

No. 14-72745

**IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

In re: ADOBE SYSTEMS, INC. et al.

ADOBE SYSTEMS, INC. et al.,

Petitioners,

v.

**UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA, SAN JOSE,**

Respondent,

SIDDHARTH HARIHARAN, et al.,

Real Parties in Interest.

From the United States District Court, Northern District of California
The Honorable Lucy H. Koh, Presiding
Case No. 5:11-2509-LHK

**MOTION BY ECONOMIC SCHOLARS FOR LEAVE TO FILE BRIEF AS
AMICI CURIAE IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS**

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Iain M. Cockburn, James C. Cooper, Kira Fabrizio, Robert G. Harris, Benjamin Klein, Jonathan Putnam, Michael Sykuta, and Glenn Woroch respectfully move this Court, pursuant to Federal Rule of Appellate Procedure 29, for leave to file the accompanying brief as *amici curiae* in support of the petition for writ of mandamus in this case.

I. INTERESTS OF *AMICI CURIAE*

Amici curiae are economists who have researched, studied, and written about the economics of legal rules. *Amici* are particularly interested in the adoption of legal rules that encourage (or at least allow) economic actors to make socially efficient decisions. *Amici* believe that the methodology used by the district court in this case to determine the reasonableness of the proposed settlement will deter socially efficient settlements.

II. WHY THE ECONOMIC SCHOLARS' BRIEF IS DESIRABLE

The proposed brief of *amici curiae* uses economic analyses and principles to illustrate the flawed reasoning and the undesirable effects of the district court's methodology. Specifically, the brief demonstrates that the court's methodology ignores a number of economic factors that could result in the rejection of efficient settlements or, depending on the factors at play, the approval of settlements that would not be in the interest of absent class members.

The brief thus demonstrates that the district court's ruling has repercussions beyond this case. If adopted by other courts, the district court's methodology threatens to impede class action litigants from reaching efficient settlements while giving courts false comfort that they have dutifully carried out the objectives of judicial review of class action settlements.

Counsel for *amici* sought consent to file the brief. Petitioners consented to its filing, but the real parties in interest did not consent.

Amici respectfully request that this Court grant them leave to file the brief *amici curiae* conditionally submitted herewith.

Dated: October 24, 2014

Respectfully submitted,

s/ Sean P. Gates

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on October 24, 2014.

I further certify that those participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

I further certify that on the date hereof I caused a copy of **MOTION BY ECONOMIC SCHOLARS FOR LEAVE TO FILE BRIEF AS AMICI CURIAE IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS** to be served on the following by placing a true copy thereof enclosed in sealed envelopes addressed as follows for collection and mailing at Morrison & Foerster LLP, 700 Wilshire Boulevard, Suite 6000, Los Angeles, California 90017-3543, in accordance with Morrison & Foerster's ordinary business practices:

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Dated: October 24, 2014

s/ Sean P. Gates

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INTERESTS OF *AMICI CURIAE**

Amici curiae are economists who have researched, studied, and written about the economics of legal rules.** While *amici* take no position as to whether the settlement in this case should ultimately be approved, they are concerned that the district court's decision—in particular, the methodology used by the court to determine the reasonableness of the proposed settlement—will deter socially efficient settlements. As *amici* discuss below, economic analyses show that settlements are affected by a number of factors that the district court failed to take into account and which would likely cause the court's methodology to render erroneous conclusions.

ARGUMENT

The settlement of costly litigation is generally socially efficient, saving party, judicial, and public resources. *See, e.g., Franklin v. Kaypro Corp.*, 884 F.2d 1222, 1225 (9th Cir. 1989). This Court has thus appropriately stated that “voluntary conciliation and settlement are the preferred means of dispute resolution” and that this “is especially true in complex class action litigation.”

* No counsel for a party authored this brief in whole or in part, and no party or counsel for a party made a monetary contribution intended to fund the preparation or submission of the brief. No person other than *amici curiae* or their counsel made a monetary contribution to the preparation or submission of this brief. Petitioners consented to the filing of this brief. Real parties in interest did not consent.

** *Amici* are listed in the signature block and described in the appendix.

Officers for Justice v. Civil Service Comm'n of the City and Cnty. of San Francisco, 688 F.2d 615, 625 (9th Cir. 1982). Adoption of the district court's methodology in this case to determine the reasonableness of a class action settlement, however, could inhibit socially efficient settlements.

The district court used a prior settlement as a minimum “benchmark” for the reasonableness of a subsequent settlement. (Op. at 6-8, 31.) The court reasoned that subsequently settling defendants should pay at least the amount of the prior settlement, in proportion to the various defendants' shares of total class compensation, given that the plaintiff obtained favorable pretrial rulings after the first settlement. (Op. at 7, 31.) In effect, the district court used the adjusted prior settlement amount as a proxy for the expected trial outcome. The district court thus multiplied by 19 the prior \$20 million settlement, setting a \$380 million minimum benchmark, which the court used to reject a \$324.5 million settlement.

Amici are sympathetic with the district court's desire to find an objective standard to measure the reasonableness of a settlement. Economic analyses, however, show that the utility of a prior settlement amount in gauging the reasonableness of a subsequent settlement is affected by a number of factors—including the impact of cost avoidance, joint and several liability rules, and party-specific considerations—that the district court did not take into account. The methodology used by the district court, if adopted by other courts, could therefore

prevent efficient settlements, fail to protect the interests of absent class members, and undermine the policy favoring class action settlements.

I. ECONOMIC THEORY PREDICTS SETTLEMENT MAY BE EFFICIENT WITHIN A RANGE OF VALUES

Economic theory shows that litigating parties may enter into an efficient settlement (i.e., a settlement that preserves resources and makes both parties better off) over a range of values dictated by the parties' respective expectations of trial outcomes and costs of trial. We present here a simple, well-established model that demonstrates this point and provides the basis for the discussion below.

The parties in a single plaintiff, single defendant case can be better off by settlement where the value to the defendant of avoiding trial exceeds the value to the plaintiff of going to trial. The value to the plaintiff of going to trial is the plaintiff's estimate of damages, discounted by the plaintiff's estimate of the probability of prevailing, minus costs of going to trial.¹ If p is the estimate of success at trial, D is the estimated damages, and C is the cost of going to trial, the value to the plaintiff of going to trial can be represented by the simple equation:

$$V_{\pi} = p_{\pi}D_{\pi} - C_{\pi}$$

¹ As a simplification, we assume that the transaction costs of settlement are zero. Settlement is also affected by a number of additional factors, which we discuss below.

The value to the defendant of avoiding trial is the defendant's expected damages, discounted by the defendant's estimate of the probability the plaintiff will prevail, plus the defendant's costs of going to trial. This value can be represented in mathematical terms by the equation:

$$V_{\Delta} = p_{\Delta}D_{\Delta} + C_{\Delta}$$

A settlement that makes both parties better off than their expected trial outcomes can occur where $V_{\Delta} > V_{\pi}$. In such a situation, the difference between V_{Δ} and V_{π} is the economic surplus of settlement versus the expected outcomes at trial:

$$Surplus = V_{\Delta} - V_{\pi} = p_{\Delta}D_{\Delta} - p_{\pi}D_{\pi} + C_{\Delta} + C_{\pi}$$

The parties can bargain to split the surplus, leaving both better off than their respective expectations of the results of trial.² For example, suppose that plaintiff and defendant agree that the plaintiff has a 50% chance of obtaining a \$30 million dollar award and the trial costs for each party would be \$2 million. The value to the plaintiff of going to trial is \$13 million (.5(30) - 2). The value to the defendant of avoiding trial is \$17 million (.5(30) + 2). The surplus is \$4 million, and both parties would be better off settling between with a settlement less than \$17 million but greater than \$13 million.

² See, e.g., Robert D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LITERATURE 1067, 1075-76 (1989); Frank H. Easterbrook, William M. Landes & Richard A. Posner, *Contribution Among Antitrust Defendants: A Legal and Economic Analysis*, 23 J. L. & ECON. 331, 354-55 (1980).

II. THE DISTRICT COURT'S METHODOLOGY IGNORES A NUMBER OF FACTORS THAT AFFECT SETTLEMENTS

The model discussed above has important implications for the use of a prior settlement as a measure of reasonableness for a subsequent settlement. First, the range of settlement depends on the parties' respective estimates of damages and the likelihood of the plaintiff succeeding at trial. Settlement thus "depends on judgment calls rather than a definite calculus."³ Any settlement within the bounds of V_{Δ} and V_{π} is rational and efficient.⁴ As discussed below, using a scaled prior settlement as a *minimum* benchmark—rather than simply a reference point—will prevent efficient settlements or result in a benchmark that fails to protect absent class members. Second, the amount of a settlement among parties is affected by avoided trial costs, which may differ among defendants and do not scale in proportion to expected damages. A failure to account for this fact, as happened here, may result in a grossly inflated benchmark that prevents efficient settlements.

Furthermore, the simple model does not take into account a host of additional factors that affect settlement, such as joint and several liability rules and a number of party-specific factors. These factors also impact the relationship

³ Geoffrey C. Hazard, Jr., *The Settlement Black Box*, 75 B.U. L. Rev. 1257, 1266 (1995).

⁴ *See id.*; *see also* Easterbrook, Landes & Posner, *supra*, note 2 at 355.

between settlement and expected trial outcomes and thus affect the usefulness of a prior settlement as a benchmark.

A. Use of a Prior Settlement as a Hard Benchmark Is Inappropriate; Efficient Settlements May Occur Over a Range of Values

A prior settlement is only one point in a possible range of efficient settlement values and gives only limited information about the expected trial outcome. Putting aside the cost of trial and other factors discussed below, the range of efficient settlements is dictated by the settling parties' views of the expected damages and the probability the plaintiff will prevail. Even where the parties each have the same information (which is atypical), these views are inherently judgment calls. We therefore expect parties to have different but still reasonable views of the expected trial outcome; predicting the decision of a judge or jury is inherently difficult.⁵ Moreover, parties may reasonably estimate plaintiff's chances of success and potential damages to vary among defendants.

A single settlement amount, therefore, gives the court some information that may be useful in determining what may be a reasonable subsequent settlement. The settlement amount reflects a point within the range of judgments of the settling parties. But parties may have differing but still reasonable views of the appropriate

⁵ See, e.g., George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 9 (1984); Gary M. Fournier & Thomas W. Zuehlke, *Litigation and Settlement: An Empirical Approach*, 71 REV. OF ECON. & STAT. 189, 190 (1989).

range of settlement for different defendants. Expected damages and the probability of success may change over the course of litigation. The reasonable variation in views counsels against using a prior settlement as a hard benchmark, especially because defendants more pessimistic about their chances at trial (due to the evidence or other factors) are more likely to settle early and to pay relatively more.

The use of a prior settlement as a *minimum* benchmark is thus particularly problematic. The district court in this case found that the prior settlement amount should (when multiplied by 19) reflect the minimum amount of a reasonable settlement because the court believed that favorable pretrial rulings subsequent to the first settlement increased the probability of plaintiffs' success at trial.

We agree that favorable pretrial rulings, all other things equal, would generally increase a plaintiff's likelihood of success at trial. Such rulings may not, however, affect the parties' settlement calculus. For instance, the parties may have expected and already accounted for the rulings. More important, because a settlement reflects only one point in a range of possible settlement outcomes, the assumption that a prior settlement should be a *minimum* benchmark—even when accounting for an increased likelihood of plaintiff's success at trial—could prevent efficient settlement or, depending on the circumstances, result in a minimum benchmark that does not protect class members' interests.

A simple numerical example illustrates these outcomes. Assume that plaintiff estimates a 50% chance of obtaining \$30 million in damages at trial against Defendant A and 19 times that amount (\$570 million) against Defendant B. Defendants are more pessimistic, estimating a 70% chance plaintiff will prevail at trial but agree with the estimated damages. Ignoring litigation costs (i.e., $V_{\Delta} - V_{\pi} = p_{\Delta}D_{\Delta} - p_{\pi}D_{\pi}$), as well as the defendant specific-factors discussed below, Defendant A and plaintiff would be better off settling between \$21 million and \$15 million. Assume that those parties settle at \$20 million.

Even if subsequent pretrial rulings increased plaintiff's chances at trial by 15 percentage points, using the \$20 million settlement as a *minimum* benchmark could prevent an efficient settlement between Defendant B and plaintiff. Again ignoring litigation costs, the settlement range for Defendant B and plaintiff would be:

$$V_{\Delta} - V_{\pi} = p_{\Delta}D_{\Delta} - p_{\pi}D_{\pi} = .85(570) - .65(570) = 484.5 - 370.5$$

In other words, Defendant B and plaintiff could enter into an efficient settlement anywhere between \$484.5 and \$370.5 million. Using 19 times the first settlement as a minimum benchmark (\$380 million) would reduce the efficient settlement range by \$9.5 million or 8.33%.

The district court's methodology could also result in a minimum benchmark that is too low, allowing for a settlement that is not in the interests of the absent class members. If the initial settlement in the case described above were \$16

million (instead of \$20 million), the minimum benchmark would be \$320 million (19 times \$16 million), which is below the plaintiff's value of going to trial (\$370.5 million). The use of such a benchmark may fail to serve the objectives of judicial review of class action settlements; it would allow plaintiffs to accept a settlement that is not in the interests of absent class members.

The use of a prior settlement as a minimum benchmark—rather than simply a data point informing the reasonableness determination—is thus likely to either prevent efficient settlements or fail to protect absent class member interests.

B. Differences in Avoided Trial Costs May Inflate a Benchmark Significantly

A failure to account for the fact that the respective defendants' litigation costs are not proportional with the assumed damages can grossly inflate a benchmark based on a prior settlement. Here, the district court reasoned that the defendants should pay 19 times the amount of the prior settlement. (Op. at 7.) As discussed above, however, economic theory predicts that the prior settlement incorporates avoided trial costs. Simply scaling a prior settlement as a benchmark incorrectly assumes that the avoided trial costs in a second settlement are proportional to the expected damages among the defendants.

To illustrate, assume that the defendants in the prior settlement believed that the plaintiffs had a 50% chance of obtaining from them \$30 million and that their estimated trial costs at the time of settlement were \$6 million. Assume that the

plaintiffs too believed they had a 50% chance of obtaining \$30 million and that the plaintiff estimated a trial cost savings of only \$250 thousand (because they would still go to trial against the remaining defendants). In this case:

$$V_A - V_\pi = (.5)30 - (.5)30 + 6 + .25 = 6.25$$

Even though the parties agree that the expected trial outcome is \$15 million, any settlement between \$21 and \$14.75 million makes both the plaintiff and the settling defendants better off because of avoided trial costs. A \$20 million settlement thus reflects these avoided costs.

Using 19 times the \$20 million as a benchmark assumes that avoided costs are exactly proportional with the ratio of expected damages. For instance, assume that all the parties agreed that the plaintiff stood the same 50% chance of prevailing against the remaining defendants, and that the expected damages would be 19 times those expected against the settling defendants. In that case, the upper range of any settlement (the value of avoiding trial to the defendants) would be:

$$V_A = p_A(19D_A) + C_A = (.5)(19(30)) + C_A = 285 + C_A$$

In other words, the top of the expected settlement range would be \$285 million plus the remaining defendants' expected trial costs. To get to the \$380 million figure, one would have to assume that those trial costs would have been \$95 million. Using the prior settlement as a benchmark, without taking into account avoided litigation costs, thus inflates the benchmark significantly.

Although avoided litigation costs may increase with expected damages (greater damages increases the incentive to spend more to litigate), that relationship is not proportional. Moreover, avoided litigation costs decrease as a case proceeds; all else equal, a later settlement is expected to have *lower* avoided litigation costs. Simply scaling a prior settlement amount in proportion with expected damages would thus inflate the benchmark.

C. The Existence of Joint and Several Liability Undermines the Utility of a Prior Settlement Amount as a Benchmark

Under Section 1 of the Sherman Antitrust Act, defendants are jointly and severally liable for damages caused by their co-conspirators and there is no right to contribution. *See Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 646-47 (1981). Accordingly, each defendant faces the possibility of being held liable for the damages caused by all of the other defendants with only a pro tanto set off for the value of any settlements.

These rules influence settlement values in several ways. Defendants fear being the last one “holding the bag” and therefore compete to settle, resulting in a plaintiff being able to obtain more through aggregate settlements than through litigation.⁶ The competition magnifies the relative payment of those defendants

⁶ This result applies so long as a finding of liability against one implies liability against the other, such as in an antitrust conspiracy case. *See Lewis A.*

that have a greater chance of losing at trial.⁷ But the rules may also give the plaintiff an incentive to accept lower settlement amounts from early settling defendants because the plaintiff may still seek the full recovery from the other defendants. The presence of asymmetric information, however, may give the plaintiff an incentive to demand a higher settlement; the plaintiff can discriminate among defendants and settle with the one willing to pay a higher price.⁸

Economics cannot predict how these competing incentives play out in a particular case, but the influence of joint and several liability rules casts doubt on the usefulness of a prior settlement as a benchmark for the expected trial outcome. On the one hand, the prior settlement may be inflated in comparison with the settling defendant's proportional share of expected damages. On the other hand, it may reflect a plaintiff's willingness to take a lower settlement given the ability to potentially recover all damages at trial, resulting in a benchmark that is too low.

D. Many Additional Party-Specific Factors Influence Settlement

Settlements are also affected by a number of party-specific factors that may vary across defendants. Depending on the influence of these factors, a prior settlement may not be a useful benchmark for a subsequent settlement.

Kornhauser & Richard L. Revesz, *Multidefendant Settlements: The Impact of Joint and Several Liability*, 23 J. LEGAL STUD. 41, 67-69 (1994).

⁷ See Easterbrook, Landes & Posner, *supra*, note 2, at 354, 360.

⁸ See Kathryn E. Spier, *A Note on Joint and Several Liability: Insolvency, Settlement, and Incentives*, 23 J. LEGAL STUD. 559, 563-66 (1994).

Degrees of Risk Tolerance. The parties' respective risk tolerance may affect the amount of a settlement. A risk-neutral defendant is indifferent to paying \$14 million in settlement or going to trial with a 14% chance of losing \$100 million. A risk-averse defendant is inclined to take the settlement because, while it has an 86% chance of paying nothing if it goes to trial, it may end up paying \$100 million. A risk-averse defendant is therefore willing to pay more to settle because it gains more—the defendant avoids the risk of a trial loss. Conversely, a risk-taking defendant is willing to pay less to settle.⁹

A settlement amount therefore reflects the degree of risk tolerance of the settling defendant. Because there is nothing inherently irrational about differing degrees of risk tolerance, nor is any degree necessarily less efficient than another, differing settlement amounts may reflect differing degrees of risk tolerance rather than an unreasonable divergence from the expected trial outcome.

Asymmetric Information. A party may have private information that shapes the party's view about the expected damages, the chance of winning at trial, or the value of settlement. For instance, a plaintiff may know information about a weakness in the case. A plaintiff able to withhold this information may obtain a

⁹ See, e.g., Jeffrey M. Perloff, Daniel L. Rubinfeld & Paul Ruud, *Antitrust Settlements and Trial Outcomes*, 78 REV. OF ECON. & STAT. 401, 403 (1996); John P. Gould, *The Economics of Legal Conflicts*, 2 J. LEGAL STUD. 279, 292-93 (1973).

larger settlement, and discovery (being imperfect) may not require disclosure.¹⁰ Defendants too may have private information, which may affect the defendants' willingness to pay to settle.

The presence and effect of asymmetric information may vary among different defendants, and it may vary over time. Differing settlement amounts may thus reflect differing degrees of asymmetric information among settling defendants and over time. For instance, plaintiffs who do not know defendants' risk tolerances may demand higher amounts to settle first with the more risk averse.¹¹

Reputation. A party's concern about its reputation may also affect settlement. A party concerned about the impact of an unfavorable trial outcome on its reputation is more willing to settle. Conversely, a party concerned that settlement sends a bad signal is less inclined to settle.¹² Differing settlement amounts may thus reflect differing concerns about reputational effects rather than a divergence from the expected trial outcome.

These party-specific differences can result in a prior settlement benchmark that gives little insight into the expected trial outcome and either prevents efficient settlements or fails to protect absent class members.

¹⁰ See Steven Shavell, *Sharing of Information Prior to Settlement or Litigation*, 20 RAND J. ECON. 183, 189, 194 (1989).

¹¹ See Amy Farmer & Paul Pecorino, *Pretrial Negotiations with Asymmetric Information on Risk Preferences*, 14 INT'L REV. L. & ECON. 273, 279-80 (1994).

¹² See Perloff, Rubinfeld & Ruud, *supra*, note 9, at 403.

III. ADOPTION OF THE DISTRICT COURT'S METHODOLOGY WOULD UNDERMINE THE POLICY FAVORING SETTLEMENT

Given all of these issues, it is clear that the methodology used by the district court in this case, if widely adopted, could undermine the policy favoring settlement. The existence of a range of efficient settlements, the failure to account for the impact of litigation costs, and party-specific factors could result in a benchmark that either prevents efficient settlements or fails to protect the interests of absent class members.

More importantly, the adoption of the district court's methodology would affect the incentives of the parties to settle. Plaintiffs may have an incentive to accept lower settlements from early-settling defendants for fear that a higher amount could foreclose later settlements. Alternatively, plaintiffs may insist on even higher settlements from early-settling defendants, assuming that later settlements could fail to gain the court's approval. Non-settling defendants could have a greater incentive to go to trial as a prior settlement—even if inflated—diminishes the range of possible settlements. These effects undermine the policy favoring class-action settlements and the goals of judicial review.

CONCLUSION

For the foregoing reasons, the Court should grant the petition and instruct the district court to take into account the factors discussed above.

Dated: October 24, 2014

Respectfully submitted,

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APPENDIX

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James C. Cooper is the Director, Research and Policy, Law & Economics Center and a Lecturer in Law at George Mason University School of Law. Dr. Cooper previously served in various positions at the Federal Trade Commission, including as Acting Director and Deputy Director, Office of Policy Planning.

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on October 24, 2014.

I further certify that those participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

I further certify that on the date hereof I caused a copy of **BRIEF of ECONOMIC SCHOLARS AS AMICI CURIAE IN SUPPORT OF PETITIONERS** to be served on the following by placing a true copy thereof enclosed in sealed envelopes addressed as follows for collection and mailing at Morrison & Foerster LLP, 700 Wilshire Boulevard, Suite 6000, Los Angeles, California 90017-3543, in accordance with Morrison & Foerster's ordinary business practices:

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Attention: Hon. Lucy H. Koh

Dated: October 24, 2014

s/ Sean P. Gates
