No. 14-3514

In the United States Court of Appeals for the Third Circuit

FEDERAL TRADE COMMISSION

v.

WYNDHAM WORLDWIDE CORP., a Delaware corporation,
WYNDHAM HOTEL GROUP, LLC, a Delaware limited liability company,
WYNDHAM HOTELS & RESORTS, LLC, a Delaware limited liability company,
AND WYNDHAM HOTEL MANAGEMENT, INC., a Delaware corporation

WYNDHAM HOTELS & RESORTS, LLC,

Appellant

On Appeal from the U.S. District Court
for the District of New Jersey (Salas, J.)
Civil Action No. 2:13-cv-01887-ES-JAD

APPELLANT'S SUPPLEMENTAL MEMORANDUM

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INTRODUCTION

The Federal Trade Commission has not declared unreasonable cybersecurity practices "unfair" through the procedures in the FTC Act. Try as it might, the Commission cannot transform complaints and consent decrees into rules and adjudications. Nor can the FTC use its own interlocutory decision denying a motion to dismiss in *LabMD* as grounds for claiming deference to its attempts to become the nation's cybersecurity regulator.

Instead of invoking its own administrative procedures, the FTC sued Wyndham directly in federal court under 15 U.S.C. § 53(b), advancing claims for both "deception" and "unfairness." As the FTC acknowledged at oral argument, that was a tactical decision on the part of the agency. The FTC intentionally forwent an administrative proceeding in the hope of obtaining monetary remedies. Wyndham has not challenged the FTC's tactical decision to sue in federal court, and this Court should not either. The FTC's choice of forum does not raise a jurisdictional question that the Court is required to consider *sua sponte*. Moreover, numerous federal-court decisions authorize actions under § 53(b) for any alleged violation of the FTC Act, and the FTC's deception claim would permit it to seek relief under § 53(b) even under a narrow interpretation of the statute.

If the Court nonetheless holds that the FTC lacked authority to bring its unfairness claim under § 53(b), it should dismiss that claim with prejudice and not

allow the FTC to re-file its unfairness claim in its own administrative courts. This dispute has been pending in federal court for nearly three years and was preceded by a two-year investigation. To date, the FTC has compelled Wyndham to spend millions of dollars to defend itself against the agency's novel and legally untenable theory that Wyndham committed an "unfair" trade practice when it was the victim of an attack by Russian criminal hackers. Having made the choice to pursue that theory in federal court, the FTC must now live with any adverse consequences, not foist them upon Wyndham by seeking a "do over" in its own courts.

Indeed, it would be pointless to allow the agency to pursue administrative remedies, because the *only* remedy the agency can pursue in its own courts is a cease-and-desist order. There is no conceivable basis for such relief now. Over five years have passed since the last cyberattack, and it is undisputed that Wyndham's data security and the entire national cybersecurity landscape have changed dramatically in that time. Proving the point, the FTC has never sought a preliminary injunction against Wyndham—a fact that belies the notion that a cease-and-desist order would somehow be appropriate years after the fact.

At the very least, the Court should hold that the FTC cannot pursue an unfairness claim against Wyndham without first promulgating a rule declaring unreasonable cybersecurity practices unfair. Although agencies generally have discretion to regulate by adjudication, this case falls within a recognized exception

to that legal principle: when an agency for the first time purports to impose an entirely new legal requirement that will have widespread application—such as a command to maintain "reasonable cybersecurity practices"—it must first issue rules. *See, e.g.*, *Ford Motor Co. v. FTC*, 673 F.2d 1008, 1009 (9th Cir. 1981).

ARGUMENT

I. The FTC Has Not Declared Unreasonable Cybersecurity Practices "Unfair" Through The Procedures In The FTC Act.

In response to the Court's first question, the FTC has not declared unreasonable cybersecurity practices "unfair" through the procedures in the FTC Act, 15 U.S.C. §§ 41-58. The FTC concedes that it has not published any rules proscribing unreasonable cybersecurity practices. FTC Br. 31. And the only agency adjudication regarding cybersecurity—*In the Matter of LabMD, Inc.*, No. 9357—is not final and thus does not amount to a formal declaration about the meaning of unfairness. *See LabMD, Inc. v. FTC*, 776 F.3d 1275, 1278 (11th Cir. 2015); *see also* Order Denying Motions for Stay, No. 9357, 2013 WL 6994755, at 5 (F.T.C. Dec. 13, 2013) ("[T]here is no 'final agency action' in this proceeding.").

The FTC's cybersecurity "complaints and consent decrees" do not constitute a declaration that unreasonable cybersecurity practices are "unfair" under the FTC Act. FTC Br. 45. Complaints and consent decrees "do[] not adjudicate the legality of any action by the party thereto" and therefore cannot declare what the law requires. *Beatrice Foods Co. v. FTC*, 540 F.2d 303, 312 (7th Cir. 1976). And, as

the Court noted at oral argument, the FTC has never directed the public to look to complaints or consent decrees for guidance, and those are not the typical sources to which counsel would turn in advising clients. Oral Arg. Tr. at 51:6-9; 52:16-22.

II. This Court Need Not And Should Not Address Any Limitations On The FTC's Ability To Seek Relief Under § 53(b) In This Case.

It follows from the answer to the Court's first question that the FTC is asking the federal courts to determine in the first instance that unreasonable cybersecurity practices qualify as "unfair" trade practices under the FTC Act. The Court's second question therefore asks whether federal courts can make such a determination in a case brought under 15 U.S.C. § 53(b). Wyndham respectfully submits that this Court need not and should not answer that question in this case.

First and foremost, neither Wyndham nor the FTC has raised the § 53(b) issue, and that issue is not a jurisdictional matter the Court is obligated to address *sua sponte*. The Supreme Court has repeatedly addressed in recent years the distinction between "federal-court 'subject-matter' jurisdiction over a controversy; and the essential ingredients of a federal claim for relief." *Arbaugh v. Y&H Corp.*, 546 U.S. 500, 503 (2006); *see also Sebelius v. Auburn Regional Med. Ctr.*, 133 S. Ct. 817, 823-26 (2013); *Gonzalez v. Thaler*, 132 S. Ct. 641, 648-49 (2012); *Henderson v. Shinseki*, 131 S. Ct. 1197, 1202-03 (2011); *Reed Elsevier, Inc. v. Muchnick*, 559 U.S. 154, 168 (2010). In these cases, the Court has adopted a "readily administrable bright line" for determining whether to classify a statutory

limitation as jurisdictional: unless Congress has "clearly state[d]" that a particular limitation is jurisdictional, "courts should treat [it] as nonjurisdictional in character." *Arbaugh*, 546 U.S. at 515-16.

The statutory limits on the FTC's authority to pursue, and the federal courts' authority to grant, a permanent injunction under § 53(b) do not satisfy this standard. Section 53(b) simply restricts the substantive *relief* available to the FTC in court. Even if the FTC transgresses that statutory restriction in a particular case, there can be no question that a federal court nonetheless has subject-matter jurisdiction under 28 U.S.C. §§ 1331, 1337(a), and 1345. Section 53(b), in other words, "does not speak in jurisdictional terms," *Auburn*, 133 S. Ct. at 824 (quotations omitted). Because Congress has not "clearly state[d]" that § 53(b) is jurisdictional, it is not. *Arbaugh*, 546 U.S. at 515-16; *see also Auburn*, 133 S. Ct. at 824-26; *Gonzalez*, 132 S. Ct. at 647-52; *Henderson*, 131 S. Ct. at 1202-06; *Reed Elsevier*, 559 U.S. at 160-69.

Since § 53(b) does not speak to this Court's subject-matter jurisdiction, the Court could follow its standard practice of declining to address non-jurisdictional arguments that the parties have not advanced. *See, e.g.*, *Bell Atl.-Pa., Inc. v. Pennsylvania Pub. Util. Comm'n*, 273 F.3d 337, 344 n.3 (3d Cir. 2001) ("Our general practice is not to address legal issues not raised below, absent exceptional circumstances."). There are especially good reasons to follow that standard

practice in this case. Were this Court to resolve the § 53(b) issue against the FTC, it would be the first court of appeals to do so and would create a circuit conflict. *See FTC v. Evans Prods. Co.*, 775 F.2d 1084, 1086-87 (9th Cir. 1985) (section 53(b) gives the district court "authority to grant a permanent injunction against violations of any provision of law enforced by the Commission") (quotations omitted); *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1113 (9th Cir. 1982) (same); *see also FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1028 (7th Cir. 1988) ("A substantial argument can be made that the statutory language … permits the FTC to proceed under the last proviso of [§ 53(b)] for any violation of a statute administered by the FTC."); *FTC v. Ameridebt, Inc.*, 373 F. Supp. 2d 558, 562-63 (D. Md. 2005); *FTC v. Mylan Labs., Inc.*, 62 F. Supp. 2d 25, 36 (D.D.C. 1999); *FTC v. Minuteman Press*, 53 F. Supp. 2d 248, 260 (E.D.N.Y. 1998). Precisely because the issue is not jurisdictional, this Court should resist an approach that might lead to conflict with the decisions of other courts of appeals.

This case presents a particularly poor vehicle to address the § 53(b) issue, because it is not squarely presented here. Even if the Court were to construe § 53(b) narrowly, the FTC's *deception* claim—which remains pending below—makes this a "proper case" to bring in federal court. That claim alleges that Wyndham engaged in "deceptive acts or practices in violation of … the FTC Act" by making "false or misleading" statements on its website. Am. Compl. ¶¶ 20-22,

44, 46. Although Wyndham vigorously disputes the merits of that claim, it certainly does not present a "novel" theory of liability—the FTC has long sued companies for making allegedly deceptive statements to consumers. *See, e.g.*, *Arrow Metal Prods. Corp. v. FTC*, 249 F.2d 83, 84 (3d Cir. 1957). The presence of the deception claim makes this a proper case to file in federal court regardless of the novelty of the unfairness claim, for the statutory language speaks in terms of "proper *cases*," not "proper *claims*." 15 U.S.C. § 53(b). Certainly, the FTC was not required to split its claims against Wyndham by pursuing one in the agency and the other in federal court. *Cf. City of Chicago v. International Coll. of Surgeons*, 522 U.S. 156, 172-73 (1997) (permitting removal of entire case, including state law claims over which a federal court would not otherwise have jurisdiction, under supplemental jurisdiction statute); *Borough of W. Mifflin v. Lancaster*, 45 F.3d 780, 787 (3d Cir. 1995) (courts can consider the implications of "two parallel proceedings" when deciding to exercise supplemental jurisdiction).

Finally, this Court should not resolve this case on the basis of the § 53(b) issue because the problems with the FTC's case run far deeper than the form of relief the Commission is seeking or the forum in which it has chosen to proceed. As a matter of statutory interpretation, a company's allegedly negligent cybersecurity practices cannot be deemed an "unfair" trade practice, regardless of whether the FTC proceeds administratively or in federal court. *See* Wyndham

Reply Br. 6-8 (citing cases); *see also Baker v. Goldman, Sachs & Co.*, 771 F.3d 37, 51 (1st Cir. 2014) ("[M]ere negligence, standing alone, is not sufficient for a violation of [a state prohibition on unfair trade practices]."); *Pizzaloto v. Hoover Co.*, 486 So.2d 124, 127 (La. Ct. App. 1986) ("Mere negligence by a merchant is not enough to sustain a cause of action under [the state prohibition on 'unfair or deceptive method, act or practice']."); *Harrison v. Whitt*, 698 P.2d 87, 90 (Wash. Ct. App. 1985) (explaining that the Washington Consumer Protection Act is "not applicable to acts of negligence or malpractice").

And even if mere negligence *could* be characterized as an "unfair" trade practice, the FTC has not given notice of what cybersecurity practices are "unreasonable." Perhaps recognizing the fair-notice problems created by its *post hoc* enforcement regime, the FTC recently announced that it will launch a new education initiative designed to inform businesses "'what they can do in terms of best practices when it comes to data security.'" A. Grande, *FTC Gearing Up for New Data Security Education Initiative*, Law360 (Mar. 5, 2015), *available at* http://goo.gl/ZIvoFG (quoting FTC Chairwoman Edith Ramirez). In the words of Chairwoman Ramirez, the FTC is undertaking that initiative because it needs to be "more concrete in some of the guidance we're putting out there." *Id*. That is a step in the right direction for *future* targets of FTC enforcement actions—but it does nothing to solve the manifest fair-notice problem with respect to Wyndham.

III. The FTC Should Be Bound By Its Tactical Litigation Decision To Sue Wyndham In Federal Court.

For those reasons, this Court need not and should not address the § 53(b) issue in this case. If the Court nonetheless does so, however, it should dismiss the unfairness claim with prejudice. By suing under § 53(b), the FTC made a tactical choice to forgo the administrative process and proceed against Wyndham in federal court. As the FTC acknowledged at oral argument, it made that choice because of the enhanced remedies the Commission believed it could obtain in a federal-court action, including equitable monetary remedies such as disgorgement or restitution. *See* Oral Arg. Tr. at 28:18-21 (the FTC "exercises its discretion to proceed under [§ 53(b)] because there are remedies available to the Commission in federal court that are not available to the Commission in the administrative process").

Thus, at the time it brought suit against Wyndham, the FTC had a choice. On the one hand, it could have sued in its own administrative courts. That would have allowed the agency to litigate before its own Administrative Law Judges (ALJs); to use the favorable rules of procedure that apply in administrative actions, *see e.g.*, 16 C.F.R. § 3.43(b) (permitting admission of hearsay); *id.* § 3.43(d)(1) (permitting ALJ to limit respondent's cross-examination); and to have the FTC's own Commissioners review any final ALJ decision, *id.* § 3.54. But proceeding administratively also would have limited the remedy the FTC could

have obtained to a cease-and-desist order. The FTC thus chose to sue Wyndham in federal court under § 53(b), where it could and did seek broader remedies, but where it also was constrained to litigate before independent Article III judges applying evenhanded procedural rules. Having made that tactical choice, the FTC should not be allowed a "do over" because one of its claims might be inappropriate for federal-court review.

Allowing the FTC to relitigate its unfairness claim before the agency would be particularly inappropriate because the FTC could not now obtain relief on that claim. As explained, the only relief the FTC can seek in an administrative action is a "cease and desist" order. *See* 15 U.S.C. § 45(b). But the FTC has no good-faith basis for seeking that relief at this point. Over five years have elapsed since the data breaches that prompted this lawsuit, *see* Am. Compl. ¶¶ 37-39, and nearly three years have passed since the FTC first sued Wyndham in federal court, *see* JA265. There is simply no reasonable dispute that Wyndham's cybersecurity practices (as well as the national cybersecurity landscape) have changed substantially during that time—and thus that the facts underlying the FTC's complaint could not support a cease-and-desist order sought three years later: Wyndham cannot be ordered to "cease and desist" from alleged cybersecurity practices that it no longer follows. Proving the point, in the over five years since

the last cyberattack at issue in this case, the FTC has *never* sought preliminary injunctive relief against Wyndham.

It would also be highly prejudicial to Wyndham to allow the FTC to restart its case in a new forum. The agency has already subjected the company to a two-year investigation and nearly three years of federal-court litigation. During that time, the FTC has taken extensive discovery—including serving 140 document requests, 76 interrogatories (including subparts), and over 40 third-party subpoenas. Responding to the FTC's wide-ranging discovery has cost Wyndham millions of dollars and required untold hours of work from lawyers and employees within the company. The parties, moreover, were only a few weeks away from the close of fact discovery when the district court stayed proceedings this past November. *See* Dist. Ct. Dkt. Nos. 224 (amended scheduling order); 269 (stay of discovery). In light of the advanced nature of this case and the substantial burdens Wyndham has already incurred, the FTC should not be permitted to start litigation anew. *See, e.g.*, *Ferguson v. Eakle*, 492 F.2d 26, 29 (3d Cir. 1974) (barring plaintiffs from voluntarily dismissing federal-court action and commencing state-court action where case had been pending for fourteen months and all discovery had been completed); *Hayden v. Westfield Ins. Co.*, 586 F. App'x 835, 842-43 (3d Cir. 2014) (same where case had been pending for seventeen months and all

discovery had been completed); *In re Diet Drugs*, 85 F. App'x 845, 847 (3d Cir. 2004) (same where case had been pending for two years).

It is also doubtful whether Wyndham could receive a fair hearing if this case were litigated at the FTC. Before last year, no private litigant had prevailed in the FTC's administrative courts in nearly twenty years. As put by FTC Commissioner Joshua Wright: "Over the last twenty years the Commission has affirmed 100 percent of ALJ decisions in favor of FTC staff while reversing 100 percent of the ALJ decisions ruling against FTC staff." Recalibrating Section 5: A Response to the CPI Symposium, *available at* http://goo.gl/q8axKc. That extraordinary record of litigation victories raises substantial questions about the fundamental fairness of any administrative proceeding to which Wyndham might be subjected.[1]

All of this is not to say that the FTC could seek no relief at all if the unfairness claim were dismissed with prejudice. The deception claim is still pending before the District Court, and the FTC can seek relief on that claim. But given the substantial amount of litigation that has already occurred, and the

[1] There are also substantial questions whether one or more FTC Commissioners would be required to recuse themselves from any agency proceeding against Wyndham in light of public comments they have made about this litigation. *See Texaco, Inc. v. FTC*, 336 F.2d 754, 760 (D.C. Cir. 1964) (FTC Commissioner should have been disqualified because "he had in some measure decided in advance that Texaco had violated the Act"), *judgment vacated on other grounds by FTC v. Texaco, Inc*, 381 U.S. 739, 740 (1965).

inability of the FTC to obtain a cease-and-desist order, the unfairness claim claim should be dismissed with prejudice even while the deception claim proceeds.

IV. Alternatively, The Court Should Require The FTC To Publish Rules.

If the Court is inclined to dismiss the unfairness claim under § 53(b) without prejudice, it should at the very least specify that the FTC can declare unreasonable cybersecurity practices "unfair" only through rulemaking, and that it cannot do so in the first instance through adjudication.

As a general matter, "the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency." *SEC v. Chenery Corp.*, 332 U.S. 194, 203 (1947). But there are exceptions to that general principle. *See NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294 (1974) ("[T]here may be situations where [an agency's] reliance on adjudication would amount to an abuse of discretion."). In particular, although an agency "can proceed by adjudication to enforce discrete violations of existing laws where the effective scope of the rule's impact will be relatively small," the agency "must proceed by rulemaking if it seeks to change the law and establish rules of widespread application." *Ford Motor Co. v. FTC*, 673 F.2d 1008, 1009-10 (9th Cir. 1981) (FTC "exceeded its authority by proceeding to create new law by adjudication rather than by rulemaking"); *Patel v. INS*, 638 F.2d

1199, 1204 (9th Cir. 1980) (INS abused its discretion by choosing adjudication over rulemaking).

In purporting to deem unreasonable cybersecurity practices "unfair," the FTC is not seeking to "enforce discrete violations of existing laws," but is instead attempting to establish for the first time an entirely new legal requirement that will have "widespread application." *Ford Motor*, 673 F.2d at 1009. The FTC can embark on such an endeavor only if it first publishes rules explaining the new requirements it now interprets Section 5 to require—otherwise there is no backdrop of "existing law" against which adjudications can be conducted. *Compare Secretary of Labor v. Beverly Healthcare-Hillview*, 541 F.3d 193 (3d Cir. 2008) (adjudication to determine whether agency rule requiring medical treatment "at no cost to employees" required reimbursement for lost time and travel expenses).

The FTC has given two reasons why it will not publish rules. *First*, the FTC claims that the rulemaking process is too "cumbersome," Oral Arg. Tr. at 54:9-11, because it requires "full-blown evidentiary hearings and witness testimony," FTC Br. 31. Congress, however, presumably imposed those procedural requirements for good reasons—such as the economic significance of deeming an entire category of conduct "unfair"—and an agency is not free to disregard those procedures simply because it finds them burdensome. In any event, the FTC has previously used those same "cumbersome" procedures to declare other practices

unfair. *See, e.g.*, *Pennsylvania Funeral Dirs. Ass'n v. FTC*, 41 F.3d 81 (3d Cir. 1994) (Funeral Industry Practices Rule); *American Optometric Ass'n v. FTC*, 626 F.2d 896 (D.C. Cir. 1980) (Ophthalmic Practices Rules); 16 C.F.R. § 410.1 (rule governing "advertising as to sizes of viewable pictures" shown on television sets); *id*. pt. 460 (rule governing "labeling and advertising of home insulation").

Second, the FTC argues that rulemaking is impossible because cybersecurity is "one of the fastest changing areas of technology." Oral Arg. Tr. 53:21-25. But the Fair Credit Reporting Act, the Children's Online Privacy Protection Act, and the Gramm-Leach-Bliley Act all require the FTC to promulgate rules about cybersecurity, *see, e.g.*, 15 U.S.C. § 1681w(a)(1) (FCRA); *id.* § 6502(b)(1) (COPPA); *id.* § 6804(a)(1)(C) (GLBA), proving that the agency *can*, in fact, publish rules of sufficient generality to take account of changes in technology. Alternatively, the FTC could publish rules embracing one of the several cybersecurity standards that already exist, and which can be amended to take account of evolving technologies, such as those published by the National Institute of Standards and Technology, the PCI Security Standards Council, or the International Organization for Standardization. *Cf. SEC Accounting Series*, Rel. No. 150, 1973 WL 149263 (Dec. 20, 1973) (adopting "principles, standards, and practices promulgated by the FASB").

March 27, 2015

Respectfully submitted,

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I. This brief complies with the type-volume limitation set by the Court on March 3, 2015, because the brief contains 15 double-spaced pages, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

II. This brief 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 brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010, in 14-point Times New Roman font.

March 27, 2015

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CERTIFICATE OF IDENTICAL COMPLIANCE OF BRIEFS

I, Eugene F. Assaf, P.C., hereby certify that the text of the electronically filed brief is identical to the text of the original copies that were dispatched on March 27, 2015, by Federal Express Overnight delivery to the Clerk of the Court of the United States Court of Appeals for the Third Circuit.

March 27, 2015

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CERTIFICATE OF PERFORMANCE OF VIRUS CHECK

I, Eugene F. Assaf, P.C., hereby certify that on March 27, 2015, I caused a virus check to be performed on the electronically filed copy of this brief using the following virus software: Microsoft Forefront Endpoint Protection, version 4.3.220.0. No virus was detected.

March 27, 2015

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CERTIFICATE OF SERVICE

I, Eugene F. Assaf, P.C., hereby certify that on March 27, 2015, I caused seven (7) copies of Appellant's Supplemental Memorandum to be dispatched by Federal Express Overnight delivery to the Clerk of the Court for the United States Court of Appeals for the Third Circuit. I also caused an electronic copy of the brief to be filed via CM/ECF, causing notice to be sent to all counsel of record, including the following counsel for Appellee:

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