEVELOPMENT OF SPORTS INFRASTRUCTURE

The Commission has recently approved aid providing funding and support to a number of sporting infrastructure projects. These have involved public funding for projects such as modernization works to football stadiums in Belgium, and the construction of multisport arenas in Sweden and Germany. On December 18, 2013, the Commission approved financial support of more than EUR 1 billion by France for the construction and renovation of nine stadiums in order to host the UEFA EURO Championship in 2016.

As an illustration of the analysis required, in the French case the Commission found that the public financing would indeed provide a (private) advantage to the companies involved in the construction and renovation of the stadiums, as well as to the operators and users of the stadiums. And it found that this would indeed have the potential to distort competition among those constructors/operators and their competitors within the European Union. As with all such public financing cases, the task of the Commission was therefore to assess whether the aid could be found compatible on the grounds that it furthered a common EU objective without unduly distorting competition.

The Commission concluded that the project would not have been viable without public support and that the aid granted was limited to the minimum necessary to ensure it would conform to the UEFA requirements in time for the Euro 2016 championship. Crucially, the Commission found that, after the championship, the stadiums would continue to be available for the resident clubs and would also serve as multifunctional arenas for the public for sporting, cultural, and social events. France also committed to set up a system of permanent control of the prices paid by the resident clubs, in order to ensure that the stadiums would be used at market conditions. This, the Commission found in its approval decision, would limit the risk of distorting competition through granting undue advantages to the resident football clubs, compared to the conditions available to competing clubs.

In 2011 the Commission considered and approved the aid aspects of Hungary's multi-year national sport development strategy, which included both building infrastructure and financing youth training. Hungary argued, and the Commission accepted, that the existing infrastructure was significantly underdeveloped and that private investors could not economically fill the gap. Hungary therefore planned to incentivize commercial investments through tax benefits involving potential aid up to EUR 455m by 2017. Football, handball, water polo, basketball, and ice hockey were all to benefit.

The Commission found that the plan was clearly state aid (in that it had a significant potential to distort competition notably between the beneficiaries and their competitors). They then weighed the potential distortion of competition against the goal of increasing the participation of the general public in sporting activities and events, while considering various safeguards that had been proposed to maintain competition. These safeguards included: (i) requiring operators to pay market prices for using the facilities constructed, (ii) setting minimum rental prices, (iii) requiring beneficiary sports clubs to ensure the widest possible benefits to the general public, (iv) ensuring that the infrastructure constructed had a multifunctional character (and was not for the benefit of the main tenant club only), etc. On balance, the Commission accepted the competition safeguards proposed and approved the scheme.

Thus, where cases are notified to the Commission, approval is usually the result, potentially after a period of negotiation of conditions to ensure the maintenance of undistorted competition.

IV. AID TO PROFESSION FOOTBALL CLUBS

However, the more controversial cases have arisen not from the notification process (like the infrastructure cases above) but, instead, from complaints submitted to the Commission that certain Member States have been distorting competition by offering clandestine financial support to clubs—particularly football clubs—in their territories.

In 2012, UEFA and the Commission issued a joint statement in which the Commission blessed certain rules imposing minimum solvency requirements upon professional clubs within UEFA's competitions. The purpose of these rules is, in part, to ensure stability and avoid potential distortions in the sport arising from the tendency of some clubs to over-borrow and risk insolvency (e.g. to purchase new players). With iconic national clubs in financial danger, the Commission noted that a temptation might arise for Member States to grant a lifeline, whether in the form of a "bail-out," tax breaks, loans on favorable terms, or other forms of support—which would risk violating State Aid rules.

This risk was not merely hypothetical. In October 2012, the Commission addressed a request for information to all Member States concerning potential State Aid given to national football clubs, as it was concerned about un-notified aid. The Commission is said to be still pursuing the leads generated by this inquiry.

Following a complaint from a retired Dutch civil servant in 2010, the Commission opened, in March 2013, an investigation into alleged measures of five Dutch municipalities to support five well-known Dutch football clubs. This investigation is ongoing and relates to waivers of financial claims, lowering rents with retroactive effect, purchase of land at favorable prices, and the purchase of facilities for the benefit of clubs.

In November 2009 the Commission also received a complaint from a representative of investors in a number of European football clubs, alleging that certain Spanish football clubs have benefitted significantly from arrangements that confer exemptions and other advantages in relation to corporation tax, capital gains tax, and income tax. According to the complaint, these advantages have been provided for in Spanish legislation, benefit a small number of clubs, and amount to several billion Euros in value.

In response to what it perceived to be Commission inaction regarding the complaint, the complainant argued that the Commission was delaying a proper investigation because the Commissioner for competition was a Spaniard, made no secret of his support for one of the football clubs in question, and had been a Minister in the Spanish government which had approved certain of the tax advantages in question. By December 2011 the Commission had not opened a formal investigation and the complainant took the matter up with the European Ombudsman, responsible for identifying incidents of maladministration on the part of the EU's institutions.

In an unprecedented decision of December 16, 2013, the Ombudsman found after investigation (a) that the Commission had failed to take a timely decision on whether infringement proceedings against Spain should be initiated; and (b) that:

> the Commission has failed to allay suspicions that the relevant Commissioner has a conflict of interests and that its inaction reflects an unwillingness by that Commissioner to start infringement proceedings which might impact negatively on a football club with which it is acknowledged that he has close links.

On December 17, 2013 the Ombudsman issued a press release calling on the Commission to act immediately to open an investigation against Spain, or justify its refusal to do so. The next day the Commissioner's spokesman called the allegations of conflict of interests "unacceptable" and the Commission has refused any suggestion of bias. Nonetheless, the Commission opened three investigations concerning public support in favor of seven Spanish professional football clubs.

According to the Commission, Real Madrid FC, Barcelona FC, Athletic Club Bilboa, and Club Atlético Osasuna all are said to have availed of a preferential corporate tax rate by enjoying an exemption from an obligation to convert into "sport limited companies," as would normally have been required under Spanish law. Other forms of support (including to an additional three clubs) involved an allegedly advantageous land transfer based on an inflated evaluation and various sophisticated loan guarantee arrangements.

The reaction in Spain was severe. The Spanish authorities responded with promises to defend the reputation of the clubs as integral to "the Spanish brand." Real Madrid president, Florentino Perez, labeled the investigation as a "campaign against Spanish football." Secretary of state, Miguel Cardenal, categorized it as a concerted effort by the Commission to damage Spain's image. The investigations were also dismissed as amounting to mere competitor jealousy of Spain's success on the field (though skeptics might argue that if aid has been paid, this might have contributed to that same success).

Such responses testify to the strong national and local allegiances that are often associated with major sporting teams, and the political nature of decisions to grant aid in the first instance. Assuming there is substance to the allegations, they also illustrate that aid is certainly not always notified by Member States, whether because it is not obvious that it qualified as notifiable aid, or because Member States hope that the aid will remain free from scrutiny.

V. WHAT'S NEXT?

The above cases have only recently opened and will take some time to conclude. In the meantime, the Commission will also be focusing on State Aid policy. In 2008 the Commission adopted its General Block Exemption Regulation ("GBER") creating a "safe harbor" mechanism for certain categories of aid deemed compatible with the internal market, meaning Member States could grant qualifying aid without having to notify the Commission.

In the context of the recent "modernization" of State Aid, the Commission's focus has been on renewing the GBER with a view to expanding it to cover additional types of aid, including aid to the sporting sector. The enabling provisions (allowing sport to be included in the upcoming revised GBER) provide:

> … State aid measures for sport, in particular those in the field of amateur sport or those that are small-scale, often have limited effects on trade between Member States and do not create serious distortions of competition. The amounts granted are typically also limited. Clear compatibility conditions can be defined on the basis of the experience acquired so as to ensure that aid to sports does not give rise to any significant distortion.

The Commission is therefore busy preparing and consulting on draft measures to enlarge the safe harbor mechanism to include certain categories of aid to sports. To the disappointment of many, the latest drafts would, if adopted, limit the block exemption to sporting infrastructure projects and not other types of aid; for example, concessions such as tax relief to a sporting club in poor financial health. Also, the conditions attached to the infrastructure aid being block exempted mean they will apply to a relatively narrow category of aid: (i) the facilities must be used by more than one professional sports user, (ii) they must provide for non-sports related functions, (iii) access must be given to all users, and (iv) use must be granted on a transparent and non-discriminatory basis. Pricing conditions must be objective and the amount of aid shall not exceed 75 percent of the total cost of the project.

Of course being outside the safe harbor of a block exemption does not mean that aid is illegal, it simply means it must be notified and individually justified, though this certainly adds to the burden all around.

The narrow scope of the sporting "safe harbor" (if adopted as is) would represent a missed opportunity for the Commission. As recent cases have shown, there is an appetite for more concrete statements, guidelines, and, where appropriate, block exemptions to ease the enforcement burden on the Commission. These would allow the Commission the resources to react more quickly, reduce the compliance burden on Member States, and, crucially, provide legal certainty for the clubs and other sporting interests that might be the recipients of aid.

What is at stake for clubs and their supporters is that any aid ultimately found to be incompatible with EU State Aid law would likely have to be repaid. In the football cases mentioned above, this has the potential to drive some of Europe's best known sporting teams and brands into bankruptcy. Although the law might require such an outcome, and although it might be justifiable under State Aid and economic principles, at a time of rising Euro-skepticism and financial hardship across the European Union, it could represent a spectacular political "own goal" for European enforcement policy.

This risk represents an illustration of the political danger that attends the application of EU law to sport. It should also encourage the Commission to be more ambitious in its policy development, as advance certainty regarding which types of aid are permitted will help to avert calamitous developments in an area that holds public attention like few others.

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Counting the Pennies in Sport: UEFA's Financial Fair Play Regulations Under the Competition Law Microscope

Brian Kennelly & Ravi S. Mehta
Blackstone Chambers

Counting the Pennies in Sport: UEFA's Financial Fair Play Regulations Under the Competition Law Microscope

Brian Kennelly & Ravi S. Mehta[1]

I. INTRODUCTION

It has been almost forty years since the manager of Tottenham Hotspur,[2] Bill Nicholson, is said to have remarked "[e]verything has changed now. Money comes before football and money is the ruination." The economic dimension of football has never been more significant. On the one hand, BT and Sky engage in a bidding war for Premiership broadcasting rights; on the other, many U.K. and European clubs slide into insolvency. It is well-established in EU competition law that "the practice of football is an economic activity" such that football clubs or national associations may be "undertakings."[3] Moreover, the finances of several leading clubs have been artificially inflated by the presence of wealthy owners who have injected large amounts of their own funds.

Amid these trends, the Union of European Football Associations ("UEFA") has introduced regulations to ensure so-called "financial fair play." As a restriction on the access to football competitions in Europe, objections have been made that the rules do not comply with EU competition law. In this article, we briefly set out the new regime and its enforcement to date before looking at the competition law complaints that have already been, or are likely to be, made against the regulations.

II. UEFA'S FINANCIAL FAIR PLAY REGULATIONS

UEFA's *Club Licensing and Financial Fair Play Regulations* ("the FFPR") were introduced in May 2010. The purpose of the FFPR is set out at Article 2(2) of the updated 2012 edition:[4]

a) to improve the economic and financial capability of the clubs, increasing their transparency and credibility;

b) to place the necessary importance on the protection of creditors and to ensure that clubs settle their liabilities with players, social/tax authorities and other clubs punctually;

c) to introduce more discipline and rationality in club football finances;

d) to encourage clubs to operate on the basis of their own revenues;

e) to encourage responsible spending for the long-term benefit of football; and

f) to protect the long-term viability and sustainability of European club football.

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[1] The authors are barristers practising at Blackstone Chambers. All opinions and errors in this piece are their own.

[2] An English football club, located in Tottenham, England.

[3] Case T-193/02 *Piau v Commission* [2005] ECR II-209, at [69] and [71].

[4] Club Licensing and Financial Fair Play Regulations, *available at* http://www.uefa.org/MultimediaFiles/Download/Tech/uefaorg/General/01/80/54/10/1805410_DOWNLOAD.pdf.

The FFPR introduced a number of rules into the license conditions for a football club to participate in national and European competitions; these are designed to limit imbalances in a club's finances. This is achieved by requiring clubs: (a) to provide financial information to licensing authorities,[5] including "future financial information;"[6] (b) not to have any "overdue payables" in the season preceding the application for a license, either to football clubs[7] or towards employees and social/tax authorities;[8] and (c) if they qualify for a UEFA club competition, to meet "break-even requirements"[9] and other heightened monitoring requirements.[10] This latter condition means a club's expenses must not exceed its income[11] beyond "acceptable deviation[s]."[12]

The FFPR are being implemented over a three-year period. Monitoring commenced in 2011 and the "break-even" assessment for the financial years ending 2012 and 2013 is being carried out during the course of the current season (2013/14).

To enforce the regime, UEFA's Club Financial Control Body ("CFCB"), established in June 2012 and consisting of an Investigatory Chamber and an Adjudicatory Chamber, is competent to: (a) decide on clubs' eligibility for UEFA club competitions, and (b) impose disciplinary measures in the case of non-fulfillment of the relevant requirements.[13] Decisions of the CFCB may be appealed to the Court of Arbitration for Sport ("CAS"), which sits in Lausanne.[14] Already, UEFA is heralding the FFPR as a success story, reporting "a 47 percent reduction in overdue transfer and employee payables between the first assessment in June 2011 and the June 2012 assessment."[15]

III. A GROWING SERIES OF PRECEDENTS

Unhelpfully, UEFA does not publish the decisions of the CFCB. However, CAS has published a number of appeals decisions that largely concern the pre-June 2012 regimes (with decisions taken by UEFA's Control and Disciplinary Body or "CDB"). These offer a hint as to the likely approach that will be adopted by CAS and (potentially) the CFCB Adjudicatory Chamber to other aspects of the regime.

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[5] *Id.,* Articles 46, bis, 47, 48, & 51.

[6] *Id.,* Article 52.

[7] *Id.,* Articles 49 & 65.

[8] *Id.,* Articles 50 & 66.

[9] *Id.,* Articles 58-63.

[10] *Id.,* Articles 64-68.

[11] *Id.,* Article 63.

[12] *Id.,* Article 62.

[13] Article 3 of the Procedural rules governing the UEFA Club Financial Control Body (2012 Edition), *available at* http://www.uefa.org/MultimediaFiles/Download/Tech/uefaorg/General/01/85/85/25/1858525_DOWNLOAD.pdf

[14] *Id.*, Article 25(2).

[15] *Club Licensing Benchmarking Report Financial Year 2011 - 11 selected findings, available at* *http://www.uefa.org/MultimediaFiles/Download/Tech/uefaorg/General/01/91/62/73/1916273_DOWNLOAD.pdf* at ¶10.

Four decisions have been handed down to date: *Györi, Bursaspor, Beşiktaş*, and *Málaga*.[16] The first three are examined at length in an article by Brian Kennelly dated 23 May 2013.[17] CAS Panels have largely upheld both exclusions and fines imposed on clubs for either failing to declare or simply having overdue payables in breach of the FFPR.

The *Málaga* decision was the first in which a CAS Panel has applied the 2012 edition of the FFPR. The club had suffered severe financial hardship and was placed in insolvency proceedings while owing significant sums to the Spanish tax authorities. At the relevant reporting dates for FFPR purposes, the tax authorities had not yet determined the club's request for its tax liabilities to be deferred. This request was later granted.

The club's position was that these sums were deferred payments and not relevant to the FFPR assessment, whereas two reports drafted by independent auditors acting on UEFA's behalf concluded that the club had millions of Euros of overdue payables. It was fined EUR 300,000 and excluded from participating in the next UEFA club competition for which it would otherwise qualify on its results or standing in the next four seasons (i.e. 2013/2014 to 2016/2017). A further exclusion from a subsequent UEFA competition would be imposed if the club had not proved by March 31, 2013 that it had no overdue payables.

The appeal before the CAS Panel was almost exclusively focused on whether the concept of an "overdue payable" should be determined by national law—where the debt in question was a sum owed to tax authorities under national legislation—or whether it was an autonomous concept under the FFPR. The Panel concluded that it was the latter and, since the club "ha[d] not submitted any specific argument why the sanction imposed would not be in line with principles of proportionality," it upheld the sanction imposed as proportionate.

Outside the CAS decisions, it is difficult to discern UEFA's practice. In a recent press release, UEFA announced that the CFCB's Adjudicatory Chamber had: (i) fined and excluded three clubs from participating in the next UEFA club competition for which they would otherwise qualify on results or standing in the next three seasons (FC Metalurh Donetsk, Ukr; FC Petrolul Ploieşti, Rom; and Skonto FC, Lva); (ii) fined two clubs (CS Pandurii Târgu Jiu, Rom and WKS Śląsk Wrocław, Pol) and (iii) reprimanded another (Vitória SC, Por) for the presence of overdue payables.[18]

Interestingly enough, in *Györi* and *Beşiktaş*, the CAS Panels had noted a decision by the UEFA Control and Disciplinary Panel concerning PAOK FC, which had significant overdue payables during the monitoring process (although not when it was awarded a license). PAOK FC submitted a reorganization plan and sought a "second chance" from UEFA. Accordingly, the

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[16] CAS 2012/A/2702 *Györi ETO v. UEFA* (8 May 2012), CAS 2012/A/2821 *Bursaspor Kulübü Dernegi v. UEFA* (22 June 2012), CAS 2012/A/2824 *Beşiktaş JK v UEFA* (29 June 2012), and CAS 2013/A/3067 *Málaga CF SAD v. UEFA* (11 June 2013).

[17] *Available at* http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=2&ved=0CDsQFjAB&url=http%3A%2F%2Fwww.blackstonechambers.com%2Fdocument.rm%3Fid%3D523&ei=L2rJUpO7E5CUhQeZ4YGgDw&usg=AFQjCNGTPCgUa4x3dJePJotoIpSSd6fdpQ&sig2=PwPB_uvCk-zXLYJrkrMw0A.

[18] *UEFA Club Financial Control Body adjudicatory chamber renders decisions* (20 December 2013), *available at* http://m.uefa.com/news/2039912/.

UEFA Control and Disciplinary Panel fined the club EUR 250,000, but suspended EUR 200,000 of that fine for a probationary period of three years. The club's exclusion from competition for one season was suspended for a similar period.

A number of common themes emerge from these precedents. CAS Panels have strengthened the FFPR by accepting that they operate independently of national law.[19] CAS decisions have also acknowledged the importance of the FFPR "to protect the long-term viability and sustainability of European club football," and the seriousness with which UEFA treats significant breaches of the regulations.[20] Panels have stressed that the disclosure obligations in the FFPR are "essential for UEFA to assess the financial situation of the clubs that are participating in its competitions."[21] In turn, UEFA's approach is not inflexible, as the *PAOK* case illustrates.

Given the broad discretion conferred on UEFA in terms of the type and severity of sanctions it may impose, it is clear that it will be difficult to challenge sanctions before CAS with a standard of review of gross disproportionality.[22] Moreover, "just because another sanction could be issued, it does not make the one issued disproportionate."[23] Indeed, a number of factors suggest that the regime will be applied in a severe manner:

- **The seriousness of breaches of FFPR**: CAS has so far been unreceptive to arguments that sanctions imposed for breaches of the FFP Regulations are disproportionate when compared to those imposed for other offenses, such as match-fixing.[24]
- **Recidivism**: CAS has not challenged the view that the absence of a previous infringement is not a decisive factor in determining the suitability of sanctions, see *Györi*[25] and *Bursaspor*.[26] On the other hand, a systemic breach of the FFPR is likely to be an aggravating factor, as it appears to have been in *Beşiktaş.*[27]
- **Fault**: A system of fault-based liability that is otherwise unapparent on the face of the FFPR emerges from the case law, namely by the fixing of fines in proportion to the gains made by the club by wrongfully participating in a competition.[28] This need not include "bad faith" as in *Beşiktaş*—in *Györi* both the club and the HFF had failed to exercise "diligence."[29]
- **The ambiguous role of national associations**: The Appeals Body in *Györi* considered that the original sanction on the club had been harsh since it had relied on the Hungarian

[19] *See Györi* at [118] and *Málaga* at [9.5]-[9.7].
[20] *Beşiktaş* at [113] and [129].
[21] *Györi* at [136] and *Bursaspor* at [115].
[22] *See*, e.g. *Beşiktaş* at [127].
[23] *Id.*
[24] *See Beşiktaş* at [127]-[128].
[25] *Györi* at [34].
[26] *Bursaspor* at [24].
[27] *Beşiktaş* at [127].
[28] *See Bursaspor* at [146] and *Beşiktaş* at [127].
[29] *Györi* [34(c)(iv)] and [158].

Football Fedaration which had itself not exercised due diligence.[30] However, in *Beşiktaş* the CAS Panel agreed with UEFA that the FFPR did not oblige UEFA to take action against the license grantor in order to sanction the license holder,[31] and that "UEFA cannot be deemed to accept every single federation's or association's decision to issue their clubs with licences."[32] It will therefore be dangerous to rely upon a national association's conduct when dealing with UEFA monitoring.

IV. COMPETITION CONCERNS WITH THE FFPR

The compatibility of the FFPR with EU competition law is not resolved. A Belgian football agent named Daniel Striani has made a formal complaint to the European Commission contending, among other things, that the FFPR (as an "agreement between undertakings" under Article 101 TFEU) is incompatible with EU competition law.[33] The complaint—brought in parallel before a civil court in Brussels (and due to be heard in March 2014)—focuses on the "break-even requirement" which, it alleges, amounts to an obligation "not to overspend" even if such overspending is designed to expand the club and make it more competitive.

The complaint identifies a number of restrictions of competition:[34]

1. "restriction of investments;
2. fossilization of the existing market structure (i.e. the current top clubs are likely to maintain their leadership, and even to increase it);
3. reduction of the number of transfers, of the transfer amounts and of the number of players under contracts per club;
4. deflationary effect on the level of players' salaries; and
5. consequently, a deflationary effect on the revenues of players' agents (depending on the level of transfer amounts and/or of players' salaries)."

At least publicly, the Commission has expressed its support for the FFPR. Indeed, it was specifically consulted by UEFA when the regulations were being drafted, leading to a *Joint Statement* from both organizations on March 21, 2012[35] which supported the FFPR, and considered that "the financial regulations by UEFA and the State aid rules by the Commission pursue broadly the same objective of preserving fair competition between football clubs.[36]" Indeed, the prediction was that "[g]iven that the FFP rules impose stricter financial management of football clubs, they are likely in the longer run to lower or eliminate the need for State

[30] *Id.* at [38].
[31] *Beşiktaş* at [120].
[32] *Id.* at [121].
[33] *See*, most notably, the op-ed by the claimant's lawyer in *Football's Anticompetitive Streak*, WALL STREET J., *available at* http://online.wsj.com/news/articles/SB10001424127887324077704578357992271428024.
[34] *Available at* http://www.financialfairplay.co.uk/latest-news/legal-challenge-to-uefa-ffp-rules-by-bosman-lawyer.
[35] *Available at* http://ec.europa.eu/competition/sectors/sports/joint_statement_en.pdf.
[36] Joint Statement at [8].

subsidies for a number of clubs."[37] It might therefore be expected that the Commission will not uphold Mr. Striani's complaint—although it is not bound by this Statement.

A refusal by the Commission to uphold the complaint may lead to an application to annul that decision before the General Court of the EU ("GCEU"). The GCEU will apply the approach of the Court of Justice of the EU ("CJEU") in *Meca Medina*[38] and *Wouters;*[39] namely: (i) does the sporting rule cause a restriction of competition within its overall context?; (ii) are the restrictions caused by the rule inherent in the pursuit of its objectives?; and (iii) is the rule proportionate in light of those objectives?

Given the clear and significant economic implications of the FFPR, including the possible retention of competition money by UEFA as a sanction for breaches of the rules, the GCEU is likely to conclude that UEFA is an association of undertakings. The real questions in the dispute will, therefore, be whether there are restrictions of competition and whether such restrictions are justified.

As to the first of these, Mr. Striani's arguments are clearly arguable. The break-even requirement is forward-looking, so that wealthy clubs with an established fan base and sponsorship structures are likely to retain their place at the summit of the game. With significant commercial deals already in place, clubs such as Real Madrid, Bayern Munich, and Manchester United, or even relative newcomers such as Manchester City and Paris Saint-Germain, are not necessarily reliant on the injection of external equity to remain competitive at the highest level. This appears to restrict competition between these select few and those clubs aspiring to "jump to the top" through exceptional funding.

Concerns continue to be raised about sponsorship deals arranged by clubs such as Manchester City or Paris Saint-Germain, where the sponsors have been commercial parties with strong links to the same government involved in the ownership structures of the club. Moreover, the arrangements with public bodies concerning sporting facilities—often another form of funding for clubs—show no sign of abating. While the Commission has argued that the FFPR would reduce the necessity for state aid, it may in fact encourage such arrangements with national and local authorities as the prohibition on "overspending" kicks in. The Commission is currently examining Europe-wide deals in relation to stadia, with five Dutch professional clubs and six Spanish top flight teams under the lens[40] and other clubs to potentially follow.[41]

The complaint relating to players' remuneration is also potentially problematic for the regulator since, if the GCEU were to conclude that the FFPR operate as a salary cap, there is no evidence of negotiations with the players' representatives prior to the regulations' entry into

[37] *Id.* at [9].

[38] Case C-519/04P *Meca Medina v Commission* [2006] ECR I-6991 at [22]-[28] and [42].

[39] Case C-309/99 *Wouters* [2002] ECR I-1577 at [97]. This was recently reaffirmed in Case C-1/12 *Ordem dos Técnicos Oficiais de Contas v. Autoridade da Concorrência* (28 February 2013), nyr at [93].

[40] *See* the press releases at http://europa.eu/rapid/press-release_IP-13-192_en.htm and http://ec.europa.eu/sport/news/20131218-state-aid_en.htm.

[41] In relation to the Liberty Stadium in Swansea, South Wales, *see* http://www.bbc.co.uk/news/uk-wales-south-west-wales-25559959.

force.[42] Finally, if the break-even rule cannot be policed effectively, or if the sanctions imposed on clubs in breach of the FFPR are applied in an "arbitrary and discriminatory manner," the FFPR might be said to interfere with competition. [43]

As to the second question, the Commission had recognized as early as 2007 that "the ensuring of financial stability of sport clubs/teams" could be a legitimate objective for restricting competition.[44] UEFA has also argued that the FFPR are necessary to protect the integrity of its competitions. These objectives are unlikely to be contested. However, Mr. Striani has argued that the FFPR are not suitably tailored to those objectives. It is notable that the regulations restrict the injection of funds/equity into a club, even when the club's debts have not grown despite annual losses (or losses across the monitoring period). Other alternatives have also been suggested by the claim, such as the introduction of a "luxury tax" or other redistributive mechanism (as in many U.S, sports) or, alternatively, guarantees from owners of clubs participating in competitions for the duration of that tournament.

It remains to be seen whether the courts will be swayed by these arguments. However, it appears that UEFA's careful plans to forestall any challenges to its prized new regulations will be tested before the FFPR have fully got off the ground.

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[42] This might otherwise protect the cap from competition analysis: Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751 at [59]-[60].

[43] *See Piau* at [94] or *Meca Medina* at [47].

[44] *See* §2.1.5 of Annex I of its Staff Working Document on Sport, *available at* http://ec.europa.eu/sport/white-paper/swd-annex-i-sport-and-eu-competition-rules_en.htm.

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Sports and Competition Law in India: The Need for a Third Umpire?

Cyril Shroff & Nisha Kaur Uberoi
Amarchand & Mangaldas & Suresh A. Shroff & Co.

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Cyril Shroff & Nisha Kaur Uberoi[1]

I. INTRODUCTION

In today's world of increased internationalization and commercialization of sports, the relationship between competition law and sports cannot be underplayed. Given the emergence and rapid growth of economic interests in sports, it certainly cannot escape the application of competition law principles. While competition law authorities in the European Union and the United States have recognized the concept of a "sporting exception" in the 20th century in order to appreciate the distinctive characteristics of sports, the ambit of such an exception is seen to be shrinking given the increasing commercialization of sports. However, there is sufficient rationale to support the sporting exception premised on the notion that sports should be treated differently from other "ordinary" industries/sectors given its special characteristics and its significant social, cultural, and recreational features.

II. ORGANIZATION OF SPORTS VIS-À-VIS ECONOMIC DIMENSION OF SPORTS

The difficulty in distinguishing between sporting and economic facets of sports has resulted in some highly challenging questions before competition law authorities across the globe. In the Indian context, three noteworthy cases have demonstrated the troubled relationship between these two areas, marking the beginning of an intense debate in relation to the application of competition law principles to the area of sports and the unique issues that arise in this regard.

Given that sporting events or activities are typically globally or nationally organized under the supervision of a single administrative body, the use or abuse of a dominant position by such bodies is often subject to judicial scrutiny. Moreover, it has been recognized internationally that "it is not the power to regulate a given sporting activity as such, which might constitute an abuse but rather the way in which a given sporting organisation exercises such power."[2] The Competition Commission of India ("CCI"), the nodal enforcement authority established under the Competition Act, 2002 ("Act"), has, in its relatively nascent existence, investigated the conduct of two sports organizations: the Board of Control for Cricket in India ("BCCI") in the case of *Surinder Singh Barmi v. The Board of Control for Cricket in India*[3] ("*BCCI* case") and

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[1] Mr. Cyril Shroff (cyril.shroff@amarchand.com) is the Managing Partner of Amarchand & Mangaldas & Suresh A. Shroff & Co., Mumbai region and Nisha Kaur Uberoi (nishakaur.uberoi@amarchand.com) is a Partner and Head of the Competition Law Practice, Mumbai region. The authors would like to acknowledge the contributions of Bharat Budholia, senior associate, and Shruti Aji Murali and Aishwarya Gopalakrishnan, associates, in the Mumbai Competition Law Practice.

[2] *Commission debates applications of competition rules to sport*, European Commission press release dated 24 February 1999, IP/99/133.

[3] Case No. 61 of 2010. Decided on 9 February 2013. It is important to note that there was a separate dissenting order wherein the BCCI was not found guilty of abuse of dominant position. Majority order *available at*

Hockey India ("Hockey India") in the case of *Dhanraj Pillay and Others v. M/s Hockey India*[4] ("*Hockey India* case"). The CCI's order in the *BCCI* case is currently under appeal before the Competition Appellate Tribunal ("COMPAT").[5]

Further, the CCI is currently investigating the All India Chess Federation ("AICF") for allegations regarding abuse of dominance by AICF in relation to banning/threatening to ban players associating themselves with other chess associations.

III. SPORTS BODIES AND CCI'S JURISDICTION

Sports bodies have contested that they do not fall within the purview of an "enterprise"[6] and are out of the CCI's jurisdiction. In its case, the BCCI contended that it does not fall within the definition of an "enterprise" under the Act as it is a not-for-profit organization not engaged in any "economic activity." The CCI, while addressing this issue, disagreed. It held that the act of "organizing events" (which involves grant of various commercial rights) is an economic activity since there is a revenue dimension involved in such activities, relying on the EU position.[7]

Previously, a decision of the Delhi High Court in *Hemant Sharma & Others v. Union of India*[8] had held that the CCI had jurisdiction over the AICF in response to a similar preliminary objection raised during the course of the CCI's investigation into the AICF. The Delhi High Court's ruling, however, was premised on the fact that the AICF levied a fee for membership and

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http://www.cci.gov.in/May2011/OrderOfCommission/612010.pdf and Dissenting order *available at* http://www.cci.gov.in/May2011/OrderOfCommission/612010S.pdf. By way of disclosure, the authors were involved in representing the BCCI.

[4] Case No. 73 of 2011. Decided on 31 May 2013. It is important to note that there was a separate dissenting order wherein Hockey India was found to be guilty of abuse of its dominant position. Majority order *available at* http://www.cci.gov.in/May2011/OrderOfCommission/732011.pdf and Dissenting order *available at* http://www.cci.gov.in/May2011/OrderOfCommission/732011R.pdf

[5] By way of disclosure, the authors are representing the BCCI.

[6] The Act defines "enterprise" as follows:

> a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

[7] C-49/07 *Motosykletistiki Omospondia Ellados NPID (MOTOE) v. Elliniko Dimosio*, 1 July 2008, *available a*t http://curia.europa.eu/juris/document/document.jsf;jsessionid=9ea7d2dc30db9364394bd21d4d03874f8a60f154d601.e34KaxiLc3qMb40Rch0SaxuMbhv0?text=&docid=67060&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=807163.

[8] WP(C) 5770/2011. In this case, the Delhi High Court, while dealing with a writ petition challenging CCI's investigation in relation to an allegation regarding abuse of dominance by AICF by banning/threatening to ban chess players associating with other chess associations, held AICF to be an "enterprise" within the definition of the Act, given that AICF was charging an annual registration fee, including separate fees for participating in tournaments organized by it. Given that in the *BCCI* Case the CCI did not factually analyze this aspect, the ratio of the *Hemant Sharma* Case in relation to AICF being an enterprise should not have been blindly followed merely because both the AICF and the BCCI perform similar functions for the game of chess and cricket, respectively.

that this constituted the economic activity that brought it within the definition of "enterprise" under the Act, in contrast with the BCCI which does not levy any fee for membership.

Similarly, relying on international precedents[9] in the *Hockey India* case, the CCI claimed jurisdiction over Hockey India by holding that the "organization" of sporting events included economic activities such as the grant of media rights and sale of tickets which were undisputedly revenue-generating activities. The CCI noted that the "nature of the activity" would, in fact, be the yardstick to decide whether the entity was an enterprise for the purpose of the Act. On this basis, they felt that sports organizations, whether not-for-profit or otherwise, are not exempt from the application of the Act, so long as they carried on any activities that the CCI regarded as "economic" in nature.

IV. NATURE OF SPORTS BODIES: NATURAL MONOPOLIES

In both the *BCCI* and the *Hockey India* cases,[10] the CCI acknowledged the importance and necessity of a pyramidical structure of governance (i.e. where the governance of a particular sport is entrusted to a single authority or federation) for particular sports, whether on a global or a nation-wide basis, recognizing the efficiency-enhancing benefits of such a structure.

However, this pyramid structure, in essence, gives rise to a natural monopoly by the sports federation in the regulation of a particular sport as well as the organization of sporting events. Nevertheless, such a natural monopoly is essential, as having multiple bodies would: (i) lead to uncertainty in terms of rules governing a particular sport; (ii) lead to flagging interest from spectators in a particular sport, as spectators would be faced with multiple leagues, tournaments, and potentially different sets of players or teams between leagues to keep track of (as opposed to one centralized league); and (iii) result in a limited pool of players for each league, on account of clashing schedules and physical limitations.

Moreover, team loyalty is also a factor to be considered, especially in the case of non-private sporting leagues, i.e. where players are representing a particular country, state, or region as opposed to playing the sport for a private club. Further, given that sport by its very nature is competitive, commercial interests in private professional leagues are, in fact, enhanced by maintaining the pyramid structure.

V. RELEVANT MARKET DEFINITION

The CCI's orders raised an abuse-of-dominance concern, questioning whether sports federations may use, or are using, this pyramidical structure to preclude third parties from setting up rival professional sports leagues.

In the *BCCI* case, the BCCI was alleged to be abusing its dominant position in relation to the grant of franchise rights, media rights, sponsorship rights, and commercial contracts ("Rights") related to the organization of the Indian Premier League ("IPL"). Interestingly, this is one of the few instances where the relevant market definition proposed by each of the BCCI, the Director General ("DG") (the investigative arm of the CCI), and the CCI was different.

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[9] *Supra Note 7; Minnesota Made Hockey, Inc. v. Minnesota Hockey, Inc., Civil No.10-3884(JRT/JJK), United States District Court, District of Minnesota* and The EU White Paper on Sports (2007).

[10] Pertinently, majority and dissenting orders were passed in both these cases.

The scope of the CCI's investigation (as set out in its order) was the conduct of the BCCI in binding itself, under an agreement for the sale of IPL media rights, to not "organize, sanction, recognize any other private professional domestic league/event" which could compete with the IPL. The CCI questioned whether that practice resulted in denial of market access to any potential competitor of the BCCI looking to establish a competing private professional cricket league/event, thereby violating Section 4(2)(c) of the Act.[11]

The DG, on the other hand, examined the conduct of the BCCI in granting the various Rights to third parties and whether or not competition was foreclosed in this process. The DG took the stance that the relevant market ought to be the market for "underlying economic activities which are ancillary for organizing the IPL" given that each of the Rights was associated with economic activities in relation to the IPL.

The BCCI, by contrast, contended that the definition of the relevant market proposed by the DG was incorrect since each of the Rights was distinct. The BCCI argued that there were separate relevant markets, given that franchise rights are not substitutable with media or sponsorship rights.

Contrary to the DG's analysis, given that the CCI's scope of investigation was (inexplicably) merely media rights, the CCI's relevant market analysis was completely different and referred to the most commonly used tools such as demand/supply side substitutability, together with the small but significant non-transitory increase in prices ("SSNIP") test. It is notable that the decision did not present any empirical analysis to indicate how the SSNIP test was applied and what the conclusions of its analysis were. Instead, the CCI referred to both various industry and news reports which have shown a wide variance in the television rating points of cricketing events in comparison to other sporting events in India, as well as other entertainment programs, to show that cricket cannot be substituted with any other sport or entertainment programming.

Further, the CCI did not present or refer to any other substantial data in terms of survey of customers, media rights companies, etc. to confirm its definition of the relevant market, which is in stark contrast to the level of detail of relevant market analysis the CCI has undertaken in other cases relating to abuse of dominance, such as the early cases of *Belaire Owners' Association v. DLF Limited* ("DLF case")[12] and *MCX Stock Exchange v. National Stock Exchange of India Limited* ("NSE case")[13] as well as more recent cases such as *Prints India* v. *Springer India Private Limited*[14] . Therefore, the CCI seems to have deviated from its previous approach in defining the relevant market and applying the principles of relevant market.

As such, the CCI's order in the *BCCI* case lacked the required level of empirical analysis and adopted an overly simplistic approach to delineate the relevant market to be that for the "organization of private professional cricket leagues/events in India."

[11] Section 4 (2)(c) of the Act states that there shall be an abuse of dominant position if an enterprise or a group indulges in practice or practices resulting in denial of market access in any manner.

[12] Case no. 19 of 2010.

[13] Case no. 13 of 2009.

[14] Case no. 16 of 2010.

Surprisingly, the CCI's analysis of the relevant market in the subsequent *Hockey India* case was different from the *BCCI* case. A key point of difference between the *Hockey India* and *BCCI* cases is that the CCI had not precisely identified the consumer in the *BCC*I case. In *Hockey India*, the CCI's analysis was more holistic and considered a plethora of factors in its assessment of dominance. For instance, the CCI observed that the sports sector constituted a "multitude of relationships" and that there are distinct consumers for different kinds of rights. The ultimate viewer is only one of the consumers to be considered.[15]

In contradistinction to the *BCCI* case, in the *Hockey India* case the CCI undertook a far more detailed analysis and considered it appropriate to define the relevant market on the basis of the specific allegations. These allegations were: (i) precluding hockey players from participating in the independent World Series Hockey League ("WSH") by imposing restrictive conditions for sanctioned and unsanctioned events in order to foreclose the market for rival leagues; and (ii) including unfair clauses in the Code of Conduct Agreement ("CoC") entered into between hockey players and Hockey India, which included disqualification from the national team for participation in unsanctioned events.

The CCI perhaps subjected its methodology in the *BCCI* case to closer scrutiny to arrive at a well-reasoned relevant market definition in the *Hockey India* case. Accordingly, based on the allegations, the relevant market was defined to be the "market for organization of private professional hockey leagues in India" and the "market for services of hockey players" in the *Hockey India* case.

It is worth considering that had the CCI adopted this approach in the *BCCI* case, (i.e. based on the precise allegations leveled against the BCCI), the framework of the CCI's analysis would have been the markets for each of the various Rights being granted in relation to the IPL. It can only be assumed that, in the *BCC*I case, the CCI's relevant market analysis in relation to sports organizations was too nascent, but that it evolved in *Hockey India*. Further, in concluding that cricket cannot be substituted for any other sport or entertainment event, the CCI may have been swayed by the fact that cricket is an extremely popular sport in India and, in its current form, attracts a substantial amount of commercial interest.

VI. ASSESSMENT OF DOMINANCE: "BIG IS NOT BAD"?

While Hockey India and BCCI may be dominant, it should be noted that dominance *per se* is not a violation. Given that competition law in India has made significant progress to reflect the more reasoned approach of "big is not bad," the CCI's foregone conclusion of abuse of dominance in the *BCCI* case was ill-conceived. As stated above, a single sports regulator would be akin to a natural monopoly that could be both efficiency-enhancing and promote sport.

In its assessment of dominance in the two cases, in order to arrive at a ruling of commercial dominance the CCI observed that both Hockey India and BCCI were conferred with the two-fold role of regulation and organization. Further, membership of Hockey India and

[15] This is also in keeping with the principles of relevant market definition under the Act, where demand-side substitutability is required to be considered.

BCCI in the International Hockey Federation ("FIH")[16] and International Cricket Council ("ICC"), respectively, as well as the by-laws of the international apex sporting associations, were relied on to attribute dominance to Hockey India and BCCI, respectively.

Moreover, in the *Hockey India* case, the CCI adopted an application of the "effects" based test to determine the actual effect of the conduct of Hockey India. The focus in both the *BCC*I and *Hockey India* cases was the foreclosure of rival private professional cricketing and hockey leagues, respectively. Given that the relevant market analysis was detailed and well-reasoned (i.e. based on the specific allegations) in the case of *Hockey India*, Hockey India was held not to have abused its dominance.

However, the CCI's incorrect application of the relevant market principles in the *BCCI* case unsurprisingly resulted in the misapplication of abuse of dominance principles, thereby holding BCCI to have abused its dominance in the relevant market for essentially the same conduct as Hockey India. The CCI's order in the *BCCI* case does not throw light on whether the grant of various Rights (which was the actual scope of investigation conducted by the DG) by the BCCI resulted in abuse of dominant position.

In contradistinction to the *BCC*I case, the CCI in the *Hockey India* case was of the view that, since there was no substantive evidence to demonstrate prejudiced application of the clauses, a contravention of the Act could therefore not be proved, which is evidence of its "effects" based approach. Interestingly, the CCI noted that the restrictive conditions imposed on hockey players were, in fact, "intrinsic and proportionate" to the objectives of Hockey India, while at the same time they did not seem to have considered the possibility of any commercial justification in relation to media rights in the *BCCI* case. Despite not having found a violation of abuse of dominance, the CCI considered it appropriate for Hockey India to "put in place an effective internal control system to its own satisfaction, in good faith and after due diligence to ensure that its regulatory powers are not used in any way in the process of considering and deciding on any matters relating to its commercial activities."

Nevertheless, the difference between the *Hockey India* and the *BCCI* cases clearly brings out the seminal role of the relevant market definition in undertaking an abuse of dominance analysis. Clarity in the relevant market, and the methodology used for defining the relevant market, would have in all probability have altered the outcome of the *BCCI* case.

VII. THE CCI AND SPORTS LEAGUES: TIME FOR A TIME OUT?

The CCI has taken significant steps in its four years as India's competition law regulator and has certainly proved to be a more proactive regulator than its predecessor.[17] However, the

[16] FIH is the international governing body for the sport of hockey in India and is recognized by the International Olympic Committee.

[17] The Act superseded the Monopolies and Restrictive Trade Practices Act, 1969, under which the Monopolies and Restrictive Trade Practices Commission was established. Given that the MRTP Act did not allow for the imposition of penalties or grant sufficient powers of regulation, the MRTPC was never an effective regulator.

CCI is in a predicament of its own making due to its contradictory rulings. This casts aspersion on the growing body of competition law jurisprudence in India and the CCI's credibility.[18]

First, in evaluating the sports sector, it is vital for the CCI to adopt the concept of "specificity of sport,"[19] which was popularized in the European Union, in order to appreciate the distinctive characteristics of sports that distinguishes it from other industries and warrants unique treatment by competition law authorities, including the CCI.

Evidently, both the *BCCI* and the *Hockey India* cases addressed the same question in law, i.e. whether or not they had abused their dominance in their respective relevant market. In the *BCCI* case, the CCI, besides prohibiting BCCI from indulging in practices that led to foreclosure of potential competitors, imposed a penalty of INR 522.4 million for a contravention of the provisions of the Act. On the contrary, the CCI let Hockey India off with a slap on the wrist, by merely cautioning it in relation to the potential conflict between its regulatory and commercial functions. Moreover, given that the CCI held that Hockey India had not abused its dominance, there was no penalty imposed. Despite the lack of consistency, it seems clear that there is an increasing intent on part of the CCI to apply competition law principles to sports organizations and events in India.

It remains to be seen as to how the CCI will close the loop in its assessment of sports regulators. Perhaps in its assessment of dominance in relation to AICF, the CCI will adopt a well-reasoned and well-researched approach by ensuring that it does not view the sports sector in a vacuum in all contexts and identifies the consumer consistently to determine the relevant market. However, the real opportunity to resolve the confusion created by the CCI lies with the COMPAT, which is currently considering the BCCI's appeal and can provide some much-needed clarity and certainty in the application of competition law to the sports sector.

[18] It is pertinent to note that this is not the first instance where the CCI has found itself in a tight spot. Earlier, the CCI was exposed to criticism in relation to conflicting verdicts on cartelization with regard to cement and tire manufacturers.

[19] The *EU White Paper on Sports* (2007) states that the specificity of sport has to be taken into consideration in the sense that restrictive effects on competition that are inherent in the organization and proper conduct of competitive sport are not in breach of EU competition rules, provided that these effects are proportionate to the legitimate genuine sporting interest pursued. The necessity of a proportionality test implies the need to take into account the individual features of each case.

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Letting the Cat Out of the Box: *Noerr-Pennington* Immunity and Consent Decrees

Thomas J. Dillickrath & William C. Lavery
Baker Botts LLP

Letting the Cat Out of the Box: *Noerr-Pennington* Immunity and Consent Decrees

Thomas J. Dillickrath & William C. Lavery[1]

I. INTRODUCTION

For over two decades, courts have considered the applicability of the *Noerr-Pennington* doctrine to immunize an antitrust defendant from liability where the defendant engages in protected First Amendment petitioning activity, including petitioning before a court.[2] Despite this long history, *Noerr-Pennington* immunity remains a controversial and somewhat untested area of law, often subject to novel questions. These novel questions frequently take place at the interstitial spaces of law and may not be clearly within settled categories of protected activities. Rather, in these situations, a judge may need to engage in an interpretive exercise to consider whether a particular form of petitioning falls within the rubric of protected conduct.

Different judges may approach these issues in different ways; there is no "rulebook" neatly summarizing every form of petitioning and classifying it as a ball or strike. Rather, judges must undertake some interpretive exercise, considering whether the questioned activity more closely resembles protected or unprotected activity. Unlike Ronald Dworkin's fictional Judge Hercules,[3] the U.S. district courts lack the time and resources to consider the entire spectrum of law to arrive at a single "right answer" in every case. Rather, our real-life jurists have to wade through competing principles to arrive at the best possible answer, and different judges will, of necessity, weigh these considerations differently.

When deciding these difficult questions—so-called "hard cases"—it is our view that in the real world there is often no single right answer, and certain forms of petitioning activity may reside permanently in these interstices, perhaps subject to case-by-case adjudication. A recent case decided in the U.S. District Court for the District of Massachusetts is illustrative. In *In re Nexium (Esomeprazole) Antitrust Litigation*,[4] the court considered the applicability of *Noerr-Pennington* immunity to consent decrees. Here, we discuss the court's well-articulated decision, and also provide an alternative argument that illustrates the ambiguity in doctrinal interpretation.

We do not suggest that the applicability of the *Noerr-Pennington* doctrine in *Nexium* was clear, or that, as a general matter, the activity at issue should or should not be protected. Like

[1] Respectively, Partner and Senior Associate in the Antitrust and Competition Practice group in Baker Botts LLP's Washington D.C. office.

[2] *United Mine Workers of Am. v. Pennington,* 381 U.S. 657, 669–70 (1965); *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.,* 365 U.S. 127, 136 (1961); *see also California Motor Transp. Co. v. Trucking Unlimited,* 404 U.S. 508, 510 (1972) (extending *Noerr-Pennington* immunity to petitioning before a court).

[3] RONALD DWORKIN, LAW'S EMPIRE (1986).

[4] 2013 WL 4832176 at *1 (D. Mass., Sept. 11, 2013).

Schrödinger's Cat, both alive and dead at the same time,[5] we suggest that in this case it might appear to be both, depending on the interpretation of *Noerr-Pennington*'s strictures by the court. That is, much of the ultimate determination is informed by the observer/judge, who will then decide whether the cat is "dead or alive," i.e., whether the petitioning activity is protected or not protected. While all this may be redolent of the metaphysical, we attempt to disentangle the various arguments below, not to suggest that any particular view is correct, but to support our notion that practitioners must embrace the inherent ambiguity.

II. SCHRÖDINGER'S CAT IS DEAD: THE PETITIONING ACTIVITY IN QUESTION IS NOT PROTECTED

A brief description of the facts underlying *Nexium* will suffice for our purposes. In *Nexium*, plaintiffs alleged they paid higher prices for a brand name drug because less expensive generic versions were prevented from entering the market due to defendants' settlement with three generic manufacturers. Defendants moved to dismiss the complaint on a number of grounds, arguing that regardless of whether they could be held liable under the antitrust laws for such conduct, the settlement with the generic manufacturers was immune from antitrust liability under *Noerr-Pennington* because it was entered as a consent judgment, formalized by a New Jersey federal district court, as opposed to a settlement agreement, memorialized only by agreement of the parties. The court denied defendants' motions to dismiss in part because it found that the consent judgments memorializing the reverse payment settlement agreements were not entitled to *Noerr–Pennington* immunity.[6]

In reaching this conclusion, the court noted that there was "little guidance" as to whether *Noerr-Pennington* should apply to consent judgments, and relied largely on a thirteen-year old article by Professor Raymond Ku (now at Case Western Reserve University School of Law) published in the *Indiana Law Review* suggesting a test for determining when *Noerr-Pennington* immunity should apply. Ku proposes a means/source test, where immunity attaches when the following conditions are met:

1. "the conduct represents valid petitioning. Valid petitioning is defined as a formal or informal attempt to persuade an independent governmental decision maker consistent with the rules of the political forum in question, and
2. any anticompetitive harms flow directly or indirectly from those persuasive efforts."[7] Ku then notes that this test can be simplified and "collapsed into a single inquiry: Is the private conduct a valid effort to influence government?"[8]

The court adopted Ku's test, holding that "entry of a consent judgment cannot be construed as conduct that is 'incidental' to litigation."[9] The court also found that the defendants

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[5] For a good example of Erwin Schrödinger's famous 1935 thought experiment, *see* http://news.nationalgeographic.com/news/2013/08/130812-physics-schrodinger-erwin-google-doodle-cat-paradox-science/. Alternatively, for a quick explanation by that esteemed physicist, Sheldon Cooper, on the sitcom *The Big Bang Theory*, view this You Tube clip, http://www.youtube.com/watch?v=LFBrRKnJMq4.

[6] *Nexium*, 2013 WL 4832176 at *1.

[7] Raymond Ku, *Antitrust Immunity, the First Amendment and Settlements: Defining the Boundaries of the Right to Petition*, 33 IND. L.REV. 385, 404 (2000).

[8] *Id*. at 421.

could have "simply stipulat[ed] to a dismissal" and, moreover, that a "decision of a court that serves merely to memorialize a bargained-for agreement that could have otherwise been resolved without judicial intervention ought not benefit from the exemption allowed by *Noerr-Pennington*."[10]

It is interesting to consider how the court arrived at this decision. Certainly, no established precedent directed the result. Given this lack of precedent, the court needed an interpretive foundation to guide its decision. Here, the court weighed the competing theories and principles at stake and focused on the degree of judicial entanglement with the activity at issue, holding that "where a judge plays nothing more than a perfunctory role in branding a privately ordered settlement with the imprimatur of law, the protections of *Noerr-Pennington* are not implicated."[11]

The key distinction here was found to be the "meaningful difference between action that is truly governmental in substance and action that is simply governmental in form."[12] In order to come to this position, the court needed to consider two countervailing principles: the protected First Amendment right to petition, and the inherently limited nature of *Noerr-Pennington* immunity.

The court's reasoning leaned heavily on Professor Ku's contention that consent decrees are often orchestrated by the parties and presented to the court as a "*fait accompli*."[13] Thus, the court appeared to place the burden on the defendants to demonstrate that the consent decrees were subject to judicial deliberation; something more than a "perfunctory role in branding a privately ordered settlement with the imprimatur of law . . ."[14] On the record, the court found that defendants did not demonstrate that the consent decree was subject to substantive judicial scrutiny.

We do not opine here on the court's decision on the facts, or even the substance of the opinion. We note that the court chose to take a narrowly cabined view of the doctrine, adopting Professor Ku's view that a consent decree does not require the court to "approve the substance of the agreement."[15] As a matter of principle and legal theory, the court predicated its decision on concerns that "[a]dopting the alternative view would provide litigants with an avenue wholly impervious to antitrust scrutiny simply by seeking out a court's rubber-stamped approval."[16] We next turn to a different analytical framework, one that credits consent decrees with more net value.

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[9] *Nexium*, 2013 WL 4832176 at *19.
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.* at 18 (citing Ku, 33 IND. L.REV. at 428).
[14] *Nexium*, 2013 WL 4832176 at *20.
[15] *Id.* (citing Ku, 33 IND. L.REV. at 429)
[16] *Id.* at 19.

III. SCHRÖDINGER'S CAT IS ALIVE: THE PETITIONING ACTIVITY IS PROTECTED: *Is there a meaningful distinction between private settlement agreements and consent judgments?*

As discussed above, the interpretative turn in this case focuses on the distinction, or lack thereof, between a private settlement and a consent decree; a distinction which the court described as "far from obvious and modest at best."[17] It is true, as both the court and Professor Ku note, that private settlement agreements leading to the dismissal of a suit under Rule 41(a)[18] do not generally qualify for *Noerr-Pennington* immunity, but others may find the distinction less modest.

On this view, a broader distinction between the two might focus on other factors. For example, dismissals under Rule 41 do not require court approval to be effected, "[do] not imply judicial approval of the underlying settlement agreement," and "impl[y] no view of the merits of the agreement and confer[] no immunities on the settling parties."[19] Moreover, private settlement agreements are not judicial orders, and may be properly characterized as private contractual arrangements.

The difference between consent judgments and private settlements has been long recognized by courts. In 1932, the Supreme Court in *United States v. Swift* "reject[ed] the argument . . . that a decree entered upon consent is to be treated as a contract and not a judicial act."[20] Consent decrees have been held to be more certain than private settlement agreements, and thus afforded more deference, primarily because of the judicial oversight involved and the recourse available to parties for any failure to abide by the agreement.[21] As the Fifth Circuit in *United States v. Miami* noted, "the only penalty for failure to abide by [a settlement] agreement is another suit. . . . A consent decree, although founded on the agreement of the parties, is a judgment."[22]

A number of other circuits have followed suit. In *Rowe v. Jones*, the Eleventh Circuit found that "because consent decrees are entered by the court and are judicially enforceable, they function like any other court order or judgment and thus *may be enforced by judicial sanctions, including citation for contempt if [they are] violated*."[23] The Ninth Circuit in *SEC v. Randolph* likewise held that a consent judgment has "the force of res judicata, and it may be enforced by judicial sanctions, including, as in this case, citations for contempt."[24]

The lack of judicial oversight for settlements under Rule 41 versus the attention given consent judgments makes sense. While a simple dismissal for monetary value is unlikely to affect

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[17] *Id.* at 18.

[18] Fed. R. Civ. P. 41(a).

[19] *SmithKline Beecham Corp. v. Pentech Pharms.*, 261 F. Supp. 2d 1002, 1008 (N.D. Ill. 2003).

[20] 286 U.S. 106, 115 (1932).

[21] *See Schering-Plough,* 402 F.3d at 1072 ("Veritably, the Commission's opinion would leave settlements, including those endorsed and facilitated by a federal court, with little confidence.").

[22] 664 F.2d 435, 439-40 (5th Cir. 1981).

[23] 483 F.3d 791, 797 (11th Cir. 2007) (internal quotation marks omitted) (emphasis added).

[24] 736 F.2d 525, 528 (9th Cir. 1984).

third parties or require the involvement of the judge, consent decrees "virtually by definition will contain equitable provisions" that a judge must evaluate before entering a judgment.[25]

As discussed above, both the court in *Nexium* and Professor Ku take a more skeptical view of a court's role in approving a consent decree. Professor Ku goes so far as to suggest that a reviewing court will merely "wink at them or tacitly approve[] them" because they would be "hard-pressed to reject" such agreements.[26] Indeed, the court in *Nexium* noted that "it is unclear how much of the content found within the consent judgments is properly attributable to the New Jersey District Court judge's deliberation" and it therefore could not, in the court's view, be fairly said that the judge "endorsed the terms of the settlement agreements."[27]

A jurist might take a more sanguine view of the role of the courts in approving consent decrees, considering that "[i]n the absence of clear evidence to the contrary, courts presume that public officers [such as judges] properly discharge their duties" and thus "consent decrees . . . are reasonably presumed valid and in conformity with the law."[28] As noted by Judge Posner in *SmithKline Beecham Corp. v. Pentech Pharms.*, before entering a consent judgment, "the judge issuing it **must** determine that it does not offend public policy, as by harming third parties, before he can approve it."[29] This requires judges to evaluate whether the agreement is "fundamentally fair, adequate and reasonable."[30]

Given this presumption that a court exercised its due diligence in approving a consent order, a court might find the question resolved, since this would more closely resemble any other court filing, rather than a private contract.[31] As the Ninth Circuit held in *Sessions Tank Liners, Inc. v. Joor Mfg., Inc.*, "deconstructing the decision-making process to ascertain what factors prompted the various governmental bodies to erect the anticompetitive barriers . . . runs afoul of the principles guiding the *Parker* and *Noerr* decisions."[32] If we follow this line of reasoning, the alleged harm in *Nexium* would at least be indirectly related to the petitioning activity, and *Noerr-Pennington* immunity should attach.

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[25] *Donovan v. Robbins*, 752 F.2d 1170, 1176 (7th Cir. 1985).

[26] 33 IND. L. REV at 433.

[27] *Id.* at 20.

[28] *See Kohli v. Gonzales*, 473 F.3d 1061, 1068 (9th Cir. 2007); *Abdul-Akbar v. Watson*, 4 F.3d 195, 205 (3d Cir. 1993).

[29] 261 F. Supp. 2d at 1008 (emphasis added).

[30] *United States v. Oregon*, 913 F.2d 576, 580 (9th Cir. 1990).

[31] Indeed, *Noerr-Pennington* immunity has been extended to many forms of petitioning only indirectly related to a court filing, including settlement offers, pre-litigation threats of suit, and other activity "reasonably and normally attendant upon effective litigation." *See Cardtoons, L.C. v. Major League Baseball Players Ass'n*, 208 F.3d 885, 890 (10th Cir. 2000) (internal quotations omitted); *McGuire Oil Co. v. Mapco, Inc.*, 958 F.2d 1552, 1560 (11th Cir. 1992) (holding that "threats, no less than the actual initiation of litigation, do not violate the Sherman Act"); *Columbia Pictures Indus., Inc. v. Prof'l Real Estate Investors, Inc.*, 944 F.2d 1525, 1528 (9th Cir. 1991) (holding that a "decision to accept or reject an offer of settlement is conduct incidental to the prosecution of the suit and not a separate and distinct activity which might form the basis for antitrust liability"); *Coastal States Marketing, Inc. v. Hunt*, 694 F.2d 1358, 1367 (5th Cir. 1983) ("If litigation is in good faith, a token of that sincerity is a warning that it will be commenced and a possible effort to compromise the dispute.").

[32] 17 F.3d 295, 300 (9th Cir. 1994).

IV. SCHRÖDINGER'S CAT IS BOTH ALIVE AND DEAD: HARD CASES

As demonstrated above, there is no precedent or authority providing a clear answer as to whether consent orders are protected by *Noerr-Pennington* immunity. Courts will take different views of the amount of deference due to any sort of petitioning activity, and whether such petitioning falls within the penumbra of protected activities. It may be that upon consideration by an appellate court, one view or the other will take hold.[33]

In the meantime, litigants and practitioners will need to consider that, until the box is opened, certain types of petitioning activities will reside in two states of being, and the judge may decide which one applies on a case-by-case basis.

[33] The Supreme Court did not reach this issue in *FTC v. Actavis, Inc.*, 570 U.S. ___ (2013), despite an opportunity to do so.

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Noerr-Pennington's Furtherance Standard for Petitioning Immunity: Application to Settlements

Christopher M. Grengs

Noerr-Pennington's Furtherance Standard for Petitioning Immunity: Application to Settlements

Christopher M. Grengs[1]

I. INTRODUCTION

This article explains that only a person's conduct that is in furtherance of a petition to obtain redress from government, and the effects that are incidental to such conduct, should be immune from liability under laws that would otherwise apply, such as the federal antitrust laws. Under the unidirectional furtherance standard of the Supreme Court's *Noerr-Pennington* doctrine, a person's conduct must be directed toward obtaining governmental action in order to obtain such immunity.

This unidirectional furtherance standard for petitioning immunity has important implications for situations where parties on opposing sides of litigation resolve their dispute by entering into a contract agreement that terminates the litigation as one of its mutually acceptable conditions. Under this standard, such a settlement between private parties should not be immune. By contrast, such a settlement between a private party and government should be immune.

The Supreme Court has not yet considered the specific question of whether *Noerr-Pennington* petitioning immunity applies to a settlement agreement.[2] But a series of lower court cases involving litigation settlements have given rise to a debate over whether or not such agreements should be immune. Much of the confusion regarding this issue is a consequence of an imprecise reading of *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.* by some lower courts and commentators.

Most lower courts that have considered decisions by private parties on opposing sides of litigation to settle have correctly held that they do not constitute immune petitioning conduct. But the Ninth Circuit in *Columbia Pictures Industries, Inc. v. Professional Real Estate Investors,*

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[1] Attorney Advisor, Federal Trade Commission Office of Policy Planning. The views expressed in this article are solely those of the author and do not necessarily represent the views of the FTC or any of its commissioners.

[2] Although courts typically favor the settlement of disputes, the Supreme Court and lower courts have indicated that private settlement agreements may potentially result in antitrust liability. *See* FTC v. Actavis, Inc., 133 S.Ct. 2223, 2232 (2013) ("this Court's precedents make clear that patent-related settlement agreements can sometimes violate the antitrust laws."). *See also* Blackburn v. Sweeney, 53 F.3d 825 (7th Cir. 1995) (dissolution agreement between former law partners settling a state court lawsuit was a horizontal agreement to allocate markets among competitors and a per se violation of Section 1 of the Sherman Act); In re YKK, Inc., 116 F.T.C. 628 (1993) (indicating that private settlement agreements are not exempt from antitrust scrutiny); Duplan Corp. v. Deering Milliken, Inc., 444 F.Supp. 648, 683 (D.S.C. 1977) ("Although settlements of patent litigation are normally as desirable as settlements of other types of litigation, settlements of such litigation are not sanctioned by the courts when they are attended by anti-competitive results.") (citation omitted), *aff'd in part and rev'd in part*, 594 F.2d 979 (4th Cir. 1979), *cert. denied*, 444 U.S. 1015 (1980), *appeal after remand sub nom.*, Burlington Indus. v. Milliken & Co., 690 F.2d 380 (4th Cir. 1982), *cert. denied*, 461 U.S. 914 (1983).

Inc. ("*PRE*"), as part of its reasoning, mistakenly replaced *Noerr*'s unidirectional furtherance standard with an over-broad, omnidirectional standard that extends in every direction to make immune from antitrust liability any conduct that is merely incidental to petitioning, including the settlement of litigation between private parties. A state district court has also incorrectly held that settlement agreements approved by a court are immune from antitrust liability, absent a sham.

Several lower courts that have considered the decision of a private party to settle with a government entity on the opposing side of litigation have correctly held that such a settlement constitutes the full realization of protected petitioning conduct. But some of these courts have incorrectly relied on a *PRE*-type incidental standard as part of their reasoning, thus creating additional confusion about the correct standard for immunity and how *Noerr-Pennington* should be applied in two distinct situations.

Section II of this article explains the Supreme Court's *Noerr-Pennington* doctrine. Section III explains that, under *Noerr*'s unidirectional standard for petitioning immunity, settlements between private parties should not be immune and settlements between a private party and government should be immune. Section IV analyzes lower court decisions on settlement agreements between private parties. Section V analyzes lower court decisions on settlement agreements between a private party and government. Section VI discusses the confusion among commentators on the issue of whether *Noerr-Pennington* should apply to settlements.

This article concludes that courts should resolve questions involving litigation settlements and the *Noerr-Pennington* doctrine using more careful language that is consistent with the original *Noerr* case. In particular, courts should clarify that the *Noerr-Pennington* doctrine articulates a unidirectional furtherance standard for petitioning immunity. Likewise, courts should clearly distinguish between situations involving settlements between private parties and settlements between a private party and government.

II. THE *NOERR-PENNINGTON* DOCTRINE

The Supreme Court first addressed the relationship between the First Amendment's petition clause and the federal antitrust laws in the 1961 case of *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*[3] The petition clause states that, "Congress shall make no law . . . abridging . . . the right of the people . . . to petition the Government for a redress of grievances."[4] The Supreme Court held that, "no violation of the [Sherman] Act can be predicated upon mere attempts to influence the passage or enforcement of laws."[5]

In *Noerr* a group of truck operators and their trade association sued a group of defendant railroads, their executives, and a public relations firm.[6] The truckers alleged that the railroads had conspired to restrain trade and monopolize long-distance freight in violation of sections 1 and 2

[3] 365 U.S. 127 (1961).

[4] U.S. CONST. amend. I. This portion of the amendment is a successor to the ancient Anglo-American right of petition. *See generally* Borough of Duryea v. Guarnieri, 131 S.Ct. 2488 (2011).

[5] *Noerr*, 365 U.S. at 135.

[6] *Id*. at 129-31.

of the Sherman Act.[7] Specifically, the truckers accused the railroads of conspiring to conduct a publicity campaign against them "designed to foster the adoption and retention of laws and law enforcement practices destructive of the trucking business, to create an atmosphere of distaste for the truckers among the general public, and to impair the relationships existing between the truckers and their customers."[8]

The railroads admitted they conducted a publicity campaign designed to influence the passage of state laws and tax rates relating to trucking and to encourage more stringent enforcement of traffic laws.[9] But they denied any motive to destroy the trucking business as a competitor or to interfere with the relationships of truckers and their customers.[10]

As described by the Court, the railroads "insisted…the campaign was conducted *in furtherance of* their rights 'to inform the public and the legislatures of the several states of the truth . . .' " about road damage done by truckers, their failure to pay a fair share of construction costs, their violations of weight and speed limits, and hazards they created.[11] The Supreme Court accepted this defense and held that the railroads' conduct did not violate the Sherman Act. The Court expressly declined to consider any of defendants' other defenses.[12]

In particular, the Court held that the publicity campaign in question was not a violation of the Sherman Act merely because it may have had a purpose to restrict competition to the benefit of the railroads and to the detriment of the competitor truckers.[13] The Court emphasized that a contrary conclusion—that the railroads' conduct violated the Sherman Act—"would raise important constitutional questions" because the "right of petition is one of the freedoms protected by the Bill of Rights, and we cannot, of course, lightly impute to Congress an intent to invade these freedoms."[14] In addition, the Court held that the campaign was not merely a "sham" to mask interference with the truckers' business relationships.[15]

Noerr observed that "to petition" is an active verb that expresses a unidirectional standard. Specifically, the Court recognized that to petition is "to seek action on" or to "solicit[ ]" the government to accomplish some "purpose."[16] Therefore, "We . . . hold that, at least insofar as

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[7] *Id*. at 129.

[8] *Id*.

[9] *Id*. at 131.

[10] *Id*.

[11] *Id*. (emphasis added).

[12] *Id*. at 132 n.6.

[13] *Id*. at 136-40. According to the Court: "the Act does not apply to mere group solicitation of governmental action . . . . The right of the people to inform their representatives in government of their desires with respect to the passage or enforcement of laws cannot properly be made to depend upon their intent in doing so. It is neither unusual nor illegal for people to seek action on laws in the hope that they may bring about an advantage to themselves and a disadvantage to their competitors." *Id*. at 139.

[14] *Id*. at 138.

[15] *Id*. at 144.

[16] *Id*. at 136-140.

the railroads' campaign was *directed toward* obtaining governmental action, its legality was not at all affected by any anticompetitive purpose it may have had."[17]

In the words of the *Noerr* Court, to petition is to engage in "conduct" that is "in furtherance of" or "directed toward obtaining" some "purpose" in the form of "governmental action." That is to say, to petition is to act to move forward a request to government that it take some action to accomplish a goal specified by the petitioner.[18]

The Court also recognized that "to petition," as an underlying verb, is distinct from an "effect," as a noun, that subsequently results. The Court referred to the fact that the truckers had "sustained some direct injury as an *incidental effect* of the railroads' campaign to influence governmental action and that the railroads were hopeful that this might happen."[19] But, according to the Court, "It is inevitable, whenever an attempt is made to influence legislation by a campaign of publicity, that an incidental effect of that campaign may be the infliction of some direct injury upon the interests of the party against whom the campaign is directed."[20]

Thus, the Court circumscribed its "incidental" language to the subsequent "effect" of the railroads' petitioning of government.[21] By contrast, the underlying petitioning conduct preceding

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[17] *Id*. at 139-40 (emphasis added). *Accord* Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 59 (1993); FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 424 (1990).

[18] The Supreme Court has recently reiterated this point in *Borough of Duryea v. Guarnieri*. "The right to petition allows citizens to express their ideas, hopes, and concerns to their government and their elected representatives . . . . [T]he right to petition is generally concerned with expression directed to the government seeking redress of a grievance." 131 S.Ct. 2488, 2495. "Interpretation of the Petition Clause must be guided by the objectives and aspirations that underlie the right. A petition conveys the special concerns of its author to the government and, in its usual form, re-quests action by the government to address those concerns." *Id*.

[19] *Noerr*, 365 U.S. at 143 (emphasis added). The Court further emphasized this means (i.e., conduct) versus consequences (i.e., effect) distinction again in *FTC v. Superior Court Trial Lawyers Ass'n*. "[I]n the *Noerr* case the alleged restraint of trade was the intended *consequence* of public action; in this case the boycott was the *means* by which respondents sought to obtain favorable legislation." *Superior Court Trial Lawyers Ass'n*, 493 U.S. at 424.

[20] *Noerr*, 365 U.S. at 143. "Inherent in such fights, which are commonplace in the halls of legislative bodies, is the possibility, and in many instances even the probability, that one group or the other will get hurt by the arguments that are made." *Id*. at 144.

[21] *Id*. at 143. The Supreme Court reiterated this distinction in Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492 (1988). In *Allied Tube* the Supreme Court held that efforts to influence the setting of a private association's product standards did not qualify for *Noerr-Pennington* immunity, even when those standards were routinely adopted by state and local governments. In doing so, the Court stated that, "where, independent of any government action, the anticompetitive restraint results directly from private action, the restraint cannot form the basis for antitrust liability if it is 'incidental' to a valid effort to influence governmental action." *Id*. at 499 (citing to *Noerr*, 365 U.S., at 143). The Court elaborated that "*Noerr* immunity might still apply . . . if . . . the exclusion of polyvinyl chloride conduit from the Code, and the effect that exclusion had of its own force in the marketplace, were incidental to a valid effort to influence governmental action." *Id*. at 502. The Court further referenced the original *Noerr* case for support. "[W]e characterized the railroads' activity as a classic 'attempt . . . to influence legislation by a campaign of publicity,' an 'inevitable' and 'incidental' effect of which was 'the infliction of some direct injury upon the interests of the party against whom the campaign is directed.' " *Id.* at 505 (citing to *Noerr*, 365 U.S. at 143). Thus, the Court reaffirmed *Noerr*'s distinction between acting "to influence" government, as a verb, from a resulting "restraint" or "effect," as a noun. *Accord* Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 57 (1993) (quoting *Noerr*, 365 U.S. at 143 for the proposition that "such 'direct injury' was merely 'an incidental effect of the . . . campaign to influence governmental action.' ").

this effect was "in furtherance of" or "directed toward" some "purpose" that could be accomplished by "governmental action."

The Court recognized that the verb "to petition" expresses action by a person directed toward obtaining governmental action to accomplish a specified goal. By contrast, the noun "effect" is a thing that is a subsequent consequence of that verb expressing such action. The Court did not consider these two parts of speech to be equivalents.

The Court also distinguished the effects of a private party's legitimate petition to government from the effects of action among private parties. The former types of effects are immune from Sherman Act liability. The latter types of effects are not. "[W]here a restraint upon trade or monopolization is the result of valid governmental action, as opposed to private action, no violation of the Act can be made out."[22]

Since *Noerr*, the Supreme Court has held that petitioning immunity from antitrust liability extends beyond the legislative context. In *United Mine Workers of America v. Pennington* the Supreme Court held that First Amendment petitioning immunity extends not only to petitioning legislatures, but also encompasses efforts to petition "public officials" generally, "regardless of intent or purpose."[23] As a result, petitioning immunity from federal antitrust liability has commonly become known as *Noerr-Pennington* immunity.[24] In *California Motor Transport Co. v. Trucking Unlimited* the Court reiterated that "the right to petition extends to all departments of the Government" as long as the petition is not a "sham."[25]

The text of the petition clause is not limited to any particular context. Thus, on its face, this constitutional right to petition government for a redress of grievances appears to apply in all legal contexts, not merely in the antitrust context.[26]

Consistent with this reading, the Supreme Court in *Noerr* cautioned against finding liability under the common law for petitioning conduct, in addition to specifically holding that defendants did not violate the federal Sherman Act.[27] More recently, the Supreme Court has specifically stated that *Noerr-Pennington* principles extend to federal laws generally, beyond the antitrust context. The Court, by analogy, has applied *Noerr-Pennington* principles to litigation involving the National Labor Relations Act.[28] In doing so, the Court concluded that it "should

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[22] *Noerr*, 365 U.S. at 136. The Supreme Court also reiterated this distinction in *Allied Tube*. "The scope of this protection depends . . . on the source, context, and nature of the anticompetitive restraint at issue." *Allied Tube*, 486 U.S. at 499.

[23] 381 U.S. 657, 670 (1965) ("Joint efforts to influence public officials do not violate the antitrust laws even though intended to eliminate competition.").

[24] *See generally* Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 56 (1993) ("Those who petition government for redress are generally immune from antitrust liability.").

[25] 404 U.S. 508, 510-11 (1972).

[26] *See Prof'l Real Estate Investors*, 508 U.S. at 59 (discussing "applying *Noerr* as an antitrust doctrine or invoking it in other contexts . . . .").

[27] *Noerr*, 365 U.S. at 136-37 ("This essential dissimilarity between an agreement jointly to seek legislation or law enforcement and the agreements traditionally condemned by § 1 of the [Sherman] Act . . . does constitute a warning against treating the defendants' conduct as though it amounted to a common-law trade restraint.").

[28] BE & K Const. Co. v. NLRB, 536 U.S. 516 (2002) (holding that employer's unsuccessful retaliatory lawsuit against unions could not serve as the basis for unfair labor practice liability, absent a finding that the suit was

follow a similar course under the NLRA" because "The right to litigate is an important one . . . ."[29] The court explained that, in both contexts, "the same underlying issue" or "underlying connection" is the question of "when litigation may be found to violate federal law . . . ."[30] The Court has not yet squarely addressed the incorporation of *Noerr-Pennington* principles against state law statutory claims, however.[31]

III. APPLICATION TO SETTLEMENTS

Noerr's unidirectional standard for immunity for petitioning conduct has important implications for settlement agreements between parties on opposing sides of a litigation dispute.[32] Under this unidirectional standard, settlements between private parties should not be immune. By contrast, settlements between a private party and government should be immune.

An agreement between private parties on opposing sides of litigation to settle that dispute should not be immune because such an agreement does not move forward a request to a government judicial branch court that it take some action to achieve a specified goal. Rather, when private parties on opposing sides of litigation agree between themselves to settle that litigation they do exactly the opposite. By definition, a litigation settlement between private parties on opposing sides of a litigation dispute is an agreement to stop all efforts to move forward their respective requests to a government judicial branch court to take action.

Such a litigation settlement between private parties entirely removes government from the equation and only the private parties remain. When private parties enter into such an agreement between themselves, those acts are not "conduct" that is "in furtherance of" or "directed toward obtaining" some "purpose" in the form of "governmental action" because government is no longer involved in the matter. Instead, private parties by doing so cut-off or short-circuit the petitioning process.

Immunizing private parties for settling litigation between themselves would produce absurd outcomes. Private parties who agree to settle a dispute before resorting to litigation gain no immunity under *Noerr-Pennington*. By definition, neither party has acted to petition government for any action whatsoever. Government is not involved. But if the exact same parties could instead petition a government judicial branch court to resolve their dispute, and then obtain immunity for agreeing to withdraw their respective petitions from a court's consideration, the agreement would receive immunity simply because the parties had walked into court and then walked back out.

Their settlement would gain immunity by virtue of mere geography—by having entered and left a court versus merely settling their dispute in a board room—and nothing more. In

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objectively baseless); Bill Johnson's Rests., Inc. v. NLRB, 461 U.S. 731 (1983) (applying the sham exception to hold that it is an enjoinable unfair labor practice for an employer to prosecute a baseless lawsuit with the intent of retaliating against an employee for the exercise of certain rights protected under the National Labor Relations Act).

[29] *Bill Johnson's Rests., Inc.*, 461 U.S. at 744.

[30] *BE & K Const. Co.*, 536 U.S. at 526.

[31] *But see* Sosa v. DIRECTV, Inc., 437 F.3d 923, 931 (9th Cir. 2006) ("we conclude that the *Noerr-Pennington* doctrine stands for a generic rule of statutory construction, applicable to any statutory interpretation that could implicate the rights protected by the Petition Clause.").

[32] Such settlements are distinct from agreements among parties on the same side of a litigation dispute.

addition, this bizarre two-tier result would, as a practical matter, favor parties who possess the considerable resources typically needed to initiate or defend against litigation over those who do not.

Immunizing settlements between private parties would also create perverse incentives. The prospect of immunity from legal liability that might otherwise apply to private settlements would serve as an incentive for private parties to clog the courts with unnecessary litigation initiated solely for the purpose of later withdrawing that same litigation in order to trigger immunity for a settlement. Courts typically favor settlements, in part, because they conserve the scarce judicial resources needed to consider litigation petitions.[33] But this perverse incentive would turn the judicial resource conservation rationale for settlements on its head and would, instead, likely strain judicial resources.

A comparison to petitioning the legislative and executive branches of government further illustrates the error of immunizing a litigation settlement between private parties.[34] Consider a hypothetical situation where private parties initiate but subsequently withdraw from the legislative or executive branch a petition to enact an anticompetitive regulatory scheme and then enter into an anticompetitive agreement to accomplish the same goal. For example, suppose one professional sports league believes that a second competing league is engaging in exclusionary conduct towards its franchises.[35] Instead of bringing an antitrust suit in a judicial branch court, suppose the first league petitions Congress and the President to enact legislation to protect its franchises from the activities of the second league by allocating markets between them. The second league then does the same for its own franchises. But before any legislation is enacted, the two leagues withdraw their respective petitions, return to their board rooms, and enter into a market allocation agreement between themselves in order to avoid future controversies.

Immunizing from legal liability an agreement that private parties enter into after they initiate, and then withdraw, their respective petitions from the legislative or executive branch of government would effectively allow those private parties to do an end-run around otherwise applicable laws, such as the Sherman Act.[36] Perversely, private parties would be granted the impenetrable bubble of petitioning immunity for the settlement agreement as a specific reward for cutting off, or short-circuiting, the very petitioning process that *Noerr-Pennington* is supposed to protect.

Immunizing from legal liability settlements between private parties who agree to withdraw their petitions from the legislative or executive branch would be inconsistent with the idea of petitioning government to obtain a redress of grievances. Under such an approach,

[33] *E.g.*, Murchison v. Grand Cypress Hotel Corp., 1992 WL 565225 (M.D. Fla. 1992) (unreported) (enforcing a settlement agreement), *aff'd* 13 F.3d 1483, 1486 (11th Cir. 1994) ("We favor and encourage settlements in order to conserve judicial resources.").

[34] *See supra* notes 23-25 and related text, discussing that the First Amendment right to petition extends to public officials, generally, across all departments of Government.

[35] *See* U.S.F.L. v. N.F.L., 842 F.2d 1335 (2d Cir. 1988).

[36] *See* Palmer v. BRG of Georgia, Inc., 498 U.S. 46, 49-50 (1990) (holding an agreement between competitors to allocate territories to be per se illegal under Section 1 of the Sherman Act). "Such agreements are anticompetitive regardless of whether the parties split a market within which both do business or whether they merely reserve one market for one and another for the other." *Id.*

immunity would apply despite the fact that the petition was withdrawn from the legislative hopper and the executive branch's consideration and the attempt to persuade government to take some action was extinguished. As in the case of judicial branch courts, such perverse incentives to strain government resources with petitions that are initiated only for the purpose of later withdrawing them would frustrate the petition clause's purpose to protect an open "right of access . . . to be heard" by government.[37]

A settlement between a private party and a government entity on opposing sides of a litigation dispute, however, should be immune from laws that might otherwise apply. By definition, government remains part of the equation in such a case. Therefore, immunity should apply. For example, where a private party brings suit against a government entity and subsequently terminates the suit in exchange for certain terms, such a settlement embodies the ultimate resolution of the private party's efforts to achieve a redress of its grievances from the government entity. Oppositely, where a government entity brings suit against a private party and subsequently terminates the suit in exchange for certain terms agreed to by the private party, such a settlement embodies the resolution of any grievances that the private party may have had regarding the government entity's claims against it.

This analysis of the applicability of *Noerr-Pennington* immunity to the substance of a final settlement agreement is unaffected by any interactions that opposing litigant parties might have had with a judicial branch court or its officials during the preceding litigation process. Such interactions, whatever they may have been, do not change the operation of the final terms of a contractual settlement.

A final litigation settlement, by definition, is a contract containing certain terms agreed to by the opposing parties who sign their names to it, and no one else. For example, the operation of a settlement's final terms does not change because a judicial branch court has previously facilitated or otherwise encouraged the settlement, versus an otherwise identical scenario where parties enter into a settlement absent such encouragement. Likewise, court procedures that formally recognize the decisions of opposing parties to settle their dispute are distinct from the nature of a settlement contract, itself.[38] Such procedures merely reflect parties' own choices about how to resolve their controversy.

The existence of safeguards to ensure fairness in the process of withdrawing a dispute from a court's consideration, as in the case of a complex class action settlement involving numerous private parties, also does not alter the operation of a settlement's final conditions.[39] A government entity's legal obligation to adhere to certain standards, such as a public interest

[37] *California Motor Transp.*, 404 U.S. at 512-13.

[38] *E.g.*, FED. R. CIV. P. 41(a)(1)(A) ("the plaintiff may dismiss an action without a court order by filing: (i) a notice of dismissal before the opposing party serves either an answer or a motion for summary judgment; or (ii) a stipulation of dismissal signed by all parties who have appeared."). *See also* Local No. 93, Int'l Ass'n of Firefighters v. City of Cleveland, 478 U.S. 501, 522 (1986) ("it is the agreement of the parties, rather than the force of the law upon which the complaint was originally based, that creates the obligations embodied in a consent decree.").

[39] *E.g.*, FED. R. CIV. P. 23(e) ("The claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court's approval. The following procedures apply to a proposed settlement, voluntary dismissal, or compromise . . . . ").

standard, does not alter the operation of the particular terms that it negotiates with a private party using its remaining discretion, either.[40]

Immunizing a final settlement based on parties' past interactions with a court during the litigation process, when immunity would otherwise be unavailable, would again create perverse incentives for parties to engage in such interactions and unnecessarily consume judicial resources for the sole purpose of gaining immunity.[41] For example, in the context of litigation between private parties, the parties would have an incentive to hold out against amicably resolving their dispute until a court involved itself in settlement negotiations, in order to trigger immunity for the final settlement agreement, based on that involvement. Similarly, if private parties could immunize a settlement based on a court's application of procedures that recognize their decisions to settle or which safeguard the fairness of the settlement process, the parties would then have an incentive to initiate litigation, walk into court, trigger those procedures, and then walk back out and settle, simply to obtain immunity for their agreement.

IV. LOWER COURT DECISIONS RELATING TO PRIVATE SETTLEMENT AGREEMENTS

Most lower courts that have considered decisions by private parties on opposing sides of litigation to settle their dispute have correctly held that they do not constitute immune petitioning conduct. But the Ninth Circuit in *Columbia Pictures Industries, Inc. v. Professional Real Estate Investors, Inc.,* as part of its reasoning, mistakenly replaced *Noerr*'s unidirectional furtherance standard with an omnidirectional standard that makes immune from antitrust liability any conduct that is merely incidental to petitioning, including the settlement of litigation between private parties.[42] One state district court has also incorrectly held that settlement agreements approved by a court are immune from antitrust liability, absent a sham.

[40] *E.g.*, 15 U.S.C. § 45(b) (requiring that "it shall appear to the [Federal Trade] Commission that a proceeding by it . . . would be to the interest of the public . . . .") and 15 U.S.C. § 16(e)(1) ("Before entering any consent judgment proposed by the United States under this section, the court shall determine that the entry of such judgment is in the public interest."). *See also* FTC v. Onkyo U.S.A. Corp., 1995 U.S. Dist. LEXIS 21222 *8 n.5 (D.D.C. 1995) (conducting a public interest inquiry and concluding that, "unless a consent decree is unfair, inadequate, or unreasonable, it ought to be approved.") (citations omitted) and United States v. Microsoft Corp., 56 F.3d 1448, 1460-1462 (D.C. Cir. 1995), *reh'g and suggestion for reh'g en banc denied* (a court's role is not to substitute its judgment for the "rather broad discretion" of the government "to settle with the defendant within the reaches of the public interest," but is "only to confirm that the resulting settlement is ' "within the *reaches* of the public interest." ' ") (citations omitted). Furthermore, seeking to immunize a settlement between a government entity and a private party based on such an obligation would be superfluous, given that such a settlement, by its basic nature, is immune from liability under laws that might otherwise apply, anyway.

[41] For example, one commentator argues that "it is probably safe to conclude that the parties' likelihood of obtaining *Noerr-Pennington* protection increases in direct proportion to the degree of court involvement in settling the litigation." Geoffrey D. Oliver, *Living on the Fault Line: Counseling Clients at the Interface of Antitrust and Intellectual Property Law*, 22 ANTITRUST 38, 40 (2008). This commentator specifically recommends that, "parties seeking to gain *Noerr-Pennington* protection should consider requesting that the judge become involved in active scrutiny of the terms of the settlement agreement, including possibly holding a hearing to review the specific provisions of the settlement agreement in light of the claims of the underlying litigation." *Id.*

[42] For purposes of this article, this particular observation is not meant to question other aspects of the Ninth Circuit or Supreme Court decisions in *PRE*.

In re New Mexico Natural Gas Antitrust Litigation appears to be the first case to directly address the applicability of *Noerr-Pennington* to private settlement agreements.[43] There, New Mexico government institutions and various individuals and corporations alleged that defendant natural gas producers and suppliers had fixed intrastate wellhead gas prices in settling prior litigation. Defendants claimed that *Noerr-Pennington* exempted the initiation, prosecution, and settlement of the litigation from antitrust liability.

In denying both parties' motions for summary judgment on the issue, the District of New Mexico held that "a private settlement accomplished without Court participation should not be afforded *Noerr-Pennington* protection."[44] The court correctly recognized that a litigation settlement between private parties removes government from the equation and, therefore, there is no reason why it should obtain petitioning immunity from antitrust liability. The court reasoned that, "When parties petition a Court for judicial action that protection attaches, but when they voluntarily withdraw their dispute from the court and resolve it by agreement among themselves there would be no purpose served by affording *Noerr-Pennington* protection."[45] Furthermore, "defendants have pointed to no case which would afford *Noerr-Pennington* protection to private settlement of litigation, and logic would indicate no reason why there should be such protection."[46] Thus, "The parties by so doing must abide with any antitrust consequences that result from their settlement."[47] The District of New Mexico also noted, however, that the settlement in question had been submitted as part of a court-approved dismissal order.[48] But it declined to rule on the effect of that order, if any, before the development of additional facts.[49]

In *Columbia Pictures Industries, Inc. v. Professional Real Estate Investors, Inc.* several movie studios alleged copyright infringement by defendant hotel operators that rented video discs for viewing in hotel rooms, under the theory that such rentals constituted public performances that violated the Copyright Act.[50] After instituting the copyright infringement action, the studios refused the request of the hotel operators to license and install in-room video systems. The hotels subsequently counterclaimed, alleging the studios' suit was merely a sham that violated sections 1 and 2 of the Sherman Act and state antitrust and unfair competition laws, and that their refusal to grant licenses and other activities constituted a pattern of anticompetitive conduct.

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[43] 1982 U.S. Dist. LEXIS 9452 (D.N.M. 1982) (unreported). *See also* Raymond Ku, *Antitrust Immunity, the First Amendment and Settlements: Defining the Boundaries of the Right to Petition*, 33 IND. L. REV. 385, 423 (2000).

[44] In re New Mexico Natural Gas Antitrust Litig. at *16.

[45] *Id.*

[46] *Id.*

[47] *Id.*

[48] *Id.* at *16-17.

[49] *Id.* at *18.

[50] 944 F.2d 1525 (9th Cir. 1991), *aff'd on other grounds,* Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49 (1993) (holding that, in order for litigation to be a sham, it must be objectively baseless and the litigant's subjective motivation must conceal an attempt to interfere directly with a competitor's business relationships through the use of governmental processes – as opposed to the outcome of that process – as an anticompetitive weapon).

In affirming the district court's grant of summary judgment in favor of the studios on the operators' antitrust counterclaim, the Ninth Circuit reasoned that the hotel operators' licensing request effectively amounted to an offer to settle the litigation. Based on this premise, the court correctly held that the studios' non-sham refusal to settle could not form the basis of an antitrust claim.[51] Effectively, such a refusal continued to move the studios' litigation petition forward toward a resolution by a judicial branch court.

The Ninth Circuit, however, incorrectly replaced *Noerr*'s unidirectional furtherance standard with an over-broad, omnidirectional incidental standard as part of its reasoning.[52] The court reasoned that "A decision to accept or reject an offer of settlement is conduct incidental to the prosecution of the suit and not a separate and distinct activity which might form the basis for antitrust liability."[53]

Such an incidental standard encompasses not only private conduct that moves a litigation petition forward toward a resolution by a judicial branch court; it extends in all directions, and sweeps in all other private conduct that merely relates to, touches upon, or is associated with a litigation petition. As the Ninth Circuit observed, an incidental standard covers not only the private initiation and subsequent advancement of a litigation petition as, for example, through the rejection of a settlement offer. It also extends to the withdrawal of that same petition from a court's consideration in order to enter into a private litigation settlement agreement which, by definition, necessarily relates to the underlying litigation petition, itself. Thus, an incidental standard is not merely unidirectional. Rather, it is omnidirectional and, therefore, is over-broad.[54]

Four other cases involving the settlement of patent disputes relating to the Hatch-Waxman Act have correctly concluded that private settlements should not be immune from antitrust liability.[55]

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[51] *Id*. at 1528-29.

[52] For purposes of this article, this particular observation is not meant to question other aspects of the Ninth Circuit or Supreme Court decisions in *PRE*.

[53] 944 F.2d 1525, 1528. Notably, notwithstanding the Ninth Circuit's language regarding "A decision to accept . . . an offer of settlement" no actual decision to accept a settlement offer was at issue in this case.

[54] The Supreme Court did not adopt this incidental standard in its decision defining sham litigation. Rather, it reaffirmed that *Noerr*'s incidental language refers to the subsequent effect of conduct to influence governmental action. *Prof'l Real Estate Investors*, 508 U.S. 49, 57 (1993) (quoting *Noerr*, 365 U.S. at 143).

[55] These cases are distinguishable from the Federal Circuit's decision in MedImmune, Inc. v. Genentech, Inc., 427 F.3d 958 (Fed. Cir. 2005) (subsequent history omitted). *See also* MedImmune, Inc. v. Genentech, Inc., 2003 WL 25550611 (C.D. Cal. 2003) (holding that the joint action of Genentech and Celltech was protected by *Noerr-Pennington*). In that case, the Patent & Trademark Office ("PTO") declared an interference between Genentech and Celltech patents regarding methods of producing certain antibodies and decided priority in favor of Celltech. Genentech then filed a 35 U.S.C. § 146 action in the Northern District of California to overturn the determination. During mediation, the parties agreed that evidence demonstrated that the Genentech patent was entitled to priority. The Northern District entered a judgment on the parties' resolution of the issue of priority and directed the PTO to vacate its prior decision, revoke Celltech's patent, and issue Genentech a continuation on its patent. The parties jointly presented the court's judgment to the PTO. The PTO entered an order that Genentech was the prior inventor and concluded that the Northern District's judgment cancelled Celltech's patent by operation of law. *Id*. at 961-62. Subsequently, the Federal Circuit held that, because statute required the parties to bring their settlement to the court,

In re Cardizem CD Antitrust Litigation considered allegations by heart medication purchasers that a private settlement agreement, in which brand manufacturer Hoechst Marion Rousel, Inc. paid generic manufacturer Andrx to delay introducing its generic, violated Section 1 of the Sherman Act and state antitrust and consumer protection laws.[56]

The Eastern District of Michigan rejected defendants' motion to dismiss argument that the agreement was immune from antitrust liability because it was "incidental to," an "incidental effect" of, or "reasonably attendant to" pending non-sham patent infringement litigation.[57] "The Agreement did not take place within the context of that suit; i.e., it was never filed with or approved by the court presiding over that matter, and the court was not even aware of its existence."[58] It was simply a "private market allocation agreement between horizontal competitors . . . ."[59] As such, "any anticompetitive harms that flow from the HMRI/Andrx Agreement are the result of purely private action, not judicial action."[60]

The court properly recognized that an agreement by private parties to settle litigation, by definition, does not involve government and, therefore, cannot constitute immune petitioning conduct.[61] It also distinguished defendants' agreement from refusals to accept settlement offers like in *PRE* and from negotiations with a state attorney general or other government official.[62] It further pointed out that, "Contrary to Defendant's contention here, the courts have not broadly applied *Noerr-Pennington* immunity to purely private settlement agreements. Rather . . . courts have not hesitated to impose antitrust liability in cases arising out of anticompetitive settlement agreements."[63] In addition, it noted that *Noerr*'s incidental language referred to the incidental effects of petitioning conduct.[64]

In *Andrx Pharmaceuticals, Inc. v. Biovail Corp. Int'l*. Andrx sued the Food and Drug Administration, Biovail, and others to clarify its rights to manufacture a generic version of

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and to bring the court's judgment to the PTO, *Noerr-Pennington* protection was unnecessary to protect the filing from claims of collusion and fraud by MedImmune against Genentech and Celltech. *Id.* at 967.

[56] 105 F.Supp.2d 618 (E.D. Mich. 2000), *aff'd* 332 F.3d 896 (6th Cir. 2003), *cert. denied sub nom.* Andrx Pharmaceuticals, Inc. v. Kroger Co., 543 U.S. 939 (2004).

[57] *Id.* at 633-36 ("HMRI argues that, because the HMRI/Andrx Agreement is an 'incidental effect' of non-sham patent infringement litigation; i.e., it is conduct reasonably attendant to litigation (a protected activity), it is immune from antitrust liability under the *Noerr-Pennington* doctrine.").

[58] *Id.* at 640.

[59] *Id.* at 636.

[60] *Id.* at 635.

[61] In particular, the court analogized the situation to one where a pharmaceutical manufacturers trade group petitions Congress for a law requiring drug makers to raise their prices, but before Congress acts the trade group members enter into an agreement to do the same thing, themselves. *Id.* at 637.

[62] *Id.* at 638-42.

[63] *Id.* at 640-41 (citing to *In re New Mexico Natural Gas Antitrust Litig.*).

[64] *Id.* at 636-37 ("The argument Defendant advances here is not supported by the Court's 'incidental effects' analysis in *Noerr*.").

Cardizem CD.[65] Biovail counterclaimed that the HMRI/Andrx settlement agreement violated Sections 1 and 2 of the Sherman Act and New Jersey common law.

The D.C. Circuit rejected Andrx's claim that the settlement was immune litigation-related conduct, in the course of affirming the district court's dismissal of Biovail's counterclaim for lack of standing, but reversing its decision to do so with prejudice. "The Agreement is not unlike a final, private settlement agreement resolving the patent infringement litigation by substituting a market allocation agreement. Such a settlement agreement would not enjoy *Noerr-Pennington* immunity and neither does the Agreement here."[66] Quoting *Cardizem*, the court noted " 'it is the result of purely private conduct and thus constitutes a private restraint of trade subject to liability under the antitrust laws.' "[67]

In re Ciprofloxacin Hydrochloride Antitrust Litigation considered antibiotic purchaser and advocacy group claims that settlements between Bayer and generic manufacturers violated Section 1 of the Sherman Act and state antitrust and consumer protection laws.[68]

The Eastern District of New York held that defendants' motion to dismiss argument that the settlements were immune from antitrust liability was "easily refuted" because they "are private agreements between the defendants, in which Judge Knapp played no role other than signing the Consent Judgment. The Consent Judgment did not include the terms of the agreements, nor was the judge even apprised of the terms before he 'so ordered' the Consent Judgment."[69] Furthermore, "Even if signing the Consent Judgment could be construed as approving the Settlement Agreements, government action that '"amounts to little more than approval of a private proposal' is not protected."[70]

The court's reasoning is notable because, in addition to reiterating that private settlements are not immune, it also correctly explained that judicial branch court procedures that recognize the decisions of private parties to settle litigation do not, themselves, achieve a purpose of redress in the form of government action. They merely reflect private parties' own decisions to cut-off or short-circuit the petitioning process.

In re Nexium Antitrust Litigation provides the most extensive analysis by a court of private settlements.[71] There, putative class action plaintiffs alleged that agreements between AstraZeneca and each of three generic manufactures to settle patent infringement litigation by

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[65] Andrx Pharmaceuticals, Inc. v. Friedman, 83 F.Supp.2d 179 (D.D.C. 2000), *aff'd in part and rev'd in part sub nom.* Andrx Pharmaceuticals, Inc. v. Biovail Corp., Int'l, 256 F.3d 799 (D.C. Cir. 2001), *cert. denied* 535 U.S. 931 (2002).

[66] *Id.* at 819.

[67] *Id.* at 818 (quoting *Cardizem CD*, at 635). Like *Cardizem*, it emphasized that " '[T]he doctrine does not authorize anticompetitive *action* in advance of government's adopting the industry's anticompetitive proposal. The doctrine applies when such action is the consequence of legislation or other governmental action, not when it is the means for obtaining such action . . . .' " *Id.* at 818-19 (quoting In re Brand Name Prescription Drugs Antitrust Litig., 186 F.3d 781, 789 (7th Cir. 1999) (Posner, J.)).

[68] 261 F.Supp.2d 188, 194-97 (E.D.N.Y. 2003). *See also* Bayer AG v. Barr Labs, Inc., 798 F.Supp. 196 (S.D.N.Y. 1992) (Knapp, J.).

[69] 261 F.Supp.2d 188, 212-13.

[70] *Id.* at 213 (quoting Cantor v. Detroit Edison Co., 428 U.S. 579, 602 (1976)).

[71] 2013 WL 4832176 (D. Mass. 2013).

keeping generic versions Nexium heartburn medication out of the market, in exchange for payment, constituted Sherman Act Section 1 and 2 violations and analogous state law violations.[72] Defendants argued that, because the New Jersey District Court had previously entered consent judgments sanctioning the settlements, any anticompetitive harms flowing from the agreements were due to government action—not private action.[73]

The District of Massachusetts noted the lack of guidance regarding the applicability of *Noerr-Pennington* to a judge's entry of a consent judgment.[74] Therefore, it considered whether the private conduct in question constituted a valid effort to influence government.[75] It noted that the distinction between private settlements and consent judgments entered by a court "is far from obvious and modest at best."[76]

The court correctly observed that the means employed to reach a consent judgment are the same as those used to enter into a private settlement or any private commercial contract, unlike a judge's opinion that is aided by the review of claims asserted in an adversarial system.[77] Thus, the maneuvering of private parties "to transform a settlement agreement into a judicially approved consent judgment, then, cannot be fairly characterized as direct 'petitioning'— – at least not as that word is commonly understood in the context of the political process."[78] In particular, "Consent judgments effected at the behest of private parties" do not have a "purpose" of "the persuasion of a judicial officer to obtain a redress of grievances" in contrast to settlements between private parties and a state government actor that is directly engaged in the decision making process.[79]

The court, however, incorrectly read *Allied Tube & Conduit Corp. v. Indian Head, Inc.* to have held that "the *Noerr-Pennington* doctrine extends not only to 'direct' petitioning but also to activities that are 'incidental' to a valid effort to influence governmental action."[80] This is a misquotation. *Allied Tube's* incidental language, like the original *Noerr* case, refers not to petitioning conduct by a private party, but to the subsequent effects of such conduct.[81]

The court also incorrectly concluded that an incidental standard would not encompass a consent judgment.[82] However, an incidental standard would, in fact, extend to a consent judgment because such a judgment necessarily relates to an associated litigation petition before a

[72] *Id*. at *1 n.2.

[73] *Id*. at *17.

[74] *Id*. at *18.

[75] *Id*. (citing to Raymond Ku, *Antitrust Immunity, the First Amendment and Settlements: Defining the Boundaries of the Right to Petition*, 33 IND. L. REV. 385, 404 (2000)).

[76] *Id*.

[77] *Id*. (citing to Ku, at 427-28).

[78] *Id*.

[79] *Id*. at *19 & n.27 (citing to A.D. Bedell Wholesale Co. v. Philip Morris, Inc., 263 F.3d 239, 252-54 (3d Cir. 2001)).

[80] *Id*. at *17 (citing to Allied Tube, 486 U.S. at 499). *See also id*. at *19 n.27 (stating that "courts have deemed settlements between private parties and the state to be incidental to the petitioning that takes place via litigation.").

[81] *See supra* note 21.

[82] 2013 WL 4832176 at *19.

judicial branch court. Thus, although the District of Massachusetts arrived at the correct result, it did so based on an incorrect, over-broad incidental standard.

The District of Massachusetts observed that most settlements do not require a judge's approval, and that was true in this case.[83] It noted that nothing prevented AstraZeneca and the three generics from stipulating to a dismissal of the patent infringement actions.[84] Thus, it correctly reasoned that, "A decision of a court that serves merely to memorialize a bargained-for agreement that could have otherwise been resolved without judicial intervention ought not benefit from the exemption allowed by *Noerr-Pennington*."[85] Therefore, the court correctly concluded that it could not accord the consent judgments immunity under *Noerr-Pennington*, in the course of making various grants and denials regarding defendants' motions to dismiss.

Furthermore, "Adopting the alternative view would provide litigants with an avenue wholly impervious to antitrust scrutiny simply by seeking out a court's rubber-stamped approval."[86] Thus, the court correctly recognized that judicial procedures that merely reflect private parties' own choices about how to resolve their controversy should not provide *Noerr* immunity for those decisions. In particular, "the entering of a consent decree does not, by itself, reflect a court's assent to the substantive terms found therein . . . ."[87] It stressed that, "the very fact that the Defendants can with a straight face advance this *Noerr-Pennington* argument based on consent judgments emphasizes that judges must be exceptionally wary of exercising their equitable powers at the joint behest of the parties."[88]

But in *Mueller v. Wellmark, Inc.*, the Iowa District Court for Polk County incorrectly held that, "Under the *Noerr-Pennington* doctrine, settlement agreements approved by a court are immune from antitrust liability, absent a sham . . . ."[89] Specifically, it concluded that a prior, judicially approved class action settlement resolving issues regarding claims payment processing for physicians appeared "genuine and valid."[90] According to the district court, "The court in that case found that the settlement was an arm's length transaction, and that it is reasonable, adequate, and is not the result of collusion between the parties. As such, it is shielded from antitrust liability under *Noerr*."[91]

However, as explained above, the mere existence of safeguards to ensure fairness in the process of withdrawing a dispute from a court's consideration does not alter the operation of the final conditions of a settlement agreement between private parties or transform an agreement between private parties into an agreement with a government entity. In particular, the order

[83] *Id.* (contrasting FED. R. CIV. P. 41(a)(1)(A) with the Antitrust Procedures and Penalties Act, Pub. L. No. 93-528, 88 Stat. 1706 and FED. R. CIV. P. 23(e)).

[84] *Id.*

[85] *Id.*

[86] *Id.*

[87] *Id.* at *20.

[88] *Id.* at *20 n.29.

[89] *See* 818 N.W.2d 244, 253 (Iowa 2012) (interlocutory appeal).

[90] *See id.*

[91] *See id.*

approving the settlement emphasized that the agreement was the product of "good faith, arm's length negotiations between" private parties.[92]

The Iowa Supreme Court affirmed the district court's grant of summary judgment against plaintiff chiropractors' state law claims of unlawful discrimination and anticompetitive conduct. But it did not address the issue of *Noerr* immunity. Instead, it affirmed based on the district court's alternative ground that there was no evidence that health insurer Wellmark violated the Iowa Competition Law in implementing the settlement.[93] Thus, the court avoided improperly immunizing a private settlement and, instead, examined the settlement as if it were not immune.

V. LOWER COURT DECISIONS RELATING TO SETTLEMENT AGREEMENTS WITH GOVERNMENT

Several lower courts that have considered the decision of a private party to settle with a government entity on the opposing side of a litigation dispute have correctly held that such a settlement constitutes the full realization of protected petitioning conduct.

Campbell v. Chicago appears to be the first case to squarely consider the application of *Noerr-Pennington* immunity to a settlement between a private party and a government entity.[94] There, plaintiff cab drivers claimed, among other things, that two cab companies violated Sections 1 and 2 of the Sherman Act by securing an ordinance favorable to them in exchange for settling a lawsuit alleging the city violated a prior taxi ordinance.

In granting defendants summary judgment, the Northern District of Illinois, Eastern Division correctly held that the cab companies were immune under *Noerr-Pennington*. The district court observed that the settlement embodied the ultimate resolution of the cab companies' acts to achieve a redress of grievances from the city. "They sought a legal remedy for an established breach of contract. They agreed to drop that legal right in exchange for an ordinance favoring their position as already the two largest holders of licenses in the City."[95] The Seventh Circuit noted the same point in affirming.[96]

Several other cases relate to the 1998 Master Settlement Agreement ("M.S.A.") between the five major U.S. tobacco companies and representatives of forty-six states, the District of Columbia, and five territories to settle litigation relating to the health effects of tobacco products.[97] Plaintiffs in these cases attacked the M.S.A., alleging various Sherman Act violations and other theories of harm. [98]

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[92] *See id*. at 264.

[93] *Id*. at 247, 264-65.

[94] 639 F.Supp.1501 (N.D. Ill. 1986), *aff'd* 823 F.2d 1182 (7th Cir. 1987).

[95] *Id*. at 1511.

[96] 823 F.2d 1182, 1186 ("The cab companies agreed to drop the damage claims in exchange for a favorable ordinance.").

[97] *See generally* PTI, Inc. v. Philip Morris, Inc., 100 F.Supp.2d 1179, 1185 (C.D. Cal. 2000).

[98] The holdings in these cases regarding the M.S.A., itself, are distinguishable from Freedom Holdings, Inc. v. Spitzer, 357 F.3d 205, 233 (2d Cir. 2004) (*Noerr-Pennington* immunity not relevant to determining whether New York state legislation enacted in 2001 subsequent to the M.S.A. is preempted by federal law) (subsequent history omitted).

These cases correctly recognize that, where a government entity brings suit against a private party and subsequently terminates the suit in exchange for certain terms agreed to by the private party, such a settlement embodies the resolution of any grievances that the private party may have had regarding the government entity's claims against it. But some of them incorrectly relied on a *PRE*-type incidental standard in their reasoning.[99]

In *Hise v. Philip Morris Inc*. the Northern District of Oklahoma correctly held that the M.S.A. deserved immunity and granted defendants summary judgment.[100] "[T]he concerted effort by defendants to influence public officials, i.e., the states' Attorneys General, to accept a settlement in exchange for dismissing the numerous lawsuits pending against defendants is among the activities protected by the *Noerr-Pennington* doctrine."[101]

In regard to the M.S.A., government entities remained part of the equation. "[T]he doctrine would surely ring hollow if it failed to encompass private entities who, after having been sued by one or more states for similar conduct, jointly petition the states in order to achieve a mutually acceptable settlement, designed to reduce the amount of time and expense involved in defending the action."[102]

However, in arriving at the correct conclusion, the court mistakenly replaced *Noerr*'s furtherance standard with the incidental standard articulated by defendants.[103] The Tenth Circuit affirmed for substantially the same reasons as the district court.[104]

In *Forces Action Project LLC v. California* the Northern District of California correctly held that defendants' activities in negotiating and entering into the M.S.A. were immune from liability as non-sham petitioning conduct.[105] It cited to *PRE* to conclude that, in the litigation context, "litigation settlements are also within the ambit of the immunity conferred."[106] But it did not distinguish between settlements between private parties and settlements between a private party and government.[107] After dismissing plaintiffs' claims for lack of standing and denying their motion to amend, the Ninth Circuit affirmed.

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[99] For purposes of this article, this particular observation is not meant to question other aspects of these decisions.

[100] 46 F.Supp.2d 1201 (N.D. Okla. 1999), *aff'd*, 208 F.3d 226 (10th Cir. 2000) (unreported), *cert. denied* 531 U.S. 959 (2000).

[101] *Id*. at 1207.

[102] *Id*. at 1206.

[103] *Id*. ("The Court is satisfied that defendants' activities, in negotiating the M.S.A. with the several settling states and achieving a settlement agreement with those states, are protected under the *Noerr-Pennington* doctrine as conduct incidental to litigation . . . .").

[104] 208 F.3d 226.

[105] 2000 WL 20977 (N.D. Cal. 2000) (unreported), *aff'd in part, rev'd and remanded in part*, 16 Fed. Appx. 774 (9th Cir. 2001) (mem. unreported), *appeal after remand*, 57 Fed. Appx. 322 (9th Cir. 2003) (mem. unreported), *aff'd and reh'g denied*, 61 Fed. Appx. 472 (9th Cir. 2003) (amended mem. unreported). In particular, see 2000 WL 20977 at *8 ("The *Noerr-Pennington* doctrine protects the right of citizens to petition the government for redress, by providing that such an act cannot form the factual basis for a later suit. Initially limited to the antitrust context, the *Noerr-Pennington* doctrine has since expanded to immunize the use of litigation as the factual basis for other litigation.").

[106] 2000 WL 20977 at *8.

[107] *Id*.

In *A.D. Bedell Wholesale Co., Inc. v. Philip Morris, Inc.* defendants argued that the M.S.A. deserved *Noerr-Pennington* protection as a government contract that resolved through negotiated compromise pending and threatened litigation, as distinct from an agreement with other private parties.[108] The Western District of Pennsylvania correctly held that defendants' actions to negotiate and execute the M.S.A. were protected by *Noerr-Pennington* and dismissed plaintiff's Sherman Act claims.[109] But it incorrectly adopted the incidental standard articulated by defendants, citing to *Hise*.[110]

The Third Circuit affirmed the district court's dismissal and joined other federal courts holding the M.S.A. to be immune.[111] But it also mistakenly adopted an incidental standard, stating that "other courts have extended *Noerr-Pennington* immunity to include efforts to influence governmental action incidental to litigation such as prelitigation threat letters."[112] Citing to *PRE* and *Campbell*, the court reasoned that, "There would seem to be no reason to differentiate settlement from other acts associated with litigation."[113] The Third Circuit did, however, on a general level distinguish settlements involving government from purely private agreements, for which "Passive government approval is insufficient."[114]

In *PTI, Inc. v. Philip Morris, Inc.* the Central District of California immunized private defendants for entering and implementing the M.S.A., citing to *Hise, Forces Action*, and the *Bedell* district court decision.[115] Thus, it granted defendants' motion to dismiss.[116]

"Under the *Noerr-Pennington* doctrine, the private defendants are clearly immune for their activities involved with the negotiation, execution, and attempts to implement the MSA . . . . Indeed, such conduct is precisely the type of activity the doctrine was intended to protect."[117] The court pointed out that "the primary objects of plaintiffs' complaint . . . are the result of active negotiations between accountable public officials and the tobacco companies."[118] Like *Hise* and *Bedell*, it also mistakenly adopted an incidental standard.[119]

In *Mariana v. Fisher* the Middle District of Pennsylvania granted defendants' motion to dismiss, citing to *Bedell* and its incidental standard.[120] In affirming, the Third Circuit also cited to

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[108] 104 F.Supp.2d 501, 505-06 (W.D. Pa. 2000), *aff'd* 263 F.3d 239 (3d Cir. 2001), *cert. denied*, 534 U.S. 1081 (2002).

[109] *Id*. at 506-07.

[110] *Id*.

[111] 263 F.3d 239, 252 & n.31 (citing to the *Hise*, *Forces Action*, and *PTI* district court decisions).

[112] *Id*. at 252-53 (citing to McGuire Oil Co. v. Mapco, Inc., 958 F.2d 1552, 1560 (11th Cir. 1992); Coastal States Mktg., Inc. v. Hunt, 694 F.2d 1358, 1367-68 (5th Cir. 1983)).

[113] *Id*. at 253.

[114] *Id*. at 251.

[115] 100 F.Supp.2d 1179, 1193 (C.D. Cal. 2000).

[116] *Id*.

[117] *Id*.

[118] *Id*. at 1194.

[119] *Id*. ("Unethical and deceptive conduct is immune from antitrust liability when it is incidental to an attempt to obtain governmental action.").

[120] 226 F.Supp.2d 575, 579-82 (M.D. Pa. 2002), *aff'd* 338 F.3d 189 (3d Cir. 2003), *cert. denied sub nom.* Mariana v. Pappert, 540 U.S. 1179 (2004).

its *Bedell* decision, and noted that it was unaware of any Supreme Court or appellate case holding that *Noerr-Pennington* cannot apply to government actors.[121]

In *Sanders v. Brown* the Northern District of California noted that every previous district court had concluded that the tobacco manufacturers' conduct in negotiating and entering into the M.S.A. was immune.[122] In addition, it cited to *Campbell* as further support for this conclusion.[123] In granting defendants' motion to dismiss, the district court adopted the incidental standard of *PRE* and *Hise*, as part of its reasoning, and also cited to *Bedell*, *PTI,* and *Forces Action* in support of this standard.[124]

In affirming, the Ninth Circuit stated that it was joining the Seventh Circuit in holding that "*Noerr-Pennington* immunity protects a private party from liability for the act of negotiating a settlement with a state entity."[125] Notably, the Ninth Circuit did not cite its own *PRE* decision or that case's incidental standard. Rather, it was careful to point out that its decision was not addressing the application of *Noerr-Pennington* to anticompetitive settlement agreements between two private entities, who might conceivably claim that petitioning a court to accept their settlement should immunize the agreement itself.[126]

In *S&M Brands, Inc. v. Summers*, the Middle District of Tennessee, in the course of dismissing several claims, cited to *Bedell, PTI,* and the *Sanders* district court to conclude that *Noerr-Pennington* would bar a *per se* Sherman Act Section 1 claim against the M.S.A.[127]

In *Vibo Corp., Inc. v. Conway* the Western District of Kentucky also applied *Noerr-Pennington* to the M.S.A. in dismissing plaintiff's claims.[128] In addition to citing to *Campbell, Hise, Bedell, PTI*, *Sanders*, and *Summers*, the district court observed that "The MSA resulted from a lawsuit initiated by the state governments against the [original participating manufacturers]. As a product of the settlement of that lawsuit, it, and all of its provisions, represent the result of the OPMs' active negotiations with state government officials."[129]

The Sixth Circuit affirmed, citing to *Sanders* and *Campbell* for their conclusions that petitioning includes the acts of negotiating and entering into a settlement or other agreements with a government entity.[130] However, in doing so, it incorrectly suggested that private actors are immune from liability if their activity is merely associated with government petitioning, citing to *Allied Tube*.[131]

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[121] *Id*. at 197-200.

[122] Sanders v. Lockyer, 365 F.Supp.2d 1093, 1103 (N.D. Cal. 2005) (citing to *PTI*, *Forces Action*, *Hise*, and *Bedell*), *aff'd sub nom.* Sanders v. Brown, 504 F.3d 903 (9th Cir. 2007), *cert. denied* 553 U.S. 1031 (2008).

[123] *Id*. at 1103.

[124] *Id*. at 1102.

[125] 504 F.3d 903, 912-13.

[126] *Id.* at 913 n.8.

[127] 393 F.Supp.2d 604, 629-30 (M.D. Tenn. 2005), *aff'd* 228 Fed.Appx. 560 (6th Cir. 2007) (unreported).

[128] 594 F.Supp.2d 758 (W.D. Ky. 2009), *aff'd* 669 F.3d 675 (6th Cir. 2012).

[129] *Id*. at 772-75.

[130] 669 F.3d 675, 684.

[131] *Id*. (citing *Allied Tube*, 486 U.S., at 501 for the proposition that "private actors remain liable for anticompetitive activity not associated with government petitioning . . . .").

VI. CONFUSION AMONG THE COMMENTATORS

Several commentators have addressed the question of whether litigation settlements should be immune from antitrust liability under *Noerr-Pennington*. None of these commentators, however, has specifically recognized that the *Noerr-Pennington* doctrine articulates a furtherance standard for petitioning immunity. Most of these commentators have not distinguished between situations involving settlement agreements between private parties and settlements between a private party and government.

Some early commentators pointed out at the time of the *New Mexico Natural Gas* litigation that the case law and legal doctrine regarding whether settlements should be immunized from antitrust scrutiny was little developed.[132] These commentators cautioned against finding antitrust violations in settlements out of concern that liability might unnecessarily inhibit settlements and, thereby, strain judicial resources.[133] At the same time, these authors generally allowed that the question of whether *Noerr* applies to a settlement may depend on its nature, including whether the settlement is between private parties or is between a private party and government.[134]

More recently, some commentators have arrived at more firm conclusions about whether settlements should be immune. Some commentators correctly conclude that private settlements should not obtain *Noerr-Pennington* immunity because they are the antithesis of efforts to obtain government action.[135] The leading antitrust treatise likewise concludes that settlements between private parties are private contracts that should not be immune, while settlements between a private party and a state actor should be immune because the state itself is a party to the contract.[136] Another commentator incorrectly argues that private settlements deserve blanket immunity, even if they nakedly restrict competition.[137] Similarly, another argues that immunity

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[132] Harry M. Reasoner & Scott J. Atlas, *The Settlement of Litigation as a Ground for Antitrust Liability*, 50 ANTITRUST L. J. 115, 116 (1981) ("The law regarding the various substantive ways a settlement can have antitrust implications is little developed. Much of what is suggested is therefore a discussion of theoretical principles not refined in the crucible of actual litigation in this area.").

[133] *Id*. at 115, 126.

[134] *Id*. at 116 ("There are legally significant subcategories ranging from simple contracts between a plaintiff and defendant to judicially approved class action settlements to government consent decrees subjected to independent judicial review.").

[135] Ku, *supra* note 43, at 421-28 ("Private settlements . . . are in fact the antithesis of efforts to solicit government action . . . . When private parties enter into a settlement agreement, they are affirmatively withdrawing consideration of the matter from the decisionmaking authority of government . . . . [T]hey have officially given up any such effort and are acting on their own."). *Accord* HERBERT HOVENKAMP ET AL., IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW § 7.2c & n.19 (2d ed. 2013) (citing to Ku at 388-89). *See also* Randy D. Gordon, *A Question of Fairness: Should* Noerr-Pennington *Immunity Extend to Conduct in International Commercial Arbitration?*, 19 AM. REV. INT'L ARB. 211, 228-31 (2008) (finding it doubtful that immunity should apply to arbitration settlement agreements).

[136] PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 205g (4th ed. 2013).

[137] John F. Resek Comment, *Biovail v. Hoechst Aktiengellschaf, Inc.: An Analysis Under the Sherman Act and the* Noerr-Pennington *Doctrine*, 10 FORDHAM INTELL. PROP. MEDIA & ENT. L. J. 571 (2000). Resek argues that a partial settlement agreement of a patent dispute is protected under *Noerr* "because the partial settlement agreement is a

should apply to settlements achieved through alternative dispute resolution, as long as the underlying conflict being resolved is not a sham.[138] But, to the extent that these commentators attempt to articulate a rationale for the application of petitioning immunity, they all misread *Noerr* as articulating an incidental standard, rather than a furtherance standard.[139]

Some commentators argue that private settlement agreements should be evaluated on a case-by-case basis and immunity should apply under *PRE*'s incidental standard where the settlement is made in "good faith" and is within the "four corners" of the litigation.[140] In this view, such a settlement is one that is not injected with additional anticompetitive terms beyond the "legitimate disputes" in question.[141] In this approach, a court would have to conduct an in-depth analysis of the underlying litigation claims in order to determine if *Noerr-Pennington* immunity should apply to each provision of a private settlement.[142]

These commentators state that "The Sherman Act was not designed to reach . . . agreements resolving legitimate disputes about each party's pre-existing legal rights . . . and *therefore* the *Noerr* doctrine should protect" those agreements.[143] The illogical implication of this approach is that *Noerr-Pennington* immunity should apply to shield certain actions from liability (i.e., agreeing to a settlement having no anticompetitive terms) precisely because, by definition, no liability can attach to those actions.

Such an approach would render *Noerr-Pennington* immunity to be without functional purpose and, therefore, entirely superfluous. If, by definition, there is nothing to hide in a private settlement agreement having no anticompetitive terms, then the cloak of *Noerr* immunity is

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private action which is incidental to a valid effort to influence government action." *Id.* at 590. In his view, "The Supreme Court has decided that the constitutional rights are sufficiently precious that the standard to defeat Noerr Immunity using the sham exception is very high." *Id.* at 594.

[138] Adam Eckstein, Comment, *The Petition Clause and Alternative Dispute Resolution: Constitutional and Consistency Arguments for Providing* Noerr-Pennington *Immunity to ADR*, 75 U. CIN. L. REV. 1683, 1707-09 (2007) ("In essence, this rule requires a genuine, litigable conflict in order for parties engaging in ADR to receive immunity.").

[139] *See* Ku, *supra* note 43, at 399 & n.97 (misquoting *Allied Tube*, 486 U.S. at 499 for the proposition that "in addition to protecting the 'act' of petitioning itself, courts recognize that *Noerr* immunity protects what can be described as 'incidental' acts associated with 'a valid effort to influence governmental action.' "); AREEDA & HOVENKAMP, *supra* note 136, ¶ 205g ("as the Ninth Circuit held in *Columbia*, settlement discussions and the resulting decisions are one of the incidents of the petitioning immunity that *Noerr* creates."); Resek, *supra* note 137, at 590 (citing to *Allied Tube* for the conclusion that "Noerr also immunizes the Hoechst-Andrx partial settlement because the partial settlement agreement is a private action which is incidental to a valid effort to influence government action."); and Eckstein, *supra* note 138, at 1684 ("To protect the constitutional right to petition and correspond with the judicial system's preference of settlements, the *Noerr-Pennington* doctrine should immunize from subsequent litigation ADR incidental to genuine petitioning of the courts.").

[140] Mark L. Kovner et al., *Applying the Noerr-Pennington Doctrine to Pharmaceutical Patent Litigation Settlements*, 71 ANTITRUST L. J. 609, 624-25 (2003). In the view of these commentators, "The *Noerr* doctrine, as developed and subject to certain exceptions, affords protection for virtually all petitioning-related conduct, including actions taken by parties in litigation that are not objectively and subjectively baseless." *Id.* at 612.

[141] *Id.* at 624.

[142] *Id.* at 624-25.

[143] *Id.* at 624 (emphasis added). "We start from the premise that settlements are entitled to *Noerr* protection to the extent they dispose of the litigation on the merits and are limited to the issues presented in the litigation, i.e., they are protected to the extent that they fall within the 'four corners' of the litigation." *Id.* at 625.

merely an unnecessary accessory garment in which to clothe the innocent, blameless body of such an agreement. This argument is exactly backwards. *Noerr-Pennington* immunizes non-sham petitioning conduct directed towards obtaining governmental action where legal liability, such as antitrust liability, might otherwise potentially apply if a private party took that action, itself.[144]

Citing to *PRE*'s incidental standard, this theory incorrectly equates the initiation and subsequent furtherance of a petition towards some goal with its exact opposite, the decision by private parties to terminate the petitioning process and to settle their dispute themselves.[145] These commentators suggest that a failure to immunize private settlements amounts to a private party being "obligated, by force of law, to continue litigating claims if it wants to stop."[146] This argument is incorrect. Just because a private settlement should not obtain *Noerr-Pennington* immunity does not mean that the rules of civil procedure have suddenly been abolished or that private parties to litigation have been converted into adversarial conscripts.[147] The option to terminate litigation and enter into a non-immune private settlement always remains.

Some suggest that *Noerr-Pennington* immunity for private settlements should vary with the level of government involvement, akin to a sliding scale. Some conclude, based on *Hise*'s incidental language, that "private settlement agreements involving *some* aspect of government involvement will be protected as valid petitioning efforts" as long as they do not constitute "unethical litigation tactics," such as a market allocation agreement.[148] Other commentators argue that immunity turns more specifically on whether a judicial branch court is involved in, directs, orders, approves, or enforces the settlement agreement, for example, in the form of a consent decree.[149] One of these suggests that "it is probably safe to conclude that the parties'

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[144] United Mine Workers of America v. Pennington, 381 U.S. 657, 669 (1965) ("The Sherman Act, it was held, was not intended to bar concerted action of this kind even though the resulting official action damaged other competitors at whom the campaign was aimed."); Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127, 136 (1961) ("the Sherman Act does not prohibit two or more persons from associating together in an attempt to persuade the legislature or the executive to take particular action with respect to a law that would produce a restraint or a monopoly.").

[145] "Where the settlement covers only the issues raised in the litigation, and therefore any alleged harm from the settlement stems only from the agreement to cease litigating, then the settlement is incidental to the litigation and Noerr should apply." Kovner et al., *supra* note 140, at 624. According to these commentators, "The initiation of legitimate (i.e. non-sham) patent litigation is clearly protected activity. This is just another way of saying that a refusal to settle is protected. If a refusal to settle is protected, so shouldn't accepting a settlement offer also be immune absent other expressly anticompetitive terms?" *Id.* at 622-23. "If parties are immunized from antitrust liability for bringing legitimate litigation, as they are under well-established law, then those same parties should be immunized for 'pulling the plug' on the litigation and diverting their resources to other pursuits." *Id.* at 613.

[146] *Id.* at 613. *See also id.* at 624 ("If bringing non-sham litigation is immunized from antitrust attack, then an agreement to stop the litigation should be, too, lest we turn private parties into public prosecutors with an obligation to continue to pursue a case for 'public interest' reasons.").

[147] *See generally* FED. R. CIV. P. 41(a)(1)(A).

[148] A.B.A Sec. of Antitrust L. Monograph 25, The *Noerr-Pennington* Doctrine 64-65 (2009).

[149] *See* M. Howard Morse, *Settlement of Intellectual Property Disputes in the Pharmaceutical and Medical Device Industries: Antitrust Rules*, 10 GEO. MASON L. REV. 359, 402-03 (2002); Jeff McGoff, Note, *Exploring the Boundary of The Noerr-Pennington Doctrine in the Adjudicative Process*, 34 U. MEM. L. REV. 429, 441-42, 450 (2004); Oliver, *supra* note 41, at 40.

likelihood of obtaining *Noerr-Pennington* protection increases in direct proportion to the degree of court involvement in settling the litigation."[150]

Some commentators have suggested other specific applications of a sliding scale-type approach. One commentator suggests that *Noerr-Pennington* immunity could be strengthened where the counter party to a settlement is a governmental entity, where a settlement "closely follows what might be a likely judicial outcome of the litigation," where a settlement is "reviewed and 'so ordered' " by a presiding court, or where the antitrust agencies were included in the process of assessing proposed judicial settlements.[151] Others also specifically suggest that collective action by multiple defendants to settle a private lawsuit brought against them in a judicial branch court is immune under *PRE*'s incidental standard, an anticompetitive class action settlement under Federal Rule of Civil Procedure 23 is likely immunized because it requires a court's review and approval, and the settlement of a case brought by government against a private party is also immune.[152]

Apart from suggesting that a settlement between private parties and government is immune, these sliding scale-type approaches are erroneous because they are imprecise. They mistakenly replace the specific basis of *Noerr-Pennington* immunity, conduct that furthers a petition toward some goal in the form of redress by government, with merely some government involvement at some point, more generally. They provide no clear guidance as to when or to what extent courts should apply *Noerr-Pennington* to settlements. Furthermore, a sliding scale approach based on government involvement would give private parties perverse incentives to avoid settling litigation amicably themselves and to, instead, unnecessarily involve courts in settlement negotiations to the maximum extent possible, in the hope of triggering immunity for doing so.

Another commentator has criticized *Sanders v. Brown* for adopting a blanket rule of immunity for the M.S.A.[153] This commentator believes the Ninth Circuit's application of *Noerr* immunity is merely an ends-driven choice between the lesser of two evils: the sanctioning of anticompetitive behavior if the M.S.A. was immunized and the possible chilling effects on speech if the M.S.A. was not immunized.[154] This commentator rightly points out that the Ninth Circuit did not provide a comprehensive analysis of the application of *Noerr* in the M.S.A. context.[155] But neither does the author, beyond an allegation that the Ninth Circuit merely used outcome-driven reasoning in order to fall in line with other courts that had previously immunized the M.S.A.[156]

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[150] Oliver, *supra* note 41, at 40.

[151] *See* James R. Atwood, *Securing and Enforcing Patents: The Role of* Noerr/Pennington, 83 J. PAT. & TRADEMARK OFF. SOC'Y. 651, 664-67 (2001).

[152] David A. Donohoe & Maiysha R. Branch, *Can a Litigation Settlement Violate the Antitrust Laws?*, METROPOLITAN CORP. COUNSEL (Dec. 2000).

[153] Robert W. Bauer, Sanders v. Brown: *State-Action Immunity and Judicial Protection of the Master Settlement Agreement*, 34 J. CORP. L. 1291, 1304 (2009).

[154] *Id.*

[155] *Id.* at 1305.

[156] *Id.* at 1299.

VII. CONCLUSION

Courts should resolve questions involving litigation settlements between parties on opposing sides of litigation and the *Noerr-Pennington* doctrine using more careful language that is consistent with the original *Noerr* case. Only conduct in furtherance of a petition to obtain redress from government and effects incidental to such conduct should obtain *Noerr-Pennington* immunity from liability under laws that would otherwise apply, such as the federal antitrust laws.

Noerr's unidirectional furtherance standard for immunity for petitioning conduct has important implication for settlement agreements between parties on opposing sides of a litigation dispute. Under *Noerr*'s furtherance standard, a settlement between private parties should not be immune. By contrast, a settlement between a private party and government should be immune. Courts should clearly distinguish between these two situations in the course of applying a furtherance standard to settlement agreements.

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Angels Rush in Where Fools Fear to Tread: State Enforcement Against Patent Trolls

Jay L. Himes & Matthew J. Perez
Labaton Sucharow LLP

Angels Rush in Where Fools Fear to Tread: State Enforcement Against Patent Trolls

Jay L. Himes & Matthew J. Perez[1]

I. INTRODUCTION

Nobody likes trolls—those mythical creatures, "considered dangerous to human beings," who hide under bridges waiting to prey on unsuspecting travelers.[2] Like their mythological namesakes, patent trolls—or, as they are known in more polite company, patent assertion entities ("PAEs")—are fearsome to many a business. Patent trolls have sued major technology companies like Apple, Hewlett-Packard, Samsung, and Google for years. Apple alone has faced over 170 lawsuits from patent trolls in the past five years.[3]

Patent trolls, it is often said, seek only to extort licensing fees for patents that they do not practice (or ever intend to practice), but that they claim have been infringed. As Kent Walker, Google's Senior Vice President and General Counsel, has put it:

> Trolls use the threat of time-consuming and expensive litigation to extort settlements, even where their claims wouldn't hold up in court.
>
> This kind of patent troll litigation has grown like a particularly noxious weed, increasing four-fold since 2005. By some estimates it cost the U.S. economy nearly $500 billion over the past two decades. And the problem is growing.[4]

"Growing," indeed. According to a June 2013 presidential report, "[t]he increase in the number of suits filed [by patent trolls] for patent infringement has . . . been accompanied by an increasingly large number of suits threatened. . . . Conservative estimates place the number of threats in the last year alone [2012] at a minimum of 60,000 and more likely at over 100,000."[5] Of late, patent trolls have begun to issue demand letters to businesses across the country—often start-up and small companies, or "downstream" technology users—accusing them of infringing patents that the trolls hold and demanding licensing fees to avoid infringement litigation.

[1] The authors are, respectively, partner and associate, Labaton Sucharow LLP, New York City. Mr. Himes, also co-chairs the firm's antitrust practice group, is the former antitrust bureau chief in the New York Attorney General's office.

[2] Wikipedia, Troll, http://en.wikipedia.org/wiki/Troll (last visited Jan. 2, 2014).

[3] Neil Hughes, *Patent 'trolls' hit Apple with 171 lawsuits in last 5 years*, APPLEINSIDER (Aug. 28, 2013, 9:36 AM), http://appleinsider.com/articles/13/08/28/patent-trolls-hit-apple-with-171-lawsuits-in-last-5-years.

[4] *See* Kent Walker, *Innovation, Not Litigation*, GOOGLE PUBLIC POLICY BLOG (Dec. 4, 2013, 3:50 PM), http://googlepublicpolicy.blogspot.com/2013/12/innovation-not-litigation.html.

[5] EXECUTIVE OFFICE OF THE PRESIDENT, PATENT ASSERTION AND U.S. INNOVATION 6 (2013) ("PRESIDENTIAL REPORT") (citing Colleen V. Chien, *Patent Assertion Entities, Presentation to the DOJ/FTC hearing on PAEs,* Washington, D.C. (Dec. 10, 2012)), available at http://www.law.berkeley.edu/files/Panel_17b_Documents.pdf.

"Although the amount of money extracted from each company is small, the number of potential defendants makes this strategy potentially profitable overall."[6]

Patent trolls "significantly retard innovation in the United States and result in economic 'dead weight loss' in the form of reduced innovation, income, and jobs for the American economy."[7] Thus, they have commanded the attention of both federal and state authorities. The FTC has invited public comments concerning their practices as part of a recently launched Commission review of PAEs.[8] Senators John Cornyn and Patrick Leahy have introduced separate bills designed to address perceived abuses by PAEs.[9] President Obama himself has weighed in: "[They] don't actually produce anything themselves. They're just trying to essentially leverage and hijack someone else's idea to see if they can extort some money out of them."[10]

Nothing has yet been done at the federal level, however. And like nature itself, State Attorneys General abhor a vacuum. The "first-movers"—the AGs in Minnesota, Nebraska, Vermont, and New York,—have each attempted to curb the ability of patent trolls to issue cease and desist or demand letters to businesses within their States. Can they do it—inasmuch as patent law is itself constitutionally based and, therefore, potentially preemptive of state enforcement? The answer is, predictably, an unequivocal "maybe." We chart the path to maybe-land below. We first describe recent state activity, and then discuss the case law on federal patent preemption. We conclude by revisiting state efforts to curb patent troll abuse against the backdrop of preemption case law.

II. STATES CHALLENGE THE TROLLS

A. Minnesota

In 2012, the Minnesota Attorney General began investigating MPHJ Technology Investments, LLC ("MPHJ") for violations of state consumer protection laws. MPHJ sent demand letters to small businesses in Minnesota, alleging that the companies infringed MPHJ patents for "using basic office equipment to scan documents to e-mail."[11] In its demand letters, MPHJ sought a licensing fee of between $1,000 and $1,200 per employee. The State AG's investigation resulted in a 2013 settlement with MPHJ in the form of an Assurance of Discontinuance ("AOD")—the first ever against a patent troll.[12] Among other things, under the

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[6] *Id.* at 10.

[7] *Id.* at 12 n.5.

[8] Edward Wyatt, *F.T.C. Votes for Inquiry Into Patent Businesses*, N.Y. TIMES, Sept. 28, 2013, at B1, *available at* http://www.nytimes.com/2013/09/28/business/ftc-targets-patent-companies.html.

[9] Senator Cornyn's proposed bill, The Patent Abuse Reduction Act of 2013, S. 1013 (May 22, 2013), would give defendants more information about the firms suing them and would limit the types of documents that defendants would have to produce in discovery. Senator Leahy's proposed bill, The Patent Transparency and Improvements Act of 2013, S. 1720 (Nov. 18, 2013), would declare explicitly that bad faith demand letters are an unfair and deceptive trade practice and thus subject to FTC enforcement authority.

[10] Gene Sperling, *Taking on Patent Trolls to Protect American Innovation*, THE WHITE HOUSE BLOG (June 4, 2013, 1:55 PM), http://www.whitehouse.gov/blog/2013/06/04/taking-patent-trolls-protect-american-innovation.

[11] Press Release, Minn. Att'y Gen. Office, Attorney General Lori Swanson Announces First-in-the-Nation Order to Stop Delaware Company from "Patent Trolling" in Minnesota (Aug. 20, 2013), http://www.ag.state.mn.us/Consumer/PressRelease/130820StopPatentTrolling.asp.

[12] *Id.*

AOD, MPHJ agreed to "cease its patent enforcement campaign in the State of Minnesota and cannot resume such business activities in Minnesota without permission of the Attorney General."[13]

B. Nebraska

The Nebraska Attorney General has similarly entered the fray. In mid-2013, the AG issued a cease and desist order against the law firm of Farney Daniels P.C., directing the firm to "immediately cease and desist the initiation of any and all new patent infringement enforcement efforts within the State of Nebraska pending the outcome of this office's investigation . . . ."[14] At the time, Farney Daniels represented Activision TV, Inc. in a patent infringement suit against Pinnacle Bancorp, Inc. in the District Court for the District of Nebraska, and had sued to enforce the same patents in other federal district courts.[15] According to the Nebraska AG, however, pre-litigation demand letters by Farney Daniels contained "false, misleading, or deceptive statements" with respect to the infringement of certain patents, and these statements "could constitute a violation of the Nebraska Consumer Protection Act."[16]

The Nebraska AG also included a civil investigative demand to Farney Daniels calling for such information as the identity of the patents that Farney Daniels had sought to enforce against Nebraska individuals or entities, the clients represented, and the persons charged with infringement.[17] In turn, Farley Daniels filed a preliminary injunction motion against the Nebraska AG in its pending infringement case, seeking to enjoin the State AG from preventing the firm's continued representation of Activision.[18]

The preliminary injunction briefing raised the federal preemption issue. Specifically, Farney Daniels argued that because federal patent laws generally immunize communications regarding patent rights from civil liability, the Nebraska AG was preempted from enforcing the State's unfair trade practices laws.[19] In response, the Nebraska AG argued that enforcing Nebraska's unfair trade practices laws did not implicate the federal patent laws, and would not impair the federal court's adjudication of the patent dispute.[20] The Court granted the injunction, holding that the Nebraska AG's enforcement activity was an impermissible prior restraint on Farney Daniel's First Amendment rights and that federal patent law preempted Nebraska state law because the Nebraska State AG had failed to show that the firm's demand letters were sent in bad faith.[21]

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[13] *Id.*

[14] Letter from David D. Cookson to Farney Daniels LLP (July 18, 2013) at 2 ("Nebraska AG Letter").

[15] Am. Compl., Activision TV, Inc. v. Pinnacle Bancorp, Inc., No. 8:13-cv-00215 (D. Neb. Aug. 19, 2013) (Bataillon, J.) ("*Activision TV*").

[16] Nebraska AG Letter, *supra* note 14, at 1 (citing NEB. REV. STAT. § 59-1601 *et seq.* (Reissue 2010, Supp. 2012), and the Uniform Deceptive Trade Practices Act, NEB. REV. STAT. § 87-301 *et seq.* (Reissue 2008, Supp. 2010)).

[17] *Id.* (attachment).

[18] Mot. for Prel. Inj., *Activision TV*, ECF No. 8 (Aug. 19, 2013).

[19] Activision TV, Inc.'s Mem. of Law at 17, *Activision TV*, ECF No. 9 (Aug. 19, 2013).

[20] Br. in Sup. of Mot. to Dismiss & in Opp. to Mot for Prel. Inj. at 16, 29-31, *Activision TV*, ECF No. 22 (Sept. 10, 2013).

[21] Order at 12-14, ECF No. 41 (Sept. 30, 2013).

C. Vermont

Our third State, Vermont, has taken perhaps the most aggressive position concerning patent trolls. First, in 2013, the Vermont Attorney General filed an action against MPHJ in Vermont State Court, asserting unfair and deceptive acts in violation of the Vermont Consumer Protection Act.[22] MPHJ's conduct included the following practices:

1. Stating that litigation would be brought against demand letter recipients, when MPHJ was neither prepared nor likely to bring litigation.
2. Using legal counsel to imply that MPHJ had performed sufficient pre-litigation due diligence on the patent infringement claims.
3. Targeting small businesses that were unlikely to have the resources to fight patent-litigation.
4. Sending demand letters that threatened suit with no independent evidence that recipients were infringing its patents.
5. Requesting in the demand letters burdensome information on any business that claimed it was not infringing MPHJ's patents.[23]

MPHJ removed the action to federal district court and moved to dismiss for lack of personal jurisdiction.[24] Vermont cross-moved to remand back to state court and to stay a decision on MPHJ's motion to dismiss.[25] The parties' motions are pending.

In addition to the Vermont AG's lawsuit, the State legislature enacted legislation that specifically prohibits bad faith assertions of patent infringement as a matter of Vermont consumer protection law.[26] This is the first such state statute. In its findings supporting the new law, the Vermont legislature found that "[a]busive patent litigation, and especially the assertion of bad faith infringement claims, can harm Vermont companies. A business that receives a letter asserting such claims faces the threat of expensive and protracted litigation and may feel that it has no choice but to settle and pay a licensing fee, even if the claim is meritless."[27]

Vermont's new law amends the State Consumer Protection Act by expressly prohibiting bad faith assertions of patent infringement. While the statute does not define "bad faith patent assertion," the law enumerates various factors, some of which may be included in a demand letter and some of which may not be, that the court may consider in analyzing the element of bad faith. The factors range from letter details about the patent (such as number, ownership, and coverage), to the patent holder's pre-letter due diligence in asserting claims of infringement, to license

[22] Compl., Vermont v. MPHJ Tech. Invs. LLC, No. 282-5-13, (Vt. Super. Ct. May 8, 2013).

[23] *Id.* at ¶ 56.

[24] *See* Notice of Removal, Vermont v. MPHJ Tech. Invest. LLC, No. 2:13-cv-00170-wks (D. Vt. June 7, 2013), ECF No. 1; Mot. to Dismiss Pursuant to Fed. R. Civ. P. 12(b)(2), (D. Vt. Sept. 17, 2013), ECF No. 16.

[25] Mot. to Remand, (D. Vt. July 8, 2013), ECF No. 9; Mot. to Stay Briefing & Decision on Mot. to Dismiss, (D. Vt. Sept. 27, 2013), ECF No. 20.

[26] 2013 Vt. Legis. Serv. 20, codified as VT. STAT. ANN. tit. 9, §§ 4195-4199. For ease of reference, a copy of the law accompanies this article as an Appendix.

[27] VT. STAT. ANN. tit. 9, § 4195(a)(6).

amounts demanded and the basis for them, to the patent holder's practices generally in asserting infringement.[28]

Furthermore, Vermont's law also specifies factors that the court may consider as indicating an absence of bad faith ("good" faith, presumably). These non-bad faith factors include providing statutorily prescribed or letter recipient-requested patent information, negotiating with the letter recipient, practicing the patent, or, indeed, even being "an institution of higher education."[29] Neither enumerated list is exclusive, as each also allows for consideration of "[a]ny other factor the court finds relevant."[30]

The Vermont legislation authorizes a private right of action in which targets of bad faith patent assertion claims can receive equitable relief, damages, costs, and fees (including reasonable attorney's fees), and exemplary damages "equal to $50,000.00 or three times the total of damages, costs, and fees, whichever is greater."[31] The Vermont AG also is authorized to investigate bad faith patent infringement assertions and to bring civil suits.[32]

D. New York

Most recent of all, on January 13, 2014 the New York AG announced a settlement with MPHJ for making allegedly deceptive patent claims against New York businesses.[33] According to the AG's investigation findings, between September 2012 and May 2013, MPHJ, through 100 subsidiaries, sent over 1,000 letters to New York businesses, asserting "likely" patent infringement by the letter recipient, and offering to negotiate a patent license.[34] Over 500 of the letters stated that MPHJ "had a positive experience from the business community to [its] licensing program, when in fact: (1) "no business had yet entered into a license agreement" covering the patents, and (2) "[o]nly a handful" of businesses targeted by the patents' prior owner in an earlier round of letters had agreed to settle infringement claims or to license the patents.[35] Many of the letters asserted that $1,200 was "a fair price for a negotiated license" even though the royalty agreed to by a few licenses "was significantly less than $1200 . . . ."[36]

MPHJ followed up its first round of letters with two other rounds, sent by its outside counsel, the last of which included a draft patent infringement complaint. In yet another round of letters, MPHJ advised that various developments caused it to suspend its licensing program, and that letter recipients could consider the matter closed unless MPHJ contacted them again.[37] In sum, despite having targeted hundreds of New York businesses, MPHJ never "filed a single

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[28] *Id.* § 4197(b)(1)-(8).

[29] *Id.* § 4197(c)(1)-(6).

[30] *Id.* § 4197(b)(9) & (c)(7).

[31] *Id.* § 4199(b).

[32] *Id.* § 4199(a).

[33] Assurance of Discontinuance, In the Matter of the Investigation of Eric T. Schneiderman, Attorney General of the State of New York, of MPHJ Technology Investments, LLC, Assur. No. 14-015 (Jan. 13, 2014) ("AOD"), http:// http://www.ag.ny.gov/pdfs/FINALAODMPHJ.pdf.

[34] AOD, The Attorney General's Findings, at ¶ 5.

[35] *Id.* at ¶¶ 6-7.

[36] *Id.* at ¶¶ 9-10.

[37] *Id.* at ¶ 25.

patent infringement lawsuit against a New York business."[38] In agreeing to settle the matter, MPHJ agreed to allow any New York licensee to void the license agreement and to receive a full refund of license payments.[39] MPHJ also agreed to comply with detailed patent assertion "guidelines" in its dealings with individual New Yorkers or "small or medium" New York businesses.[40] The settlement guidelines, in summary, include the following obligations:

- *Diligence and good faith obligations in contacting alleged infringers*: MPHJ may not assert patent infringement claims against New York persons unless it has taken reasonable, good faith efforts to substantiate the claim.[41] These obligations, which apply to both the patent holder and its attorney, are designed to prohibit "mass mailings."[42]
- *Disclosure requirements*: MPHJ may not assert infringement unless it also provides information describing the basis for its claim "with reasonable specificity," including information bearing on the patent's "likely invalidity."[43] MPHJ must also make disclosures concerning related patents, which could also be the subject of alleged infringement. [44]
- *License fee information*: Where MPHJ seeks a specified fee, it must provide a "factual basis" for the amount sought.[45]
- *Patent holder transparency*: MPHJ is prohibited from hiding its identity from alleged infringers.[46] Further, MPHJ must disclose any licensing agreement or covenant not to sue that it has made with a manufacturer, or any indemnity available from the manufacturer, which may affect MPHJ's claims against targeted businesses.[47]

Significantly, the New York AG also announced that the MPHJ guidelines represent "minimum standards" that patent trolls "seeking to contact New York businesses must follow to avoid liability for unlawful deceptive practices."[48] Moreover, the guidelines "are not safe harbors" even if met, because the AG is prepared "to supplement [them] with additional requirement in future cases."[49] Thus, although New York lacks the kind of specific legislation found in Vermont, the New York AG's announced enforcement intention means that patent trolls who ignore the MPHJ guidelines do so at their peril.

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[38] *Id.* at ¶ 19.

[39] AOD, Prospective Relief, at ¶ 1.

[40] *Id.* at ¶ 6. Essentially, businesses with 1,000 or more employees are excluded from coverage. *Id.* The guidelines themselves are at ¶¶ 9-15.

[41] *Id.* at ¶¶ 9-10.

[42] *See* Press Release, A.G. Schneiderman Announces Groundbreaking Settlement With Abusive 'Patent Troll,'" (Jan. 14, 2014) ("NYAG Release"), http://www.ag.ny.gov/press-release/ag-schneiderman-announces-groundbreaking-settlement-abusive-%E2%80%9Cpatent-troll%E2%80%9D.

[43] AOD, Prospective Relief, ¶ 11.

[44] *Id.* at ¶¶ 15(a) and (b).

[45] *Id.* at ¶ 12.

[46] *Id.* at ¶ 13.

[47] *Id.* at ¶ 15(c).

[48] NYAG Release, *supra* note 43.

[49] *Id.*

E. Resulting Common Question

The Minnesota and New York AGs' efforts to address patent trolls have concluded, at least for the time being. Meanwhile, in Vermont the preemption issue remains unresolved. However, as noted above, the *Activision* court held that federal law preempted the Nebraska' AG's enforcement efforts. Because continued State interest in patent trolls is foreseeable, we consider whether or not the *Activision* court got it right. Can state enforcement survive a preemption challenge based on federal patent law?

III. OVERVIEW OF FEDERAL PREEMPTION ANALYSIS

Under the Supremacy Clause of the U.S. Constitution, "state law that conflicts with federal law is 'without effect.'"[50] However, because "the States are independent sovereigns in our federal system,"[51] federal preemption of state law should not be presumed. To the contrary, "the historic police powers of the States [are] not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress," particularly when Congress "legislated . . . in a field which the States have traditionally occupied."[52] Thus, "[t]he purpose of Congress is the ultimate touchstone."[53]

Briefly, preemption analysis comes in three flavors: (1) explicit preemption, (2) field preemption, and (3) conflict preemption.[54] Explicit preemption is the easiest to identify: the federal law on its face unequivocally states its own preemptive effect. By contrast, field and conflict analysis are used where the federal statute is not explicit, thus requiring extra effort to divine whether or not Congress intended federal law to preempt state law.

Field preemption turns on whether state law seeks to "regulate[] conduct in a field that Congress intended the Federal Government to occupy exclusively."[55] Congressional intent to preempt the "field" may be inferred from a "'scheme of federal regulation . . . so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it' or where an Act of Congress 'touch[es] a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject.'"[56]

Conflict preemption relies less on inference and exists when the state law actually clashes directly with federal law—where, for example, it is impossible for a private party to comply with

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[50] Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516 (1992) (quoting Maryland v. Louisiana, 451 U.S. 725, 746 (1981)). *See generally* U.S. Const. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

[51] Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996).

[52] *Id*. at 485 (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

[53] *Medtronic*, 518 U.S. at 485. *See also* Allegan, Inc. v. Athena Cosmetics, Inc., No. 2013-1286, slip op. at 8 (Fed. Cir. Dec. 30, 2013) (holding that the California Unfair Competition Law was not preempted by the Federal Food, Drug, and Cosmetic Act in part because Congress expressed no desire to supplant the States' traditional authority to regulate health and safety).

[54] *Hunter Douglas*, 153 F.3d at 1332 (citing English v. Gen. Elec. Co., 496 U.S. 72, 78-79 (1990)).

[55] *English*, 496 U.S. at 79.

[56] *Id.* (quoting *Rice*, 331 U.S. at 230).

both bodies of law.[57] In addition, state law may be preempted when it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[58]

Although preemption has three flavors, they are not "rigidly distinct."[59] For instance, sometimes field preemption blends with conflict preemption because a "'state law that falls within a preempted field conflicts with Congress' intent (either express or plainly implied) to exclude state regulation.'"[60]

IV. JUDICIAL RESPONSE TO PATENT LAW PREEMPTION ARGUMENTS

Although constitutionally anchored in the "patent clause,"[61] federal patent law is not explicitly preemptive. Therefore, field or conflict preemptions determine whether a state law can stand. Typically, the courts begin by analyzing the purpose of the federal patent laws.

The federal patent law system embodies "a carefully crafted bargain for encouraging the creation and disclosure of new, useful, and nonobvious advances in technology and design in return for the exclusive right to practice the invention for a period of years."[62] While an inventor may keep his invention a secret—and thereby reap the benefits of his invention indefinitely—"[i]n consideration of its disclosure and the consequent benefit to the community," the inventor can receive a patent that (where valid) guarantees at least 17 years of exclusive enjoyment.[63]

Thus, the patent law reflects "a careful balance between the need to promote innovation and the recognition that imitation and refinement through imitation are both necessary to invention itself and the very lifeblood of a competitive economy."[64] Moreover, just as patent law defines that which is subject to protection, so too it frees from restriction that which is unpatentable, and that for which a patent has expired, so as "to assure that ideas in the public domain remain there for the free use of the public."[65] Accordingly, federal patent law preempts

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[57] *English*, 496 U.S. at 79. *See, e.g.*, Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963) (holding that a California law governing the sale of mature avocados based upon oil content was preempted because it conflicted with federal regulations that placed no significance on oil content to determine the maturity of avocados).

[58] Hines v. Davidowitz, 312 U.S. 52, 67 & 74 (1941) (holding that a Pennsylvania law requiring aliens to register obstructed the federal goal of "provid[ing] a standard for alien registration in a single integrated and all-embracing system in order to obtain the information deemed to be desirable in connection with aliens."). *See also Maryland*, 451 U.S. at 747.

[59] *Hunter Douglas*, 153 F.3d at 1332 (quoting *English*, 496 U.S. at 79 n.5).

[60] *Id.*

[61] U.S. Const. art. I, cl. 8 ("The Congress shall have Power . . . [t]o promote the Progress of Science and useful Arts, by securing for limited Times to . . . Inventors the exclusive Right to their . . . Discoveries").

[62] Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 150-51 (1989).

[63] *Id.* at 151. At the time of the *Bonito Boats* decision, the patent term was 17 years. For patent applications filed on or after June 8, 1995, the term was amended to 20 years from the date on which the application was filed. *See* Uruguay Round Agreements Act of 1994, § 532(a)(1), Pub. L. 103-465, 109 Stat. 4809, amending 35 U.S.C. § 154(a)(2). Subject to various limitations, 35 U.S.C. § 154(b)(1)(B) provides that no patent application will remain pending before the Patent and Trademark Office for more than three years.

[64] *Id.* at 146.

[65] Aronson v. Quick Point Pencil Co., 440 U.S. 257, 262 (1979).

state laws that offer "'patent-like protection' to discoveries unprotected under federal patent law."[66]

For example, in *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*,[67] the plaintiff, a vessel manufacturer, sought to bar sale of a competing product under a Florida statute that prohibited the unauthorized use of a process known as "direct molding" to manufacture a vessel hull. The plaintiff, however, had marketed its own hull freely and without patent protection for years, and that activity rendered the plaintiff's manufacturing process unpatentable.[68] The Supreme Court unanimously held that the plaintiff could not rely on the protection conferred by the Florida statute because it conflicted with federal patent law.

As the Court explained, the Florida law "prohibits the entire public from engaging in a form of reverse engineering of a product in the public domain."[69] But reverse engineering, the Court emphasized, "may act as a spur to the inventor, creating an incentive to develop inventions that meet the rigorous requirements of patentability. The Florida statute substantially reduces this competitive incentive, thus eroding the rule of free competition upon which the attractiveness of the federal patent bargain depends."[70] In other words, Florida's statute conflicted with federal patent law by creating property rights in an invention that the patent law deemed non-patentable. Hence, federal preemption applied.

The federal patent laws, however, do not necessarily displace all state laws and state-created causes of action. *Dow Chemical Co. v. Exxon Corp.*[71] is an example of conflict, rather than field, preemption operating. In *Dow*, the Federal Circuit upheld the plaintiff's state law unfair competition claims for intentional inference with current and prospective contractual relations, even though each claim required showing that the patents involved were unenforceable due to inequitable conduct.[72] The Court noted that the state's unfair competition law was directed to tortious conduct in the marketplace, and sought the "maintenance of orderly contractual relations."[73] Because the state law "regulate[d] conduct in a different field from federal patent law,"[74] it was "not preempted merely because patents and patent issues are presented in the substance of those contracts."[75]

In a later decision, *Hunter Douglas Inc. v. Harmonic Design, Inc.*,[76] the Federal Circuit read Supreme Court precedent to confirm that "federal patent law issues housed in a state law

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[66] Ultra-Precision Mfg., Ltd. v. Ford Motor Co., 411 F.3d 1369, 1377-78 (Fed. Cir. 2005) (quoting *Bonito Boats*, 489 U.S. at 156 (1989)).

[67] 489 U.S. 141 (1989).

[68] *See* 35 U.S.C. § 102, as amended by the Leahy-Smith America Invents Act of 2011, Pub. L. 112-29, 125 Stat. 284.

[69] *Bonito Boats*, 489 U.S. at 160-61 (citation omitted).

[70] *Id*. at 161.

[71] 139 F.3d 1470 (Fed. Cir. 1998).

[72] *Id*. at 1472 n.1, 1475 n.3.

[73] *Id*. at 1478.

[74] *Id*. at 1477.

[75] *Id*. at 1478.

[76] 153 F.3d 1318 (Fed. Cir. 1998), *overruled in part on other grounds by* Midwest Indus., Inc. v. Karavan Trailers, Inc., 175 F.3d 1356, 1359 (Fed. Cir. 1999).

cause of action are capable of being adjudicated, even if there is no accompanying federal claim."[77] This precedent demonstrated not only the substantial difference between the patent laws and state unfair competition laws, but also that "regulation of business affairs is traditionally a matter for state regulation."[78]

At the same time, however, the *Hunter Douglas* court recognized that federal patent law preempts state tort law from imposing liability for either: (1) conduct before the Patent and Trademark Office unless accompanied by fraud or sham patent prosecution;[79] or (2) publicizing a patent in the marketplace unless accompanied by allegations that the patentee acted in bad faith.[80] This second prong is germane to evaluating whether States may invoke their unfair competition or consumer protection laws against the conduct that has sparked their interest in patent trolls to date—sending demand or cease and desist letters to alleged infringers. Under prevailing authority, federal preemption under the patent laws has the stronger hand, and will be trumped only where the patent holder's conduct is objectively baseless.

The Federal Circuit faced this issue squarely in *Globetrotter Software, Inc. v. Elan Computer Group, Inc.*,[81] where the patent holder argued that federal law preempted state-law claims for unfair competition and tortious inference with economic advantage based on the patent holder's pre-litigation communications. The Court held that in order to avoid preemption, the state-law claims needed to include a bad faith element:

> A patentee that has a good faith belief that its patents are being infringed violates no protected right when it so notifies infringers." Accordingly, a patentee must be allowed to make its rights known to a potential infringer so that the latter can determine whether to cease its allegedly infringing activities, negotiate a license if one is offered, or decide to run the risk of liability and/or the imposition of an injunction.[82]

The *Globetrotter* court adopted a particular species of bad faith, however—one that requires objective, not subjective, baselessness—which the Court imported from *East Railroad*

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[77] *Id.* at 1334 (citing Hathorn v. Lovorn, 457 U.S. 255, 266 n.18 (1982); Pratt v. Paris Gaslight & Coke Co., 168 U.S. 255, 257-59 (1897)).

[78] *Hunter Douglas*, 153 F.3d at 1334 (citing California v. ARC Am. Corp., 490 U.S. 93, 101 (1989)).

[79] *Hunter Douglas*, 153 F.3d at 1336. *See also* Nobelpharma AB v. Implant Innovations, Inc., 141 F.3d 1059 (Fed. Cir. 1998); Abbott Labs. v. Brennan, 952 F.2d 1346 (Fed. Cir. 1991); Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961).

[80] *Hunter Douglas Inc.*, 153 F.3d at 1336. *See also* Mikohn Gaming Corp. v. Acres Gaming, Inc., 165 F.3d 891, 897 (Fed. Cir. 1998) ("Federal precedent is that communications to possible infringers concerning patent rights is not improper if the patent holder has a good faith belief in the accuracy of the communication."); Virginia Panel Corp. v. MAC Panel Co., 133 F.3d 860, 869 (Fed. Cir. 1997) ("[A] patentee must be allowed to make its rights known to a potential infringer so that the latter can determine whether to cease its allegedly infringing activities, negotiate a license if one is offered, or decide to run the risk of liability and/or the imposition of an injunction."); Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700, 709 (Fed. Cir. 1992) (stating that a patent holder "that has a good faith belief that its patents are being infringed violates no protected right when it so notifies infringers"). *Cf.* Zenith Elecs. Corp. v. Exzec, Inc., 182 F.3d 1340, 1353-54 (Fed. Cir. 1999) (holding that a federal Lanham Act unfair competition claim did not conflict with federal patent laws *per se*, but requiring the addition of a "bad faith" element).

[81] 362 F.3d 1367 (Fed. Cir. 2004).

[82] *Id.* at 1374 (quoting Virginia Panel Corp., 133 F.3d at 869).

Presidents Conference v. Noerr Motor Freight, Inc.[83] and its progeny. In *Noerr*, the Supreme Court held that conduct directed towards influencing legislative activity was immunized from antitrust liability unless it was a sham. The Supreme Court thereafter extended the immunity doctrine to litigation in the courts in *California Motor Transportation Co. v. Trucking Unlimited*.[84] Finally, in *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc.*,[85] the Supreme Court added content to the sham exception by requiring that litigation activity be "objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits."[86] Conduct amounting to "an objectively reasonable effort," the Supreme Court further wrote, "cannot be sham regardless of subjective intent."[87]

The Federal Circuit in *Globetrotter* relied on these Supreme Court decisions, together with Court of Appeals rulings applying the *Noerr* doctrine not only to antitrust claims,[88] but also to business torts, writ large.[89] The *Globetrotter* court thus held that federal patent law preemption ought to depend on whether the patent holder's pre-litigation communication was objectively baseless.[90] This required the communication's recipient to "offer clear and convincing evidence that [the patent holder] *had no reasonable basis* to believe that the [accused infringing device] infringed [the holder's] patents."[91]

Applying this analysis, the Federal Circuit held that the alleged infringer's state law unfair competition and tortious inference claims were preempted because the infringer failed to show objective baselessness—that the patents were either invalid or not infringed. Subjective evidence of the patent holder's particular motivation in sending its demand letter was insufficient to avoid preemption.

The Supreme Court has yet to rule on this matter. However, *Globetrotter's* analysis—requiring bad faith in the form of objective baselessness—represents the current state of the law.

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[83] 365 U.S. 127 (1961).

[84] 404 U.S. 508 (1972).

[85] 508 U.S. 49 (1993).

[86] *Id*. at 60.

[87] *Id*. at 57.

[88] *Globetrotter Software*, 362 F.3d at 1376 (citing Primetime 24 Joint Venture v. Nat'l Broad. Co., 219 F.3d 92, 100 (2d Cir. 2000); A.D. Bedell Wholesale Co. v. Philip Morris Inc., 263 F.3d 239, 252-53 (3d Cir. 2001); Coastal States Mktg., Inc. v. Hunt, 694 F.2d 1358, 1367 (5th Cir. 1983); McGuire Oil Co. v. Mapco, Inc., 958 F.2d 1552, 1560 (11th Cir. 1992)). *See also* 1 PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 205e ("*Noerr* protects the right to petition the government. Although a mere threat directed at one's competitor to sue or to seek administrative relief does not involve or 'petition' the government, it would be anomalous and socially counterproductive to protect the right to sue but not the right to threaten suit.").

[89] IGEN Int'l, Inc. v. Roche Diagnostics GmbH, 335 F.3d 303, 310 (4th Cir. 2003); South Dakota v. Kan. City S. Indus., Inc. 880 F.2d 40, 50-51 (8th Cir. 1989).

[90] *Globetrotter Software*, 362 F.3d at 1376.

[91] *Id.* at 1377 (emphasis in original) (quoting Golan v. Pingel Enter., Inc., 310 F.3d 1360, 1371 (Fed. Cir. 2002). *See also* Dominant Semiconductors Sdn. Bhd. v. OSRAM GmbH, 524 F.3d 1254, 1260 (Fed. Cir. 2008) ("To be objectively baseless, the infringement allegations must be such that 'no reasonable litigant could reasonably expect success on the merits.'") (quoting GP Indus., Inc. v. Eran Indus. Inc., 500 F.3d 1369, 1374 (Fed. Cir. 2007)); *800 Adept, Inc. v. Murex Secs. Ltd.*, 539 F.3d 1354, 1370 (Fed. Cir. 2008) (objective baselessness requires "clear and convincing evidence" that the patentee had "no reasonable basis to believe that its patent claims were valid or that they were infringed").

Absent objective baselessness in the patent troll's assertion of its rights, federal patent law preempts state unfair competition law and other state-law claims. "Subjective considerations of bad faith are irrelevant if the [challenged pre-litigation] assertions are not objectively baseless."[92]

V. STATE EFFORTS AGAINST PATENT TROLLS REVISITED

As we noted earlier, in *Activision* the District of Nebraska held that federal patent law preempted the State AG's enforcement activity because there was no showing that Farney Daniels asserted its clients' patent claims in bad faith under the *Globetrotter* test of objective baselessness.[93] Indeed, although the Nebraska AG argued against preemption, it did not cite *Globetrotter*, much less attempt to show that Farney Daniels (or its clients) knew or should have known that the patents-at-issue were either invalid or not infringed.[94] Instead of putting forth facts, the State AG relied on "word-plucking" from various decisions to support its central point—which was not really in dispute—that "[i]t could not have been Congress' intention to preempt all state unfair and deceptive trade practices laws just because an individual inserts the word 'patent' in an otherwise fraudulent scheme or because a scheme involved patents in some way."[95] In these circumstances, the *Activision* court's preemption holding was virtually pre-ordained.

In the Vermont AG's as yet unresolved deceptive trade practices litigation against MPHJ, the State asserted that various patent-related statements and omissions in MPHJ's demand letters were false and misleading. Thus, MPHJ allegedly: (1) had failed to show that letter recipients were infringing; and (2) used shell companies to make it difficult for letter recipients to determine both patent ownership and the entity with standing to sue for infringement.[96] To avoid preemption, these allegations could well require showing objective baselessness—that MPHJ had no reasonable basis for to believe that the demand letter recipients had infringed its patents.[97]

However, the Vermont AG also emphasized allegedly false and misleading demand letter statements that were **not** directly connected to MPHJ's patent infringement assertions. These included MPHJ statements that: (1) most businesses chose to promptly acquire licenses for the patents; (2) MPHJ's licensing program was well-received by the business community; (3) recipients had received two prior letters when often they had not; and (4) MPHJ's proposed license of between $900 and $1200 per employee was a "fair price for a license negotiated in good faith" based on the response of "many" companies, when, in fact, the average license was under

[92] *Dominant Semiconductors*, 524 F.3d at 1264 (quoting GP Indus., Inc., 500 F.3d 1375). *See also, e.g.,* Order at 14, *Activision TV*, ECF No. 41 (Sept. 30, 2013) (holding that patent holder bad faith was not shown); ClearPlay, Inc. v. Nissim Corp., No. 07-81170, 2011 WL 3878363, at *8-9 (S.D. Fla. Sept. 2, 2011) (holding that federal patent law preempted claim under Florida's Deceptive and Unfair Trade Practices Act); DeSena v. Beekley Corp., 729 F. Supp. 2d 375, 401 (D. Me. 2010) (holding that bad faith in the publication of the patent must be established to avoid preemption of Maine Uniform Deceptive Trade Practices Act); *In re* Innovatio IP Ventures, LLC Patent Litig., 921 F. Supp. 2d 903, 914 (N.D. Ill. 2013).

[93] Order at 13-14, *Activision TV*, ECF No. 41 (Sept. 30, 2013) (quoting *Globetrotter*).

[94] Br. in Sup. of Mot. to Dismiss & in Opp. to Mot for Prel. Inj. at 29-31, *Activision TV*, ECF No. 22 (Sept. 10, 2013).

[95] *Id*. at 31.

[96] Compl. at ¶¶ 56 & 57, Vermont v. MPHJ Tech. Invs. LLC, No. 282-5-13 (Vt. Super. Ct.).

[97] *Globetrotter Software*, 362 F.3d at 1377.

$900 per employee.[98] On this basis, the Vermont AG sought to plead "consumer fraud, and nothing more. . . . MPHJ's unfair and deceptive acts are unrelated to whether the letter recipients were, in fact, infringing the patents."[99] Arguably, allegations such as these may avoid federal preemption of the Vermont's state law claims.

But should the court analyze preemption by dropping the State AG's patent-related allegations in one bucket, and its non-patent-related allegations into another? Where litigation is involved, the whole may often be greater than the sum of its parts.[100] Accordingly, bucketing the State AG's false and deceptive statements risks ignoring (to mix metaphors) the forest for the trees. The rub is that, for the Vermont AG, the forest is the fraud and deception directed to state residents, while for MPHJ it's the patent holder's right to exclude.

This brings us to Vermont's recent statutory attack on patent trolls. Whether the statute itself applies to the pending MPHJ action is unclear. Because the lawsuit predates the new law's effective date by several weeks, an issue of retroactive application, which we do not here address, is presented. But this much can be said: the new law is, if nothing else, clever.

Vermont's law is, of course, the work of the State's duly elected legislature, and thus packs the punch of sovereignty. As the Supreme Court has reminded, "we have long presumed that Congress does not cavalierly pre-empt state-law causes of action."[101] Moreover, the law's multi-page findings of fact—focusing on the State's interest in "nurtur[ing] small and medium sized IT and other knowledge based companies," while recognizing that "Vermont is preempted from passing any law that conflicts with federal patent law"[102]—bespeak carefulness and caution, not haste or passion. The statute's bad and not-bad faith factors, together with its open invitation to the court to consider whatever else may be relevant, represent a balanced approach to adjudicating patent infringement demand letters and related pre-infringement litigation conduct generally—whether involving trolls or practicing patent holders.

Therefore, powerful arguments can be marshaled to uphold Vermont's new law against a preemption attack. *Globetrotter's* litmus test for deciding preemption—objective baselessness—represents only Court of Appeals law, not that of the Supreme Court law. This test may simply be inadequate to accommodate countervailing state interests in protecting against patent troll abuse. Vermont's own law goes further, permitting consideration of both objective and subjective baselessness, as well as any other factor that may be probative of whether the patent holder's conduct warrants approval or condemnation. If *Globetrotter's* path is to be widened, the Vermont statute offers the tools.

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[98] Mem. in Support of Mot. to Remand at 3-4, Vermont v. MPHJ Tech. Invest., LLC, No. 2:13-cv-00170 (D. Vt. July 8, 2013), ECF No. 9-1.

[99] *Id.* at 14.

[100] *Cf.* Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 699 (1962) (in antitrust conspiracy cases, "plaintiffs should be given the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each.") (citing authorities).

[101] *Medtronic*, 518 U.S. at 485.

[102] VT. STAT. ANN. tit. 9, § 4195(a) (1), (3) & (7).

Vermont's statutory approach has spawned similar proposed legislation recently introduced in Nebraska.[103] The New York AG has continued the trend of progressively aggressive enforcement by stating publicly that its AOD against MPHJ and accompanying guidelines will ostensibly serve as the starting point for future actions against patent trolls operating in New York.

VI. CONCLUSION

True it is that States traditionally regulate business affairs and protect against fraud and deception practiced on their citizens and resident businesses. On the other hand, however, the Constitution's patent clause reflects the overarching federal interest in encouraging innovation as an engine of progress. Existing case law suggests that state efforts to respond to patent troll abuse face an uphill battle to avoid federal preemption. Yet, Vermont's newly enacted statute, along with the actions undertaken by the AGs of Minnesota, Nebraska, and New York, may provide the traction needed. Bearing in mind the circumstances in Washington, D.C. these days, state fixes may well be all we can hope for—and are a lot better than none at all.[104]

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[103] NEB. LEG. Bill No. 677, 103rd Legis., 2nd Sess. (Jan. 8, 2014).

[104] *See* Melissa Lipman, *FTC's Ohlhausen Urges Caution on 'Patents Trolls,'* LAW360 (Jan. 6, 2014), http://www.law360.com/competition/articles/498994?nl_pk=267e9e92-50e0-42ee-bbf0-2966a66b4c4a&utm_source=newsletter&utm_medium=email&utm_campaign=competition (reporting comments by FTC Commissioner Maureen Ohlhausen that the issues concerning patent trolls are "very complex" and that the federal government "need[s] to take the time to get it right.").

Sec. 6. 9 V.S.A. chapter 120 is added to read:

CHAPTER 120. BAD FAITH ASSERTIONS

OF PATENT INFRINGEMENT

§ 4195. LEGISLATIVE FINDINGS AND STATEMENT OF PURPOSE

(a) The General Assembly finds that:

(1) Vermont is striving to build an entrepreneurial and knowledge based economy. Attracting and nurturing small and medium sized internet technology ("IT") and other knowledge based companies is an important part of this effort and will be beneficial to Vermont's future.

(2) Patents are essential to encouraging innovation, especially in the IT and knowledge based fields. The protections afforded by the federal patent system create an incentive to invest in research and innovation, which spurs economic growth. Patent holders have every right to enforce their patents when they are infringed, and patent enforcement litigation is necessary to protect intellectual property.

(3) The General Assembly does not wish to interfere with the good faith enforcement of patents or good faith patent litigation. The General Assembly also recognizes that Vermont is preempted from passing any law that conflicts with federal patent law.

(4) Patent litigation can be technical, complex, and expensive. The expense of patent litigation, which may cost hundreds of thousands of dollars or more, can be a significant burden on small and medium sized companies.

Vermont wishes to help its businesses avoid these costs by encouraging the most efficient resolution of patent infringement claims without conflicting with federal law.

(5) In order for Vermont companies to be able to respond promptly and efficiently to patent infringement assertions against them, it is necessary that they receive specific information regarding how their product, service, or technology may have infringed the patent at issue. Receiving such information at an early stage will facilitate the resolution of claims and lessen the burden of potential litigation on Vermont companies.

(6) Abusive patent litigation, and especially the assertion of bad faith infringement claims, can harm Vermont companies. A business that receives a letter asserting such claims faces the threat of expensive and protracted litigation and may feel that it has no choice but to settle and to pay a licensing fee, even if the claim is meritless. This is especially so for small and medium sized companies and nonprofits that lack the resources to investigate and defend themselves against infringement claims.

(7) Not only do bad faith patent infringement claims impose a significant burden on individual Vermont businesses, they also undermine Vermont's efforts to attract and nurture small and medium sized IT and other knowledge based companies. Funds used to avoid the threat of bad faith litigation are no longer available to invest, produce new products, expand, or hire new workers, thereby harming Vermont's economy.

(b) Through this narrowly focused act, the General Assembly seeks to facilitate the efficient and prompt resolution of patent infringement claims, protect Vermont businesses from abusive and bad faith assertions of patent infringement, and build Vermont's economy, while at the same time respecting federal law and being careful to not interfere with legitimate patent enforcement actions.

§ 4196. DEFINITIONS

In this chapter:

(1) "Demand letter" means a letter, e-mail, or other communication asserting or claiming that the target has engaged in patent infringement.

(2) "Target" means a Vermont person:

(A) who has received a demand letter or against whom an assertion or allegation of patent infringement has been made;

(B) who has been threatened with litigation or against whom a lawsuit has been filed alleging patent infringement; or

(C) whose customers have received a demand letter asserting that the person's product, service, or technology has infringed a patent.

§ 4197. BAD FAITH ASSERTIONS OF PATENT INFRINGEMENT

(a) A person shall not make a bad faith assertion of patent infringement.

(b) A court may consider the following factors as evidence that a person has made a bad faith assertion of patent infringement:

(1) The demand letter does not contain the following information:

(A) the patent number;

(B) the name and address of the patent owner or owners and assignee or assignees, if any; and

(C) factual allegations concerning the specific areas in which the target's products, services, and technology infringe the patent or are covered by the claims in the patent.

(2) Prior to sending the demand letter, the person fails to conduct an analysis comparing the claims in the patent to the target's products, services, and technology, or such an analysis was done but does not identify specific areas in which the products, services, and technology are covered by the claims in the patent.

(3) The demand letter lacks the information described in subdivision (1) of this subsection, the target requests the information, and the person fails to provide the information within a reasonable period of time.

(4) The demand letter demands payment of a license fee or response within an unreasonably short period of time.

(5) The person offers to license the patent for an amount that is not based on a reasonable estimate of the value of the license.

(6) The claim or assertion of patent infringement is meritless, and the person knew, or should have known, that the claim or assertion is meritless.

(7) The claim or assertion of patent infringement is deceptive.

(8) The person or its subsidiaries or affiliates have previously filed or threatened to file one or more lawsuits based on the same or similar claim of patent infringement and:

(A) those threats or lawsuits lacked the information described in subdivision (1) of this subsection; or

(B) the person attempted to enforce the claim of patent infringement in litigation and a court found the claim to be meritless.

(9) Any other factor the court finds relevant.

(c) A court may consider the following factors as evidence that a person has not made a bad faith assertion of patent infringement:

(1) The demand letter contains the information described in subdivision (b)(1) of this section.

(2) Where the demand letter lacks the information described in subdivision (b)(1) of this section and the target requests the information, the person provides the information within a reasonable period of time.

(3) The person engages in a good faith effort to establish that the target has infringed the patent and to negotiate an appropriate remedy.

(4) The person makes a substantial investment in the use of the patent or in the production or sale of a product or item covered by the patent.

(5) The person is:

(A) the inventor or joint inventor of the patent or, in the case of a patent filed by and awarded to an assignee of the original inventor or joint inventor, is the original assignee; or

(B) an institution of higher education or a technology transfer organization owned or affiliated with an institution of higher education.

(6) The person has:

(A) demonstrated good faith business practices in previous efforts to enforce the patent, or a substantially similar patent; or

(B) successfully enforced the patent, or a substantially similar patent, through litigation.

(7) Any other factor the court finds relevant.

§ 4198. BOND

Upon motion by a target and a finding by the court that a target has established a reasonable likelihood that a person has made a bad faith assertion of patent infringement in violation of this chapter, the court shall require the person to post a bond in an amount equal to a good faith estimate of the target's costs to litigate the claim and amounts reasonably likely to be recovered under § 4199(b) of this chapter, conditioned upon payment of any amounts finally determined to be due to the target. A hearing shall be held if either party so requests. A bond ordered pursuant to this section shall not exceed $250,000.00. The court may waive the bond requirement if it finds the person has available assets equal to the amount of the proposed bond or for other good cause shown.

§ 4199. ENFORCEMENT; REMEDIES; DAMAGES

(a) The Attorney General shall have the same authority under this chapter to make rules, conduct civil investigations, bring civil actions, and enter into assurances of discontinuance as provided under chapter 63 of this title. In an action brought by the Attorney General under this chapter the court may award or impose any relief available under chapter 63 of this title.

(b) A target of conduct involving assertions of patent infringement, or a person aggrieved by a violation of this chapter or by a violation of rules adopted under this chapter, may bring an action in Superior Court. A court may award the following remedies to a plaintiff who prevails in an action brought pursuant to this subsection:

(1) equitable relief;

(2) damages;

(3) costs and fees, including reasonable attorney's fees; and

(4) exemplary damages in an amount equal to $50,000.00 or three times the total of damages, costs, and fees, whichever is greater.

(c) This chapter shall not be construed to limit rights and remedies available to the State of Vermont or to any person under any other law and shall not alter or restrict the Attorney General's authority under chapter 63 of this title with regard to conduct involving assertions of patent infringement.

Sec. 7. EFFECTIVE DATE

This act shall take effect on July 1, 2013.

Date the Governor signed the bill: May 22, 2013