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The Government's Aggressive Enforcement of Export Control Laws is Quickly Becoming a Thorn in the Side of Companies Engaged in International Commerce

"Sanctions are the new FPCA." So declared the Deputy Attorney General Lisa A. Monaco last year and on a number of occasions since then. But many lawyers were left to ponder exactly what that means. It has been clear for years that doing business with Specially Designated Nationals (or SDNs) was fraught with peril—the rules even preclude U.S. legal representation absent a license, which the Treasury Department has not been quick to grant. In the last year, however, the government's reinvigorated sanctions enforcement program has relied increasingly on the Export Control Reform Act and associated Export Administration Regulations. As a result, a regulatory regime that was once primarily the bailiwick of international trade dealmakers has vaulted to the forefront of the white-collar and government litigation world. And based on the growing allocation of resources, the institution of interagency and international task forces, and a recent spate of enforcement actions, all indications are that companies engaged in international commerce will

continue to face scrutiny—and will need to remain vigilant—for the foreseeable future.

What are the Export Control Reform Act and the Export Administration Regulations?

The United States export control regime dates as far back as World War II, when Congress passed the Export Control Act of 1940 in anticipation of the United States' entrance in the War. A series of subsequent legislation—the Export Control Act of 1949, the Export Administration Act of 1979, and others—augmented the original legislation and gave rise to the Export Administration Regulations, 15 C.F.R. §§ 730-774, or the EAR. Mostly recently, Congress passed the Export Control Reform Act of 2018, which provided permanent statutory authority for the EAR.

The EAR govern the export of "dual-use goods"—primarily commercial goods that may have a military use or application. The Commerce Department's Bureau of Industry and Security is responsible for

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David Lancaster Joins the Firm to Lead the Intellectual Property Litigation Practice in London

David Lancaster has joined the firm as a partner in our London office. Previously a partner at Pinsent Masons, David is highly experienced in representing clients in patent litigation before the English Courts and in coordinating proceedings before the European Patent Office and European national courts. [Q](#)

Senior Counsel Kathleen M. Sullivan Selected for Lawdragon's 2023 Hall of Fame Class

Los Angeles office Senior Counsel, and the Founding Chair of the firm's National Appellate Litigation practice, Kathleen M. Sullivan, has been selected for Lawdragon's 2023 Hall of Fame class. The list includes litigators who have practiced for over 30 years and have made a significant impact on the litigation landscape. [Q](#)

administering and enforcing the EAR. The EAR thus are distinct from the International Traffic in Arms Regulations (also known as ITAR), which relate to articles, services, and related technical data that are inherently military in nature and are administered by the State Department. The EAR are also distinct from economic and trade sanctions administered by the Treasury Department's Office of Foreign Asset Control (often referred to as OFAC).

Violations of the EAR can result in administrative fines, denial of export privileges, and even imprisonment. Monetary penalties imposed by the Commerce Department can reach \$353,534 or twice the value of the transaction. *See* 50 U.S.C. § 4819(c)(1); 88 Fed. Reg. 3. As discussed further below, the Commerce Department recently fined one offender \$300 million as part of a negotiated resolution. Willful violations of the EAR can result in a criminal fine of \$1 million per violation, asset forfeiture, and up to 20 years' imprisonment. 50 U.S.C. § 4819(b), (d).

What kinds of activities and products are subject to these rules? The EAR are an extraordinarily complex set of rules, a complete explanation of which is beyond the scope of this article. Generally speaking though, the EAR regulate "exports" and "reexports" of certain commodities, software, and technology. An "export" includes not only a physical shipment or transmission of an item out of the United States, but also the disclosure or other transfer of technology, source code, or related information to a foreign person within the United States (a so-called "deemed export"). A "reexport" is the shipment from one foreign country to another foreign country, and a "deemed reexport" a disclosure within a foreign country to a person from another foreign country. 15 C.F.R. §§ 734.13-14.

The EAR apply not only to all items that are located or originated in the United States, but also to a number of foreign-made and -produced items. For example, foreign-made commodities, software, and technology that contain more than a defined amount of U.S.-origin products can be regulated by the EAR. 15 C.F.R. § 734.3. For example, a foreign-made computer could be subject to the EAR if it incorporates U.S.-origin circuit board technology that itself is subject to the EAR. The EAR thus, by their terms, apply extraterritorially: non-U.S. persons acting abroad can be subject to liability so long as their conduct violates the regulations.

The EAR are organized primarily based on certain *kinds of items* and certain *destinations of export*, and the Commerce Department's Bureau of Industry and Security (or BIS) maintains two corresponding lists: the Commerce Control List and the Commerce Country Chart. The Control List categorizes items in nine broad categories

(for example, "Electronics," "Computers," "Navigation and Avionics"), each of which consists of five groups ("Equipment, Assemblies and Components;" "Test, Inspection and Production Equipment;" "Materials;" "Software;" and "Technology). The Control List also incorporates the reason for the control (for example, "Encryption Items," "Surreptitious Listening," "Missile Technology") and ultimately provides an alphanumeric code for each kind of commodity, software, or technology subject to the EAR. The Commerce Country Chart then explains, for every country, whether a license is required to export specific kinds of items to that country.

The EAR also contain certain "general prohibitions" that apply beyond the Control List and Country Chart. For example, General Prohibition Five prohibits exports and reexports to certain end-users and end-uses (for example, military end uses in Burma, Cambodia, China, Russia, and Venezuela; and a long list of designated persons). General Prohibition Six requires a license for any export or reexport to embargoed countries such as Cuba, Iraq, Iran, North Korea, Russia, Belarus, and Syria. There are ten General Prohibitions in all. 15 C.F.R. Part 736.

What new tools does the government have to increase enforcement of these rules? Through a combination of expanded resources, interagency and international partnerships, and new and updated enforcement policies, the Biden Administration has ramped up export control enforcement and created a number of new risks for manufacturers, shippers, and other participants in the economy for high-tech goods and services.

Expanded resources. Galvanized by the war in Ukraine, ongoing tensions with China, and other geopolitical threats, the Justice Department announced that it would add 25 additional prosecutors to the National Security Division, which prosecutes criminal export control violations. The Department also signaled that a key focus would be on corporate enforcement, including by appointing a Chief Counsel for Corporate Enforcement on September 11, 2023. On the civil side, the Commerce Department's budget for export control enforcement has increased, as well. For fiscal year 2023, Congress increased funding for the Commerce Department's BIS by more than 25%.

Interagency and international partnerships. BIS has also been at the center of a number of interagency and international partnerships. Chief among these has been the Disruptive Technology Strike Force. Announced in February 2023, this initiative brings together agents from BIS, prosecutors from the DOJ National Security Division, agents from the FBI and Homeland Security, and prosecutors and investigators from 14 United

States Attorney's Offices around the country. The Strike Force is co-chaired by the Assistant Secretary for Export Enforcement, Matt Axelrod, and the Assistant Attorney General for National Security, Matt Olsen. Within just three months, the Strike Force announced five coordinated enforcement actions across the country that included multiple arrests, indictments, and temporary denial orders. The cases related to conduct such as supplying parts and components to Russian commercial airline companies, misappropriating code from U.S. technology companies and providing it to Chinese competitors, and providing sensitive technology to Russian military and intelligence services.

Task Force KleptoCapture, announced shortly after fighting began in Ukraine, brings together resources from the Commerce, State, and Treasury Departments, as well as the FBI, U.S. Marshals Service, U.S. Secret Service, Homeland Security Investigations, IRS Criminal Investigation, the U.S. Postal Inspection Service, and others to enforce the sweeping sanctions, export restrictions, and economic countermeasures that the United States and other countries imposed in response to the Russian attack in Ukraine.

In July 2023, BIS and OFAC signed a formal agreement memorializing the two agencies' cooperation. The agreement is designed to ensure that BIS and OFAC enforcement teams work together even more closely and seek to enter into joint resolutions with sanctions and export control violators.

Similar efforts can be seen on an international level. In June 2023, the "Five Eyes" alliance members—Australia, Canada, New Zealand, the United Kingdom, and the United States—agreed to formal coordination on export control enforcement. The agreement provides for enhanced information-sharing related to control violators, evasion and similar problematic practices, and other trends and data collected by each country's enforcement apparatus. BIS also announced that it expected to conduct joint investigations and coordinated enforcement actions with other Five Eyes members. Commerce Department officials are working toward similar agreements among G7 members, as well.

New and updated enforcement policies. Three key policy changes within the Commerce Department have contributed to increased enforcement activity. Most controversially, BIS adopted a policy that penalizes a company's failure to self-report potential violations. Many companies are familiar with Justice Department and other regulatory policies that encourage leniency where a company voluntarily self-discloses violations of law. But in what has come to be called the "Axelrod Memo"—named for Assistant Secretary of Export Enforcement Matt Axelrod, who implemented the policy—BIS took

that a step further by announcing that not only would voluntary self-disclosure would continue to be a mitigating factor, but a company's *failure* to self-disclose would be an *aggravating* factor justifying a harsher penalty. This increases the stakes for companies that have discovered potential violations and are considering how to proceed. And that is especially true because the Axelrod Memo provides additional benefits to companies that report competitors' and other companies' violations. Specifically, companies who report violations by others will be deemed to have provided "extraordinary cooperation"—and further leniency—if they later find themselves in BIS's crosshairs. So a company that discovers potential violations not only faces additional penalties if it chooses not to self-disclose, but its competitors and others in the market may actively be volunteering evidence to BIS.

Two other changes have enabled BIS to increase pressure on companies. First, BIS now publicly announces charges at the beginning of a case rather than waiting until it has reached a resolution with the violator to issue a charging letter. As a result, companies will face greater pressure to reach quicker resolutions with BIS so that they can lift the cloud of uncertainty created by a public accusation. Second, BIS policy no longer permits companies to enter into no-admit-no-deny settlements. Unlike many civil regulatory agencies like the SEC, FTC, and others, BIS now requires companies to admit to the conduct as part of a negotiated resolution.

How is the government using these new tools? Export control enforcement has been extremely active in the last year. In addition to the Disruptive Technology Strike Force arrests mentioned above, the Justice Department has made a number of arrests and obtained a number of convictions in cases involving export control violations. For example, on August 31, 2023, law enforcement agents in Cyprus—acting at the request of the United States—arrested a dual Russian-German citizen on allegations of obtaining U.S.-sourced microelectronics for a company that supplies electronics components for use by the Russian military. *United States v. Petrov*, No. 23 Mag. 6023 (S.D.N.Y.). In another case, a California-based electronics distribution company and its president and owner pleaded guilty where they had concealed information from BIS agents and Customs officers as part of a scheme to export chemicals used in semiconductor manufacturing to a company in China. *United States v. Jiang*, No. 20 Cr. 43 (D.R.I.).

BIS, for its part, has entered into some key resolutions too, including one that involved a \$300 million penalty. In that case, California-based data storage company Seagate Technology and its Singapore affiliate shipped millions of hard drives to Huawei, the Chinese manufacturing

company that has been a target of U.S. sanctions and export controls. *In re Seagate Technology LLC*, Bureau of Industry Security (Apr. 19, 2023). In another case, BIS reached a settlement with a 3D printing company based in South Carolina for exporting certain technology to Germany and certain aerospace technology and metal alloy powder to China. *In re 3D Systems Corp.*, Bureau of Industry and Security (Feb. 27, 2023).

What can companies do to mitigate the risk of export control violations and enforcement actions? Export regulations and the broader sanctions regime are constantly evolving, and companies dealing in sensitive technologies and other potential dual-use goods must create a strong record of vigilant efforts to comply. The key mitigation strategy for companies that find they have violated export control laws is similar to any criminal violation: timely and voluntary self-disclosure, full cooperation with government investigations, and full and effective remediation. Under policy that the DOJ National Security Division implemented in March 2023, companies that take these three steps will—absent aggravating circumstances—presumptively receive a non-prosecution agreement and no fine. As a result, companies thus should consider taking the following prophylactic steps:

Conduct a risk assessment. Consider things like the location of your operations, the industry sector, the competitiveness of the market, potential clients and business partners, and transactions with foreign governments. Assess the policies, procedures, and controls currently in place and whether they are suited to the current risks the company faces. Does the company devote a disproportionate amount of time to policing low-risk areas instead of high-risk, such as sales of nuclear technology or exports to hot-button jurisdictions such as Russia? Make sure the company has a process for tracking and integrating lessons learned from both the company's own prior issues and from similarly situated companies. And make sure to document the methodology you use to conduct these analyses and to identify and address the particular risks the company faces.

Review and refresh policies and procedures. Timely and voluntary self-disclosure often is not possible without sensible, effective policies and procedures that will detect export control violations or at a minimum alert company management to potential issues. Based on the risk assessment, consider whether the company's process for designing and implementing new policies and procedures, and updating existing policies and procedures, is effective. Ensure the right company personnel have been involved in the design of policies and procedures and the right business units been consulted prior to rolling them out.

Consider whether the company has been effective in communicating its policies and procedures to employees. And make sure to document the efforts the company has taken to monitor and implement policies and procedures that reflect and deal with the spectrum of risks it faces.

Ensure training and compliance systems are suited to the company. Make sure employees receive training on the key risks relevant to their roles, that the training is interactive and effective, and that there are adequate mechanisms to ensure employees internalize the information covered in training. Collect and preserve attendance sheets, post-training quizzes, employee acknowledgements, and other evidence of the company's training efforts.

Document the commitment of middle and senior management to compliance. Identify and document concrete actions management has taken to demonstrate the importance of the company's compliance and remediation efforts.

Ensure adequate resources are available to compliance efforts. Company personnel responsible for ensuring compliance should have seniority and independence, experience and ability, funding and resources, access within the company, and autonomy to ensure they effectively can police the company's adherence to export control laws.

Implement measures to ensure preservation of documents and other evidence. Not only does an effective compliance program need such preservation to detect potential issues, but full cooperation with government investigations requires timely and voluntary preservation, collection, authentication, and disclosure of relevant documents and information.

And if a potential issue does arise, immediately engage experienced counsel to assess the company's exposure and develop a response strategy. 

Breaking the Chain: Section 112-Based Priority Arguments

An *inter partes* review (IPR) is a legal process in the United States that allows any party to challenge the validity of an issued patent before the United States Patent and Trademark Office (USPTO). In an IPR, a patent challenger is allowed only to set forth invalidity arguments rooted in 35 U.S.C. § 102 (anticipation) and/or 35 U.S.C. § 103 (obviousness). However, in recent years, patent challengers have successfully used 35 U.S.C. § 112 (written description or enablement) in their IPR petitions to prevent a patent from claiming the benefit of the filing date of earlier parent applications or patents, and then using those very same parents or other intervening art as the bases for a challenger's Section 102 or Section 103 invalidity grounds. If factually feasible, the use of 35 U.S.C. § 112 to break the chain of priority can be another tool a challenger may use as part of its IPR strategy.

Background

Inter Partes Review

An IPR is an administrative trial procedure for challenging the validity of a U.S. patent before the Patent Trial & Appeal Board (PTAB) of the USPTO. Any person who is not the owner of a patent can file an IPR petition against an issued U.S. patent. This person is often referred to as the petitioner or patent challenger. In contrast to district court patent litigations, which can involve a wide range of substantive issues, including, for example, infringement, enforceability (*e.g.*, inequitable conduct), other equitable defenses (*e.g.*, unclean hands, laches), damages, injunctions and more, IPR petitioners are only permitted to set forth invalidity challenges (or grounds) based on anticipation under 35 U.S.C. § 102 and/or obviousness under 35 U.S.C. § 103. As a result, a petitioner may only use prior art references such as other patents or printed publications to challenge the patent that is the subject of the IPR petition. Notably absent from the IPR process is the ability to challenge a patent under 35 U.S.C. § 112. As discussed herein, however, this statutory ground still has an important role to play.

After a petition is filed with the USPTO, a patent owner may file a preliminary response to the petition. The PTAB then determines whether there is a reasonable likelihood that the petitioner would prevail with respect to at least one claim challenged. If the PTAB determines there is a reasonable likelihood, then it institutes a trial. A final determination by the PTAB is typically issued within one year from the institution date. Like district court judgments in patent cases, IPRs may be appealed to the U.S. Court of Appeals for the Federal Circuit.

Priority Date: Breaking the Chain

A key consideration in patent validity, both in district courts and at the PTAB, is the determination of what qualifies as prior art for a challenged patent. In order to determine which references will qualify, it is necessary first to determine the “priority date” of the challenged patent—that is, the earliest filing date in a family of patent applications. It is generally most desirable for a patent owner to claim priority to the earliest possible filing date in order to limit the scope of references that can be used to challenge its patent.

For a patent owner to claim entitlement to an earlier priority date based on an earlier-filed application, several requirements must generally be met, including that the earlier-filed application discloses the invention claimed in the later-filed application sufficient to satisfy the written description and enablement requirements of 35 U.S.C. § 112. *See* 35 U.S.C. § 120; *In re NTP, Inc.*, 654 F.3d 1268, 1277 (Fed. Cir. 2011); *see also* 35 U.S.C. § 119(e). Priority is typically determined on a claim-by-claim basis. When a link in the chain of priority fails, *i.e.*, when any of the priority requirements are not satisfied for each of the applications leading to the challenged patent, the challenged patent is unable to claim priority to the earlier parent application. The later priority date expands the pool of possible prior art that can be used as a ground in a validity challenge. A patent challenger could even assert as invalidating prior art patents and/or patent publications stemming from the very same parent applications that the challenged patent claimed priority to.

35 U.S.C. §112—Written Description and Enablement

Section 112(a) provides two separate avenues to attack a claim of priority: inadequate written description and lack of enablement. To gain the benefit of the filing date of an earlier application, each application in the chain leading back to the earlier application must comply with the written description requirement. *See* 35 U.S.C. § 120; *Arthrex, Inc. v. Smith & Nephew, Inc.*, 35 F.4th 1328, 1343 (Fed. Cir. 2022). In other words, the disclosure of each application relied upon for priority must reasonably convey to those skilled in the art that the inventor had possession of the claimed subject matter as of the filing date sought. *Id.*; *see also Tronzo v. Biomet, Inc.*, 950 F. Supp. 1149, 1154-55 (S.D. Fla. 1996), *aff'd in part*, 156 F.3d 1154 (Fed. Cir. 1998). And earlier applications satisfy the enablement requirement only if one skilled in the art, after reading their disclosures, could practice the invention (make and use the full scope of the invention) claimed in the later-filed patent without undue experimentation. *See Genentech, Inc. v. Novo Nordisk, A/S*, 108 F.3d 1361, 1365

(Fed. Cir. 1997).

Successful Use of Priority Chain-Breaking

In recent years, patent challengers have been successful in invalidating challenged patents before the PTAB by breaking the chain of priority for lack of Section 112 support and using parent patents or publications as invalidating prior art. And the Federal Circuit has affirmed such challenges. *See, e.g., Indivior UK Ltd. v. Dr. Reddy's Lab's S.A.*, 18 F.4th 1323, 1330 (Fed. Cir. 2021); *Arthrex, Inc. v. Smith & Nephew, Inc.*, 35 F.4th 1328 (Fed. Cir. 2022); *Reckitt Benckiser v. Ansell Healthcare*, IPR2017-00063 Paper 38 and IPR2017-00066 Paper 35.

Parent Patents as Prior Art

If a patent (whether a continuation or continuation in part) is unable to claim priority back to an earlier filed application in the family, then a patent challenger may use intervening parent patents or patent publications as prior art to invalidate the child patent. Although breaking priority through lack of enablement is possible, there are more examples in the case law of breaking priority because of insufficient written description.

This strategy has been used successfully in IPRs and has been affirmed by the Federal Circuit. In *Indivior UK Ltd. v. Dr. Reddy's Lab's S.A.*, the '454 patent at issue issued from a series of continuation applications from the parent '571 application. 18 F.4th 1323, 1325 (Fed. Cir. 2021). In its IPR petition, Dr. Reddy's alleged that the claims of the '454 patent lacked written description support in the '571 application, and hence were not entitled to the benefit of its filing date. *Id.* Dr. Reddy's then argued that, without the benefit of the earlier priority date, the asserted claims were anticipated by the '571 application publication. *Id.* The claims at issue in *Indivior* related to an orally dissolvable film for delivery of therapeutic agents, and listed ranges of weight percentages (and in one instance not discussed here, a specific weight percent of polymer. *Id.* Regarding the range claims, the PTAB found that the claims lacked written description support in the '571 application. *Id.* Accordingly, the PTAB held that these claims were anticipated by the parent '571 application publication. *Id.* The Federal Circuit affirmed the PTAB's decision. *Id.* at 1330.

Even as recently as last year, the Federal Circuit in *Arthrex, Inc. v. Smith & Nephew, Inc.* upheld the PTAB's holding that a patent was invalid based on the publication of a parent application as a result of lack of written description in a parent priority application. 35 F.4th 1328 (Fed. Cir. 2022). In this case, the '907 patent at issue claimed the benefit of priority to the earlier parent application through a series of continuation, continuation-in-part (CIP), and divisional applications, including

the relevant '707 application. *Id.* at 1342. The Court, however, found that the intervening '707 application lacked written description support of an element of the invention claimed in the patent at issue. As a result, the chain of priority for the asserted patent was broken and the PTAB concluded that the patent at issue was not entitled to an earlier priority date. *Id.* at 1343-44. The PTAB thus held, and the Federal Circuit upheld, that a parent application publication was prior art to the patent at issue and anticipated the claimed invention. *Id.*

This strategy has also been used successfully in district court litigations, and again, has been affirmed by the Federal Circuit. For example, in *Tronzo v. Biomet, Inc.*, the Federal Circuit reversed a district court's judgment that two claims were not invalid, finding that the claims at issue were not entitled to the filing date of the parent application and were therefore anticipated by intervening prior art, including Tronzo's British application, which was the counterpart to the U.S. application that yielded the '589 patent. 156 F.3d 1154, 1155-58 (Fed. Cir. 1998). Similarly, in *Zenon Envtl., Inc. v. United States Filter Corp.*, the Federal Circuit reversed the district court's holding that the '319 patent at issue was not invalid because it found that the patent at issue was not entitled to the earlier filing date of the grandparent '373 patent, and instead was anticipated by the same. 506 F.3d 1370, 1378 (Fed. Cir. 2007). The Federal Circuit found the intervening applications in the chain leading back to the '373 patent at issue did not comply with the written description requirement and "[t]hus, the chain of continuity was broken." *Id.* at 1381. As such, the Federal Circuit held that the patent at issue was not entitled to the earlier priority date and was therefore anticipated by the '373 patent. *Id.* at 1382.

CIPs and Continuations

The possibility of priority chain-breaking arguments may be heightened where the patent at issue is, or has descended from, a CIP application. In this situation, a challenger may draw an inference that the material in the patent at issue cannot be found in a single source. This is particularly compelling where any claims of the patent at issue recite subject matter from more than one patent family. The Federal Circuit has held that applicants must satisfy Section 112 requirements in a single parent application in order to claim the benefit of an earlier filing date for individual claims. *Studiengesellschaft Kohle, M.B.H. v. Shell Oil Co.*, 112 F.3d 1561 (Fed. Cir. 1997) (affirming district court's holding that Section 120 does not permit the combination of two earlier disclosures to acquire an earlier filing date). As discussed above, priority is determined on a claim-by-claim basis. Thus, in such a situation, each claim must be analyzed individually to

determine whether it could have been added to either of the two priority applications without introducing new matter.

However, priority chain-breaking is not limited to CIPs. Breaking priority is also possible in continuation applications, typically where a nonprovisional application discloses new matter that was not included in the provisional application. For example, in *Purdue Pharma L.P. v. Iancu*, the Federal Circuit affirmed the PTAB's finding that the '376 patent at issue was not entitled to claim priority to its related provisional application, and that the claims were therefore obvious over an intervening reference that qualified as prior art as a result of the later priority date. 767 Fed. Appx 918 (Fed. Cir. 2019); *see also* discussion of *Indivior, supra*.

Looking Ahead

Patentees and challengers alike should consider priority chain-breaking arguments based on Section 112 priority arguments when evaluating strategy for a patent case, particularly in the context of IPRs. A petitioner may attempt to invalidate the patent at issue using Section 112 bases to break the chain of priority, and then use intervening prior art, including patents that have published or issued earlier from the same family, as Section 102 or Section 103 prior art against the challenged patent claims. As seen above, there have been several cases recently where this was successfully done.

In the IPR context, this strategy could be useful to patent challengers. Given the complexity of most invalidity arguments, arguments concerning breaking priority may have a higher likelihood of success as part of an IPR proceeding based on the aforementioned precedent.

Section 112 also offers an alternative priority chain-breaking invalidity argument in district court actions. For the same claims, a petitioner can argue as independent challenges that (1) the claims are invalid for lack of written description support under Section 112; and (2) the claims are not entitled to priority to the earlier applications because they lack written description support in the earlier application, and without the benefit of the priority claim the claims are anticipated by the parent patents and/or publications.

Both IPRs and district court litigations also provide opportunities to raise other prior art-based challenges. A petitioner or litigant could, for example, also assert Section 103 grounds in the same action. However, this strategy creates a specific tension: by arguing there is no support for the claims of an asserted patent in a single parent application, assuming challengers are successful in breaking priority, they could become limited to Section 103 obviousness invalidity arguments with respect to

parent publications or patents. In other words, by arguing it is necessary to combine disclosures from two applications to satisfy the written description requirement for certain claims of the asserted patents, it could then become difficult to argue that a single parent publication teaches every element of the same claims. Nevertheless, if properly managed, such tensions can be overcome and even advantageous.

Finally, a future Section 112 challenge to the chain of priority is something for patent applicants to consider during prosecution. As discussed above, choices made in prosecution, such as the decision to pursue a CIP, may play a role in the strength of a patent's chain of priority if challenged in district court or at the PTAB. Using this lens, patentees should focus on what is new and what is truly within the claim scope, before facing a priority challenge.

Although chain of priority is a highly fact-based inquiry, it may be a worthwhile strategy consideration in the context of IPRs, district court litigations, and even patent prosecution. [Q](#)

Class Action Litigation Update:

Five Years After the Supreme Court's Ruling in China Agritech, Application of American Pipe Tolling Remains Unsettled

In two landmark decisions - *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 554 (1974) and *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345 (1983)—the Supreme Court adopted and then clarified a new doctrine that the commencement of a class action suspends the applicable statute of limitations as to the putative class members, including both those who seek to join the existing class action and those who bring their own individual (non-class) suits. In adopting this doctrine (commonly referred to as “*American Pipe* tolling”), the Supreme Court focused on the underlying “efficiency and economy” goals of class action litigation, noting that absent such tolling, putative “class members would not be able to rely on the existence of the [class] suit to protect their rights,” thereby leading a “needless multiplicity of” protective lawsuits by class members. *Crown, Cork & Seal Co.*, 462 U.S. at 350-51.

The Supreme Court last revisited *American Pipe* tolling five years ago, with its decision in *China Agritech, Inc. v. Resh*, 138 S. Ct. 1800 (2018). There, the Supreme Court resolved a split among federal courts of appeals and narrowed the application of *American Pipe*, holding that the doctrine “does not permit the maintenance of a follow-on class action past expiration of the statute of limitations.” *Id.* at 1804. The Court reasoned that the “efficiency and economy” goals underlying *American Pipe* did not apply to successive class actions because “[w]ith class claims . . . efficiency favors early assertion of competing class representative claims.” *China Agritech*, 138 S. Ct. at 1807.

Since *China Agritech*, courts have struggled with whether *American Pipe* tolling applies in two thorny situations: (1) a follow-on class action where the court did not deny class certification on the merits in an earlier class action, and (2) where plaintiffs’ counsel seeks to add or substitute class representatives because the original class representatives lacked Article III standing. Regardless of where they end up on these decisions, courts grappling with these issues tend to base their opinions on the efficiency and economy goals underlying the Supreme Court’s decisions. But, what is clear is that both plaintiffs and defendants should understand the state of the law on these issues, because of their potentially huge implications for a class action’s continued viability. After all, a timeliness argument is often one of the cleanest ways for a defendant to get rid of a class action.

Does China Agritech apply where the court did not deny class certification on the merits?

Until a court officially certifies a class, there is no class entity. That is why courts, plaintiffs, and defendants refer to a “putative” class in the early phases of a class action, and why counsel appointed to pursue the case for the broader plaintiff group are typically labeled “interim” class counsel (*i.e.*, because they do not yet represent a certified class). Given these realities, some plaintiffs have argued that *China Agritech* cannot apply by its terms or logic until a court grants or denies class certification because there is no official decision on a case’s “class” nature. Courts addressing this argument, however, have not always agreed.

In *In re Celexa & Lexapro Marketing & Sales Practices Litigation*, 915 F.3d 1 (1st Cir. 2019), for example, the plaintiffs alleged that a pharmaceutical company engaged in fraud to push its antidepressant drugs on minors for whom the FDA had not approved the use of these drugs. A plaintiff brought a follow-on class action claim that relied on *American Pipe* tolling applying between the filing of an earlier class action and the dismissal of that suit, but the First Circuit held that *American Pipe* tolling did not apply to the plaintiff’s claims under *China Agritech*, and it therefore affirmed the district court’s decision denying class certification. *Id.* at 16.

The plaintiff argued that *China Agritech* was inapplicable because there was no substantive ruling on class certification in the earlier class action. The First Circuit disagreed, noting that although the plaintiff’s argument had some facial appeal, the Supreme Court’s reasoning in *China Agritech* was not limited to situations where the court denied class certification in the earlier action. *Id.* at 16-17. According to the First Circuit’s interpretation, *China Agritech* stands for the proposition that “the tolling effect of a motion to certify a class applies only to individual claims, no matter how the motion is ultimately resolved.” *Id.* at 17. Invoking judicial efficiency and economy concerns, the court reasoned that “[t]o hold otherwise would be to allow a chain of withdrawn class-action suits to extend the limitations period forever.” *Id.*

The Third Circuit reached a similar result in *Blake v. JP Morgan Chase Bank NA*, 927 F.3d 701 (3d Cir. 2019). There, the plaintiffs filed a follow-on class action to an earlier class action that had been dismissed on statute of limitations grounds and was on appeal. The plaintiffs tried to distinguish *China Agritech* on the grounds that the court’s ruling on class certification in the first class action was not final (because it was on appeal), but the Third Circuit held that was “a distinction without a difference.” *Id.* at 709. The court reasoned that tolling new actions while the first action was pending would be at odds with the policy rationale behind *China Agritech* because it would “encourage more plaintiffs to seek second bites at the apple,” “undermine Rule 23’s instruction to

resolve class certification early on,” and “could lead to endless tolling.” *Id.* at 710. The court summed up its interpretation of *China Agritech’s* rule as follows: “a timely class action tolls its purported class members’ individual claims, but never their class claims.” *Id.*

District courts in other circuits have reached the same conclusion. See *Cleary v. Am. Airlines, Inc.*, 2022 WL 5320126, at *3 (N.D. Tex. July 22, 2022) (“But the Supreme Court does not limit *China Agritech* only to cases involving a denial of class certification.”); *Prac. Mgmt. Support Servs., Inc. v. Cirque du Soleil Inc.*, 2018 WL 3659349, at *4 (N.D. Ill. Aug. 2, 2018) (“If the Supreme Court wanted to make its holding contingent on the reason why the earlier class action was dismissed, it would have done so.”); *Dormani v. Target Corp.*, 2018 WL 3014126, at *2 (D. Minn. June 15, 2018) (holding that *American Pipe* did not apply to successive class actions where the first class action was dismissed for failure to state a claim), *aff’d on other grounds*, 970 F.3d 910 (8th Cir. 2020).

Other courts have rejected these views and held that *China Agritech’s* limitation on *American Pipe* tolling does not apply where an earlier court did not decide class certification on the merits. In *Famular v. Whirlpool Corp.*, 2021 WL 395468, at *1 (S.D.N.Y. Feb. 3, 2021), for example, the court held that *American Pipe* tolling applied to follow-on class claims where a New York subclass was voluntarily dismissed from an earlier class action prior to any decision on class certification. *Id.* at *2. The *Famular* court rooted its decision in the same judicial efficiency and economy principles other courts cited to reach the opposite conclusion. The court reasoned that “[r]equiring each potential sub-class of plaintiffs to simultaneously sue despite the pendency of a putative nationwide class would create a multiplicity of litigation that squanders resources and undermines judicial economy.” *Id.* (internal quotation marks and citation omitted). Other courts have similarly held that *China Agritech* does not bar *American Pipe’s* application to follow-on class actions where class certification was not decided on the merits in first action. See *In re Snap Inc. Sec. Litig.*, 334 F.R.D. 209, 222-23 (C.D. Cal. 2019) (holding that *China Agritech* did not apply where the court denied a prior motion for class certification in order to reopen the lead plaintiff selection process following the withdrawal of a lead plaintiff for medical reasons).

As these cases demonstrate, the slight weight of authority seems to fall against tolling for follow-on class actions, even if an earlier case did not reach a decision on class certification. But, there are decisions in important class action districts finding such tolling remains. Parties should look into their specific Circuit’s and District’s rulings on this issue, because they vary.

Does American Pipe tolling apply where plaintiffs seek to add or substitute class representatives because the original class representatives lacked Article III standing?

Lower courts have also struggled with whether *American Pipe* tolling applies when plaintiffs’ counsel seeks to add or substitute new class representatives because the original class representatives lacked Article III standing over all or some of the class claims.

The majority approach, adopted by the Second and Seventh Circuits, is that *American Pipe* tolling applies in these situations. In *In Fund Liquidation Holdings LLC v. Bank of America Corp.*, 991 F.3d 370 (2d Cir. 2021), *cert. denied*, 142 S. Ct. 757 (2022), two investments funds filed a class action complaint alleging that numerous banks conspired to manipulate certain benchmark interest rates. A year after the funds filed the complaint, the banks discovered that the funds had been dissolved years earlier, and the case was actually being litigated by a separate entity, which asserted it was assigned the dissolved entities’ claims. *Id.* at 375. The court held that *China Agritech* did not bar the application of *American Pipe* tolling to this entity’s motion to file an amended complaint adding additional funds as class representatives. *Id.* at 393. The court followed the Seventh Circuit’s opinion in *In re Allstate Corp. Securities Litigation*, 966 F.3d 595, 615-16 (7th Cir. 2020), which held that *China Agritech* does not prohibit using *American Pipe* tolling to add or substitute class representatives within the same action. The Seventh Circuit explained that prohibiting the use of *American Pipe* tolling within the original class action to add new class representatives would “undermine th[e] goals of efficiency and economy” underlying *American Pipe*. *Id.* Other courts have since followed the Second and Seventh Circuits’ approach. See *Bos. Ret. Sys. v. Uber Techs., Inc.*, No. 2021 WL 4503137, at *4 (N.D. Cal. Oct. 1, 2021) (“Multiple circuit courts have agreed that *China Agritech* does not apply to the addition of new plaintiffs to a class action.”); *Byrd v. Progressive Direct Ins. Co.*, 2021 WL 1225961, at *6 n.7 (W.D. Ky. Mar. 31, 2021) (same).

At least one court has reached the opposite conclusion. In *Evans v. Wal-Mart Stores, Inc.*, 2019 WL 3325806 (D. Nev. July 23, 2019), the plaintiff filed a class action against Wal-Mart for failure to timely pay unpaid wages to employees who were discharged or resigned. The court granted the plaintiff’s motion for class certification in part, but limited the class to include only class members who, like the plaintiff, voluntarily terminated their employment with Wal-Mart. *Id.* at *2-*3. The plaintiff sought to amend her complaint to include a class representative for employees who were involuntarily discharged, but the court held that the new class representative’s claims were time barred and that *American Pipe* tolling did not apply.

Id. at *4-5. The plaintiff tried to distinguish *China Agritech* on the ground that she sought to add a class representative to an existing class action, but the court was unpersuaded. It noted that the uncertified claims were not fit for certification, and it made no difference for these claims whether some other claims were certified or whether the motion for class certification was denied in its entirety. *Id.* at *5.

Given the Circuit-level decisions on this issue, as well as the logic they employed, it is likely that additional courts will follow suit in the future to find that *American Pipe* tolling applies. However, the remaining uncertainty suggests that a party to a class action should be aware of and research this issue in their venue, because it could provide an important timeliness argument.

Trademark and Copyright Update:

Over the past several years, the emergence of non-fungible tokens (“NFTs”) has given rise to intriguing questions regarding the intersection of trademark law and digital assets. Trademark registrations play an important role in protecting brands and their associated goods and services. The application of trademark law to NFTs is still in its nascent stage, with courts only just beginning to define how and when NFTs may infringe on trademarks. This practice note summarizes and discusses three recent trademark cases involving NFTs: 1) *Hermès v. Rothschild*; 2) *Yuga Labs v. Ripps*; and 3) *Nike v. StockX*. These cases are among the first to address the intersection of NFTs and trademark law, dealing with novel questions about the extension of real-world trademark rights to the virtual world.

Hermès v. Rothschild, 1:22-cv-00384-JSR

In January 2022, Hermes International filed a lawsuit in the U.S. District Court for the Southern District of New York against artist Mason Rothschild, alleging that Rothschild infringed on Hermes’s trademark rights through NFTs, known as “MetaBirkins,” that depicted Hermes’s Birkin handbags.

After the court denied Rothschild’s motion to dismiss, 603 F. Supp. 3d 98 (S.D.N.Y. 2022), and the parties’ cross motions for summary judgment, 2023 WL 1458126 (S.D.N.Y. Feb. 2, 2023), the case proceeded to trial in February 2023. In pretrial briefing, as well as at trial, Rothschild argued that his NFTs were works of art protected by the First Amendment, drawing a parallel with Andy Warhol prints. He contended that the use of Hermes trademarks in his artwork, per the *Rogers v. Grimaldi* test, was permissible as long as it did not explicitly mislead consumers. In *Rogers v. Grimaldi*, the Second Circuit held that the Lanham Act is inapplicable to “artistic works” as long as the defendant’s use of the mark is (1) “artistically

relevant” to the work and (2) not “explicitly misleading” as to the source or content of the work. 875 F.2d 994, 999 (2d Cir. 1989). Conversely, Hermes maintained that the NFTs constituted unlicensed digital exploitation of their exclusive trademarks, necessitating evaluation under the likelihood of confusion standard.

On February 8, a jury delivered a verdict in favor of Hermes, finding that Rothschild had infringed on Hermes’s trademark. Dkt. 144. In his jury instructions (Dkt. 143), Judge Rakoff largely followed the *Rogers* test.

On March 3, Hermes filed a motion for a permanent injunction, seeking to permanently block Rothschild from promoting and selling the MetaBirkins NFTs. Dkt. 165. And on March 14, Rothschild filed a renewed motion for judgment as a matter of law or a new trial, alleging insufficient evidence and improper jury instructions. Dkt. 172.

On June 23, Judge Rakoff denied Rothschild’s request for judgment in his favor or a new trial, and instead granted Hermes’s petition for a permanent injunction. 2023 WL 4145518 (S.D.N.Y. June 23, 2023). The court enjoined Rothschild from using the Birkin marks or misleading the public about the source of the MetaBirkins NFTs due to the likelihood of generating confusion among consumers. Additionally, the court ordered Rothschild to transfer the domain name www.metabirkins.com and related materials to Hermes, and to disgorge any profits he derived from the MetaBirkins NFTs since the beginning of the trial.

The court’s opinion, although recognizing NFTs as artistic expression, emphasizes the need to avoid misleading consumers about the origin of such digital artworks. *See* Dkt. 191. No appeal has been noticed as of the publication of this note.

Yuga Labs, Inc v. Ripps, 2:22-cv-04355-JFW-JEM

In June 2022, Yuga Labs, the creator of the Bored Ape Yacht Club (“BAYC”) NFTs, sued self-proclaimed artists Ryder Ripps and Jeremy Cahen for trademark infringement in the U.S. District Court for the Central District of California, alleging that the artists created NFTs that used the same images and trademarks as the BAYC NFTs. Yuga Labs argued that the artists were intentionally causing confusion among consumers and aiming to harm their business. In their answer, Ripps and Cahen claimed that their collection was a satirical take on the BAYC NFTs and asserted that Yuga Labs’ claims were barred by the First Amendment and fair use.

In March 2023, Yuga Labs moved for summary judgment, and in April, the court granted the motion, found that defendants had infringed Yuga Labs’ trademark, and set trial for damages only. *See* 2023 WL 3316748, at *1 (C.D. Cal. Apr. 21, 2023). The court concluded that the *Rogers* test did not apply, finding that,

contrary to defendants' claims, defendants' collection did not qualify as protected artistic expression under the First Amendment (in contrast to Judge Rakoff's jury instruction in *Hermes* that "MetaBirkins NFTs, including the associated images, are in at least some respects works of artistic expression") (*Hermes*, Dkt. 143). The court further found that even if the *Rogers* test did apply, that defendants had intentionally attempted to mislead consumers. It noted that the domains rrbayc.com and apemarket.com, associated with the collection, contained branding elements confusingly similar to Yuga Labs' branding. The ruling emphasized that the NFTs are more than just digital certifications; they are considered virtual goods for the purposes of the Latham Act, agreeing with Judge Rakoff's ruling in *Hermes* that "defendant's goods [do not need to] be tangible for Lanham Act liability to attach." 2023 WL 3316748, at *4.

***Nike v. StockX*, 1:22-cv-00983-VEC**

In February 2022, Nike filed a lawsuit in U.S. District Court for the Southern District of New York against StockX, an online marketplace and clothing reseller, primarily of sneakers. Nike alleged that StockX-minted NFTs, called "Vault NFTs," using Nike's trademarks without authorization and sold them at heavily inflated prices. Nike's claim raises questions about whether a tie between NFTs and associated physical goods affects whether they are considered goods under the Latham Act.

In its answer, StockX asserted the affirmative defenses of fair use and that Nike's claims are barred by the first sale doctrine, which allows purchasers of lawfully trademarked goods to display, offer, and sell those goods under their original trademark. StockX also asserted that the Vault NFTs are "absolutely not 'virtual products' or digital sneakers" because each is tied to a physical good (i.e., a Nike sneaker). Dkt. 41 at 5. StockX has asserted that consumers who purchase the Vault NFTs have "two choices regarding ongoing possession: (1) retain digital possession of the Vault NFT" and leave the physical shoe in StockX's inventory; or "(2) take possession of the physical good from the vault at any time, in which case the Vault NFT is removed from the customer's digital portfolio and permanently removed from circulation." *Id.* Nike has asserted that some Vault NFTs have been de-coupled from the associated shoes, "depriving the Vault NFT owner of possession of the shoes that are supposedly connected to the NFT." Dkt. 39 at 4. What is undisputed between the parties is that the Vault NFT can be resold multiple times while the shoe originally associated with the NFT remains in StockX inventory. According to StockX, however, each NFT continues to be tied to the specific sneaker with which it was originally associated. And because, as StockX has asserted, each Vault NFT

serves as a digital receipt for a specific sneaker, StockX has further asserted that each Vault NFT cannot actually be sold as a separate product. In contrast, according to Nike, the fact that NFTs can be resold multiple times without a buyer claiming the associated physical sneaker, as well as de-coupled from the associated sneaker, makes the Vault NFTs not simply digital receipts, but rather separate products. *Nike* has not yet reached the dispositive motion stage.

The outcome of *Nike* will likely have implications for how trademarks are treated when there is interplay between NFTs and physical assets. Unlike the NFTs at issue in *Hermes* and *Yuga Labs*, each Vault NFT is associated with a specific physical asset—a sneaker. *Nike* may establish precedents for the creation, purchase, and sale of NFTs that are associated with physical assets and provide further clarity on the boundaries of trademark infringement and consumer confusion.

Competition Litigation Update:

THE RISKS OF Algorithmic Pricing

What is algorithmic pricing?

Algorithmic pricing refers to a collection of pricing rules or strategies that are predetermined and used to establish prices. Algorithmic pricing software utilizes historical patterns and current data within a specific market to provide pricing recommendations that align with the preferences and objectives of the end-user (i.e., the price-setter). Recently, the term algorithmic pricing has been more commonly used to refer to the use of computer systems to apply a pricing strategy that automatically determines prices, with little or no manual intervention. Although this practice can lead to more efficient pricing and better market outcomes, it has also raised competition law concerns.

With algorithmic pricing, there is potential for collusion or price-fixing among competitors, even without the competitors specifically knowing of the collusion. This is because if algorithms are programmed to monitor competitors' prices and automatically adjust their own prices in response, it may lead to artificially inflated prices and reduced competition.

DOJ and FTC's Treatment of Algorithmic Pricing

The Department of Justice ("DOJ") and the U.S. Federal Trade Commission ("FTC") have been somewhat conservative in their treatment of algorithmic pricing. They proposed that when examining cases involving pricing algorithms used by competitors, the focus should be on determining whether PRICES REFLECT AN ILLEGAL AGREEMENT, AS OPPOSED TO... there is an illegal agreement between prices, as opposed to mere

“conscious parallelism.”

Overall, there is limited precedent from regulatory authorities concerning algorithmic pricing in the United States. In 2015, the DOJ announced its first prosecution specifically targeting internet commerce and the use of pricing algorithms in *United States v. Topkins*, No. 15-cr-00201, *criminal information filed* (N.D. Cal. Apr. 6, 2015). The defendant, David Topkins, was a seller of wall posters on Amazon’s Marketplace and was accused of conspiring with other poster sellers to fix the prices of posters sold online. To coordinate and enforce the price-fixing conspiracy, Topkins and his co-conspirators agreed to use pricing algorithms that were designed to monitor and match each other’s prices. In this conspiracy, one company would program an algorithm to search for the lowest price offered by a non-conspiring competitor on particular posters, and to set that company’s price for that poster just below the non-conspiring competitor’s price. Meanwhile, another conspiring company programmed its algorithm to match the first company’s prices. Topkins shortly pled guilty to one count of price-fixing, a violation of the Sherman Antitrust Act, which prohibits anti-competitive agreements among competitors. According to the DOJ’s press release, Topkins agreed to pay a \$20,000 fine and to cooperate with the ongoing investigation into the price-fixing conspiracy. “Former E-Commerce Executive Charged with Price Fixing in the Antitrust Division’s First Online Marketplace Prosecution,” April 6, 2020, *available at* <https://www.justice.gov/opa/pr/former-e-commerce-executive-charged-price-fixing-antitrust-divisions-first-online-marketplace> (last accessed April 12, 2023). Although *Topkins* involved a relatively simple pricing algorithm and a human agreement to collude, it is significant because it demonstrates that the DOJ is willing to pursue antitrust enforcement actions against individuals and companies using pricing algorithms to facilitate collusion or engage in other anti-competitive practices.

The FTC, however, did not indicate that this was any change in its antitrust approach. In 2017, the then Acting Chairman of the FTC, Maureen Ohlhausen, said in a speech that “[f]rom an antitrust perspective, the expanding use of algorithms raises familiar issues that are well within the existing canon,” and that “[t]his is just not a place where antitrust needs to impose new rules in response to new tools.” *Should We Fear The Things That Go Beep In the Night? Some Initial Thoughts on the Intersection of Antitrust Law and Algorithmic Pricing*, Maureen K. Ohlhausen, May 23, 2017, *available at* <https://www.ftc.gov/public-statements/2017/05/should-we-fear-things-go-beep-night-some-initial-thoughts-intersection> (last accessed April 13, 2023), at 2, 7-8 (“Ohlhausen”). She said that in a free market, individual actors are free

to set their prices based on all the information that is legally available to them. Ohlhausen however also asked important questions: “Are there opportunities for mischief in the black box nature of all this? Will the use of pricing algorithms allow firms to collude or increase prices in ways that will ultimately go undetected by the enforcement agencies? Does antitrust doctrine need to change in important ways to reflect the greater use of automated decision-making across markets?” *Id.*

FTC officials did indicate in public statements that the rise in “robo-sellers” employing pricing algorithms to establish their prices could complicate distinguishing between intentional collusion and conscious parallelism: “a number of current inquiries used to distinguish conscious parallelism from express collusion will be of limited use in the machine context. Concepts such as ‘intent’ and ‘meeting of the minds’ . . . ‘presuppose quintessentially human mental states’ and thus ‘may prove less useful in dealing with computer software and hardware.’” Terrell McSweeney and Brian O’Dea, “The Implications of Algorithmic Pricing for Coordinated Effects Analysis and Price Discrimination Markets in Antitrust Enforcement,” American Bar Association, *Antitrust*, Vol. 32, No. 1 (Fall 2017), *available at* https://www.ftc.gov/system/files/documents/public_statements/1286183/mcsweeney_and_odea_-_implications_of_algorithmic_pricing_antitrust_fall_2017_0.pdf at 75 (“McSweeney and O’Dea”).

More recently, in 2020, Deputy Assistant Attorney General Richard A. Powers said that “the U.S. legal standard for a criminal antitrust violation remains constant; it requires proof beyond a reasonable doubt of an agreement among two or more competitors to fix prices, rig bids, or allocate markets, that occurs in, or affects, interstate commerce.... Criminal prosecution is typically limited to bid rigging, price fixing, and allocation agreements, and the Antitrust Division has significant experience prosecuting anticompetitive conspiracies carried out by a range of means and methods, and that could include using pricing algorithms.” “Deputy Assistant Attorney General Richard A. Powers Delivers Remarks at Cartel Working Group Plenary: Big Data and Cartelization, 2020 International Competition Network Annual Conference” Washington, D.C., Sept. 17, 2020, *available at* <https://www.justice.gov/opa/speech/deputy-assistant-attorney-general-richard-powers-delivers-remarks-cartel-working-group> (last accessed April 14, 2023). Powers further explained that in the context of collusive agreements, the U.S. will prosecute any involved intermediaries as well: “[I]f an intermediary, such as a programmer or platform, facilitates a conspiracy among competitors to use a common pricing algorithm for the purpose of fixing prices, under U.S. law, we could

prosecute both the competitors and the intermediary who facilitated the illegal agreement.” *Id.*

However, at the 21st Annual International Competition Network Conference in 2022, Assistant Attorney General Jonathan Kanter, who oversees DOJ’s Antitrust Division, seemed to indicate that organizations might need to take proactive steps relating to algorithmic pricing. According to Kanter, “Whether you use a smoke-filled room in a basement or you’re using AI and an API, it’s still the same thing. It’s still collusion.” He suggested that there is a role for corporate compliance programs preventing collusion by algorithms, and that companies proactively design and train algorithms and AI programs to avoid collusion, in a similar way to how they train employees to comply with other legal requirements.

Claims Brought Against Algorithmic Pricing in U.S. Courts By Private Plaintiffs

Plaintiffs have filed a number of suits alleging that algorithmic pricing is a violation of Section 1 of the Sherman Act. These suits are currently in the initial stages of litigation within federal courts around the U.S., and none of them has gone to verdict. These suits contend that the competitors and their software provider participate in a “hub and spoke” conspiracy to establish fixed prices. “Hub and spoke” conspiracies refer to a

type of antitrust violation where a central firm, or “hub,” coordinates a price-fixing or collusion scheme among multiple competitors, the “spokes.” In this type of model, the hub acts as an intermediary, enabling the spokes to engage in anti-competitive behavior without directly communicating with each other.

As an example, in a recent lawsuit filed in U.S. District Court in Las Vegas, hotel guests are pursuing class-action damages, claiming excessive room charges resulting from an anticompetitive scheme. *Gibson v. MGM Resorts Int’l*, Case No. 2:23-cv-00140-MMD-DJA. The plaintiffs assert that major Las Vegas Strip hotel-casinos engaged in price-fixing by using a third-party vendor to set their hotel room prices. The complaint alleges that the vendor facilitated “algorithmic-driven price-fixing” by collecting competitor pricing data and providing unlawful room rate recommendations for hotel operators’ profit maximization.

In summary, the utilization of algorithmic pricing can be used to improve market efficiency and outcomes. However, for any business using algorithmic pricing, it is important to recognize the accompanying risk of being accused of collusion and price-fixing when algorithms monitor and adjust prices in response to competitors. 

VICTORIES

NAR Defeats Antitrust Claim Based on Key Zillow Website Change

Our firm obtained a complete and resounding summary judgment victory on an \$850 million antitrust claim against our client National Association of Realtors and co-defendant Zillow in a dispute with upstart tech real estate brokerage REX – Real Estate Exchange, Inc. represented by lead counsel David Boies.

Our client, the National Association of Realtors (NAR) is the biggest trade association in the country, representing 1.5 million real estate agents and brokers. NAR is comprised further of hundreds of local associations of Realtors and many of these local associations own and operate multiple listing services (“MLS”), which is the means by which most agents collaboratively exchange and share each other’s listings information. To provide best practices and help guide these Realtor association owned MLS’s, NAR publishes MLS model rules that, if adopted by MLS’s, govern how each participants listing information can be used. In 2001, NAR promulgated an optional rule just as internet listings were becoming

popular that made clear MLS’s at their discretion could require participants to separate MLS listings from non-MLS listings on their websites. This case was about the day twenty years later that Zillow decided to join MLS’s and started complying with the 70% of MLS’s that had adopted that optional rule.

REX was a residential real estate brokerage start-up, which accused the real estate industry is a “cartel” of conspiring agents whose main purpose is to prop up their own commissions. REX alleged NAR and Zillow conspired to exclude REX as a competitor based on this optional rule in order to control real estate listings information and maintain supracompetitive commissions.

Shortly after Zillow joined MLS’s, it changed its website, moving REX listings to a second, non-default tab. REX filed suit within a matter of weeks, seeking an injunction against Zillow to revert to the old website design. REX brought antitrust claims as well as false advertisement, unfair practices, and defamation claims, claiming that the conspiracy had caused the failure of REX’s entire business, which it claimed was valued at over

\$1 billion.

Quinn Emanuel was brought on immediately for the defense and went to work demonstrating that the reality was that REX built its business on a loophole, that REX's business was already failing well before the Zillow website design change, and most critically, that there was never any conspiracy or agreement between Zillow and NAR to "segregate, conceal, and demote" REX listings. NAR and Zillow beat back the preliminary injunction threat, but through misleading pleading, REX was able to defeat our motion to dismiss by alleging that the "so called voluntary" No-Commingle Rule was actually mandatory in practice (although we were successful in getting REX's Lanham Act claims against NAR kicked).

Our team pushed in discovery to demonstrate this was not the case. REX, NAR, and Zillow all filed cross motions for summary judgment. We hammered our main refrain: that there was no evidence of a contract, combination or conspiracy, a threshold element of Section 1 antitrust claims. After a two-day marathon oral argument, Judge Zilly of the Western District of Washington issued a 31-page opinion granting NAR summary judgment on the issue of agreement, dismissing all claims against NAR with prejudice.

Evergreen v PCEC

Quinn Emanuel recently achieved a dismissal with prejudice for Pacific Coast Oil Company ("PCEC") in a case where the plaintiff sought to prevent the dissolution of an oil trust and \$50 million in damages.

PCEC owns and operates oil wells in Southern California. Its prior owners created a publicly traded trust that receives 80% of the net profits. But when PCEC set aside funds for plugging and abandonment of the wells in 2019, distributions ceased, and it became clear that the Trust would dissolve at the end of 2021 under the Trust Agreement's terms. Evergreen, an investor in the Trust, sued to stop dissolution and for \$50 million in damages for the reduced distributions.

Quinn Emanuel's first step was to stop Evergreen's lawsuit for lack of standing. When Evergreen moved for a preliminary injunction in California Superior Court to stop dissolution, Quinn Emanuel argued that Evergreen's claims were derivative because they were based on alleged harm to the Trust. The Court agreed, denying Evergreen's motion and ruling that Evergreen lacked direct standing.

Evergreen then filed an amended complaint pleading derivative claims on behalf of the Trust. Quinn Emanuel immediately threatened to move to compel arbitration and, realizing that its derivative claims were indisputably subject to arbitration, Evergreen agreed. Quinn Emanuel again crafted a knock-out standing argument, this time that the Trust Agreement barred Evergreen from suing

derivatively. And despite the state court judge's initial rejection of this argument, Quinn Emanuel convinced the arbitrators, who denied Evergreen's motion for preliminary injunction and dismissed all of its claims with prejudice for lack of standing.

While the arbitration was pending, Evergreen tried to evade its standing problems by filing a second amended complaint in California Superior Court in 2022 that advanced a new direct claim for tortious interference against PCEC's parent company and one of its principals. But Quinn Emanuel crafted a strategy to dismiss this claim under California's two-year statute of limitations, arguing that the statute began to run in 2019 when distributions stopped. The Court agreed and dismissed that claim with prejudice.

Quinn Emanuel stopped Evergreen's case in its tracks. The Court and the arbitrators dismissed Evergreen's \$50 million lawsuit with prejudice before it ever reached the merits. **Q**

business litigation report**quinn emanuel urquhart & sullivan, llp**

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