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"SACRIFICE AND RECOUPMENT" IN THE ANTITRUST ANALYSIS OF PATENT SETTLEMENTS: ACTAVIS THROUGH THE LENS OF BROOKE GROUP, ASPEN SKIING, AND TRINKO

BRYAN GANT*

Patent settlements are typically procompetitive, benefiting not only the settling parties but also the courts and the general public. But in rare cases patent settlements might instead harm competition, and thus raise antitrust concerns. How are courts to determine when antitrust scrutiny should — and, more importantly, should not — be applied to patent settlements?

The answer ostensibly came in the Supreme Court's 2013 decision in FTC v. Actavis, Inc. *Under* Actavis*, antitrust scrutiny of patent settlements may "sometimes" be appropriate where there is a "large," "unexplained" "reverse payment" from the patentee to the patent challenger. Unless, that is, the "reverse payment" is "fair value," represents "saved litigation costs," or is a "traditional" or "commonplace" way to settle. Unfortunately, the Supreme Court did not define any of these terms, and Chief Justice Roberts in his dissent thus could only wish "good luck to the district courts" asked to interpret the decision, many of whom have struggled to do so.*

But the key "mysteries" of Actavis *can all be solved by recognizing that Actavis follows a line of antitrust cases that ask whether an alleged monopolist made an otherwise-irrational sacrifice in expectation of recouping anticompetitive benefits. This Article therefore places* Actavis *within the same legal framework as predatory pricing cases like* Brooke Group v. Brown & Williamson Tobacco *and refusal to deal cases like* Aspen Skiing v. Aspen Highlands Skiing *and* Verizon Communications v. Law Offices of Curtis V. Trinko*. In doing so, the article explains the*

* Bryan Gant is a partner in the Global Competition Group of White & Case LLP and represents defendants in ongoing cases involving *Actavis*. The views expressed herein are his own, and do not necessarily reflect the views of White & Case or its clients. He would like to thank Professor Daniel Sokol, Tripp Odom, and Helen J. Gant for their comments and suggestions.

hidden underpinnings of Actavis*, solves the apparent mysteries that have baffled the lower courts, and offers a roadmap to courts seeking to properly apply antitrust scrutiny to patent settlements.*

I. INTRODUCTION

Courts have long recognized the benefits of settlement, which allows parties to avoid costly litigation, facilitates compromises the parties could not achieve through the binary win-or-lose litigation process, and avoids unduly burdening courts and the general public.[1] Patent settlements in particular have the potential to further benefit consumers by using an agreement made prior to the patent's expiration to create a path to the market for a challenger who might not have succeeded otherwise.[2]

However, the Supreme Court has held that at least some limited forms of patent settlement could instead *delay* a patent challenger's entry into the market, and thus such settlements may "sometimes" raise antitrust concerns, at least in certain circumstances.[3] How, then, are courts to determine when it is appropriate to apply antitrust scrutiny to a patent settlement, and when it is not appropriate?

The Supreme Court's 2013 decision in *FTC v. Actavis, Inc.*[4] tried to answer this question, but in doing so created substantial confusion.[5] *Actavis* held that patent settlements may "sometimes" be suspect under antitrust laws, at least at the motion to dismiss stage, when they involve "large" "unexplained" "reverse payments" from the patentee to the patent challenger, because (the Court held) such payments risk delaying a patent challenger's entry into the market and suggest that the patentee may have the market power to exclude competition.[6] Or, at least, *Actavis* held that such

1. *See, e.g.*, FTC v. Actavis, Inc., 570 U.S. 136, 153 (2013) ("We recognize the value of settlements and the patent litigation problem."); Wygant v. Jackson Bd. of Educ., 476 U.S. 267, 305 (1986) (Marshall, J., dissenting) (noting that generally, settlements are favorable); Williams v. First Nat'l Bank of Pauls Valley, 216 U.S. 582, 595 (1910) (looking favorably upon the use of compromise to resolve disputes); St. Louis Mining & Milling Co. v. Mont. Mining Co., 171 U.S. 650, 656 (1898) ("[S]ettlements of matters in litigation, or in dispute, without recourse to litigation, are generally favored . . . ."); Am. Sec. Vanlines, Inc. v. Gallagher, 782 F.2d 1056, 1060 (D.C. Cir. 1986) (acknowledging the prevalent public policy in favor of parties voluntarily settling their litigation matters); TBK Partners, Ltd. v. W. Union Corp., 675 F.2d 456, 461 (2d Cir. 1982) (noting the "paramount policy of encouraging settlements").

2. *Actavis*, 570 U.S. at 154 ("[S]ettlement on terms permitting the patent challenger to enter the market before the patent expires would also bring about competition, again to the consumer's benefit.").

3. *See id.* at 141, 158–59.

4. 570 U.S. 136 (2013).

5. *See generally id.* (holding that reverse payment settlements can sometimes violate antitrust laws because they can create "unfair restraints on trade").

6. *Id.* at 141 ("[R]everse payment settlements such as the agreement alleged in the

settlements can be suspect under the antitrust laws so long as they are not "traditional," "commonplace," or "fair value" and do not represent payment only of the patentee's saved or avoided litigation costs.[7]

If the reader is confused at this point, they are in very good company. For example, just what *is* a "reverse payment?" What do the terms "large," "unexplained," "traditional," "commonplace," or "fair value" mean, and why are such payments not suspect?[8] Why can a patentee "pay" its saved or avoided litigation costs to settle, when other types of payment are potentially suspect? And on what basis could a court infer market power from a reverse payment? *Actavis* never answers any of these questions, and indeed never even defines the central terms (like "reverse payment") that might help explain its ruling.[9] Justice Roberts in dissent thus could only wish "[g]ood luck to the district courts" applying *Actavis*,[10] and it is fair to say that courts have struggled to understand and apply it as the Supreme Court intended.

But all these "mysteries" can be solved simply by recognizing that in *Actavis* the Court applied the same basic "sacrifice and recoupment" framework that it had previously used in predatory pricing cases such as

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complaint before us can sometimes violate the antitrust laws."); *id.* at 157 ("[W]here a reverse payment threatens to work unjustified anticompetitive harm, the patentee likely possesses the [market] power to bring that harm about in practice."); *id.* ("An unexplained large reverse payment itself would normally suggest that the patentee has serious doubts about the patent's survival."); *id.* at 158 ("In sum, a reverse payment, where large and unjustified, can bring with it the risk of significant anticompetitive effects . . . .").

7. *Id.* at 152 ("In the traditional examples cited above, a party with a claim (or counterclaim) for damages receives a sum equal to or less than the value of its claim."); *id.* ("Insofar as the dissent urges that settlements taking these commonplace forms have not been thought for that reason alone subject to antitrust liability, we agree, and do not intend to alter that understanding."); *id.* at 156 ("The reverse payment, for example, may amount to no more than a rough approximation of the litigation expenses saved through the settlement. That payment may reflect compensation for other services that the generic has promised to perform — such as distributing the patented item or helping to develop a market for that item. There may be other justifications."); *id.* ("Where a reverse payment reflects traditional settlement considerations, such as avoided litigation costs or fair value for services, there is not the same concern that a patentee is using its monopoly profits to avoid the risk of patent invalidation or a finding of noninfringement."); *id.* at 159 ("[T]he likelihood of a reverse payment bringing about anticompetitive effects depends upon its size, its scale in relation to the payor's anticipated future litigation costs, its independence from other services for which it might represent payment, and the lack of any other convincing justification.").

8. *See, e.g.*, King Drug Co. of Florence v. Cephalon, Inc., 88 F. Supp. 3d 402, 416 (E.D. Pa. 2015) ("*Actavis* did not identify any specific formula for determining whether a reverse payment is sufficiently large.").

9. *See Actavis*, 570 U.S. at 160 ("We therefore leave to the lower courts the structuring of the present rule-of-reason antitrust litigation.").

10. *Id.* at 173 (Roberts, J., dissenting).

Brooke Group v. Brown & Williamson Tobacco[11] and refusal to deal cases such as *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*[12] and *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*.[13] In *Brooke Group*, *Aspen Skiing*, and *Trinko*, the Supreme Court held that antitrust liability could apply only if the alleged monopolists made large sacrifices — below cost pricing or the termination of a prior profitable course of dealing — that would have been economically irrational unless "recouped" through the harm or delay they imposed on a rival.[14] *Actavis* likewise involved an alleged sacrifice by the patentee (a "reverse payment") that might be recouped through the delayed entry of a patent challenger, and thus follows the same sacrifice and recoupment framework the Court had previously established for other forms of antitrust conduct.[15]

Recognizing this sacrifice and recoupment framework solves five "mysteries" that have troubled courts since the *Actavis* decision:

First Mystery. The first "mystery" of *Actavis* is simply what qualifies as a "reverse payment," i.e., conduct that might sometimes make certain patent settlements subject to antitrust scrutiny. The answer is that because *Actavis*, like *Brooke Group*, *Trinko*, and *Aspen Skiing*, uses an alleged monopolist's willingness to incur short-run losses to suggest the possibility of a long-run anticompetitive effect, it first requires showing that there *was* such a short-run sacrifice. As explained in Part III, a reverse payment is therefore best understood as a large sacrifice by the patentee that benefits the patent challenger, which the patentee would not rationally have been willing to make if it did not expect to receive some anticompetitive benefit in return, and which therefore can be used by a court to infer the potential for patent weakness, market power, and anticompetitive effect.

Second Mystery. Actavis holds that "fair value" agreements should not be treated as anticompetitive.[16] But what is a "fair value" agreement? The answer, as explained in Part IV, is likely an agreement that *lacks* what makes a reverse payment potentially suspect in the first place: a large, unexplained

11. 509 U.S. 209 (1993).

12. 472 U.S. 585 (1985).

13. 540 U.S. 398 (2004).

14. While *Brooke Group*, *Aspen Skiing*, and *Trinko* all involved claims under Sherman Act § 2 (monopolization), *Actavis* involved the related question of whether a patent monopoly was lawful or unlawful — and thus, the sacrifice and recoupment test's application in an FTC Act § 5 (or for that matter Sherman Act § 1) context is not surprising.

15. *Actavis*, 570 U.S. at 140.

16. *Id.* at 156 ("Where a reverse payment reflects traditional settlement considerations, such as . . . fair value for services, there is not the same concern that a patentee is using its monopoly profits to avoid the risk of patent invalidation or a finding of noninfringement.").

sacrifice by the patentee. But in answering this question, the fair value inquiry raises another one: What does it mean to make a sacrifice under *Actavis* or, put differently, a sacrifice relative to *what*? As explained in Part IV.A, the sacrifice cannot merely be a sacrifice relative to an ideal hypothetical alternative agreement that might have been entered, because not only are profit-maximizing "market value" alternatives often illusory, the Supreme Court in *Brooke Group* and *Trinko* rejected the idea of applying antitrust scrutiny based on a company's failure to maximize profits and instead looked for a sacrifice in absolute terms.[17] Nor, as explained in Part IV.B, must the agreement have been entered solely for the benefit of the patentee in order to be fair value, as the Federal Trade Commission has argued based on misreading *Actavis*. Rather, as explained in Part IV.C, a fair value agreement is one that lacks a large, unexplained patentee sacrifice in absolute terms — i.e., that lacks a true, out-of-pocket sacrifice in the same sense as in *Brooke Group* and *Aspen Skiing*/*Trinko*.

Third Mystery. Actavis also holds that where there is a large, unexplained reverse payment, the patentee "likely" has sufficient market power for such a payment to cause anticompetitive harm.[18] But if we mistakenly think of a reverse payment as something received by the patent challenger, as some do, the idea that a benefit to the *patent challenger* can show market power for the *patentee* is a baffling non sequitur. Why should the fact that Party A receives value suggest that Party B has market power? As discussed in Part V, however, this inference of potential market power is less baffling if a reverse payment is viewed first as a sacrifice by the patentee in the same vein as the sacrifices in *Brooke Group* and *Aspen Skiing* — as one might initially infer that a purported monopolist would only make such a sacrifice if it has the market power to recoup that sacrifice through extended market exclusivity. Finally, this conclusion also makes clear that any such inference of market power is rebuttable, just as in *Brooke Group* — which ultimately requires not just inferring the possibility of recoupment by the monopolist, but showing that any such recoupment is possible.[19]

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17. *See* Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223–26 (1993); *Trinko*, 540 U.S. at 408–10, 415–16.

18. *Actavis*, 570 U.S. at 157 (noting that "where a reverse payment threatens to work unjustified anticompetitive harm, the patentee likely possesses the power to bring that harm about in practice").

19. *See Brooke Grp.*, 509 U.S. at 226 (concluding that recoupment and competitive injury must be based not only on "below-cost pricing" but also on "an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market"). Notably, *Brooke Group* addressed the standards applicable at trial; *Actavis* concerns the standards a court should apply at a motion to dismiss — and an inference drawn at the motion to dismiss stage should not be permitted to become irrebuttable at trial. *See infra* Part V.B.

Fourth Mystery. *Actavis* held that a payment from the patentee to the challenger that merely approximates the patentee's saved or avoided litigation costs would not raise antitrust concerns.[20] But why not, given that such a payment (1) apparently could be made in cash (which *Actavis* otherwise thought suspect), and (2) would surely be a benefit to the patent challenger, which not only receives a payment from the patentee but also saves its own litigation costs?[21] The answer, as explained in Part VI, is simply that there is no sacrifice in paying your opponent the same amount to settle as you would have otherwise paid your lawyers to litigate, and therefore nothing to "recoup" under the sacrifice and recoupment framework.

Fifth Mystery. *Actavis* took pains to distinguish a "large" "unexplained" "reverse payment" from a "traditional" compromise that the majority says should not raise antitrust concerns.[22] But why should "traditional" forms of compromise be exempt from the antitrust scrutiny of *Actavis*? As explained in Part VII, the Court has long used the "form" of conduct as a guardrail to protect procompetitive conduct in sacrifice and recoupment cases, such as by requiring that the plaintiff show below-cost pricing in *Brooke Group* or a prior profitable course of dealing in *Trinko* before subjecting traditionally procompetitive conduct to the potentially deterring effects of antitrust scrutiny.[23] The Court in *Actavis* similarly protected longstanding forms of procompetitive settlement from antitrust scrutiny by excluding forms of settlement that have not traditionally been considered problematic or likely to raise anticompetitive concerns.[24]

Applying the sacrifice and recoupment framework used in *Brooke Group*, *Aspen Skiing*, and *Trinko* therefore solves the five major mysteries of *Actavis* and permits a court to apply the decision as the Supreme Court must have intended.

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20. *Actavis*, 570 U.S. at 156 (noting that reverse payments based on costs that may otherwise have occurred, such as litigation costs, do not raise concerns about the misuse of monopoly profits).

21. *See id.* at 152 (noting that a "money" payment by the patentee to the patent challenger is "quite different" from a traditional settlement).

22. *Id.* (detailing the stark difference between a "traditional example" of a settlement, in which the claiming party receives "the value of its claim," and a "reverse payment settlement," in which a party with no damages claim receives payment to "stay away from the patentee's market").

23. *See infra* Part VII; *Brooke Grp.*, 509 U.S. at 222; Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 408 (2004).

24. *See Actavis*, 570 U.S. at 156.

II. BROOKE GROUP, ASPEN SKIING, AND TRINKO: USING SACRIFICE AND RECOUPMENT TO IDENTIFY SUSPECT CONDUCT

A. Using a Monopolist's Sacrifice to Suggest the Possibility of Recoupment Through Anticompetitive Effects

The Supreme Court has long held that a short-run sacrifice by an alleged monopolist can sometimes suggest the potential for recoupment of that sacrifice through long-run anticompetitive effects.[25] In "predatory pricing" cases, for example, a monopolist is alleged to price below its costs, making a short-run sacrifice, with the expectation that doing so will drive its less well-heeled rivals out of the market and thus allow the monopolist to then raise its prices to supracompetitive levels.[26] However, the Supreme Court has further held, in cases such as *Brooke Group*, that such pricing can be actionable only if "the competitor had . . . a dangerous probability of . . . recouping its investment in below-cost prices," i.e., if (a) the conduct is capable of driving off current competitors and (b) the market is susceptible to sustained monopoly pricing following the victim's exit because competitors will not simply flood in as prices increase.[27]

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25. This is not to say, however, that the Supreme Court would treat all profit sacrifices as suspect, and much less as antitrust violations. Rather, as the Seventh Circuit has noted, a profit sacrifice is merely "helpful" to identifying suspect conduct — and not itself an antitrust problem. Viamedia, Inc. v. Comcast Corp., 951 F.3d 429, 462 (7th Cir. 2020) (explaining why "profit sacrifice is neither [a] necessary nor sufficient" element of antitrust claims, but merely "helpful" to identifying suspect conduct). Indeed, there are many circumstances where it would be wholly inappropriate to measure anticompetitive conduct by whether or not it involved an initial profit sacrifice — such as research and development into new products, which requires a short term sacrifice for long term gain but is obviously procompetitive. *See, e.g.*, U.S. DEP'T OF JUST., COMPETITION & MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 39–43 (2008), https://www.justice.gov/sites/default/files/atr/legacy/2009/05/11/236681.pdf.

26. *See Brooke Grp.*, 509 U.S. at 225; Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986) ("[P]redatory pricing schemes require conspirators to suffer losses in order eventually to realize their illegal gains . . . ."); Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 117 (1986) (defining predatory pricing as "pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run"); Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 698 (1975) (describing "the classically-feared case of predation" as deliberately foregoing present revenues to rid the market of competitors and "recouping the losses" in the later absence of market rivals; therefore, predation "cannot exist" without "a temporary sacrifice of net revenues in the expectation of greater future gains").

27. *Brooke Grp.*, 509 U.S. at 224–26; *see also* Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312, 325–26 (2007); Stearns Airport Equip. Co. v. FMC Corp., 170 F.3d 518, 528 (5th Cir. 1999) ("If there is no likelihood of recoupment,

Sacrifice and recoupment also are at the heart of refusal to deal jurisprudence. In *Aspen Skiing*, the alleged monopolist — controlling three of the four ski mountains in the Aspen area — refused to continue dealing with its one-mountain competitor despite a prior, profitable course of dealing, and further refused to sell its competitor lift tickets even at a retail price.[28] The effect was potentially to drive the one-mountain competitor out of business, as it could not effectively compete without offering consumers a multi-mountain lift ticket. The Supreme Court upheld a jury verdict for the plaintiff, noting that in refusing to deal the defendant "was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival."[29] In *Trinko*, the Supreme Court further explained that in *Aspen Skiing* the alleged monopolist's "unilateral termination of a voluntary (*and thus presumably profitable*) course of dealing suggested a willingness to forsake short-term profits to achieve an anticompetitive end."[30] *Trinko* therefore understood *Aspen Skiing* to involve a short-run sacrifice by the monopolist that it could expect to recoup through long-run anticompetitive effects.[31]

B. The Guardrails of Brooke Group and Trinko: Form and Intent Based Screens Against Over-Enforcement

Predatory pricing and refusals to deal thus may sometimes violate the antitrust laws. However, as discussed in more detail in Part VII below, antitrust scrutiny must be applied carefully in this area because these cases also involve conduct that would, in most cases, be seen as procompetitive and beneficial: Low pricing (in the case of predatory pricing) and independent business decisions (in the case of refusals to deal with a rival).[32]

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it would seem improbable that a scheme would be launched."); Dial A Car, Inc. v. Transp., Inc., 82 F.3d 484, 487 (D.C. Cir. 1996); Rebel Oil v. Atl. Richfield Co., 51 F.3d 1421, 1438, 1441 (9th Cir. 1995).

28. *See* Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 593–94 (1985).

29. *Id.* at 610–11; *see also* Novell, Inc. v. Microsoft Corp., 731 F.3d 1064, 1075 (10th Cir. 2013) (explaining refusal to deal jurisprudence).

30. Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S 398, 409 (2004); *see also Novell*, 731 F.3d at 1073–75 (explaining how courts adopt rules in predatory pricing and refusal to deal contexts).

31. *See, e.g.*, Covad Commc'ns Co. v. Bell Atl. Corp., 398 F.3d 666, 675–76 (D.C. Cir. 2005) (citing *Brooke Group* in a refusal to deal case for the principle that conduct can violate the antitrust laws if it is "predatory").

32. *See infra* Part VII; *see, e.g.*, *Brooke Grp.*, 509 U.S. at 224 (avoiding antitrust scrutiny that would risk becoming "an obstacle to the chain of events most conducive to a breakdown of oligopoly pricing and the onset of competition"); *Trinko*, 540 U.S. at 414 (weighing the benefits of intervention against the various costs of intervention);

The Supreme Court therefore sought to avoid deterring such procompetitive conduct by over-enforcement of the antitrust laws, and did so by applying two important antitrust guardrails: form and intent.

First, the Supreme Court in *Brooke Group* and *Trinko* instituted important form-based guardrails limiting the types of conduct that might raise antitrust suspicions. For example, *Brooke Group* addressed so-called predatory pricing, i.e., pricing that is "too low" and that harms competition as a result. Low pricing is of course the very essence of competition, however.[33] Any less efficient competitor could, in theory, claim that its more efficient opponent's low pricing threatened to drive the less efficient competitor out of the market, and thus that the more efficient competitor should be compelled to raise its prices. Even if such a suit might not succeed, the mere threat of antitrust liability for lowering prices would risk discouraging efficient competitors from doing so. To avoid this result, the Supreme Court limited antitrust scrutiny of low pricing (perhaps absent bundling or other potential antitrust causes of action) only to *below cost* pricing, as that form of pricing might suggest the potential for anticompetitive effect, and thus ultimately be more likely to potentially raise antitrust concerns.[34]

Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986) (noting that mistaken intervention may be costly as lowering prices is often "the very essence of competition"); Atl. Richfield Co. v. USA Petrol., 495 U.S. 328, 341 (1990) (quoting Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 116 (1986)) ("It is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition."); *Weyerhaeuser*, 549 U.S. at 320 (stating that the "costs of erroneous findings of predatory-pricing liability are quite high" and could "chill the very conduct the antitrust laws are designed to protect"); Daniel A. Crane, *The Paradox of Predatory Pricing*, 91 CORNELL L. REV. 1, 13 (2005) (noting that the Supreme Court's approach to predatory pricing, by focusing on potentially successful predation, may not capture conduct that some authors would view as suspect); Frank H. Easterbrook, *On Identifying Exclusionary Conduct*, 61 NOTRE DAME L. REV. 972, 977 (1986) ("[F]alse positives are much more harmful than false negatives. Market processes undercut monopolies wrongfully permitted, but no similar processes undercut judicial decisions that wrongly condemn efficient conduct.").

33. *See Brooke Grp*., 509 U.S. at 224–27.

34. *Matsushita*, 475 U.S. at 594; *see also Brooke Grp.*, 509 U.S. at 222; *Atl. Richfield*, 495 U.S. at 337–38, 341 ("Cutting prices . . . is the essence of competition."); Cascade Health Sols. v. PeaceHealth, 502 F.3d 895, 915 (9th Cir. 2007) (citing Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1705 (2005)) ("*Brooke Group*'s safe harbor for above-cost discounting in the single product discount context is not based on a theory that above-cost pricing strategies can never be anticompetitive, but rather on a cost-benefit rejection of a more nuanced rule."); *id.* (quoting Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1705 (2005)) ("[A]ny consumer benefit created by a rule that permits inquiry into above-cost, single-product discounts, but allows judicial condemnation of those deemed legitimately exclusionary, would likely be outweighed by the consumer harm occasioned by overdeterring nonexclusionary discounts"); ZF Meritor, LLC v. Eaton Corp., 696 F.3d

Similarly, in *Trinko*, the Supreme Court worried that overly restricting the right of a company to choose its business partners could not only impair the ability to structure businesses in competitive ways, but indeed actively promote collusion.[35] The Court further recognized the limitations lower courts face in making such economic decisions, such as which business partners a company should choose; simply put, "courts are of limited utility in examining difficult economic problems."[36] *Trinko* thus limited antitrust scrutiny to refusals to deal involving the termination of a prior profitable course of dealing and/or a refusal to sell a competitor a product otherwise available at retail — conduct that was reasonably identifiable and might provide insight into the monopolist's anticompetitive expectations.[37] The "form" of the conduct therefore serves as a guardrail to protect competition from over-enforcement of the antitrust laws in both these cases.

Second, the Supreme Court in these cases used "intent" as a screen to help assess the likely competitive effect of the conduct, and to thereby determine if antitrust scrutiny might be appropriate. For example, in *Aspen Skiing* the monopolist's sacrifice suggested "a distinctly anticompetitive bent," as the monopolist would not ordinarily have refused to continue receiving profits from a profitable course of dealing, or refused sales at retail price, if it did not receive a greater benefit from harm to competition. Thus, the Supreme Court would later explain in *Trinko*, antitrust scrutiny was appropriate.[38] However, it is important to remember that intent will not *substitute* for

254, 274–75 (3d Cir. 2012) (citing Pac. Bell Tel. Co. v. Linkline Commc'ns, Inc., 555 U.S. 438, 452 (2009)) ("[A]lthough there may be rare cases where above-cost prices are anticompetitive in the long run, it is 'beyond the practical ability' of courts to identify those rare cases without creating an impermissibly high risk of deterring legitimate procompetitive behavior (i.e., price-cutting).").

35. *Trinko*, 540 U.S. at 410, 415–16; *see also* United States v. Colgate & Co., 250 U.S. 300, 307 (1919) ("[T]he [Sherman] [A]ct does not restrict the long recognized right of a trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal . . . .").

36. United States v. Topco Assocs., 405 U.S. 596, 609 (1972).

37. *See Trinko*, 540 U.S. at 409–10; *In re* Adderall XR Antitrust Litig., 754 F.3d 128, 135 (2d Cir. 2014) (noting no duty to deal absent evidence of profit sacrifice); ASAP Paging Inc. v. CenturyTel of San Marcos, Inc., 137 F. App'x 694, 698–99 (5th Cir. 2005) (holding no antitrust claim where the monopolist's refusal to deal permitted it to realize short term gains). *Compare* Metronet Servs. Corp. v. Qwest Corp., 383 F.3d 1124, 1131–33 (9th Cir. 2004) (finding no obligation to continue unprofitable dealing), *with* Viamedia, Inc. v. Comcast Corp., No. 16-cv-5486, 2017 U.S. Dist. LEXIS 24213, at *12–13 (N.D. Ill. Feb. 22, 2017) ("Neither is it unimaginable that a monopolist might wish to withdraw from a prior course of dealing and suffer a short-term profit loss in order to pursue perfectly competitive ends."). *But see* Otter Tail Power Co. v. United States, 410 U.S. 366, 370–72, 377–78 (1973) (finding liability where monopolist refused to provide services to competitor despite offering them to all others).

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

unlawful conduct, and that conduct must be shown before a court can ask why the parties engaged in it.[39] In other words, it is not enough for a court simply to determine that an alleged monopolist intended to harm rivals; "sharp elbows" are expected in competition.[40] Rather, a court must first identify conduct that might harm competition.

III. A REVERSE PAYMENT REQUIRES (1) A PATENTEE SACRIFICE THAT MIGHT BE RECOUPED THROUGH ANTICOMPETITIVE EFFECTS AND (2) A BENEFIT TO THE PATENT CHALLENGER

With this background, we turn to the first mystery of *Actavis*. *Actavis* holds that a so-called "reverse payment" in connection with a patent settlement — i.e., one in which the patentee "pays" the patent challenger to drop its patent challenge — can sometimes raise antitrust concerns.[41] But what qualifies as a suspect "reverse payment?"[42]

The courts have struggled to answer this question, when they sought to answer it at all. Because *Actavis* provides no definition, much of the initial debate centered around whether a reverse payment must be made in cash or whether other forms of "value" might suffice.[43] While the Supreme Court in *Actavis* might well have meant to define a reverse payment as a payment of

39. *See infra* note 136 (collecting authority for the proposition that a "bad" intent cannot transform lawful conduct into unlawful conduct under the antitrust laws).

40. *See, e.g.*, FTC v. Qualcomm Inc., 969 F.3d 974, 1005 (9th Cir. 2020) (quoting Tension Envelope Corp. v. JBM Envelope Co., 876 F.3d 1112, 1122 (8th Cir. 2017)) (stating that the defendant "has also 'acted with sharp elbows — as businesses often do'").

41. *See* FTC v. Actavis, Inc., 570 U.S. 136, 152–59 (2013).

42. Because *Actavis* (and most cases applying it) involved patent settlements in the pharmaceutical industry, it is common in these cases to refer to the patentee as the "brand" (i.e., the branded pharmaceutical manufacturer) and the patent challenger as the "generic" (i.e., the generic pharmaceutical manufacturer challenging the brand's patents). *See id*. at 141 ("Apparently most if not all reverse payment settlement agreements arise in the context of pharmaceutical drug regulation . . . ."). However, nothing in *Actavis* limits the reach of the decision to this one particular industry, and some aspects of the decision are easier to understand in a more general framework. *See* Spex Techs., Inc. v. Kingston Tech. Corp., No. SACV 16-1790, 2019 U.S. Dist. LEXIS 228888, at *10–11 (C.D. Cal. Dec. 23, 2019) (rejecting the argument that *Actavis* is limited to Hatch-Waxman Act litigation). This Article therefore tries to avoid the industry-specific "brand/generic" terminology in favor of the more generally-applicable terms "patentee/patent challenger."

43. *Compare, e.g.*, *In re* Lamictal Direct Purchaser Antitrust Litig., 18 F. Supp. 3d 560, 569 (D.N.J. 2014) (limiting reverse payments to cash), *with In re* Nexium (Esomeprazole) Antitrust Litig., 968 F. Supp. 2d 367, 392 (D. Mass. 2013) ("Nowhere in *Actavis* did the Supreme Court explicitly require some sort of monetary transaction . . . ."), *and In re* Niaspan Antitrust Litig., 42 F. Supp. 3d 735, 750–751 (E.D. Pa. 2014) (agreeing that a reverse payment does not need to be exclusively made in cash).

cash or close equivalents,[44] courts have generally declined to adopt that approach and have instead expanded *Actavis* to apply to the payment of other forms of value that do not involve the payment of cash by the patentee.[45] Unfortunately, though, many courts stop there, concluding that a reverse payment need not be in cash but failing to offer any other way to identify agreements that might potentially raise antitrust concerns, and thus, like the Supreme Court in *Actavis*, stop short of actually *defining* the term "reverse payment."[46]

However, the meaning of "reverse payment" is apparent if a court analyzes *Actavis* from the perspective of *Brooke Group*, *Aspen Skiing*, and *Trinko*, i.e., looks for a sacrifice that the alleged monopolist rationally would have made only if it expected to recoup that forfeiture through the exclusion of competition or some other anticompetitive effect. *Actavis* suggests that a court can infer from a reverse payment that (a) the patent at issue was weak (*see* Part III below),[47] (b) the patentee has market power (*see* Part V), and, then, (c) ultimately there was the potential to "recoup" the reverse payment through anticompetitive effects.[48] As explained below, and as is generally recognized, only a patentee's sacrifice would permit each of these inferences, and thus support the Supreme Court's reasoning, i.e., just as in *Brooke*

44. The Supreme Court made clear that a patent challenger "walk[ing] away with money simply so it will stay away from the patentee's market" is "quite different" from traditional forms of settlement. *Actavis*, 570 U.S. at 152. Thus, the majority opinion not only contains multiple references to "money" and "dollars," but also can be read to distinguish "traditional" settlements from "unusual" reverse payments based on the fact that in unusual reverse payments, unlike with traditional settlements that may provide value to both sides, there is cash or money flowing to the patent challenger. *Id.* at 152, 156 (discussing a reverse payment "in which A, the plaintiff, pays money to defendant B" and in which the defendant "walks away with money"). The distinction between monetary and non-monetary "payments" may therefore be a form-based guardrail similar to those discussed in Part VII below, such as limiting predatory pricing to "below cost" pricing — though this view has not been accepted by the courts. *See infra* Part VII.

45. *See, e.g.*, *In re Nexium (Esomeprazole) Antitrust Litig.*, 968 F. Supp. 2d at 392 (noting that, in discussing reverse payments, the *Actavis* Court did not specify the necessity for a cash payment).

46. *Actavis*, 570 U.S. at 156 (discussing, but failing to define "reverse payment"); *see, e.g.*, King Drug Co. of Florence, Inc., v. SmithKline Beecham Corp., 791 F.3d 388, 401 (3d Cir. 2015) (noting that the *Actavis* Court's conclusion caused uncertainty in antitrust litigation).

47. *See Actavis*, 570 U.S. at 157–58 (requiring payment capable of serving as a "workable surrogate for a patent's weakness"); *see also id.* at 154–55 (noting that "a high reverse payment signal[s] to other potential challengers that the patentee lacks confidence in its patent").

48. *See id.* at 147 (describing a reverse payment as something the patentee could "recoup" through the exercise of the patent exclusivity).

Group, *Aspen Skiing*, and *Trinko*, only a sacrifice by the monopolist can suggest recoupment through anticompetitive effects.[49]

A. The "Actavis Inference" Seeks to Identify Conduct That Suggests Patent Weakness, Market Power, and Ultimately Potential Anticompetitive Effect

To understand *Actavis*, and how the Supreme Court's decision fits into its prior antitrust jurisprudence, we must first understand what *Actavis* was trying to accomplish. Although settlement is typically procompetitive, and avoids litigation costs and wasting judicial resources, *Actavis* addressed the following situation that might, in theory, instead harm competition:

> Company A sues Company B for patent infringement. The two companies settle under terms that require (1) Company B, the claimed infringer, not to produce the patented product until the patent's term expires, and (2) Company A, the patentee, to pay B many millions of dollars. Because the settlement requires the patentee to pay the alleged infringer, rather than the other way around, this kind of settlement agreement is often called a "reverse payment" settlement agreement. And the basic question here is whether such an agreement can sometimes unreasonably diminish competition in violation of the antitrust laws.[50]

The challenge in answering the Supreme Court's question is the uncertainty that surrounds the patent at issue, in light of the fact that the parties settled.[51] On one hand, if a court would have considered the patent valid and infringed, then the settlement cannot have harmed competition, at

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49. The need for a patentee sacrifice is well-recognized, though its importance to the *Actavis* analysis is not yet universally understood. *See, e.g.*, *Smithkline Beecham Corp.*, 791 F.3d at 405 (asking whether "the source of the benefit to the claimed infringer is something costly to the patentee"); *In re* Loestrin 24 Fe Antitrust Litig., 261 F. Supp. 3d 307, 332 (D.R.I. 2017) ("The text of *Actavis* suggests that the Court should consider both [the perspective of the patentee and alleged infringer] in considering an alleged unlawful reverse payment."); Aaron Edlin et al., *Activating* Actavis, ANTITRUST, Fall 2013, at 16, 18 ("Where the payment takes a form other than a simple cash transfer from the patentee to the claimed infringer, consideration should be valued from the perspective of the patentee."); Aaron Edlin et al., *The* Actavis *Inference: Theory and Practice*, 67 RUTGERS L. REV. 585, 594 (2015) [hereinafter Edlin et al., *The* Actavis *Inference*] ("[F]or noncash reverse payments, the courts should seek to measure the dollar value sacrificed by the patent holder as a result of the agreement it reached with the alleged infringer."); Bryan Gant, *Understanding* Actavis*: How Courts Misinterpret* FTC v. Actavis, Inc.*, and How to Get It Right*, 22 HARV. NEGOT. L. REV. 111, 125–29 (2016) (approaching the issue from a bargaining perspective and explaining why the Court's focus on patentee sacrifice protects bargaining and settlement).

50. *Actavis*, 570 U.S. at 140–41.

51. *See id.* at 171–72 (Roberts, J., dissenting) (explaining that just as with any "hard legal question" the parties to a patent dispute do not know at the outset of litigation whether the patent is valid; however, this "doesn't mean there is no answer until a court declares one").

least as long as the settlement is no more exclusive of competition than the patent itself would be, i.e., as long as it is within the "scope of the patent."[52] Congress, moreover, has concluded that patents should be presumed valid.[53] For this reason, several courts prior to *Actavis* applied the so-called "scope of the patent test," refusing to apply antitrust scrutiny to patent settlements unless they extended exclusivity beyond the patent term.[54] On the other hand, however, if the patent would have been held invalid or not infringed, then the patent challenger's agreement to drop a meritorious challenge in return for a large, unexplained reverse payment could perhaps harm competition in at least some cases, at least theoretically, as, in theory, such an outcome could permit a patentee to avoid the invalidation of a patent that should have been invalidated.[55]

Whether a patent settlement risks harming competition and thus should be subject to antitrust scrutiny therefore may depend on whether the patent at issue in the underlying case was valid and infringed. But because the parties settled, no court has actually answered that question. How, then, are courts to know whether there is any basis for antitrust scrutiny of the patent settlement in such a case, particularly *without* retrying the underlying patent case at the motion to dismiss stage to determine whether the statutory assumption of patent validity can be overcome?

Actavis purports to circumvent this problem, at least at the motion to dismiss stage, by using the patentee's conduct to infer something about the likely expected outcome of the patent suit.[56] Thus, the Supreme Court held

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52. *Id.* at 171 (Roberts, J., dissenting) ("[S]ettling a patent claim *cannot possibly* impose unlawful anticompetitive harm if the patent holder is acting within the scope of a valid patent . . . .").

53. 35 U.S.C. § 282(a) ("A patent shall be presumed valid . . . . The burden of establishing invalidity of a patent or any claim thereof shall rest on the party asserting such invalidity.").

54. *See, e.g.*, FTC v. Watson Pharms., Inc., 677 F.3d 1298, 1315 (11th Cir. 2012) (applying the "scope of the patent test"); *see also In re* Tamoxifen Citrate Antitrust Litig., 466 F.3d 187, 212–13 (2d Cir. 2006); *In re* Ciprofloxacin Hydrochloride Antitrust Litig., 544 F.3d 1323, 1335–36 (Fed. Cir. 2008); Valley Drug Co. v. Geneva Pharms., Inc., 344 F.3d 1294, 1308 (11th Cir. 2003).

55. *See* Brief for Petitioner at 46, FTC v. Actavis, Inc., 570 U.S. 136 (2013) (No. 12-416), 2013 WL 267027; *see also In re* K-Dur Antitrust Litig., 686 F.3d 197, 212–13 (3d Cir. 2012) (noting that a rule favoring settlement may allow "less sound" patents or cases of "less clear infringement" to continue when perhaps they should have been invalidated). To be clear, this Article merely restates the argument here — and does not necessarily agree that this argument is a correct one.

56. This should not be read to suggest that *Actavis*'s inference of patent weakness is a correct one, and much less that it is irrebuttable. That a patentee might mistakenly believe that its patent might be weak, or that a patentee might be averse to the risks of litigation, does not make an ironclad patent any less ironclad. Any inference *Actavis*

that an "unexplained large reverse payment itself would normally suggest that the patentee has serious doubts about the patent's survival," and could be a "workable surrogate for a patent's weakness, all without forcing a court to conduct a detailed exploration of the validity of the patent itself."[57] And, ultimately, such a "workable surrogate" could further suggest the possibility that the patentee will succeed in excluding competition and recouping its "unexplained large reverse payment."[58] This is the "*Actavis* inference," as later commentators have dubbed it, an inference of potential patent weakness, and accordingly of potential anticompetitive effect, based on the patentee's willingness to make a large, unexplained reverse payment.[59]

B. Only a Sacrifice by the Patentee can Suggest Patent Weakness, Market Power, or Anticompetitive Effect

The *Actavis* inquiry therefore needs its inference, its (supposedly) "workable surrogate" for patent weakness, to establish any potential basis for antitrust scrutiny, particularly in the face of a presumptively-valid patent.[60] And, as noted, *Actavis* draws this inference from a "reverse payment." A reverse payment therefore must be something capable of

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draws should thus be viewed solely as preliminary, and certainly rebuttable. On the other hand, even if an antitrust plaintiff were to prove that a patent the patentee believed valid and infringed was in fact *invalid* or not infringed, the agreement — entered at a time when there was a presumptively valid patent and no one had demonstrated otherwise — would not therefore be transformed into an anticompetitive agreement, because antitrust conduct is assessed as of the time it occurs. *See In re* Wellbutrin XL Antitrust Litig., 133 F. Supp. 3d 734, 753 (E.D. Pa. 2015) (citing Polk Bros., Inc. v. Forest City Enters., Inc., 776 F.2d 185, 189 (7th Cir. 1985); SCM Corp. v. Xerox Corp., 645 F.2d 1195, 1207 (2d Cir. 1981)) ("In conducting the rule of reason analysis, the Court will evaluate the Wellbutrin Settlement's reasonableness at the time it was entered into. The Court will also evaluate the settlement as a whole, and not in a piecemeal, provision-by-provision approach.").

57. *Actavis*, 570 U.S. at 157–58; *see also id.* at 154 ("[R]everse payment signal[s] to other potential challengers that the patentee lacks confidence in its patent . . . .").

58. *Id.* at 157 ("[W]here a reverse payment threatens to work unjustified anticompetitive harm, the patentee likely possesses the [market] power to bring that harm about in practice.").

59. Edlin et al., *The* Actavis *Inference*, *supra* note 49, at 594; Gant, *supra* note 49, at 122–25.

60. That the patentee sacrifice is necessary to overcome the statutory presumption of patent validity, and thus bring the case outside of the "scope of the patent" analysis used prior to *Actavis*, refutes the suggestion by Edlin et al. that while "a sacrifice by the patent holder is the primary focus of the present analysis, a sacrifice is not the only route to establishing an anticompetitive effect." Edlin et al., *The* Actavis *Inference*, *supra* note 49, at 594 n.28. Without a patentee sacrifice to serve as the "workable surrogate" under *Actavis*, a court has no basis on which to conclude that any anticompetitive effects could have occurred — because without this workable surrogate, there is simply a valid patent, and a patent settlement that by all accounts was within the scope of that patent.

suggesting patent weakness, along with market power[61] and the potential for anticompetitive effect, i.e., whatever "reverse payment" means, it must "normally suggest that the patentee has serious doubts about the patent's survival" and be a "workable surrogate for a patent's weakness."[62] So what sort of agreement would provide that "workable surrogate" for patent weakness and thus suggest the possibility of anticompetitive effects?

i. A Patentee Might Not Be Expected to Make a Large, Unexplained Sacrifice It Could Not Then Recoup Through Anticompetitive Effects

A short-term patentee sacrifice could serve as such a workable surrogate in some cases, at least in theory,[63] because the fact that the patentee made such a sacrifice might suggest that the "patentee ha[d] serious doubts about the patent's survival."[64] The reasoning is that the patentee would not ordinarily make a large sacrifice to settle if it felt it had no risk of losing the patent case; thus, the fact that the patentee was willing to make such a sacrifice could in some cases be taken as evidence, at least at the motion to dismiss stage, that the patentee expected to recoup that sacrifice by avoiding the perceived risk of patent invalidation.[65] It therefore is the *patentee's sacrifice* that is the "workable surrogate" on which *Actavis* relies to infer the potential for the patentee to "recoup" anticompetitive benefits.[66] This, of course, echoes the analyses in *Brooke Group*, *Aspen Skiing*, and *Trinko*, each of which required a sacrifice to suggest the potential for an anticompetitive effect. Indeed, *Actavis* notes that a reverse payment "amounts to a *purchase* by the patentee of the exclusive right to sell its product,"[67] language which

61. *See infra* Part V (explaining how a sacrifice allows an initial inference of market power).

62. *Actavis*, 570 U.S. at 157–58.

63. Again, accepting this premise for purposes of applying *Actavis* does not necessarily mean agreeing with it. *See, e.g.*, Gant, *supra* note 49, at 121 (explaining the weakness of this inference, and why it must not be accepted as a final conclusion with respect to anything under *Actavis*).

64. *Actavis*, 570 U.S. at 157–58.

65. *See, e.g.*, *In re* Nexium (Esomeprazole) Antitrust Litig., 42 F. Supp. 3d 231, 262 (D. Mass. 2014) (quoting Herbert Hovenkamp, *Anticompetitive Patent Settlements and the Supreme Court's* Actavis *Decision*, 15 MINN. J.L. SCI. & TECH. 3, 25 (2013)) ("[A] large payment would be an irrational act unless the patentee believed that generic production would cut into its profits.").

66. *See Actavis*, 570 U.S. at 147 (describing a reverse payment as something the patentee could "recoup" through the exercise of the patent exclusivity).

67. *Id.* at 153 (emphasis added).

directly echoes *Brooke Group*'s comment that predatory pricing represents an "*investment* in below-cost prices."[68]

Actavis further focused on the recoupment of this sacrifice through anticompetitive effects on the market, noting that the "patent, if valid and infringed, might have permitted [the patentee] to charge drug prices sufficient to *recoup* the reverse settlement payments."[69] Indeed, whether such recoupment was possible was a key question in the decision; *Actavis* noted that a practical question was whether the parties would "be able to enter into such an anticompetitive agreement? Would not a high reverse payment signal to other potential challengers that the patentee lacks confidence in its patent, thereby provoking additional challenges, perhaps too many for the patentee to 'buy off?'"[70] If so, then recoupment would not be possible.[71] The Court concluded however, that the structure of the Hatch-Waxman Act reduces the incentives of subsequent challengers to meaningfully contest the validity of the patent, and thus, that driving out even one challenger might allow recoupment through delayed generic entry.[72]

Finally, in *Actavis* the Court held that a patentee's willingness to enter into a large and unexplained reverse payment may sometimes suggest an anticompetitive bent, asking if the "basic reason" for the agreement was "a desire to maintain and to share patent-generated monopoly profits."[73] *Actavis* thus echoes the intent discussion in *Trinko*, which addressed the supposedly "anticompetitive bent" disclosed by refusing to continue a prior profitable course of dealing with a rival.[74] Having identified conduct that might raise antitrust suspicions — a large, unexplained reverse payment — *Actavis*, like *Trinko*, considers whether that conduct reveals an intent by the alleged monopolist to delay competition, and uses that inference of intent to help interpret potentially ambiguous conduct.

Actavis therefore follows the same framework of sacrifice and recoupment as in *Brooke Group*, *Aspen Skiing*, and *Trinko*. While this area of the

68. Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 212, 224 (1993) (emphasis added).

69. *Actavis*, 570 U.S. at 147 (emphasis added).

70. *Id.* at 154–55.

71. *See, e.g.*, *Brooke Grp.*, 509 U.S. at 224–26. *Compare In re* Ciprofloxacin Hydrochloride Antitrust Litig., 363 F. Supp. 2d 514, 534–35 (E.D.N.Y. 2005) (concluding pre-*Actavis* that recoupment of a reverse payment is not possible because other generics will then challenge the patent), *with* Herbert Hovenkamp, *Sensible Antitrust Rules for Pharmaceutical Competition*, 39 U.S.F. L. REV. 11, 25 (2004) ("If there is good reason for believing the patent invalid others will try [to invalidate it].").

72. *Actavis*, 570 U.S. at 155.

73. *Id.* at 158.

74. Verizon Commc'ns Inc. v. Law Offices of Curtis v. Trinko, LLP, 540 U.S. 398, 409 (2004).

antitrust law has not yet seen a "*Trinko*" to explain the "*Aspen Skiing*" of *Actavis*, courts applying *Actavis* should therefore look for the same type of sacrifice required in prior Supreme Court sacrifice and recoupment cases.

ii. A Benefit to the Patent Challenger Is Also Necessary, but No Substitute for a Patentee Sacrifice

Before proceeding, however, we should pause to consider whether the *Actavis* inference could be based on conduct other than a sacrifice by the patentee. Most importantly, we might think that it would be possible to look to whether the patent challenger received any benefit in connection with settlement, and to ask if such a benefit could be a workable surrogate for a weak patent. But in fact, such a benefit, while necessary for there to have been a "payment" at all, is of little use in determining the potential for patent weakness and anticompetitive effect under *Actavis*.[75]

a. A Benefit to the Patent Challenger Is Also Necessary to Show a Large, Unexplained Reverse Payment

Initially, it is certainly true that a benefit to the patent challenger is an important part of the *Actavis* analysis, though such a benefit is necessary to show potential anticompetitive conduct, not sufficient. It is true that there is no way to infer that the patent challenger agreed to a later entry date (the anticompetitive harm at issue in *Actavis*) without showing that it received some benefit from the agreement that would encourage it to agree to such delay. Because a payment requires a payor *and* a payee, if the challenger received no benefit, then it can hardly be said that it was "paid" for delaying entry.[76] And the Court's discussion of a benefit to the patent challenger in *Actavis* is therefore unsurprising and does not refute in any way the conclusion that a reverse payment also requires a patentee sacrifice. Rather, because a reverse payment requires a patent challenger benefit as well as a

75. It has previously been shown that the mere fact that an agreement makes the patent challenger more willing to compromise does not suggest anticompetitive effect. *See generally* Gant, *supra* note 49.

76. *Actavis*, 570 U.S. at 145, 154 (alleging that the "true point of the payments was to compensate the generics for agreeing not to compete" and that such payments may "induce" delay); *id.* at 152 ("A, the plaintiff, pays money to defendant B purely so B will give up the patent fight."); *id.* at 169 ("[A] party with no claim for damages . . . walks away with money simply so it will stay away from the patentee's market."); *id.* at 154 (noting that sometimes payments are larger than what the challenger would earn in profits if it won the patent challenge, thus the payment is essentially to "stay[] out of the market").

patentee sacrifice, it would be odd if *Actavis* had *not* mentioned such a benefit; both sides of the payment are required.[77]

b. However, a Benefit to the Patent Challenger Does Not Suggest Patent Weakness

However, a benefit to the patent challenger is of comparatively little value in the *Actavis* analysis because it cannot support the *Actavis* inference of patent weakness; such a benefit simply tells us nothing about the strength or weakness of the patent at issue. Simply put, a patent challenger would *accept* a large benefit from a patentee with an ironclad patent just as surely as it would accept the same benefit from a patentee with a weak patent; why should it care?[78] At most, a court might be able to look to the fact that the challenger *demanded* a large payment as evidence that it viewed the patent as potentially vulnerable, but this would be of minimal value both because

77. Nor can a benefit to the patent challenger be condemned based on the argument that it alters the incentives of the patent challenger to settle. On this theory the state of California passed a statute, Assembly Bill 824 ("AB 824"), which in some cases might be said to require little more than a benefit to the patent challenger in order to raise an inference of anticompetitive effects. *See, e.g.*, Kristen O'Shaughnessy, et al., *California's New Reverse Payment Law Departs from Supreme Court Standard in* FTC v. Actavis, WHITE & CASE (Oct. 17, 2019), https://www.whitecase.com/publications/alert/californias-new-reverse-payment-law-departs-supreme-court-standard-ftc-v-actavis. But by focusing on the patent challenger's benefit, rather than the patentee's sacrifice, this rule undermines "traditional" forms of settlement that allow the parties to compromise between litigation expectations, as such compromises necessarily involve value for both parties. *See* Gant, *supra* note 49, at 125–29.

Moreover, the California statute has a substantial preemption problem. Because *Actavis* permits antitrust scrutiny of patents only where a large, unexplained reverse payment can serve as a "workable surrogate" for patent weakness, and because the "anything of value" to a patent challenger under AB 824 cannot serve as such a workable surrogate, *see infra* Part III.B.ii.b–c (explaining why the generic benefit cannot serve as a workable surrogate for patent weakness), an antitrust action under AB 824 must proceed against the backdrop of a presumptively valid patent. *See* 35 U.S.C. § 282(a). Without any mechanism for invalidating or avoiding the rights granted under such a patent, AB 824 therefore must shorten or ignore the patent rights granted by the U.S. Patent & Trademark Office — something the California state legislature has no power to do. AB 824 is thus in direct conflict with federal patent law and preempted by the same.

78. *See* Gant, *supra* note 49, at 125.

the challenger may have been bluffing,[79] or even just wrong,[80] and because the important fact is not that the challenger asked for a large payment to settle (rational to do in any hard bargaining situation), but rather that the patentee thought it better to meet that demand than to litigate. That the patent challenger agreed to receive a benefit therefore tells us nothing about the strength or weakness of the patent — at least, as discussed above, unless that benefit comes from a patentee *sacrifice*.

Similarly, it is not persuasive to suggest that a patentee would only provide value to a patent challenger, even at no cost to itself, if it believed that its patent was weak. On the contrary, a patentee with an absolutely ironclad patent that can settle at no cost to itself, and with an entry date that respects its patent term, would rationally do so regardless of the benefit its opponent receives. Willingness to enter such a no-cost settlement cannot suggest patent weakness regardless of how much the challenger receives.

For example, imagine a (purely hypothetical) patent that is 100% likely to be upheld and found to be infringed. However, to prove the validity and infringement of this perfect patent, the patentee will need to engage in a year of litigation, with all the attendant costs and annoyances. Rather than continuing litigation, though, the patent challenger offers to respect the full term of the patent, i.e., give the patentee exactly what it wants, if the patentee simply makes an introduction to a potential supplier that will save the patent challenger tens of millions of dollars. Doing so costs the patentee nothing. It would not be "irrational" or a "sacrifice" for the patentee to agree to such a no-cost settlement, such that we could infer that it would only take this deal if it was concerned about the strength of its patent and seeking to harm competition. On the contrary, it might be irrational for the patentee to *refuse* the challenger's offer, and continue litigating for another year, just to deny the patent challenger that benefit. And indeed, this is true virtually no matter how much the patent challenger stands to benefit, or how strong the patentee's patent might be; why should the patentee care what the challenger receives, when it has received what it wanted out of the exchange (its full patent term) and given up *nothing* to get it?

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79. United States v. Weimart, 819 F.3d 351, 369 (7th Cir. 2016) ("Bargaining 'hard' can include bluffs about negotiating positions."); Dalton v. McCourt Elec., LLC, No. 12-3568, 2013 U.S. Dist. LEXIS 176582, at *13, n.2 (E.D. Pa. Dec. 17, 2013) (quoting *In re* Trans Union Corp. Privacy Litig., No. 00 C 4729, 2009 U.S. Dist. LEXIS 116934, at *39 (N.D. Ill. Dec. 9, 2009)) ("In the hurly-burly of negotiation, depending on the style of the lawyer, it is not uncommon to encounter posturing, brinkmanship, bluster, puffing, bluffing, braggadocio, and some sharp elbows.").

80. *See* United Food & Com. Workers Loc. 1776 & Participating Emps. Health & Welfare Fund v. Teikoku Pharma USA, Inc., 296 F. Supp. 3d 1142, 1179–80 (N.D. Cal. 2017) ("[A]ccess to imperfect information or overconfidence based on that imperfect information . . . can impact settlements or willingness to enter settlements.").

We therefore cannot infer that a patentee would only permit a challenger to receive a benefit if the patent was weak. On the contrary, a patentee would rationally enter such a no-cost settlement regardless of the strength or weakness of its patent. The "workable surrogate" for patent weakness in *Actavis* therefore simply does not "work" when viewed solely from the perspective of the patent challenger, as a benefit to the patent challenger standing alone provides no insight into the strength of the patent.

Finally, by focusing primarily on the benefit to the patent challenger, courts encounter the problem that prompted the Court in *Actavis* to call reverse payments "unusual" and "quite different" from a traditional, commonplace compromise.[81] But what makes a reverse payment "unusual?" It cannot be that the patent challenger benefits; most settlements provide both parties with greater value than they expect to receive from litigating.[82] Why else would anyone ever settle? If a benefit to the patent challenger transformed a normal settlement into a reverse payment settlement, then the Supreme Court was simply wrong to call such settlements "unusual" — on the contrary, they would be the norm.

c. A Benefit to the Patent Challenger Cannot Be Used as a "Proxy" or Replacement for a Patentee Sacrifice

It might be asked, however, whether a benefit to the patent challenger necessarily or ordinarily *equates* to a patentee sacrifice, such that if a plaintiff can show such a benefit, it can be inferred that the benefit must have come from a patentee sacrifice and thus that the patent might be weak. To see why this is not so, consider three categories of contemporaneous agreements likely to be entered alongside a patent settlement: (a) a mutually beneficial "win-win" agreement," (b) an agreement beneficial to one side at no cost to the other ("win-neutral"), and (c) an agreement that harms one side to benefit

81. *Actavis*, 570 U.S. at 147, 152.

82. *See infra* note 86 (collecting authority for the proposition that settlements typically benefit both parties); *see also, e.g.*, *In re* Actos End Payor Antitrust Litig., No. 13-CV-9244, 2015 U.S. Dist. LEXIS 127748, at *44 (S.D.N.Y. Sept. 22, 2015) *rev'd on other grounds sub nom* United Food & Com. Workers Loc. 1776 & Participating Emp. Health & Welfare Fund v. Crosby Tugs, LLC, 848 F.3d 89 (2d Cir. 2017) (citing Asahi Glass Co. v. Pentech Pharms., Inc., 289 F. Supp. 2d 986, 994 (N.D. Ill. 2003)) (focusing solely on a benefit "would ignore the limiting principles set forth in [*Actavis*] and subject virtually *any* settlement to antitrust scrutiny"); Kent Bernard, *Hatch-Waxman Patent Case Settlements — The Supreme Court Churns the Swamp*, 15 MINN. J. L. SCI. & TECH. 123, 131 (2014) ("[*A*]*ny* settlement agreement involves some sort of consideration to the defendant . . . . Settlement, after all, is a compromise — not total surrender."); Gant, *supra* note 49, at 128–29 (explaining the importance of patent settlements and why the Court declined to adopt an approach that would prevent parties from compromising between their respective patent positions).

the other ("win-lose").[83] While in all three scenarios at least one side benefits, that benefit is not sufficient to show that the other side sacrificed — on the contrary, the other side may *also* have benefited, thus negating any suggestion of a sacrifice.[84]

Win-Win. Mutually beneficial agreements are one of the most fundamental building blocks of trade. Such agreements are, in economic terms, "Pareto superior," meaning that they make at least one of the parties better off and neither of the parties worse off,[85] and are thus common ways both to settle disputes and to enter into agreements generally.[86] For example, consider the purchase of a used car for $25,000. Intuitively, we might think that the car was worth exactly $25,000 to everyone involved, because that was the price paid. But this intuition is often wrong, because if everyone agreed that the car was worth exactly $25,000 then why bother trading $25,000 for $25,000? The answer is that the buyer values the car more highly than $25,000 and would have (if necessary) been willing to pay up to $30,000, while the store values the $25,000 more highly than the car as it paid only $15,000 wholesale. From the store's perspective, it has made $10,000 in gross profit, while from the buyer's perspective, she has enjoyed a $5,000 "consumer surplus."[87]

Far from "unusual," such win-win agreements are both routine and fairly easy to understand, and certainly cannot suggest irrational conduct.[88]

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83. If the parties were, for some reason, to instead agree to terms that made one or more side worse off and *neither* side better off — a "neutral-lose," "lose-neutral," or "lose-lose" agreement — it would not transfer any value and thus not be a "payment."

84. *See* Gant, *supra* note 49, at 125–29 (explaining the benefits of "integrative" or win-win bargaining to reach an agreement in complex disputes).

85. *See generally* Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 YALE L.J. 1211 (1991) (examining the "Pareto optimality" and the "cost of making transactions in a market economy").

86. *See, e.g.*, United States v. De La Mata, 535 F.3d 1267, 1270 (11th Cir. 2008) (stating reasons why settlement of a forfeiture claim is mutually beneficial, including saved litigation costs); *In re* Joint E. & S. Dist. Asbestos Litig., 14 F.3d 726, 729 (2d Cir. 1993) (stating the purpose of the class is to "facilitate the formation of a settlement that will mutually benefit both [parties]"); Shelby Cty. Health Care Corp. v. Am. Fed'n of State, Cty. & Mun. Emp., Loc. 1733, 967 F.2d 1091, 1097 (6th Cir. 1992) (noting that settlement agreements are "presumably mutually beneficial"); Judkins v. HT Window Fashion Corp., 529 F.3d 1334, 1340 (Fed. Cir. 2008) ("The fact that both [parties] took from the settlement something of value points to a constructive, mutually beneficial resolution to a legitimate dispute.").

87. *See, e.g.*, Ind. Lumbermens Mut. Ins. Co. v. Reinsurance Results, Inc., 513 F.3d 652, 658 (7th Cir. 2008) (explaining consumer surplus); DENNIS CARLTON & JEFFREY PERLOFF, MODERN INDUSTRIAL ORGANIZATION 71 (3d ed. 2000) ("Typically, consumers value the goods they purchase above the amount they actually pay for them. Consumer surplus is the amount above the price paid that a consumer would willingly spend, if necessary, to consume the units purchased.").

88. *See* FTC v. Actavis, Inc., 570 U.S. 136, 147, 152 (2013).

However, there are still ways to misunderstand such an agreement.

First, it is possible to mistake one side's gain for a sacrifice by the other side. In our car example, the dealer receives a benefit (ignoring fixed costs) of $10,000. A simplistic view might thus assume that the buyer has taken a *loss* of $10,000; after all, she paid $25,000 for something that could be bought wholesale for $15,000. But to purchase the car for $15,000, the buyer would need to, *inter alia*, establish a wholesaling relationship with a distributor, purchase a large volume of cars on a regular basis, and wait for delivery. Put differently, the dealer has a "comparative advantage" in retailing cars, as it would be highly inefficient for the buyer to try to replicate the dealer's position in the market to save $10,000.[89] Thus, when considered from both parties' perspectives (as it must be), this purchase of a car is not suspicious simply because the dealer makes a profit.[90]

Second, a court could misunderstand the agreement by solely asking which side received the "better" benefit. For example, does the fact that the dealer made $10,000 gross profit while the buyer gained only $5,000 in consumer surplus mean that the buyer "lost money?" Not at all. That the dealer might have received greater additional value than the buyer means only that the buyer did not "win" to the maximum extent possible by getting the theoretical absolute minimum price; she still "won" a benefit of $5,000. The same is true, moreover, even if this win was below some measure of "market value" — i.e., if the market price of the used car was below $25,000 — as the buyer still valued the car at $30,000, and thus obtained a consumer surplus regardless of whether she received the absolute best deal that she could have received in the market.[91]

Finally, a word of caution. Some have described reverse payment patent settlements as "win-win" because over the *long term* the patentee might expect to more than recoup its initial sacrifice, while also benefiting the

89. *See* Alan Sykes, *Comparative Advantage and the Normative Economics of International Trade Policy*, 1 J. INT'L. ECON. L. 49, 49 (1998) (describing comparative advantage in the context of opportunity costs, as the "engine of trade"); R. George Wright, *At What Is the Supreme Court Comparatively Advantaged*, 116 W. VA. L. REV. 535, 545–46 (2013).

90. It could similarly be possible to misunderstand an agreement by focusing overly on results rather than expectations. *See In re* Wellbutrin XL Antitrust Litig., 133 F. Supp. 3d 734, 753–54 (E.D. Pa. 2015); Schering-Plough Corp. v. FTC, 402 F.3d 1056, 1071 (11th Cir. 2005) ("The Commission's finding that the 'Upsher licenses were worth nothing to Schering' overlooks the very nature of the pharmaceutical industry where licenses are very often granted on drugs that never see the market.").

91. *See also infra* Part IV.A (explaining why "market value" is a poor guide in a constrained market).

patent challenger.[92] But the contemporaneous agreement — the alleged reverse payment — is not a win for the patentee, but rather a loss that is later recouped. To understand this distinction, consider predatory pricing, in which a monopolist prices below cost, taking an initial loss, which it then expects to recoup after driving others out of the market. Though the monopolist in such a predatory pricing scheme ultimately stands to "win" with supracompetitive profits, the initial below-cost pricing is not a win but a loss, because the monopolist initially loses money on each sale. Here, too, a reverse payment is not a "win-win" contemporaneous agreement but an initial sacrifice, and a win-win contemporaneous agreement is not a reverse payment as it contains no such initial sacrifice and thus no loss to recoup.

Win-Neutral. To return to our hypothetical, what if the dealer — doing a favor for the buyer, a personal friend in financial trouble — sells her the car for $15,000, i.e., at exactly the cost the dealer paid for the car? In this scenario, the dealer provides the buyer with $15,000 in consumer surplus ($30,000 minus the $15,000 the buyer paid), but the dealer earns no profit.

Such a transaction is not too hard to imagine, particularly because the buyer otherwise could not have purchased a car from the dealer. The social benefits of such a favor may be worth the minimal transaction costs associated with the dealer sourcing and selling the car. While the dealer might in some sense be said to have "lost" $10,000 in potential profit, this profit is illusory; the buyer could not and thus would not have paid $25,000, because she was in financial trouble. And we assume the dealer will have no trouble procuring another car to sell to the next customer at $25,000.[93] Thus, this is a win-neutral agreement, in which one side is able to do something for the other side at little or no cost to itself.[94]

Such agreements may be less common than the extremely common win-win agreements discussed above, but they are likewise not hard to understand. Indeed, as discussed above, if a patentee can achieve a favorable settlement by providing a benefit to the patent challenger at no cost to itself, it would make perfect sense for it to enter that agreement, regardless of the size of the benefit to the patent challenger and regardless of the strength of

92. *See, e.g.*, *Actavis*, 570 U.S. at 154 ("The patentee and the challenger gain; the consumer loses."); FTC v. Watson Pharms., Inc., 677 F.3d 1298, 1302 (11th Cir. 2012) (describing a reverse payment settlement as a "win-win" because the brand maintains its patent and the patent challenger receives more settlement money than it would earn in profits even if it won the patent litigation).

93. *But see infra* Part IV.A (discussing the implications when this assumption is not correct, and why the antitrust laws would nonetheless reach the same results).

94. WILLIAM URY, GETTING PAST NO: NEGOTIATING IN DIFFICULT SITUATIONS 118 (1991) ("The most common way to expand the pie is to . . . [i]dentify items you could give the other side that are of high benefit to them but low cost to you.").

the patent.[95] Such no-cost agreements, like a win-win agreement, are Pareto superior; they make at least one party better off and none worse off, and thus can be expected to rationally occur.[96]

Win-Lose. Finally, what if our buyer paid $10,000 for a toy car instead? Unless there was some other explanation, such an agreement would seem "unusual,"[97] as the dealer would receive roughly $10,000 in profit and the buyer would only receive a toy.[98] Such an arrangement, if not explained, may raise questions. This sort of irrational "sacrifice," where one party appears to take an inexplicable loss in absolute terms, was allegedly at issue in *Actavis*.[99] And if entered as part of a patent settlement, such an arrangement could in theory constitute a reverse payment (though perhaps not a "large" one given the dollar figures in our hypothetical).

The astute reader will notice something that this type of win-lose agreement has in common with the win-win agreement discussed above: they both benefit the dealer, and indeed in our hypothetical do so to the exact same extent ($10,000). By looking at these two very different agreements solely from the perspective of the dealer, we might mistakenly think that they are the same — that because in each case the dealer walks away with a $10,000 profit, a win-win and a win-lose transaction are equally suspicious. Yet the two agreements otherwise have little in common when viewed in totality; we might realistically ask why anyone would ever pay $10,000 for a toy car, but it takes no great understanding of economics to see why someone might pay $25,000 for what she sees as a $30,000 car.

A court therefore cannot infer that if a patent challenger received a benefit, the patentee must have taken a loss. A benefit to the patent challenger is necessary, not sufficient, to show a reverse payment.[100] Rather, a reverse

95. *See supra* Part III.B.ii.c.

96. *See* Calabresi, *supra* note 85, at 1215 (describing Pareto superiority).

97. *See Actavis*, 570 U.S. at 147 (noting reverse payment settlements are "unusual").

98. *See id.*

99. Appearances can of course be deceiving; perhaps the toy car is the last piece in the very rich buyer's 30-year collection project, and one of a kind, such that the buyer expects to receive far more than $10,000 in value from owning it. Sure, $10,000 for such a toy might seem excessive, but, then, people have paid far more than that (over $5 million in fact) for cardboard pictures of baseball players. *See, e.g.*, ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 132 (8th ed. 2013) ("Because different consumers place different values on the consumption of particular goods, the maximum amount they are willing to pay for those goods also differs."). An initial suspicion about the agreement thus should not be permitted to become an irrebuttable presumption of wrongdoing.

100. Nor can a benefit to the patent challenger constitute a suspect reverse payment simply because the challenger received more from the contemporaneous agreements than it stood to gain by winning the patent case, as at least one court has incorrectly held.

payment under *Actavis* must be both a sacrifice by the patentee and a benefit to the patent challenger.

C. A Reverse Payment Must Be Large Enough to Suggest Patent Weakness

That a reverse payment must be a patentee sacrifice also helps define the meaning of the term "large" in *Actavis*.[101] Simply put, a large payment must be one that is large enough to provide the "workable surrogate for a patent's weakness" *Actavis* demands, by providing meaningful insight into the patentee's views of the strength or weakness of the patent.[102] For example, if a patentee were found to have made a $1 million payment above fair value and saved litigation costs in connection with a settlement of a $10 *billion* a year product, that $1 million would represent roughly 52 minutes worth of sales.[103] While $1 million is maybe a lot of money to you or me, such a payment simply would not be large enough to suggest that the patent was weak; a $1 million payment is more or less a rounding error in that settlement, and thus tells us little to nothing about how the patentee viewed the strength or weakness of its patent. "Large" within the meaning of *Actavis* therefore must mean a sacrifice by the patentee that would be seen as large within the context of the overall value of the patent.

King Drug Co. of Florence, Inc. v. Cephalon, Inc., 88 F. Supp. 3d 402, 417 (E.D. Pa. 2015) (concluding, based on a single sentence in *Actavis*, that the relevant test is "what would induce *the generic* to stay off of the market"); *see also Actavis*, 570 U.S. at 154 (noting that a patentee could "sometimes pay a generic challenger a sum even larger than what the generic would gain in profits if it won the paragraph IV litigation and entered the market"). While *Cephalon* also cited Hovenkamp, *supra* note 65, at 12, for this proposition, that article says only that the potential for a patent challenger to receive more via a reverse payment than it stands to win in the patent case is reason to suspect that potentially-anticompetitive reverse payment settlements might *occur*, not that the patent challenger's benefit can suffice to *establish* such a payment. And simply put, there is no mechanism to use such a benefit to the patent challenger — no matter how large — to infer patent weakness if the patentee did not concurrently make a sacrifice that might permit such an inference. *See supra* Part III.B.ii.b–c.

101. *See Actavis*, 570 U.S. at 158 ("[A] reverse payment, where large and unjustified, can bring with it the risk of significant anticompetitive effects . . . ."); *id.* ("[T]he size of the unexplained reverse payment can provide a workable surrogate for a patent's weakness, all without forcing a court to conduct a detailed exploration of the validity of the patent itself."); *see also, e.g.*, *Cephalon*, 88 F. Supp. 3d at 416 ("*Actavis* did not identify any specific formula for determining whether a reverse payment is sufficiently large.").

102. *Actavis*, 570 U.S. at 158; *see also* Gant, *supra* note 49, at 144–46 (analyzing this question further from an integrative bargaining perspective). As discussed *infra* Parts IV and VI, such a payment must also remain large after subtracting saved litigation costs and fair value, as neither represents a "sacrifice" by the patentee.

103. $1 million is 0.01% of $10 billion, and 52 minutes is 0.01% of a year.

IV. "FAIR VALUE" IS THE ABSENCE OF A PATENTEE SACRIFICE IN ABSOLUTE TERMS, AND IS NOT DEFINED BY "MARKET VALUE" OR BY THE "REASONS" FOR THE AGREEMENT

We therefore have established that a reverse payment is, first and foremost, a patentee sacrifice. But simply knowing that there must be a patentee sacrifice is not quite enough to fully understand *Actavis*; we must also understand what it *means* to make a sacrifice. Or, more precisely, a sacrifice relative to *what*. To understand this point, we turn to the question of "fair value" in *Actavis*, though again we find the definition not in *Actavis* itself, but rather in *Brooke Group*, *Aspen Skiing*, *Trinko*, and their progeny.

Actavis holds that value provided by the patentee to the patent challenger in connection with a patent settlement is not suspect under the antitrust laws if that value was merely "fair value for services."[104] But why not? Here, too, the sacrifice and recoupment framework answers the question. "Fair value" under *Actavis* surely means the lack of a patentee sacrifice, as when a patentee receives fair value from a business arrangement entered in connection with settlement it has not made the sacrifice necessary to infer patent weakness or anticompetitive effect.

But what does it mean for a patentee not to have made a "sacrifice?" While that sounds like a very straightforward question — and, as we conclude below, it has a very straightforward answer — there are at least three potential answers that have been proposed in reverse payment cases:

> (1) Fair value in *Actavis* should be read to mean "market value," such that a contemporaneous agreement must provide the patentee the same value as an ideal agreement reached on the open market or else the patentee has made a sacrifice relative to what it might have gained from a different, "market value" transaction[105] (discussed in Part IV.A below);
>
> (2) A contemporaneous agreement should be considered fair value only if the "basic reason" the parties entered the agreement was to compensate the patent challenger for goods and services rather than to settle, such that the value provided under the agreement was effectively unrelated to the settlement[106] (discussed in Part IV.B below); or

104. *Actavis*, 570 U.S. at 156.

105. *See, e.g.*, *In re* Nexium (Esomeprazole) Antitrust Litig., 42 F. Supp. 3d 231, 263–64 (D. Mass. 2014) (addressing fair market value); Edlin et al., *The* Actavis *Inference*, *supra* note 49, at 594 (suggesting that parties must obtain the same value through patent settlements as they would have been able to obtain in the market through "arms-length, stand-alone" transactions).

106. *See, e.g.*, Complaint Counsel's Appeal of the Initial Decision at 33–34, *In re* Impax Labs., Inc. (F.T.C. July 10, 2018) (No. 9373) [hereinafter Impax Labs Complaint] (advocating this test).

(3) Fair value is the absence of a patentee sacrifice in absolute terms, meaning that so long as a patentee at least breaks even (a "win-neutral" deal) there can be no reverse payment (discussed in Part IV.C below).

As shown below, only the third option is consistent with the term "fair value," the Court's guidance in *Actavis*, and established antitrust principles, and thus, fair value must mean the absence of a patentee sacrifice in absolute terms, just as in *Brooke Group* and *Trinko*.

A. Failure to Achieve Market Value Cannot Support the Actavis Inference of Patent Weakness, Market Power, and the Potential for Anticompetitive Effects

We will start with the wrong answer — that the Supreme Court's use of the term "fair value" in *Actavis* must actually be a misprint, as the Supreme Court must surely have meant "market value."[107] As shown below, such a conclusion is at odds with the normal legal meaning of the term "fair value," because it asks courts to compare a settlement to illusory hypotheticals. Furthermore, it rejects the Supreme Court's guidance in cases like *Brooke Group* and *Trinko* by replacing a "sacrifice" in the Court's jurisprudence with a mere failure to profit maximize.

i. Actavis Addressed "Fair Value" Because Settlements Rarely Involve the Exchange of "Market Value"

Although the legal definition of the terms "fair value" and "market value" may overlap, they focus on entirely distinct questions.[108] As discussed

107. *See Actavis*, 570 U.S. at 156 (noting that fair value is the standard).

108. *See, e.g.*, Swope v. Siegel-Robert, Inc., 74 F. Supp. 2d 876, 888 (E.D. Mo. 1999) (comparing the differing analyses of fair value and market value, noting that in the fair value analysis there is no market; therefore, "[t]here is no implication that both parties have entered the market place, or that all of the parties are equally well-informed of the circumstances involved in the transaction . . . ." and "one of the parties lacks the ability to back out or withdraw from the transaction"); Calais Co. v. Ivy, 303 P.3d 410, 418 n.24 (Alaska 2013) (citing UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE 112–13 (2000)) (rejecting the view that "fair value, market value, and fair market value are 'virtually synonymous'" because these values will rarely be the same); *see also* Balt. & Ohio R.R. v. United States, 305 U.S. 507, 524 (1939) (noting that market value is just one way to determine fair value); Lucas v. Alexander, 279 U.S. 573, 579 (1929) (stating "fair value" can be ascertained by means other than market value); DH2, Inc. v. SEC, 422 F.3d 591, 593 (7th Cir. 2005) (citing 17 C.F.R. §§ 270.2a-4(a)(1), (c)) (distinguishing fair value and market value); Pueblo Bancorporation v. Lindoe, Inc., 63 P.3d 353, 361–63 (Colo. 2003) (noting "fair value does not mean fair market value" but instead "the shareholder's proportionate ownership interest in the value of the corporation"); Robblee v. Robblee, 841 P.2d 1289, 1294 (Wash. Ct. App. 1992) (quoting Columbia Mgmt. Co. v. Wyss, 765 P.2d 207, 212 (Or. Ct. App. 1988)) ("[E]xcept in a

below, an agreement is fair value if the particular individuals involved in a transaction obtained something economically reasonable under their circumstances and in light of the constraints they faced.[109] By contrast, "market value" (or, confusingly, "fair market value"[110]) is "the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts."[111] Thus unlike a fair value standard, which looks to the actual parties and the actual prices that would have been fair for those parties to pay under the actual circumstances, market value asks what price would have been paid

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few jurisdictions . . . , 'fair value' does *not* mean 'fair market value.' Market value is, at most, one factor in determining fair value."); INT'L VALUATION STANDARDS COMM., EXPOSURE DRAFT OF PROPOSED REVISED INTERNATIONAL VALUATION STANDARD 2 — BASES OTHER THAN MARKET VALUE § 6.4 (2006), https://web.archive.org/web/20070621040820/http://www.ivsc.org/pubs/exp_drafts/ivs2.pdf (distinguishing "fair value" and "market value" by determining whether "the price is fair between two specific parties" by evaluating "the respective advantages or disadvantage that each will gain from the transaction" and acknowledging that while "*[m]arket value*" may meet these criteria, this is not necessarily always the case"). *But see* Cedar Rapids Gas Light Co. v. Cedar Rapids, 223 U.S. 655, 669–70 (1912) (noting fair value is sometimes an appropriate measure for market value); Weigel Broad. Co. v. Smith, 682 N.E.2d 745, 749 (Ill. App. Ct. 1996) ("[N]one of the cases suggests that fair value can never be equated to fair market value.").

109. *See infra* Part IV.C.; Bank One Corp. v. Comm'r, 120 T.C. 174, 308–09 (2003), *aff'd in relevant part, sub nom.* JP Morgan Chase & Co. v. Comm'r, 458 F.3d 564 (7th Cir. 2006) (stating fair value focuses on actual persons, while fair *market* value focuses on hypothetical persons with full information in an open market); *see also* INT'L VALUATION STANDARDS COUNCIL, INTERNATIONAL VALUATION STANDARDS 2013: FRAMEWORK AND REQUIREMENTS ¶¶ 38, 40–41 (2013), http://www.valuersinstitute.com.au/docs/professional_practice/International%20Valuation%20Standards%202013.pdf ("*Fair value* is the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties. [] [*F*]*air value* can be distinguished from *market value*. *Fair value* requires the assessment of the price that is fair between two identified parties taking into account the respective advantages or disadvantages that each will gain from the transaction. It is commonly applied in judicial contexts. In contrast, *market value* requires any advantages that would not be available to market participants generally to be disregarded. *Fair value* is a broader concept than *market value*."). Fair value is often used where assets are thinly traded, as there will not often be a "market" in which to crystalize value. *Compare id.* ¶¶ 41–42 (discussing fair value), *with id.* ¶¶ 29–34 (discussing market value).

110. *See Value*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining fair market value).

111. I.R.S. Publication 561 (02/2020), Determining the Value of Donated Property (Feb. 13, 2020), https://www.irs.gov/publications/p561; *see also, e.g.*, INT'L VALUATION STANDARDS COUNCIL, IVS 104 BASES OF VALUE 18, ¶ 30.1 (2017), http://www.cas.org.cn/docs/2017-01/20170120142445588690.pdf ("[T]he estimated amount for which an *asset* or liability *should* exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently, and without compulsion.").

in a *hypothetical* unconstrained market by *hypothetical* unconstrained buyers and sellers who can freely walk away.[112]

Parties settling disputes are, generally speaking, not unconstrained buyers and sellers who can freely walk away, but rather constrained to prefer agreement over non-agreement. It therefore should not be expected that such parties would enter market value agreements.[113] For example, imagine that the car dealer and the buyer in our hypothetical above are now locked in litigation over $7,000 in claimed damages that the buyer is seeking from the dealer. To settle, the buyer offers to purchase another car for $18,000 rather than the usual market price of $25,000. As before, the dealer paid $15,000 for the car, and can purchase another car for that price, so while it will see its profits reduced relative to the theoretical market price, it will earn $3,000 it would otherwise not receive (as the buyer otherwise would not buy, much less at full price). A settlement and a gain of $3,000 (or even $0) is of course better than no settlement in that situation — it is "fair value," even if not "market value." Entering such a settlement — while perhaps in some sense a "sacrifice" relative to the "market value" — not only would not be irrational for the dealer, but in fact would perhaps be the only economically rational course of action.[114]

By contrast, applying a "market value" standard to the settlement of litigation would ask settling parties to do something that would often be completely *irrational*: Refuse to settle unless by settling the parties obtain as much value as they might obtain by dealing at arm's length in an unconstrained market outside litigation. In our hypothetical, for example, the dealer would be forced to continue litigating, risking a loss of $7,000, simply because a *gain* of $3,000 to settle was somehow deemed insufficient as compared to a hypothetical market value transaction that it hypothetically could have entered — and indeed would be forced to do so even though in practice no such hypothetical market value transaction was available.[115]

Likewise, under *Actavis* the decision to settle for fair value but for less than market value cannot serve as a "workable surrogate for a patent's weakness," and cannot be the type of reverse payment that would support an

112. *See* I.R.S. Publication 561, supra note 111; INT'L VALUATION STANDARDS COUNSEL, *supra* note 111, at 18–19, ¶¶ 30.1, 30.2.

113. *See, e.g.*, Air Line Pilots Ass'n Int'l v. O'Neill, 499 U.S. 65, 81 (1991) ("In labor disputes, as in other kinds of litigation, even a bad settlement may be more advantageous in the long run than a good lawsuit."); *see also infra* note 147 (collecting cases).

114. *See, e.g.*, Michael Moffitt, *Three Things to Be Against ("Settlement" Not Included)*, 78 FORDHAM L. REV. 1203, 1207 (2009) (noting the effect potential litigation can have in shaping settlements).

115. *See also* Gant, *supra* note 49, at 139–40 (rejecting the "outside litigation" test requiring settling parties to enter only agreements identical to what the parties might have reached outside of the litigation context).

inference of potential anticompetitive effects.[116] Simply put, a patentee would accept a gain and a settlement on acceptable terms regardless of the patent's merits, as a gain and a settlement beats no gain and no settlement, regardless of whether the patent is strong or weak. *Actavis* therefore does not look to a sacrifice relative to "market value."

ii. Actavis Does Not Apply a Market Value Standard Even Where There Is a Foregone Alternative

But before proceeding, we should consider the "hard" case here. What if the car dealer in the above hypothetical was only able to procure one car of this type, for which there was significant demand, such that by selling to the buyer at $18,000 the dealer was foregoing another sale at $25,000 that it will not be able to recover? In this situation, some scholars have suggested that "fair value" for antitrust purposes would be the foregone market value of the alternative deal, presumably because they believe it would not be economically reasonable to enter into a settlement when doing so "sacrificed" the opportunity for a more profitable alternative.[117] However, this conclusion is incorrect for two independent reasons.

a. Market Value Alternatives Are Often Illusory

First, in practice such "alternatives" are often entirely illusory, particularly in the pharmaceuticals context in which *Actavis* cases most often arise. As the Supreme Court has noted, "[f]irms do not expand without limit and none of them enters every market that an outside observer might regard as profitable, or even a small portion of such markets."[118]

Indeed, the same literature suggesting that courts adopt a market value test also makes clear that patentees and patent challengers in the pharmaceutical industry (where most reverse payment cases arise) rarely actually *enter* alternative deals outside of settlement.[119] What these sources incorrectly see as suspect — the fact that parties in litigation might "get creative" to find ways to work together profitably so that they can settle and exit that litigation, even if that means doing business together in a way they usually would not — is therefore also reason to reject the assumption that absent the settlement they would have entered some other, better hypothetical deal.

116. FTC v. Actavis, Inc., 570 U.S. 136, 158 (2013).

117. *See* Edlin et al., *The* Actavis *Inference*, *supra* note 49, at 594.

118. Bell Atl. Corp. v. Twombly, 550 U.S. 544, 569 (2007) (quoting PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW 155, ¶ 307d (Supp. 2006)).

119. *See* C. Scott Hemphill, *An Aggregate Approach to Antitrust: Using New Data and Rulemaking to Preserve Drug Competition*, 109 COLUM. L. REV. 629, 633 (2009) (noting that agreements reached as part of patent settlements are rarely reached outside of settlement and arguing that this should be a concern).

Most likely, they would not have done so, and any foregone "market value" alternative is almost always illusory.

Moreover, even if the parties *were* to routinely enter alternative agreements, it is rare that entering development or similar deals is a zero-sum game, such that doing a deal with one party precludes also doing a separate deal with another party at market value. Although there may sometimes be unique cars that the dealer cannot replace with another, in most cases the dealer actually can buy another car to sell at full price. There is thus no valid basis on which to set a "market value" for most agreements entered alongside settlement, and a market value alternative is thus typically illusory.[120]

b. Failure to Profit Maximize Is Not a "Sacrifice" Under the Antitrust Laws

But the "market value alternative" approach is in error even in the rare case in which alternatives are not illusory. To show why, once again turn back to *Brooke Group*, in which the Court held that above-cost pricing is not a sacrifice regardless of whether higher prices might have been more profitable.[121] Plaintiffs in predatory pricing cases have long sought to argue that "above-cost" in *Brooke Group* should be redefined to include the "opportunity cost" of pricing below market value, such that if an alleged monopolist prices below "market value," it thus prices "below cost."[122] Courts consistently reject this approach of requiring monopolists to profit maximize, however, and reiterate that *Brooke Group* instead requires a sacrifice in absolute terms — below cost pricing, not below-market pricing.[123]

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120. *See, e.g.*, Verizon Commc'ns, Inc. v. FCC, 535 U.S. 467, 482–83 (2002) (discussing how "value" is particularly hard to measure where "costly facilities rarely changed hands and so were seldom tagged with a price a buyer would actually pay and a seller accept"). *See generally* ASWATH DAMODARAN, DAMODARAN ON VALUATION: SECURITY ANALYSIS FOR INVESTMENT AND CORPORATE FINANCE 497–540 (2d ed. 2006) (noting the same determination). This is not to say, however, that, if forced to apply a market value analysis instead of *Actavis*'s fair value analysis, a defendant would be without all recourse. Although it will be rare that any actual alternative agreement will have been foregone in connection with a patent settlement, it is nonetheless sometimes possible to find a market value comparator by looking at other agreements at other times under other circumstances. But there is simply no requirement under *Actavis* to do so.

121. Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222–24 (1993).

122. *See* United States v. AMR Corp., 335 F.3d 1109, 1113–14, 1116–17 (10th Cir. 2003).

123. *See, e.g.*, Rebel Oil Co. v. Atl. Richfield Co., 146 F.3d 1088, 1095 (9th Cir. 1998) (quoting *In re* IBM Peripheral EDP Devices Antitrust Litig., 459 F. Supp. 626, 631 (N.D.

One reason for this rule, as the Supreme Court has repeatedly instructed, is simply that courts should not be in the business of requiring parties to make what the court considers the "best" deal (an inquiry for which courts are poorly suited at best), but rather may only look for irrational agreements that involve a true sacrifice by the alleged monopolist.[124] *Trinko* thus rejects the idea of courts "act[ing] as central planners, identifying the proper price, quantity, and other terms of dealing — a role for which they are ill-suited," and thus the idea of a court deciding which of a company's various options was the "right" one.[125] In the *Actavis* context, a court second-guessing a

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Cal. 1978)) ("The measure of marginal cost proposed by Rebel is thus really the opportunity cost to ARCO of choosing to enter into the exchange agreement rather than selling the crude oil elsewhere. Opportunity costs are vastly different from ARCO's marginal or variable costs, and we agree that 'the use of the concept of opportunity costs [to show predatory pricing] must be held improper as a matter of law.'"); *AMR Corp.*, 335 F.3d at 1118–19 (rejecting the test that "effectively treats foregone or 'sacrificed' profits as costs, and condemns activity that may have been profitable as predatory"); Cont'l Airlines, Inc. v. Am. Airlines, Inc., 824 F. Supp. 689, 701 (S.D. Tex. 1993) (expressing that opportunity cost is not a cost of implementing a particular business choice, and cannot be included in considering average variable price); *see also* Gant, *supra* note 49, at 141–42 (noting this point in passing).

124. *See* Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 408–10, 415–16 (2004) (stating antitrust laws do not "give judges *carte blanche* to insist that a monopolist alter its way of doing business whenever some other approach might yield greater competition"); Novell, Inc. v. Microsoft Corp., 731 F.3d 1064, 1074–75 (10th Cir. 2013) (explaining risk of substituting judicial insight for business judgment by stating "to the extent that *Aspen*'s test still might be accused of being underinclusive to some degree even in the narrow field of refusals to deal, the general rule is firm independence and refusal to deal doctrine exists only to address one of the most obvious exceptions to that general rule. If the doctrine fails to capture every nuance, if it must err still to some slight degree, perhaps it is better that it should err on the side of firm independence — given its demonstrated value to the competitive process and consumer welfare — than on the other side where we face the risk of inducing collusion and inviting judicial central planning."); *In re* United Artists Theatre Co., 315 F.3d 217, 231 (3d Cir. 2003) ("The art of governing [a company] (it is emphatically not a science) is replete with judgment calls and 'bet the company' decisions that in retrospect may seem visionary or deranged, depending on the outcome."); *Brooke Grp.*, 509 U.S. at 229.

125. *Trinko*, 540 U.S. at 408. Indeed, there is typically no "right answer" to a patent dispute, and thus no "right settlement" that the parties should have entered. *See* Gant, *supra* note 49, at 127 (explaining why there is no right answer to patent litigation); Joshua P. Davis, *Toward a Jurisprudence of Trial and Settlement: Allocating Attorney's Fees by Amending Federal Rule of Civil Procedure 68*, 48 ALA. L. REV. 65, 122 (1996) (rejecting idea of a "right answer to a dispute"); *see also* King Drug Co. of Florence, Inc. v. SmithKline Beecham Corp., 791 F.3d 388, 409 (3d Cir. 2015) ("*Actavis* does not stand for the proposition that parties must reach the most procompetitive settlements possible."); *In re* Cipro Cases I & II, 348 P.3d 845, 864 n.10 (Cal. 2015) ("There is no statutory right to have parties enter the agreement most favorable to competition, only a prohibition against entering agreements that harm competition."); Buffalo Broad. Co. v. Am. Soc'y of Composers, Authors & Publishers, 744 F.2d 917, 933 (2d Cir. 1984); Am. Motor Inns v. Holiday Inns, Inc., 521 F.2d 1230, 1249 (3d Cir. 1975) (stating businesses

"below market" settlement would similarly be asked to determine which of a range of possible business agreements the patentee "should" have preferred over that agreement — something courts are ill-equipped to do, particularly in a field as complex as the pharmaceutical industry.[126]

To understand the danger of such second-guessing, imagine that in our original used car hypothetical, there is a dealer next door that is willing to sell a roughly equivalent used car for $24,000 rather than the $25,000 our dealer was offering, but that our buyer nonetheless purchases a car from our original dealer for $25,000. Is the buyer's purchase of the car thus irrational? The answer is far more complicated than might be imagined. First, the two cars are not identical — even if the same make, model, and year, and even if we imagine that they have the exact same mileage and are in the exact same condition — as one is priced higher than the other, which may lead buyers to assume that it is of higher quality.[127] Moreover, the dealers are different, presumably employing different salespeople of differing persuasiveness, have different service departments, etc. And how these differences impact the buyer will be very much a matter of personal preference. The buyer may thus view the higher-priced car as providing sufficient value to more than offset any difference in price, even if the two cars are virtually identical. Finally, we should not assume that the buyer has conducted exhaustive market research before deciding to buy a car; the buyer may simply not know that there is a cheaper option next door, and merely making a bad or ill-

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are not "guarantors that the imaginations of lawyers could not conjure up some method of achieving the business purpose in question which would result in a somewhat lesser restriction of trade").

126. *See, e.g.*, *Trinko*, 540 U.S. at 408; *Novell*, 731 F.3d at 1074–75 (explaining importance of prior profitable course of dealing to distinguish unlawful conduct); Covad, Commc'ns Co. v. Bell Atl. Corp., 398 F.3d 666, 673 (D.C. Cir. 2005) (noting the same); Concord v. Boston Edison Co., 915 F.2d 17, 25 (1st Cir. 1990) ("[H]ow is a judge or jury to determine a 'fair price?' Is it the price charged by other suppliers of the primary product? None exist. Is it the price that competition 'would have set' were the primary level not monopolized? How can the court determine this price without examining costs and demands, indeed without acting like a rate-setting regulatory agency, the rate-setting proceedings of which often last for several years? Further, how is the court to decide the proper size of the price 'gap?' Must it be large enough for all independent competing firms to make a 'living profit,' no matter how inefficient they may be? If not, how does one identify the 'inefficient' firms? And how should the court respond when costs or demands change over time, as they inevitably will? We do not say that these questions are unanswerable, but we have said enough to show why antitrust courts normally avoid direct price administration, relying on rules and remedies (such as structural remedies, *e.g.*, prohibiting certain vertical mergers) that are easier to administer.").

127. *See* Wendy Gerwick Couture, *Price Fraud*, 63 BAYLOR L. REV. 1, 47–50 (2011) (collecting authority that consumers tend to view higher-priced items as superior).

informed business decision is not typically an antitrust violation.[128]

Thus, even when dealing with something as simple as a used car, for which there is an identifiable market, the idea that the buyer "should" have purchased the cheaper option, and that not purchasing the cheaper option is thus somehow suspicious, may well be mistaken. And of course, this is a greatly simplified example; courts trying to decide which agreement a pharmaceutical company should have preferred — a much more complicated inquiry — face an even harder task, which courts are not typically equipped to decide, and which they should thus approach very cautiously at best. A court therefore cannot replace the "sacrifice" in *Brooke Group*, *Aspen Skiing*, and *Trinko* with a failure to profit maximize at "market value."

c. Aspen Skiing Involved a True Sacrifice, and Does Not Require Companies to Profit Maximize

Finally, *Aspen Skiing* is not to the contrary, and in fact illustrates the rule adopted in *Brooke Group* and *Trinko*. In *Aspen Skiing*, a case *Trinko* called "at or near the outer boundary of § 2 liability,"[129] the alleged monopolist forfeited actual and concrete profits by discontinuing an existing profitable deal with a rival, and the Supreme Court held that such a sacrifice could raise potential antitrust concerns.[130] But *Aspen Skiing* would surely have been decided differently if there had been a limited number of tickets that could be sold each day, and greater demand for the tickets than supply, such that by selling a ticket to its competitor the alleged monopolist would be denied a chance to sell that same ticket to its own customers — and, indeed, forced to instead direct its customers to its rival to purchase the tickets.[131] Given a choice between two mutually-exclusive sales, even a monopolist may choose to supply its own customers rather than a rival, and may presumably do so even if the competitor were to offer a higher price than the monopolist's customers, such that preferring its own customers might appear "irrational"

128. *See* FTC v. AbbVie, Inc., 107 F. Supp. 3d 428, 436 (E.D. Pa. 2015) (rejecting allegations by the FTC because "[t]his is not a situation where the FTC has alleged that [the patentee] agreed to sell [a product] to [the generic] for less than its cost," and refusing to "go forward on the basis of the existence of a reverse payment simply because the FTC believes [the patentee] signed a bad deal for itself and a good deal for [the generic]"); Crane & Shovel Sales Corp. v. Bucyrus-Erie Co., 854 F.2d 802, 809 (6th Cir. 1988) (stating "antitrust liability cannot be premised on improvident business decisions.").

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

130. *See id.* at 408–09.

131. *See id.* at 408–09, 415–16; *see also, e.g.*, RxUSA Wholesale, Inc. v. Alcon Labs., Inc., 661 F. Supp. 2d 218, 228 (E.D.N.Y. 2009), *aff'd*, 391 Fed. App'x 59 (2d Cir. 2010) (noting no obligation to enter into an agreement with plaintiff rather than other distributors).

(i.e., offer less immediate profit) on a market value basis.[132]

Actavis, therefore, does not require that a patentee and patent challenger agree to the best possible or "market" rate, as failure to do so simply does not suggest the irrationality of a true patentee sacrifice and thus cannot serve as a workable surrogate for patent weakness. *Actavis* used the term "fair value" rather than "market value" for a reason, and that reason is that failure to realize market value is not a workable surrogate for patent weakness or anticompetitive effect as the *Actavis* inference would require. Many patentees would prefer a profit and a settlement over no profit and no settlement, even when the profit is not the ideal gain that they might have enjoyed in a market value transaction, and there is nothing remotely irrational about such a choice. "Fair value" under *Actavis* therefore should not be rewritten to mean the legally distinct concept of "market value."

B. Courts Must Reject the FTC's "Basic Reason" Test, Which Confuses Intent to Settle with Intent to Delay and Would Bar Virtually All Contemporaneous Agreements

For the same reasons, and more, courts should also reject the "basic reason" test now advocated by the FTC, effectively as a substitute or replacement for the "fair value" test the Supreme Court offered.[133]

In *Actavis*, the Supreme Court noted that "[i]f the basic reason" for a reverse payment "is a desire to maintain and to share patent-generated monopoly profits, then, in the absence of some other justification, the antitrust laws are likely to forbid the arrangement."[134] The FTC has since interpreted this passage to mean that a contemporaneous deal to a patent settlement is not "fair value" unless its "basic reason" is to compensate for goods or services, rather than to "induce the generic challenger to abandon its claim" — in other words, unless the reason for the contemporaneous agreement has effectively nothing to do with the parties' decision to settle.[135]

But this "basic reason" test for determining fair value is flawed, perverse, and misunderstands the instructions of *Actavis*.

First, by merging the question of whether there was a reverse payment with the question of the parties' intent, the FTC forgets to look for the potentially-anticompetitive *conduct Actavis* requires. The antitrust laws do not condemn thought crimes, and the Supreme Court has long held that intent

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132. *See, e.g.*, Imperial Irrigation Dist. v. Cal. Indep. Sys. Operator Corp., 146 F. Supp. 3d 1217, 1235 (S.D. Cal. 2015) (stating there was no duty to supply a rival when monopolist wished to reserve supply to sell itself and did not have excess capacity).

133. *See, e.g.*, Impax Labs Complaint, *supra* note 106, at 33–34 (advocating this test).

134. FTC v. Actavis, Inc., 570 U.S. 136, 158 (2013).

135. *See, e.g.*, Impax Labs Complaint, *supra* note 106, at 33–34 (quoting *Actavis*, 570 U.S. at 154).

cannot transform proper conduct into improper conduct but rather only helps interpret the competitive effects of said conduct.[136]

The FTC's error here can be understood by once again considering *Trinko* and *Aspen Skiing*. *Trinko* noted that in *Aspen Skiing* the cancellation of a prior profitable course of dealing suggested that the monopolist had a "distinctly anticompetitive bent."[137] This conclusion helped the Court interpret potentially-ambiguous conduct such as the refusal to deal with a rival. The Court did not suggest, however, that a distinctly anticompetitive bent could be used to infer the cancellation of a prior profitable course of dealing. Intent must follow conduct, rather than conduct following intent.

Any proper inquiry under *Actavis* must therefore begin by asking whether there was a suspect reverse payment, i.e., the type of conduct that *Actavis* held could suggest the potential for anticompetitive effects.[138] This is why the "basic reason" language in *Actavis* appears near the end of the decision, as only after the Court establishes that there was allegedly a large, unexplained reverse payment does it *then* ask the question on which the FTC focuses: What was the basic reason for that payment, i.e., what was the intent of the conduct?[139] If an agreement was instead fair value — i.e., involved no reverse payment — there was no such conduct from which to infer any

136. *See supra* Part II.B; Bd. of Trade of Chi. v. United States, 246 U.S. 231, 238 (1918) (noting intent may be relevant "not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences"); Am. Needle, Inc. v. Nat'l Football League, 560 U.S. 183, 203 n.10 (2010) (stating the same); Joshua P. Davis & Ryan J. McEwan, *Deactivating* Actavis: *The Clash Between the Supreme Court and (Some) Lower Courts*, 67 RUTGERS U.L. REV. 557, 580–81 n.132 (2015) (minimizing intent's role in the *Actavis* analysis); Michael A. Carrier, *How Not to Apply* Actavis, 109 NW. U.L. REV. COLLOQUY 113, 122 (2015) ("*Actavis* did not add an intent requirement into rule-of-reason analysis."). A well-functioning market can be full of malicious, mean-spirited, aggressive competition — and intent to harm rivals is not anticompetitive. *See* Aerotec Int'l, Inc. v. Honeywell Int'l, Inc., 836 F.3d 1171, 1184 (9th Cir. 2016) (quoting Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 225 (1993)) ("Competitors are not required to engage in a lovefest; indeed, '[e]ven an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws.'"); Novell, Inc. v. Microsoft Corp., 731 F.3d 1064, 1078 (10th Cir. 2013) (explaining if "intent to harm a competitor alone [was] the marker of antitrust liability, the law would risk retarding consumer welfare by deterring vigorous competition"); Olympia Equip. Leasing v. W. Union Tel. Co., 797 F.2d 370, 379 (7th Cir. 1986) ("[I]f conduct is not objectively anticompetitive the fact that it was motivated by hostility to competitors . . . is irrelevant.").

137. Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 409 (2004).

138. *See Actavis*, 570 U.S. at 156 (discussing fair value).

139. *See id.* at 158 (emphasis added) ("Although the parties may have reasons to prefer settlements that *include reverse payments*, the relevant antitrust question is: What are those reasons?").

potentially-anticompetitive intent. By starting with intent rather than conduct, the FTC effectively condemns all settlements where it deduces some anticompetitive "intent" in the agreement — an absurd and improper result.

Second, the FTC's proposed "basic reason" test would effectively outlaw all settlements involving contemporaneous agreements, and would do so for the purported crime of making it possible for the parties to settle. Under the FTC's test, even fair value agreements containing no patentee sacrifice could be condemned if the parties' "intent" was to "induce the generic challenger to abandon its claim."[140] "Induce the generic to abandon its claim" is just another way of saying "offer sufficiently attractive terms to allow the parties to reach a settlement." All settlements do so; inducing the other side to stop litigating is the *point* of settlement!

Actavis did not seek to outlaw all such settlements; on the contrary, the Supreme Court went to great lengths to explain that inducing settlements will often be appropriate, including agreements that incorporate "fair value" deals.[141] Instead, the passage of *Actavis* on which the FTC relies makes clear that it is not "inducing settlement" that is a problem, but rather inducing settlement *using a reverse payment* — i.e., if a patentee "seeks to induce the generic challenger to abandon its claim *with a share of its monopoly profits that would otherwise be lost in the competitive market*."[142] The FTC, therefore, cannot use the first clause in this sentence in *Actavis* to condemn all patent settlements with contemporaneous agreements on the basis that they "induce" settlement — it must look to the *whole* sentence.[143]

Fair value under *Actavis* thus cannot mean that the patentee's "basic reason" for the agreement must have been entirely independent of any desire to "induce" the patent challenger to abandon its claims — i.e., to settle. Rather than a test for "fair value," the "basic reason" language in *Actavis* serves the same role as the "anticompetitive bent" in *Trinko*, and thus comes into play only after suspect conduct has been shown.[144]

C. Fair Value in Absolute Terms Is Instead the Right Standard under Actavis, Brooke Group, and Trinko

Instead, the Supreme Court adopted a "fair value" standard. Under the normal legal definition, an agreement is fair value if the particular

140. *See, e.g.*, Impax Labs Complaint, *supra* note 106, at 33–34.

141. *See Actavis*, 570 U.S. at 155–58 (explaining the various types of settlements that would ultimately not raise concerns under the antitrust laws).

142. *Id.* at 154 (emphasis added).

143. *See id.* at 158–59 (rejecting such an approach).

144. *See supra* Part II.B (explaining how intent in *Trinko* explained the conduct).

individuals involved in a transaction obtained something economically reasonable under their circumstances and in light of the constraints they faced.[145] Thus, for example, courts in the securities context have made clear that "fair value" is the amount necessary to compensate a shareholder, regardless of whether it is the same amount that their shares might trade for on an open market.[146] This definition is consistent with the requirement of a sacrifice in *Actavis*. A party that receives something economically reasonable under the circumstances, after all, has not taken the irrational step needed to serve as a workable surrogate for potential patent weakness; it has not made a sacrifice that it will need to recoup through exercise of a monopoly. Instead, it has simply received fair value.

The conclusion that courts should consider fair value using its ordinary definition is also consistent with the approach courts take when they are themselves asked to approve settlements. Rather than demanding that any settlement be "market value," when courts are asked to approve a settlement they ask simply whether it is better than the alternative of litigation.[147] If so,

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145. *See supra* notes 108–11.

146. *See, e.g.*, Cox Enters. v. News-Journal Corp., 510 F.3d 1350, 1357 (11th Cir. 2007) ("This is not to say that 'fair value' is synonymous with 'fair market value.' Most courts have rejected the notion of such synonymity."); Swope v. Siegel-Robert, Inc., 243 F.3d 486, 492–93 (8th Cir. 2001) (citing and quoting Harry J. Haynsworth, *Valuation of Business Interests*, 33 MERCER L. REV. 457, 459 (1982)) (rejecting the idea that "fair value" is "equivalent to 'fair market value'" because fair *market* value attempts to reflect "the context of a hypothetical sale between a willing seller and buyer, a situation that does not exist in the dissenting shareholder situation"); Joseph W. Anthony & Karlyn Vegoe Boraas, *Betrayed, Belittled . . . But Triumphant*: *Claims of Shareholders in Closely Held Corporations*, 22 WM. MITCHELL L. REV. 1173, 1186 (1996) (emphasis added) ("'Fair value' is not the same as, or short-hand for, 'fair *market* value.' 'Fair value' carries with it the statutory purpose that shareholders be fairly compensated, which may or may not equate with the market's judgment about the stock's value."); *see also* New Haven Inclusion Cases, 399 U.S. 392, 487–88 (1970) (assessing the value of stock based on inherent value rather than merely the market value); Merion Cap. L.P. v. Lender Processing Servs., C.A. No. 9320-VCL, 2016 Del. Ch. LEXIS 189, at *37 (Del. Ch. Dec. 16, 2016) (quoting Finkelstein v. Liberty Dig., Inc., No. 19598, 2005 Del. Ch. LEXIS 53, at *12 (Del. Ch. Apr. 25, 2005)) ("The concept of fair value under Delaware law is not equivalent to the economic concept of fair market value.").

147. *See, e.g.*, Air Line Pilots Ass'n Int'l v. O'Neill, 499 U.S. 65, 81 (1991) ("In labor disputes, as in other kinds of litigation, even a bad settlement may be more advantageous in the long run than a good lawsuit."); Hensley v. Eckerhart, 461 U.S. 424, 443 n.2 (1983) (Brennan, J., dissenting) (arguing litigants must conduct "calculations as to whether litigation — including the attorney's fees it entails — represents a better investment than compromise and settlement or simply acceding to the opposing party's demands"); Ahearn v. Fibreboard Corp., 162 F.R.D. 505, 520 (E.D. Tex. 1995) (acknowledging settlement was "better than any alternative"); Guzman v. Consumer Law Grp., P.A., No. 1:11-cv-00187-JRH, 2016 U.S. Dist. LEXIS 62410, at *6–7 (S.D. Ga. May 11, 2016) ("A settlement is fair, reasonable and adequate when the interests of the class as a whole

then it is reasonable and fair value because the settling parties acted rationally in taking the settlement instead of continuing to litigate. And, as illustrated above, a transaction need not be perfectly equal between the parties or provide market value in order to be "win-win."[148]

Just like in *Brooke Group*, *Aspen Skiing*, and *Trinko*, in *Actavis* the Court was looking not for mere failure to profit maximize, but rather for a true sacrifice similar to pricing below cost or terminating a prior profitable course of dealing. Thus, a fair value contemporaneous agreement under *Actavis* is any agreement in which the patentee makes no sacrifice in absolute terms, i.e., a break-even or better arrangement. This is the only reading of fair value that remains consistent with *Actavis*, and that can be consistent with the decades of antitrust jurisprudence on which *Actavis* depends.

V. ONLY A PATENTEE SACRIFICE CAN SUGGEST MARKET POWER

The next question is why *Actavis* held that "where a reverse payment threatens to work unjustified anticompetitive harm, the patentee likely possesses the [market] power to bring that harm about in practice."[149]

A. Unlike a Benefit to the Patent Challenger, a Sacrifice By the Patentee May Suggest Patentee Market Power

If a reverse payment were viewed primarily or solely from the perspective of the patent challenger, the Supreme Court's inference of market power from a large, unexplained reverse payment would be a non sequitur; as the *patent challenger's* receipt of value is a poor indicator of whether the

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are better served if the litigation is resolved by the settlement rather than pursued."); MANUAL FOR COMPLEX LITIGATION (THIRD) § 30.42 (1995) ("In determining whether a settlement should be approved, the court must decide whether it is fair, reasonable, and adequate under the circumstances and whether the interest of the class as a whole are better served if the litigation is resolved by the settlement rather than pursued."); *In re* Checking Acct. Overdraft Litig., 830 F. Supp. 2d 1330, 1345 (S.D. Fla. 2011) (quoting *In re* Mexico Money Transfer Litig., 164 F. Supp. 2d 1002, 1014 (N.D. Ill. 2000)) ("The Court is 'not called upon to determine whether the settlement reached by the parties is the best possible deal, nor whether class members will receive as much from a settlement as they might have recovered from victory at trial.'").

148. *Cf.* Pac. Bell Tel. Co. v. LinkLine Commc'ns, Inc., 555 U.S. 438, 454 (2009) (noting impossibility of court determining "fair" or "proper" profit from an agreement). The district court in *Cephalon* thus improperly relied on the suggestion that it mattered whether the patent challenger received "a much larger percentage of the projected value" than the brand. King Drug Co. of Florence v. Cephalon, Inc., 88 F. Supp. 3d 402, 416 (E.D. Pa. 2015). The correct analysis is not whether the parties received equal value — a perfect 50/50 split — but rather whether the patentee made a large sacrifice relative to the alternative of not entering the agreement. *See supra* Part III.B.ii.c (explaining how a "win-win" agreement could be mistaken for a "win-lose" agreement by comparing the two parties' "wins").

149. *See* FTC v. Actavis, Inc., 570 U.S. 136, 157 (2013).

patentee has market power. There are likely very few people or companies in this world whose response to an offered benefit would be to inquire as to whether the offeror has market power. Why should they care?

Instead, a large, unexplained reverse payment suggests market power because a patentee "without [market] power is [un]likely to pay 'large sums' to induce 'others to stay out of its market,'"[150] and thus that a patentee is willing to make a large, unexplained sacrifice may in some cases suggest that it also has the market power to recoup that sacrifice.[151] Once again, it is the patentee sacrifice and recoupment that matters, as it is only this that makes sense of the inference *Actavis* draws.

B. Inferences Are Not Enough; Market Power Must Ultimately Be Proven By the Plaintiff

This also makes clear, however, that any assumption of market power under *Actavis* is at most a rebuttable presumption (and perhaps not even that), as, under *Brooke Group*, recoupment cannot simply be assumed based on the monopolist's sacrifice but rather must be proven.[152] *Actavis* assumes that it would be irrational for a patentee without market power to make a large, unexplained reverse payment and thus infers that such a payment might suggest market power.[153] And on the motion to dismiss posture in *Actavis*, this inference may be enough to survive dismissal. But not only do companies sometimes do irrational things, a company might make such a payment on the mistaken belief that it has market power when in fact, it does not, among many other potential explanations for the alleged payment. Thus, while a patentee sacrifice may *suggest* market power, that suggestion is not an irrebuttable presumption.

Rather, as in *Brooke Group*, the plaintiff ultimately bears the burden of showing that the patentee's alleged sacrifice could actually have been recouped by anticompetitive effects. This ultimately requires showing that the patentee would have the market power to exclude competition and thus recoup its sacrifice. While the *Actavis* inference may be enough to survive

150. *See id.*

151. *See, e.g.*, Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993); Stearns Airport Equip. Co. v. FMC Corp., 170 F.3d 518, 528 (5th Cir. 1999).

152. *See Brooke Grp.*, 509 U.S. at 225–26; *see also* Novell, Inc. v. Microsoft Corp., 731 F.3d 1064, 1075 (10th Cir. 2013) ("To avoid penalizing normal competitive conduct, then, we require proof not just that the monopolist decided to forsake short-term profits. Just as in predatory pricing cases, we *also* require a showing that the monopolist's refusal to deal was part of a larger anticompetitive enterprise.").

153. *Actavis*, 570 U.S. at 157.

a motion to dismiss, proving anticompetitive effect is required for a plaintiff to recover damages under *Actavis*.

VI. PAYING SAVED LITIGATION COSTS IS NOT SUSPECT UNDER *ACTAVIS* BECAUSE DOING SO INVOLVES NO ACTUAL SACRIFICE

The next question answered by the sacrifice-based framework is why a patentee may pay a patent challenger the patentee's saved litigation costs when doing so may create a substantial benefit for the challenger — something a "benefit"-focused approach would consider problematic. By this point, the answer is perhaps not surprising: there is no patentee sacrifice.

A. The Patentee Paying the Challenger Its Saved Litigation Costs Provides a Potentially Significant Benefit to the Patent Challenger, but Is Not a Reverse Payment

In *Actavis*, the Court held that a payment representing nothing more than the patentee's saved litigation costs would not raise antitrust concerns, as it would not "bring[] about anticompetitive effects."[154]

However, these saved litigation costs can be significant; even the "direct costs" of lawyers and experts may be in the neighborhood of $10 million per suit,[155] and there may be more than one suit. And by settling, the patent challenger likewise avoids costs that it would have incurred on its own side, as the challenger would likewise have needed to pay lawyers and other costs. Thus, when a patentee pays the challenger the patentee's saved litigation costs the challenger may obtain a $20 million or greater benefit in direct costs alone ($10 million from the patentee and $10 million saved in its own direct costs). Moreover, such a payment may take the form *Actavis* considered suspect: a payment of money.[156] Why isn't that a problem?

This is not even the full tally of litigation savings, in fact, as by settling, both the patentee and patent challenger may save many times this amount in "hidden" or "indirect" litigation costs — all other forms of waste from the litigation process, such as added costs in obtaining financing, impact on stock price, management time spent on litigation, uncertainty regarding the expected lifespans of key patents, etc.[157] — and the patentee could

154. *Id.* at 156, 159.

155. *See id.* at 170 (Roberts, J. dissenting).

156. *See id.* at 152 (calling the payment of money by the patentee to the patent challenger "quite different" from traditional forms of settlement).

157. *See, e.g.*, Ironworkers Dist. Council v. Andreotti, No. C.A.-9714-VCG, 2015 Del. Ch. LEXIS 135, at *23 (Del. Ch. Ct. May 8, 2015) (highlighting that corporations could rightly consider the time, expense, and business impact of litigation, including the "significant distraction and impairment of morale for directors, officers, and employees

presumably pass along some or all of these "indirect" saved costs to the patent challenger in exchange for a settlement.

For example, imagine that a company facing a patent challenge to its biggest product is simultaneously working on another product in the same category. Should it devote more effort to promoting its current product or to bringing the new product to market?[158] The answer presumably depends on the resolution of the patent case, and while that case remains pending the company, thus, cannot efficiently allocate its resources. This uncertainty is a "cost" that flows from the fact that the litigation remains ongoing, not from the risk of an adverse outcome, and is thus a "litigation cost."[159]

These indirect costs can be significant; even just the cost of devoting executive time to litigation, which is only one component of the indirect costs discussed above, has been estimated at anywhere from fifty-three percent to seventy-nine percent of the fees paid to an attorney on a case.[160]

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of the Company"); America's Test Kitchen, Inc. v. Kimball, No. 1684 CV 03325-BLS2, 2018 Mass. Super. LEXIS 45, at *7–8 (Mass. Super. Ct. Apr. 2, 2018) (analyzing work product protection regarding the business impact of public litigation); Michaela Keet et al., *Indirect and Invisible Organizational Costs: Making Informed Decisions about Litigation and Settlement*, 50 CARDOZO J. OF CONFLICT RESOL., 49, 51 (2018) ("[A] cost-benefit analysis of whether to litigate or settle must account for indirect organizational costs as well as direct legal expenses"); *see also* Gant, *supra* note 49, at 146. *See generally* Craig A. McEwen, *Managing Corporate Disputing: Overcoming Barriers to the Effective Use of Mediation for Reducing the Cost and Time of Litigation*, 14 OHIO ST. J. ON DISP. RESOL. 1 (1998) (exploring indirect costs).

158. *See, e.g.*, Lighting Ballast Control LLC v. Philips Elecs. N. Am. Corp., 744 F.3d 1272, 1283 (Fed. Cir. 2014), *rev'd on other grounds*, 790 F.3d 1329 (procedures in patent litigation "can affect the cost, time, and uncertainty of litigation, and in turn affect economic activity founded on the presence or absence of enforceable patents"); *In re* Exennium, Inc., 715 F.2d 1401, 1403 (9th Cir. 1983) (noting the cost of uncertainty regarding title).

159. *See Actavis*, 570 U.S. at 156, 159.

160. Keet et al., *supra* note 157, at 72 (citing Robert H. Lande, *Are Antitrust "Treble" Damages Really Single Damages?*, 54 OHIO ST. L.J., 115, 143 (1993)). One study concluded that a very large litigation between Texaco and Pennzoil reduced the overall value of the two companies by $1–2 billion, due in large part to indirect litigation costs. David M. Cutler & Lawrence H. Summers, *The Costs of Conflict Resolution and Financial Distress: Evidence From the Texaco-Pennzoil Litigation* 1–2, 13, 16 (Nat'l Bureau of Econ. Rsch., Working Paper No. 2418, 1987) (explaining the inefficiencies and waste of resources litigation may cause: "Clearly one explanation [for the loss in value] is the fees that both companies will pay to the many lawyers, investment bankers, and advisors that have been retained. Even making generous allowance for these costs, however, we are unable to account for a large fraction of the loss in combined value. It appears that there have been additional costs to Texaco's shareholders from disruptions in Texaco's operations, difficulties in obtaining credit, incentive problems created by fears that Texaco would cease operations, and distraction of top management."). Another study discussed a case in which a defendant paid a plaintiff twenty-five times its demand solely to avoid the costs of litigation. *See* Keet et al., *supra* note 157, at 53–

Paying an amount equivalent to these indirect litigation costs to the patent challenger could provide that challenger with a substantial benefit, on top of (again) the benefit the challenger receives from obtaining certainty on its own end. So why would paying saved litigation costs not raise the same suspicions identified in *Actavis*?

B. That Saved Litigation Costs Are Not a Reverse Payment Cannot Be Explained on the Basis That They Are De Minimis or Based Only on Their Procompetitive Benefits

First, start with the unsatisfying answers. Perhaps we may think a $20 million or more benefit to the patent challenger is simply de minimis in a patent settlement, such that, although it has some anticompetitive effect courts should simply ignore that effect. And in many cases, it may well be true that saved litigation costs are too small to have a meaningful impact on the agreement, as $20 million (for example) is not particularly large relative to the overall market value of some patented products, particularly in the pharmaceutical marketplace.

But in some cases, the saved litigation costs can be far higher, particularly when the parties have lawsuits in dozens or hundreds of jurisdictions around the world, all of which will require separate litigation. And while some pharmaceuticals are blockbusters with billions in sales, not all are — and even if they were, *Actavis* is not limited to pharmaceuticals even if most *Actavis* cases arise in that context. Thus, if *Actavis* held that saved litigation costs are always de minimis, that rule may seem arbitrary. When viewed from the perspective of the patent challenger, there is no obvious reason why saved litigation costs would be expected to always be sufficiently de minimis in a patent settlement as to serve as a "safe harbor."

Alternatively, perhaps we simply think that avoiding litigation costs is procompetitive, which it surely is; in the indirect costs example above, the ability to efficiently allocate resources and avoid waste was certainly a procompetitive outcome.[161] But *Actavis* did not merely hold that *avoiding* litigation costs would be procompetitive, it also held that the patentee *paying* those avoided litigation costs to the patent challenger does not "bring[] about anticompetitive effects" notwithstanding that such a payment might provide

54 (citing SIMON VANDE WALLE, PRIVATE ANTITRUST LITIGATION IN THE EUROPEAN UNION AND JAPAN: A COMPARATIVE PERSPECTIVE 268 (2013)).

161. *See Actavis*, 570 U.S. at 153 (noting the "general legal policy favoring the settlement of disputes"); *In re* 1-800 Contacts, Inc., No. 9372, 2018 FTC LEXIS 184, at *67–68 (F.T.C. Nov. 7, 2018) ("Settling lawsuits is generally economically efficient."); Paladin Assocs. v. Mont. Power Co., 328 F.3d 1145, 1157 (9th Cir. 2003) (avoiding waste is procompetitive).

the challenger with significant benefits.[162] The procompetitive benefits of avoiding litigation costs therefore cannot explain why a patentee can transfer its saved litigation costs to its opponent in settling.

C. Paying Saved Litigation Costs Is Not a Reverse Payment Because It Involves No Patentee Sacrifice; Only the Lawyers Lose Out in Such a Settlement

Instead, again the answer comes from sacrifice and recoupment. Simply put, where a patentee pays the patent challenger what it would otherwise waste through litigation, it makes no sacrifice. A patentee who would have paid its lawyers $10 million, and instead pays its adversary $10 million, has lost nothing; only its lawyers lose out. And that the patent challenger saves $10 million is likewise no sacrifice by the patentee; the patentee has no vested interest in enriching the patent challenger's lawyers. Likewise, a patentee that pays an opponent an amount less than the patentee stands to incur in indirect litigation costs is no worse off; it has avoided waste that would have cost it far more than it paid, and thus come out ahead. Because payment of saved litigation costs does not therefore represent a sacrifice, it cannot serve as a workable surrogate for patent weakness and is not a suspect reverse payment.[163] This is, in short, the classic "win-neutral" agreement, where the patentee is able to create value for the patent challenger in order to settle, but without incurring any costs of its own.

D. A Large Payment Therefore Must Remain Large After Subtracting Saved Litigation Costs

Recognizing that saved litigation costs are not a sacrifice and thus not a payment also fatally undermines the argument that a "large" payment under *Actavis* is any payment that exceeds saved litigation costs, even by a single dollar, like some absurd version of *The Price Is Right*.[164] If a patent

162. *Actavis*, 570 U.S. at 156, 159.

163. *See In re* Impax Labs, Inc., No. 9373, 2019 FTC LEXIS 25, at *56 n.19 (F.T.C. Mar. 28, 2019) ("*Actavis* indicates it is appropriate to compare the size of the payment to the *payor's* expected saved litigation costs, not the combined savings . . . . This makes sense because it is the excess of Endo's payment over its other savings or justified benefits that should be understood as directed toward buying market exclusivity.") (internal citations omitted).

164. *See, e.g.*, *In re* Opana ER Antitrust Litig., 162 F. Supp. 3d 704, 718 (N.D. Ill. 2016) ("A 'large' payment is anything more than the value of the avoided litigation costs plus any other services provided from the generic to the brand manufacturer."). Although *Opana* cited *In re Lipitor Antitrust Litigation*, it did so in error, as *Lipitor* holds exactly the opposite. *See In re* Lipitor Antitrust Litig., 46 F. Supp. 3d 523, 543 (D.N.J. 2014) (asking "whether [the payment] is 'large' once the subtraction of legal fees and other services provided by generics occurs").

challenger is willing to settle for an amount equal to saved litigation costs, in a settlement which otherwise matches the patentee's expectations for the outcome of the litigation and is thus a good result, but will do so only so long as the patentee lets them keep the pen used to sign the agreement . . . absent some great sentimental attachment, the patentee should give them the pen. Yet for those who define "large" in *Actavis* as "any amount that exceeds saved litigation costs," that humble Bic® would transform a lawful settlement into a large reverse payment, on the theory that no one would enter such a deal absent anticompetitive intent.[165] The idea that the patentee's willingness to sacrifice a 98-cent Bic® pen could, by barely pushing the payment outside of saved litigation costs, serve as a workable surrogate for a patent's weakness is absurd; it cannot do anything of the sort.

Instead, as discussed above, *Actavis* notes that a number of factors go into whether a large payment is substantial enough to provide meaningful information regarding (a) the strength or weakness of the underlying patent case and (b) market power.[166] Because paying saved litigation costs to your opponent is not a "reverse payment" — large or otherwise — the first dollar that exceeds saved litigation costs cannot suffice to tell us anything meaningful about the patent or the market. Instead, a "large" payment under *Actavis* must be one that *remains large* "once the subtraction of legal fees and other services provided by generics occurs," as it is only this portion that can ever fairly be called a patentee sacrifice.[167]

165. It is not clear whether courts adopting the *The Price Is Right* rule would then treat the 98-cent value of the pen as an anticompetitive harm by itself, and ask exactly how many milliseconds of delay 98 cents can purchase, or whether they would seek to bring the entire payment of saved litigation costs outside of the "safe harbor" on that basis. If it is the latter, then a payment of $10,000,000 representing saved litigation costs would be a reverse payment of $0, whereas a payment of $10,000,000.98 would see the entire amount treated as suspect. Any such rule would be difficult to defend, to say the very least.

166. *Actavis*, 570 U.S. at 159 (characterizing *Actavis* factors as "size, its scale in relation to the payor's anticipated future litigation costs, its independence from other services for which it might represent payment, and the lack of any other convincing justification"); Barba v. Shire US, No. 13-21158-CIV, 2016 U.S. Dist. LEXIS 182548, at *9–10, 15 (S.D. Fl. Jan. 19, 2016) (rejecting the notion that a reverse payment was large if it exceeded saved litigation costs, and considering other factors: "Ultimately . . . there is no actual definition of 'large' in *Actavis*. Instead, there is a series of factors to consider . . . ."); s*ee also supra* Parts III.B, VI.

167. *In re Lipitor*, 46 F. Supp. 3d at 543; *see also In re* Aggrenox Antitrust Litig., 94 F. Supp. 3d 224, 243 (D. Conn. 2015) ("Even if the payments exceed avoided litigation costs, the *Actavis* factors — the size of the payments, their scale in relation to litigation costs, their independence from other services for which they might be fair consideration, and any other convincing justification — still matter."); Gant, *supra* note 49, at 144–46 (explaining the role of "largeness" in the *Actavis* analysis).

VII. "TRADITIONAL" COMPROMISES ARE NOT SUSPECT UNDER ACTAVIS BECAUSE THEIR FORM PREVENTS A COURT FROM INFERRING ANTICOMPETITIVE INTENT OR HARM

We now turn to the final mystery of *Actavis*, which is again explained by *Brooke Group*, *Aspen Skiing*, and *Trinko*. *Actavis* holds that "traditional" forms of settlement, such as a compromise of damages, should not be considered reverse payments notwithstanding that they may involve the patentee giving up something of value that benefits the patent challenger.[168] For example, if a patentee accepts $40 million for a damages claim it has against the patent challenger rather than the full $100 million it is claiming, this could be seen as a "payment" of $60 million to the challenger, but under *Actavis* would not be an antitrust concern.[169]

But why not?[170] The answer appears to be that *Actavis* sought, as a matter of policy, to limit the reach of antitrust scrutiny to protect settlement.[171] To do so, *Actavis* requires courts to identify forms of agreement that are commonplace and traditional as a screen before applying antitrust scrutiny.[172] Put differently, *Actavis*'s exclusion of "traditional" and "commonplace" settlements from antitrust scrutiny is a guardrail designed to keep antitrust law from undermining procompetitive patent settlements and thus to keep antitrust law from improperly deterring competition.[173]

Trinko involved a similar guardrail. In theory many refusals to deal with rivals could be the basis for an antitrust claim under a sufficiently overbroad reading of Sherman Act Section 2. However, the Court in *Trinko* worried that overly restricting the right of a company to choose its business partners could not only impair the ability to structure businesses in competitive ways,

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168. *Actavis*, 570 U.S. at 147, 156.

169. *Id.* at 151–52; *see also In re* Ciprofloxacin Hydrochloride Antitrust Litig., 261 F. Supp. 2d 188, 252 (E.D.N.Y. 2003) (raising the issue of whether this should be considered a reverse payment). *See generally* Mark Schildkraut, *Patent-Splitting Settlements and the Reverse Payment Fallacy*, 71 ANTITRUST L. J. 1033 (2003) (arguing that often in patent settlements there is consideration; therefore, reverse payments may not in fact always be anticompetitive).

170. *See, e.g.*, Stephen Yelderman, *Do Patent Challenges Increase Competition?*, 83 U. CHI. L. REV. 1943, 2022–23 (2016) ("[P]reserving the ability to settle patent cases in the traditional way seems rather arbitrary . . . .").

171. *Actavis* recognized the importance of settlement. *Actavis*, 570 U.S. at 146, 154 (acknowledging the "public policy favoring settlement of disputes" and "recogiz[ing] the value of settlements"); *see also supra* note 1 (collecting authority on settlement).

172. *See Actavis*, 570 U.S. at 154.

173. The Federal Circuit continues to apply *Noerr Pennington* immunity to attempted patent settlements — at least outside of the Hatch-Waxman Act context — in light of the difference between "routine[,] unsuccessful offers to settle" and the reverse payments in *Actavis*. *See* Indus. Models, Inc. v. SNF, Inc., 716 F. App'x 949, 957 (Fed. Cir. 2017).

but indeed actively promote collusion.[174] *Trinko* thus limited antitrust scrutiny to those "refusal to deal" cases that involved a prior profitable course of dealing and/or a refusal to sell a competitor a product otherwise available at retail.[175] Similarly, although some have suggested that even above-cost pricing may be "predatory," *Brooke Group* and similar cases hold that only *below-cost* pricing is potentially actionable, since "mistaken inferences in [predatory pricing] cases . . . are especially costly, because they chill the very conduct the antitrust laws are designed to protect."[176] The Court, in these cases, thus limited antitrust scrutiny to "forms" of conduct that could be more readily identified, rather than asking courts to second-guess all possibly-suspect conduct.[177]

Like *Trinko* and *Brooke Group*, *Actavis* involves a normally procompetitive activity that in the vast majority of cases will tend only to benefit competition: Settlement.[178] As discussed at the outset of this article, settlement is typically beneficial not only to the parties but also the courts and the general public, as it avoids litigation costs and judicial waste, and in the patent context may permit earlier entry of competition. Courts should not seek to discourage such procompetitive settlement conduct any more than they would discourage low pricing in *Brooke Group* or independent business decisions in *Trinko*. But, as in *Aspen Skiing*, there could be circumstances where this normally-beneficial activity could theoretically be problematic, and there must be some way to find these exceptions without throwing the procompetitive baby out with the antitrust bathwater.[179]

The Supreme Court in *Actavis* thus held that the presence of a large, unexplained reverse payment raises the possibility of antitrust scrutiny.[180] However, there will likely be many traditional forms of compromise that may appear to contain a "payment" but that actually reflect procompetitive compromise, such as the example the Supreme Court gave of compromising

174. Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 410, 415–16 (2004); *see also* United States v. Colgate & Co., 250 U.S. 300, 307 (1919) ("[T]he [Sherman] [A]ct does not restrict the long recognized right of a trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal . . . .").

175. *See Trinko*, 540 U.S. at 409–10; *see also supra* note 37.

176. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986); *see also supra* note 34.

177. *See supra* note 32.

178. *See* FTC v. Actavis, 570 U.S. 136, 148, 154 (2013).

179. *See Trinko*, 540 U.S. at 409–10 (discussing *Aspen Skiing*); *see also* Novell, Inc. v. Microsoft Corp., 731 F.3d 1064, 1073 (10th Cir. 2013) (explaining how antitrust law establishes rules to address such conduct).

180. *See Actavis*, 570 U.S. at 159.

a damages claim for less than the claimed amount.[181] *Actavis*, like *Brooke Group* and *Trinko*, thus adopted a guardrail that would not extend antitrust scrutiny to the broad range of "traditional," "commonplace," and "familiar" agreements that such scrutiny might otherwise inadvertently deter.[182] However, it still allowed scrutiny for a limited set of "unusual" settlements the Court thought might raise concerns.[183] Courts should therefore look to whether the agreements before them are of a type and form that has traditionally been used to reach compromise between litigants before declaring them to be "reverse payments" under *Actavis*, and should not extend *Actavis* to the types of agreements that are traditional and commonplace ways to reach a settlement.[184]

Finally, it is no answer to suggest that the antitrust laws would never consider the form of the agreement in determining the potential for anticompetitive effect; on the contrary, they have long done so. While the antitrust laws often favor substance over form,[185] in *Trinko* the Court looked to the form of the refusal to deal (i.e., whether there was a prior profitable course of dealing between the parties) to provide critical guidance regarding the potential reach of the antitrust laws,[186] and in *Brooke Group* the Court focused on the form of the pricing (i.e., above or below cost) to do the same.[187] *Actavis* likewise makes clear that the structure of the transaction is a critical guidepost, as "settlements taking these commonplace *forms* have not been thought for that reason alone subject to antitrust liability."[188] Indeed, *Actavis* contrasts such "forms" against the unusual "forms" of settlement that might raise antitrust issues.[189] In other words, far from

181. *See id.* at 151–52.

182. *See id.* at 158.

183. *See id.* at 152. Indeed, the FTC recognized this in *Actavis*, arguing that *Actavis* should not apply to "a wide range of ordinary settlement practices." *See* Reply Brief for Petitioner at 10, FTC v. Actavis, Inc., 570 U.S. 136 (2013) (No. 12-416), 2013 WL 1099171.

184. *See* Gant, *supra* note 49, at 147–60.

185. *In re* 1-800 Contacts, Inc., No. 9372, 2018 FTC LEXIS 184, at *37–38 (F.T.C. Nov. 7, 2018) (citing Am. Needle, Inc. v. NFL, 560 U.S. 183, 191 (2010); Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752, 760 (1984)) (stating antitrust laws "aim[] at substance rather than form").

186. *See* Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 409–10 (2004).

187. *See* Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993).

188. *Actavis*, 570 U.S. at 152 (emphasis added); *see also id.* (acknowledging "familiar settlement forms").

189. *Id.* at 147–48 ("That form of settlement is unusual . . . . [T]here is reason for concern that settlements taking this form tend to have significant adverse effects on competition.").

ignoring form, the sacrifice and recoupment framework uses form as a screen to avoid over-enforcement of the antitrust laws, and has done so for decades.

Actavis therefore follows *Trinko* and *Brooke Group* in limiting the reach of antitrust laws to traditional forms of conduct unlikely to raise antitrust concerns, and courts that refuse to appreciate or apply these limitations will apply *Actavis* in ways the Supreme Court did not intend.

VIII. CONCLUSION

Courts have long struggled to determine when *Actavis* would require applying antitrust scrutiny to patent settlements and when it would not. But while *Actavis* is far from a picture of clarity, it can be properly applied — and its key mysteries all solved — simply by understanding that the case operates through the same sacrifice and recoupment framework used in *Brooke Group*, *Aspen Skiing*, and *Trinko*. Viewed through this lens, *Actavis* — while still an objectionable decision that the Supreme Court should revisit — can at least be applied in a way that makes sense and comports with longstanding antitrust principles.

SHIFTING CONTOUR OF DATA SHARING IN FINANCIAL MARKET AND REGULATORY RESPONSES: THE UK AND AUSTRALIAN MODELS

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I. INTRODUCTION

Starting from Directive 2015/2366 on Payment Services in the Internal Market[1] — known as PSD II in the European Union (EU) — countries across the world have or are contemplating a new framework to govern data sharing among different players in the financial market. "Open Banking," as this trend is called, requires or encourages — depending on the regulatory models adopted in different jurisdictions — banks to share consumer-permissioned banking data with third parties securely, in a form that facilitates its use.[2] The Open Banking initiatives have diffused from the EU, and the UK, to elsewhere. The current Open Banking trend raises analytical questions: is data sharing novel in the banking sector? Before introducing Open Banking, did banks share their data with third parties, and if so, how? On the other hand, however, if data sharing did exist in the pre-Open Banking world, why would governments ever bother to introduce the Open Banking initiatives at all? What are the rationales or concerns justifying such regulatory intervention? What do these regulatory responses look like, and how effective are they in reacting to these concerns?

This Article seeks to contribute to the existing literature by addressing these questions through a comparative lens. For our present purpose, we focus on Open Banking initiatives in the UK and Australia. The former is widely seen as a pioneer in Open Banking by rolling out its regime in 2018,[3] while Australia is the first to launch a comprehensive data-sharing regime across the whole economy.[4] Both could serve as a template for other jurisdictions to articulate their regimes. Analyzing key aspects of the regulatory designs of these two models not only underscores the major differences and the rationales underpinning them but also helps inform other countries to configure or reflect upon their regulatory schemes when

1. Directive (EU) 2015/2366, of the European Parliament and of the Council of 25 November 2015 on Payment Services in the Internal Market, 2015 O.J. (L 337) 35 [hereinafter PSD II].

2. *See UK's Open Banking to Launch on 13 January 2018*, OPEN BANKING IMPLEMENTATION ENTITY (Dec. 19, 2017), https://www.openbanking.org.uk/about-us/latest-news/uks-open-banking-launch-13-january-2018/ ("Open Banking is a term that describes a secure set of technologies and standards that allow customers to give companies other than their bank or building society permission to securely access their accounts.").

3. *See id.* ("[T]he UK will be the first nation to launch Open Banking when its service goes live in early 2018.").

4. *See* Victor Chatenay, *Australia Has Rolled Out an Open Banking Regime*, BUS. INSIDER (July 6, 2020, 9:36 AM), https://www.businessinsider.com/australia-open-banking-regime-goes-live-2020-7 (noting that on July 1, 2020, Australia's Consumer Data Right Act became law and will continue to be implemented across different sectors of the economy in stages).

introducing similar data-sharing initiatives.

Against this background, this Article proceeds as follows. Part II sets the stage by unpacking the trajectory of data-sharing in the banking sector and the underlying concerns that lead to regulatory responses via Open Banking initiatives. Part III then examines in-depth the selected issues around Open Banking, including the participants, the scope of data to be shared, liabilities arising from authorized transactions, measures dealing with security and data protection concerns, and the legality of screen scraping after Open Banking. Part IV concludes.

II. OPEN BANKING: ORIGIN, RATIONALES, AND NORM DIFFUSION

A. Data Sharing in Banking Sector: A Shifting Landscape

Banks in most jurisdictions are subject to a legal obligation — by way of contracts, statutes, or case law — to maintain "bank secrecy" or "bank confidentiality" and conceal clients' information.[5] By virtue of clients' consent or otherwise, banks could share consumers' information with third parties. Data sharing between banks and third parties might proceed through either contractual arrangements or technologies. On the former, one oft-seen arrangement is between a bank and a credit bureau to evaluate the creditworthiness of prospective or existing customers.[6] Of particular note is the latter — data sharing through so-called "screen scraping," a process by which automated scripts extract portions of data from one application for another to use.[7] When screen scraping, a third party has access to a clients' account credentials. By virtue of this insight, said third party can unearth additional data without involving or alerting the bank where the account is

5. Traditionally, contract law is the most important source governing bankers' duty of secrecy. Where the contract is silent, this duty is interpreted by the courts to be an implied term between a bank and its customer. Tournier v. Nat'l Provincial & Union Bank of England, [1924] 1 KB 461 (Bankes LJ). *See generally* Dora Neo, *A Conceptual Overview of Bank Secrecy*, *in* CAN BANKS STILL KEEP A SECRET? 3–30 (Sandra Booysen & Dora Neo eds., 2017) (noting how banks are prohibited from disclosing their clients' information in different countries).

6. *See, e.g.*, HSBC, CREDIT INFORMATION MANAGEMENT POLICY (2020), https://www.hsbc.com.au/content/dam/hsbc/au/docs/pdf/hsbc-credit-policy.pdf (explaining that credit information is important to determining credit worthiness and how credit information may be used in the process).

7. BASEL COMM. ON BANKING SUPERVISION, REPORT ON OPEN BANKING AND APPLICATION PROGRAMMING INTERFACES 19 (2019) [hereinafter BASEL COMM., REPORT ON OPEN BANKING]; *see* GoCardless, *Screen Scraping 101: Who, What, Where, When?*, THE OPEN BANKING HUB (July 19, 2017), https://openbankinghub.com/screen-scraping-101-who-what-where-when-f83c7bd96712 (describing how services use screen-scrapping to access a user's banking information, such as their last transaction, and the potential associated risks).

located.[8]

Screen scraping is nothing new. It closely relates to the emergence of "data aggregation" (also known as "account aggregation," or "financial aggregation" as applied in the financial sector) some two decades ago. Data aggregation services were first offered in the United States in the late 1990s.[9] Such services catalogue clients' account information from various institutions in a central location; these service providers collate consumers' financial data relating to, among other things, their "deposit accounts, credit accounts, managed funds accounts, and[] brokerage accounts."[10] They also collate non-financial data (e.g., those from email accounts).[11] This business model has since diffused throughout Europe and the Asia Pacific.[12] As early as 2000, for instance, Australia had seven firms providing data aggregation services: two associated with financial institutions, and one provided by a stockbroker.[13] More recently, Fintech firms have been tapping into the potential of data by purchasing data made available by data aggregators and then using it to offer new products and services.[14] Another technique employed by third parties in recent years is reverse engineering, which extracts information about the source code of mobile banking applications to determine which information is exchanged between the bank's server and the applications.[15] As it is more robust and generally unaffected by changes to the bank's interface, data aggregators typically prefer reverse engineering to screen scraping.[16]

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8. AUSTL. SEC. & INV. COMM'N, CONSULTATION PAPER 20: ACCOUNT AGGREGATION IN THE FINANCIAL SERVICES SECTOR 15 (2001) [hereinafter ASIC CONSULTATION PAPER 20].

9. *See id.* at 1.

10. *Id.* at 7.

11. *Id.*

12. *See, e.g.*, Hiroshi Fujii et al., *E-Aggregation: The Present and Future of Online Financial Services in Asia-Pacific* (Composite Info. Sys. Lab'y, Mass. Inst. of Tech. Sloan Sch. of Mgmt., Working Paper No. 2002-06, 2002), http://web.mit.edu/smadnick/www/wp/2002-06.pdf.

13. *See* ASIC CONSULTATION PAPER 20, *supra* note 8, at 17–18 (illustrating the results of the aggregation services provider study).

14. *See* Brian J. Hurh et al., *Consumer Financial Data Aggregation and the Potential for Regulatory Intervention*, 71 CONSUMER FIN. L. Q. REP. 20, 21 (2017) (noting that with the acquired data, the offered products and services can be "more targeted and tailored" to the consumer).

15. *See* THE AUSTL. GOV'T THE TREASURY, REVIEW INTO OPEN BANKING: GIVING CUSTOMERS CHOICE, CONVENIENCE AND CONFIDENCE 72 (Dec. 2017) [hereinafter THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING], https://treasury.gov.au/sites/default/files/2019-03/Review-into-Open-Banking-_For-web-1.pdf.

16. *See* BASEL COMM., REPORT ON OPEN BANKING, *supra* note 7, at 9 (acknowledging, however, that both techniques still pose risks to the customer because

The underlying concerns around screen scraping or reverse-engineering have led banks to introduce their application programming interfaces ("APIs") — a standardized communication method that enables data flow between systems in a seamless yet controlled way.[17] The degree of openness of these interfaces may vary, such as the level of protection, the bank's duty towards clients, and the bank's ability to compete with outside developers.[18] Banks lacking budgets and expertise to develop their APIs may instead engage data aggregators as middlemen by contracts.[19]

B. Rationales for Data Sharing: Benefits and Concerns

Data sharing presents advantages and disadvantages for different stakeholders in the financial industry. An advantage is that it could give consumers more control over when and what data is shared with third parties — be they banks, other financial institutions, or Fintech start-ups — in search of better, personalized deals, thereby improving personal finance decisions.[20] Examples are countless. The platform of Akoni, a British firm, helps companies maximize the return on their deposits and provides personalized cash tips and benchmarks reflecting similarly sized companies.[21] By making the market transparent and increasing the variety of choices available, data sharing helps reshape the banking industry — at least in retail banking — where clients often display "stickiness" to an incumbent due to switching

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the data aggregator retains access to the customer's account and may perform unauthorized actions, such as engaging in a financial transaction).

17. Penny Crosman, *Wells Fargo's Bid to Vanquish Screen Scraping*, AM. BANKER (June 7, 2016, 6:30 AM), https://www.americanbanker.com/news/wells-fargos-bid-to-vanquish-screen-scraping ("APIs connect servers in a way that avoids all the problems of screen scraping — the sharing of user names and passwords, the overloading of banks' servers with high-volume requests, the inability to use two-factor authentication.").

18. Lael Brainard, Governor, Fed. Rsrv. Sys., Speech at the Northwestern Kellogg Public-Private Interface Conference on "New Developments in Consumer Finance: Research & Practice": Where Do Banks Fit in the Fintech Stack? (Apr. 28, 2017), https://www.federalreserve.gov/newsevents/speech/brainard20170428a.htm.

19. *Id.*

20. *See id.* (suggesting that "screen scraping . . . may be the most effective tool for the customers of small community banks to access the financial apps they prefer" and thus, a necessary tool "to remain competitive until more effective broader industry solutions are developed").

21. *See, e.g.*, *Frequently Asked Questions*, AKONI, https://akonihub.com/static/faq (last visited July 10, 2021).

costs.[22] Data sharing can, in other words, help fix the "lock-in" problem,[23] addressing concerns that banks' information monopoly can victimize Fintech start-ups via anti-competitive practices.[24] With better data access, one report shows that Australians could save up to $11.6 billion AUD annually by switching service providers.[25] Another benefit is that the "growth in volume, variety, and sources of data" can reduce barriers to entry, this is particularly advantageous for new firms with innovative plans for this novel information."[26]

As promising as data sharing can be, however, there are concerns around the current practice. First, it is not uncommon for banks to overlook the opportunities that come with data sharing and instead perceive it as a threat to their fundamental values,[27] raising concerns that they would be recast as an involuntary "platform as a service" ("PaaS") provider and compelled to face fiercer competition to maintain their clients.[28] Incumbents are also concerned with the level playing field: what are the obligations imposed onto these Fintech start-ups when traditional banks are forced or "nudged" to

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22. *See* Alasdair Smith, CMA Inquiry Chair, Speech at the BBA Retail Banking Conference on Competition and Open Banking (June 29, 2017), https://www.gov.uk/government/speeches/alasdair-smith-on-competition-and-open-banking (explaining the difficulties consumers may have accessing information and how "opening banking" can help remedy this information gap).

23. Giuseppe Colangelo & Oscar Borgogno, *Data, Innovation and Transatlantic Competition in Finance: The Case of the Access to Account Rule* 7 (Stanford — Vienna Transatlantic Tech. L. F., EU Law Working Papers, Paper No. 35, 2018) (explaining "lock-in problems" and their effect on the banking industry).

24. AUSTL. GOV'T PRODUCTIVITY COMM'N, REP. NO. 82, DATA AVAILABILITY AND USE 567 (2017) [hereinafter PRODUCTIVITY COMM'N (AUSTL.), DATA AVAILABILITY AND USE] (noting that data sharing "would almost certainly" encourage efficient competition to the benefit of consumers); Colangelo & Borgogno, *supra* note 23, at 10 ("[F]ront-end providers are more prone to be victims of anti-competitive practices carried out by banks and other incumbents than end-to-end providers.").

25. PRODUCTIVITY COMM'N (AUSTL.), DATA AVAILABILITY AND USE, *supra* note 24, at 101.

26. *Id.* at 553.

27. *See* ACCENTURE, THE BRAVE NEW WORLD OF OPEN BANKING 5 (2018); Daniel Ziffer, *Open Banking Will Threaten the Dominance of the Big Four Banks — But It Has Been Delayed*, ABC NEWS, (Dec. 20, 2019, 8:27 PM), https://www.abc.net.au/news/2019-12-20/open-banking-revolution-to-shake-up-the-dominance-of-big-four/11813498.

28. *See* Colangelo & Borgogno, *supra* note 23, at 21 (explaining different ways "banks are likely to [fiercely] compete . . . to attract as many new customers and third-party providers as possible"); Jane K. Winn, Reengineering European Payment Law 27 (June 30, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3412457 (explaining the disadvantages to banks resulting from being classified as PaaS providers).

assume this new role as a PaaS provider?[29] Second, while screen scraping or reverse-engineering represents a less costly approach for third parties to access consumers' data, these techniques have pitfalls from a technical perspective. Screen scraping, for instance, does not guarantee data accuracy or currency, as banks may reconfigure their settings from time to time.

Moreover, the data collected by third parties could be stolen or misused for payment fraud.[30] Banks may find it problematic to distinguish between consumers, aggregators, and unauthorized third parties when someone logs onto the account.[31] These practices could also arguably burden a bank's IT system by extracting a large amount of data.[32] Other concerns are cybersecurity,[33] data breach (e.g., whether the third parties can pass the information to fourth parties and beyond),[34] and of course, the allocation of liability arising from unauthorized transactions.[35] Furthermore, while many jurisdictions do not explicitly ban screen scraping or reverse engineering, these techniques have, as a matter of practice, created controversy in various jurisdictions — *American Airlines, Inc. v. FareChase, Inc.*[36] and *eBay, Inc. v. Bidder's Edge, Inc.*[37] in the United States,[38] and *Ryanair Ltd. v Bravofly*[39]

29. Winn, *supra* note 28, at 27.

30. BASEL COMM., REPORT ON OPEN BANKING, *supra* note 7, at 9.

31. *Id.* (acknowledging that this is done when third parties store customer credentials, thus giving them access to the customer's account).

32. *Id.* (noting that the third-party data aggregators may "extract large volumes of data at multiple intervals").

33. *See, e.g.*, ASIC CONSULTATION PAPER 20, *supra* note 8, at 46 (referring to one U.S. commentator's report that appropriate agreements should be signed between banks and data aggregators to address privacy and security concerns).

34. BASEL COMM., REPORT ON OPEN BANKING, *supra* note 7, at 12 (cautioning that third parties may use or share the customer's information beyond the scope of the customer's consent).

35. *Id.* at 14 (stating that liability laws may be unable to properly determine liability in an open banking or data sharing dispute).

36. Temporary Injunction at 2–4, Am. Airlines, Inc. v. FareChase, Inc., No. 067-194022-02 (67th Dist. Ct. Tarrant Cty., Tex. Mar. 8, 2003).

37. 100 F. Supp. 2d 1058 (N.D. Cal. 2000).

38. One recurring issue in the United States is whether the trespass-to-chattels doctrine would apply to screen scraping. Temporary Injunction at 4, *Am. Airlines, Inc.*, No. 067-194022-02 (granting a temporary injunction to ban, among others, Farechase from using software to obtain and copy data from American Airlines' system); *eBay, Inc.*, 100 F. Supp. 2d at 1063–65 (moving for a preliminary injunction to prevent Bidder's Edge from further accessing eBay's system after Bidder's Edge accessed it approximately 100,000 times a day). For a comparative study of the legality of screen scraping in the United States, the United Kingdom, and Australia, see generally Han-Wei Liu, *Two Decades of Laws and Practice Around Screen Scraping in the Common Law World and its Open Banking Watershed Moment*, 30 WASH. INT'L L.J. 28 (2020).

39. Ryanair Ltd v. Bravofly [2009] IEHC 224. Ryanair claimed, among others, that

in Ireland, are cases in point.

C. A Snapshot of Global Normative Diffusion of Open Banking: EU and Beyond

The EU was the first jurisdiction mandating access to account data by Directive 2015/2366 on Payment Services in the Internal Market — known as PSD II.[40] EU Member States were required to transpose the PSD II into national law by January 13, 2018.[41] To date, all EU Members have acted accordingly.[42] PSD II was built on its predecessor, the first Payment Systems Directive ("PSD I"),[43] adopted in 2007 as the foundation to establish safer and more innovative payment services across the single market.[44] The revisions by PSD II represents an effort to adapt to the evolving technology in the payment services market and its associated challenges.

PSD II applies to all payment service providers ("PSPs"); it is a broad term that encompasses both banks and various third parties providing selected financial services (including account information and payment initiation services).[45] It obliges banks to provide a customer's data to authorized third parties in specified circumstances.[46] Such third parties are either Payment Initiation Service Providers ("PISPs")[47] or Account Information Service Providers ("AISPs"),[48] collectively known as Third-Party Providers ("TPPs"). Generally, PISPs expedite online transactions by allowing consumers to directly execute an online payment from their accounts and offer cost-effective solutions for both merchants and consumers.[49] For example, Banked is a UK-authorized fintech company[50] that allows a

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Bravofly's practice of screen-scraping breaches Ireland's Trademarks Act and the Copyright and Related Rights Act and violated the terms and conditions of using Ryanair's website.

40. Directive (EU) 2015/2366, of the European Parliament and of the Council of 25 November 2015 on Payment Services in the Internal Market, 2015 O.J. (L 337) 35.

41. *Id.* art. 109 at 111.

42. *Payment Services (PSD2) — Transposition Status*, EUR. CMM'N, https://ec.europa.eu/info/publications/payment-services-directive-transposition-status_en (last updated May 5, 2021).

43. Directive 2007/64/EC, of the European Parliament and of the Council of 13 November 2007 on Payment Services in the Internal Market, 2007 O.J. (L 319) 1.

44. *Id.* recital 4 at 1.

45. PSD II, *supra* note 1, arts. 1, 4(3), 4(11), annex I, at 53–54, 57, 116.

46. *Id.* arts. 2, 66–67 at 54, 92–93.

47. *Id.* art. 66 at 92–93.

48. *Id.* art. 67 at 93.

49. *Id.* art. 4 at 57–60; *id.* recital 28 at 39.

50. *Financial Services Register*, FIN. CONDUCT AUTH., https://register.fca.org.uk/s/firm?id=0010X00004EMNS0QAP (last visited July 10, 2021).

merchant to share its financial details and request payment, with the customer then authorizing this transfer of funds.[51] AISPs consolidate data across different clients' accounts, giving them a better overview of their financial situation.[52] This can help facilitate the development of other services in the Fintech ecosystem[53] — for example, Bippit compiles a customer's information and shares it with a financial adviser so they can advise clients virtually.[54] Due to their different functions, PISPs are often described as having "read-write" access, while AISPs have "read-only" access.[55]

Central to the PSD II is consent: for a TPP to access a customer's data (or "payment service user"), it must obtain their explicit consent.[56] Upon receiving the customer's consent, the bank must securely communicate with the PISP or AISP to provide the necessary data,[57] regardless of whether they have a pre-existing contractual relationship with that TPP.[58] Therefore, the framework empowers bank customers to retrieve their data as easily as they can access the funds in their accounts, making it available to Fintech firms in exchange for new services.[59]

By freeing up data, PSD II is the first regime that definitively opens up the payment services market to TPPs other than banks.[60] The underlying rationale is, as mentioned above, to increase competition in the industry by

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51. David Kimberly, *Faster, Safer: Payments Under Open Banking*, FIN. MAGNATES (Aug. 16, 2019, 11:01 AM), https://www.financemagnates.com/fintech/payments/faster-safer-payments-under-open-banking/.

52. PSD II, *supra* note 1, recital 28, art. 4, at 39, 53–54 (defining and explaining the technology that gives customers an overview of their financial situation).

53. *8 Frequently Asked Questions About Account Information Service Providers*, FINTEC SYS. (Oct. 5, 2018), https://knowledge.fintecsystems.com/en/blog/8-frequently-asked-questions-about-account-information-service-providers (describing AISPs and their impact on the Fintech Industry).

54. *How It Works*, BIPPIT, https://bippit.com/how-it-works/ (last visited July 13, 2021).

55. THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at 2, 108; Kelly Read-Parish, *Open Banking: AISPs and PISPs Explained*, FINEXTRA (Feb. 11, 2019), https://www.finextra.com/blogposting/16647/open-banking-aisps-and-pisps-explained.

56. PSD II, *supra* note 1, art. 64(1) at 91.

57. *Id.* arts. 66–67 at 92–93; *see also infra* Part III.B.

58. PSD II, *supra* note 1, arts. 66(5), 67(4) at 92–93.

59. Fernando Zunzunegui, *Digitalisation of Payment Services* 16 (Ibero-American Inst. for L. & Fin., Working Paper No. 5/2018, 2018) (noting that access to this data can be quite valuable for customers).

60. PSD II has gone further than PSD I by permitting non-bank firms to use not only "payment institution" status, but also "PISP" or "AISP" status. *Id.* at 24–25.

bringing innovative players into the market.[61] Also, PSD II addresses some of the concerns around data sharing examined earlier: it can create a more integrated payment market with common standards, increase the safety and security of payments, and protect consumer data in an Open Banking system where self-regulation may be insufficient.[62]

In implementing PSD II, the UK was the first to offer a governmental program to work toward Open Banking.[63] Her Majesty's Treasury in 2015 announced its commitment to delivering an open standard for APIs and data sharing in the UK retail banking sector to increase the opportunities for competition, thereby improving outcomes for customers in the banking industry.[64] This implementation was achieved in 2018 by the Retail Banking Market Investigation Order 2017,[65] issued by the Competition and Markets Authority ("CMA").[66] This CMA Order applies to the nine largest banks in the UK,[67] requiring them to make certain data available via an API to authorized third parties.[68]

While these European initiatives may represent the "cradle of Open Banking," the practice has since been adopted in other jurisdictions in their forms.[69] The most notable example is Australia, which recently rolled out

61. *See European Parliament Adopts European Commission Proposal to Create Safer and More Innovative European Payments*, EUR. CMM'N (Oct. 8, 2015) [hereinafter EUR. COMM'N, *Safter and More Innovative European Payments*], https://ec.europa.eu/commission/presscorner/detail/ro/IP_15_5792 (stating that these innovations will provide protection for European customers); OPEN BANKING IMPLEMENTATION ENTITY, OPEN BANKING: GUIDELINES FOR OPEN DATA PARTICIPANTS 3 (2018) [hereinafter OBIE, GUIDELINES FOR OPEN DATA PARTICIPANTS], https://www.openbanking.org.uk/wp-content/uploads/Guidelines-for-Open-Data-Participants.pdf (detailing how open banking operates to bring new players into the market).

62. *See* Zunzunegui, *supra* note 59, at 27; EUR. COMM'N, *Safer and More Innovative European Payments*, *supra* note 61 (outlining changes to the regulations brought by PSD II).

63. Zunzunegui, *supra* note 59, at 15.

64. HM TREASURY (U.K.), DATA SHARING AND OPEN DATA IN BANKING: RESPONSE TO THE CALL FOR EVIDENCE 7 (2015) (concluding that given the noted benefits the government is "commit[ed] to deliver[ing] and open API standard in UK banking").

65. Retail Banking Market Investigation: The Retail Banking Market Investigation Order 2017 (UK) [hereinafter UK CMA Order].

66. *Id.* § 2.9.

67. *Id.* § 3.1.1 (listing RBSG, LBG, Barclays, HSBCG, Nationwide, Santander, Danske, Bol, and AIBG as the nine largest UK banks).

68. *Id.* § 2; *Third Party Providers*, OBIE [hereinafter OBIE, *Third Party Providers*], https://www.openbanking.org.uk/providers/third-party-providers/ (last visited Apr. 24, 2021) (detailing the steps required to become a provider); *see also infra* Part III.A–B.

69. *See* EMEA Center for Regulatory Strategy, *Open Banking Around the World*, DELOITTE, https://www2.deloitte.com/global/en/pages/financial-services/articles/open-banking-around-the-world.html (last visited July 13, 2021) (summarizing open banking models outside of the EU and noting there are two general categories: "market-driven"

its Open Banking regime as part of the broader Consumer Data Right ("CDR"). CDR is unique because it is broadly framed as a data policy initiative rather than a financial service one,[70] and while it will apply first to banks, it will gradually be rolled out to the whole economy. [71]

The regime was passed on August 1, 2019, in the Treasury Laws Amendment (Consumer Data Right) Act 2019 (Cth) ("CDR Act").[72] However, the Australian Competition and Consumer Commission ("ACCC") pushed back its roll-out from February to July 2020 as a result of incomplete tests.[73] The CDR roll-out emerged as a response to several reviews, including one by the Australian Productivity Commission in 2017[74] and one by the Farrell Review in the same year.[75] Notably, CDR works towards a comprehensive data access regime, furthering the existing data access rules set forth under the Australian Privacy Principles ("APPs").[76] Among others, the regime requires data-holders (e.g., banks) to securely transfer a customer's data, upon request, to an accredited third party. Like its UK/EU counterpart, CDR intends to encourage competition, enhance consumer welfare, reduce switching costs, and enable a range of business opportunities to emerge from data sharing.[77]

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or "regulatory-driven").

70. *Id.* (noting that as a data policy initiative, it could be implemented in any industry of the economy).

71. Explanatory Memorandum, Treasury Laws Amendment (Consumer Data Right) Bill 2019 (Cth) 5, 7 (Austl.) [hereinafter Explanatory Memorandum, CDR Bill] (emphasizing the Government's dedication to applying CDR across various sectors of the economy, such as "the energy and telecommunications sectors").

72. This Act amended the *Competition and Consumer Act 2010* (Cth) (Austl.), *Australian Information Commissioner Act 2010* (Cth), and *Privacy Act 1988* (Cth) (Austl.) to create the Consumer Data Right.

73. Press Release, Austl. Competition & Consumer Comm'n, Consumer Data Right Timeline Update (Dec. 20, 2019) [hereinafter ACCC, CDR Timeline Update], https://www.accc.gov.au/media-release/consumer-data-right-timeline-update (citing the ACCC's dedication to ensuring a user-friendly system and "robust privacy protection" as the reason for postponing the launch).

74. PRODUCTIVITY COMM'N (AUSTL.), DATA AVAILABILITY AND USE, *supra* note 24, at 35 (recommending the creation of an economy-wide Consumer Data Right).

75. THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at 11, 13–14 (recommending that Open Banking be implemented through the broader CDR framework). A Senate Committee is also currently conducting an inquiry into the future direction of the CDR framework, including potential "write-access" in the banking sector (for payment initiation) and roll-out to the superannuation sector. SENATE SELECT COMM. ON FIN. TECH. & REGUL. TECH., PARLIAMENT OF AUSTRALIA, ISSUES PAPER 9 (2019).

76. *See infra* Part III.B.

77. Explanatory Memorandum, CDR Bill, *supra* note 71, at 5 (outlining the aims and values of the CDR).

Conceptually, the approaches adopted by different jurisdictions fall within one of the following camps. Some of them — like the EU, UK, and Australian schemes — follow the mandatory (or prescriptive) approach by laying down a comprehensive framework of Open Banking.[78] Others take the voluntary (or facilitative) model via guidelines, standards, and technical specifications on APIs to assist data sharing.[79] The "Finance-as-a-Service: API Playbook" issued by the Monetary Authority of Singapore and the Association of Banks in Singapore,[80] and the "Open API Framework for the Hong Kong Banking Sector" released by Hong Kong Monetary Authority,[81] are prime examples. Still, in other jurisdictions, there is currently no regulatory framework to mandate or facilitate Open Banking, although there has been discussion on the subject. In the United States, for instance, it is heatedly debated as to whether Section 1033 of the Dodd-Frank Wall Street Reform and Consumer Protection Act can serve as a vehicle to require financial institutions to share consumer data with TPPs.[82] With this backdrop, we now turn to examine the regulatory approaches dealing with specific concerns around data sharing in the UK and Australia below.

III. A COMPARATIVE ANALYSIS OF AUSTRALIA AND THE UK

A. Who Can Participate?

In the UK, the CMA Order applies to the nine largest banks — known as the "CMA9" — requiring them to make certain data available through an

78. BASEL COMM., REPORT ON OPEN BANKING, *supra* note 7, at 11–12 (describing the mandatory and formal nature of the EU, UK, and Australian frameworks).

79. *Id.* (highlighting Hong Kong and Singapore as examples of countries employing the facilitative model).

80. ASS'N OF BANKS & MONETARY AUTH. OF SINGAPORE, FINANCE-AS-A-SERVICE: API PLAYBOOK (2016).

81. HK MONETARY AUTH., OPEN API FRAMEWORK FOR THE HONG KONG BANKING SECTOR (2018) (detailing the regulatory framework set for the Hong Kong banking sector).

82. *See, e.g.*, Michael S. Barr et al., *Consumer Autonomy and Pathways to Portability in Banking and Financial Services* 3 (Ctr. on Fin., Law & Policy, Univ. Mich. Working Paper No. 01, 2019), http://financelawpolicy.umich.edu/files/umich-cflp-working-paper-consumer-autonomy-and-data-portability-pathways-Nov-3.pdf ("Section 1033 of the Dodd-Frank Act grants consumers the right to access their personal financial information. But there is significant dispute about the scope of § 1033 . . . ."); Mary Wisniewski, *The Data Access Debate Is About to Get A Lot More Interesting*, AM. BANKER (Jan. 27, 2017, 3:27 PM), https:/www.americanbanker.com/news/the-data-access-debate-is-about-to-get-a-lot-more-interesting (noting that some interpret § 1033 as only "contemplate[ing] a direct relationship between a customer and bank" while others argue that it "codif[ies] consumers' right to access their financial data through third-party apps").

API.[83] Non-CMA9 providers may also voluntarily participate in Open Banking. To access data via the banks' APIs, TPPs must be eligible under the PSD II so they can obtain authorization from the Financial Conduct Authority ("FCA").[84] Upon being granted such regulatory permission, TPPs are placed on a "whitelist" — known as the Open Banking Directory, as maintained by the Open Banking Implementation Entity ("OBIE"),[85] to provide services using Open Banking.[86]

In Australia, the CDR regime will apply to, in the case of the banking sector, all authorized deposit taking institutions ("ADIs") other than foreign banks.[87] However, implementation will be phased in, with trials by the four largest banks — ANZ, Commonwealth, Westpac, and NAB.[88] These major banks are required to provide access to customer data under the CDR by July 2020;[89] other ADIs must do so by July 2021.[90] Moreover, to receive such data, TPPs must become "Accredited Recipients"[91] by meeting certain criteria, including privacy and security requirements.[92]

B. What Data Should Be Shared?

The scope of data sharing may vary depending on jurisdiction. Under the UK's "Read-Only Data Standard," participating banks must release and make freely available both "reference information" and "product

83. The CMA9 are listed in the UK CMA Order as Barclays, HSBC, Lloyds, Nationwide, RBSG, BoI, AIB, Santander, and Danske. UK CMA Order, *supra* note 65, § 3.1.1.

84. *See Frequently Asked Questions*, BANK OF APIS, https://www.bankofapis.com/faq (last visited July 13, 2021).

85. OBIE, *Third Party Providers*, *supra* note 68.

86. OBIE, GUIDELINES FOR OPEN DATA PARTICIPANTS, *supra* note 61, at 5.

87. *Consumer Data Right (Authorised Deposit-Taking Institutions) Designation 2019* (Cth) (Austl.) [hereinafter *CDR Banking Instrument*].

88. *Competition and Consumer (Consumer Data Right) Rules 2019* (Cth), sch 3 pt 6 (Austl.) [hereinafter *Consumer Data Rules*].

89. ACCC, CDR Timeline Update, *supra* note 73.

90. *ACCC Consultation on Proposed Timetable for Participation of Non-major ADIs in the CDR*, AUSTL. COMPETITION & CONSUMER CMM'N (Feb. 7, 2020), https://www.accc.gov.au/focus-areas/consumer-data-right-cdr-0/accc-consultation-on-proposed-timetable-for-participation-of-non-major-adis-in-the-cdr.

91. *Competition and Consumer Act 2010* (Cth) s 56BD(1)(b) (Austl.) [hereinafter *Competition and Consumer Act*].

92. *See generally* AUSTL. COMPETITION & CONSUMER CMM'N, DRAFT, CONSUMER DATA RIGHT SUPPLEMENTARY ACCREDITATION GUIDELINES: INFORMATION SECURITY (Sep. 23, 2019) [hereinafter ACCC, CDR SUPPLEMENTARY GUIDELINES: INFORMATION SECURITY], https://www.accc.gov.au/system/files/CDR%20draft%20supplementary%20accreditation%20guidelines%20-%20information%20security.pdf; *infra* Part III.D.

information."[93] The former includes all branch locations and opening hours, and ATM locations.[94] "Product information" covers prices, charges/interest rates, features and benefits, terms and conditions, and customer eligibility criteria for a wide range of products — including both personal and business current accounts, as well as lending products for small and medium enterprises.[95] "Service quality indicators" — results from customer surveys relating to the likelihood that they would recommend them to someone else — must also be shared.[96] The UK's framework also regulates data-sharing from a payment account[97] that is related to a specific consumer: in this type of data sharing, the bank must allow a TPP to access the data that is necessary to perform that TPP's service (excluding any data that is considered "sensitive" in that it can be used to commit fraud, e.g., personal security credentials).[98] This ensures that AISPs can access a customer's account information and transaction history,[99] while PISPs can access information regarding the initiation and execution of payment transactions.[100] Such interactions are caught by the PSD II even where they are "one leg out" (only one party is located within the EU), extending the geographical scope beyond the previous PSD (applied only to interactions taking place entirely within the EU).[101] Thus, in contrast to the CDR framework, which sometimes considers the nationality of the data subject (*see* below), the PSD II regime simply applies where one or both of the PSPs involved are located within the EU.[102]

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93. UK CMA Order, *supra* note 65, § 10.1.

94. *Id.* § 12.1.1.

95. *Id.* § 12.1.2.

96. *Id.* §§ 13, 15.

97. *FCA Handbook: The Perimeter Guidance Manual*, 8 Fin. Conduct Auth. § 15.3 (June 2021).

98. Zunzunegui, *supra* note 59, at 17; Commission Delegated Regulation (EU) 2018/389, of 27 November 2017 Supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with Regard to Regulatory Technical Standards for Strong Customer Authentication and Common and Secure Open Standards of Communication, art. 36(1) 2018 O.J. (L 69) 23, 41 [hereinafter RTS].

99. RTS, *supra* note 98, art. 36(1)(a) at 41.

100. *Id.* art. 36(1)(b)–(c) at 41.

101. PSD II, *supra* note 1, art. 2(1)–(2) at 54; *Q&As: Geographical Scope of Application of the RTS on Strong Customer Authentication (SCA) and Secure Communication Requirements — Two-leg Transactions*, EUR. BANKING AUTH. (Sep. 6, 2019), https://eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2018_4030; DEUTSCHE BANK, PAYMENT SERVICES DIRECTIVE 2: DIRECTIVE ON PAYMENT SERVICES IN THE INTERNAL MARKET "(EU) 2015/2366" 12 (2016) [hereinafter DEUTSCHE BANK, PAYMENT SERVICES DIRECTIVE 2], https://cib.db.com/docs_new/White_Paper_Payments_Services_Directive_2.pdf.

102. *See* DEUTSCHE BANK, PAYMENT SERVICES DIRECTIVE 2, *supra* note 101, at 12.

In Australia, "CDR data" is broadly framed under the CDR Act to include information within a class specified by a designating instrument, extending to those wholly or partly derived from such information.[103] In the banking sector, more specifically, it refers to three classes of information: "information about [a] user of [a] product" (e.g., information identifying the person), "information about use of [a] product" (e.g., information about a transaction made by the person), and "information about a product" (e.g., price, feature, and terms and conditions associated with the product).[104] CDR data can be roughly split into two categories, product data and consumer data, with only the latter specific to consumers. It is noteworthy that CDR data is qualified by geographical limitations. Generally, for data to be CDR data, it must have been generated or collected in Australia by an Australian person; or been generated or collected in Australia and related to an Australian person; or been generated or collected outside Australia by an Australian person and related to an Australian person.[105] Interestingly, access to CDR data is also currently limited to read-only privileges, contrasting to the PSD II regime's allowances for both read-only access (by AISPs) and read-write access (that is, payment initiation by PISPs).[106]

By Open Banking, the UK and Australia both extend the scope of data that is subject to access. The UK Data Protection Act 2018 features the "right to portability" as required under Article 20 of the General Data Protection Regulation ("GDPR") and makes it an offense for a controller to alter or destroy information to prevent such disclosure.[107] Although this right was set to further strengthen the control over a data subject's own data,[108] it is qualified by the fact that it applies only to "personal information" — information that relates to that identifiable person — and only that which was "provided" to the controller by the consumer.[109] By contrast, data access under the PSD II and PSR is not limited to data that is "personal" and extends beyond data provided by the consumer. As mentioned above, for instance, banks must publicly release reference/product data and service quality

103. *Competition and Consumer Act*, *supra* note 91, s 56AI (defining CDR data to include both data directly and indirectly derived from all other CDR data).

104. *CDR Banking Instrument*, *supra* note 87, ss 6–8.

105. *Competition and Consumer Act*, *supra* note 91, s 56 AC(3).

106. THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, 93–94 (contrasting PSD II's requirements with CDR's).

107. Data Protection Act 2018, c. 12, § 172(3).

108. Regulation (EU) 2016/679, of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) art. 20(1), 2016 O.J. (L 119) 1, 45 [hereinafter GDPR].

109. *Id.*

indicators under the UK's additional Read-Only Standard.[110] The PSD II regime hence widens the scope of data access beyond that of the GDPR, with each approach more in line with its respective purpose. While the GDPR aims to further strengthen the control of data subjects over their own data, the PSD II also seeks to facilitate innovation and development of new Fintech services.[111]

Likewise, CDR expands the scope of data access established under Australian Privacy Principle 12 ("APP 12"). While the data access right under APP 12 is similarly qualified by "personal information,"[112] it is even more limited than its EU/UK counterpart. For instance, while the Federal Court of Australia recently in its decision of *Privacy Commissioner v Telstra Corp.*[113] interpreted the term "personal information" to have two conditions — (1) it must be "about an individual" and (2) identity is "apparent, or can reasonably be ascertained, from the information or opinion" — it offers limited guidance on when information would be considered to be "about an individual."[114] The lack of clear instructions arguably narrows the scope of application of APP 12.[115] Furthermore, APP 12 does not apply to most small businesses — those with an annual financial turnover of no more than $3 million AUD.[116] The CDR regime could address these pitfalls: it now provides access to a far greater range of information by using "consumer data" rather than "personal information" as a basis.[117]

Further, consumer data is broadly framed as covering information that is

110. UK CMA Order, *supra* note 65, §§ 12–17.

111. *See* Sophie Wijdeveld, *PSD2 Innovation and GDP Protection: A Fintech Balancing Act, Part One: Consent*, CLIFFORD CHANCE (Oct. 18, 2019), https://talkingtech.cliffordchance.com/en/data-cyber/data/psd2-innovation-and-gdpr-protection--a-fintech-balancing-act.html ("[P]ayment services providers need to balance the innovative opportunities offered by [PSD II] with the data protection challenges created by GDPR.").

112. *Privacy Act 1988* (Cth) sch 1 pt 5 s 12.1 (Austl.).

113. *Priv Comm'r v Telstra Corp* (2017) 249 FCR 24 (Austl.).

114. *Id.* at 30, 63. The Court stated that this assessment requires an "evaluative conclusion" and depends on the facts of the case. Uncertainty thus remains as to what constitutes information "about an individual" and is therefore potentially "personal information." M Feltham, *Privacy Commissioner v Telstra Corp Ltd* 14 PRIV. L. BULL. 42 (2017).

115. JAMES MEESE ET AL., CONSUMER RIGHTS TO PERSONAL DATA: DATA ACCESS IN THE COMMUNICATIONS SECTOR 28 (2019) (noting that the term "personal information" is too narrow to include all of the relevant consumer data and may result in a "confusing . . . system of data rights").

116. *Privacy Act 1988*, *supra* note 112, s 6D.

117. *See* MEESE ET AL., *supra* note 115, at 1 (calling for Australia to adopt a reform like the EU's GDPR).

"directly" or "indirectly" derived from other CDR data.[118] The latter arguably captures the data that has been re-organized, created, or otherwise value-added from "base" data. This may be worrying for industry stakeholders, as it could breach intellectual property rights,[119] reducing incentives to invest in data.[120] Consequently, information that has been "materially enhanced" is excluded from the scope of the data access rule. In the designation instrument issued for the banking industry, more specifically, "materially enhanced information" refers to data derived from product use data (source material) that has undergone "insight or analysis," which "render[s] the information significantly more valuable than the source material" by enhancing its "usefulness, usability or commercial value."[121] The exemption does not apply, however, in some circumstances — for instance, if it is publicly available, or disclosure is otherwise required by law.[122] Certain credit information like court proceeding information, personal insolvency, or serious credit infringement is explicitly excluded from the scope of disclosure.[123]

While significant expansions to the scope of data access have thus been made, there are plans in both nations to extend this even further. The UK's Smart Data Initiative will apply similar data sharing across the "regulated markets" (e.g., utilities, communications, rail, and financial services)[124] and

118. *Competition and Consumer Act*, *supra* note 91, s 56AI (1)–(2).

119. In the context of EU/UK, in particular, this can also turn on the clash between the Open Banking initiative and the *sui generis* "database right" contained in article 7(1) of Directive 96/9/EC, of the European Parliament and of the Council of 11 March 1996 on the Legal Protection of Databases 1996 O.J. (L 77) 20; transposed by regulations 13 and 14 of The Copyright and Rights in Databases Regulations 1997, SI 1997/3032. No such right exists in Australia, where databases may only be protected if they fall under general copyright law. *See IceTV Pty Ltd v Nine Network Australia Pty Ltd* (2009) 239 CLR 458.

120. *See* THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at 36–38 (arguing that obliging data holders to share their "value-added" data may in fact have negative impacts on investment, intellectual property, and commercial agreements and recommending that this type of data not be included within Open Banking).

121. *CDR Banking Instrument*, *supra* note 87, s 10(1). To set a clear standard, section 10(3) lists information that is "not materially enhanced information," including, notably, calculated balances, amount of interest earned or charged, and fees charged, among others.

122. *Id.* s 10(2).

123. *Id.* s 9.

124. *See* Dep't for Digit., Culture, Media & Sport, *National Data Strategy*, U.K. GOV'T, https://www.gov.uk/government/publications/uk-national-data-strategy/national-data-strategy (last updated Dec. 9, 2020); *see also* HM GOV'T (U.K.), NEXT STEPS FOR SMART DATA: PUTTING CONSUMERS AND SMES IN CONTROL OF THEIR DATA AND ENABLING INNOVATION 13 (2020) [hereinafter HM GOV'T (U.K.), NEXT STEPS FOR SMART DATA].

possibly the "digital market" (e.g., social media companies).[125] While Australia intends to apply its Consumer Data Right to the energy and telecommunications sectors before eventual "economy-wide" implementation.[126]

C. Who Should Bear Losses Caused?

Open Banking brings both benefits and risks. While data can be held and used by more entities, this also entails more points of storage and stages in which data could be compromised.[127] Unauthorized[128] or defective[129] transactions therefore lead to issues of liability: which party bears the loss resulting from fraudulent or erroneous activities?[130] Previously, where consumers shared their banking login credentials with data aggregators via screen scraping, they were often responsible for losses arising from unauthorized transactions.[131] Such an issue becomes more problematic with

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125. *See* HM GOV'T, NEXT STEPS FOR SMART DATA, *supra* note 124, at 17.

126. Explanatory Memorandum, CDR Bill, *supra* note 71, at 5, 7–8 (outlining the stages of implementation).

127. THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at 50 (noting that more points of storage make it easier for the data to be hacked and more transfers increase the risk that the data may be sent to the incorrect user); *Trust in Open Banking: Negotiating Data Liability Between Banks and TPPs*, FINEXTRA (Nov. 22, 2019) [hereinafter, FINEXTRA, *Trust in Open Banking*], https://www.finextra.com/newsarticle/34820/trust-in-open-banking-negotiating-data-liability-between-banks-and-tpps (acknowledging the need to address "the threat of losing [data and ensuring it] remains the central priority").

128. An "unauthorized transaction" is a transaction made without the customer's consent. *See, e.g.*, PSD II, *supra* note 1, art. 64(1) at 91 ("[A] payment transaction is considered to be authori[z]ed only if the payer has given consent to execute the payment transaction.").

129. A "defective transaction" is a transaction "requested by the customer but wrongly processed by the providers involved" (which may incur charges from the intended recipient). INST. OF INT'L FIN., LIABILITY AND CONSUMER PROTECTION IN OPEN BANKING 1 (2018), https://www.iif.com/portals/0/Files/private/32370132_liability_and_consumer_protection_in_open_banking_091818.pdf.

130. *See* BASEL COMM., REPORT ON OPEN BANKING, *supra* note 7, at 14 (stating regulatory frameworks and approaches to the issue of liability for data breaches); Reinhard Steennot, *Reduced Payer's Liability for Unauthorised Payment Transactions Under the Second Payment Services Directive (PSD2)* 34(4) COMP. L & SEC. REV. 954, 957 (2018) (exploring liability issues arising from data sharing); INST. OF INT'L FIN., *supra* note 129, at 5 (noting that in countries like the United States, with no specific regulatory framework for such liability issues, bilateral agreements will sometimes dictate liability, otherwise the customer may have to resort to a civil suit).

131. *See* BASEL COMM., REPORT ON OPEN BANKING, *supra* note 7, at 14 (noting that in the absence of a clear framework, when "customer-permissioned data" falls into the hands of the wrong party, it is difficult to determine how much responsibility should fall on the customer).

multiple entities involved in the provision of services in the Open Banking context: consumers, banks, TPPs and even fourth parties.[132]

Jurisdictions following the mandatory approach, such as the EU/UK, have a dedicated framework to address these issues.[133] Presumably, such rules may overcome several challenges seen in jurisdictions with no specific regulatory intervention — a consumer in the United States, for example, may hope for a bilateral agreement between their banks and the third party for dispute resolution, but in its absence, must rely solely on the civil liability framework.[134] Consumers under the latter system typically have to assume the burden of proof by identifying which party may have made a mistake to hold it accountable.[135] The EU/UK liability regime, in contrast, reverses the default setting by shifting the burden to service providers in several ways and requiring that consumers receive a refund for their loss except in limited circumstances (as discussed below).[136]

Likewise, in Australia, such allocation of responsibility was considered "important for the proper functioning of Open Banking,"[137] as clarifying the liability for each party would "build community trust and confidence."[138] It would also offer certainty for industry participants like data holders and data recipients, and eliminate bilateral negotiations surrounding the liability risks associated with Open Banking — although such a regime has not yet been put in place in Australia.[139] The Australian Treasury's *Review into Open Banking* contrasted this to market-driven attribution of liability, which could result in less-informed parties accepting the associated risks as "buried in a dense set of terms and conditions and therefore not readily understood and

132. *Id.* at 7, 14 (explaining that as more parties gain access to and share data, identifying and assigning liability in the case of erroneously shared data becomes more difficult).

133. *See* INST. OF INT'L FIN., *supra* note 129, at 3 (exemplifying the PSD II and its guidelines as a regulation that provides rules on "liability conditions").

134. *Id.* at 5.

135. *Id.* (calling out the "worst-case scenario," in which case the information necessary to meet this burden of proof is often "outside the consumer's reach" and noting that even once this burden is met, the consumer must carry litigation's additional burdens of time and expense).

136. *Id.* (explaining, for instance, that the EU requires professional indemnity insurance, or its equivalent, for third parties accessing consumer account information and that the bank must refund the consumer before requesting compensation from liable third parties).

137. THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at 65.

138. *Id.*

139. *Id.* (emphasizing the importance of "consistency and transparency across all data sharing arrangements . . . [to] provide certainty for customers on who bears the liability for any losses").

genuinely agreed to."[140] Against this backdrop, we now turn to the substance of such frameworks in the EU/UK and Australia.

i. EU/UK Model

In the UK, the liability framework is set forth under its Payment Services Regulations 2017 ("PSR 2017"),[141] which transposed the EU's PSD II.[142] Overall, PSR 2017 uses a rule of thumb whereby banks — termed Account Servicing Payment Service Providers ("ASPSP") — must immediately reimburse the customer for the loss caused by an unauthorized transaction, regardless of whether it occurred as a result of third-party access.[143] This does not apply where the bank "has reasonable grounds to suspect fraudulent behavior" by the customer and fulfills the relevant notification obligation.[144] Furthermore, per PSR 2017, if there is a deficiency when executing a payment transaction (e.g., non-execution, late execution, incorrect execution) and such payment was initiated through a TPP — specifically, a PISP — it is the bank that will be liable.[145] However, if the PISP is found to be responsible for the unauthorized or deficiently executed transaction, it must then compensate the bank.[146] As a general rule, the burden will fall on either the bank or TPP to show that the transaction was authenticated rather than on customers to prove otherwise.[147] Furthermore, both PISPs and AISPs must have professional indemnity insurance (or a comparable guarantee).[148]

The EU/UK regime articulates a set of interrelated obligations governing the customers, banks, and TPPs concerning liability. Customers, termed "payers" under PSR 2017, are obliged to notify their bank when they learn an unauthorized transaction has taken place and wish to seek rectification.[149] They must make such a notification "without undue delay" on becoming aware of the transaction, and "in any event, no later than 13 months after the

140. *Id.*

141. Payment Services Regulations 2017, SI 2014/752 [hereinafter PSR].

142. Payment Services Regulations 2017 Explanatory Memorandum, c. 2, Explanatory Notes ¶ 1.

143. PSD II, *supra* note 1, art. 73 at 96; PSR, *supra* note 141, art. 76; FINEXTRA, *Trust in Open Banking*, *supra* note 127.

144. PSR, *supra* note 141, art. 76, ¶ 3.

145. PSD II, *supra* note 1, art. 73(2) at 96; PSR, *supra* note 141, art. 76, ¶ 5(a).

146. PSD II, *supra* note 1, art. 73(2) at 96; PSR, *supra* note 141, art. 76, ¶ 5(b), art. 95.

147. *See, e.g.*, PSR, *supra* note 141, art. 75.

148. PSD II, *supra* note 1, art. 5(2)–(3) at 62; PSR, *supra* note 141, art. 6, ¶ 7(e)–(f).

149. PSD II, *supra* note 1, art. 71(1) at 96–97; PSR, *supra* note 141, art. 74, ¶ 1.

debit date."[150] A logical consequence following customers' failure to do so would be — though not expressly spelled out in the regime — that they bear all losses arising from unauthorized transactions (i.e., they lose their statutory entitlement reimbursed by the bank).[151] Further, it is less clear whether a customer can get their account rectified if he or she has "undue delay" — a term left undefined — in making such notification within the prescribed 13 month timeframe.[152]

Relatedly, while it is not clear whether a customer should also contact the TPP, the foregoing notification duty will, as a matter of practice, effectively make the bank the first contact.[153] Questions continue to go unanswered: should the bank then pass this information onto the TPP for investigation upon receiving a notification from customers? What can and should be done by the bank while the TPP investigates the unauthorized transaction? Although the PSR 2017 appears silent on these issues, the FCA has stated that the bank and TPP are permitted to have voluntary arrangements to settle such liabilities.[154]

A more difficult question arises if both the bank and TPP deny any wrongdoing after the notification. While it is clear here that customers would not be caught in the middle — they will be reimbursed by the bank anyway, no matter who would be ultimately liable — it is less obvious as to the allocation of burden of proof between banks and TPPs. The FCA has clarified, in terms of payments initiated via a TPP, that the burden "lies with

150. PSR, *supra* note 141, art. 74, ¶ 1; *see* PSD II, *supra* note 1, art. 71(1) at 96–97.

151. However, this issue is not entirely clear and there has been no specific guidance from the EU nor from the FCA. Kai Zhang, *Payer Liability under PSD2 — Unintended Complexity?* BRYAN CAVE LEIGHTON PAISNER (June 27, 2019), https://www.bclplaw.com/en-US/thought-leadership/payer-liability-under-psd2-unintended-complexity.html (reasoning that this allocation of liability encourages customers to timely report any unauthorized payment transaction).

152. Steennot, *supra* note 130, at 116 (observing that "it remains unclear whether the payer can still obtain rectification if he [was] notified [of] the unauthorized transaction within 13 months, but not without undue delay after becoming aware of the unauthorized transaction").

153. *See Open Banking, Open Liability: Accountability Issues for Open Banking APIs*, ASHURST (Feb. 28, 2018) [hereinafter *Open Banking, Open Liability*], https://www.ashurst.com/en/news-and-insights/legal-updates/open-banking-open-liability-accountability-issues-for-open-banking-apis/ (questioning whether it is the best practice for banks to serve as the refund point of contact, especially "where there is a direct interaction between TPP and the customer").

154. FIN. CONDUCT AUTH., PAYMENT SERVICES AND ELECTRONIC MONEY — OUR APPROACH. THE FCA'S ROLE UNDER THE PAYMENT SERVICES REGULATIONS 2017 AND THE ELECTRONIC MONEY REGULATIONS 2011 122, 139 (2019) [hereinafter FCA APPROACH DOCUMENT], https://www.fca.org.uk/publication/finalised-guidance/fca-approach-payment-services-electronic-money-2017.pdf.

the PISP to show that it was not responsible for the error."[155] The PISP thus needs to show that the payment order was correctly handled within its "sphere of influence" — that is, the parts of the transaction over which the PISP has control.[156] Nevertheless, what would trigger this "sphere of influence" expression remains unclear in practice.[157]

If, on the other hand, the loss or misappropriation of the payment instrument was traced to the customer, that customer would be liable for losses up to a maximum of £35.[158] Yet, customers would assume full liability for losses — without a cap — if they have acted fraudulently, or otherwise intentionally, or with gross negligence breached the obligations[159] concerning the use of the payment instrument[160] and the safe-keeping of security credentials.[161] Some intriguing issues emerge from this context. First, what yardsticks are used to assess "detectability"? Second, how is the notion of "gross negligence" interpreted in this context? On the former, PSR 2017 and PSD II are largely silent, thus leaving room for debate in practice.[162] On the latter, PSD II in its recitals makes clear that "gross negligence" must be more than a mere breach of a duty of care; rather, it refers to conduct that exhibits "a significant degree of carelessness."[163] Prime examples include writing a PIN on a note that is kept besides the payment instrument, leaving the payment instrument in an easily accessible place, or typing in a password knowing that a person is watching.[164] The

155. *Id.* at 139.

156. *Id.* ("[The PISP must show] that the payment order was received by the customer's ASPSP and, within the PISP's sphere of influence, the payment transaction was authenticated, accurately recorded[,] and not affected by a technical breakdown or other deficiency.").

157. *Open Banking, Open Liability*, *supra* note 153 (noting that the "sphere of influence" may still lead to disputes).

158. PSD II, *supra* note 1, art. 74(1) at 96–97; PSR, *supra* note 141, art. 77, ¶¶ 1–2. Note that under the PSD II, this limit is €50. However, the customer will not be liable for any amount where the loss was not detectable, or where the loss was caused by an employee, agent, or branch of a PSP, or its outsourced provider.

159. These obligations are imposed under PSD II Articles 69 and 74. PSD II, *supra* note 1, art. 69, 74 at 94, 96–97; PSR, *supra* note 141, art. 72.

160. According to the FCA, "'payment instrument' has a wide definition . . . includ[ing] payment cards, e-banking[,] and telephone banking arrangements." FCA APPROACH DOCUMENT, *supra* note 154, at 98.

161. PSD II, *supra* note 1, art. 74(1) at 96–97; PSR, *supra* note 141, art. 77, ¶ 3.

162. "Detectable" is not defined in PSD II Article 4 ("Definitions"), nor in Article 74 ("Payer's liability for unauthorised payment transactions"). *See also* Zhang, *supra* note 151 (identifying PSR provisions where the meanings of certain threshold words are ambiguous).

163. PSD II, *supra* note 1, recital 72 at 47.

164. *Id.*; Steennot, *supra* note 130, at 961.

FCA clarified that "it is not sufficient . . . to assert that the customer 'must have' divulged" security credentials[165] — further underscoring that evidence must be provided to prove fraud or gross negligence, with the burden of proof once again on the bank.[166]

It comes as no surprise that allocation of liability has been one of the most controversial issues under the PSD II regime.[167] Banks are the first port of call for refunds even where there is a direct interaction between a customer and TPP, with banks citing this liability model to be a "key challenge" of third-party access.[168] The Institute of International Finance has recommended that responsibility should instead lie first on the party (the bank or TPP) from which the transaction originated.[169]

In brief, notwithstanding some ambiguities around the liability allocation arrangements, the current regime under the PSD II/PSR 2017 has been working towards being more payer (customer)-friendly than its predecessor.[170] Customers can, for instance, have the same protection if they use a PISP to initiate the transactions.[171] Customers' liability for losses not arising from grossly negligent or intentional breach of their obligations has been reduced from £50 to £35.[172] Furthermore, supporting evidence is required to prove a customer's fraud or gross negligence, and gross negligence has been clarified to require more than a mere breach of the duty of care.[173] Some commentators thus point out that under the new regime, "if one actually keeps his personalized security credentials safe, risks [for the customer] become very limited."[174]

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165. FCA APPROACH DOCUMENT, *supra* note 154, at 123–24.

166. PSD II, *supra* note 1, art. 72(2) at 96; PSR, *supra* note 141, art. 75, ¶ 4.

167. *See Open Banking, Open Liability*, *supra* note 153 (emphasizing that the European Payments Council expressed discontent with banks being held liable when they already take on financial risks and burdens).

168. *See* DELOITTE, EUROPEAN PSD2 SURVEY: VOICE OF THE BANKS 10 (2018), https://www2.deloitte.com/content/dam/Deloitte/cz/Documents/financial-services/Deloitte_European_PSD2_Voice_of_the_Banks_Survey_012018.pdf (listing primary challenges that banks identified with the PSD II).

169. INST. OF INT'L FIN., *supra* note 129, at 6.

170. *See* Steennot, *supra* note 130, at 963 (listing ways in which the PSD II regime increases customer protections).

171. PSD II, *supra* note 1, art. 73(2) at 96; PSR, *supra* note 141, art. 76, ¶ 5; Steennot, *supra* note 129, at 963.

172. Payment Services Regulations 2009, SI 2009/209, art. 62, ¶ 1, which set a maximum of £50 for such payer's liability, has been replaced by PSR 2017, art. 77, ¶ 1, which sets a maximum of £35.

173. PSD II, *supra* note 1, art. 72(2) at 96; PSR, *supra* note 141, art. 75, ¶ 4; Steennot, *supra* note 129, at 963–64.

174. Steennot, *supra* note 129, at 964.

Allocating liabilities raises two inter-related questions. One, what can be done about the fact that unauthorized transactions could go hand in hand with the lack of security measures? Two, what, if any, mechanism is put in place to address disputes arising from the Open Banking context? On the former, the EU/UK framework requires "strong customer authentication" and places rather strict liability on banks — no liability can be imposed on customers in the absence of such mechanisms.[175] As for the latter, the UK's Open Banking Standard has gone beyond PSD II to establish a Dispute Management System ("DMS").[176] Although it does not offer a liability or dispute resolution model in itself, it creates common best practice principles for banks and TPPs.[177]

ii. Australian Model

As in the UK, an accredited data recipient must have adequate insurance (or comparable guarantee) to compensate consumers for losses arising from contravention of duties under the CDR regime.[178] They may, subject to the services they offer and potential liability exposure, require professional indemnity insurance, cyber insurance, or both.[179]

A CDR participant is protected from liability under Section 56GC of the CDR Act where they provide CDR data as per the regulations and Consumer Data Rules. Unlike the PSD II/PSR 2017, however, the CDR does not contain a liability framework itself. Thus, the "ePayments Code" — to which most banks subscribe — would appear the most relevant instrument that comes into play concerning liabilities associated with unauthorized transactions. There are issues around the use of the ePayments Code in this context. First, the ePayments Code is voluntary and does not apply to TPPs unless they subscribe to it.[180] Second, while the ePayments Code has one chapter dedicated to allocating liability arising from unauthorized

175. PSD II, *supra* note 1, art. 74(2) at 97; PSR, *supra* note 141, art. 77, ¶ 4(c); *see infra* Section III.D.

176. *See Dispute Management System*, OBIE, https://www.openbanking.org.uk/providers/dispute-management-system/ (last visited July 13, 2021).

177. INST. OF INT'L FIN., *supra* note 129, at 5 ("The DMS is a voluntary mechanism under which participants adhere to a code of best practices, including on how to handle cases at the first instance, and how those can be taken to mediation, adjudication or arbitration.").

178. *Consumer Data Rules*, *supra* note 88, r 5.12(2)(b).

179. AUSTL. COMPETITION & CONSUMER CMM'N, DRAFT, CONSUMER DATA RIGHT SUPPLEMENTARY ACCREDITATION GUIDELINES: INSURANCE 5 (Sep. 23, 2019), https://www.accc.gov.au/system/files/CDR%20draft%20supplementary%20accreditation%20guidelines%20-%20insurance.pdf.

180. AUSTL. SEC. & INV. COMM'N, EPAYMENTS CODE 2 (2016), https://download.asic.gov.au/media/3798542/epayments-code-published-29-march-2016.pdf.

transactions, its focus is on the relationship between subscribing banks and customers.[181] More specifically, the ePayments Code provides a set of rules under which a customer (i.e., account-holder) will only be liable for losses in specified circumstances: for instance, where the customer contributed to the loss by "unreasonably delaying reporting the misuse, loss, or theft of a device" or breach of passcodes,[182] or where the bank can prove "on the balance of probabilities that [the customer] contributed to a loss through fraud or breaching the passcode security requirements."[183] Notably, a breach of the passcode security requirement could cover acts like voluntary disclosure of a customer's login credentials to a third party, or recording passcodes on anything carried with the device, or otherwise "act[ing] with extreme carelessness in failing to protect the security" of passcodes.[184] In such cases, the customer may be liable for any losses arising from associated unauthorized transactions.[185] Therefore, the ePayments Code may struggle to accommodate screen scraping practices as customers are likely to breach the security requirement if they share data with TPPs.[186] The legality of screen scraping technologies with the ePayment Code has become a source of debate, which will be considered later.[187] In summary, unlike its EU/UK counterpart, the CDR has not yet articulated a full-fledged regime allocating the liabilities between different parties in the contemporary Open Banking ecosystem.

D. How to Address Security and Privacy Concerns?

Although the risks associated with data sharing are not entirely novel, the greater access to data does increase the potential points of cyber-attacks and

181. *See generally id.* (noting that the Code regulates electronic payment services and "banks, credit unions, building societies and other providers of electronic payment facilities to consumers subscribe").

182. *Id.* s 11.5.

183. *Id.* s 11.2.

184. *Id.* s 12.

185. *Id.* s 11.

186. *See* THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at 51 (recognizing that the ASIC has not formed a definitive view on screen scraping, though quoting the ASIC's belief that "such actions could be viewed as the consumer breaching the standard banking terms and conditions for non-disclosure of passwords . . . in the ePayments Code"); *see also ASIC & ACCC: Screen Scraping is a Valid Method of Data Sharing*, AUSTL. FINTECH (Mar. 9, 2020), https://australianfintech.com.au/asic-accc-screen-scraping-is-a-valid-method-of-data-sharing-2/; James Eyers, *ASIC, ACCC Give Green Light to 'Screen Scraping'*, FIN. REV. (Feb. 28, 2020), https://www.afr.com/companies/financial-services/asic-accc-give-green-light-to-screen-scraping-20200228-p54588.

187. *See infra* Part III.E.

data breaches.[188] How to manage these concerns has become a daunting task for policymakers in both the UK and Australia, as discussed below.

i. EU/UK Model

The PSD II states that it "guarantees a high level of consumer protection, security of payment transactions, and protection against fraud."[189] It also stresses that the national authorities should "have in place adequate and effective safeguards" to respect fundamental rights, including privacy.[190] To this end, it sets out various mechanisms — from rigorous authentication methods to mandatory risk management and reporting systems. However, it has been debated whether these measures are resilient enough in managing security and data protection concerns.[191]

Regarding security concerns, the EU/UK regime allows banks to deny TPPs access to a payment account for "objectively justified and duly evidenced reasons relating to unauthori[z]ed or fraudulent access to the payment account."[192] In such cases, the bank shall inform the customer "before access is denied and at the latest immediately thereafter."[193] Also, banks must report such incidents to the relevant authority (in the UK, the FCA).[194]

More generally, all PSPs under the PSD II/PSR 2017 are required to have a framework with appropriate measures and control mechanisms to manage operational and security risks.[195] Such a framework should be "proportionate to its size and the nature, scope, complexity and riskiness of its operating

188. Pieter T.J. Wolters & Bart P.F. Jacobs, *The Security of Access to Accounts Under the PSD2*, 35 COMP. L. & SEC. REV. 29, 30 (2019) (arguing that customers within an open banking system are vulnerable at more points to their information being abused for "identity theft, blackmail, [or] illegal pricing discrimination").

189. *Id.* at 30; *see* PSD II, *supra* note 1, recitals 5–7, 33, 42, 66–67, 69, 75, 77, 84–85, 95, 109 at 36, 40, 42, 46–49, 51, 53.

190. PSD II, *supra* note 1, recital 46 at 42.

191. *See, e.g.*, Wolters & Jacobs, *supra* note 188, at 40–41 (arguing that these measures, like robust authentication, are inadequate and are subordinate to the goal of market development).

192. PSD II, *supra* note 1, art. 68(5) at 94; PSR, *supra* note 141, art. 71, ¶ 7.

193. PSD II, *supra* note 1, art. 68(5) at 94; PSR, *supra* note 141, art. 71, ¶ 8(a)–(b).

194. PSD II, *supra* note 1, art. 68(6) at 94; PSR, *supra* note 141, art. 71, ¶ 8(c).

195. These obligations apply to not only banks but to AISPs and PISPs, which must become an authorized provider to access data under PSD II. Such authorization will only be granted if the relevant national authority is satisfied that the company is suitable to provide AIS or PIS based on their internal control mechanisms (i.e., systems safeguarding the business from fraud and error), risk management procedures (e.g., risk identification, monitoring, and customer authentication), and incident response (e.g., monitoring and reporting policies), among others. PSD II, *supra* note 1, arts. 5, 95–96 at 59–63, 104–05; PSR, *supra* note 141, arts. 5, 98–99, sch. 2.

model, and of the payment services it offers."[196] A PSP is required to notify the FCA without undue delay in the event of a noteworthy operational or security breach.[197] Another notable design is the introduction of the "strong customer authentication" ("SCA") requirement. Where customers wish to use services offered by a TPP, SCA requirements would generally apply.[198] SCA involves a customer's demonstration of at least two of three types of identity verification: knowledge (e.g., a password), possession (e.g., possessing a particular mobile device by accepting a push notification), and/or inherence (e.g., fingerprint or iris recognition).[199] While SCA must be used in all other cases,[200] there are certain exemptions based on payment avenue, frequency, degree of risk, and amount of the transaction[201] — a provider can, for instance, choose not to apply SCA in transactions involving low amount,[202] low risk,[203] or "trusted beneficiaries" nominated by the customer.[204] These exemptions attempt to balance security and payment interests.[205] Notably, a bank forgoing SCA under an exemption will alter the allocation of liability (to its detriment) in regard to losses from unauthorized transactions. While a customer would usually be liable if they acted with "gross negligence" in failing to keep payment instruments or credentials safe,[206] in circumstances where SCA is not used by the bank, the customer will instead only bear losses where they have acted *fraudulently*.[207] Overall, the SCA method increases the certainty that the legitimate customer wishes to make a payment or access their account, rather than someone attempting to commit fraud.[208]

All firms that wish to participate in the Open Banking regime must be subject to common standards for communication, authentication, data

196. FCA APPROACH DOCUMENT, *supra* note 154, at 242.

197. PSD II, *supra* note 1, art. 96(1) at 105; PSR, *supra* note 141, art. 99, ¶ 1.

198. PSD II, *supra* note 1, art. 97 at 106; PSR, *supra* note 141, art. 100. It is the TPP that is obliged to apply the SCA, while the bank must simply allow the TPP to rely on the authentication procedures provided to the customer.

199. PSD II, *supra* note 1, art. 4(30) at 59.

200. *Id.* art. 97 at 106; PSR, *supra* note 141, art. 100.

201. PSD II, *supra* note 1, art. 98(3) at 107; FCA APPROACH DOCUMENT, *supra* note 154, at 256. The exemptions are transposed into UK law by PSR art. 100, ¶ 5.

202. RTS, *supra* note 98, art. 16 at 32.

203. *Id.* art. 18 at 33.

204. Such exemptions are specified in the RTS. *Id.* arts. 10–18 at 31–33.

205. Zunzunegui, *supra* note 59, at 29–30.

206. PSD II, *supra* note 1, art. 74(1) at 96.

207. *Id.* art. 74(2) at 97.

208. *See* RTS, *supra* note 98, art. 2 at 28–30.

storage, and security.[209] Many of these requirements are set forth under the Regulatory Technical Standards for Strong Customer Authentication and Common and Secure Open Standards of Communication ("RTS"). The RTS took effect in 2019 after being released by the European Banking Authority ("EBA") in cooperation with the European Central Bank ("ECB") and was then approved as a Commission delegated regulation.[210]

The RTS elaborates on managing operational and security risks under the PSD II, which has been adopted in the UK.[211] For instance, both banks and TPPs are required by PSD II/PSR 2017 to ensure that they communicate with each other "in a secure way" and per the specific standards set out by the RTS.[212] To this end, the RTS fleshes out detailed requirements for secure communication like the use of "strong and widely" recognized encryption techniques,[213] keeping sessions as short as possible, [214] limiting staff access to confidential information,[215] and various obligations for interfaces.[216] It also requires "transaction monitoring mechanisms" to be in place to detect unauthorized or fraudulent transactions.[217]

These RTS requirements are elaborated upon in the UK's data standards, released by the OBIE.[218] This is an independent, private entity funded and organized mainly by the CMA9 banks,[219] although some public oversight mechanisms are in place.[220] The decision-making body of OBIE consists of

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209. *See generally* THE OPEN BANKING STANDARD, OPEN DATA INSTITUTE (Louise Bolotin ed. 2020), http://theodi.org/wp-content/uploads/2020/03/298569302-The-Open-Banking-Standard-1.pdf (explaining that with Open Banking, financial institutions must adopt uniform standards across the industry).

210. RTS, *supra* note 98, art. 38(2) at 42.

211. For example, the security measures referred to in regulations 68, 69, 70, 77, and 100 of the PSR are adopted from the RTS. FCA APPROACH DOCUMENT, *supra* note 154, at 211.

212. PSD II, *supra* note 1, arts. 66(3)(d), 67(2)(c) at 92–93.

213. RTS, *supra* note 98, art. 35(1) at 41.

214. *Id.* art. 35(2) at 41.

215. *Id.* art. 35(5) at 41.

216. *Id.* arts. 30–33 at 37–40.

217. *Id.* art. 2(1) at 27–28.

218. *Read-Write Data API Specifications*, OBIE, https://openbanking.atlassian.net/wiki/spaces/DZ/pages/1077805207/Read+Write+Data+API+Specification+-+v3.1.2 (last updated Aug. 20, 2019).

219. COMPETITION & MKTS. AUTH., RETAIL BANKING MARKET INVESTIGATION 441 (2016) (ordering the UK's nine largest banks to set up an Implementation Entity "tasked with agreeing, implementing, and maintaining open and common banking standards").

220. The chair is accountable to the CMA and must provide monthly reports to them. The steering group includes observers from four public bodies (the HM's Treasury, the FCA, the Payment Systems Regulator, and the Information Commissioner's Office). *See id.* at 39; UK CMA Order, *supra* note 65, sch. 1 item 2.

CMA9 representatives, customer representatives, and representatives from various stakeholder groups (e.g., Fintechs).[221] These parties collectively shape the data standards released by OBIE, imposing various requirements (such as API, data format, and security standards) that ensure the practical and secure functioning of Open Banking.[222] Besides security measures, the EU/UK regime is also concerned with a potential data breach by stating at the outset that "data protection by design and data protection by default should be embedded in all data processing systems"[223] and that personal data should be provided and processed "in accordance with Directive 95/46" — the predecessor of the GDPR.[224] As for the interaction between the GDPR and the PSD II, several points are noteworthy. First, it is generally agreed that the PSD II is not "*lex specialis*" vis-à-vis the GDPR, but rather provides a specific framework on how payment data should be accessed.[225] The European Data Protection Board ("EDPB"), for instance, in its response to the Dutch Data Protection Authority, implied as much about Article 94 of the PSD II by stating that, "the interpretation and the implementation of the articles in PSD2 have to be made in light of the GDPR."[226] BEUC — the European Consumer Organisation — made this point even clearer:

> *[A]ccess to bank account information can very often reveal sensitive data which would fall under Article 9 GDPR.* Explicit consent under the GDPR should be required as the legal basis for processing in those situations where special categories of data would be involved. Otherwise, banks and

221. UK CMA Order, *supra* note 65, sch. 1 Part A. Specifically, stakeholder views are presented by the conveners of advisory groups (representing Fintechs, challenger banks, PSPs, and others).

222. *Id.* § 10.1 (detailing providers' requirements to implement and maintain "without charge" open API and data sharing standards).

223. PSD II, *supra* note 1, recital 89 at 50.

224. *Id.* art. 94(1) at 104. Article 94 of the GDPR states that references to the repealed Directive shall be read as references to GDPR.

225. *See, e.g.*, EUR. BANKING FED'N, GUIDANCE FOR IMPLEMENTATION OF THE REVISED PAYMENT SERVICES DIRECTIVE 83 (2019) [hereinafter EBF, PSD2 GUIDANCE], https://www.ebf.eu/wp-content/uploads/2020/01/EBF-PSD2-Guidance-Final-v.120.pdf; FCA APPROACH DOCUMENT, *supra* note 154, at 220 ("A PSP must ensure that it meets its obligations under both the PSRs 2017 and data protection law cumulatively."); *cf.* Giangiacomo Olivi, *PSD2: Legal Issues in Open Banking (and GDPR!)*, DENTONS (Feb. 26, 2019), https://www.dentons.com/en/insights/articles/2019/february/26/psd2-legal-issues-in-open-banking-and-gdpr (explaining that PSD II "could be *lex specialis* with respect to GDPR" because the PSD II passed in 2015, before the GDPR was enacted).

226. Letter from Andrea Jelinek, Chairperson, Eur. Data Prot. Bd., to Sophie in 't Veld, Member, Eur. Parliament 2 (July 5, 2018) [hereinafter EDPB 2018 Letter], https://edpb.europa.eu/sites/edpb/files/files/file1/psd2_letter_en.pdf (explaining that GDPR data protections must be consistently applied throughout the EU because, under Article 94, "references to the repealed Directive 95/46 shall be construed as references to the GDPR").

> TPPs would be actively circumventing the GDPR. In this sense, PSD II is not *lex specialis*.[227]

Two related issues arise from the above observation. For one, each Open Banking participant should be considered as a separate data controller and should be responsible for its own data processing. While banks are obliged to ensure data access by TPPs via dedicated interfaces, such third parties are not selected by banks; thus, banks do not have the duty to ascertain a TPP's GDPR compliance.[228]

For another, the term "consent" should be read differently under the PSD II and the GDPR — they have different functions with different requirements. Specifically, data sharing under Article 94(2) of the PSD II and Regulation 97 of the PSR 2017 is conditioned upon a customer's "explicit consent," which is an "additional requirement of a contractual nature" and is "not the same as (explicit) consent under the GDPR."[229] The consent in the Open Banking regime should be understood therefore in conjunction with GDPR Article 6(1)(b) given that processing data is necessary for the performance of a contract to which the data subject is a party. Accordingly, "when entering a contract with a payment service provider under PSD2, data subjects must be made fully aware of the purposes for which their personal data will be processed and have to explicitly agree[] to these clauses."[230] For purposes other than those necessary for performing a contract, one can rely on "consent" under GDPR Article 6(1)(a), provided that other conditions are met.[231] In short, PSD II increases the standard of data protection by imposing additional consent.

Another sticking issue around consent arises when a consumer allows a TPP access to their data, such data would often involve the transactions

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227. EUR. CONSUMER ORG. (BEUC), BUEC'S RECOMMENDATIONS TO THE EDPB ON THE INTERPLAY BETWEEN THE GDPR AND PSD2, 3–4 (2019), https://www.beuc.eu/publications/beuc-x-2019-021_beuc_recommendations_to_edpb-interplay_gdpr-psd2.pdf.

228. *See* EBF, PSD2 GUIDANCE, *supra* note 225, at 84.

229. EDPB 2018 Letter, *supra* note 226, at 4 ("Such clauses should be clearly distinguishable from the other matters dealt with in the contract and would need to be explicitly accepted by the data subject.").

230. *Id.*

231. Specifically, those conditions set forth under Articles 4(11) and 7 of the GDPR. Some practitioners suggest that, from a practical perspective, PSPs will have to "build an explicit consent mechanism aligned with the PSD2, but not with the GDPR. As far as GDPR is concerned, they will have to rely on another lawful basis (namely, contractual necessity) to process data from a GDPR perspective." Scott McInnes et al., *EU: The Interplay of PSD2 and GDPR — Some Select Issues*, BIRD & BIRD (Feb. 2019), https://www.twobirds.com/en/news/articles/2019/global/eu-the-interplay-of-psd2-and-gdpr-some-select-issues.

between that customer with a third party — the so-called "silent party."[232] Would processing a silent party's data put TPPs inconsistent with the GDPR absent the consent of that such party? In this regard, the EDPB stated that in the case of TPPs, the "legitimate interests pursued by the controller or by a third party" under GDPR Article 6(1)(f) should provide a lawful basis for processing a silent party's personal data.[233] Yet, the EDPB noted that this legitimate interest must not be "overridden by the interests or fundamental rights and freedoms of the data subject," and such processing must be unavoidable, comparable, and align with other GDPR principles like "purpose limitation, data minimi[z]ation and transparency."[234]

Speaking of data minimization, the PSD II regime does mirror what is required under GDPR Article 5(1)(c). For instance, in the context of AISP PSD II only allows entities to request and access the information that is necessary to initiate the payment transaction.[235] Relatedly, the PSD II excludes "sensitive payment data" (e.g., personalized security credentials) from the scope of the access to accounts.[236]

Notwithstanding these security and data protection measures, there are still concerns. In terms of security measures, notably, there are criticisms against the "fall-back" option allowing the use of screen scraping.[237] It is also argued that the PSPs have considerable discretion to organize the authentication process, which can undermine the goal to make the process as secure as possible.[238] It is likewise suggested that the data minimization principle could be easily compromised by TPPs by offering a wide range of services.[239] However, these pitfalls do not necessarily mean that customers lack adequate protection as a matter of practice: it remains to be seen how

232. For instance, a customer named John transferred money to his friend Jane to share dining costs. If John decides to use an AISP's services by allowing the bank to share data, Jane's information would be included as part of that information. *See* EDPB 2018 Letter, *supra* note 226, at 2.

233. *See id.* at 3.

234. *Id.*

235. *See, e.g.*, PSD II, *supra* note 1, arts. 66(3)(f), 66(3)(g), 67(2)(d) at 92–93; PSR, *supra* note 141, art. 69, ¶ 3(f), art. 70, ¶ 3(d).

236. PSD II, *supra* note 1, arts. 4(32), 67(2)(e), at 59, 93; PSR, *supra* note 141, art. 2, ¶ 1, art. 70, ¶ 3(e).

237. *See infra* Part III.E.

238. Wolters & Jacobs, *supra* note 188, at 29 (noting that "banks do not seem required to trust this process" and banks do not need to be able "to verify the authentication or the integrity of the payment order").

239. *Id.* at 32 (stating that the required information "depends on the offered service;" therefore, if a broad range of services are offered, the limitation can be avoided).

the security and data protection requirements will be tested in the next few years.[240]

ii. Australia Model

According to the Australian Information Commissioner, "securing CDR data is an integral element of the CDR regime."[241] Like in its EU/UK counterpart, authorization is an effective tool: data relating to identifiable consumers can generally only be transferred to Accredited Data Recipients ("ADR") (or the consumer themselves).[242] To become accredited,[243] a TPP must demonstrate sufficient security measures,[244] as evaluated through the "information security obligation" (discussed below).[245] Such requirements are an ongoing duty — where a TPP fails to maintain them after accreditation; the ACCC can revoke, suspend or impose conditions upon their status as an ADR.[246]

While the legislation itself features some of these protection principles,[247] the CDR framework also contains the flexibility to react to emerging privacy and security risks.[248] This is achieved by way of rule-making (e.g., the CDR

240. Also note the penalties available for enforcement under the PSR: the FCA may impose a financial penalty corresponding to those under the Financial Services and Markets Act 2000 (PSR arts. 111, 112, ¶ 6), cancel a PSP's authorization (art. 10), publish a statement of public censure (art. 110) or seek an injunction (art. 113). PSR, *supra* note 141, arts. 10, 111, 112, ¶ 6, 113.

241. OFF. OF THE AUSTL. INFO. COMM'R, CDR PRIVACY SAFEGUARD GUIDELINES, CHAPTER 12: PRIVACY SAFEGUARD 12 – SECURITY OF CDR DATA, AND DESTRUCTION OR DE-IDENTIFICATION OF REDUNDANT DATA 3 (2020) (stating that securing this data is important to ensure that it is not misused, lost, accessed without authorization, or modified).

242. *Competition and Consumer Act*, *supra* note 91, s 56BD(1)(b). While transfers of data out of the CDR system are possible, it is highly restricted. THE TREASURY (AUSTL.), CONSUMER DATA RIGHT PRIVACY PROTECTIONS 5 (2018) [hereinafter THE TREASURY (AUSTL.), CDR PRIVACY PROTECTIONS], https://treasury.gov.au/sites/default/files/2019-03/CDR-Privacy-Summary.pdf.

243. Accreditation criteria are set by the ACCC pursuant to section 56BH(1) of the Competition and Consumer Act. *See also Consumer Data Rules*, *supra* note 88, pt 5.

244. THE TREASURY (AUSTL.), CDR PRIVACY PROTECTIONS, *supra* note 242, at 5; Explanatory Memorandum, CDR Bill, *supra* note 71, at 20.

245. ACCC, CDR SUPPLEMENTARY GUIDELINES: INFORMATION SECURITY, *supra* note 92, at 5.

246. THE TREASURY (AUSTL.), CDR PRIVACY PROTECTIONS, *supra* note 242, at 5 (explaining the ACCC's oversight power); OFF. OF THE AUSTL. INFO. COMM'R, CDR PRIVACY SAFEGUARD GUIDELINES, *supra* note 241 (stating that, if the applicant does not remain compliant with Privacy Safeguard 12, its accreditation may be revoked).

247. While Safeguards 1 to 11 largely aim to address privacy concerns, Safeguard 12 also addresses security concerns. *Competition and Consumer Act*, *supra* note 91, s 56 EO(1).

248. THE TREASURY (AUSTL.), CDR PRIVACY PROTECTIONS, *supra* note 242, at 4

Rules) and standard-setting processes (e.g., the "Data Standards").[249] The Rules are made by the ACCC to flesh out the substantial requirements of the scheme,[250] while the Data Standards help to ensure functionality and security at a practical level.[251] In contrast to the UK's private, industry-funded OBIE, these are developed by a government-appointed Data Standards Chair[252] with assistance from a public Data Standards Body[253] (currently the CSIRO's "Data 61" team).[254] Nonetheless, there is still room for industry input in developing the Standards, with the Chair using his powers to establish a Banking Advisory Committee.[255]

The CDR regime's "information security obligation" imposes requirements that resemble those of its EU/UK counterpart. It requires an ADR to take appropriate measures to protect CDR data "from misuse, interference and loss, and from unauthori[z]ed access, modification and disclosure," with minimum steps outlined in the CDR Rules.[256] Like in the EU/UK regime,[257] these minimum requirements mean that an ADR must — at least annually — identify potential security risks and detail the mitigation measures they have implemented in response.[258] Similar to various other PSD II requirements,[259] an accredited person must also establish processes

(explaining the flexibilities in the framework to respond to risks).

249. *Id.* The Consumer Data Rules are made by the ACCC. *See Competition and Consumer Act*, *supra* note 91, s 56BA. The Data Standards are made by the Data Standards Chair. *See id.* s 56FA.

250. For example, the Rules prescribe requirements for collection, disclosure, and use of CDR data. *See id.* s 57BB.

251. For example, the Standards may prescribe the processes and format for data transfer (among other things). *See id.* s 56FA(1); Explanatory Memorandum, CDR Bill, *supra* note 71, at 7, 48.

252. *Competition and Consumer Act*, *supra* note 91, s 56FA(1).

253. *Id.* s 56FK(1).

254. *See Consumer Data Standards*, CSIRO, DATA61, https://data61.csiro.au/en/Our-Research/Focus-Areas/Special-Projects/Consumer-Data-Standards (last updated Jul. 3, 2020).

255. This Committee includes banks, consumer, and Fintech representatives. *See Competition and Consumer Act*, *supra* note 91, s 56FH(2)(a); THE TREASURY (AUSTL.), PRIVACY IMPACT ASSESSMENT: CONSUMER DATA RIGHT 52 (2019) [hereinafter THE TREASURY (AUSTL.), PRIVACY IMPACT ASSESSMENT]; *Banking Advisory Committee*, CONSUMER DATA STANDARDS, https://consumerdatastandards.org.au/about/advisory-committee/ (last visited July 16, 2021).

256. *Consumer Data Rules*, *supra* note 88, r 5.12, sch 2 item 1.3; ACCC, CDR SUPPLEMENTARY GUIDELINES: INFORMATION SECURITY, *supra* note 92; see also *Consumer Data Rules*, *supra* note 88, sch 2 for the minimum requirements.

257. PSD II, *supra* note 1, art. 95(2) at 104. Under PSD II, the PSP must also provide this assessment to their competent authority.

258. *Consumer Data Rules*, *supra* note 88, sch 2 item 1.3.

259. The EU/UK regime requires "strong customer authentication," "strong and

to limit unauthorized access (including multi-factor authentication for all access to CDR data other than by the data's CDR consumer), secure their network and systems (including by use of encryption), and implement a formal program to identify and remediate vulnerabilities quickly.[260] Such security capabilities must be reviewed and adjusted at least annually, or more frequently where there has been a "material change" in the nature and extent of threats.[261] Lastly, and again analogously to its EU/UK counterpart,[262] the Rules require incident management and reporting in the form of "CDR data security response plans."[263] Such procedures must detect and respond to information security incidents "as soon as practicable."[264] They must also involve the notification of "eligible data breaches"[265] to the Information Commissioner and to affected consumers where required[266] and "information security incidents" to the Australian Cyber Security Centre.[267]

The most salient feature in the CDR regime is perhaps the thirteen Privacy Safeguards ("PSs") introduced by the CDR Act.[268] While the PSD II/PSR regime contains several provisions on data protection, the CDR Act goes one step further by creating its own privacy protection mechanism. These legally binding statutory provisions are inserted into the Competition and Consumer Act 2010 itself,[269] setting out rights and obligations in relation to collecting,

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widely recogni[z]ed" encryption techniques, and internal control mechanisms to detect and classify security incidents. *See* PSD II, *supra* note 1, arts. 95(1), 97 at 104, 106; RTS, *supra* note 98, art. 35(1) at 41.

260. *Consumer Data Rules*, *supra* note 88, sch 2 item 2.2.

261. *Id*. item 1.5(2).

262. The EU/UK regime requires PSPs to maintain effective incident management procedures and report major incidents to the competent authority. *See* PSD II, *supra* note 1, arts. 95(1), 96(1) at 104–05.

263. *Consumer Data Rules*, *supra* note 88, sch 2 item 1.7(2).

264. *Id.* item 1.7(1).

265. An "eligible data breach" is a data breach "likely to result in serious harm to any of the individuals to whom the information relates." *Privacy Act 1988*, *supra* note 112, s 26WE.

266. *Consumer Data Rules*, *supra* note 88, sch 2 item 1.7(3)(b); *see also Privacy Act 1988*, *supra* note 112, pt IIIC.

267. "In any case, this notification must occur no later than 30 days after the ADR becomes aware of the security incident." *Consumer Data Rules*, *supra* note 88, sch 2 item 1.7(3)(c).

268. OFF. OF THE AUSTL. INFO, COMM'R, CDR PRIVACY SAFEGUARD GUIDELINES, *supra* note 241, at CHAPTER A: INTRODUCTORY MATTERS 4 (listing the thirteen Privacy Safeguards).

269. *See Competition and Consumer Act*, *supra* note 91, div 5; OFF. OF THE AUSTL. INFO, COMM'R, CDR PRIVACY SAFEGUARD GUIDELINES, *supra* note 241, at CHAPTER A: INTRODUCTORY MATTERS 4.

holding, using, and disclosing CDR data.[270] They are more onerous than the long-established APPs under the Privacy Act 1988.[271] Several broader points can be drawn here. First, the interplay between the PSs and the APPs/Privacy Act can be even more complicated than its EU/UK counterpart. In some instances, the PSs operate alongside the APPs, while in others, the PSs operate to exclude the APPs.[272] Specifically, the application of PSs depends on the context — for instance, while they primarily apply to ADRs, they are also applicable to data holders concerning their handling of the CDR data.[273] Moreover, the obligations imposed could vary depending on the CDR entity. For instance, while APP 1 sets forth overall privacy management for all APP entities,[274] PSs have different requirements for a CDR data holder (i.e., banks) and an ADR (i.e., TPPs).[275] This is to ensure that "there are no gaps" in data protection under the CDR regime.[276]

Second, the CDR regime features various GDPR-style protections. The PSs, for instance, cast a wider net by applying to CDR data that *relates to* individuals or entities,[277] while the APPs apply to "personal information" that is *about* an identified or "reasonably identifiable" individual.[278] The

270. OFF. OF THE AUSTL. INFO, COMM'R, CDR PRIVACY SAFEGUARD GUIDELINES, *supra* note 241, at CHAPTER A: INTRODUCTORY MATTERS at 4. Note that the Safeguards "only apply to data for which there are one or more consumers" (consumer data) rather than product data. *Competition and Consumer Act*, *supra* note 91, s 56EB(1).

271. *Compare Privacy Act 1988*, *supra* note 112 (setting out what constitutes an APP breach but not identifying the safeguards in place), *with Competition and Consumer Act*, *supra* note 91, div 5 (stating both of the privacy safeguards that are in position to protect CDR consumers and their data).

272. Explanatory Memorandum, CDR Bill, *supra* note 71, at 54–66 (stating that the privacy safeguards are in place to operate with the APPs; however, noncompliance may result in the privacy safeguards excluding the APPs).

273. Almost all PSs (barring 3 and 4) apply to ADRs, while only PSs 1, 10, 11, and 13 apply to data holders (when handling CDR data). OFF. OF THE AUSTL. INFO, COMM'R, CDR PRIVACY SAFEGUARD GUIDELINES, *supra* note 241, at CHAPTER A: INTRODUCTORY MATTERS 6.

274. An "APP entity" is defined in section 6 of the Privacy Act as "a [Commonwealth] agency or organi[z]ation." In this context, "organi[z]ation" excludes businesses that had a turnover of less than $3,000,000 AUD in the last financial year ("small businesses"). *Privacy Act 1988*, *supra* note 112, ss 6C, 6D.

275. *Competition and Consumer Act*, *supra* note 91, s 56ED(4)–(5).

276. OFF. OF THE AUSTL. INFO, COMM'R, CDR PRIVACY SAFEGUARD GUIDELINES, *supra* note 241, at CHAPTER A: INTRODUCTORY MATTERS 7. *Competition and Consumer Act*, *supra* note 91, s 56EC indicates several scenarios where the APP do not apply in the CDR context.

277. *Competition and Consumer Act*, *supra* note 91, ss 56AI(3), 56EB(1); Explanatory Memorandum, CDR Bill, *supra* note 71, at 7.

278. *Privacy Act 1988*, *supra* note 112, s 6, sch 1. It is arguable whether social media platforms' collection of location data, or fitness trackers' collection of heart rate and

GDPR applies to "data controllers" and "data processors,"[279] while PSs likewise apply to data holders and recipients — which, like its EU/UK counterpart, includes "small business[es]."[280] More crucially, the PSs enhance privacy protection in various aspects.[281] For instance, both the GDPR and PSs require "express consent,"[282] while implied consent is also allowed under the APPs.[283] However, the CDR is more restrictive than the GDPR — it does not permit the non-consent-based collection, use, or transfer on grounds like "legitimate interests" of the businesses.[284] Furthermore, like the GDPR,[285] the CDR regime gives any persons affected (including individuals) the standing to sue for CDR breaches — including privacy breaches.[286] Also, similar to the GDPR,[287] contravention of most PSs may attract severe civil penalties.[288] Relating to this is that the CDR

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sleep pattern data, would fall within the scope of personal information. MEESE ET AL., *supra* note 115, at 7. This contrasts to the GDPR and CDR — specifically, "personal data" as defined under article 4(1) of the GDPR, or CDR data as defined under section 56AI *Competition and Consumer Act* — which both clearly cover indirect data. *See id.* at 7, 9.

279. GDPR, *supra* note 108, arts. 2–3 at 32–33.

280. Unlike the APPs which do not apply to "small businesses," the PSs bind CDR entities regardless of size. *See Competition and Consumer Act*, *supra* note 91, ss 56ED–56EO; THE TREASURY (AUSTL.), CDR PRIVACY PROTECTIONS, *supra* note 242, at 4.

281. *See* THE TREASURY (AUSTL.), PRIVACY IMPACT ASSESSMENT, *supra* note 255, at 12.

282. *Consumer Data Rules 2020* (Cth) rr 4.9, 4.11 (Austl.); GDPR, *supra* note 108, arts. 4(11), 6(1)(a), 7 at 34, 36–37.

283. *Privacy Act 1988*, *supra* note 112, ss 16A, 16B.

284. Under GDPR article 6(1)(f), processing may be lawful if it is necessary for "legitimate interests pursued by the controller."

285. GDPR, *supra* note 108, art. 82 ("Any person who has suffered material or non-material damage as a result of an infringement of this Regulation shall have the right to receive compensation from the controller or processor for damages suffered.").

286. *Competition and Consumer Act*, *supra* note 91, s 56EY ("A person who suffers loss or damage . . . by an act or omission . . . may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention."). There is no such right under the Privacy Act. THE TREASURY (AUSTL.), PRIVACY IMPACT ASSESSMENT, *supra* note 255, at 98–99.

287. GDPR article 83(5) breaches can lead to fines of up to €20,000,000 or, "in the case of an undertaking, up to 4% of the total worldwide annual turnover of the preceding financial year, whichever is higher."

288. *Competition and Consumer Act*, *supra* note 91, s 56EV. Breaches can lead to fines up to $500,000 AUD for individuals or $10,000,000 AUD for corporations, or three times the total value of the benefits that have been obtained, or 10% of the annual domestic turnover of the entity committing the breach (whichever is greater). This is vastly increased compared to the Privacy Act's civil penalty of "2000 penalty units" in section 13G, which is only for serious or repeated breaches.

regime has a wider geographical jurisdiction than the Privacy Act/APPs.[289]

New concerns, however come hand in hand with these improvements. The most obvious one is the complexity of the multi-tier privacy framework with personal information regulated by the APPs, a broader set of data governed by the PSs, and common law playing a role as well.[290] The overall result can be "a series of overlapping and confusing processes and policies," which can complicate compliance for consumers and businesses and hence increase transaction costs.[291] One solution is to overhaul the Privacy Act and APPs entirely rather than introducing a parallel framework.[292] Another sticky point is the "silent party's data" problem. Like its EU/UK counterpart, the Australian Treasury has highlighted this concern by stating that "[r]ules may provide requirements for consent by silent parties, balancing the competing data rights of the parties, and may provide rules restricting certain uses of data (e.g., profiling of silent parties)."[293] The OAIC Privacy Guidelines make clear that it is prohibited to use CDR data "for the purpose: of identifying; compiling insights in relation to; or building a profile in relation to; any identifiable person who is not a CDR consumer who made the consumer data request" (including via aggregating the CDR data), unless the ADR obtains required consent.[294]

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289. The CDR regime applies to "some cases where there would not be an Australian link for the purposes of the Privacy Act" — for instance, "where data is collected by a foreign company, outside of Australia, on behalf of an Australian registered company or an Australian citizen, the CDR would apply, but the Privacy Act would not." THE TREASURY (AUSTL.), PRIVACY IMPACT ASSESSMENT, *supra* note 255, at 158.

290. MEESE ET AL., *supra* note 115, at 28 (noting that this "complicated legal framework" will be difficult for businesses to comply with and confusing for Australians).

291. *Id.* (advocating that the Australian Government implement a different approach to alleviate some of these challenges).

292. *See, e.g.*, *id.* at 28 (recommending options for the Australian Government to assist businesses while acting efficiently); BUS. COUNCIL OF AUSTL., SUBMISSION NO. 9, RESPONSE TO THE TREASURY LAWS AMENDMENT (CONSUMER DATA RIGHT) BILL 2018 (SECOND STAGE) 8 (Feb. 28, 2019).

293. THE TREASURY (AUSTL.), PRIVACY IMPACT ASSESSMENT, *supra* note 255, at 123.

294. OFF. OF THE AUSTL. INFO. COMM'R, CDR PRIVACY SAFEGUARD GUIDELINES, *supra* note 241, at CHAPTER 6: PRIVACY SAFEGUARD 6 — USE OR DISCLOSURE OF CDR DATA BY ACCREDITED DATA RECIPIENTS OR DESIGNATED GATEWAYS 11; *Consumer Data Rules*, *supra* note 88, r 4.12(3)–(4).

E. Is Screen Scraping Still Legal?

Another controversial issue is the legality of screen scraping after both jurisdictions formalize data sharing through the Open Banking initiatives,[295] as detailed below.

i. EU/UK Model

In the EU/UK, while the PSD II seeks to make screen scraping redundant as more firms begin to use open APIs, the Directive itself does not prohibit it.[296] Instead, such accessibility is regulated in the RTS, which spells out the specific requirements for communication channels in Section 2.[297] As a general rule, from the date that the RTS came into effect on September 14, 2019, TPPs' access to accounts must take one of the authorized forms.[298] Banks are required under the RTS to ensure access and prepare an interface for these third-party providers — either by creating a dedicated API or modifying their existing interface (enabling TPPs to identify themselves).[299] The latter can be seen as screen scraping in a "new, modified form" and has sometimes been referred to as "screen scraping plus."[300] Banks must now ensure that their interfaces comply with these communication standards.[301] Despite the dedicated APIs, there are still concerns that such an interface could be unavailable or not performing to the required standard.[302] This gives rise to the "fall-back" option — banks must permit this type of third-party access until the dedicated interface is restored to the required level of availability and performance.[303]

Controversy about the presence of this fall-back option — with the EBA

295. *See generally* Han-Wei Liu, *Two Decades of Laws and Practice Around Screen Scraping in the Common Law World and Its Open Banking Watershed Moment*, 30 WASH. INT'L L. J. 28 (2020) (comparing regulatory frameworks among different countries and arguing that data sharing initiatives could reduce demand for screen scraping).

296. THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at 125–26.

297. *See* RTS, *supra* note 98, § 2 at 37–42 ("Specific requirements for the common and secure open standards of communication.").

298. *Id.* art. 38(2) at 42; Zunzunegui, *supra* note 59, at 29.

299. RTS, *supra* note 98, art. 31 at 38. Note that a TPP has an obligation to identify itself under PSD II articles 66(3)(d) and 67(2)(c).

300. Adam Polanowski & Przemyslaw Gruchala, *Can a User's Account be Accessed Through Screen Scraping?*, NEWTECH LAW (Mar. 15, 2019), https://newtech.law/en/can-a-users-account-be-accessed-through-screen-scraping/.

301. Zunzunegui, *supra* note 59, at 29.

302. RTS, *supra* note 98, art. 33 at 39–40.

303. *Id.* art. 33(4) at 39.

opposing it and the European Commission in favor of it[304] — led to it being tempered with an exemption under Article 33(6) of the RTS.[305] Under this provision, banks can be exempted from the requirement that they implement the fall-back mechanism if they can demonstrate that they meet four conditions: they have complied with Article 32's requirements for dedicated interfaces, have stress-tested the dedicated interface for at least six months, proven wide usage by TPPs for at least three months, and have resolved any problems with the dedicated interface without undue delay.[306] If all of these requirements are met, the competent national authority (in the UK, the FCA) may provide an exemption, such that the bank is not required to allow screen scraping as a fall-back option.[307] In accessing the data held by such banks, PSPs are thus not permitted to use screen scraping under any circumstances.[308]

In short, TPPs may legitimately employ screen scraping plus (which identifies the TPP and thus complies with PSD II requirements) where a bank modifies their existing interface for this purpose rather than creating an API.[309] Where the bank instead creates an API for data access, screen scraping can only be conducted in narrow circumstances — specifically, where the API is not performing to the required standard.[310] The legality of screen scraping is even further restricted where a bank has implemented a compliant, stress-tested, and widely-used API. In such cases, the FCA can provide an exemption to the fall-back provision, ensuring that accessing bank-held data via screen scraping will always be prohibited.[311]

ii. Australian Model

The role of screen scraping is less evident in Australia, with CDR legislation being silent on the issue. Rather than prohibiting or endorsing

304. Screen scraping was prohibited entirely in the EBA's original draft. Rationales included that TPPs using screen scraping were in violation of the obligation to identify themselves under PSD II articles 65(3)(d), 67(2)(c), and that they gained access to information unnecessary for the provision of service. However, certain stakeholders lobbied against this total ban, leading the European Commission to introduce the fallback provision in a later draft of the RTS. *See* Wolters & Jacobs, *supra* note 188, at 36.

305. *Id.*; EUR. BANKING AUTH., GUIDELINES ON THE CONDITIONS TO BENEFIT FROM AN EXEMPTION FROM THE CONTINGENCY MECHANISM UNDER ARTICLE 33(6) OF REGULATION (EU) 2018/389 (RTS ON SCA & CSC) 3 (2018).

306. RTS, *supra* note 98, art. 33(6) at 40.

307. *Id.*

308. Wolters & Jacobs, *supra* note 188, at 36.

309. *See* RTS, *supra* note 98, arts. 30–31 at 37–38. The obligation for a TPP to identify itself is imposed under PSD II articles 66(3)(d) and 67(2)(c).

310. *See* RTS, *supra* note 98, art. 33 at 39–40.

311. *Id.* art. 33(6) at 40; Wolters & Jacobs, *supra* note 188, at 36.

this practice, the Farrell Review recommended Open Banking should aim to make the practice redundant by facilitating more efficient data transfer mechanisms.[312] More recently, the Australian Securities and Investments Commission ("ASIC") expressed that it has no intention to prevent screen scraping, though it has foreshadowed in its recently released Consultation Paper 341 that customers will be liable for loss arising from authorized transactions following the use of screen scraping under certain circumstances.[313] However, despite its apparent legality in this sense, there is some uncertainty about the resulting liability where screen scraping has been used. For instance, as mentioned above, the ASIC has noticed that by providing their login details, a consumer could be in breach of the standard banking terms and conditions for non-disclosure of passwords, thus potentially losing their protection under the ePayments Code and becoming liable for losses that occur.[314] This issue was also identified in the Farrell

312. THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at x (noting that "customer data should be transferred via APIs" in accordance with appropriate rules and standards).

313. Joseph Brookes, *Fintechs Get 'Screen Scraping' Green Light From Australian Regulators*, WHICH-50 (Mar. 3, 2020), https://which-50.com/fintechs-get-screen-scraping-green-light-from-australian-regulators/ (quoting the Executive Director of the Australian Securities and Investments Commission, Tim Gough: "[the agency] would monitor the market closely but had no plans to prevent screen scraping"); AUSTL. SEC. & INV. COMM'N, CONSULTATION PAPER 341: REVIEW OF THE EPAYMENTS CODE: FURTHER CONSULTATION 36 (2021) [hereinafter ASIC CONSULTATION PAPER 341], https://asic.gov.au/media/eh2fceff/cp341-published-21-may-2021.pdf ("It is not a prohibition on the use of screen scraping but clarifies the position that a consumer takes particular actions at their own risks.").

314. THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at 51. ePayments Code section 11.2 states that where a bank can "prove on the balance of probabilities that a user contributed to the loss through . . . breaching the pass code security requirements in clause 12," the customer is liable in full. Clause 12 requires that a customer does not "voluntarily disclose pass codes to anyone," which is breached when providing a TPP with security credentials so that they may use screen scraping technology. More recently, Australian Senate's Select Committee on Financial Technology and Regulatory Technology, in its interim report, suggested that "an outright ban on screen scraping is not prudent at the present time, . . . in many cases these practices are enabling companies to innovate and provide competition in the financial services sector. This situation should continue to be monitored, however, as Open Banking is rolled out." SENATE SELECT COMM. ON FIN. TECH. & REGUL. TECH., INTERIM REPORT (2020) [hereinafter SENATE SELECT COMM., INTERIM REPORT], https://parlinfo.aph.gov.au/parlInfo/download/committees/reportsen/024366/toc_pdf/SelectCommitteeonFinancialTechnologyandRegulatoryTechnology.pdf;fileType=application%2Fpdf. As noted above, while ASIC has no plan to ban screen scraping, it has indicated that customers will have to bear the risks in using screen scraping if (i) the use of that service "amounted to 'disclosure' of the consumer's passcode; and (ii) the subscriber (i.e., banks that subscribe to the e-Payment Code) can "prove on the balance of probability that the use of that services contributed to the loss." ASIC CONSULTATION PAPER 341, *supra* note 313, at 36.

Review.[315]

It seems a shame that the Australian government did not phase out screen scraping or at least keep it as an exception. For one, allowing screen scraping could essentially create two-tiered system where scrapers would continue to utilize this technique, which runs counter to other government security advice,[316] undermines the purpose of the consumer data right,[317] and could result in the loss of protections under the ePayments Code.[318] For another, it would provide little, if any, incentive for some fintech players to seek accreditation if they could instead rely on screen scraping, resulting in financially vulnerable people continuing to engage with non-CDR accredited entities bound by lower privacy protections.[319] However, one should also bear in mind the potential anti-competitive effects associated with a total ban — which seems more feasible until the CDR regime becomes mature.[320] This is especially so considering that the Australian economy heavily relies on screen scraping as a cost-effective tool.[321]

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315. THE TREASURY (AUSTL.), REVIEW INTO OPEN BANKING, *supra* note 15, at 52 (stating that customers may not be "aware precisely what they've done in providing their login details in this way").

316. FIN. RIGHTS LEGAL CTR. & CONSUMER ACTION L. CTR., SUBMISSION NO. 36, COMMENT ON THE SENATE SELECT COMMITTEE ON FINANCIAL TECHNOLOGY AND REGULATORY TECHNOLOGY'S INQUIRY INTO FINANCIAL TECHNOLOGY AND REGULATORY TECHNOLOGY 12 (2019) (arguing that the practice is "exactly opposite to every other piece of online safety and security advice").

317. *Id.* at 16 (noting that the Consumer Data Right creates "a fundamental right to port and transfer one's own personal financial data . . . but in a safe environment" and "[w]ithout a ban on screen-scraping . . . there is very little incentive for businesses . . . to use CDR accredited software over screen scaping technology").

318. *Id.* at 14 (indicating that "providing access to one's banking data using screen scraping technology amounts to a breach of the terms and conditions of a customer's bank account, and places customers at risk of losing their protections under the E-Payments Code" under section 11.2).

319. *Id.* at 16–17 (providing a quote from FinTech Australia, which notes that "many fintech companies are happy with existing screen scraping solutions, and are likely to continue to use these solutions").

320. FINTECH AUSTL., SUBMISSION NO. 19, SUBMISSION PAPER: SENATE ISSUES PAPER RESPONSE 35 (2019) (arguing that banning screen scraping would be anticompetitive as screen scraping is the most "secure, economical, accessible, and accepted system by which fintechs can and do seek information").

321. FINTECH AUSTL., SUBMISSION PAPER: SUBMISSION TO OPEN BANKING INQUIRY 9 (2017) (noting that the most successful companies are those that can access and utilize consumer data, increasingly so in the financial services industry, and outlawing screen scaping will harm Australian companies' ability to do so and compete with other companies internationally). According to FinTech Australia, to be CDR accredited receipts, it would cost between $100,000 AUD to $250,000 AUD. Thus, it suggested that "CDS must be implemented in a way that is 'easier to access, provides better functionality and is cheaper than screen scraping." On the cost-benefit analysis, see, e.g., FINTECH AUSTL., SUBMISSION PAPER: SUBMISSION TO THE AUSTRALIAN COMPETITION

Overall, while it seems that screen scraping is currently legal as a technique running parallel to the CDR scheme, this is controversial and may be subject to change, with various stakeholders arguing for or against a ban. There is also uncertainty as to liability associated with the practice.[322]

IV. CONCLUSION

While many countries have reacted to the changing landscape by rolling out Open Banking initiatives to tap into the potential of consumer banking data, their responses have taken different shapes. As discussed, although both the UK and Australia have adopted mandatory approaches that require data sharing with certain common features, there are striking differences. While Australia casts a wide net with a cross-sector CDR regime, the UK model applies to only the banking sector — though the recent "Smart Data" initiative reveals that the UK seems to be moving towards the Australian approach by applying data sharing to other sectors. Both regimes apply to a wide range of data to be shared, though Australia has reacted to the industry by excluding materially enhanced information from the scope of data sharing.

The UK maintains a clear framework for allocating liabilities between different parties; it is regrettable, however, that Australia's CDR has no such comparable system yet. Both jurisdictions have dedicated frameworks dealing with security and data protection issues; yet, the relationship between the PSs and Privacy Act/APPs in Australia is rather complicated for compliance. Screen scraping is generally banned in the UK except for the fall-back option. However, it is not yet prohibited in Australia, given that many online businesses still heavily rely on this handy tool for their operations. While it may be too early to judge which model will prevail, it is clear that the Australian model missed the opportunity to tackle some of the more critical issues head-on. These nuanced differences may nevertheless help other jurisdictions reflect on their regulatory approaches in this data-driven shifting landscape.

AND CONSUMER COMMISSION CONSUMER DATA RIGHT- PARTICIPATION OF THIRD[-]PARTY SERVICE PROVIDERS (2020), https://www.accc.gov.au/system/files/CDR%20Rules%20-%20Intermediaries%20consultation%20submission%20-%20Fintech%20Australia%20REDACT.pdf; SENATE SELECT COMM., INTERIM REPORT, *supra* note 314, at 152.

322. However, ASIC's acting Executive Director recently told the Senate Committee that there is "no evidence of which we're aware of any consumer loss from screen scraping." *See* Brookes, *supra* note 313.

TWO MINUTES FOR UNFAIR RESTRAINT: HOW THE NHL-CHL PLAYER TRANSFER AGREEMENT SERVES AS A CATALYST FOR ABUSE OF DOMINANCE

ALEX DOURIAN*

I. INTRODUCTION

The NHL-CHL Player Transfer Agreement ("Agreement") is an arrangement between the National Hockey League ("NHL") and Canadian Hockey League ("CHL").[1] It stipulates that an NHL club must return any

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1. *See* Agreement Between the National Hockey League "NHL" and the Canadian Hockey League "CHL," NHL-CHL, (2013) [hereinafter NHL & CHL Agreement], https://olis.oregonlegislature.gov/liz/2018R1/Downloads/CommitteeMeetingDocument

CHL player drafted and signed to an NHL entry-level contract ("ELC") to his CHL club if the NHL club does not retain that player on its active roster at the start of the season.[2] The Agreement applies solely to CHL players ages 18 and 19.[3] Its language limits the ability of these players to play in alternative leagues around the world and thus capture adequate compensation pursuant to their market value.[4] With this restriction on the major junior hockey labor market, the Agreement violates Section 79 of the Canadian Competition Act ("Act"), which prohibits market-dominating entities in Canada from engaging in practices that lessen or prevent substantial competition in a market.[5]

This Comment will explore the CHL's background, the Agreement itself, as well as the Act, which is Canada's equivalent to the Sherman Antitrust Act. This Comment will primarily focus on Section 79 of the Act, which provides civil redress against entities engaging in "abuse of dominant position."[6] This Comment will also compare various "abuse of dominant position" cases brought before the Competition Tribunal ("Tribunal"), and examine how the Tribunal's reasoning in cases where it found abuse applies to the CHL's stranglehold on major junior hockey in Canada. Essentially, by maintaining total market control over major junior hockey and engaging in contractual terms that create an exclusionary effect on the class of player it targets, the Agreement has prevented or lessened competition substantially in both Canadian/North American hockey markets and markets abroad. This Comment will conclude by offering recommendations as to how the League or the Tribunal can alleviate the restrictive conditions placed upon these players.

II. BACKGROUND ON THE CHL AND THE ACT

A. The CHL

The CHL is an umbrella organization consisting of three separate major junior hockey leagues in Canada, all of which play at what is called the "major junior" level: the Ontario Hockey League ("OHL"), the Quebec

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2. *Id.* at 6, 9.

3. *Id.* at 6–10.

4. *See id.* at 6, 9 (stipulating that NHL clubs must send their unretained underage CHL players back to their respective CHL clubs); *Do Junior Hockey Players Get Paid? The Truth Revealed*, STICKHANDLING PRO (last visited July 19, 2021), https://www.stickhandlingpro.com/blog/Do-Junior-Hockey-Players-Get-Paid-The-Truth-Revealed/ (noting that junior hockey players receive mere stipends, not salaries).

5. *See* Competition Act, R.S.C. 1985, c C-34, § 79 (Can.).

6. *Id.*

Major Junior Hockey League ("QMJHL"), and the Western Hockey League ("WHL").[7] Across the three leagues, the CHL consists of fifty-two Canadian clubs and eight American clubs.[8] Collectively, these leagues are a major provider of talent for the NHL. On opening night of the 2019–2020 season, 339 former CHL players were listed on NHL rosters, accounting for almost fifty percent of rostered players at that time.[9] At the 2020 NHL Draft, seventy-eight CHL players were selected, which comprised "more than thirty-five percent of all selections made by NHL teams."[10] Some of the greatest players in NHL history have emerged from the CHL, such as Mario Lemieux, Bobby Orr, and Sidney Crosby.[11] Major junior hockey is the highest level of amateur hockey in Canada, and the CHL is the only league of its kind.[12] Players are drafted to CHL teams through an entry draft system at age fifteen or sixteen, and which league they are drafted to depends entirely on where they live.[13]

Since 2014, the CHL has battled class-action suits brought by current and former players seeking minimum wage pay, overtime pay, and back wages.[14] Arguing that the CHL runs a "for-profit" business, the players maintained that it should be subject to Canadian statutory wage regulations.[15] While the parties reached a settlement in February 2020, the Canadian provincial governments reviewed the issue of player status and clarified that they consider CHL players to be student-athletes, which allows them to be paid less than minimum wage.[16]

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7. *About the CHL*, CHL, https://chl.ca/aboutthechl (last visited July 19, 2021).

8. *Id.*

9. *339 CHL Alumni on 2019–20 Opening Night NHL Rosters*, CHL (Oct. 2, 2019), https://chl.ca/article/339-chl-alumni-on-2019-20-opening-night-nhl-rosters.

10. *29 NHL Teams Select CHL Players in 2020 NHL Draft*, CHL (Oct. 18, 2020), https://chl.ca/article/29-nhl-teams-select-chl-players-in-2020-nhl-draft.

11. *See Top Ten Junior Players of All Time*, GREATEST HOCKEY LEGENDS.COM: HOCKEY HIST. BLOG (Dec. 27, 2018), http://www.greatesthockeylegends.com/2013/06/top-ten-junior-players-of-all-time.html.

12. *See About the CHL*, *supra* note 7 ("The Canadian Hockey League is the world's largest development hockey league . . . .").

13. *See generally Understanding the CHL's Major Junior Draft Process*, HEROS (Oct. 8, 2014), https://heroshockey.com/understanding-the-chls-major-junior-draft-process/ (outlining the various territories each league may select players from).

14. Rick Westhead, *CHL Settles Minimum-Wage Lawsuits for $30 Million*, TSN (May 15, 2020), https://www.tsn.ca/chl-settles-minimum-wage-lawsuits-for-30-million-1.1476278.

15. *Id.*

16. *See id.* ("One source familiar with the matter said the CHL's 60 teams . . . will pay about $250,000 apiece and that the league and its insurer will pay for the balance;" the article also quotes a statement from the CHL that says the "provincial governments reviewed the issue of player status and clarified in their legislation that [CHL] players

Little market competition exists for CHL players.[17] As previously noted, players are drafted to CHL clubs through an entry draft system, and their CHL rights are retained by their respective CHL clubs in perpetuity until they age out (at twenty years old) or are traded.[18] Rather than receive salaries, CHL players receive stipends from teams for housing, food, equipment, and other necessities.[19]

B. The Agreement

The most current version of the NHL-CHL Agreement came into effect in November 2013.[20] It was due to expire upon completion of the 2019–2020 season before the parties agreed to extend it for an additional season in April 2020.[21] Section C(1)(a) of the Agreement states that any CHL player who is eighteen or nineteen years old, is drafted by an NHL club, and signed to an ELC must be returned to his CHL club if he does not make the final roster.[22] In other words, if an NHL club does not keep the player on its roster, it cannot loan that player to any club (including its minor league affiliates) except that which holds his CHL rights.[23] Moreover, once the NHL club returns the player to his CHL club it cannot recall him for the remainder of that season.[24] There are some exceptions to this clause, including emergency circumstances and situations where the NHL club is willing to compensate the CHL club for recalling the player.[25]

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are amateur student athletes and not employees covered by minimum wage or employment laws.").

17. *See* KEVIN P. MONGEON, REPORT ON THE ECONOMICS OF THE CANADIAN HOCKEY LEAGUE AND ITS TEAM MEMBERS 12 (2016), https://andrewchernoff.files.wordpress.com/2016/07/317727968-tab-8.pdf.

18. *See id.* ("[U]pon entry into the league[,] a [player's] services are retained by their team for the duration of their career. The draft and Player Service Agreement have collectively eliminated the [labor] market for player services. As long as teams are able to trade players and the Leagues are the only supplier of Major Junior Hockey, teams will retain the entire value of a [player's] services.").

19. *See id.* at 14 (discussing player stipends).

20. NHL & CHL Agreement, *supra* note 1, at 2.

21. *NHL Extends Player Development Agreements for the 2020–21 Season*, SPORTSNET (Apr. 28, 2020, 1:14 PM) [hereinafter SPORTSNET, *NHL Extends Player Development Agreements*], https://www.sportsnet.ca/hockey/nhl/nhl-extends-player-development-agreements-2020-21-season/.

22. *See* NHL & CHL Agreement, *supra* note 1, at 6–7, § C(1)(a).

23. *See id.*

24. *See id.* at 7, § C(1)(b) (noting exceptions where a player may be recalled by his NHL club).

25. *Id.* (stipulating the player cannot be recalled for more than five NHL games, and also noting that "inconvenient," for purposes of § C(1)(b), means the recall cannot cause the player to miss one or more of his CHL club's games).

NHL-signed CHL players merely receive living stipends pursuant to their student-athlete status.[26] For CHL players who possess the requisite skill and talent, the earning potential for their age range in alternative leagues varies significantly.[27] The following is a breakdown of the salary ranges players may expect in various leagues across the world for the 2020–2021 season:

Estimated Player Salaries by League[28]

American Hockey League (NHL Minor League Affiliate)	$51,000-$70,000
KHL (Russia)	$100,000-$1,200,000
SHL (Sweden)	$93,800-$293,126
DEL1 (Germany)	$46,900-$234,501
LIIGA (Finland)	$35,175-$146,563
NLA (Switzerland)	$109,674-$493,590
Extraliga (Czech Republic)	$30,000-$200,000

26. *See* Westhead, *supra* note 14 (reporting that CHL players are classified as amateur student athletes).

27. *Compare AHL PHPA CBA*, PRO. HOCKEY PLAYERS ASS'N, https://phpa.com/site/agreements (last visited July 20, 2021) (noting the minimum AHL salary for the 2020–21 season is $51,000), *with* COLLECTIVE BARGAINING AGREEMENT BETWEEN NATIONAL HOCKEY LEAGUE AND NATIONAL HOCKEY LEAGUE PLAYERS' ASSOCIATION 25–26, art. 9, § 4, (2013) [hereinafter NHL COLLECTIVE BARGAINING AGREEMENT], https://cdn.nhlpa.com/img/assets/file/NHL_NHLPA_2013_CBA.pdf (stipulating the "maximum minor league compensation" for players on entry level contracts for the 2020–21 season is $70,000), *and Projected Player Salaries 2020–2021: For Europe-Russia-Asia*, 2112 HOCKEY AGENCY, https://2112hockeyagency.com /salary-expectations/ (last visited Apr. 28, 2021) (illustrating player salaries in Russian, Asian, and European leagues).

28. *See AHL PHPA CBA*, *supra* note 27; NHL COLLECTIVE BARGAINING AGREEMENT, *supra* note 27, at 26; *Projected Player Salaries 2020–2021: For Europe-Russia-Asia*, *supra* note 27.

C. The Competition Act of Canada

The Act is the Canadian equivalent to the U.S. Sherman Antitrust Act. Its purpose is to promote fair competition in Canada to increase the country's opportunities to participate in global markets while acknowledging the impact that foreign competition has on the domestic market.[29] Historically, competition law in Canada had a criminal disposition, which required prosecutors to meet a higher standard of proof in cases.[30] Beginning in the mid-1970s, the Canadian government supplanted some of the Act's criminal provisions with civil ones.[31] Challenges under these new provisions are exclusively reviewed by the Tribunal as opposed to trial courts, although appellate courts may hear appeals from the Tribunal.[32] Among these civil provisions is Section 79, which prohibits entities from engaging in what it refers to as an "abuse of dominant position."[33] Abuse of dominant position exists when:

> [O]ne or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business, that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and the practice has had, is having[,] or is likely to have the effect of preventing or lessening competition substantially in a market . . . .[34]

D. Cases Brought Under Section 79

The following discussion will describe the various settings in which the Tribunal has brought abuse of dominance actions, as well as the standard the Tribunal measures allegedly market-constraining activity against. In *Canada (Director of Investigation & Research) v. NutraSweet Co.*,[35] the Director of Investigation and Research ("Director") filed an application in part under Section 79 against NutraSweet ("NSC"), an aspartame sweetener producer.[36] It was the first time the Tribunal considered a Section 79

29. Competition Act, R.S.C. 1985, c C-34, § 1.1 (Can.).

30. OSLER, HOSKIN & HARCOURT, LLP, CANADIAN COMPETITION LAW 5 (2018) [hereinafter OSLER, CANADIAN COMPETITION LAW], https://www.acc.com/sites/default/files/resources/vl/membersonly/InfoPAK/1479421_1.pdf.

31. *Id.*

32. *See id.* (noting the civil standard of proof, "balance of probabilities," is lower than the criminal standard, "proof beyond a reasonable doubt," and that the Government gave the Tribunal "exclusive jurisdiction to hear applications" related to any of these civil provisions).

33. Competition Act § 79(1).

34. *Id.*

35. (1990), 32 C.P.R. 3d 1 (Can. Competition Trib.).

36. *Id.* at para. 1.

application.[37] The Director accused NSC of engaging in contractual practices that created an "exclusive supply relationship" with its customers, which created significant barriers to entry in the aspartame market.[38] Ultimately, the Tribunal found that NSC's practices violated Section 79 by meeting all three elements of abuse.[39] The NSC possessed clear, substantial control of the Canadian market for aspartame, evidenced by their market share, which accounted for over ninety-five percent of aspartame sales in Canada at the time.[40] The Tribunal held that such market power, coupled with less-than-ideal entry conditions for competitors and constraints placed upon its biggest customers, amounted to clear and substantial market control.[41] Moreover, NSC engaged in anti-competitive acts by including supply clauses in its customer contracts to keep competitors from entering into the market or expanding any existing market share.[42] The Tribunal found that the clauses were included primarily for exclusionary purposes than anything else.[43] Lastly, the Tribunal held that the exclusionary terms in NSC's customer contracts catalyzed a substantial lessening or prevention of competition in the Canadian aspartame market.[44] This was because the terms encumbered an overwhelming majority of the market, and prevented "small scale or 'toe-hold entry'" into that market — essentially, during the time when a customer contracted with NSC for a supply of aspartame products, no other aspartame supplier could negotiate with or sell to that customer.[45]

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37. *See* Canada (Dir. Investigation & Rsch.) v. Laidlaw Waste Sys. Ltd. (1992), 40 C.P.R. 3d 289, para. 1 (Can. Competition Trib.) (noting that this was the second case brought under Section 79 since it went into effect, with *NutraSweet* being the first).

38. *See NutraSweet Co.* (1990), 32 C.P.R. 3d 1, at para. 13 (noting the Director brought a separate claim against NSC, alleging it was selling below its acquisition cost — one of the anti-competitive acts specifically set out in § 78).

39. *See id.* at paras. 154–56.

40. *Id.* at paras. 80, 82 (maintaining that the evidence of NSC's market power was so compelling that the Tribunal did not need to explore the "boundaries" of substantiality, as NSC's market control was blatant).

41. *Id.*; *see also id.* at paras. 104, 106, 108 (describing various provisions in NSC's contracts that created such customer constraints, such as exclusive supply clauses that required the customer to buy all aspartame products from NSC, trademark display clauses that required customers to display NSC's logo on their packaging, and meet-or-release clauses that effectively gave NSC a right of first refusal in the event another supplier offered a NSC customer aspartame products at a lower price).

42. *Id.* at para. 121.

43. *Id.*

44. *Id.* at para. 144.

45. *Id.* at paras. 140, 144; *see also id.* at paras. 118–19 (noting, however, various "meet-or-release" clauses in NSC's contracts, which stipulated that when an aspartame competitor offered services to a NSC customer, the customer could invoke the clause which would provide NSC an opportunity to match the offer; the Tribunal found these clauses did not mitigate any entry-barring effects created by exclusivity, since

A generally applicable principle the Tribunal promulgates in *NutraSweet* is the idea that when determining whether a particular entity possesses market power for purposes of Section 79, one can look to whether significant entry barriers exist that either lessen or completely prevent competition from outside competitors or market entrants.[46]

In *Commissioner of Competition v. Toronto Real Estate Board*,[47] the Tribunal Commissioner filed an application against the Toronto Real Estate Board ("TREB"), alleging that certain information-sharing practices that TREB engaged in violated Section 79.[48] These dissemination practices pertained to the display of information taken from the Multiple Listing Service ("MLS") database on the Virtual Office Websites ("VOWs") of real estate brokers.[49] In essence, TREB members were prohibited from displaying pertinent information from the MLS database on their VOWs.[50] The disputed information included data pertaining to sold and pending homes, terminated listings, and "offers of commission" to the brokers representing the home purchaser.[51] The Commissioner argued that the restrictions disincentivized innovation of real estate services in favor of more traditional practices, resulting in traditional brokers maintaining market control.[52] In ruling against TREB, the Tribunal found that TREB's conduct met all three elements of the abuse of dominant position test.[53] Firstly, TREB "substantially or completely control[led] the supply of MLS-based residential real estate brokerage services [in the Greater Toronto Area (GTA)] because it control[led] how its Members compete[d] through its rule-making ability."[54] Secondly, TREB intended, both subjectively and

competitors would still be discouraged by the fact that NSC could match any price offered to a particular customer).

46. *See id.* at para. 74 (noting how any definition of market control invariably includes a consideration of market entry conditions).

47. 2016 Comp. Trib. 7 (Can.).

48. *Id.* at para. 2.

49. *Id.*

50. *Id. See generally id.* at paras. 70–72 (describing the MLS database as a "system which allows agents to share information and provide maximum exposure of properties listed for sale;" such information included how long a property was on the market, images of the property, historical data, and more).

51. *See id.* at para. 14 (noting two other important VOW restrictions: "prohibitions on (i) the use of information included in the VOW Data Feed for any purpose other than display on a website and (ii) the display on a VOW" of the disputed data).

52. *See id.* at para. 19(c) (adding that, by restricting broker access to VOWs, the MLS restrictions effectively "[discouraged] entry and expansion by brokers wishing to introduce innovative services" and further "entrenched" the positions of more traditional brokers).

53. *Id.* at para. 4.

54. *Id.* at paras. 253–54 (outlining the various reasons why the Tribunal agreed with

objectively, to engage in the practice of anti-competitive acts.[55] Lastly, but for those practices, competition in the Greater Toronto real estate market would have been substantially greater.[56] The Tribunal came to this conclusion after finding that in the absence of MLS and VOW restrictions, real estate services and offerings in the GTA market would have been far more competitive, innovative, and ultimately more beneficial for consumers.[57] More specifically, it found that the MLS restrictions perpetuated and entrenched "static traditional brokerage" and disincentivized firms from innovating and developing new services.[58] The Tribunal found abuse of dominant position here after determining that the data-sharing restrictions had "substantially reduced the degree of non-price competition in the supply of [real estate brokerage services] in the [GTA], relative to the degree that would likely exist in the absence of those restrictions."[59] The "but for" test emerged from *TREB* as a major method of determining whether a practice or act significantly disrupts the development of competition in a particular market.[60]

In *Commissioner of Competition v. Vancouver Airport Authority*,[61] the Commissioner submitted a Section 79 application against the Vancouver Airport Authority ("VAA").[62] The application alleged that the VAA's policy of permitting only two in-flight caterers to operate at the Vancouver International Airport ("YVR") excluded competitors from entering the

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the Commissioner's assertion); *see also id*. at para. 174 (explaining that a substantial degree of market power is needed to establish dominance). *But see id.* at para. 166 (noting that the reality of markets is that "firms often have *some* market power").

55. *See id.* at para. 319 ("TREB had a subjective intention to exclude, through the VOW Restrictions, potential entrants into the relevant market and existing TREB Members who were poised to disrupt the traditional residential brokerage business model that is followed by TREB's other Members in the [Greater Toronto Area]."); *see also id.* at para. 433 ("[I]t was reasonably foreseeable that the VOW Restrictions would have an exclusionary effect on VOW-based competitors.").

56. *See id.* at para. 504 (concluding that when compared to a world where the VOW restrictions did not exist, their "incremental adverse effect" on competition was substantial; "these anti-competitive effects [took] the form of increased barriers to entry, increased costs for VOWs, reduced range and quality of brokerage services, and reduced innovation.").

57. *Id.* at para. 27 (finding that the MLS restrictions "negatively affected the range and quality of services" offered).

58. *Id.*

59. *Id.* at para. 4 (noting the adverse impact the data-sharing practices had "on innovation, quality and the range of residential real estate brokerage services that likely would be offered . . . in the absence of [such] restrictions").

60. *See id.* at para. 27 (discussing the "but for" test).

61. 2019 Comp. Trib. 6 (Can.).

62. *Id.* at para. 1.

Galley Handling Market, and denied the market the benefits that competition would afford it.[63] The Tribunal found that the VAA substantially controlled the Airside Access Market at YVR and subsequently the Galley Handling Market as well.[64] The VAA held sole discretion over which suppliers could compete in the market.[65] As a result, it could indirectly influence the level of competition and, therefore, the price and non-price characteristics of competition in that market.[66] For a supplier to compete in the Galley Handling Market, it required access to the airside, which the VAA had sole authority to provide.[67]

While the Tribunal found that the VAA controlled the relevant markets at YVR, it could not find that the VAA violated the second element of the abuse of dominant position test because it had a legitimate, overriding purpose in excluding additional servicers from the market, which outweighed any anti-competitive effects of the exclusionary practice.[68] At the outset, the Tribunal concluded that while the VAA did not directly compete in the relevant Gallery Handling Market, it did have a plausible competitive interest in it, such that the VAA benefitted from the exclusion of additional services in the market.[69] However, the Tribunal, determined that VAA's conduct had legitimate business motives that counterbalanced its exclusionary nature.[70] As a result, any actual or reasonably foreseeable anti-competitive effects of such conduct were not disproportionate to the VAA's efficiency and pro-

63. *Id.* at para. 2.

64. *See id.* at paras. 445–46.

65. *See id.* at para. 453 ("Firms that are not able to obtain VAA's authorization to access the airside at [the airport] do not, and cannot, compete in the Galley Handling Market there . . . . VAA is able to control who competes and who does not compete, as well as how many firms compete . . . . Through this control, VAA [can] indirectly influence . . . the price and non-price dimensions of competition in that market.").

66. *Id.*

67. *Id.*; *see also id.* at para. 41 (describing the airside as the part of the airport that lies within "the security perimeter," and includes runways, taxiways, and the area where the aircrafts are parked).

68. *Id.* at paras. 458, 511; *see also id.* at paras. 457, 459–62 (outlining the analytical framework the Tribunal must undertake when determining whether a firm that does not compete in the relevant market has engaged in anti-competitive practices).

69. *See id.* at para. 510 (holding "that VAA has a PCI in the Galley Handling Market because the evidence . . . provides [an] *objectively ascertainable factual basis* to believe that VAA has a competitive interest in that market").

70. *See id.* at paras. 512–13 (noting that entrants coming into the market pose three significant risks: (1) ramp-up time of new providers, (2) new entrants would cause airlines and consumers to experience disruptions in service for an extended period of time, and (3) the manifestation of the first two risks would diminish the VAA's ability to compete with other airports).

competitive rationales.[71] This suggests that where the introduction of new entrants would pose substantial risks to a particular market in the form of service or production disruption, an entity may have a legitimate interest in preventing or lessening competition.[72] Such an interest may outweigh any anti-competitive or exclusionary effects the practice creates, thus justifying those effects.[73]

III. APPLYING SECTION 79'S FRAMEWORK TO THE AGREEMENT

The three aforementioned cases identify the Tribunal's framework for evaluating cases under Section 79. In applying these considerations to the Agreement, one can see how it contravenes Section 79 requirements. Thus, constituting an abuse of dominant position by the NHL and CHL.

A. Substantial Control

The first element of the dominant position test is that an entity must possess substantial or complete control of a market.[74] Substantial and complete control is synonymous with the term "market power."[75] When determining what market power is, there is no "one size fits all" test; rather, one must look at the specific context of the case and facts at hand to determine whether a particular entity possesses substantial market power.[76] Generally, the Tribunal has looked at several factors in ascertaining whether the entity in question has such influence.[77] These include, but are not limited to, "evidence of high market share, barriers to entry, limited excess capacity in [competitors' possession] . . . [and] limited penetration of competitors" in the market.[78] For instance, in *NutraSweet*, the Tribunal remarked how NSC

71. *Id.* at para. 513.

72. *Id.* at paras. 512–13.

73. *Id.*

74. *See* Competition Act, R.S.C. 1985, c C-34, § 79(1)(a) (Can.) ("[O]ne or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business . . . .").

75. *See* OSLER, CANADIAN COMPETITION LAW, *supra* note 30, at 45 ("The Tribunal has consistently interpreted the words *substantially or completely control* as being synonymous with market power, namely, 'an ability to set prices above competitive levels for a considerable period of time.' This position was endorsed . . . in *Canada Pipe*.").

76. *See* Canada (Dir. of Investigation & Rsch.) v. NutraSweet Co. (1990), 32 C.P.R. 3d 1, para. 73 (Can. Competition Trib.) ("The specific factors that need to be considered in evaluating control or market power will vary from case to case.").

77. *See, e.g.*, OSLER, CANADIAN COMPETITION LAW, *supra* note 30, at 47 (noting that the Tribunal usually finds market power in Section 79 cases where a firm has more than 80% of the market share and barriers to entry into the market exist).

78. *Id.*

showed signs of two of the aforementioned indicators of market power: it had an extremely high market share, about ninety-five percent, and its contracts with customers created significant barriers to entry.[79] Market power may exist even where high market share and barriers to entry are less apparent than what the Tribunal has previously considered in other cases.[80] In such instances, the Tribunal or court will utilize a "but for" test in asking whether the practice in question substantially impairs competition.[81] The Tribunal applied the "but for" test in *TREB*, where it concluded that but for TREB's restrictions on the supply of real estate information, consumers would have more competitive and innovative service offerings at their disposal.[82]

The CHL owns the entire major junior hockey market, as all three major hockey junior leagues in Canada (the OHL, QMJHL, and WHL) fall under its umbrella.[83] As a result, any hockey player wishing to play major junior hockey must submit to the CHL's rules and regulations.[84] Upon being drafted into one of the three leagues, players' respective CHL clubs hold their major junior rights in perpetuity unless the club trades them, which effectively eliminates competition between major junior teams.[85] Not only does the CHL possess the entire major junior hockey market, it grants its clubs "exclusive geographic territories rights and local monopoly in Major Junior Hockey."[86] Such a benefit allows these clubs to increase ticket prices

79. *See NutraSweet Co.* (1990), 32 C.P.R. 3d 1, at para. 82 ("The evidence that NSC possesses appreciable market power given its market share[,] . . . entry conditions[,] and the constraints operating on its largest customers is sufficiently compelling so that the boundaries of *substantial* need not be explored. Its 'control' is clearly substantial.").

80. *See* OSLER, CANADIAN COMPETITION LAW, *supra* note 30, at 47 ("For cases in which market power and barriers to entry are less obvious . . . a rule of thumb is to ask whether . . . levels of non-price competition [would be] substantially higher, in the absence of the impugned practice. If so, then market power may exist."); *see also NutraSweet Co.* (1990), 32 C.P.R.3d 1, at para. 74 ("[I]t is difficult to see how any definition of control, including the dictionary definition, could exclude a consideration of conditions of entry.").

81. *See* Canada (Comm'r of Competition) v. Toronto Real Est. Bd., 2016 Comp. Trib. 7, para. 27 (Can.).

82. *Id.*

83. *See About the CHL*, *supra* note 7.

84. *See id.*

85. *See* MONGEON, *supra* note 17, at 12 ("The OHL and WHL have eliminated all intraleague competition for players. First, players gain entry into the league via the entry-level draft that involves teams picking players. Second, upon entry into the league a player's services are retained by their team for the duration of their career. The draft and Player Service Agreement have collectively eliminated the labo[]r market for player services. As long as teams are able to trade players and the Leagues are the only supplier of Major Junior Hockey, teams will retain the entire value of a player's services.").

86. *Id.* at 10.

at their discretion, further perpetuating the exploitation of these players.[87] For players who believe the major junior hockey route is the best path for their development, their only option is to play for a CHL-affiliated league, which then places significant restrictions on where they can play once drafted and signed by an NHL club.[88]

B. Anti-Competitive Practices

The second element of the abuse of dominant position test is that the entity enjoying substantial market control must engage in anti-competitive practices.[89] A "practice" generally consists of more than one isolated act; however, for the purposes of Section 79, courts have ruled that a singular act may satisfy the "practice" requirement if it is "sustained and systemic" and has a lasting impact on the market.[90] The Tribunal or the courts generally will not consider an act to be anti-competitive unless it has a "predatory, exclusionary or disciplinary purpose."[91] In determining whether an act is conducted for anti-competitive purposes, courts will weigh both the subjective and objective intent of the entity in question.[92] Section 78 of the Act outlines specific types of conduct that are considered anti-competitive under Section 79; however, while the list of proscribed conduct is extensive, it does not expressly limit the types of anti-competitive conduct to those mentioned therein.[93]

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87. *See id.* (describing that without competition from other teams for ticket sales, CHL teams can exercise "profit-maximizing" behavior by increasing ticket prices).

88. *See id.* at 8, 10.

89. Competition Act, R.S.C. 1985, c C-34, § 79(1)(b) (Can.) ("[The entity has] engaged in or [is] engaging in a practice of anti-competitive acts . . . .").

90. *See* Canada (Comm'r of Competition) v. Canada Pipe Co., 2006 FCA 233, para. 60 (Can.) (remarking how the Tribunal found that the term "practice" may entail more than a single act but may also be "one occurrence that is sustained and systemic, or that has had a lasting impact on competition").

91. *See* OSLER, CANADIAN COMPETITION LAW, *supra* note 30, at 48 ("In *Canada Pipe*, the [Court] endorsed this position regarding objective intent and then adopted a competitor-oriented approach to determining whether conduct constitutes a practice of anti-competitive acts, focusing on whether there were (objectively) intended predatory, exclusionary or disciplinary effects on a *competitor*.").

92. *Id.*

93. *See* Competition Act § 78 (listing acts that are considered anti-competitive); *see also* OSLER, CANADIAN COMPETITION LAW, *supra* note 30, at 48 ("However, significantly, the Tribunal has found many other types of practices . . . to constitute anti-competitive acts as well, with the result that the category of anti-competitive acts is by no means restricted to those listed in § 78.").

While the Agreement is a single act, e.g., a singular agreement between two parties, the parties in privity to the Agreement intended it to have a long lasting and systemic effect on CHL players who are drafted by NHL clubs and subsequently signed to ELCs.[94] This type of enduring restraint is akin to the customer supply clauses in *NutraSweet*, where the Tribunal held that the clauses constituted a "practice" because they appeared in every customer contract and had a long-lasting effect on not only those customers but the industry as a whole.[95] Like the customer supply clauses in *NutraSweet*, the Agreement's restraints apply to all entry-level contracts entered into between an NHL club and a prospect drafted from the CHL.[96] Moreover, akin to the exclusionary and anti-competitive terms in *NutraSweet*'s customer contracts, the CHL clearly intended the terms of the Agreement to serve an exclusionary purpose because they expressly limit where the players can play once signed to an ELC and, indirectly, how much they can make.[97] The framework of the Agreement intends to exclude this specific class of player from participating in any other professional hockey market in the world, except for the CHL or NHL.[98]

A neutral body examining the Agreement and overall business of the CHL may consider some legitimate business justifications for the CHL's actions which counterbalance its anti-competitive nature.[99] These justifications would likely include the argument that if the NHL club could loan these players to alternate leagues, the quality of competition in the CHL would diminish substantially, causing a decrease in fan enthusiasm and ultimately

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94. *See* NHL & CHL Agreement, *supra* note 1, at 2, § A (providing the Agreement will be in effect for seven seasons); *see also* SPORTSNET, *NHL Extends Player Development Agreements*, *supra* note 21 (noting the NHL and CHL extended the agreement for one more year).

95. *See* Canada (Dir. Of Investigation & Rsch.) v. NutraSweet Co. (1990), 32 C.P.R. 3d 1, paras. 104, 109 (Can. Competition Trib.) (explaining that the exclusive supply clauses constituted a "practice" because they appeared in most supply contracts and required the customer to agree to use NSC aspartame as the sole or primary sweetener in its Canadian-produced products throughout the duration of the agreement and purchased all its NutraSweet aspartame requirements from NSC itself, rather than intermediaries).

96. *See* NHL & CHL Agreement, *supra* note 1, at 6–7, § C(1)(a).

97. *See id.*; *see also Do Junior Hockey Players Get Paid? The Truth Revealed*, *supra* note 4 (mentioning how CHL players receive mere stipends in lieu of salaries).

98. *See* NHL & CHL Agreement, *supra* note 1, at 6–7, § C(1)(a).

99. *See generally* Canada (Comm'r of Competition) v. Toronto Real Est. Bd., 2016 Comp. Trib. 7, para. 279 (Can.) (requiring that prior to a finding of an anti-competitive practice "engaged in by [an entity that] does not compete in the relevant market," the Commissioner must establish that the entity "has a plausible competitive interest in the market"); *see also id.* at para. 280 ("In the case of a trade association, this may be as straightforward as demonstrating that it has a plausible interest in protecting some or all of its members from new entrants or from smaller disruptive competitors in the market.").

revenue.[100] In analyzing this potential argument, one should first understand that the CHL produces between thirty and forty percent of each NHL draft class.[101] NHL clubs collectively drafted seventy-eight CHL players in the 2020 NHL Draft.[102] Out of those, only forty-three have signed NHL entry-level contracts and thus must bear the Agreement's burdens as of July 10, 2021.[103] Using the 2020 NHL draft class as an example for future draft classes, one can conclude the Agreement's constraints do not affect many players in any one particular year because in each draft, 217 players are selected, which means that for the 2020 draft class specifically, only 19.8% of the players are subject to the Agreement's constraints.[104] For those players that fall into that percentage, however, the Agreement places heavy limitations on them as to where they can play and how much money they can make.[105] Considering that ice hockey is the most popular sport in Canada, it is unlikely that the loss of such a small group of players to other leagues would cause the CHL to experience substantial revenue loss or any other deleterious effect.[106]

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100. *See* Tony Ferrari, *Redesigning the CHL–NHL Agreement*, DOBBER PROSPECTS (Mar. 3, 2021), https://dobberprospects.com/2021/03/03/re-designing-the-chl-nhl-agreement/. *See generally 78 CHL Players Selected in 2020 NHL Draft*, CHL (Oct. 7, 2020) [hereinafter *CHL Players Selected*], https://chl.ca/article/78-chl-players-selected-in-2020-nhl-draft (noting how six of the top ten draft picks in the 2020 draft were players from the CHL).

101. *See* Bob Duff, *Number of NHL Draftees From CHL In Steady Decline*, FEATURD (June 23, 2019), https://stories.featurd.io/2019/06/23/number-of-nhl-draftees-from-chl-in-steady-decline/.

102. *See CHL Players Selected*, *supra* note 100 (remarking that CHL players consisted of more than 35% of the 217 total picks made by NHL teams at the 2020 NHL Draft, including nineteen first round picks, six top ten picks, and the first overall pick, Alexis Lafreniere).

103. *2020 NHL Entry Draft*, CAPFRIENDLY, https://www.capfriendly.com/draft (last visited July 20, 2021).

104. *See* Wayne Jones, *How the NHL Entry Draft Works: A Complete Guide*, HOCKEY ANSWERED, https://hockeyanswered.com/how-the-nhl-entry-draft-works-a-complete-guide/ (last visited July 20, 2021) (stating the draft is seven rounds long and that each round has thirty-one draft picks, totaling 217 players drafted in all).

105. *See* NHL & CHL Agreement, *supra* note 1 (limiting where CHL players can play if signed to an NHL contract but not retained on the roster); Westhead, *supra* note 14 (stating that Canadian provincial governments consider CHL players as student athletes, which means minimum wage and other employment laws do not cover them).

106. *See generally Top 10 Most Popular Sports of Canada in the year 2020–21*, NEO PRIME SPORT (Jan. 29, 2021), https://neoprimesport.com/top-10-most-popular-sports-of-canada-in-the-year-2020-21/ (noting that ice hockey is the official national sport of Canada).

C. Substantial Lessening/Prevention of Competition

The third element in the abuse of dominant position test is that the act had the effect of preventing or lessening competition substantially in a market.[107] The Tribunal has not applied this element directly to labor markets.[108] In *Commissioner of Competition v. Canada Pipe*,[109] however, the Court of Appeal noted that the appropriate test for determining whether the conduct substantially prevented or lessened competition examines whether the relevant markets would be more competitive "but for" the allegedly restrictive act or practice.[110] In determining whether this is the case, the Tribunal has focused on whether, in the absence of such dominance, the "prices [of products or services] would be significantly higher . . . ." [111] Analogizing this line of reasoning to the Agreement, one can reasonably conclude that players' salaries and earning potential at age eighteen or nineteen would be significantly higher "but for" the Agreement's restraints.

One argument the CHL could make in rebutting application of the third element to the Agreement is that it has a legitimate business justification in keeping these players in the CHL. It may argue that if they left for other leagues, the CHL would experience a diluted on-ice product and substantial revenue loss.[112] Such a deleterious result, the CHL could say, would cause

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107. Competition Act, R.S.C. 1985, c C-34, § 79(1)(c) (Can.) ("[T]he practice has had, is having, or is likely to have the effect of preventing or lessening competition substantially in a market . . . .").

108. *See generally, e.g.*, Canada (Dir. of Investigation & Rsch.) v. NutraSweet Co. (1990), 32 C.P.R. 3d 1 (Can. Competition Trib.) (addressing exclusive supply contracts for aspartame); Canada (Comm'r of Competition) v. Toronto Real Est. Bd., 2016 Comp. Trib. 7 (Can.) (considering real estate information dissemination practices); Canada (Comm'r of Competition) v. Vancouver Airport Auth., 2019 Comp. Trib. 6 (Can.) (reviewing market exclusion practices); Canada (Comm'r of Competition) v. Canada Pipe Co., 2006 FCA 233 (Can.) (discussing loyalty rewards programs); Canada (Comm'r of Competition) v. Direct Energy Mktg. Ltd., 2015 Comp. Trib. 2 (Can.) (examining water heater markets).

109. 2006 FCA 233 (Can.).

110. *See id.* at para. 38 ("I would therefore endorse the formulation of the legal test proposed by the appellant: the question that must be assessed for the purposes of paragraph 79(1)(*c*) is, would the relevant markets — in the past, present, or future — be substantially more competitive but for the impugned practice of anti-competitive acts?").

111. *See* OSLER, CANADIAN COMPETITION LAW, *supra* note 30, at 49–50 (providing an example of this test considered by the Bureau with respect to Apple's supply terms with wireless carriers, in which it found that while evidence existed showing how these terms affected wireless carriers' negotiations with competitors, the effects did not amount meaningfully to the point where the Bureau could conclude they placed a significant impact on Apple's competitors or consumers).

112. *See* Taylor Haase, *Primer: Understanding NHL-CHL Transfer Agreement*, DK PITTSBURGH SPORTS (June 24, 2019), https://legacy.dkpittsburghsports.com/2019/06/24/nhl-chl-transfer-agreement-faq-rules-penguins-tlh/ (arguing that the Agreement actually keeps the leagues optimally competitive since they retain their top players); *see*

a significant disruption for those who consume the CHL product because of the diminished on-ice product. This line of reasoning parallels the VAA's argument in *Vancouver Airport Authority*, which maintained that if new competitors entered the Galley Handling Market at YVR, customers would suffer a disruption of service for an extended period of time.[113] The VAA argued that such a disruption would have the detrimental effect of impeding its ability to compete with other airports for new airlines, as well as new routes from existing airlines.[114] The difference in these two particular situations, however, is that whether the CHL would experience a significantly diminished on-ice product is not entirely certain. As mentioned previously, only forty-three CHL players from the 2020 NHL draft class have signed NHL ELCs as of July 10, 2021.[115] Even if all twenty-six players decided that other leagues better suit them, the thirty-five NHL-drafted CHL players who have not signed ELCs would remain in the CHL and thus likely contribute to keeping the product in adequate form.

Moreover, whether the CHL would lose substantial revenue as a result of these players leaving is unclear at best, as the member-leagues and clubs have multiple methods by which they generate profit.[116] While economic studies indicate that individual players do contribute to the bottom lines for their respective CHL clubs, it is likely that alternative profit-generating methods would offset any loss in revenue a club would experience from losing any one particular player.[117] One such method is through multi-platform broadcasting.[118] While the CHL never disclosed the financial details of its 2014 broadcast rights agreement with Canadian sports network

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also Patrick Johnston, *The NHL-CHL Agreement Doesn't Help Development of Canadian Juniors One Bit*, THE PROVINCE (July 17, 2019), https://theprovince.com/sports/hockey/nhl/patrick-johnston-fire-the-nhl-chl-agreement-into-the-sun (hypothesizing that keeping the top players in the CHL could theoretically attract more fans to games).

113. *Vancouver Airport Auth.*, 2019 Comp. Trib. 6, at paras. 512–13 ("VAA has been concerned that some airlines and consumers would suffer a significant disruption of service for a transition period of at least several months.").

114. *Id.*

115. *See 2020 NHL Entry Draft*, *supra* note 103.

116. *See* MONGEON, *supra* note 17, at 8–10 (noting how the CHL exhibits "profit-maximizing" behavior through "patterns of relocation and expansion," as well as exclusive geographic territory rights, which create local monopolies for each team and allow them to increase ticket prices as a result).

117. *Id.* at 11 ("The expected difference in attendance for teams with a winning percentage of 0.450 to 0.550 is 400 spectators per game.").

118. *See* David Cushnan, *CHL Extends Sportsnet Deal Until 2025/26*, SPORTSPRO (Feb. 20, 2014), https://www.sportspromedia.com/news/chl_extends_sportsnet_deal_until_2025_26 (stating that in 2014, Sportsnet and the CHL agreed to a twelve-year extension of their broadcast rights agreement).

Sportsnet, it is likely that CHL clubs enjoy a considerable bump in revenue from the deal.[119]

In *Canada Pipe*, the Federal Court of Appeal endorsed the "but for" test when looking at whether the anti-competitive practice had the effect of lessening or preventing competition substantially in a market.[120] The test looks at whether the "relevant markets — in the past, present or future — [would] be substantially more competitive but for the impugned practice of anti-competitive acts."[121] Applying this test in the Agreement's context, one can surmise that but for the Section C(1)(a) of the Agreement, hockey labor markets all over the world would be substantially more competitive. If not for Section C(1)(a), the affected class of player would have substantially more freedom to play in any league in which his NHL rights holder deems appropriate.[122] As a result, the market in those leagues would become more competitive as it would see an influx of talent, and the player entering those leagues would have more opportunities to earn a salary that is proportionate with what his free-market value demands.[123]

Studies have shown that aside from affecting players' current earning potential, the Agreement's constraints may have detrimental effects on earning potential later on in players' careers as well.[124] According to a study of data accumulated from draft classes between 2005 and 2014, players drafted out of the top Swedish and Finnish leagues generally made the NHL earlier and more frequently than their CHL counterparts.[125] As a result, there

119. *See id.*

120. *See* Canada (Comm'r of Competition) v. Canada Pipe Co., 2006 FCA 233, paras. 38, 41 (Can.), (endorsing the "but for" test and noting that such an interpretation of Section 79(1)(c) of the Act is consistent with the Tribunal's interpretations in previous Section 79 cases; the test bespeaks the "plain meaning" of the statute's language and is consistent with the Tribunal's analysis in previous cases).

121. *Id.* at para. 38; *see id.* at para. 40 (quoting Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039, 1055 (8th Cir. 2000)) (acknowledging that the "but for" discussion has appeared in American antitrust jurisprudence as well: there is a difficult yet required task of "construct[ing] . . . a 'but for' market free of the restraints and conduct alleged to be anticompetitive"); *see also* Canada (Dir. of Investigation & Rsch.) v. Laidlaw Waste Sys. Ltd. (1992), 40 C.P.R. 3d 289, para. 164 (Can. Competition Trib.) ("[T]he substantial lessening which is to be assessed need not necessarily be proved by weighing the competitiveness of the market in the past with its competitiveness at present. Substantial lessening can also be assessed by reference to the competitiveness of the market in the presence of the anti-competitive acts and its likely competitiveness in their absence.").

122. *See* Johnston, *supra* note 112 ("[T]here's nothing stopping players from outside the CHL from playing pro as teens, or more drastically, moving to Europe where you can immediately start making a wage . . . .").

123. *See id.*

124. *See id.*

125. *See* Prashanth Iyer, *Evaluating Nordic Drafting — A Potential Market*

is potential for CHL players to lose out on earning potential as more European players secure lucrative NHL contracts over them.[126]

Moreover, in *NutraSweet*, the Tribunal articulated another test for this element that asked whether the anti-competitive acts engaged in by the entity preserve or add to its market power.[127] In the NHL-CHL Agreement context, one can conclude that the Agreement's constraints contribute to the CHL's market power by creating exclusivity where CHL players signed to NHL ELCs can play if the NHL club wishes to loan the player instead of retaining him on its roster.[128] This type of exclusivity is comparable to that considered in *NutraSweet*, where aspartame buyers were prohibited from purchasing aspartame products from any other supplier but NutraSweet.[129] In forcing these players to return to their CHL club once cut by their respective NHL clubs, the CHL retains its influence in major junior hockey in North America and over the affected players because it prevents these top-tier talents from playing anywhere else.[130] Moreover, the ruling by various provincial legislatures that CHL players are considered "student-athletes" further contributes to the league's market stranglehold as it can employ, market, and profit off the players without returning any portion of the proceeds to them.[131]

Inefficiency, HOCKEY GRAPHS (July 1, 2019), https://hockey-graphs.com/2019/07/01/evaluating-nordic-drafting-a-potential-market-inefficiency/ (noting that this phenomenon makes sense as these European professional leagues more readily prepare these players for the transition into the NHL).

126. *See* Johnston, *supra* note 112 ("[T]he agreement is putting major junior draftees behind their peers in terms of long-term development, suppressing their hopes of NHL stardom.").

127. *See* Canada (Dir. of Investigation & Rsch.) v. NutraSweet Co. (1990), 32 C.P.R. 3d 1, para. 139 (Can. Competition Trib.) ("The issue with respect to the contract terms associated with exclusivity . . . is the degree to which these anti-competitive acts add to the entry barriers into the Canadian market and, additionally therefore, into the industry."); *see also id.* at para. 144 ("The tribunal is convinced that the exclusivity in NSC's contracts, which includes both the clauses reflecting agreement to deal only or primarily in NutraSweet brand aspartame and the financial inducements to do so, impedes 'toehold entry' into the market and inhibits the expansion of other firms in the market. Since exclusive use and supply clauses appear virtually in all of NSC's 1989 contracts, and thus cover over 90 percent of the Canadian market for aspartame, it is clear that during the currency of those contracts there is little room for entry by a new supplier.").

128. *See* Johnston, *supra* note 112 ("If you are 18 or 19 and were drafted [to the NHL] from a [CHL club], you can't go and play pro hockey at any level outside of the NHL for two years.").

129. *Id.*; *see also NutraSweet Co.* (1990), 32 C.P.R. 3d 1 at para. 162 (discussing the exclusive dealings between NutraSweet and its clients).

130. *See* Johnston, *supra* note 112.

131. *See* Westhead, *supra* note 14 ("All Canadian provincial governments reviewed the issue of player status and clarified in their legislation that our players are amateur

In conjunction with the "but for" test, the Tribunal in *TREB* noted that an "appropriate focus of assessment under Section 79(1)(*c*) of the Act should be upon the *incremental* effect of the [restrictions] on competition."[132] While in any one year the Agreement's restrictions may not affect a substantial number of players, its incremental effect of preventing or lessening competition in multiple markets over the years has caused these players to lose high-earning potential during the early stages of their career and possibly later on.[133] In the absence of Section C(1)(a), competition would be substantially greater than it is currently or is likely to be in the future if it remains intact.[134] Moving forward, players could earn a salary that reflects their actual worth in the hockey labor market, whereas, currently, they must accept earning literal cents for every hour they work.[135]

IV. WHAT REMEDIES ARE AVAILABLE?

From a curative perspective, the Tribunal has the power to issue various types of remedies once it finds an entity has violated Section 79.[136] For one, it may issue administrative monetary penalties ("AMPs").[137] The Competition Bureau categorizes these penalties as civil remedies and

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student athletes and not employees covered by minimum wage or employment laws.").

132. Canada (Comm'r of Competition) v. Toronto Real Est. Bd., 2016 Comp. Trib. 7, para. 503 (Can.) ("More specifically, the specific focus of this stage of the assessment is upon whether competition would be substantially greater in the absence of the VOW Restrictions than it is at the present time, or is likely to be in the future, if they remain unchanged."); *see also id.* at para. 500 ("The issue is whether the VOW Restrictions have insulated, are insulating, or are likely to insulate TREB's Members from new forms of rivalry that, in aggregate, would likely substantially increase competition in their absence, as reflected in materially lower prices or in materially greater non-price benefits of competition. When a group of rivals . . . insulates itself from increased competition, they are in essence exercising a cognizable form of market power.").

133. *See* Johnston, *supra* note 112 (noting that players outside of the CHL can move to Europe before or after being drafted to begin making money and arguing that because European players generally make the NHL earlier and more frequently than North American players, CHL players may be losing earning potential as the Europeans secure more contracts and dollars from NHL clubs).

134. *Id.*

135. *See* Colin Perkel, *Junior Hockey Employment Lawsuit on Thin Ice; Judges Refuse to OK $30-million Deal*, CBC SPORTS (Oct. 28, 2020, 3:48 PM), https://www.cbc.ca/sports/hockey/chl-junior-hockey-employment-lawsuit-judges-refuse-signoff-1.5780550 (mentioning that according to the plaintiffs in the CHL employment lawsuit, some players earned as little as $35 per week while technically working anywhere from 35–65 hours weekly).

136. Competition Tribunal Act, R.S.C. 1985, c 19, §§ 8, 11 (Can.).

137. *See* OSLER, CANADIAN COMPETITION LAW, *supra* note 30, at 5–6 ("[E]mpowering the Tribunal to order AMPs of up to $10 million for violation of the abuse of dominance provision (or $15 million for a subsequent violation) . . . .").

distinguishes them from fines, which it says derive from criminal conduct.[138] According to the Bureau, the primary purpose of AMPs is to promote compliance with the Act.[139]

In addition to AMPs, the Tribunal may issue an order prohibiting the anti-competitive conduct from continuing.[140] In *NutraSweet*, the Tribunal submitted an order prohibiting NSC from, inter alia, entering into contracts with customers that contained terms requiring the customer to buy all of its aspartame supplies from the respondent.[141] The Tribunal found these terms severable from the overall agreement in that it did not invalidate the entire NSC contract but merely the terms that enhanced exclusivity in the market.[142]

Turning to the NHL-CHL Agreement, the relevant provision is Section C(1)(a), which states in the pertinent part, "[a] signed Player age 18 or 19 who has been claimed from the CHL and who is not retained by his NHL Club, must be assigned to the Junior Club of the CHL for whom he last played or with whom he owes contractual obligations."[143] The Agreement, which spans fourteen pages, contains terms having to do with matters other than player rights.[144] Therefore, a strike-down of the entire Agreement is likely unnecessary to perpetuate the type of remedy the affected player class deserves. Instead, it makes more sense to invalidate Section C(1)(a) only, keeping the rest of the Agreement intact while also providing the affected players flexibility in seeking alternative employment with clubs that can provide compensation consistent with their market value.[145]

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138. *Frequently Asked Questions — Amendments to the Competition Act*, GOV'T OF CAN., https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03046.html (last updated Nov. 5, 2015) ("Administrative monetary penalties, or 'AMPs,' are civil remedies, and quite distinct from fines (which are criminal).").

139. *Id.* ("The purpose of an AMP is to promote and encourage compliance with the *Competition Act*, and failure to pay one may be enforced civilly as a debt due to the crown.").

140. *See* OSLER, CANADIAN COMPETITION LAW, *supra* note 30, at 50 ("In addition to its power to impose AMPs, the Tribunal may issue an order prohibiting the continuation of the practice in question and, if such an order would not restore competition in the market, direct any or all of the persons against whom an order is sought to take such actions, including the divestiture of assets or shares, as are reasonable and necessary to overcome the effects of the practice in the market.").

141. *See* Canada (Dir. of Investigation & Rsch.) v. NutraSweet Co. (1990), 32 C.P.R. 3d 1, para. 181 (Can. Competition Trib.) ("We will therefore issue an order prohibiting NSC from enforcing, or entering into, certain terms of contracts for the supply of aspartame to Canadian customers . . . which require the purchaser to purchase or use only NSC aspartame . . . .").

142. *See id.*

143. NHL & CHL Agreement, *supra* note 1, at 7, § C(1)(a).

144. *See id.* at 2–6, 11–12, 14–15, §§ B, E, G (discussing other topics, such as advertising rights, insurance, and league funding).

145. *See Projected Player Salaries 2020–2021: For Europe-Russia-Asia*, *supra* note

The CHL may argue that if NHL clubs can loan these players to the AHL or overseas, the quality of competition in the CHL-member leagues would diminish, which could affect the leagues' earnings through decreased ticket, advertisement, or television revenue.[146] Of the seventy-eight CHL players selected in the 2020 NHL Draft, only forty-three have signed NHL ELCs thus far.[147] Therefore, fifty-two CHL players, not signed to NHL contracts, remain with their CHL clubs, thus largely maintaining the quality of competition.[148] Furthermore, even if 18 or 19-year-olds can play in the AHL or abroad, there is no guarantee they would do so — the players may feel that playing in the CHL is best for their development, or, rather, they are unable to secure a contract that makes the jump worth it. Either way, just because the CHL would lose its stranglehold on these players, it does not follow that the CHL clubs would undoubtedly lose them to other leagues.

Invalidating Section C(1)(a) of the Agreement would enable NHL clubs, in conjunction with its prospects, to determine the most suitable development route on a situational basis.[149] If the parties, i.e., the player and the NHL club he is signed with, believe playing in Europe is best for the player's development, he could go and do so while earning a respectable salary. In referring to the various league salary estimates, the player would generate substantially more income — even at the lower end — than he would playing for his CHL club.[150]

Moreover, giving NHL clubs the freedom to choose where to develop their CHL prospects may ultimately help the CHL retain the top-tier talent it craves. For example, when Toronto Maple Leafs' forward Auston Matthews was seventeen, NHL scouts unanimously considered him the top prospect in his draft class.[151] Matthews is American-born, which provided for the unique

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27 (providing salary estimates for the major professional hockey leagues in Europe); *see also AHL PHPA CBA*, *supra* note 27 (noting the minimum AHL salary for the 2020–21 season is $51,000).

146. *See* MONGEON, *supra* note 17, at 6 ("An important outcome of the co-production of games is the fact individual team revenues, as well as league-wide revenues, are a function of the contribution of players throughout the entire league.").

147. *See 2020 NHL Entry Draft*, *supra* note 103.

148. *Id.*

149. *See generally* Johnston, *supra* note 112 (discussing how NHL clubs are able to fully dictate the development path for their European prospects, including whether to start them immediately in the AHL or keep them with their European clubs, as opposed to CHL prospects who must return to the CHL).

150. *See Projected Player Salaries 2020–2021: For Europe-Russia-Asia*, *supra* note 27 (providing salary estimates for the American Hockey League and each of the major European leagues).

151. Mike Johnston, *Person of Interest: The 411 on Auston Matthews*, SPORTSNET (May 7, 2015, 8:49 PM), https://www.sportsnet.ca/hockey/nhl/person-of-interest-the-

opportunity of an American-born player being selected first overall in the NHL Draft.[152] Before the beginning of his draft year season (2015–16), however, Matthews decided to play in the NLA, the top professional league in Switzerland, which created a considerable amount of attention from hockey pundits and fans alike.[153] By playing in the NLA, Matthews was able to choose his own development path and concurrently earn a legitimate salary.[154] However, his decision came at the expense of the Everett Silvertips, the CHL club that drafted him in 2012.[155] Since Matthews' decision, many pundits have contemplated the possibility of similar prospects doing the same.[156] By removing the Agreement's constraints surrounding player mobility, the CHL could theoretically entice more players like Matthews to join the CHL rather than forgo it in lieu of other leagues that currently allow more flexibility.

If the Tribunal or a court issued an order invalidating Section C(1)(a), players like Matthews would be more inclined to play their pre-NHL hockey in North America knowing an NHL club could draft them, sign them to an ELC, and decide the best development route, which could include playing in the AHL. Ultimately, this could keep the players playing in North America,

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152. *See id.* (noting the previous six American players drafted first overall in the NHL Entry Draft).

153. *See* Chris Peters, *Auston Matthews, Top NHL Draft Prospect, Signs With Swiss Pro Team*, CBS SPORTS (Aug. 7, 2015, 8:05 AM), https://www.cbssports.com/nhl/news/auston-matthews-top-nhl-draft-prospect-signs-with-swiss-pro-team/ (noting several benefits of Matthews signing in Switzerland, including developmental, scheduling, and coaching reasons, as well as the fact that he would receive a real salary, compared to the NCAA and WHL).

154. *See* Joseph Gravellese, *Auston Matthews Adds New Twist to NCAA vs. CHL Hockey Wars*, BC INTERRUPTION (May 13, 2015, 7:00 AM), https://www.bcinterruption.com/2015/5/13/8597115/auston-matthews-adds-new-twist-to-ncaa-vs-chl-hockey-wars ("[B]ut all available data suggest that for first team players, a low-end salary is around 75,000 Swiss francs per year, or about $82,000. Salaries for ex-NHLers playing in Switzerland can top $300,000. It's fair to say that wherever Matthews' potential salary would fall in that range, it's a lot more than the stipends players receive for playing in the CHL, or the $0 for playing in the NCAA.").

155. *'Tips Prospect Matthews to Play Professionally in Europe*, EVERETT SILVERTIPS (Aug. 7, 2015), https://everettsilvertips.com/tips-prospect-matthews-to-play-professionally-in-europe.

156. *See* Jonathan Willis, *The Question Isn't "Why Would Auston Matthews go to Switzerland?" It's "Why Don't More Top NHL Draft Prospects do the Same?"*, EDMONTON J. (May 12, 2015), https://edmontonjournal.com/sports/hockey/nhl/cult-of-hockey/the-question-isnt-why-would-auston-matthews-go-to-switzerland-its-why-dont-more-top-nhl-draft-prospects-do-the-same (explaining that players drafted out of Europe, as opposed to the CHL, have more versatility in where they can play after being drafted and can earn legitimate wages for their services, which may be attractive to many prospects of Matthews' caliber).

which would enable them to build their brands here, with North American hockey fans watching them. As a result, fans would have deeper interests in these players, which could help television ratings, endorsements, ticket revenue, and much more down the road.

V. CONCLUSION

The Canadian legislature enacted Section 79 of the Competition Act to dissuade entities from abusing situations where they hold dominance in a market. In the case of the CHL, the League dominates the Canadian major junior hockey market. Moreover, the umbrella leagues do not pay their players wages commensurate with their market values, providing them only living stipends. The non-compensatory model of the CHL, coupled with the market exclusivity that Section C(1)(a) of the Agreement creates, has a significant anti-competitive effect on the players' ability to compete for fair market compensation and substantially lessens labor competition not only in Canada, but all over the world as well. If the Tribunal or a court invalidated Section C(1)(a) on abuse of dominant position grounds, NHL clubs could choose the best development path for their respective CHL prospects, and the CHL prospects themselves would be able to seek wages in various leagues that are commensurate with their market value.

DUDENHOEFFER: WHY CONCEALMENT OF FRAUD VIOLATES THE FIDUCIARY DUTY-OF-PRUDENCE

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I. INTRODUCTION

In 1974, Congress sought to encourage a form of a retirement fund known as an employee stock ownership plan ("ESOP").[1] The statutory mandates of these plans are outlined in the Employee Retirement Income Security Act

1. *See* 29 U.S.C. § 1001 (explaining the Congressional findings and policy aims of the Employee Retirement Income Security Act of 1974).

("ERISA").[2] ESOPs are invested in stock of the company in which the employee works.[3] In this way, ESOP planners' ("plan fiduciaries") obligations are necessarily unique.[4] Whereas most fiduciaries are required to prudently diversify investments to protect their beneficiaries, ESOP planners are not similarly mandated.[5] Further, Congress allows ESOP planners to concurrently be officers of the corporation in which the stock was invested.[6] This exception makes it much more likely that a plan fiduciary will, at some point, have access to insider information pertinent to the fund.[7]

Issues arise when a plan fiduciary is also an officer of the corporation that the ESOP is primarily invested in.[8] If that corporate officer/plan fiduciary knows the corporation is engaged in fraud, courts have struggled to determine what duties the plan fiduciary acquires relative to ESOP plan beneficiaries.[9] Plaintiffs have suggested the plan fiduciary must divest the fund, diversify the fund, and/or disclose the fraud.[10]

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2. *See id.*

3. *E.g.*, *Employee Stock Ownership Plan (ESOP) Facts*, NAT'L CTR. FOR EMP. OWNERSHIP, https://www.esop.org/ (last visited Sept. 29, 2021) (discussing the advantages of ESOPs, such as increased wages and retirement assets for employees and higher growth rates for companies that offer ESOPs).

4. *See generally The Fiduciary's Guide to Conflict of Interest Claims*, RMO LLP, https://rmolawyers.com/fiduciarys-guide-conflict-of-interest-claims/ (last visited Sept. 29, 2021) (noting that most fiduciaries are obligated to protect beneficiaries' interests above their own at all times, in all situations).

5. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 416–17 (2014) (acknowledging that the nature of ESOPs absolves plan fiduciaries of an obligation to diversify because the duty to diversify necessarily contradicts the nature of ESOPs).

6. *See In re* Wells Fargo ERISA 401(K) Litig., 331 F. Supp. 3d 868, 877 (D. Minn. 2018) (stating that ERISA does not prohibit corporate insiders from serving as plan fiduciaries of ESOPs). *See generally* Daniel L. Rotenberg, *Congressional Silence in the Supreme Court*, 47 U. MIAMI L. REV. 375 (1992) (noting the principle of statutory interpretation that when Congress knows how to legislate in an area and chooses not to, Congressional silence should not be interpreted as unintentional).

7. *See generally* COREY ROSEN, ET AL., THE INSIDE ESOP FIDUCIARY HANDBOOK (Nat'l Ctr. for Emp. Ownership, 4th ed. 2020) (detailing the inherent increased risk of serving as an ESOP fiduciary and corporate officer concurrently).

8. *See* Will Kenton, *Insider Information*, INVESTOPEDIA, https://www.investopedia.com/terms/i/insiderinformation.asp (last updated Mar. 21, 2020) (summarizing how corporate officers may obtain insider information and what liabilities can arise from using such information).

9. *Compare* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 632 (2d Cir. 2018) (finding there may be a duty to disclose the insider information), *with* Martone v. Robb, 902 F.3d 519, 528 (5th Cir. 2018) (finding a duty to disclose insider information implausible), *and* Whitley v. BP, P.L.C., 838 F.3d 523, 529 (5th Cir. 2016) (finding a duty to stop future stock purchases implausible).

10. *See Jander*, 910 F.3d at 623; Allen v. Wells Fargo & Co., 967 F.3d 767, 771 (8th Cir. 2020).

In *Fifth Third Bancorp. v. Dudenhoeffer*,[11] the Supreme Court established that plaintiffs who claim the plan fiduciary knew of fraud are required to propose a plausible alternative action that the plan fiduciary could have taken that could not have been viewed as more likely to harm the fund.[12] Since *Dudenhoeffer*, the Circuit Courts have disagreed on whether plaintiffs satisfy that burden when alleging that a plan fiduciary should have disclosed the fraud.[13]

In 2020, in *Allen v. Wells Fargo & Co.*,[14] the Eighth Circuit sided with the Fifth Circuit, holding that a plaintiff suing under 29 U.S.C. § 1104's standard of "care, skill, prudence, and diligence under the circumstances" cannot plausibly allege a fiduciary duty arises to disclose the company's own fraudulent behavior to correct the inflated value of stock in the ESOP.[15] Contrarily, in *Jander v. Retirement Plans Committee of IBM*[16] the Second Circuit is the only Circuit to find that plaintiffs can plausibly plead earlier disclosure of the fraud is required by the fiduciary's duty-of-prudence.[17]

Part II of this Comment establishes that *Dudenhoeffer* directed the Circuits to determine whether the duty-of-prudence describes: (1) a plan fiduciary who discloses their company's own fraudulent behavior; or (2) a plan fiduciary who protects the ESOP from the damage public knowledge of the fraudulent behavior would cause.[18] Part III analyzes how the Second Circuit is more faithful to the *Dudenhoeffer* inquiry. More specifically, Part III argues that *Jander* better conforms with *Dudenhoeffer*'s balance inquiry, that general economic principles provide appropriate support for *Jander*'s conclusion, and that the health of retirement funds, like ESOPs, cannot be evaluated on short-term time scales. Part IV recommends the Supreme Court resolve the disagreement between the circuits. First, the Court should side with the Second Circuit's finding that plaintiffs can plausibly plead the duty-

11. 573 U.S. 409 (2014).

12. *See id.* at 429–30.

13. *Compare Jander*, 910 F.3d at 623 (holding that plaintiffs did plausibly plead disclosure, satisfying the standard), *with Allen*, 967 F.3d at 774 (holding that plaintiffs failed to meet the standard when proposing disclosure was an available alternative).

14. 967 F.3d 767 (8th Cir. 2020).

15. *See Allen*, 967 F.3d at 772, 774 (following *Martone* and criticizing the Second Circuit for finding the opposite); *see also Martone*, 902 F.3d at 527 (concluding that plaintiffs failed to meet *Dudenhoeffer*'s test).

16. 910 F.3d 620 (2d Cir. 2018).

17. *See Jander*, 910 F.3d at 630 (finding that plaintiffs who allege that disclosure is inevitable can plausibly allege that earlier disclosure was the more prudent course of action).

18. *See Dudenhoeffer*, 573 U.S. at 429–30 (instructing the lower courts to consider the plausibility of the disclosure alternative and whether freezing future stock purchases is consistent with existing insider trading laws); *see also* 29 U.S.C. § 1104.

of-prudence is breached by a failure to disclose fraud. Alternatively, like in *Jander* and *Allen*, where discovery of the fraud is inevitable, plaintiffs should be allowed to plausibly plead earlier disclosure is required.

II. THE CIRCUITS CANNOT AGREE WHAT IS PLAUSIBLE UNDER DUDENHOEFFER

At the heart of the circuit's varying applications of the Court's *Dudenhoeffer* decision lies a fundamental disagreement over how courts should analyze the plaintiff's burden to prove that the plan fiduciary was obligated to disclose the fraud. Resolving this disagreement requires analyzing *Dudenhoeffer*'s underlying considerations, identifying where the circuit courts have disagreed, and examining popular arguments defendants in *Dudenhoeffer* cases use.

A. Dudenhoeffer: SCOTUS Tells the Circuit Courts to "work it out amongst themselves"

Three cases define the disagreement.[19] In 2014, the Supreme Court in *Dudenhoeffer*, established a higher pleading requirement for plaintiffs proceeding under ERISA's duty-of-prudence standard, which resulted from the *Twombly*/*Iqbal* paradigm shift.[20] However, the Court entrusted the lower courts with defining "plausible pleading" under ERISA.[21]

In *Dudenhoeffer*, the plaintiffs were participants in an ESOP.[22] The participants sued their employer and various officers under ERISA for allegedly breaching their fiduciary duty by continuing to invest the ESOP in assets — the employer's stock — the defendants knew to be risky and overvalued because the company was engaged in fraud.[23] The plaintiffs alleged the defendants "knew or should have known" of the risk and the inflated value of the investments based on the defendants' access to non-public information.[24] Initially, plaintiffs suggested ESOP planners may have

19. *See generally Dudenhoeffer*, 573 U.S. at 409 (defining the inquiry for the lower courts); *Jander*, 910 F.3d at 620 (finding plaintiffs satisfied the test); *Allen*, 967 F.3d at 767 (finding plaintiffs did not satisfy the test).

20. *See generally* Ashcroft v. Iqbal, 556 U.S. 662 (2009) (marking a shift from the pleading standard of "merely possible" to "plausible"); Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007) (requiring a pleading be "plausible").

21. *See Dudenhoeffer*, 573 U.S. at 429–30 (articulating the "plausible pleading" test for the lower courts).

22. *Id.* at 413.

23. *Id.* (noting that Fifth Third Bancorp engaged in subprime mortgage lending practices leading up to the 2008 housing market collapse).

24. *Id.*

a duty to divest or diversify the ESOP.[25] However, the Court unequivocally stated that whatever fiduciary obligations ESOP planners may have, the duty cannot plausibly be to violate insider trading laws specifically or securities regulations generally.[26]

Under "the *Dudenhoeffer* standard," plaintiffs may still claim a breach of the duty-of-prudence if plaintiffs allege an alternative action could have been taken, which was consistent with insider trading and securities regulations.[27] This alternative course of action, however, must "plausibly allege an alternative action that [the fiduciary] could have taken that would have been consistent with [insider trading] laws and that a prudent fiduciary in the same circumstances *would* [/could] not have viewed as more likely to harm the fund than to help it."[28] Clearly, the "could" standard is a demanding requirement.[29] The Circuits disagree on whether disclosure of fraudulent behavior fulfills the "could" standard.[30]

B. Other Considerations in Dudenhoeffer Reveal the Attitudes of the Court Towards ERISA

While *Dudenhoeffer* left the disclosure question open, the unanimous opinion written by Justice Breyer definitively foreclosed two arguments, which may hint at the philosophical attitudes of the Supreme Court in ERISA suits generally.[31] First, the Court summarily eliminated the argument that

25. *Id.* (suggesting that the plan fiduciaries should have sold the stock before it decreased in value).

26. *See id.* at 414–25 (noting several of the express exceptions made between general laws of trusts and ESOP fiduciary duties because of the unique nature of ESOP funds).

27. *See id.* at 428–30 (defining plaintiff's options as confined by insider trading laws).

28. *Id.* at 428 (emphasis added) ("[A] plaintiff must plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances *would* not have viewed as more likely to harm the fund than to help it."); *id.* at 429–30 (emphasis added) ("[L]ower courts faced with such claims should also consider whether the complaint has plausibly alleged that a prudent fiduciary in the defendant's position *could* not have concluded that stopping purchases . . . or publicly disclosing . . . would do more harm than good . . . .").

29. *See* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 626 (2d Cir. 2018) (noting that *Dudenhoeffer*'s "could" language suggests not what an average fiduciary would do, but what any reasonable fiduciary does).

30. *Compare id.* at 630–31 (finding that fraud, which will inevitably be disclosed, ought to be disclosed earlier), *with* Allen v. Wells Fargo & Co., 967 F.3d 767, 773–74 (8th Cir. 2020) (finding that any disclosure of fraud is subject to a reasonable concern that the stock will drop in value).

31. *See Dudenhoeffer*, 573 U.S. at 424–30 (noting the Court rejected a presumption of prudent investing because it was too defense-friendly and violated plan beneficiaries' ability to exercise their rights under ERISA).

defendants were obligated to attempt to "outperform" the market based purely on public information.[32] In the Court's view, individual fiduciaries cannot be expected to be more skilled at valuing a stock than the aggregate knowledge of the entire stock market, which produces public stock evaluations.[33] Simply put, given the same information, a single plan fiduciary cannot be expected to better evaluate a stock than the collective wisdom of the entire market combined, absent special circumstances.[34]

Second, the Court rejected the argument that defendants' investment decisions in ERISA-ESOP, breach of duty-of-prudence cases are entitled to a "presumption of prudence."[35] This holding, while not directly at issue in the current disagreement, nonetheless illuminates the attitudes of the Court. The holding supports the use of general economic principles to support a court's analysis in an ESOP stock-drop case.[36] Moreover, the second foreclosed argument was deemed too "defense-friendly" and violative of the "careful balancing" of ERISA between encouraging ESOP use and enforcing the rights of ESOP beneficiaries.[37] Specifically, in rejecting the "presumption of prudence," the Court noted that granting such a presumption would foreclose virtually all ESOP plan beneficiaries' claims against fiduciaries, which was a step too far in the Court's view.[38]

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32. *See id.* at 426 (spending only three paragraphs rejecting the argument that ESOP fiduciaries were not entitled to rely on public information of stocks' market values and further characterizing the argument as "implausible as a general rule, at least in the absence of special circumstances").

33. *See id.* (citing Halliburton Co. v. Erica P. John Fun, Inc., 573 U.S. 258, 273 (2014)) (relying on what "many investors" think about trying to outperform the market).

34. *See* Hutch Ashoo & Chris Snyder, *Why Trying to 'Beat the Market' Doesn't Work and Is the Wrong Question*, PILLAR WEALTH MGMT. CO., https://pillarwm.com/how-to-outperform-the-stock-market-100-foolproof-guide/ (last visited Sept. 29, 2021) (noting the inherently speculative nature of trying to outperform markets with active day trading).

35. *See Dudenhoeffer*, 573 U.S. at 418–19 (contrasting the loosened standard for diversification for ESOP, which is grounded in the statute, with the presumption of prudence which is not grounded in the statute).

36. *See id.*; *see also, e.g.*, Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 568 U.S. 445 (2013) (discussing market theory throughout the opinion). *See generally* David D'Alessandro et al., *Stock Drop Litigation Cases Are On The Rise: Will Your Retirement Plan Be A Target?*, JDSUPRA (July 23, 2020), https://www.jdsupra.com/legalnews/stock-drop-litigation-cases-are-on-the-78743/ (explaining that stock-drop cases are those that result from a sudden drop in the price of an investor's stock).

37. *Dudenhoeffer*, 573 U.S. at 424 (acknowledging that the concern to uphold Congress's intent to encourage ESOP creation was valid, but that the presumption was too defense-friendly to overcome competing concerns of Congress's desire to uphold the rights of plan beneficiaries).

38. *See id.* (finding that the presumption "makes it impossible for a plaintiff to state a duty-of-prudence claim, no matter how meritorious, unless the employer is in very bad economic circumstances" and that the better approach is a context specific analysis of

C. Dudenhoeffer Suggested Just Two Avenues to Recovery for ESOP Plaintiffs

The *Dudenhoeffer* Court set forth a three-part analysis for lower courts to consider, which both the Second and Eighth Circuits later employed.[39] First, courts must remember that a duty-of-prudence, under both ERISA and the common law of trusts, does not require fiduciaries to take illegal action; for example, violating insider trading laws.[40]

Second, where a complaint proposes a plan fiduciary should have stopped purchasing the employer's stock or should have publicly disclosed the fraud, courts should consider what implication this may have on other bodies of law.[41] The Court noted that the U.S. Securities and Exchange Commission ("SEC") had not filed amici or otherwise made its views known.[42] And while the SEC's precise view of the law remains unknown,[43] in 2020, the SEC filed a letter supporting foreclosing plaintiff's arguments in *Jander*, but did not elaborate further.[44] Third, courts must consider whether the complaint plausibly alleges: (1) stopping purchases; or (2) publicly disclosing, in the eyes of any reasonable fiduciary, could not have been viewed as likely to cause more harm than good.[45] At a minimum, if a plan fiduciary could articulate any reasonable hypothetical which would make the proposed action more harmful, plaintiffs cannot recover.[46]

In effect, *Dudenhoeffer* leaves plaintiffs only two avenues to recovery,

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the complaint's allegations).

39. *See id.* at 428–30 (stating the requisite analysis and three important considerations accompanying the analysis); *see also* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 622, 626 (2d Cir. 2020); Allen v. Wells Fargo & Co., 967 F.3d 767, 772 (8th Cir. 2020).

40. *See Dudenhoeffer*, 573 U.S. at 428–29 (articulating that whatever duty fiduciaries may have, it cannot be to "break the law").

41. *See id.* at 429 (noting that while Congress anticipated a "common law of ERISA" would emerge, courts should not impose upon areas of law that concern the purview of other agencies, like the SEC).

42. *Id.*

43. *See* SEC, https://secsearch.sec.gov/search?utf8=%3F&affiliate=secsearch&query=Dudenhoeffer (last visited Mar. 25, 2021) (searching "Dudenhoeffer" on the SEC's website and locating no formal opinion or comment).

44. *See* Brief for Petitioner at 16–17, Ret. Plans Comm. of IBM v. Jander, No. 20-289 (petition for cert. filed Sept. 1, 2020), 2020 WL 5785563 (noting the SEC's view that defendants should prevail but abstaining from setting forth a proposed rule).

45. *See Dudenhoeffer*, 573 U.S. at 428–29 (implying that, by foreclosing all other plaintiff theories of stock-drop cases, these two avenues are likely plaintiff's last remaining viable arguments).

46. *See* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 622–23 (2d Cir. 2020) (employing the "more restrictive test" even though the parties disagreed about the proper standard).

absent special circumstances not defined by the current case law.[47] Plaintiffs can either propose that fiduciaries should have: (1) stopped purchasing employer stock; or (2) publicly disclosed the fraud.[48] Thus far, all other avenues to recovery presented to the circuit court in breach of duty-of-prudence cases have been rejected.[49]

D. The Second Circuit, Leader in Finance Cases, Holds the Door Open for Plaintiffs

In 2018, the Second Circuit, in *Jander*, engaged in the *Dudenhoeffer* analysis.[50] In *Jander*, plaintiffs alleged that defendants — IBM's corporate officers and ESOP plan fiduciaries — knew or should have known that IBM was overvaluing its microelectronics department through *creative* accounting.[51] Employing the *Dudenhoeffer* analysis, plaintiffs proposed two alternative courses of action prudent IBM fiduciaries should have taken: (1) stop investing in IBM stock; and/or (2) publicly disclose the overvaluation problem.[52] To bolster their public disclosure argument, Jander further alleged that because IBM intended to sell the microelectronics department soon, discovery of the overvaluation was inevitable and should have been disclosed earlier to mitigate harm to the stock.[53] On appeal, Jander dropped the halting IBM stock purchases argument and limited the appeal to the proposed alternative of disclosure.[54]

The *Jander* court expanded on the analysis *Dudenhoeffer* left open.[55]

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47. *See Dudenhoeffer*, 573 U.S. at 426 (foreclosing plaintiff's proposed alternatives, but leaving open possible exceptions if "special circumstances" are present).

48. *See id.* at 425–28 (implying these two avenues are the only likely arguments available to plaintiffs, given that all other ones presented in the circuit courts have been expressly rejected).

49. *See, e.g.*, Amgen Inc. v. Harris, 577 U.S. 308 (2016) (per curiam); *see also* Laffen v. Hewlett-Packard Co., 721 F. App'x 642 (9th Cir. 2018).

50. *Jander*, 910 F.3d at 622–23.

51. *Id.* at 623 (suggesting that this overvaluation was evidenced by their willingness to offload the microelectronics department by paying GlobalFoundries to take the microelectronics department from IBM).

52. *Id.*

53. *See id.* at 629 (bolstering this claim by noting that if the fraud were discovered later, the protracted nature of the fraud would undermine faith in future IBM pronouncements).

54. *Id.* at 628–29 (citing economic analyses that suggest protracted fraud incurs a reputational impact that fraud over shorter periods of time and/or self-disclosed does not).

55. *See id.* at 628 (acknowledging the conflict between the "would" burden and the "could" burden, allowing plaintiffs to rely on economic theories to establish plausible alternatives, and rejecting defendants' arguments that *Dudenhoeffer* cases invoke the heightened pleading standard for a fraud claim).

First, *Jander* highlighted an important balance acknowledged by Congress and the Supreme Court between the fair enforcement of the rights of ESOP participants and beneficiaries against the encouragement of the creation and use of ESOPs.[56] Second, *Jander* highlighted a tension between the demanding "could not have" test and the implied desire of the *Dudenhoeffer* court to allow plaintiffs to plead their claims.[57] Third, *Jander* noted that the heightened pleading standard of Federal Rule of Civil Procedure 9(b) is only activated when a plaintiff either directly alleges fraud as a cause of action or invokes the fraud exception under ERISA to the statute of limitations.[58]

i. Jander Followed Dudenhoeffer's Balancing Consideration

Jander acknowledged the balance between participant rights and ESOP encouragement.[59] *Jander* highlights precisely what the lower courts have struggled with post-*Dudenhoeffer*.[60] Saddling fiduciaries with an uncomfortable duty to disclose fraud based on insider information could disincentivize the creation of ESOPs, which Congress explicitly sought to encourage.[61] Contrarily, labeling disclosure as an "implausible" proposed alternative action could foreclose plaintiffs from ever enforcing their rights as participants and beneficiaries of ESOPs.[62] The tension between these considerations is foundational to the post-*Dudenhoeffer* divergence.[63] The Fifth and Eighth Circuits find that the balance between beneficiary rights and ESOP creation would be violated because *Jander*'s ruling would discourage ESOP creation because of liability risks.[64] Contrarily, *Jander* argues that a

56. *See id.* at 625–26 (noting that the presumption of prudence struck down in *Dudenhoeffer* was a poor means of addressing concerns that frivolous suits would discourage the creation of ESOPs).

57. *See id.* at 627–28 (explaining the "could not" formulation is a more demanding standard).

58. *See id.* at 632 (noting that the heightened pleading standard, which exists to protect defendants from the stigma of being accused of fraud, is not applicable in stock-drop cases where plaintiffs are not alleging fraud but are alleging imprudent investing, which has no such stigma).

59. *See id.* at 625–26 (explaining the requisite balancing interests of Congress).

60. *See* Allen v. Wells Fargo & Co., 967 F.3d 767, 774 (8th Cir. 2020) (disagreeing with *Jander* without distinguishing the facts but criticizing the use of "general economic principles," which could apply in every ESOP stock-drop case).

61. *See* 29 U.S.C. § 1001 (listing the findings that led Congress to enact ERISA).

62. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 427–29 (2014) (foreclosing all of plaintiffs' proposed alternatives except disclosure, and perhaps, the halting of future stock purchases).

63. *Cf. Jander*, 910 F.3d at 626 (arguing that a fact-specific inquiry best balances the encouragement of ESOP creation and use, while not making all plaintiffs' recovery impossible).

64. *See Allen*, 967 F.3d at 767; Martone v. Robb, 902 F.3d 519 (5th Cir. 2018).

sufficiently context-specific approach quells these concerns while not foreclosing all plaintiffs from recovering.[65]

ii. Jander Highlights the Need for Clarification of Which Dudenhoeffer Standard Should Prevail

The parties in *Jander* "fundamentally" disputed the standard for a plaintiff's pleading in a duty-of-prudence case under ERISA.[66] The dispute arose from a discrepancy in Justice Breyer's original opinion in *Dudenhoeffer*.[67] Early in the opinion, the test for a plaintiff's plausible pleading is stated as a proposed alternative action that a fiduciary "would not" have viewed as more likely to harm the fund than benefit it.[68] This formulation suggests a test of what the average fiduciary would do.[69] Later in *Dudenhoeffer*, the Court rephrases the test as requiring plaintiffs to plead an alternative course of action that a reasonably prudent fiduciary "could not" have viewed as more likely to harm the fund than to help it.[70] This formulation suggests a stricter test similar to rational basis review.[71] Where a plaintiff in a rational basis test has to prove there is no rational basis for government action, *Dudenhoeffer* plaintiffs have to prove no prudent fiduciary would find the proposed alternative action objectionable.

The *Jander* court declined to decipher which test was the "correct" test and found that plaintiffs even satisfied the stricter "could not" test.[72] A likely factor in the *Jander* court's decision to ignore the "would not" test was the Supreme Court's reversal of a Ninth Circuit case, *Amgen Inc. v. Harris*,[73] in which the Court remanded the case with instructions to engage in *Dudnehoeffer*'s analysis, citing the "could not" test.[74] When remanding *Amgen*, the Supreme Court cited the portion of *Dudenhoeffer* which used the

65. *See Jander*, 910 F.3d at 626.

66. *See id.* at 625–26 (noting that *Dudenhoeffer* considered the "correct standard" to be the one that filtered out frivolous claims, which defendants argued was a stringent "any prudent fiduciary standard").

67. *Compare Dudenhoeffer*, 573 U.S. at 428 (suggesting a standard invoking an average fiduciary), *with id.* at 430 (suggesting a standard invoking whether any reasonable fiduciary would find disclosure more harmful).

68. *Id.* at 426–27.

69. *See Jander*, 910 F.3d at 626.

70. *Dudenhoeffer*, 573 U.S. at 429–30.

71. *See generally* Lochner v. New York, 198 U.S. 45 (Holmes, J., dissenting) (establishing the rational basis test is satisfied if any single rational basis could exist for Congressional action).

72. *See Jander*, 910 F.3d at 631.

73. 577 U.S. 308 (2016) (per curiam).

74. *Id.* at 309–11; *see Jander*, 910 F.3d at 627–28 (citing *Amgen* at length before ultimately finding plaintiffs satisfied both tests).

"could not" language, suggesting that test was the "correct" test.[75]

iii. Jander Rejects Defendants' Attempts to Impose FRCP 9(b) on Plaintiffs' Pleadings

Finally, and most definitively, the *Jander* court summarily rejected a common argument by defendants in stock-drop cases, that FRCP 9(b) applies the heightened pleading standard to these cases.[76] Although *Dudenhoeffer* cases allege a fiduciary had knowledge of fraud, the allegations are of fiduciary imprudence; and thus, do not merit the heightened pleading standard under FRCP 9(b).[77] An allegation of imprudent investing does not carry the stigma of fraud — one of the rationales behind 9(b)'s heightened pleading requirement.[78] The *Jander* court cabined 9(b)'s reach in duty-of-prudence cases to those using the fraud exception to ERISA's statute of limitations.[79]

E. The Eighth Circuit Finds Plaintiffs' Arguments Unconvincing Without Engaging the Full Dudenhoeffer Analysis

In 2020, the Eighth Circuit decided *Allen v. Wells Fargo & Co.*,[80] where plaintiffs sued Wells Fargo and plan fiduciaries for breach of ERISA's duty-of-prudence.[81] Plaintiffs claimed that Wells Fargo engaged in aggressive sales quotas, which necessarily pressured employees to open over 3.5 million unauthorized accounts using existing customers' confidential information.[82] Plaintiffs further claimed that disclosure of the fraud was inevitable because federal banking regulators had been investigating the matter for several years.[83] Plaintiffs' claims stem from the resulting stock-drop.[84]

The *Allen* court partially employed the three-part analysis set forth in *Dudenhoeffer* and followed by *Jander*.[85] The *Allen* court quickly decided to

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75. *See Amgen*, 577 U.S. at 311 (citing *Dudenhoeffer*'s "could not" language but not explicitly resolving its apparent contradiction).

76. *See Jander*, 910 F.3d at 632 (noting the stigma rationale applicable to a fraud accusation is not applicable to a breach-of-duty accusation).

77. *Id.*

78. FED. R. CIV. P. 9(b).

79. *See Jander*, 910 F.3d at 632 (noting the court has also refrained from using 9(b)'s heightened standard in other ERISA cases); *see also* 29 U.S.C. § 1113.

80. 967 F.3d 767 (8th Cir. 2020).

81. *See id.* at 770–71.

82. *Id.*

83. *Id.* at 771.

84. *Id.* (noting plaintiffs' significant losses in the wake of the scandal).

85. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 428–30 (2014) (outlining the necessary considerations for stock-drop cases); *see also Allen*, 967 F.3d at

use the "could not" standard and ultimately found plaintiffs' breach of duty-of-prudence claim implausible.[86] While the court noted that the relevant inquiry is a fact-intensive one, it saw the "could not" language as too demanding a test for the *Allen* plaintiffs to overcome.[87] The inquiry, the court noted, is also temporally restrained, concerned only with the facts known to the fiduciary at the time relevant to the cause of action.[88]

The *Allen* court rejected the plaintiffs' duty-of-prudence claim by embracing the Fifth Circuit's view of similar cases.[89] Additionally, it expressed skepticism of *Jander*'s reliance on "general economic principles."[90] The opinion highlights the divide between the two circuits' interpretations of *Dudenhoeffer*.[91]

The *Allen* plaintiffs attempted to distinguish their case from the plaintiffs in the Fifth Circuit by contending that their "duty to disclose" argument was supported by the "fact" that discovery of the fraud was inevitable; an argument the court noted Fifth Circuit plaintiffs made in *Martone v. Robb*.[92] Under the argument, when fraud will inevitably be discovered and disclosed, a reasonably prudent fiduciary will opt to disclose earlier rather than later, because it is a "general economic principle" that fraud concealed over time is more harmful than fraud that is disclosed quickly.[93] The *Allen* court summarized the *Martone* decision as rejecting this logic because: (1) if the principle truly was "generally known" it would be applicable in virtually all ERISA fraud cases; and (2) it contradicts the Fifth Circuit's finding in *Whitley v. BP, P.L.C.*[94] that earlier disclosure of fraud could have been

772–73 (using the *Dudenhoeffer* inquiry).

86. *See Allen*, 967 F.3d at 774–75 (finding that even a short-term stock-drop satisfied defendant's burden).

87. *See id.* (finding that plaintiffs' argument had merit, but that the argument was not so convincing that the court would find that no "prudent fiduciary" would disagree).

88. *Id.* at 773 (specifying that only the facts known to the fiduciary at the time of the investing decision can impose liability).

89. *Id.* (citing Whitley v. BP, P.L.C., 838 F.3d 523, 529 (5th Cir. 2016); Martone v. Robb, 902 F.3d 519 (5th Cir. 2018)).

90. *See id.* at 773–74 (expressing doubt on the theory that fraud inflicts more harm on stock value the longer the fraud goes on).

91. *See id.* at 774 (criticizing *Jander* and putting forth its own view of the *Dudenhoeffer* inquiry).

92. *Id.* at 773–74 (pointing to the ongoing investigation into the matter by government regulators). *See generally* Martone v. Robb, 902 F.3d 519 (5th Cir. 2018) (finding that even if inevitable discovery were sufficiently shown, plaintiffs failed to meet the burden of the "could not" test).

93. *Allen*, 967 F.3d at 773 (citing Martone v. Robb, 902 F.3d 519 (5th Cir. 2018)).

94. 838 F.3d 523 (5th Cir. 2018).

considered more harmful by a reasonably prudent fiduciary.[95]

The *Allen* court explicitly noted that *Jander* is the only case in which the *Dudenhoeffer* standard was satisfied by a plaintiff with a disclosure of fraud argument.[96] The *Allen* court rejected *Jander* and called the "general economic principle" too generic to be beneficial to plaintiffs and further opined that an unusual disclosure made during a regulatory investigation could do more harm than good.[97]

F. Defendants Rely on Pegram v. Herdrich, Seeking to Foreclose Plaintiffs from Proceeding to Discovery

In 2000, the Supreme Court decided *Pegram v. Herdrich*,[98] which involved an unusual set of facts that *Dudenhoeffer* defendants have since used to argue that plaintiffs are barred from recovery.[99] At face value, *Pegram*'s holding seems to support such an outcome.[100]

Herdrich was an enrollee in a health maintenance organization ("HMO") where patients acquired pre-paid medical services.[101] Pegram, a physician, examined Herdrich for abdominal pain and, despite alarming symptoms, decided Herdrich should wait eight days for an appointment at an HMO facility with Pegram's staff fifty miles away.[102] Herdrich's appendix burst before the eight days and he suffered other complications.[103]

Herdrich made an ERISA (non-ESOP) claim against Pegram, who was a fiduciary, because the medical services were pre-paid.[104] The Court was

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95. *Allen*, 967 F.3d at 773–74.

96. *Id.* at 774 (calling *Jander* the "sole instance" after recapping two sister circuits' *Dudenhoeffer* cases finding for defendants).

97. *See id.* at 774–75 (noting the possibility of a greater stock drop if the disclosure were made outside the normal reporting regime).

98. 530 U.S. 211 (2000).

99. *See* Brief for Petitioner, *supra* note 44, at 30 (summarizing *Pegram*'s holding: "ERISA requires that 'the fiduciary with two hats wear only one at a time, and wear the fiduciary hat when making fiduciary decisions.' Consequently '[i]n every case charging breach of ERISA fiduciary duty' the 'threshold question' is whether the defendant 'was acting as a fiduciary . . . when taking the action subject to complaint.' If not, then ERISA liability cannot attach.").

100. *See Pegram*, 530 U.S. at 231 (asserting that plaintiffs cannot hold plan fiduciaries liable for actions taken in a non-fiduciary capacity that are not for the sole benefit of plan beneficiaries).

101. *Id.* at 215.

102. *Id.*

103. *Id.*

104. *See ERISA: Court Rules Physician HMO Has Fiduciary Duty*, CAL. HEALTHLINE (Apr. 23, 1999), https://californiahealthline.org/morning-breakout/erisa-court-rules-physician-hmo-has-fiduciary-duty/.

ultimately unwilling to find that medical decisions made by Pegram while treating Herdrich made Pegram liable for breaching a fiduciary duty.[105] Importantly, the Court found that Pegram could only be liable for actions taken in his capacity as a fiduciary not as a medical professional.[106] In other words, the two roles were separable.

III. JANDER IS NOT IMPERVIOUS BUT IS MORE FAITHFUL TO DUDENHOEFFER'S STANDARDS AND GOALS

Only the Second, Fifth, and Eighth Circuits have published *Dudenhoeffer* opinions.[107] The disagreement results primarily from a single sentence in the Court's opinion in *Dudenhoeffer*: "[L]ower courts faced with such claims should also consider whether the complaint has plausibly alleged that a prudent fiduciary in the defendant's position could not have concluded that stopping purchases . . . or publicly disclosing negative information would do more harm than good to the fund . . . ."[108]

The majority circuits (the Fifth and Eighth) have concluded that prudent fiduciaries cannot plausibly view disclosing their company's fraudulent behavior to be more beneficial to the fund than harmful.[109] The Second Circuit has taken the opposite position.[110] The majority circuits have extended *Dudenhoeffer* beyond the practical realities of long-term investing by analyzing short-term harm without analyzing long-term harm.[111] Also, the majority circuits do precisely what Justice Breyer warned against in

105. *See Pegram*, 530 U.S. at 222–31 (noting the Court's doubts that Congress intended medical decisions to be considered fiduciary decisions).

106. *See id.* at 231–37.

107. Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620 (2d Cir. 2018); Martone v. Robb, 902 F.3d 519 (5th Cir. 2018); Allen v. Wells Fargo & Co., 967 F.3d 767 (8th Cir. 2020).

108. Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 429–30 (2014) (articulating the test for the first time); *see also* Amgen Inc. v. Harris, 577 U.S. 508 (2016) (per curiam) (remanding a Ninth Circuit case with instructions to follow the *Dudenhoeffer* test).

109. *See, e.g.*, *Martone*, 902 F.3d at 527 (finding that disclosure was not "so clearly beneficial" to be availing for plaintiffs' pleading).

110. *See Jander*, 910 F.3d at 631 (noting that while the *Dudenhoeffer* standard is a demanding one, at the pleading stage, with all inferences drawn in plaintiff's favor, general economic principles can be accepted, and if needed, rejected at a later stage of the suit).

111. *Cf.* Richard Best, *3 Reasons Not to Sell After a Market Downturn*, INVESTOPEDIA, https://www.investopedia.com/articles/investing/021116/3-reasons-not-sell-after-market-downturn.asp (last updated Aug. 30, 2021) (arguing that large market dips, even crashes like 2008 and Brexit reactions, should not affect long-term portfolio strategies because it is not "part of the plan").

Dudenhoeffer; they foreclose all avenues to recovery for plaintiffs.[112] Last, the majority circuits violate traditional notions of the fiduciary duty to avoid conflicts of interest and duties to serve shareholders and other stakeholders.[113]

A. The Harm Inquiry of a Retirement Fund Cannot Be Confined to a Short-Term Stock Drop

The Eighth Circuit, relying on the Fifth's decision in *Martone*, inappropriately cabins its analysis of harm into a short-term stock drop inquiry.[114] When courts answer *Dudenhoeffer*'s pivotal inquiry, "could a reasonably prudent fiduciary have viewed the proposed alternative as more harmful," the majority circuits are satisfied by the mere possibility of a reactionary drop in stock prices following disclosure.[115] This shallow analysis is: (1) too defense-friendly, like the presumption of prudence in *Dudenhoeffer*; and (2) particularly inappropriate because the funds at issue are retirement funds which are inherently focused on long-term returns.[116]

The Supreme Court, in *Dudenhoeffer*, rejected a defense-friendly presumption of prudent decision-making adopted by every circuit court to consider the presumption and noted that the defense-friendly, judicial creation inappropriately tipped the balance struck by Congress between the interests of ESOP participants and the encouragement of ESOP creation.[117] A shallow inquiry of the pivotal question set forth in *Dudenhoeffer*, which

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112. *See Dudenhoeffer*, 573 U.S. at 424–25 (acknowledging the competing concerns of Congress but finding that the presumption of prudence would make it impossible for plaintiffs to plead even meritorious cases).

113. *See* Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 MINN. L. REV. 1951, 1963–67 (2018) (describing a lack of academic agreement on whether shareholder theory is a norm or law but maintaining that shareholder theory is a staple of fiduciary duties in corporate law).

114. *See* Allen v. Wells Fargo & Co., 967 F.3d 767, 774–75 (8th Cir. 2020) (accepting, presumably, any drop in value for any length of time as sufficient).

115. *See id.* at 775 (relying on *Martone* to accept alleged harm without analyzing the length or extent of probable harm).

116. *See* Kent Greenfield, *The Rise of the Working Class Shareholder: An Application, An Extension, and a Challenge*, 99 B.U. L. REV. 303, 306 (2019) (noting that unlike some short-term focused shareholders, retirement funds are the "prototypical long-term" funds where beneficiaries seek increased value over time); U.S. DEP'T OF LABOR, EMP. BENEFITS SEC. ADMIN., RETIREMENT PLANS AND ERISA 6, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs (last visited Sept. 29, 2021) (noting that at the federal level, plan participants are not entitled to receive benefits until they are sixty-five years old, have invested in the plan for ten years, or are no longer employed by the company).

117. *See Dudenhoeffer*, 573 U.S. at 412, 425 ("weeding out" the "plausible sheep from the meritless goats" was a valid concern, but the presumption did not serve this concern in a way that protected the "plausible sheep").

effectively forecloses plaintiffs' recoveries, is similarly too defense-friendly and tips the balance against ESOP participants enforcing their rights.[118]

The shallow inquiry suffers another deficiency aside from failing *Dudenhoeffer*'s balancing consideration.[119] Given that the funds at issue are retirement funds, an analysis of harm that is unconcerned with the long-term well-being of the fund is inappropriate.[120] The short-term stock drop consideration may be one factor in the analysis, but the reasonably prudent fiduciary analysis cannot be readily separated from the fact that these cases ask what a prudent fiduciary of a retirement fund would do.[121] Whereas a day trader or general shareholder in a company may devalue a stock based on its short-term value, an ESOP beneficiary valuing the stock will be more concerned with its long-term value.[122]

If immediate disclosure of fraud would halve the value of a fund in one month but the fund would recover in one year, no reasonable fiduciary could argue that delayed disclosure was a prudent decision for a retirement fund.[123] Considerations of long-term value are entirely missing from the Eighth Circuit's analysis.[124]

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118. *See id.* at 424 (rejecting a presumption of prudence, in part, because it forecloses even the most meritorious claims by plaintiffs).

119. *See id.* (quoting Conkright v. Frommert, 559 U.S. 506, 517 (2010)) (describing the balance as between the "fair and prompt enforcement of" beneficiaries' rights and the creation of ESOPs).

120. *See* Greenfield, *supra* note 116, at 306.

121. *See id.* (noting that "any effort by companies to prioritize short-term returns at the expense of the long-term health of the company will be opposed by employee investors" of pensions funds).

122. *Compare* Justin Kuepper, *Day Trading: An Introduction*, INVESTOPEDIA, https://www.investopedia.com/articles/trading/05/011705.asp (last updated Sept. 8, 2021) (noting that day traders profit from small changes in the market over short time scales), *with* Akhilesh Ganti, *Employee Stock Ownership Plan (ESOP)*, INVESTOPEDIA, https://www.investopedia.com/terms/e/esop.asp (last updated Apr. 8, 2021) (noting that an ESOP's value to beneficiaries stems from their ability to "cash out" upon retirement or quitting their existing job because the stock cannot be kept by the employee after they are no longer working).

123. *See* Victoria Schwartz, *Disclosing Corporate Disclosure Policies*, 40 FLA. ST. U. L. REV. 487, 493 (2013) (noting that empirical economic studies show investors value disclosure requirements because relevant information gives investors confidence in their decisions and protects the "believability of the flow of information" and that lack of disclosure creates an assumption of the worst).

124. *See* Allen v. Wells Fargo & Co., 967 F.3d 767, 774–75 (8th Cir. 2020) (deciding, briefly, that a prudent fiduciary could find earlier disclosure "more harmful," but not placing the harm in any temporal context).

i. Allen Rejects General Economic Principles by Inaccurately Characterizing Those Principles as Too "Generic"

One criticism of the "stock-drop" plaintiffs' arguments is a reliance upon the "general economic principle" that fraud is more harmful over time.[125] However, any concerns of excessively generic assertions are quelled by analyzing whether "inevitable disclosure" is plausibly pleaded.[126] The majority circuits are correct that generic claims of "inevitable disclosure" should not be availing to plaintiffs.[127] But where inevitable disclosure can be specifically alleged, as is often the case, "general economic principles" should be sufficient.[128] Further, the Eighth Circuit's concern with plaintiffs' claims being "too generic" would be more properly aimed at later stages of litigation, as opposed to the pleading stage where plaintiffs need only allege facts that make their right to recovery "plausible," not "likely to prevail."[129] Relatedly, whether the "general economic theories" are persuasive is better left to a jury, as a question of fact, rather than a judge, as a question of law.[130]

If inevitable discovery can be specifically alleged, plaintiffs' cases are more compelling.[131] Defendants' arguments that plaintiffs' allegations are "too generic" are more properly aimed at the "inevitable discovery" allegation than the "fraud over time" assumption.[132] The argument that fraud, concealed over time, does more harm to the company than fraud, self-disclosed after a brief amount of time is well supported.[133]

However, an inquiry into whether inevitable disclosure has been properly alleged would comport with the "context specific analysis" mandated by the

125. *See id.* at 773–74 (pointing to similar arguments made in *Martone*).

126. *See id.* at 774–75 (criticizing *Jander*'s inevitability decisions by noting that the sale of the company was only "likely," meaning it was not inevitable).

127. *See id.* at 774 (noting that generic inevitable disclosure claims satisfying the *Dudenhoeffer* pleading standard have only been successful in *Jander*).

128. *See id.* at 771 (pleading that Wells Fargo was already under investigation by a government regulator because indicators of fraud had been detected).

129. *See* Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (noting that when accepting pleadings as true, the plaintiff need only state a claim that is "plausible on its face," not one that is probable).

130. *See* Pullman-Standard v. Swint, 456 U.S. 273, 287–88 (1982) (noting the differences between questions of law and questions of fact).

131. *See* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 629–30 (2d Cir. 2018) (accepting plaintiff's allegations that disclosure of the fraud was inevitable and that exposure of longer-term fraud would undermine a company's credibility).

132. *See generally* Schwartz, *supra* note 123 (explaining that shareholders value negative information because its disclosure makes the company more believable).

133. *See* Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887, 1903–06 (2013) (noting the different kinds of harm that a fraudulent disclosure to a regulator makes, which a self-reported disclosure, by extension, would not).

Dudenhoeffer Court.[134] Whether a company's fraud would inevitably have been discovered requires a case-by-case analysis.[135] The *Allen* court's accusation that *Jander*'s analysis is too generalized is misplaced.[136] By rejecting "general economic principles" and foreclosing those principles as a matter of law, the majority circuits inhibit, rather than promote, case-by-case analysis.

B. The Eighth Circuit Effectively Adopts a New Presumption of Prudence

In *Dudenhoeffer*, the Court rejected a judicially created "presumption of prudence" because it barred plaintiffs' recovery unless the company was on the verge of collapse.[137] The Eighth Circuit's rejection of the proposed alternative action of disclosing fraud, even in the face of inevitable discovery, is a similar de facto bar to recovery.[138]

Thus far, every proposed alternative action has been rejected as implausible.[139] Selling the stock violates insider trading laws.[140] Diversifying the fund imposes a duty explicitly precluded by the statute's plain language.[141] Freezing future purchases of the employer's stock has not been presented to a circuit court post-*Dudenhoeffer*, but likely violates insider trading principles and would signal to the public that something was wrong with the fund.[142] This likely leaves only one avenue open for plaintiffs to recover: a duty to disclose fraud.

The Second Circuit acknowledged the proposed alternative inquiry is fact-

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134. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 425 (2014) (rejecting the presumption of prudent investing by ESOP fiduciaries because it foreclosed broad classes of plaintiffs instead of evaluating individual cases).

135. *See id.*

136. *See* Allen v. Wells Fargo & Co., 967 F.3d 767, 774 (2d Cir. 2020) (suggesting *Jander*'s analysis is applicable in every stock-drop case).

137. *Dudenhoeffer*, 573 U.S. at 425.

138. *See Allen*, 967 F.3d at 773 (noting that *Dudenhoeffer*'s standard was a demanding one yet foreclosing on plaintiffs' primary argument in circuit courts to date).

139. *See id.* (foreclosing disclosure as an option that no prudent fiduciary would forego).

140. *See Dudenhoeffer*, 573 U.S. at 423 (rejecting any proposed alternatives that require a fiduciary to break insider trading laws). *See generally* Andrew W. Marrero, *Insider Trading: Inside the Quagmire*, 17 BERKELEY BUS. L.J. 234 (2020) (noting the complex and confusing nature of insider trading laws and the statute's lack of clarity).

141. *See* 29 U.S.C. § 1104(a)(2) (exempting fiduciaries from the diversification requirements of ERISA because it defeats the inherent purpose of ESOPs).

142. *See Allen*, 967 F.3d at 775 (arguing that an action which "spooks the market" could reasonably be anticipated by a fiduciary to cause an outsized stock drop).

specific.[143] This language is noticeably absent from the Eighth Circuit's rationale.[144] Additionally, the brief and summary dismissal of plaintiffs' suggestion that earlier disclosure of fraud is better for the health of the fund, suggests a de facto foreclosure on plaintiffs pleading any alternative course of action in a duty-of-prudence ERISA claim.[145]

If the Eighth Circuit's interpretation were to prevail, plaintiffs in these cases would be forced to use the "absent special circumstances" caveats the courts have attached to each of the foreclosed alternative actions.[146] This regime is the new presumption of prudence.[147] If plaintiffs are not entitled to recovery, absent special circumstances, this has the same effect as the presumption of prudence.[148] In essence, the majority Circuits presume that fiduciaries have no duty to disclose fraud because they reject economic theories that suggest fraud causes increased harm over time.[149] In this way, should the Supreme Court reject *Jander*'s interpretation of the *Dudenhoeffer* test, it would effectively reject the part of *Dudenhoeffer* that seeks to preserve plan beneficiaries' abilities to assert their rights.[150]

C. The Eighth Circuit Allows Fiduciary Behavior Which Contradicts Traditional Notions of the Fiduciary Duty

The fiduciary's duties are plainly outlined in 29 U.S.C. § 1104(a)(1)(A).[151] The plan fiduciary may only act for the benefit of "participants" and "beneficiaries" of the ESOP.[152] Neither definition includes the interests of

143. *See* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 626 (2d Cir. 2018) (examining the Court's "context-sensitive scrutiny" inquiry set forth in *Dudenhoeffer*).

144. *See Allen*, 967 F.3d at 774–77 (lacking a fact-specific inquiry).

145. *See id.* at 774–75 (finding plaintiffs' claims based on general economic principles inadequate even with all inferences drawn in plaintiffs' favor).

146. *See* Fifth Third Bancorp v. Duddenhoeffer, 573 U.S. 409, 426 (2014) (leaving open the possibility for plaintiffs to allege public information forms a basis to propose the fiduciary should have recognized the stock was overvalued).

147. *See Allen*, 967 F.3d at 773–74 (rejecting the economic theories that fraud is more harmful over time because if they truly were "generally known" then the Fifth Circuit would not have found for defendants in *Whitley*).

148. *See id.* (suggesting that unless new, more convincing data supports the "general economic principles," they will be unavailing to plaintiffs in any case brought in this circuit).

149. *See id.* at 773–75 (explaining and rejecting general economic principles because they would apply in "virtually every fraud case" and this was inherently impossible because *Martone* found the principles inapplicable).

150. *See Dudenhoeffer*, 573 U.S. at 429–30 (stating the test for a claim of the breach of the duty of prudence); *see also id.* at 424 (quoting Conkright v. Frommert, 559 U.S. 506, 517 (2010)) (noting concern for upholding beneficiaries' rights).

151. 29 U.S.C. § 1104(a)(1)(A).

152. *Id.*

the company or the employer.[153] This accords with ESOPs being a form of cooperative where employees are given additional incentives to better the company.[154] Several interests are served by disclosing fraud, including correction of inflated stock price, informing investors of facts pertinent to their assets, and the potential benefit of reducing harm over the long-term.[155] Thus, plaintiffs operating under this theory of the case have, at minimum, met the low standards of mere "plausible pleading."[156]

Similarly, traditional notions of shareholder theory, which are deeply embedded in U.S. economic policies, including ERISA, run contrary to the Eighth Circuit's reasoning.[157] Shareholder theory is the basic notion that business' sole obligations are to maximize shareholder value.[158] Thus, allowing ERISA fiduciaries to avoid disclosing fraud, considering general economic principles, violates shareholder theory and ERISA's explicit commands.[159]

i. Defendants in Stock-Drop Cases Overextend Pegram

Defendants in *Dudenhoeffer* cases assert that a plan fiduciary who is also a corporate officer cannot be held personally liable for actions taken in their corporate capacity that are not for the exclusive benefit of ESOP

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153. *Id.* § 1002(7)–(8).

154. *See* Ganti, *supra* note 122 (listing the incentive structure of ESOPs).

155. *See* Jared A. Funk, *What's the Price Tag?: Measuring the Economic Impacts of Fraud*, FRAUD MAG. (May/June 2015), https://www.fraud-magazine.com/article.aspx?id=4294988056 (listing factors that exacerbate the harms of fraud, including the possible increase in harm over time, the harm of a cover-up, the costs of an investigation, and how many higherups are involved). *But see* Rebekah Susan Mammen & Vinisha Verghese Edakalathur, *Forensic Accounting: Impact of Fraud on Stock Price*, 8 INT'L J. OF BUS. & MGMT. INVENTION 89, 91–95 (2019) (analyzing stock prices of three companies after fraud announcements and finding no price change).

156. *See* Ashcroft v. Iqbal, 556 U.S. 662 (2009) (establishing that pleadings cannot be hypothetically possible, but rather must be minimally plausible).

157. *See* Greenfield, *supra* note 116, at 303–04 (detailing the "enduring" debate between shareholder theory and stakeholder theory and recent legislation incorporating the former).

158. *See* Peter Landau, *Stakeholder vs. Shareholder: How They're Different & Why It Matters*, PROJECT MANAGER (Jan. 31, 2019), https://www.projectmanager.com/blog/stakeholder-vs-shareholder (defining "shareholder" and comparing and contrasting with the related term "stakeholder"). *But see Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans (announcing a shift from focus on shareholders to a focus on stakeholders).

159. *See* Funk, *supra* note 155 (detailing the harms shareholders incur in the event of fraud); 29 U.S.C. 1104(a)(1)(A) (mandating a lone duty to beneficiaries).

participants/beneficiaries.[160] Relying on *Pegram*, defendants make an improper assumption that ESOP beneficiaries' interests are severable from what is beneficial for shareholders generally.[161] Further, these arguments overextend the portion of ERISA that allows for these dual roles while ignoring the portion of ERISA which, in conjunction with the common law of trusts, directs fiduciaries to avoid conflicts of interests.[162]

But more importantly, *Pegram* is readily distinguishable from the current circuit disagreement.[163] The Court in *Pegram* was hesitant to hold a physician liable for medical decisions which did not align with plaintiff's financial interests.[164] Those specific and valid hesitations are not applicable in traditional *Dudenhoeffer* cases.

D. Defendants Rely on Two Primary Arguments

Several counterarguments face the Second Circuit's reasoning. Some of these counterarguments have merit, while others stretch the bounds of logical consistency.[165] Two prevailing arguments dominate the case law.[166]

i. Allowing Plaintiffs to Proceed Based on Economic Generalities Are Applicable to Any Stock-Drop Case

The Eighth Circuit criticizes the Second Circuit as allowing plaintiffs to proceed based on an allegation that any plaintiff in any *Dudenhoeffer* case could make.[167] This criticism is misplaced.

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160. *See* Brief for Petitioner, *supra* note 44, at 32–35 (arguing that the *Jander* plaintiffs are seeking to hold defendants liable for not disclosing the overvaluation in quarterly SEC filings, which combined with the argument that defendants would spook the market in a disclosure outside of normal filings should result in a judgement for IBM).

161. *See* Landau, *supra* note 158 (defining "shareholder" and "stakeholder" in such a way that ESOP beneficiaries can be properly categorized as both).

162. *See generally* Fred Reish, *The Fiduciary Rule: What's Next (Part 4)?: Interesting Angles on the DOL's Fiduciary Rule #88*, NAT'L L. REV. (Apr. 25, 2018), https://www.natlawreview.com/article/fiduciary-rule-what-s-next-part-4-interesting-angles-dol-s-fiduciary-rule-88 (noting the duty to avoid conflicts of interest).

163. *See generally* Pegram v. Herdrich, 530 U.S. 211 (2000) (detailing a situation in which a physician would be held liable for medical decisions that were antithetical to the beneficiary's pecuniary interest).

164. *See id.* at 218–22 (noting the dangers of physicians making health decisions while considering financial interests).

165. *Compare* Brief for Petitioner, *supra* note 44, at 2 (stating Jander's argument as "[i]f the harm from undisclosed fraud only grows over time and no fraud lasts forever, then disclosure is always inevitable and earlier disclosure is always the prudent course"), *with id.* at 14 (noting that under *Pegram*, plan fiduciaries have no duty to beneficiaries when acting in their corporate capacity).

166. *See id.* at 25–32 (presenting two arguments against *Jander*).

167. *See* Allen v. Wells Fargo & Co., 967 F.3d 767, 774 (8th Cir. 2020) (suggesting

As an initial matter, reliance on a "general economic theory" is likely unavailing for plaintiffs if they cannot specifically allege facts necessary to show inevitable disclosure.[168] If disclosure appears to have been concealable, then the "general economic principle" that fraud is more harmful over time is irrelevant.[169] Specific facts are required in plaintiffs' pleadings which tend to show the fraud would inevitability have been disclosed.[170]

Moreover, the general economic principles plaintiffs assert are sound.[171] When fraud is uncovered, as opposed to self-reported, investors distrust the company in the future and are less likely to invest in it.[172] The *Jander* plaintiffs supported this "general economic principle" with various peer-reviewed economic analyses.[173] Fiduciaries opting not to disclose known fraud are likely calculating the harms to the company and its short-term investors, not the harms to ESOP beneficiaries saving for retirement.[174]

ii. The Second Circuit's Precedent Would Allow Excessively Burdensome Discovery

Another critique of *Jander* lies in its alleged consequences. The majority circuits, as well as other sources, suggest that *Jander*'s precedent allows for burdensome discovery if plaintiffs can use "general economic principles."[175] This critique runs contrary to the considerations laid forth in

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that if the use of "general economic principles" was sufficient, then plaintiffs would be allowed to proceed in "virtually every fraud case").

168. *See id.* (detailing the *Jander* plaintiffs' specific allegations which suggested inevitable discovery of fraud).

169. *See generally* Schwartz, *supra* note 123 (listing the harms caused by fraud which result from a reaction to its discovery becoming public knowledge).

170. *See id.*

171. *See* Funk, *supra* note 155 (detailing the harms shareholders incur in the event of fraud).

172. *See id.*

173. *See Allen*, 967 F.3d at 774 (citing Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620 (2d Cir. 2018)) (noting that the *Jander* plaintiffs cited several "economic analyses").

174. Stephen P. Ferris & A.C. Pritchard, *Stock Price Reactions to Securities Fraud Class Actions Under the Private Securities Litigation Reform Act* 33–34 (Univ. Mich., John M. Olin Ctr. for Law & Econ., Working Paper No. 01-009, 2001), https://ssrn.com/abstract=288216 (noting the primary harm to stock comes from the initial revelation of the fraud and the effects slowly fade).

175. *See* Brief for Petitioner, *supra* note 44, at 6, 17–18, 31–32 (arguing that the *Jander* court's precedent would allow for frivolous claims to proceed, contravening *Dudenhoeffer*'s concern with weeding out "the plausible sheep from meritless goats"); Wilson v. Edison Int'l, Inc., 315 F. Supp. 3d 1177, 1193 (C.D. Cal. 2018) (agreeing with the rationale in *Amgen* in the absence of Ninth Circuit guidance).

Dudenhoeffer.[176] There, the Court was not concerned with burdensome discovery, but rather, with meritless discovery.[177] Understandably, defendants do not allege plaintiffs' claims are meritless.[178]

While *Dudenhoeffer* explicitly noted that Congress sought to encourage the creation of ESOP funds, this concern cannot outweigh *Dudenhoeffer*'s other concern of beneficiaries enforcing their rights.[179] Plan beneficiaries' right to recover their retirement funds lost through fraud should outweigh the mere specter of excessive litigation and subsequent discovery which might discourage the creation of ESOPs.[180] Indeed, *Dudenhoeffer* was explicitly cognizant of foreclosing all of plaintiffs' avenues to recovery when it rejected the "presumption of prudence."[181] Enacting a similar bar to recovery here, based merely on speculatively excessive discovery, runs contrary to *Dudenhoeffer*'s explicit rationale for meritorious discovery.[182]

E. The Pegram Problem

Treating the duties of plan fiduciary and corporate officer as readily severable is unnecessary and, even if it were necessary, unworkable.[183] Majority courts and critics of the Second Circuit argue that *Pegram* forecloses plaintiffs' recovery in these cases because defendants would be held liable for their actions as non-fiduciaries.[184] *Pegram* forecloses plaintiffs from holding plan fiduciaries liable for actions taken in their

176. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 425 (2014) (noting any proper standard for ESOP cases should be aimed at weeding out frivolous claims).

177. *See id.*

178. *See generally* Brief for Petitioner, *supra* note 44 (arguing throughout that in future hypothetical cases, where fraud may or may not have occurred, the *Jander* decision would allow for burdensome discovery, but never alleging that Jander's case itself was meritless).

179. *See Dudenhoeffer*, 573 U.S. at 424–25.

180. *See generally* Teresa Ghilarducci, *Big Retirement Losses If The Market Crashes Tomorrow*, FORBES (Dec. 5, 2018, 3:29 PM), https://www.forbes.com/sites/teresaghilarducci/2018/12/05/big-retirement-losses-if-the-market-crashes-tomorrow/?sh=1ad0ad547dab (estimating that retirement funds lost $2.4 trillion in the last two quarters of 2008).

181. *See Dudenhoeffer*, 573 U.S. at 425 (noting the presumption of prudence operates to bar all plaintiffs from enforcing their rights under an ESOP).

182. *See id.* at 424 (noting a concern for "meritless, economically burdensome lawsuits").

183. *See* ROSEN ET AL., *supra* note 7 (noting the inherent risks associated with being an insider ESOP fiduciary and how to handle the position with minimum litigation exposure).

184. *See* Pegram v. Herdrich, 530 U.S. 211, 225–26 (2000) (stating that fiduciaries under ERISA may only "wear their fiduciary hat" when acting in a way that will affect beneficiaries).

corporate capacity that were not to their exclusive benefit.[185]

"The *Pegram* problem" arises in specific, but not all, *Dudenhoeffer* cases.[186] When plaintiffs argue that a disclosure of fraud should have been made, defendants can argue that unusual disclosure made outside the normal reporting regime could dramatically "spook the market."[187] In response, plaintiffs may contend that the plan fiduciary, in their corporate capacity, should have made a disclosure in a standard reporting schedule, such as a quarterly SEC report.[188]

The majority circuits, when confronted with the *Pegram* problem, have accepted that standard reporting is an action done solely in a corporate officer capacity and thus the plan fiduciary is not obligated to act in the interest of plan beneficiaries by disclosing.[189] However, defendants using *Pegram* ignore ERISA's duty to avoid conflicts of interest.[190] Courts could reason that in like situations, corporate officers violate their duty to avoid conflicts of interest by omitting known fraud.[191]

IV. JANDER REQUIRES UPROOTING LESS CASE LAW

The Eighth Circuit unavoidably contradicts parts of *Dudenhoeffer*.[192] If the Court were to distinguish *Pegram* from the current disagreement, the

185. *See id.* at 213 (noting the "fatal difficulties" such a holding would yield, particularly for physician-fiduciaries).

186. *See, e.g.*, Martone v. Robb, 902 F.3d 519 (5th Cir. 2018) (finding no *Pegram* problem because plaintiffs did not allege an alternative action that the defendant should have taken in a non-fiduciary capacity).

187. *Contra* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 628–29 (2d Cir. 2018) (rejecting this argument).

188. *See id.* at 630 (accepting such an argument as plausible, but also finding it unnecessary because the Court rejected defendant's argument).

189. *See* Harris v. Amgen, Inc., 788 F.3d 916, 941–42 (9th Cir. 2015) (agreeing with the Sixth Circuit in Dudenhoeffer v. Fifth Third Bancorp, 692 F.3d 410, 423 (6th Cir. 2012), that reports are made in a fiduciary capacity only); Amgen Inc. v. Harris, 577 U.S. 308, 311 (2016) (reiterating that the disclosure argument may work, but ultimately the *Dudenhoeffer* standard must be satisfied). *Contra* Deak v. Masters, Mates & Pilots Pension Plan, 821 F.2d 572, 580 (11th Cir. 1987) (noting that ERISA plan fiduciaries have a duty to avoid situations where their actions as corporate officers will conflict with complete loyalty to plan beneficiaries).

190. *Deak*, 821 F.2d at 580.

191. *See id.*

192. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 424 (2014) (quoting Conkright v. Frommert, 559 U.S. 506, 517 (2010)) (recognizing the balance struck by ERISA in "ensuring fair and prompt enforcement of rights under a plan and the encouragement of the creation of such plans").

resolution would be straightforward and uphold the balance pursued in *Dudenhoeffer*.[193]

A. Unless the Supreme Court Intends to Overturn Dudenhoeffer, It Must Reject Some Part of the Eighth Circuit's Rationale

The Supreme Court should grant certiorari to resolve this disagreement and should clarify that the majority circuits cannot mandate blanket dismissal of a plaintiff's case merely because the plaintiff's proposed alternative action requires the defendant to disclose their previous fraudulent behavior.[194] A bright-line rule which construes this proposed alternative to be inherently implausible runs afoul of basic tenets of shareholder theory by allowing fiduciaries to blatantly disregard shareholder and stakeholder value.[195] Additionally, any such bright-line rule would also run contrary to the Court's statement in *Dudenhoeffer* that the inquiry is inherently context specific.[196] Even *Jander*'s critics acknowledge this is the proper inquiry.[197]

Alternatively, the Court should allow "inevitable discovery" cases to proceed as they significantly bolster a plaintiff's claim that earlier disclosure is preferable in those situations.[198] The Court should reemphasize what it considered relevant in the *Dudenhoeffer* decision — that a general economic theory can be an appropriate consideration.[199] The Court should reject the argument that plaintiffs rely on "generic accusations" that will be alleged in all stock drop cases.[200] Even if plaintiffs are relying on general economic principles, they cannot proceed to discovery without specific allegations of fraud that are sufficiently plausible under *Twombly*/*Iqbal*.[201]

Last, the Court should clarify that lower courts may not cabin the

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193. *See id.*

194. *See id.* at 425 (rejecting standard which makes plaintiff's enforcement of rights impossible).

195. *See id.*

196. *See id.*

197. *See, e.g.*, Allen v. Wells Fargo & Co., 967 F.3d 767, 774 (8th Cir. 2020) (arguing that *Jander*'s interpretation violates the context specific requirement, in their view, because general economic principles can be alleged by plaintiffs in every case).

198. *See, e.g.*, Funk, *supra* note 155 (suggesting that fraud concealed overtime is more harmful).

199. *See Dudenhoeffer*, 573 U.S. at 426–27 (relying on the fact that "many investors take the view" that trying to outperform markets is unrealistic).

200. *See* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 629–30 (2d Cir. 2018) (noting that in all cases, the economic theories alone will not suffice without other "fact-specific" arguments).

201. *See generally* Ashcroft v. Iqbal, 556 U.S. 662 (2009) (establishing that pleadings must be "plausible" and not "merely possible"); Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007) (creating plausible pleading standard).

harm/benefit analysis to considering short-term value of the investment assets comprising the ESOP. Fiduciaries correctly argue disclosure of fraud can and often does cause short-term stock devaluation; however, plaintiffs must be allowed to counter with considerations of the harm of overvalued stock prices, underinformed investors, and the long-term harm of ongoing fraud in a business.[202] At the very least, the Court should allow for a case-by-case determination of this plausibility analysis. To this end, the Court should expressly reject the reasoning of the majority circuits insofar as they forego a context specific analysis for a blanket foreclosure upon plaintiffs' recoveries.

B. The Court Should Distinguish Dudenhoeffer Cases from Pegram

The *Pegram* problem is entirely avoidable because the *Pegram* case is easily distinguishable from *Dudenhoeffer* cases.[203] The Court should distinguish *Pegram* because *Dudenhoeffer* cases do not involve a conflict between financial concerns and health concerns. Inarguably, a physician need not make medical decisions solely for the financial benefit of the patient-beneficiary.[204]

Dudenhoeffer cases frequently concern plan fiduciaries making SEC filings.[205] Defendants in these cases argue that SEC filings are made solely in a corporate officer capacity, but this is not self-evident.[206] The Court should find that SEC filings are made in both a plan fiduciary and corporate officer capacity. Such a finding is bolstered by the argument that disclosures in SEC filings are not for the sole benefit of ESOP beneficiaries but for the corporate shareholders as well.[207]

C. The Court Should Resolve Any Potential Contradiction Within Dudenhoeffer and its Progeny

The Court should explicitly acknowledge and clarify which *Dudenhoeffer*

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202. *See* Schwartz, *supra* note 123 (explaining that empirical studies show part of the harm experienced by fraud is a lasting lack of trust of future disclosures).

203. *See* Pegram v. Herdrich, 530 U.S. 211, 231–32 (2000) (considering important the unusual case of a fiduciary-physician).

204. *See id.*

205. *See* Brief for Petitioner, *supra* note 44, at 19, 24–25 (noting the argument that fiduciaries should disclose in standard SEC filings, and that the lawyers for several *Dudenhoeffer* cases were the same and made the same arguments).

206. *See id.* at 30–31 (stating that when disclosures are made in SEC filings, they are done so in a corporate capacity, not a fiduciary capacity).

207. *See* Schwartz, *supra* note 123 (arguing that a lack of information harms shareholders).

test is correct. In one part of *Dudenhoeffer*, the Court tells lower courts to analyze whether a reasonable fiduciary "would" not have viewed the proposed alternative as more likely to harm the fund than to help it.[208] Later in the opinion, the Court uses "could" instead, suggesting a more demanding standard.[209]

To decide which test is correct, the Court should consider the two options in the context of other considerations from *Dudenhoeffer*. *Dudenhoeffer* articulates the balance the Court strikes between the encouragement of ESOPs and the ability of plaintiffs to enforce their rights as plan beneficiaries.[210] In doing so, the Court struck down a judicial creation it found too defense-friendly.[211] If the Court finds *Jander*'s reasoning unconvincing, it should nonetheless find that siding with the majority would violate the previously articulated concern of beneficiary rights and avoiding judicial creations which are too defense-friendly.[212] To that end, the Court should establish the "would" test as the correct test to achieve the balance it initially articulated in *Dudenhoeffer*.[213] Even on remand, the Court instructed the Second Circuit to use both tests to reconsider arguments, suggesting a contradiction still needing resolution.[214]

V. CONCLUSION

Dudenhoeffer created a high burden for plaintiffs. While setting that standard, however, the Court explicitly acknowledged that it still disfavored overly defense-friendly judicial creations.[215] The Eighth Circuit's interpretation closes yet another door on plaintiffs' plausibly proposed

208. Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 428 (2014) (emphasis added) ("To state a claim for breach of the duty of prudence . . . a plaintiff must plausibly allege an alternative action . . . that a prudent fiduciary in the same circumstances *would* not have viewed it as more likely to harm the fund than to help it.").

209. *Id.* at 430 (emphasis added) ("[L]ower courts . . . should also consider whether the complaint has plausibly alleged that a prudent fiduciary in the defendant's position *could* not have concluded . . . disclosing negative information would do more harm than good to the fund . . . .").

210. *Id.* at 424 (stating that the Court agrees that there needs to be a balance between allowing beneficiaries to enforce their rights and promoting ESOPs as Congress wants).

211. *See id.* at 418–19 (holding that there is no defense-friendly "presumption of prudence" exception created by the law).

212. *Id.* at 424.

213. *Id.* at 428.

214. Ret. Plans Comm. of IBM v. Jander, 140 S. Ct. 592, 594 (2020) (per curiam) (using the "would" test in one paragraph, then "could" in the following).

215. *See Dudenhoeffer*, 573 U.S. at 425 (stating the appropriate test should weed out only meritless claims).

alternative actions.[216] The decision is merely another defense-friendly judicial creation.[217]

Unless the Supreme Court wishes to effectively overrule *Dudenhoeffer*, the Eighth Circuit cannot prevail. At the very least, the Court would have to: (1) reaffirm that the inquiry is fact-intensive and the proposals of disclosing fraud cannot be presumptively implausible; (2) allow for a more lenient inquiry in cases where plaintiffs allege the fraud would inevitably be discovered; or (3) provide some other proposed alternative plaintiffs may allege which would allow plaintiffs to recover from fiduciaries who concealed information which decreased the value of retirement funds.

Surely, when the *Dudenhoeffer* Court, in the absence of SEC guidance, set out to define the inquiry courts should conduct on plaintiff's duty-of-prudence suits, they did not envision an outcome where plaintiffs cannot plausibly allege any alternative action fiduciaries should have taken.[218] The Fifth and Eighth Circuits, however, do just that.

216. Allen v. Wells Fargo & Co., 967 F.3d 767 (8th Cir. 2020).

217. *See Dudenhoeffer*, 573 U.S. at 412 (holding that the presumption was foreign to any other duty-of-prudence case and was inappropriate).

218. *See id.* at 429 (noting a lack of SEC guidance).

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