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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

FEDERAL TRADE COMMISSION Plaintiff, v. WYNDHAM WORLDWIDE CORPORATION, et al., Defendants.	Civil Action No.: 2:13-cv-01887-ES-SCM **DEFENDANTS' REPLY IN SUPPORT OF THEIR MOTION TO STAY DISCOVERY PENDING RESOLUTION OF DEFENDANTS' MOTIONS TO DISMISS** **MOTION DATE MAY 20, 2013**

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INTRODUCTION

The FTC devotes remarkably little attention to the two critical questions at issue: (1) whether Defendants' pending motions to dismiss this first-of-its-kind data-security litigation, if granted, would dispose of the entire action; and (2) whether proceeding with discovery while those motions are pending would impose significant costs on the court system, the parties, and third parties, including resolution of substantial objections interposed by the FTC regarding the investigatory-files privilege, the deliberative-process privilege, and the law-enforcement-evidentiary privilege. The answer to both questions is yes, and there is good cause for a discovery stay while the Court considers Defendants' motions to dismiss.

ARGUMENT

Each of the FTC's arguments against Defendants' stay request misses the mark. ***First***, the FTC starts from the false premise that the Commission has already produced its relevant documents, while Defendants have "provided little in response." FTC Opp. at 5. That is backwards. It is the FTC who has objected to producing any and all relevant documents at every opportunity. Defendants, in contrast, have spent ***over $5 million*** during the past three years responding to the FTC's discovery requests. And it is Defendants, not the FTC, who have produced thousands of confidential, internal communications.

Despite the FTC's claim that it has produced "substantial amounts of discovery," *id.*, the overwhelming majority of the FTC's productions came from third parties in response to the 38 document subpoenas the FTC has already served. *See* Hradil Decl., Ex. A (Dec. 14, 2012 letter from K. Cohen to E. Assaf) (producing approximately 20,000 pages of third-party documents); *id.*, Ex. B (Jan. 18, 2013 letter from J. Krebs to E. Assaf) (producing over 200,000 pages of third-party documents); *id.*, Ex. C (Feb. 7, 2013 letter from J. Krebs to E. Assaf) (producing third-party data); *id.*, Ex. D (Mar. 12, 2013 letter from J. Krebs to E. Assaf) (producing approximately 20,000 pages of

third-party documents). The FTC's production of its own documents has been meager in comparison. The agency has produced approximately 1,000 of its own documents and less than 16,000 total pages. *See id.*, Ex. B (Jan 18, 2013 letter from J. Krebs to E. Assaf). And, in contrast to the highly sensitive information the FTC has demanded from Defendants and from third parties, the FTC has refused to produce essentially any of its non-public, confidential information. *See, e.g., id.*, Ex. E (Sep. 5, 2012 Resp. to Defendants RFP Nos. 11 and 13) (agreeing to produce only "publicly available documents" related to its prior data-security investigations). Instead, Defendants have received press releases, public workshop agendas, and other public documents that are easily accessible on the FTC's website.

Virtually every piece of critical evidence the FTC possesses meanwhile has been hidden behind a blunderbuss of objections:

- Deliberative-process privilege;
- Law-enforcement-evidentiary privilege;
- Attorney work product;
- Attorney-client privilege;
- Investigatory-files privilege;
- General assertions of confidentiality; and
- Assertions that essentially all non-public information the FTC possesses is irrelevant.[1]

The FTC has used those objections to refuse to produce ***any*** documents responsive to ***thirteen*** requests. *See, e.g., id.*, Ex. E (Sep. 5, 2012 Resp. to Defendants RFP Nos. 9, 10, and 12); *id.*, Ex. F (Oct. 24, 2012 Resp. to Defendants RFP Nos. 21-22); *id.*, Ex. G (Mar. 18, 2013 Resp. to Defendants RFP Nos. 24-31). Those requests seek basic, key facts like what the FTC believes "reasonable and appropriate" data-security practices require and whether the Commission follows its own, unannounced data-security standards. *See, e.g., id.*, Ex. E (Sep. 5, 2012 Resp. to Defendants RFP

[1] *See, e.g.*, Hradil Decl., Ex. E (Sep. 5, 2012 Resp. to Defendants RFP Nos. 1, 9-14, and 16-19); *id.*, Ex. F (Oct. 24, 2012 Resp. to Defendants RFP Nos. 21-22); *id.*, Ex. G (Mar. 18, 2013 Resp. to Defendants RFP Nos. 23-33); *see also id.*, Ex. E (Sep. 5, 2012 Resp. to Defendants RFP No. 4) ("the FTC is not charged with criminal law enforcement or the apprehension or prosecution of criminals.").

Nos. 9-10). In light of the FTC's refusal to produce any of its key internal documents, the FTC's claim that it "has responded to Defendants' discovery requests diligently and in good faith" rings hollow. FTC Opp. at 1.

The FTC's consistent refusal to produce relevant, non-public documents also pales in comparison to the extensive discovery Defendants have provided. Defendant Wyndham Hotels and Resorts, LLC ("WHR") provided the FTC with over one million pages of non-public documents before the Commission even filed suit.[2] Since discovery in this case began, Defendants have produced an additional eight thousand pages of internal documents and communications. The number of pages produced so far by Defendants thus exceeds the FTC's production by orders of magnitude. And, unlike the FTC, a large portion of Defendants' production contains ***highly confidential internal communications*** that are actually relevant to this case.

All of this shows the FTC is right about one thing: discovery has "been largely one-sided up to this point." *Id.* at 9. But it is Defendants who have provided extensive discovery despite the FTC's refusal to produce virtually anything other than publicly available documents, largely available to anyone from the FTC's website. The Commission thus has no reason to accuse Defendants of dodging their discovery obligations. Nor, given its discovery behavior, can the FTC claim equity is on its side.

Second, the FTC argues that a stay is unwarranted because Defendants "pursued discovery for months after first filing [their motions to dismiss] in the District of Arizona." *Id.* at 1. But far from supporting the FTC's position, the parties' previous discovery efforts only underscore the need

[2] The FTC inaccurately suggests WHR delayed the investigation. Not so. WHR fully cooperated for two years without the FTC suggesting otherwise. WHR started producing documents within a month of the FTC's request and worked with the FTC throughout the process to properly tailor its document production. And the three months it took WHR to respond to the FTC's interrogatory-like questions was reasonable given the amount of information sought. But even if WHR did delay the investigation, it does not change the fact that the FTC ultimately received more than one million pages of documents, responses to fifty written questions, and seven in-person presentations.

for judicial resolution of the key disputed legal issues before discovery proceeds any further. In accordance with standing rules in Judge Rosenblatt's chambers in the District of Arizona, *see* ECF No. 17, Defendants commenced discovery shortly before filing their initial motions to dismiss. Defendants did so, however, anticipating that the parties would engage in some preliminary discovery prior to the court's ruling on the motions to dismiss and with the hope that the parties would be able to agree to a reasonable approach to discovery and work out any disagreements without guidance from the court. However, by the time briefing is complete on Defendants' motions to dismiss, this case will have been pending for nearly a year—a significant amount of time for the parties to operate without any guidance as to the elements of the claims in dispute, the relevant defenses Defendants may raise, and the proper framework for litigating this case.

More significantly, the limited discovery the parties have conducted to date has only confirmed that the parties need judicial guidance about the relevant legal and factual issues before discovery continues. Over the past several months, Defendants and the FTC have had deep and intractable disagreements about the proper scope and extent of discovery in this case. Those disagreements have covered a broad variety of issues, including what subject matters are relevant to the FTC's claims, the timeframe that is most relevant to this case, the corporate entities and custodians from which discovery is required, and the aspects of Defendants' businesses that are most at issue. In addition, the FTC has refused to produce entire categories of documents that Defendants believe to be critically important, including the Commission's statements to third parties concerning what constitutes "reasonable and appropriate" data-security measures, the FTC's enforcement efforts concerning other cyberattacks, the FTC's knowledge of other hacking incidents, and the FTC's internal policies and procedures concerning what constitutes "reasonable and appropriate" data-security measures. Guidance from this Court as to the scope and contours of a cause of action for

allegedly deficient data-security practices under Section 5 (if, in fact, any such cause of action exists at all) would materially aid the parties in resolving those disputes.

In the absence of a stay, the parties likely will need to engage in substantial litigation efforts to resolve their discovery disputes. Because of the FTC's heavy reliance on executive privileges and its refusal to produce ***any*** non-public documents of any significance, Defendants would need to present substantial submissions on the applicability of the deliberative-process, law-enforcement, and investigatory-files privileges, on the confidentiality obligations of the Commission with respect to third-party documents, and on key relevance issues. Resolving those disagreements likely will require substantial involvement from the Court, and perhaps even *in camera* review of disputed documents. For its part, the FTC had stated that it too might seek to compel production of documents from Defendants, thus only further embroiling the parties and the Court in extended discovery disputes.

Third, aside from its misguided and abstract plea to equity, the FTC's Opposition makes no effort to explain how a stay of Defendants' discovery obligations would prejudice the Commission. The FTC, for example, never claims that it needs additional discovery to plead its case against Defendants. Nor does the FTC offer any concrete example of evidence it might lose if this Court grants a stay. Instead, the FTC merely speculates that "[t]he longer discovery is delayed in this matter, the more likely that . . . relevant information will be lost." FTC Opp. at 5.[3] That speculation ignores that Defendants have litigation holds in place to preserve relevant evidence. *See Weisman v.*

[3] *Adams v. Trs. of the New Jersey Brewery Emps.' Pension Trust Fund*, the FTC's primary prejudice case, addresses Rule 41 dismissals for failure to prosecute, not discovery stays. *See* 29 F.3d 863, 867 (3d Cir. 1994). Unlike the FTC, the Third Circuit in *Adams* also considered whether the facts established that a delay would cause a loss of evidence rather than assuming delay automatically places evidence at risk. *See id.* at 873-74 (finding the delay caused no prejudice).

Mediq, Inc., 1995 WL 273678, at *2 (E.D. Pa. May 3, 1995) (refusing to presume, without evidence, that a discovery stay would cause the loss of documents or witness testimony).

A stay of third-party discovery similarly would leave the FTC unharmed. Because the "third parties subpoenaed by the FTC have completed, or are very close to completing, their productions," FTC Opp. at 9, the Commission ***already has the documents*** it needs from those parties. *See also id.* at 8 ("[E]very third party subpoenaed by the FTC has provided substantial materials in response.") The FTC nonetheless argues a stay might harm it because a third party could destroy a stray document or two the party had not yet produced. That a party might destroy a responsive document after being served with a subpoena is a fanciful argument. *Cf. Weisman*, 1995 WL 273678, at *2. But even if that remote possibility exists, the minor inconvenience the FTC would suffer from losing a small number of responsive documents is far outweighed by the burden that continuing with discovery would impose on third parties and on Defendants. *See Ohio Bell Tel. Co., Inc. v. Global NAPs Ohio, Inc.*, 2008 WL 641252, at *1 (S.D. Ohio Mar. 4, 2008) ("In ruling upon a motion for stay, the Court is required to weigh the burden of proceeding with discovery upon the party from whom discovery is sought against the hardship which would be worked by a denial of discovery.").

That burden would be substantial. WHR spent $5 million and reviewed over a million pages of documents during the FTC's initial investigation to produce documents from the two key document custodians—the two employees most likely to have documents responsive to the FTC's requests. Yet the FTC belittles that effort and demands Defendants produce documents from at least eleven additional employees. *See* FTC Opp. at 6-7. That will require Defendants to collect millions of additional documents—most of which are likely irrelevant—and to divert its employees' attention from their normal duties to help collect those documents. In addition, the FTC's 47 document requests seek highly sensitive business information. Those requests, for example, seek "[a]ll

minutes of Board of Directors meetings"—regardless of the topics discussed—"all documents related to internal or external tests or assessments of" Defendants' network security, all documents provided to any "external data security assessor," and essentially all communications between Defendants and any payment processing vendor. Hradil Decl., Ex. H (Oct. 31, 2012 FTC RFP Nos. 1, 4, 19, 21, 28-29). Defendants should not face these substantial costs or have to reveal sensitive internal or otherwise confidential communications while significant doubts remain whether the FTC has authority to pursue its novel causes of action. *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 558 (2007) (holding deficiencies in a complaint "should … be exposed at the point of minimum expenditure of time and money by the parties and the court"); *North Am. Comm., Inc. v. Infoprint Solutions Co., LLC*, 2011 WL 4571727, at *3 (W.D. Pa. July 13, 2011) (staying further discovery in a case where discovery had already commenced in order to "avoid[] undue cost and waste of time and effort").

The potential burden on third parties is equally significant. Although Defendants have served only three third-party discovery requests—in stark contrast to the FTC, which has served 38 third-party subpoenas—Defendants would need to serve many more such requests in the near future absent a stay. Those requests, as explained in Defendants' opening brief, could provoke disputes over the proper scope of third-party discovery in this case. Indeed, MasterCard and Visa have already raised objections that may require motions practice if the parties cannot reach agreement. *See, e.g.*, ECF No. 100-1 at 5-6. The FTC's response that a stay is unnecessary because MasterCard and third parties who find Defendants' requests objectionable could seek a protective order misses the point. Defendants seek a discovery stay to avoid burdening itself, third parties, and the Court with discovery disputes in a case that may not belong in federal court at all.

The FTC's other suggestion that Defendants could voluntarily postpone third-party discovery is unrealistic. If discovery continues, Defendants need to know details about data breaches at other companies and how those companies responded to those incidents to mount an effective defense against the FTC's assertion that Defendants' data-security practices were "unreasonable." Defendants could not, for example, take or defend depositions without that information. Thus, Discovery must stop altogether or Defendants must press forward with their third-party discovery. And *Weisman*, although the FTC claims otherwise, does not support the Commission's fall-back request that its third-party discovery continue while other discovery is stayed. Although the court in *Weisman* exempted initial disclosures from its discovery stay, it stayed "all non-self-executing discovery, which includes Defendants and non-parties alike." 1995 WL 273678, at *2 (granting a stay "across the board").

Fourth, the arguments presented in Defendants' motions to dismiss undoubtedly warrant a stay. Despite tacitly acknowledging the weakness of its Section 5 unfairness claim, the FTC argues discovery should continue because its Complaint contains a backup deceptive-trade-practices claim. *See* FTC Opp. at 13 ("Even if the Court were to hold that the FTC lacks authority to bring an unfairness claim in this context, the FTC would still seek largely the same information in discovery relating to the deception count."). That argument ignores that Defendants have also moved to dismiss the Commission's deception claim in its entirety and that there is a substantial basis for doing so. *See* ECF No. 91-1 at 23-28. As Defendants have previously explained in three different briefs, the privacy policy on which the FTC hangs its deception claim ***expressly disavows*** making any representation about the security of payment-card data collected by WHR franchisees. Hradil Decl., Ex. I (WHR's Privacy Policy) at 4 ("We do not control the use of this Information or access to the Information by the Franchisee and its associates."). Despite Defendants repeatedly bringing that

disclaimer to the FTC's attention, the Commission has filed two complaints that nonetheless omit the critical language that a court would want to see. The FTC has refused to directly quote that language because it knows Defendants' disclaimer is fatal to its deception claim. Moreover, no court has ever sustained a deception claim in an FTC data-security case, and (for the reasons Defendants' have given) this Court should not be the first. The Commission's deception allegations thus cannot make up for its novel and flawed unfairness claim.

Although the FTC does spend one paragraph attempting to support its unprecedented Section 5 unfairness claim, its defense of that claim only underscores that its arguments cannot withstand scrutiny. According to the Commission, the FTC's imposition of data-security standards through *post hoc* litigation is not novel because it has brought unfairness actions unrelated to data security in the past and because companies have previously settled with the FTC after the Commission labeled their data-security practices "unfair." But previous unfairness suits ***unrelated to data security*** obviously do nothing to establish that the Commission has the sweeping authority it claims in this case. And the fact that the FTC has used the high costs of litigation to "strong-arm[] … regulated parties into 'voluntary compliance' without the opportunity for judicial review," *Sackett v. EPA*, 132 S. Ct. 1367, 1374 (2012), should only be further cause for alarm at the FTC's mode of regulation in this area, not a reason for deferring to the FTC's unjustified claim of regulatory jurisdiction. In any event, the discovery process in this case must be informed by the ***actual elements*** of a Section 5 data-security claim as determined by the Court (if such a claim exists at all), and not by the elements as the FTC has asserted them in unchallenged (and unreviewed) enforcement actions.

At bottom, the FTC does not and cannot deny that no Article III court has ever considered whether inadequate data-security practices can amount to "unfair" trade practices under Section 5 or whether data-security representations in a privacy policy can be "deceptive" in the face of a clear

disclaimer stating otherwise. And even if such claims exist, no Court has ever determined what the elements of those causes of action would be, what defenses would be available, and what the proper framework is for litigating those claims. The novelty of those issues is precisely why a broad constituency of groups and individuals—from small businesses and business associations, to academics, to public-policy think tanks, to former FTC officials—have submitted *amicus* briefs in this case. Discovery should thus be stayed unless and until this Court decides whether this case belongs in federal court at all and, if so, offers guidance as to how the parties should go about litigating the FTC's claims.

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Respectfully submitted,

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