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UNITED STATES COURT OF APPEALS  
FOR THE THIRD CIRCUIT

FEDERAL TRADE COMMISSION, ) Case No. 14-3514

v. )

) March 3, 2015

WYNDHAM WORLDWIDE )  
CORPORATION, A Delaware )  
Corporation, WYNDHAM HOTEL )  
GROUP, LLC, a Delaware )  
Limited Liability Company; )  
et al, )

) 601 Market Street  
) Philadelphia, PA 19106

Wyndham Hotels and )  
Resorts, LLC., )  
Appellant )

) 10:13 a.m.-11:28 a.m.

ARGUMENT

BEFORE THE HONORABLES: THOMAS L. AMBRO  
ANTHONY J. SCIRICA  
JANE R. ROTH

APPEARANCES:

For Appellant: EUGENE F. ASSAF, ESQ.  
KIRKLAND & ELLIS LLP  
655 15th Street, N.W.  
Suite 1200  
Washington, D.C. 20005

For Appellee: JOEL R. MARCUS, ESQ.  
FEDERAL TRADE  
COMMISSION  
600 Pennsylvania Avenue, N.W.  
Washington, D.C. 20580

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1 P R O C E E D I N G S

2 (Call to Court)

3 JUDGE AMBRO: We have four cases to be  
4 argued this morning. The first is No. 14-3514,  
5 Federal Trade Commission v Wyndham Worldwide  
6 Corporation, et al, Mr. Assaf and Mr. Marcus.

7 MR. ASSAF: I'd like to reserve five  
8 minutes of rebuttal with the Court's permission.

9 JUDGE AMBRO: That's fine.

10 MR. ASSAF: May it please the Court,  
11 Gene Assaf on behalf of Wyndham.

12 After Wyndham was the victim of Russian  
13 cyber criminals, the FTC brought an unfairness action,  
14 and we believe it should be dismissed for three  
15 reasons.

16 In brief, first, as a matter of  
17 statutory interpretation, whatever unfair trade  
18 practices means it cannot be stretched to mean  
19 negligent behavior, and clearly negligent or negligent  
20 omissions, which allowed criminal activity to take  
21 place.

22 Second, in terms of our fair notice  
23 point --

24 JUDGE AMBRO: And you had what, you had  
25 three instances of hacking; is that correct? One in

1 '08 and two in '09?

2 MR. ASSAF: Your Honor, I think yes.  
3 Three are pled, and because we're on a motion to  
4 dismiss, we've had to accept those pleadings. But the  
5 Russian cyber criminals were never apprehended, and  
6 there's been no showing at this point regarding what  
7 happened with the back doors, which makes this --  
8 which makes part of this case interesting.

9 In other words, I agree, they pled  
10 three incidents. The federal criminal authorities  
11 came in, tried to find out what happened.  
12 Unfortunately, this is beyond the record, but  
13 unfortunately there were back doors left, which not  
14 even the consultants figured out.

15 So Wyndham went out, they hired  
16 consultants, not one, not two, not three, but five  
17 groups. They came in, best technologists in America,  
18 they couldn't figure out that the Russians had left  
19 behind back doors which allowed the incident.

20 JUDGE SCIRICA: Why isn't that a matter  
21 of proof?

22 MR. ASSAF: It is going to be a matter  
23 of proof, Your Honor, as opposed to the substantial  
24 consumer harm, which I don't think is beyond the  
25 pleadings, and I think is not a matter of proof. I

1 think that -- what -- that issue is one not only of  
2 Twombly, but it actually goes to the entire statutory  
3 framework, even under the FTC's view of what  
4 constitutes --

5 JUDGE SCIRICA: So you reject the  
6 analogy to negligence that the order of dismissal in  
7 the LabMD order provided?

8 MR. ASSAF: Yes, Your Honor. I think  
9 actually -- and that's an issue which, by the Court's  
10 questions, caused us to go back and revisit, not only  
11 LabMD and the 28(j) filings, but look at the entire  
12 procedural framework of the FTC. And there's clearly  
13 no deference here, because there's --

14 JUDGE SCIRICA: I understand there's no  
15 deference. It's -- all it is -- I mean, the Eleventh  
16 Circuit made clear that particular point as well. But  
17 the arguments in the LabMD were pretty persuasive. I  
18 mean, if we were to follow those, would you have any  
19 arguments to make before us?

20 MR. ASSAF: I would, Your Honor,  
21 because I would actually use the FTC's own position.

22 So in LabMD there are two key  
23 pleadings. One is the motion to dismiss, and the  
24 other is a motion to stay decided by the Commission.  
25 And in the motion to stay, the Commission cites to

1 Reliable Sprinkler, the D.C. Circuit case by Judge  
2 Garland. And the Commission says, we haven't  
3 determined anything yet, okay, this is preliminary,  
4 because what's going to happen is, as a policy matter  
5 and a factual matter we will now hear the allegations,  
6 and so nobody's rights and obligations have yet been  
7 determined and thus not final.

8 So, Your Honor, I actually -- I don't  
9 think that the LabMD decision is even illustrative of  
10 -- I can bet where I think the Commission would like  
11 to come out, but in terms of administrative law, in  
12 terms of administrative law, I don't think they've  
13 gotten there under Reliable Sprinkler. And that has  
14 not been cited in the briefs, Your Honor, but I would  
15 encourage the Court to look at Reliable Sprinkler by  
16 Judge Garland.

17 JUDGE ROTH: Is LabMD a litigation  
18 position?

19 MR. ASSAF: Excellent question, Your  
20 Honor. In terms of -- I think it's been argued two  
21 ways by the briefs below. I don't think it's final  
22 because it -- and I think it's more in the -- akin to  
23 the litigation positions such as amicus briefs or  
24 litigation position before the final determination.

25 So I think at best it's a litigation

1 position that's not final. So it would be akin to  
2 those lines of cases where the SEC filed amicus briefs  
3 or took litigation positions, and the Court said,  
4 these are mere litigation positions, not entitled to  
5 deference.

6 Your Honor, I think the starting point  
7 of the statutory interpretation question --

8 JUDGE AMBRO: When did Wyndham send out  
9 the -- during '08 or '09 the statement that it had  
10 encryption ability that was using, that it had  
11 firewalls that it was using, and that it was keeping  
12 up with all commercial reasonable standards?

13 MR. ASSAF: Your Honor, they didn't  
14 send that out, but it was part of the website terms of  
15 service. So when you clicked down on the terms of  
16 service, there are multiple paragraphs on what we are  
17 doing, and we have very specific statements as to what  
18 we're doing; the type of encryption technology we're  
19 using, the types of sockets we're using. And that's  
20 one of the reasons, Your Honor, that I want to  
21 emphasize, that deception point is not only not in  
22 front of the Court, but the ruling that we're  
23 advocating from the Court would do nothing to limit  
24 the FTC's agenda on cyber security with respect to  
25 deception.

1                   And so if a company says, this is what  
2                   we're going to do on cyber security and they don't  
3                   live up to that, we have no quarrel with that. And so  
4                   the FTC would be, in fact, on Friday when President  
5                   Obama announced his -- the new proposed legislation,  
6                   the FTC's first response was, what we tell companies  
7                   is keep your words on cyber security, do what you say  
8                   and say what you do.

9                   And so I think it's very important to  
10                  say we haven't contested the deception point, and  
11                  that's a much more narrow discussion for Judge Salas,  
12                  which is why the parties didn't even ask for that to  
13                  be certified. It's whether a reasonable consumer  
14                  would be deceived, and the likelihood of deception.  
15                  But that's a much more narrow question, Your Honor,  
16                  and that would not be implicated by the ruling we're  
17                  advocating in terms of -- on fairness doctrine.

18                  JUDGE ROTH: If somebody established  
19                  standards for protecting data that's accumulated  
20                  electronically by different -- well, by companies -- I  
21                  gather the federal government on the news this  
22                  morning, there's an agency that's being accused of not  
23                  guarding its information sufficiently. Should it --  
24                  should there be a standard, should it just be for  
25                  commercial enterprises? If there should be a



1 standard, who should develop it?

2 MR. ASSAF: So there's a substantial  
3 policy question, Your Honor. The GAO issued a report  
4 two years ago saying multiple federal agencies have  
5 been hacked. In terms of the standard, that's why I  
6 think there's such an easy path out that gives all  
7 stakeholders a win here.

8 The SEC has done it with FASB, they  
9 don't say just look at reasonable accounting, or else  
10 we're going to go after you. There are two critical  
11 standards here that people could look at, or the FTC,  
12 or the federal government can encourage people to look  
13 at.

14 One is PCI, which is by the card brands.  
15 And the other is the NIST standards that  
16 again has been playing out in the congressional debate  
17 about whether those NIST standards should now be  
18 developed or implemented.

19 President Obama's executive order of  
20 last year said for critical infrastructure, such as  
21 power plants and banks, those NIST standards will now  
22 apply. And so I think we're moving in the right  
23 direction, and I think there are standards out there  
24 that an agency or the stakeholders could develop. And  
25 I think -- I'm hopeful that we will get there, because

1 I think it would be very useful.

2 The transaction costs today of trying  
3 to guess where the FTC is, and trying to guess and go  
4 through an investigation --

5 JUDGE AMBRO: Could you make an inquiry  
6 of the FTC as to whether your practices are compliant?

7 MR. ASSAF: To my -- the FTC would be  
8 able to answer that. My understanding is no, Your  
9 Honor, and ironically President Obama's proposed  
10 legislation from last week would now actually allow  
11 companies to go in to make an inquiry, and they would  
12 then get a safe harbor.

13 JUDGE SCIRICA: Yeah. This -- you  
14 know, this may go both to jurisdiction and to notice,  
15 but isn't it difficult to say that you were not on  
16 notice, actual notice that this kind of reasonable  
17 effort on your part was indicated and -- I mean, there  
18 were all these consent decrees, there were testimony  
19 before Congress, there were orders that issued, 34  
20 cease and desist orders. I mean, how can you say that  
21 you were not on notice in these matters?

22 MR. ASSAF: Well, with respect to the  
23 consent decrees, the large majority of them prior to  
24 the Wyndham breach were deception, which we talked  
25 about earlier.

1 JUDGE SCIRICA: Sure.

2 MR. ASSAF: There were five unfairness  
3 to be sure, but even those, Your Honor, if you look at  
4 those, what they say is you shall maintain reasonable  
5 data security methods. They don't go to Judge Roth's  
6 questions and say, thou shall implement PCI or data  
7 security that's consistent with these standards.

8 And so in terms of what a federal  
9 litigant or potential litigant would look at, Your  
10 Honor, when a district court judge would enter an  
11 order, for example, in this case, they would never be  
12 able to enter an order saying, you shall have  
13 reasonable data security measures. They would have to  
14 detail, because it's on penalty of contempt what  
15 exactly you're on notice of.

16 And similarly, your -- Judge Scirica,  
17 for your question, what were the companies on notice  
18 of. The first unfairness decrees were roughly two  
19 years before the breach, and there were five of them.  
20 But all they said is reasonable data security, and  
21 that's against the back drop of every single, every  
22 single federal court case --

23 JUDGE SCIRICA: Including Sperry and  
24 Hutchinson?

25 MR. ASSAF: The Supreme Court -- I'll

1 even get to that case. But there's nothing, nothing  
2 in the federal court decisional law, that is anything  
3 less or that is mere negligence.

4 So you look at every Court of Appeals  
5 decision, and it's always something more than mere  
6 negligence as to what constitutes an unfair trade  
7 practice.

8 JUDGE AMBRO: The argument here was  
9 that you got three alleged hacking attacks, plus a  
10 statement put out that you have systems in place, and  
11 the statements are not true. That would be the plus  
12 that would be alleged here.

13 MR. ASSAF: Okay. And on the plus  
14 factor, Your Honor, analytically, I think the  
15 deception point is separate and apart from what --  
16 because that is a very narrow issue of what the  
17 consumers were told, and we believe that if you look  
18 at the website and it's in the appendix, in terms of  
19 the technology we were using, that's why we didn't  
20 make that part of the interlocutory appeal request.

21 Because one of the thing that's -- you  
22 asked about pleading, Judge Scirica, one thing that's  
23 also going on here is like the FTC has not and  
24 actually cannot allege that any of the alleged  
25 deficiencies that they've now looked at through two

1 years of investigations were the cause of the breach.

2 That's really important.

3 JUDGE SCIRICA: Likely cause -- or  
4 likely cause?

5 MR. ASSAF: Or likely cause. I'm  
6 adding the likely cause, Your Honor. At this point,  
7 they can't even say that these were the likely cause.  
8 And we know that because the consultants and the  
9 federal criminal authorities couldn't even identify  
10 the likely cause of the breach.

11 So it gets to the constraint on the  
12 agency, Your Honor, and the cost imposed by this.  
13 What happens in today's world that a company like  
14 Wyndham goes through a two year investigation, the FTC  
15 looks at over a million pages of documents, and are  
16 they going to identify somebody that didn't change  
17 their password on time, they surely are. I would  
18 imagine in every organization that would happen.

19 And then they -- but that shouldn't --  
20 that can't serve as the ability for the agency then to  
21 go forward, because there's no constraint. As one  
22 commissioner said, our entire agenda is ex post not ex  
23 ante, and it's the only regime that I'm aware of in  
24 administrative law that allows that especially for  
25 mere negligence.

1 JUDGE SCIRICA: So if you take a most  
2 extreme position, no firewalls, no passwords, et  
3 cetera, et cetera, none of this would qualify as  
4 unfair?

5 MR. ASSAF: I think you still have the  
6 deception point, Your Honor, but I don't think --  
7 first of all, I don't think that's the allegations in  
8 this case, no firewalls, no passwords, et cetera. And  
9 at some point, Your Honor, yes, there becomes a  
10 pleading issue of whether they would plead something  
11 more than negligence, but that hasn't happened here.

12 They had a two year investigation and  
13 what they pled were negligence -- with negligence, and  
14 in fact, negligent omissions. They haven't pled  
15 recklessness, they haven't pled gross negligence. And  
16 so I think in terms of the line drawing, Your Honor,  
17 we're clearly just by their pleading on the other side  
18 of the line.

19 JUDGE ROTH: Does unfairness require a  
20 positive act or can unfairness be a failure to act?

21 MR. ASSAF: So I don't know if the  
22 Court needs to reach that decision. The statute says  
23 act and practices, I'm not relying solely on the act  
24 versus omission distinction. But here, again, in  
25 terms of pleading, what they've pled is largely a

1 negligent omission case. But that's not central to  
2 our argument. I do think it raises concerns both of  
3 fairness and statutory authority when somebody is  
4 being the subject of a law enforcement action for  
5 negligent omissions that allowed criminal activity by  
6 a third party.

7 And again, as far as we know, there's  
8 been no other FT -- may I finish, Your Honor?

9 JUDGE AMBRO: Yeah, go ahead, just you  
10 have five more minutes.

11 MR. ASSAF: Thank you. I was going to  
12 remind Your Honor when I was sworn in here in 1990 by  
13 Judge Weiss, somebody else said that, but I didn't --  
14 I thought it would be estopped from using the extra time  
15 that I was given in 1990.

16 JUDGE AMBRO: It carries over  
17 sometimes.

18 JUDGE ROTH: We have a long memory.

19 MR. ASSAF: In terms of -- I'm sorry,  
20 Judge Roth, you -- I was answering your question --

21 JUDGE AMBRO: Act or omission.

22 MR. ASSAF: Oh, act or omission. And  
23 so here, the complaint is fairly read as negligent  
24 omissions, which again goes to, I think, the  
25 transactional cost. I'm very comfortable with arguing

1 the statutory language here, and looking at the  
2 federal Courts of Appeals that look at what happened  
3 in terms of application of the words, unfair trade  
4 practice.

5 And I'd like to make just two quick  
6 points, Your Honor, before my remaining four minutes  
7 run out. I think in some ways, you look at both the  
8 Eleventh Circuit and the Fourth Circuit's approach to  
9 this statutory language, unfair trade practice, with  
10 the same company at issue, Orkin, the pesticide  
11 company.

12 So the Eleventh Circuit says, when  
13 Orkin implements a policy to take advantage of  
14 consumers and change their contracts, raise their  
15 prices, and there are 200,000 people hurt, that rises  
16 to the level of unfair trade practice, Eleventh  
17 Circuit.

18 The Fourth Circuit, now to be sure,  
19 it's under the baby FTC Act, but nevertheless, looking  
20 at the same statutory construct, and what does the  
21 Fourth Circuit do, in allegations where the pesticide  
22 company failed, failed to properly apply pesticides to  
23 certain consumers, the Fourth Circuit, along the lines  
24 of every other federal court case that we have found  
25 interpreting unfair trade practice says mere



1 negligence is not enough. And negligent omissions  
2 especially are not enough.

3 So, Your Honor, I don't know if it's  
4 central to the issue, but I think it certainly informs  
5 the issue. And then when we get to the statutory  
6 interpretation point, aside from the policy issues,  
7 the FTC's position is that 5(n), the limitations are  
8 the beginning and the end. And we say no, you have to  
9 give meaning to unfair trade practice itself in 5(a).

10 And we could have a long debate, but  
11 let's remember the legislative context in which this  
12 arose. In 1980, Congress was concerned about  
13 overreaching by the FTC, and so you have the policy  
14 statement. In 1994, 5(n) was amended to bootstrap the  
15 policy statement.

16 Now, the FTC would have the Court  
17 believe that when Congress enacted an amendment that  
18 was in response to overreaching by the FTC, what  
19 Congress did was eliminate the first part of the  
20 statutory language. And, in fact, Your Honor, in  
21 fact, create a regime in which it's not only mere  
22 negligence under the FTC's view, but it's actually,  
23 it's actually strict liability.

24 And, in fact, Your Honor, if you look  
25 at page 44 of the FTC opposition brief, it's very

1 significant. This is step one, I hate to say it, keep  
2 coming back here and we'll all have less hair and  
3 maybe a little more gray, but they're going to have  
4 this issue of whether data security breaches, one  
5 could be held liable under a strict liability  
6 standard, and you see that in the FTC briefs. They  
7 say, common law principles do not limit the FTC's  
8 authority under Section 5 as a general matter, and  
9 then they go on to say, that the FTC's authority may  
10 extend beyond the boundaries of the common law, does  
11 not mean that Wyndham didn't receive notice, et  
12 cetera.

13 Make no mistake, their position is that  
14 this can be read as a strict liability statute, and I  
15 would say, Congress didn't act in 1994 to substitute  
16 the meaning of unfair trade practice. I would say  
17 they limit it. In fact, the FTC in their brief, again  
18 page 22 and then at the bottom from 24 to 25, they  
19 say, Your Honors, that Congress did limit the FTC's  
20 authority once and only once during this amendment.

21 So how could they limit the authority  
22 and yet eliminate the first part of the statute? And  
23 all the federal court decisional law applying, what we  
24 would say is higher than a negligent standard.

25 JUDGE AMBRO: You've been up almost 20

1 minutes, and yet, you haven't addressed whether the  
2 FTC can bring this action under 53(b) in the first  
3 place.

4 MR. ASSAF: Excuse me, Your Honor.

5 JUDGE AMBRO: And without declaring  
6 that unreasonable cyber security practices are unfair  
7 through an administrative process either by rulemaking  
8 or internal adjudication, why not?

9 MR. ASSAF: So the Court's letter of  
10 February 20th, 2015 -- may I finish this answer?

11 JUDGE AMBRO: Yeah, no, you go ahead,  
12 you're on our time, now.

13 MR. ASSAF: Thank you, Judge Becker.  
14 So --

15 JUDGE AMBRO: I'll take that as a big  
16 compliment. One of my heroes.

17 MR. ASSAF: Have they declared the  
18 cyber practices unfair? No. I don't think consent  
19 decrees count, I don't think the 2007 brochure counts,  
20 and I don't think Chevron deference applies.

21 So are we -- are they asking this  
22 federal court in the first instance, I think the  
23 answer to that question is yes, which then gets to the  
24 question --

25 JUDGE AMBRO: Can they.

1 MR. ASSAF: -- the money question, the  
2 third question. And under Ninth Circuit Evans, the  
3 FTC -- the statute says proper case, which one can  
4 argue would be the routine application such as a fraud  
5 case.

6 Evans, the Ninth Circuit says, it's  
7 actually the application of any alleged violation of  
8 the FTC Act. So you look at Evans and say, well, all  
9 right, maybe Evans was wrongly decided.

10 JUDGE SCIRICA: Seventh Circuit.

11 MR. ASSAF: And I mean this with  
12 respect, he was a professor of mine, Judge Ripple,  
13 okay, not an expansive constitutionalist, okay, Judge  
14 Ripple says I think the Ninth Circuit is right, and  
15 then you have a series of district court cases.

16 The only one that we found actually  
17 disagreeing with Judge Ripple and Evans is Judge  
18 Gesell in D.D.C., but that later is not vacated, but  
19 there's a later opinion in Mylan Labs, in which Judge  
20 Hogan then says, oh, no, I adopt the broader  
21 interpretation.

22 So against this backdrop on 13(b), I'm  
23 not -- believe me, I know I'm asking the Court for  
24 various things, and I kept my powder dry on 13(b),  
25 because I don't think I should convince the Court to

1 create a circuit split, and I think any alleged  
2 violation is fine, plus as a prudential matter, as a  
3 prudential matter, we actually thought about this.  
4 And I would prefer to be in federal court in front of  
5 Article III judges as opposed to the agency.

6 Since 1995 --

7 JUDGE AMBRO: Isn't that the real  
8 answer?

9 JUDGE SCIRICA: I can't figure out why  
10 the agency doesn't want to be in front of itself.

11 MR. ASSAF: Well, statistically, Your  
12 Honor, in terms of the empirical evidence, since 1995  
13 only one defendant has prevailed in front of the  
14 agency. So, yes, as former litigators, I like my  
15 chances better in front of life-tendered Article III  
16 judges. That is one answer, Your Honor.

17 But even if the Court were inclined to  
18 reach out and say the Seventh Circuit and the Ninth  
19 Circuit is wrong, and -- then I think you get into  
20 another discussion regarding Francis Ford, and  
21 whether they should've engaged in rulemaking if this  
22 is really -- I think this is a not novel  
23 interpretation.

24 JUDGE SCIRICA: Yeah, but you don't  
25 need rulemaking. I mean, you could go through the

1 adjudication process.

2 MR. ASSAF: So I've asked you though --

3 JUDGE SCIRICA: The courts give a lot  
4 of discretion to the administrative agencies on that,  
5 don't they?

6 MR. ASSAF: The Court clearly under  
7 *Chenery*, the agency has discretion between -- as  
8 a general matter as we said in our brief, but I think  
9 this thing gets into the notion of *Francis Ford Motor*,  
10 which is discussed by the Ninth Circuit and says,  
11 there are limited circumstances that adjudication is  
12 limited, and when the agency embarks on a wholly new  
13 path. And I would say that mere negligence or Judge  
14 Roth negligent omissions is a wholly new path, then I  
15 think that rulemaking, which the FTC has the power to  
16 do. And this Court has looked at in the funeral  
17 directors' cases.

18 Now, the FTC's response to that in a  
19 district court was, well, it takes a lot of time.  
20 That may be true, but that's part of administrative  
21 law, is that the time actually renders benefits so  
22 that courts aren't wailing around in trying to find  
23 out what the answers are. So I think that it would  
24 have to be rulemaking.

25 And then my last point on 13(b), Your

1 Honor --

2 JUDGE ROTH: Let me ask a quick  
3 question.

4 JUDGE SCIRICA: Go ahead.

5 JUDGE ROTH: Don't we need to go  
6 further into this case in the pleadings in order to  
7 determine really what has been done, what notice there  
8 was, is this really some place that the FTC should  
9 step in?

10 MR. ASSAF: I'd have to give that some  
11 more thought, Your Honor, but I don't think so. And  
12 my thoughts are somewhat preliminary since last week,  
13 but in some ways, we're in a world where we're now  
14 talking about claim splitting. Because there can be  
15 no real dispute that the deception claim is properly  
16 in federal court.

17 As Judge Ambro, you asked by your  
18 questions, and I said earlier on, deception agenda is  
19 protected by our position in this case. And so they  
20 filed in federal court under deception, and it's hard  
21 for me to analytically to sort whether the agency  
22 would then be encouraged to split their claim, so we'd  
23 have an agency proceeding and then a federal court  
24 proceeding, I don't think that's the right answer  
25 either, competing proceedings.

1           So I think getting back to the Court's  
2           question of February 20th, the deception claim is  
3           clearly here under 13(b). And then the question is,  
4           if I were litigating the stay in federal court, which  
5           I am, I would make the arguments I've already made,  
6           but I would also say, you shouldn't just as a matter  
7           of judicial economy split out the unfairness claim to  
8           the agency as -- since the federal court claim.

9           It's almost like a pendant claim or  
10          supplemental jurisdiction, and I know we're far afield  
11          now, but there's no other way to reconcile the  
12          unfairness claim and the deception claim with one  
13          exception, dismiss the unfairness claim and then we  
14          don't have the 13(b) issue.

15          JUDGE AMBRO: Judge Scirica has a  
16          question and I have a final question.

17          MR. ASSAF: Okay.

18          JUDGE SCIRICA: On the possible remedy  
19          here if all the district court could award would be  
20          injunctive relief, would that change your arguments on  
21          notice and due process?

22          MR. ASSAF: So I think, Your Honor, the  
23          agency has pled injunctive relief that includes  
24          disgorgement.

25          JUDGE SCIRICA: Right.



1 MR. ASSAF: And which I think is  
2 another reason why I think the agency is here.

3 JUDGE SCIRICA: But I'm saying without  
4 the -- if all they could get was injunctive relief  
5 without disgorgement.

6 MR. ASSAF: Then would that change my  
7 arguments on 13(b)?

8 JUDGE SCIRICA: Yeah.

9 MR. ASSAF: I don't think so, Your  
10 Honor. I'd want to think that through a little bit,  
11 but I don't think so. I think that they -- it would  
12 make the 13(b) issue actually more clear because then,  
13 they would only be going to the court for a narrow  
14 application injunction, consistent with the  
15 legislative history, that's clearly what Congress  
16 wanted. They wanted the agency to be able to go to  
17 federal court.

18 Now, here it's a little odd since it's  
19 been six or seven years after the breach and we've  
20 been in federal court two years, and they haven't  
21 moved for an injunction. And I think when they do for  
22 an injunction, they can't get an injunction.

23 So in some ways, it is a little head  
24 scratching, Your Honor, I think we all come at that,  
25 like we're here, they filed under 13(b) in order to

1 get an injunction, and they haven't moved for an  
2 injunction. And they haven't even pled what's  
3 necessary for an injunction.

4 In fact, Your Honor, one of the first  
5 things -- this is in the record, one of the first  
6 things we did in district court was file a motion  
7 saying, tell us what kind of injunction you would like  
8 because unreasonable data security isn't detailed  
9 under Third Circuit case law, you'd have to have an  
10 order under penalty of contempt.

11 The agency objected, then the agency  
12 objected again, and they don't want to tell us what  
13 exactly we would -- what the order would look like.  
14 Which I think, yes, Your Honor, in some ways we're  
15 chasing our tail here, because I don't know if they're  
16 ever going to move for an injunction, but in my final,  
17 with the Court's indulgence, the one thing I didn't  
18 say if I've got 30 seconds on substantial consumer  
19 injury, because it's why I think they can't get an  
20 injunction.

21 JUDGE AMBRO: We'll get you back on  
22 rebuttal on that, but the final question on this part,  
23 what is the proper case under Section 53(b)?

24 MR. ASSAF: A proper case under the  
25 Seventh Circuit and Ninth Circuit is any alleged

1 violation of the FTC Act. And if I'm guessing, Your  
2 Honor, and your question is in terms of original  
3 jurisdiction, I think the FTC -- that's a limit on  
4 remedies, 13(b) as opposed to what I think they're  
5 here under 1331, 1337 and 1345 original jurisdiction.

6 I think there's a jurisdiction that  
7 lies in the district court for this action. I think  
8 13(b) is a question of alleged remedy at some point,  
9 but under the broader interpretation by the Ninth and  
10 Seventh Circuit, and Judge Hogan in Mylan Labs, I  
11 think it's any alleged violation.

12 JUDGE SCIRICA: Irrespective of whether  
13 a novel theory is being proposed.

14 MR. ASSAF: So this is clearly a novel  
15 theory. And so I am not arguing to create a circuit  
16 split on that. I'm happy whether one takes the  
17 position of Judge Ambro's observation of a more  
18 scholarly observation of I don't want to create a  
19 circuit split. I'm happy with being in federal court.

20 JUDGE AMBRO: All right. Thank you.  
21 We'll get you back on rebuttal.

22 MR. ASSAF: Thank you, Your Honors.

23 JUDGE AMBRO: Mr. Marcus.

24 MR. MARCUS: May it please the Court.

25 I'm Joel Marcus from the Federal Trade Commission.

1 JUDGE AMBRO: If I can just ask you to  
2 -- I guess we call it sort of issue zero. Has the  
3 Congress entrusted the FTC with declaring new practices  
4 unfair in the first instance?

5 MR. MARCUS: Well, the Congress  
6 certainly entrusted the FTC with defining the scope of  
7 unfairness, a very broad word that Congress has  
8 limited only once. And so -- but what Congress has  
9 also done is it's given the FTC a choice between  
10 proceeding in the first instance as an administrative  
11 matter, that's under Section 5 of the FTC Act or  
12 proceeding under Section 13(b) codified as Section  
13 53(b) --

14 JUDGE AMBRO: Yeah. Just so people  
15 -- when we say 53(b) and 13(b) it's the same.

16 MR. MARCUS: That always makes it  
17 confusing. So in answer to Judge Scirica's question,  
18 the agency often exercises its discretion to proceed  
19 under Section 13(b) because there are remedies available  
20 to the Commission in federal court that are not available  
21 to the Commission in the administrative process.

22 So, for example, the Courts of Appeals  
23 that have addressed this issue have unanimously  
24 concluded that the scope of injunctive relief also  
25 includes equitable relief like rescission of contracts

1 and restitution and, you know, equitable monetary  
2 remedies that the Commission itself does not have the  
3 authority to award. The Commission itself under  
4 Section 5 of the FTC Act can only issue what the  
5 statute calls a cease and desist order, and that's,  
6 you know --

7 JUDGE AMBRO: That's the internal  
8 adjudicative process.

9 MR. MARCUS: -- tantamount to an  
10 injunction, yeah.

11 JUDGE SCIRICA: Has the Supreme Court  
12 blessed that broad interpretation of remedies beyond  
13 injunctive relief?

14 MR. MARCUS: Well, the Supreme Court  
15 has in cases like Porter versus Warner and the  
16 DeMario case. The Court doesn't have briefing on  
17 this, of course, but this is a fairly established body  
18 of law particularly in the Courts of Appeals.

19 This Court actually itself addressed  
20 this once in an unpublished opinion, where it accepted  
21 as a general matter the theory that's been widely  
22 adopted by other Courts of Appeals throughout the  
23 country.

24 Let me see if I have a cite to that.  
25 I'm afraid I don't, but we would be happy to supply

1 that --

2 JUDGE AMBRO: That's fine.

3 MR. MARCUS: -- upon request.

4 So the -- Congress has given the FTC  
5 this choice, and there are reasons why the FTC might  
6 proceed in one venue rather than in another venue.

7 But that also leads to the underlying question, can  
8 the FTC choose to have a case that makes new --

9 JUDGE AMBRO: That's a good point. I  
10 mean, assuming the FTC has not yet declared  
11 unreasonable cyber security practices to be unfair --

12 MR. MARCUS: Right.

13 JUDGE AMBRO: -- are you asking federal  
14 courts to decide that in the first instance?

15 MR. MARCUS: Yes. And that is -- I  
16 mean, so let's table whether we're asking the federal  
17 courts to decide that in the first instance, because I  
18 don't think we are in light of the LabMD order in  
19 particular.

20 JUDGE AMBRO: Well, LabMD was a motion  
21 to dismiss. I mean that's not really --

22 MR. MARCUS: Okay. So if I can just  
23 table that discussion. But the answer is yes, the  
24 FTC --

25 JUDGE AMBRO: How long do you want to

1 table it for?

2 MR. MARCUS: Until I give this one  
3 answer, Your Honor.

4 JUDGE AMBRO: All right.

5 THE COURT: So the FTC has brought  
6 novel theories of unfairness in federal courts before,  
7 so the Neovi case, for example, which involved  
8 that check service. It's a Ninth Circuit decision,  
9 and it involved a service where you could write  
10 electronic checks by supplying your account number,  
11 and it turned out to be a kind of open bar for people  
12 committing fraud.

13 That issue had never arisen before the  
14 FTC before, and yet the FTC brought the case in  
15 federal court, presumably because there was a lot of  
16 potential restitution to help consumers get some of  
17 their money back.

18 In cases like the cramming cases, these  
19 are referred to in footnote 11 of the FTC's red brief.  
20 The FTC brought cases against telephone companies who  
21 were acting as billing agents for people who were  
22 putting fraudulent charges on people's telephone  
23 bills.

24 The telephone companies themselves were  
25 not the people committing the fraud, they were merely

1 the conduit for the bills. But even though the FTC  
2 had not previously addressed that as an administrative  
3 matter, the FTC brought the case as a 13(b) case in  
4 federal court.

5 JUDGE SCIRICA: Was the Accusearch  
6 case, was Accusearch --

7 MR. MARCUS: The Accusearch is a Tenth  
8 Circuit case.

9 JUDGE SCIRICA: But was that a  
10 direct --

11 MR. MARCUS: Yes, that --

12 JUDGE SCIRICA: -- action in federal  
13 court or was that from a cease and desist order?

14 MR. MARCUS: I believe the Accusearch  
15 may have been an original -- pardon me for one minute.

16 JUDGE SCIRICA: An agency adjudication.

17 MR. MARCUS: If the -- yes, that  
18 would've been an original action in federal court I  
19 believe.

20 JUDGE AMBRO: Okay. So let's go back  
21 to the question, assuming the FTC --

22 MR. MARCUS: Okay.

23 JUDGE AMBRO: -- hasn't yet declared  
24 unreasonable cyber security practices to be unfair --

25 MR. MARCUS: Okay.



1 JUDGE AMBRO: -- are you asking federal  
2 courts to that for instance?

3 MR. MARCUS: So, yes, and that's --  
4 there's no problem with that because that's the choice  
5 that Congress has made to allow the FTC to proceed in  
6 either venue.

7 JUDGE AMBRO: And is that just the last  
8 proviso in 13(b)?

9 MR. MARCUS: Well, so, yes, it's the  
10 second proviso in 13(b), and it's the one that says,  
11 provided further that in proper cases, the Commission  
12 may seek and after proper proof, the Court may issue a  
13 permanent injunction.

14 But the preface to that is in the  
15 beginning --

16 JUDGE AMBRO: I mean when you look at  
17 the legislative history it talks about fraud cases.

18 MR. MARCUS: Well, they talk about --

19 JUDGE AMBRO: And the Seventh and the  
20 Ninth Circuit cases in Evans Products and in the  
21 Seventh Circuit cases those were essentially fraud  
22 cases.

23 MR. MARCUS: Well, Neovi certainly  
24 didn't discuss the meaning of proper case, but Neovi  
25 wasn't really a fraud case. It was more akin to this

1 case. That was the check writing company.

2 And the legislative history does give  
3 fraud cases as a kind of paradigmatic example of the  
4 sort of case that would clearly be a proper case. But  
5 I think if you read H. N. Singer in the Ninth  
6 Circuit, and if the Court doesn't have the citation to  
7 that, the citation to that is 668 F2d --

8 JUDGE AMBRO: I have it.

9 MR. MARCUS: -- 1107, okay, and the  
10 Evans case and the World Travel case in the Seventh  
11 Circuit, they're not limiting in those decisions --

12 JUDGE AMBRO: But Singer, for example,  
13 the page we're going to get to I guess was 1111 is  
14 that it was a routine fraud case, right?

15 MR. MARCUS: Singer itself may  
16 have been, but the Court spoke more broadly on Evans I  
17 don't believe was, and the case was actually -- the  
18 issue was actually litigated there. And so it wasn't  
19 just, you know, kind of offhand dictum.

20 And so -- but if you read 53(b)(1), it  
21 refers to when the Commission has reason to believe  
22 that any person, partnership, corporation, et cetera  
23 is violating or about to violate any provision of law  
24 enforced by the Federal Trade Commission.

25 So that suggests that Section 5, which

1 is a provision of law enforced by the Federal Trade  
2 Commission can be, and that's the provision that  
3 outlaws unfairness, can be a proper case.

4 An improper case would be, for example,  
5 a case that's specifically excluded from Section 5,  
6 such as a case against a common carrier or a meat  
7 packer, or an airline, you know, where one of the --

8 JUDGE AMBRO: But the concern I have,  
9 it looks like when 13(b) was passed, you have the  
10 Senate Report No. 93-151 says, "The Commission will  
11 have the ability in routine fraud cases to seek, to  
12 merely seek a permanent injunction in those situations  
13 which is not desired to expand upon the prohibition of  
14 the FTC Act through the issuance of a cease and desist  
15 order."

16 And then I'll concede, there are cases  
17 in the '80s where Courts have gone further. But it  
18 looks like when you come back to the statute, at least  
19 what to the extent when one puts credence in  
20 legislative history that's sometimes written by  
21 staffers with one boss, not necessarily a whole  
22 committee, let alone Congress, it looks like it's to  
23 be done in a very small set of cases.

24 MR. MARCUS: Well, I don't think that  
25 even if you could ascribe that intent to that

1 statement to the entire Congress, which, you know,  
2 some judges think you can, some think you can't. I  
3 don't think it's entirely fair to read that as a  
4 strict limitation on Section 13(b). I think that is  
5 the kind of case that was, you know, the kind of  
6 obvious example of the case that would be brought.

7 But without --

8 JUDGE AMBRO: Well, but you've got  
9 commissioners --

10 MR. MARCUS: But Congress had the  
11 same --

12 JUDGE AMBRO: -- back then, I mean,  
13 just give you a quote from Commissioner Starek  
14 in 1995. "The legislative history," this is the  
15 quote, "That the 'legislative history' indicates that  
16 the permanent injunction proviso is to be invoked only  
17 when the agency concludes that a case presents no  
18 issues warranting detailed administrative  
19 consideration."

20 What you're dealing with here in cyber  
21 security would seem to warrant detailed administrative  
22 consideration.

23 MR. MARCUS: If I may then now shift  
24 gears to whether this case warrants detailed  
25 administrative consideration.

1 JUDGE SCIRICA: May I ask you a  
2 question before you -- I'm sorry, go ahead.

3 MR. MARCUS: Go ahead.

4 JUDGE SCIRICA: You may not be  
5 finished.

6 JUDGE AMBRO: That's okay, I'll come  
7 back.

8 JUDGE SCIRICA: Oh. Why is  
9 disgorgement indicated in this particular case?

10 MR. MARCUS: Well, it may or may not be  
11 depending on the proof that's introduced at trial,  
12 Judge Scirica. If the FTC can show that there were  
13 charges placed on credit card bills that consumers  
14 couldn't reasonably avoid, and that they wound up with  
15 out of pocket expenses, something that's very, very  
16 possible.

17 JUDGE SCIRICA: Well, in an  
18 administrative proceeding you could find out whether  
19 they were all reimbursed as alleged, couldn't you?

20 MR. MARCUS: Well, yes, but then the  
21 FTC in an administrative proceeding would not have the  
22 authority to --

23 JUDGE SCIRICA: I understand that.

24 MR. MARCUS: -- then go --

25 JUDGE SCIRICA: Are you precluded from

1 doing both, from filing, going directly into court  
2 afterwards?

3 MR. MARCUS: Well, we are subject to in  
4 Section 19 of the FTC Act, there's a provision that  
5 allows the FTC to seek damages after a cease and  
6 desist order is issued, but it has procedural  
7 hurdles, and it has standards of proof and all of  
8 that, are you know, significantly more burdensome.

9 And so the FTC rarely does that, just  
10 because it's much more difficult to get actual redress  
11 for consumers, which is what we're after at the end of  
12 the day.

13 And so again, it's --

14 JUDGE SCIRICA: No, I understand in the  
15 general case. I'm wondering why -- well, maybe it's  
16 -- it hasn't been established. But the argument is  
17 that no money is owed at this point.

18 MR. MARCUS: That's Wyndham's argument.

19 JUDGE SCIRICA: Right.

20 MR. MARCUS: And again this is -- you  
21 know, we're at a motion to dismiss here, and so there  
22 are many questions in this case that remain to be  
23 proved, you know, either on summary judgment or on a  
24 trial on the merits, and the scope of equitable relief  
25 and the -- what exactly happened, you know, in terms

1 of the data breaches and we don't know at this point.

2 JUDGE SCIRICA: Thank you.

3 MR. MARCUS: We have the FTC's  
4 allegations at which at this stage in the proceedings,  
5 I think the Court needs to take as a given. And those  
6 allegations are, you know, fundamental security  
7 failures, lack of firewalls, you know, lack of  
8 encryption, failure to update security systems, you  
9 know --

10 JUDGE AMBRO: Can one --

11 MR. MARCUS: -- and passwords. So --

12 JUDGE AMBRO: -- violate a statute by  
13 engaging in conduct that the FTC has yet to declare  
14 unfair, pursuant to its authority under N, subsection  
15 N?

16 MR. MARCUS: I think so. I think that  
17 the term unfair is more or less defined by Congress.  
18 5(n) which was adopted by Congress in 1994 to codify  
19 the FTC's own policy statement from 1980 takes the  
20 virtually boundless word unfair, and puts some  
21 substantial bounds on it, and it has three factors.

22 First, there has to be substantial harm  
23 to consumers. Second, the harm has to be, you know,  
24 reasonably avoidable by the consumers, and third,  
25 there's a kind of cost benefit analysis in the

1 statute.

2 JUDGE ROTH: Aren't your opponents  
3 saying that that creates a circle, a limit within  
4 which you can operate, but that doesn't mean that  
5 everything within that circle you can do?

6 MR. MARCUS: Well, they start from the  
7 position that the word unfair is severely limited, and  
8 that Congress limited it even further. I don't think  
9 that's a correct reading of the way the Supreme Court  
10 has interpreted unfair. I don't even think it's a  
11 correct reading of the dictionary definition of  
12 unfair.

13 I think that unfair has been read by  
14 the Supreme Court and was actually intended by  
15 Congress, if you look at the legislative history from  
16 1914, all the way back, was intended to essentially  
17 encompass every manner of consumer harm. That's  
18 essentially what the D.C. Circuit's case in American  
19 Financial determined.

20 And by defining the outer boundary of  
21 the essentially unlimited word unfair, Congress, in  
22 effect, created the definition of unfairness. And  
23 other courts have read the statute that way,  
24 particularly the Ninth Circuit did that in Neovi. If  
25 you read the opinion, it says, a -- the FTC, an Act is



1 unfair if it X, Y, Z, goes through the three 5(n)  
2 factors. The Tenth Circuit read the statute that way  
3 in Accusearch. And I think that it makes sense as a  
4 logical matter to do that. When you have an  
5 essentially unbounded concept, when you establish a  
6 boundary, the boundary becomes, in effect, the  
7 definition of what it means to be unfair.

8 And so --

9 JUDGE AMBRO: So what is -- I asked  
10 this question of Mr. Assaf, what is a proper case  
11 under Section 13(b)?

12 MR. MARCUS: Well, so this goes back to  
13 our earlier discussion, and I don't think there's any  
14 real disagreement between us here. I think the Ninth  
15 Circuit had --

16 THE COURT: Well, but basically he  
17 doesn't want to be before you in your own little den  
18 because he's not sure he's going to get a fair shake  
19 in his view, but. So what is a proper case under  
20 13(b)?

21 MR. MARCUS: So a proper case, and the  
22 FTC's in agreement with the Ninth Circuit and the  
23 Seventh Circuit certainly that a proper case is a case  
24 that involves a violation of any provision of law  
25 enforced by the Federal Trade Commission. That's

1 consistent with the statute, and it's the way courts  
2 have approached this.

3 And as we were discussing earlier,  
4 there may be some legislative history that touches on  
5 this issue, but I don't think that that really limits  
6 the concept.

7 JUDGE AMBRO: Now, when you look at  
8 5(n) it says that the Commission shall have no  
9 authority to declare invalid, unlawful an act or  
10 practice as unfair unless it causes, et cetera. It  
11 also acknowledges that the Commission may consider  
12 established public policies in making this  
13 determination.

14 Doesn't it look like -- and I'm just --  
15 don't you get to home plate, don't you have somewhere  
16 back in the dugout, say the Commission finds this to  
17 be unfair?

18 MR. MARCUS: Well, certainly every time  
19 the Commission issues a complaint, it takes a vote on  
20 that complaint, and there has to be a majority vote by  
21 the commissioners, just to issue a complaint. And  
22 including the 13(b) complaint in federal court.

23 And so certainly the --

24 JUDGE AMBRO: What kind of notice is  
25 that, that it's an unfair practice deemed by the FTC

1 other than they filed a complaint?

2 MR. MARCUS: Well, in terms of notice,  
3 I think it's important to separate the notice aspects  
4 from the underlying legal violation aspect. So the  
5 statute, you know, kind of -- in terms of what is  
6 unfair, it speaks for itself. I mean, it has been  
7 interpreted by the Commission for many, many years to  
8 focus principally on consumer injury, and then has  
9 those other factors in it to the avoidability and the  
10 cost benefit analysis.

11 And so in terms of the underlying  
12 liability issues, whether you violate the statute, you  
13 know, the focal point has been whether consumers have  
14 been issued -- have been injured. I apologize. And  
15 that is, you know, directly out of the 1980 policy  
16 statement where the Commission said, and this was  
17 basically codified by Congress quite directly,  
18 unjustified consumer injury is the primary focus of  
19 the FTC Act.

20 And that's what 5(n) is after and  
21 that's what --

22 JUDGE AMBRO: The --

23 MR. MARCUS: -- people are, you know,  
24 on the hook for.

25 THE COURT: You say that the FTC has to

1 vote to file a complaint.

2 MR. MARCUS: That's correct.

3 THE COURT: And I think in this case,  
4 did not Commissioner Rosch dissent?

5 MR. MARCUS: Yes, I'm being --

6 THE COURT: At least as to Count II --

7 MR. MARCUS: -- told that Commissioner  
8 Rosch decided to --

9 THE COURT: -- I think. Can you supply  
10 a copy of that dissent, or is that --

11 MR. MARCUS: Let me -- he just said, I  
12 dissent, he did not put anything in writing.

13 JUDGE ROTH: I wish we could do that  
14 here.

15 MR. MARCUS: Supreme Court Justices  
16 used to do that back in the old days.

17 But still there was, you know, a  
18 majority vote, it was duly voted on by the Commission  
19 and that doesn't make it any less of a, you know,  
20 Commission official act.

21 I would like to circle back, Judge  
22 Ambro, to the underlying question here, which is  
23 whether the FTC is actually -- and this is question  
24 one in the Court's letter, has actually addressed some  
25 of the policy issues here.

1 And I think the answer is an  
2 unmistakable yes. The LabMD order, an  
3 interlocutory order to be sure, but an official --

4 JUDGE AMBRO: It's an interlocutory  
5 order and it's on a motion to dismiss, and I don't  
6 know of any internal FTC rules that say that that type  
7 of thing is precedent, is it?

8 JUDGE ROTH: It's the litigation  
9 position of the FTC in ruling on the matter before it.

10 MR. MARCUS: It's not actually the  
11 litigation position because the way the administrative  
12 procedure works is there's a separated trial staff who  
13 acts as the litigators, and they litigate before the  
14 ALJ. And the Commission sits as an adjudicator in  
15 those cases, just like a district court judge sits as  
16 an adjudicator. And then the matter is reviewable in  
17 the Court of Appeals.

18 JUDGE AMBRO: Gina.

19 MR. MARCUS: Thank you, Judge Ambro.  
20 Directly from the Commission's own decision.

21 So in that case, the Commission wasn't  
22 just saying oh, well, we're the lawyers here and we --

23 JUDGE ROTH: The district judge isn't  
24 arguing before herself the district judge.

25 MR. MARCUS: I understand. It --

1 JUDGE ROTH: That you, Judge, have  
2 jurisdiction to hear me.

3 MR. MARCUS: It's an odd artifact of  
4 the -- of some of the progressive era and New Deal  
5 agencies. The FCC has the same kind of thing, and I'm  
6 sure other agencies do as well. I think some of the,  
7 you know, health and safety agencies do, where they  
8 have commissions acting in dual capacities.

9 But the important point is that the Lab  
10 MD order represented the Commission's policy making  
11 determination as an adjudicative body in that case.  
12 The case was argued by the separated trial staff  
13 complaint counsel and LabMD's own counsel in a very  
14 formal process, just the way it would be litigated  
15 before a district court.

16 And the Commission acting in its  
17 capacity as an adjudicator issued a formal ruling.  
18 Now, you've read the opinion, it's quite thorough,  
19 it's quite comprehensive, and it interprets the Act,  
20 and it was voted on unanimously. This time there were no  
21 dissents in the LabMD order.

22 And it was determined, you know,  
23 basically as an interpretive matter, we're reading our  
24 own statute, we're bringing our policy judgment to  
25 bear on these issues, and the Commission determined

1 that a failure to protect data security was an unfair  
2 act within the meaning of Section 5 of the FTC Act.

3 And, you know, we can debate whether  
4 that gets Chevron deference or some lower form of  
5 deference, we believe it gets Chevron deference, but  
6 there are some arguments to the contrary perhaps, but  
7 nevertheless, it does represent the Commission's  
8 formal determination as an adjudicator, voted on by  
9 the five commissioners that it is an unfair practice  
10 to fail to adopt a security, data security measures.

11 JUDGE SCIRICA: And the timing of this  
12 was after the events that occurred in this particular  
13 case, so --

14 MR. MARCUS: The timing of that  
15 particular --

16 JUDGE SCIRICA: -- could it have --

17 MR. MARCUS: -- thing -- again now,  
18 Judge Scirica, it's important to separate the notice  
19 part of this case from the underlying --

20 JUDGE SCIRICA: I understand.

21 MR. MARCUS: -- liability part of this  
22 case.

23 JUDGE SCIRICA: I understand.

24 MR. MARCUS: So in terms of the notice  
25 part of this case, yes, LabMD was after the events

1 here, but there were many, many other administrative  
2 complaints that had been issued prior to that time, at  
3 least five of them unfairness complaints, where the  
4 Commission basically said, you didn't have firewalls,  
5 you didn't have password security, you didn't have  
6 updated --

7 JUDGE SCIRICA: And these all --

8 MR. MARCUS: -- patches.

9 JUDGE SCIRICA: -- ended in consent  
10 decrees.

11 MR. MARCUS: Well, the cases ended in a  
12 consent decree, but the Commission issued a formal  
13 complaint, administrative complaint, Part 5  
14 complaint --

15 JUDGE SCIRICA: Uh-huh.

16 MR. MARCUS: -- and each one of those  
17 complaints was published on the Commission's website  
18 and, in fact, it was put out before the consent  
19 decrees is entered, the complaint and the proposed  
20 decree are put out for public comment. So this is a  
21 very public proceeding, where the Commission announced  
22 quite plainly, a set of acts that it would consider to  
23 be unfair acts under the FTC Act.

24 And, you know, I --

25 JUDGE AMBRO: What kind of deference do



1 you want to give to LabMD?

2 MR. MARCUS: Well, as we argue as in  
3 our --

4 JUDGE AMBRO: It's not a Chevron  
5 difference, is it?

6 MR. MARCUS: We think that there's a  
7 good argument to be made for Chevron deference.

8 JUDGE AMBRO: Even though that normally  
9 applies only to final agency action?

10 MR. MARCUS: Well, you know, I think  
11 that as we pointed out in our 28-J letter, the  
12 touchstone of Chevron is not so much finality, but  
13 formality. And the LabMD order is a formal order  
14 adopted by a unanimous vote of the Commission at the  
15 end of a particular point of the adjudicative process.

16 And should I wait for Judge Ambro?

17 JUDGE ROTH: No, you go ahead.

18 MR. MARCUS: Okay.

19 JUDGE ROTH: He can walk and listen at  
20 the same time.

21 MR. MARCUS: So even if though I prefer  
22 not to get bogged down in the debate about Chevron,  
23 you know, at the very least, there are other forms of  
24 deference that the Supreme Court has recognized and --

25 JUDGE SCIRICA: And if we assume --

1 let's assume we give no deference at all, it may be  
2 persuasive, we may agree with everything in it, but we  
3 give no deference at all and --

4 MR. MARCUS: Well, if you give --

5 JUDGE SCIRICA: -- then you're not in a  
6 great position.

7 MR. MARCUS: Well, I think that you  
8 still have before you even under that scenario, Judge  
9 Scirica, you still have before you a formal order of  
10 the Commission taking the policy position that the  
11 Court seems to think is important here. And the  
12 policy position is that this set of acts or omissions  
13 is an unfair practice under the FTC.

14 And if I could -- Judge Roth you were  
15 asking about the concept of act versus omission  
16 before, and I think that -- I mean, if you look at the  
17 International Harvester case cited in our brief,  
18 that's an FTC case, that was a pure omission case. It  
19 was a failure to notify of a hazardous condition.

20 And in Neovi itself, the Ninth Circuit  
21 warned against, you know, immunizing a website  
22 operator for turning a blind eye to improper  
23 practices. That again was an omission case.

24 JUDGE AMBRO: Let me come back to the  
25 LabMD thing, which is troubling me. Assuming that

1 complaints and consent decrees or decisions on motion  
2 to dismiss are clear enough to give notice when  
3 companies read them, how do companies know when they  
4 should be reading them?

5 MR. MARCUS: Well, I -- you know --

6 JUDGE AMBRO: That wouldn't be my -- if  
7 I were counsel and I was advising somebody that  
8 wouldn't be the first place I would necessarily look,  
9 I mean, as to whether there was an unfair practice.

10 MR. MARCUS: Certainly Congress gave  
11 the FTC very broad jurisdiction over, you know, almost  
12 all sectors of the economy. And I think any careful  
13 general counsel would be looking at what the FTC is  
14 doing, because there are all manner of unfair  
15 practices. The FTC has gotten involved in a vast  
16 array of different types of unfairness and practices.

17 There are all kinds of, you know,  
18 complicated statutes that apply to almost everything  
19 corporations do, particularly big corporations like  
20 Wyndham. And so, you know, if you're a careful  
21 general counsel you do pay attention to what the FTC  
22 is doing, and you do look at these things.

23 Keep in mind if you're going to notice,  
24 Judge Ambro, Wyndham itself said right on its webpage,  
25 we follow commercially reasonable practices, we

1 encrypt our data, we use firewalls. I don't see how  
2 you can possibly come and say we had no idea we were  
3 supposed to encrypt our data, we had no idea we were  
4 supposed to use firewalls.

5 JUDGE AMBRO: No, but the idea is,  
6 encryption by a certain standard, firewalls by a  
7 certain standard.

8 MR. MARCUS: Well, at this point, the  
9 allegations of the complaint are essentially no  
10 firewalls. At this point, the allegations of the  
11 complaint are, you know, passwords that didn't even  
12 pass the minimal level of -- you know, they were like  
13 essentially password as your password, it wasn't quite  
14 that bad, but almost.

15 So keep in mind again, we're at --

16 JUDGE AMBRO: Have you informed the  
17 public that it needs to look at complaints and consent  
18 decrees for guidance?

19 MR. MARCUS: Well, again, these are  
20 businesses that operate and we --

21 JUDGE AMBRO: Do you have any examples  
22 of where that's been done?

23 MR. MARCUS: Well, in terms of, you  
24 know, specific notices mailed out to companies saying,  
25 hey, you need to look at this, I don't think so. But

1 this is an important federal agency that undertakes --  
2 that has broad ranging jurisdiction and undertakes  
3 frequent actions against all manner of practices and  
4 all manner of businesses and --

5 JUDGE ROTH: But since it's not only  
6 businesses that require cyber security, should the FTC  
7 be the cop in this area, or should we consider whether  
8 we want a comprehensive regulation not only of  
9 commercial businesses, but of government agencies, of  
10 non-profit organizations, of you know, across the  
11 board. Should the FTC jump in and grab a certain  
12 portion of that and say, we're going to be the czars  
13 here.

14 MR. MARCUS: Well, right now, Congress  
15 gave the Commission authority over acts, commercial  
16 acts in interstate commerce. Congress has not, at  
17 this point, except in a few narrow areas like banking  
18 and some credit card transactions and healthcare  
19 information, Congress has not spoken in the more  
20 comprehensive way that you're referring to Judge Roth.

21 One of the difficulties, of course, is  
22 that this is one of the fastest changing areas of  
23 technology, and it's exceedingly difficult to come up  
24 with specific standards particularly when you're an  
25 administrative agency and you have to conduct

1 rulemaking procedures --

2 JUDGE ROTH: Well, I mean, should for  
3 that reason --

4 MR. MARCUS: -- and things like that  
5 and --

6 JUDGE ROTH: -- should an  
7 administrative agency be the body that creates the  
8 standards?

9 MR. MARCUS: Well, you know, again in  
10 terms of rulemaking, the FTC probably has authority to  
11 do that, it's a very cumbersome process, and I think  
12 ultimately a Sisyphean task. It would never end  
13 because the technology changes so fast.

14 Congress can step in if it wants to. I  
15 think one way of reading Congress' inaction is that  
16 it's content with FTC enforcement on a case-by-case  
17 basis.

18 JUDGE ROTH: Well, in the present day  
19 I'm not sure inaction can be ready with any rational  
20 motivation.

21 MR. MARCUS: But nevertheless, I think  
22 that it's important to keep in mind here that we are  
23 not talking about whether, you know, Wyndham should  
24 have used the 13 word pass -- the 13 letter password  
25 with the asterisk and the exclamation point. We're

1 talking about very fundamental failures of data  
2 security. Fundamental failures of data security that  
3 Wyndham itself knew that it needed to undertake in  
4 order to protect its customers.

5 And at the end of the day, the FTC is a  
6 consumer protection agency that is, at this point, the  
7 only consumer protection agency that is able to  
8 proceed against companies that accept confidential  
9 data from their customers and then fail to take steps  
10 to protect that data.

11 JUDGE SCIRICA: In defining --

12 MR. MARCUS: Now, we're talking here  
13 about fairly basic steps.

14 JUDGE SCIRICA: I'm sorry.

15 JUDGE AMBRO: Go ahead.

16 JUDGE SCIRICA: In defining unfairness,  
17 do you continue to press the negligence analogy --

18 MR. MARCUS: Well --

19 JUDGE SCIRICA: -- you did in LabMD?

20 MR. MARCUS: In our -- there's two  
21 aspects of this, Judge. So one is the notice aspect.

22 JUDGE SCIRICA: I understand.

23 MR. MARCUS: And so our argument there  
24 is that there's a general background standard of care  
25 that all companies know they have to, you know, adhere

1 to. And the general reasonableness and negligence  
2 standard is part of the notice case.

3 In terms of the unfairness, our  
4 position is that 5(n) effectively defines unfairness.  
5 Reasonableness and the kind of negligence-like  
6 theories are incorporated into that cost benefit  
7 analysis that Section 5(n) incorporates into the  
8 statute.

9 So, in other words, you have to -- the  
10 FTC has the burden to show that there weren't  
11 countervailing benefits that offset the harm to the  
12 consumers. That's like the kind of law and economics  
13 view of negligence that, you know, courts have  
14 adopted.

15 It's not just, you are negligent,  
16 therefore it's unfair. It's a much more complex  
17 undertaking than that. And it's one, of course, that  
18 is best conducted in the first instance not before an  
19 appellate court on a complaint, but in front of a  
20 district court who will take evidence establishing the  
21 three factors that are relevant here, and will be  
22 able to assess on the entirety of the 5(n) factors,  
23 whether or not Wyndham has acted unfairly.

24 JUDGE SCIRICA: As a matter, obviously  
25 we make the decision on the basis of the statute and



1 cases, but as a matter of policy, why don't you take  
2 that argument one step further and say from your point  
3 of view, why isn't it better for the agency to make  
4 that determination on a complaint, get a cease and  
5 desist order and establish a principle and then have  
6 that adjudicated further rather than going directly to  
7 the district court?

8 MR. MARCUS: Well, in terms of the  
9 principle, of course, it is the FTC's view that we  
10 effectively have established that principle. And that  
11 the specific standards of the sort that Judge Roth is  
12 referring to are things that can be established  
13 through testimony and through evidence, and will be a  
14 factual matter for the Court to decide. What were the  
15 failures, were there any offsetting benefits to those  
16 failures.

17 That's the sort of thing, by the way,  
18 the district courts do every day, they take expert  
19 testimony, they make decisions. That doesn't require  
20 any specific policy making judgment necessarily, these  
21 are factual determinations.

22 And even in FTC cases, the FTC often  
23 brings cases involving whether your advertisements for  
24 your dietary supplements are supported by scientific  
25 evidence. And in 13(b) cases, the Commission

1 frequently brings cases that say your studies don't  
2 support the claim made, and the Court will hear expert  
3 evidence from doctors and from scientists and they're  
4 debating the studies that do or don't support, the  
5 flaws and the methodology work, things like that. And  
6 that is a factual matter.

7 The underlying policy matter I think  
8 has been addressed by the Commission over and over  
9 again in 50 data security cases brought at the  
10 administrative level, and cases like LabMD, the  
11 Commission has voted with the vote of all the  
12 commissioners over and over again to support the idea  
13 that failure to have adequate data security is an unfair  
14 practice under the FTC Act.

15 And at this point, I think it's -- it  
16 begins to look more like your kind of typical run of  
17 the mill case than a novel application of the Act.  
18 The -- again, the specifics may vary from case-to-  
19 case, in terms of what happened, in terms of whether  
20 or not it was reasonable. But again, that's the sort  
21 of thing the district courts look at every single day  
22 of the week and they determine.

23 For that matter, district courts look  
24 at novel statutes every day of the week, and they  
25 determine. And in Courts of Appeals then on appeal

1 look at novel statutes. I don't think that's required  
2 here.

3 JUDGE AMBRO: Any further questions?

4 MR. MARCUS: If no further questions,  
5 we respectfully submit that the Court affirm the  
6 district court's judgment and allow this case to  
7 return for trial.

8 JUDGE AMBRO: Thank you very much.

9 MR. MARCUS: Thank you, Your Honors.

10 JUDGE AMBRO: Mr. Assaf. Famous last  
11 words, but we probably will stick to the five minutes.

12 MR. ASSAF: May it please the Court, a  
13 couple of housekeeping matters. The complaint was  
14 voted out with a dissent I think Commission Rosch did  
15 not write a dissent for this case, but referred to his  
16 other writings objecting to the use of an unfairness  
17 claim without standards.

18 Secondly the LabMD case which the  
19 Court has asked about, again, that was a 4-0 decision  
20 as well, one Commissioner had already been recused,  
21 goes to the point of why we don't have to be at the  
22 agency, Commissioner Brill had already said enough  
23 publicly to say that she had preordained the result.

24 I would encourage the Court, and I don't  
25 think it's part of the record, but I think it's

1 available to the Court, and we're able to submit it,  
2 the FTC's motion or decision on the motion to stay Lab  
3 MD is a critical document not only because it  
4 discusses Reliable Sprinkler, which is 324 F3d at 733,  
5 saying that the agency can change its mind, this is  
6 only an administrative complaint, there will be policy  
7 making afterwards, goes exactly to the panel's  
8 questions.

9 But I also think when you marry that  
10 with the Eleventh Circuit brief that they file, clever  
11 to be sure, but I think there's serious questions of  
12 estoppel. They were trying to tell the Eleventh  
13 Circuit, oh, this isn't final, this is just in the  
14 beginning, a lot of things could change. And now  
15 they're here, saying oh, well, we've made a decision,  
16 we're entitled to deference, whether it be Chevron  
17 deference or Skidmore deference, I don't think they  
18 could reconcile the two.

19 JUDGE AMBRO: All of your cases on fair  
20 notice pertain to an agency's interpretation of its  
21 own regulation or the statute that governs that  
22 agency.

23 Does this fair notice doctrine apply  
24 where it is a court announcing an interpretation of a  
25 statute in the first instance?

1 MR. ASSAF: I think it would, Your  
2 Honor. I think if you go to Ford Motor from the Ninth  
3 Circuit, which is cited in our briefs, I think that's  
4 what was happening there. That the Court said, this  
5 is -- although rulemaking by adjudication is allowed  
6 under Chenery, there are limits to it, and when the  
7 Court is asked to announce a new rule basically, we  
8 are going to say, no, no, you have to go to  
9 rulemaking, not by adjudication, rulemaking.

10 And while the FTC has said that's  
11 cumbersome, it could be but if all the things that the  
12 agency does, and I applaud their mission most of the  
13 time, but actually time and effort here will be well  
14 spent. People are looking for guide posts.

15 To your questions, Your Honor, this  
16 does not change their deception theories. They can  
17 still go people after deception. But, Judge Roth,  
18 they could say, for the time being, we're going to  
19 look at PCI standards and this standards and companies  
20 are on notice of that.

21 Or to your question, Judge Ambro, the  
22 answer is no to your question, have they ever  
23 published a rule or regulation or interpretive  
24 guidance saying people should look at our consent  
25 decrees and our 2007 brochure. The answer to that

1 question is no.

2 JUDGE AMBRO: Can't they give a  
3 publicly accessible statement such as was done in  
4 Beverly Healthcare?

5 MR. ASSAF: So Beverly Healthcare I  
6 think illustrates the point. I think it goes to also  
7 the Whitman case, when there is a narrow amount of gap  
8 filling, in other words, for the protection of  
9 workers. And then the question is, does travel  
10 expenses get paid for their testing after they've been  
11 nicked, that's a pretty narrow gap to fill, as opposed to  
12 here, which is a large gap. And again, it's against a  
13 back drop that there's not a single federal court case  
14 saying negligence is enough for an unfair trade  
15 practice. So Beverly --

16 JUDGE AMBRO: If you look at Beverly  
17 Healthcare and then maybe you look at TJX, or you look  
18 at Card System Solutions, I mean aren't you really on  
19 notice that these are the type of things that are  
20 really troubling the FTC in this new area, this -- you  
21 know, new era that changes seemingly every month,  
22 cyber security?

23 MR. ASSAF: I don't think so, Your  
24 Honor. In fact, I come back to Beverly Healthcare, I  
25 forgot who wrote it, but the phrase ascertainable

1       certainty, okay. If anything, the notice that you  
2       should avoid data security practices that are  
3       unreasonable, I don't think with all due respect,  
4       comes close to ascertainable certainty.

5                   And remember, in that case it was, was  
6       the roof 13 feet or was it 12 feet, was somebody on  
7       notice that it was close enough. Here we're in a much  
8       different world.

9                   I would like to, Your Honor, if I can,  
10       I promised you I'd get to substantial consumer harm,  
11       and it's not a pleading issue. It goes directly to --  
12       again, if you accept their limitation of 5(n), here  
13       you -- if there's one amicus brief that I would  
14       encourage the Court to read it's the Electronics  
15       Transactions Association. Because what's happening  
16       here, and you all talked about this, there's a lot of  
17       policy here besides statutory interpretation.

18                   The costs are enormous on companies,  
19       but also the system has already taken care of the  
20       unfairness cost. And why do I say that, federal  
21       regulations say you're reimbursed and \$50 is the  
22       limit. Card brands, however, have said zero.

23                   And so if we accept the FTC's  
24       proposition that they are the agency charged with this  
25       and they've developed an expertise, they've conducted

1 a two year investigation, and then they pled around  
2 what all the courts across the country know, that  
3 consumers have -- are paid -- are out of pocket zero  
4 on these breaches. And that's a decision that the  
5 stakeholders have already made, the banks, the  
6 merchants, the card brands, that consumers pay zero.  
7 And so there's a reason why they've pled around it.

8 And so it's Iqbal Twombly plus. We're  
9 spending all of this energy when the agency knows to  
10 this date, they haven't identified a single person who  
11 lost a dollar. And because the scheme is set up to do  
12 that, as opposed to deception, if somebody's saying we  
13 do this and they don't deliver, they could be used by  
14 the FTC. But this --

15 JUDGE AMBRO: So your allegation is  
16 that there were over the course of two years 600,000  
17 people that were -- had their accounts hacked, and  
18 then there was \$10.6 million worth of damages.

19 MR. ASSAF: The allegation was \$10.6  
20 million in unreimbursed fraud -- errant fraud loss,  
21 and at the district court there --

22 JUDGE AMBRO: You're saying to some  
23 extent it's being paid for by?

24 MR. ASSAF: Well, they -- Judge Salas  
25 (ph) pressed them, and they said, well, hypothetically



1 somebody couldn't have been reimbursed. But we now  
2 know it's a judicial admission, and as an agency I  
3 think they have a special obligation to acknowledge  
4 it.

5 In the district court they've admitted,  
6 they haven't found a single person, they've  
7 interviewed I think 380, okay, and they can't find a  
8 single person. So it goes to even their notion of the  
9 statute that a substantial consumer harm, when they  
10 haven't found anybody who lost a dollar, and we're  
11 here spending millions of dollars for an  
12 investigation.

13 JUDGE AMBRO: That's the next part of  
14 the case if you get there.

15 MR. ASSAF: And so, Your Honor, in  
16 closing I would say as I started, this is a modest  
17 approach. We are not asking the Court to cut back on  
18 deception jurisdiction, and the FTC and consumers have  
19 a lot of tools. They have deception, they have  
20 unfairness that is more than negligence, and  
21 consumers, I've been following the debate on Bayer and  
22 BMW, in terms of a public law analysis, consumers here  
23 have lots of options if they were actually harmed.

24 And so I would again ask Your Honors to  
25 consider the fact that unfairness, this would be the

1 first case ever that a federal court has said mere  
2 negligence is enough --

3 JUDGE AMBRO: All right.

4 MR. ASSAF: -- and as I -- Judge Ambro,  
5 I see reaching for your mic, I am finishing up. And  
6 so I would ask the Court to look at that. If the  
7 Court would like additional briefing on either Chevron  
8 or anything --

9 JUDGE AMBRO: I would -- of the two  
10 questions that were asked on February 20, I would ask  
11 counsel if they would submit a double-spaced, no more  
12 than 15 pages supplemental memoranda, let's say by --  
13 how's two weeks from tomorrow, if that'd be all right,  
14 15 pages each, and just file them simultaneously on  
15 those two questions asked on the -- on February 20.

16 And then also I would ask counsel if  
17 you would get together with the clerk's office and  
18 have a transcript prepared of this oral argument, and  
19 just split the cost. And also, and finally, I'd just  
20 like to thank both of you for an exceptionally well  
21 done oral arguments.

22 MR. ASSAF: Thank you, Your Honor.

23 JUDGE AMBRO: It's much appreciated.

24 MR. ASSAF: And I speak for the FTC,  
25 we've been privileged to appear in front of judges who

1 have been very well prepared for this, so thank you so  
2 much. Thank you.

3 JUDGE AMBRO: It's a real pleasure,  
4 thank you.

5 (Proceedings concluded at 11:28 a.m.)

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CERTIFICATION

I, Sheila G. Orms, certify that the foregoing is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter.

Dated: March 5, 2015



Signature of Approved Transcriber

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CERTIFICATION OF LIAISON COUNSEL

I, Kenneth Winn Allen, certify on behalf of counsel for Appellant Wyndham Hotels and Resorts and counsel for Appellee Federal Trade Commission that the foregoing transcript is accurate.

Date: March 16, 2015

Handwritten signature of Kenneth Winn Allen in blue ink.

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Kenneth Winn Allen  
Counsel for Wyndham Hotels & Resorts