No. 14-3514

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

FEDERAL TRADE COMMISSION,

Plaintiff-Appellee,

v.

WYNDHAM HOTELS & RESORTS, LLC, *et al.*,

Defendants-Appellant.

On Interlocutory Appeal From An Order Of The United States District Court
For the District Of New Jersey, Case No. 2:13-cv-01887-ES-JAD

SUPPLEMENTAL MEMORANDUM OF THE FEDERAL TRADE COMMISSION

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In its February 20 letter, the Court asks, at bottom, whether a federal court can hear a case charging a violation of the FTC Act if the Commission has not already decided, in its adjudicative capacity, that the Act prohibits the particular conduct at issue. The answer is yes. Congress empowered the Commission to choose in any given case between two alternative avenues for enforcing the FTC Act: (1) conducting an administrative adjudication or (2) filing suit for equitable relief in federal court under Section 13(b). Congress nowhere limited that second option to "fraud" cases or cases that are "routine" under some amorphous definition. Any such limitation would be inadministrable and highly disruptive to the FTC's enforcement program. Indeed, it would contradict years of judicial decisions under Section 13(b) that address a wide variety of decidedly *non*-routine issues involving both consumer-protection and antitrust.

This case presents no basis for upsetting that settled judicial practice. To begin with, Wyndham has expressly waived any argument that this case should have been brought in an administrative rather than a judicial tribunal, and that waiver is dispositive because, as Wyndham itself pointed out at argument, this Court need not rely on Section 13(b) for subject-matter jurisdiction. In any event, the statutory text of Section 13(b) clearly empowers the FTC, in its discretion, to bring suit in a district court for an injunction to remedy the violation of "any provision of law enforced by" the agency. If Congress had meant to restrict that

authority to "fraud" cases or "routine" cases, it would have said so expressly in the statute rather than using the open-ended term "proper."

Finally, Congress did nothing unusual when it empowered federal courts to decide in the first instance whether commercial conduct violates the three-part test set forth in Section 5(n), which prohibits practices that cause harm to consumers they cannot reasonably avoid but that is not outweighed by countervailing benefits. Federal district courts make similar determinations every day, often in novel and complex legal contexts. Indeed, given the nature of the security lapses alleged in the Commission's complaint, this case may be, if anything, more straightforward than many other cases that federal courts routinely adjudicate.

I. THE FTC HAS DETERMINED THAT INADEQUATE DATA SECURITY CAN BE AN "UNFAIR PRACTICE"

The first question in this Court's February 20 letter asks whether the FTC has "declared that unreasonable cybersecurity practices are 'unfair' … through the procedures provided" in the FTC Act. The second question—which relates to Section 13(b) and is the focus of this submission—expressly "[a]ssum[es]" that the answer to that first question is no. Feb. 20, 2015 Letter at 1.

In fact, the answer is yes: the FTC *has* acted under its procedures to establish that unreasonable data security practices that harm consumers are indeed unfair within the meaning of Section 5. First, the LabMD Order directly states the Commission's considered determination that inadequate data security can be an

unfair practice. *See* FTC Br. 37-38. Second, the FTC has voted to issue more than 20 complaints—two of them filed in federal court before this case was filed—charging deficient data security as unfair practices. *See*, *e.g.*, FTC Br. 6-8. The complaints are akin to policy statements or interpretive rulings, which, though not binding, "reflect a body of experience and informed judgment to which courts and litigants may properly resort for guidance." *Transky v. Dep't of Health & Human Services*, 760 F.3d 307, 314 n.7 (3d Cir. 2014) (citation omitted); *see also Berckeley Inv. Group, Ltd. v. Colkitt*, 455 F.3d 195, 221 n.24 (3d Cir. 2006) (agency enforcement actions can function as interpretive rulings). Finally, the Commission has made clear in formally approved testimony to Congress that it deems inadequate data security to be a potentially unfair practice.[1]

These administrative materials not only supply fair notice to potential defendants,[2] but also provide guidance to district courts for use in their

[1] Prepared Statement of the Federal Trade Commission before the Senate Committee on the Judiciary (Feb. 4, 2014) at 3 (https://www.ftc.gov/system/files/documents/public_ statements/prepared-statement-federal-trade-commission-privacy-digital-age-preventing-data-breaches-combating/140204datasecurity cybercrime.pdf); Prepared Statement of the Federal Trade Commission before the Senate Committee on Science, Commerce, and Transportation (July 27, 2010) at 6 (https://www.ftc.gov/sites/default/files/documents/public_ statements/prepared-statement-federal-trade-commission-consumer-privacy/100727consumer privacy.pdf). Written testimony presented by a commissioner is voted on by the full Commission and represents the agency's official position.

[2] This memorandum solely addresses the questions posed in this Court's February 20 letter; it does not rebrief the distinct "fair notice" issues the FTC has already addressed in its principal brief (at 40-52). Nonetheless, the Commission has stated

determinations of liability in particular cases. For example, the *BJ's Wholesale Club* complaint charged unfair practices where the defendant had "failed to employ reasonable and appropriate security measures to protect personal information"—specifically, it had not encrypted data, changed default passwords, detected reasonably detectable intrusions, or conducted reasonable security investigations. 140 F.T.C. 465, 467 (Sept. 20, 2005); *see* FTC Br. at 45-47 (discussing this and other complaints). The district court can look to this and other FTC materials as it assesses whether, in violation of Section 5(n), Wyndham's similar security practices caused substantial harm to consumers that they could not reasonably avoid and that is not outweighed by countervailing benefits.

In any event, this case would be an appropriate use of Section 13(b) even if the Commission had not adopted this prior body of administrative determinations. As discussed in the next section, Congress gave the Commission discretion to choose a judicial forum for the resolution of Section 5 disputes, and it did not condition the availability of that forum on the Commission's prior use of an administrative forum in similar cases.

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for more than a decade that it will pursue inadequate data security under Section 5's unfairness prong, and these complaints are an independent basis for finding such notice. FTC Br. 45-49. Similarly, the 2007 Business Guide (FTC Br. 49-52) provided notice that the FTC could take action against the very types of inadequate data-security measures alleged here. Industry participants are charged with knowledge of such agency guidance because "[i]t is a vital part of [their] business to be knowledgeable in [their] field." *Omnipoint Corp. v. FCC*, 78 F.3d 620, 630 (D.C. Cir. 1996) (citation omitted).

II. THIS IS A "PROPER CASE"

At argument, the panel asked whether this case is a "proper case" within the meaning of Section 13(b). As discussed below, it is.

As a threshold matter, that issue is not properly presented here because Wyndham waived it. Wyndham never asked either the district court or this Court to dismiss the case on "proper case" grounds, and it readily conceded at argument that this *is* a "proper case." Arg. Trx. 26:24–27:19. As Wyndham further pointed out, resolution of this issue is unnecessary to establish jurisdiction because the district court independently has jurisdiction under 28 U.S.C. §§ 1331, 1337, and 1345.[3] Any challenge to the suit under Section 13(b) thus can be and has been waived. *See Steel Co. v. Citizens for a Better Environment*, 523 U.S. 83, 90 (1988).

In any event, this case is "proper" under Section 13(b), much like hundreds of other consumer-protection and antitrust cases the Commission has brought under that provision. Section 13(b) states in pertinent part that "[w]henever the Commission has reason to believe that any … corporation is violating … any provision of law enforced by the Federal Trade Commission … the Commission

[3] Section 1331 grants the district court "original jurisdiction of all civil actions arising under the … laws … of the United States"; 28 U.S.C. § 1337 grants it "original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce"; and 28 U.S.C. § 1345 grants it "original jurisdiction of all civil actions, suits or proceedings commenced by … any agency" of the United States. In contrast, the second proviso of Section 13(b) authorizes the FTC to sue and specifies the remedial powers of the court.

… may bring suit in a district court of the United States to enjoin any such act or practice." 15 U.S.C. § 53(b). The statute confirms that the Commission may use this authority to obtain either (1) "preliminary" equitable relief in aid of an administrative proceeding or (2) "permanent" equitable relief in a stand-alone federal court proceeding. The latter option is the subject of the "second proviso" in Section 13(b): "[p]rovided further, [t]hat in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction." *Id.* Read as a whole, Section 13(b) thus authorizes the agency to invoke federal court jurisdiction for the violation of "*any* provision of law enforced by the Federal Trade Commission," which necessarily includes "unfair acts or practices" under Sections 5(a) and 5(n) of the FTC Act. *See FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1111 (9th Cir. 1982); *FTC v. United States Oil & Gas Corp.*, 748 F.2d 1431, 1434 (11th Cir. 1984); *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1028 (7th Cir. 1988).

As courts have consistently concluded, *see* Section III, *infra*, the "proper cases" language does not further limit the cases in which the Commission may "seek" permanent equitable relief. Instead, it leaves to the FTC's discretion the cases in which it wishes to invoke judicial rather than administrative enforcement. The word "proper," used repeatedly throughout Section 13(b), simply means "appropriate" or "suitable." *See American Heritage Dictionary of the English*

Language at 1452 (3d ed. 1992). A proper case is any case in which a permanent injunction would be appropriate: *i.e.*, any case, as Section 13(b) indicates at the start, in which a law enforced by the FTC has been violated and equitable remedies are needed for consumers. Congress has often used the term "proper case" in similar ways—as a grant, not a limitation, of authority.[4] If Congress had meant to limit the availability of district court proceedings to "routine fraud" cases or to subjects the Commission had already addressed at some particular level of specificity, it would have said so directly. It would not have used a term ("proper") with such a broad and permissive meaning.

At argument, the Court asked whether the legislative history might support a narrower interpretation of "proper case" that encompasses only "routine fraud" cases. Arg. Trx. 35:8-23. The short answer is no. As an initial matter, snippets of legislative history cannot supply limitations that are absent from the statutory text. *See, e.g., Graham Cty. Soil & Water Cons. Dist. V. U.S. ex rel. Wilson*, 559 U.S. 280, 291-92 (2010); *American Tobacco Co. v. Patterson*, 456 U.S. 63, 75 (1982).

[4] *See* 9 U.S.C. § 7 (arbitrator may "in a proper case" require production of documentary evidence); 48 U.S.C. § 872 (district courts in Puerto Rico "may grant writs of mandamus in all proper cases"); 28 U.S.C. § 1605(c) ("Nothing shall preclude the plaintiff in any proper case from seeking relief in personam in the same action brought to enforce a maritime lien …."); Fed. R. Civ. P. 19(a)(2) ("A person who refuses to join as a plaintiff may be made …, in a proper case, an involuntary plaintiff.").

In any event, nothing in *this* legislative history supports a "routine fraud" limitation in the first place.

In the passage read by the Court at argument, the Senate Report identifies, as an example of when the FTC might choose to proceed directly in court, "the routine fraud case … in which [the FTC] *does not desire* to further expand upon the prohibitions of the Federal Trade Commission Act through the issuance of a cease-and-desist order." S. Rep. 93-151 at 31 (emphasis added). But this passage identifies only the obvious case in which, as Congress understood, the Commission would not "desire" to conduct an administrative adjudication but would prefer to pursue the broader remedies, such as equitable monetary relief, available under Section 13(b). The passage does not suggest a constraint on the Commission's discretion; instead, it confirms that Congress intended to enable the Commission to choose Section 13(b) remedies, as it "desire[d]," *id.*, for any case within its jurisdiction. Indeed, the same Report confirms that the law was meant to establish "expanded powers for a revitalized Federal Trade Commission, to enable it to protect consumers … [more] effectively," by, *inter alia*, "permit[ting] the commission to obtain" a permanent judicial injunction "against *any act or practice which is unfair or deceptive* to a consumer." S. Rep. 93-151 at 9, 30 (emphasis added). In Senate debate, Senator Hart explained that the law "provides the Federal Trade Commission with vital antitrust … enforcement powers—the power

to … seek preliminary and permanent injunctions where necessary." 119 Cong. Rec. 23,620 (daily ed. July 12, 1973) (Statement of Sen. Philip Hart).

At argument, the Court also referred to a 1995 FTC opinion authored by Commissioner Starek, *see* Arg. Trx. at 36:12-19, but that opinion also interprets Section 13(b) in the same broad way. The opinion noted that the Commission may invoke the second proviso of Section 13(b) where it "concludes that a case presents no issues warranting detailed administrative consideration," but it did not say it could invoke Section 13(b) *only* in such cases. Rather, the Commission emphasized that Congress left the "choice whether to request such relief … *solely within the Commission's discretion*." *R.R. Donnelley & Sons Co.*, 120 F.T.C. 36, 147 n.23 (1995) (emphasis added).

Finally, there is nothing at all unusual about Congress's decision to give the Commission a choice between administrative and judicial litigation for violations of Section 5. As Congress understood, district courts often resolve very similar cases in other contexts and are well-equipped to do so. For example, district courts routinely resolve the difficult and novel legal and factual issues that arise in patent litigation about evolving technologies and in personal injury cases involving conflicting medical evidence and disputed standards of care. The questions presented in this case are certainly no more challenging for a district court to address. Indeed, if the evidence confirms the complaint's allegations that

Wyndham failed to use reasonable security measures, such as changing default passwords and encrypting consumer data, this case will be easier to resolve than many other types of cases commonly filed in district court.

III. ANY NEW SUBJECT-MATTER LIMITATION ON SECTION 13(b) ACTIONS WOULD CONTRADICT YEARS OF ANTITRUST AND CONSUMER-PROTECTION CASE LAW

Consistent judicial precedent confirms that the "proper cases" language does not limit the Commission's authority to invoke Section 13(b) to redress violations of Section 5 to subjects the Commission has already addressed. Numerous courts have held that a "proper case" is any case that the Commission chooses to bring directly in court for violation of an FTC-enforced statute. *See, e.g.*, *FTC v. Evans Products Co.*, 775 F.2d 1084, 1087 (9th Cir. 1985); *H.N. Singer, Inc.*, 668 F.2d at 1113; *World Travel Vacation Brokers*, 861 F.2d at 1028; *FTC v. Mylan Labs., Inc.*, 62 F. Supp. 2d 25, 36 (D.D.C. 1999); *FTC v. Virginia Homes Mfg. Co.*, 509 F. Supp. 51, 54 (D. Md. 1981), *aff'd mem.*, 661 F.2d 920 (4th Cir. 1981); *FTC v. Ameridebt*, 373 F. Supp. 2d 558 (D. Md. 2005). No court has dismissed an FTC complaint on the ground that it was not "proper" under Section 13(b). Nor has Congress amended Section 13(b) to counteract that unanimous precedent, even though it has repeatedly amended the FTC Act over the four decades since Section 13(b) was enacted. *See*, *e.g.*, FTC Br. 5 (discussing 1994 amendments).

With similar consistency, courts have repudiated "attempt[s] to limit § 13(b)

to cases involving 'routine fraud' or violations of previously established FTC rules." *Evans Products*, 775 F.2d at 1087 (citing *H.N. Singer*, 668 F.2d at 1111). In *Evans*, for example, the Ninth Circuit rejected that argument and held instead that "Congress … gave the district court authority to grant a permanent injunction against violations of any provisions of law enforced by the Commission." *Id*. In another case, the Seventh Circuit noted the consensus of "several other courts" that Section 13(b) "permits the FTC to proceed under the last proviso of section 13(b) for any violation of a statute administered by the FTC," although it did not need to reach that issue because Section 13(b) would have covered the case before it under any interpretation. *World Travel Vacation Brokers*, 861 F.2d at 1028.

Several district courts have also adopted that same consensus position. As one court explained, in rejecting the argument that Section 13(b) does not apply to complex antitrust cases: "Although the permanent injunction proviso speaks of 'proper cases,' there is nothing in the statute, regulations or case law restricting the statutory term 'proper cases' to *per se* violations of the antitrust laws." The court held that the second proviso "may be used to enjoin violations of 'any provision of law' enforced by the FTC." *Mylan Labs.*, 62 F. Supp. 2d at 36; *accord Virginia Homes*, 509 F. Supp. at 54 (Section 13(b) "by its very terms applies to violations of 'any provision of law enforced by the FTC.'"); *Ameridebt*, 373 F. Supp. 2d 558.

That proposition has now become such settled black-letter law that it is

rarely, if ever, litigated, and Section 13(b) has become an integral component of the FTC's enforcement activities. Invoking Section 13(b), the FTC commonly files non-"routine" consumer protection cases that involve new legal theories, complex facts, and expert testimony. In addition to the *Neovi* and *Accusearch* cases discussed in the FTC's brief and at oral argument (FTC Br. 28-29; Arg. Trx. 31:5-32:25), many district courts have heard FTC cases presenting novel applications of Section 5 without a prior Commission administrative adjudication.[5]

[5] In *Ameridebt*, for example, the court explicitly found "proper" a case presenting "novel and difficult legal issues" in which the Commission alleged violations of Section 5 in the marketing of debt management services against a purported non-profit entity. 373 F. Supp. 2d at 562. In *FTC v. Seismic Entertainment Productions, Inc.*, 2004 WL 2403124 at *3 (D. N.H. 2004) (unreported), the court issued preliminary relief without questioning whether the case was proper. That case involved the "new arena of internet advertising" in which the defendant remotely placed "adware" on consumers' computers that did "not necessarily fit easily into the traditional concepts of unfair and deceptive acts and practices"). In many other cases, the Commission has filed and settled complaints involving novel issues and neither the courts nor the parties questioned whether the cases were "proper." *E.g.*, *FTC v. D Squared Solutions, LLC*, No. 03-cv-3018 (D. Md. Oct. 2003) (Commission's first case alleging unfair practice to use a computer program to barrage consumers with pop-up ads); *FTC v. Certified Merchant Servs., Ltd*, No. 4:02-cv-44 (E.D. Tex. Feb. 2002) (Commission's first case alleging unfairness against a payment processor that debited customer accounts without authorization); *FTC v. Cornerstone & Co., LLC*, No. 14-cv-01479 (D.D.C. Aug. 2014) (Commission alleged for first time that a debt broker's failure to take adequate measures to prevent disclosure of consumers' sensitive personal information without consent is an unfair practice); *U.S. v. ChoicePoint, Inc.*, No. 1-06-CV0198 (N.D. Ga. Jan. 2006) (Commission authorized Department of Justice to seek injunction and civil penalties pursuant to Sections 5 and 13(b) alleging for first time that consumer reporting agency's failure to employ adequate measures to authenticate the identities of prospective subscribers or monitor unauthorized subscriber activity was unfair); *FTC v. Pricewert, LLC*, No. 09-CV-2407 (N.D.

And many district courts have likewise adjudicated consumer-protection cases that turn on non-routine issues, such as the level of scientific evidence needed to substantiate advertising claims in particular contexts. *See, e.g.*, *FTC v. Direct Mktg. Concepts, Inc.*, 569 F. Supp. 2d 285, 303 (D. Mass. 2008), *aff'd*, 624 F.3d 1 (1st Cir. 2010); *FTC v. QT, Inc.*, 448 F. Supp. 2d 908, 938-48 (N.D. Ill. 2006), *aff'd*, 512 F.3d 858 (7th Cir. 2008).

In addition, although this happens to be a consumer-protection case, many Section 13(b) cases arise under the Commission's parallel antitrust authority to combat "unfair methods of competition." These antitrust cases often involve singularly non-"routine" issues of law and economics. For example, the Supreme Court recently decided a Section 13(b) case that involved the complex interplay of antitrust and patent law and, in particular, the antitrust dimensions of settlements of pharmaceutical patent infringement law suits that resulted in "reverse payments" from plaintiffs to defendants. *FTC v. Actavis, Inc.*, 133 S. Ct. 2223 (2013). If Section 13(b) applied only to "routine" cases or "fraud" cases, *Actavis* should never have reached the Supreme Court, let alone been decided by it.

Cal. June 2009) (Commission's first case alleging unfair practice to host a website that distributes malicious and illegal content including spyware and spam); *FTC v. Zuccarini*, No. 01-CV-4854 (E.D. Pa. 2001) (Commission's first case alleging unfair practice to "mousetrap" unsuspecting consumers' web browsers to defendant's website to deliver a series of pop-up advertisements); *FTC v. Amazon.com, Inc.*, No. 2:14-cv-01038 (W.D. Wash. July 2014) (Commission alleges unfair to bill account-holder parents for charges incurred by their children without account holder consent).

If this Court were to part with its sister courts and impose new subject-matter limitations on Section 13(b), its ruling would cast doubt on a substantial portion of the FTC's enforcement program for antitrust as well as consumer-protection cases. At a minimum, such a ruling would trigger threshold litigation as to whether an alleged violation is sufficiently "routine" for the Commission to proceed to federal court without an administrative adjudication, and there would be no clear standards for resolving that issue.

Finally, any ruling that non-"routine" cases must be handled administratively, while other matters may be heard in federal court, could lead to wasteful piecemeal proceedings. For example, the FTC often couples an unfairness count with other counts charging deception or regulatory violations arising out of the same conduct; indeed, it has done so in this very case.[6] If this Court were to rule that certain types of cases may be brought under Section 13(b) only if they are "routine" in some undefined sense, the FTC would be forced to conduct administrative proceedings on one theory of liability and litigate a parallel Section 13(b) case in order to obtain otherwise unavailable equitable remedies. Such claim-splitting would result in wastefully duplicative proceedings in two tribunals hearing the same facts. The FTC could avoid that irrational result only by abandoning either (1) the claim consigned to the administrative process or (2) the

[6] The deception count remains pending before the district court. *See* Arg. Trx. 7:19-8:3.

remedies that are available only under Section 13(b). Congress could not have intended such aberrant outcomes when it gave the FTC discretion to choose between administrative and judicial proceedings to redress violations of Section 5. That is further confirmation that Congress intended the permissible subject matter of Section 13(b) cases to extend as far as the permissible subject matter of FTC administrative adjudications.

Respectfully submitted,

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March 27, 2015

CERTIFICATE OF SERVICE

I Certify that on March 27, 2015, I electronically filed the foregoing Supplemental Memorandum with the clerk of the Court for the United States Court of Appeals for the Third Circuit by using the appellate CM/ECF system. All parties to this case will be served by the CM/ECF system.

/s/ Joel Marcus

CERTIFICATE OF PERFORMANCE OF VIRUS CHECK

I certify that on March 27, 2015, I performed a virus check on the electronically filed copy of this Supplemental Memorandum using Symantec Endpoint Protection version 12.1.4112.4516 (last updated March 26, 2015). No virus was detected.

/s/ Joel Marcus

CERTIFICATE OF IDENTICAL COMPLIANCE

I certify that the text of the electronically filed Supplemental Memorandum is identical to the text of the copies that were sent on March 27, 2015, to the Clerk of the Court of the United States Court of Appeals for the Third Circuit.

/s/ Joel Marcus

CERTIFICATE OF COMPLIANCE WITH TYPEFACE AND TYPE STYLE REQUIREMENTS

This Supplemental Memorandum complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this Supplemental Memorandum has been prepared in a proportionally spaced typeface using Microsoft Word 2010, in 14-point Times New Roman.

/s/ Joel Marcus