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Implications of Statute of Limitations Rulings in Mortgage-Backed Securities Cases

The financial crisis of 2007 and 2008 led to catastrophic losses for investors in residential mortgage-backed securities ("RMBS"). In the wake of the crisis, numerous suits were filed by investors and insurers against Wall Street banks. Plaintiffs allege that the banks issued loans to homeowners, packaged loans into securities, and sold them to investors—or induced plaintiffs to insure the securities—pursuant to offering materials that misrepresented the loans' characteristics. The volume of these cases, all filed over the past few years, involving a similar set of background facts and a relatively new and complex type of security, created a series of decisions that have moved and clarified the law of statute of limitations. The holdings are not just relevant to the flood of RMBS cases currently facing the courts, but for all parties interested in bringing, or defending, securities and fraud-related claims.

Is "Inquiry Notice" Even the Standard Anymore?

A recent line of cases has suggested that the traditional "inquiry notice" standard for claims brought under the Securities Act of 1933 no longer applies. Rather, courts have adopted the more plaintiff-friendly standard of whether an investor could have actually amassed sufficient facts to survive a motion to dismiss.

The shift began with the Supreme Court's decision in *Merck & Co. v. Reynolds*, 130 S. Ct. 1784 (2010). In *Merck*, the Supreme Court established a new test for measuring the statute of limitations for claims under the Securities Exchange Act of 1934. The 1934 Act's two-year limitations period was traditionally measured by the "inquiry notice" standard, but *Merck* rejected it, holding that the limitations period does not begin to run until "a reasonably diligent plaintiff would have discovered 'the facts constituting the violation,' including scienter—irrespective of whether the actual

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Quinn Emanuel Opens Second German Office in Hamburg Led by Intellectual Property and Antitrust Litigator Dr. Nadine Herrmann

The firm has opened its second German office in Hamburg. The 11-lawyer office will focus on intellectual property and antitrust litigation. Dr. Nadine Herrmann, the former Head of Allen & Overy's German Intellectual Property Group, is Managing Partner of the Hamburg office. Dr. Herrmann, who received her Ph.D. in law *summa cum laude* from Marburg University, also has a LL.M. from The University of Sydney, Australia. She is qualified as an English solicitor and has significant experience practicing in the United Kingdom and in the U.S. An author of a text book on EU antitrust law, she is an internationally recognized expert in IP and technology law by publications such as *Chambers* and *IAM 250—The World's Leading Patent & Technology Licensing Lawyers.* The leading German business daily *Handelsblatt* referenced Dr. Herrmann's career as one of the top 25 in German business. With the addition of the 11 lawyers in the firm's Hamburg office, the firm now has over 20 lawyers in Germany. All focus on IP and Antitrust. Q

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plaintiff undertook a reasonably diligent investigation." *Id.* at 1798. "Inquiry notice" does not trigger the statute of limitations, the Court held, because even a diligent investigation may not feasibly lead to "facts constituting the violation." *Id.* at 1788. The Supreme Court thus confirmed that the proper focus is not on *when the investigation should have begun*, but rather must be on *when a reasonable investigation would have borne sufficient fruit.*

In *City of Pontiac General Employees' Retirement System v. MBIA Inc.*, 637 F.3d 169, 175 (2d Cir. 2011), the Second Circuit addressed the question of what is 'sufficient' fruit. The Second Circuit concluded that, under *Merck*, the 1934 Act's statute of limitations does not begin to run until a plaintiff could plead sufficient facts to survive a motion to dismiss: A "fact is not deemed 'discovered' until a reasonably diligent plaintiff would have sufficient information about that fact to adequately plead it in a complaint." As the Second Circuit explained: "Since the purpose is to prevent stale claims, it would make no sense for a statute of limitations to begin to run before the plaintiff even has a claim . . . . [I]n the limitations context, it makes sense to link the standard for 'discovering' the facts of a violation to the plaintiff's ability to make out or plead that violation." Lower courts have since applied the *Merck* and *City of Pontiac* standard to 1934 Act cases. *See, e.g., S.E.C. v. Wyly,* 788 F. Supp. 2d 92 (S.D.N.Y. 2011); *Space Coast Credit Union v. Barclays Capital, Inc.*, No. 11-cv-2802 (S.D.N.Y. Mar. 20, 2012).

The question nonetheless remained: Was the abrogation of the "inquiry notice" standard driven by some peculiarity of the 1934 Act's text? The numerous RMBS cases that were brought in the wake of the financial crisis provided the opportunity for many courts to address that question. RMBS defendants have argued that investors were on "inquiry notice" of their claims in 2007 and 2008, due to general news reporting about a shifting economy, loosened underwriting guidelines in the industry, and similar materials. One way plaintiffs have pushed back is to argue that defendants' motions are focused on the entirely wrong standard—and many courts have agreed. For instance, the court in *In re Bear Stearns Mortgage Pass-Through Certificates Litigation* sided with "the majority of judges in this district" in holding that there was "no principled basis for cabining *Merck*'s holding" to 1934 Act's claims. No. 08-cv-8093, 2012 WL 1076216, at *12 (S.D.N.Y. Mar. 30, 2012). As such, "Defendants' focus on inquiry notice is misplaced. The operative question is no longer when a reasonable plaintiff would have known that she had a likely cause of action and inquired further. Rather, the question is whether a plaintiff could have pled '33 Act claims with sufficient particularity to survive a 12(b)(6) motion . . . ." *Id.* at 13. Most recently, the Southern District sided with the Federal Housing Finance Agency in applying *Merck* to FHFA's 1933 Act claims. *Federal Housing Fin. Agency v. UBS Am., Inc.*, 11-cv-5201 (S.D.N.Y. May 4, 2012), Order at 22-24. *See also In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 371 n. 39 (S.D.N.Y. 2011) (applying *Merck* to 1933 Act claims); *In re Direxion Shares ETF Trust*, No. 09-cv-8011, 2012 WL 717967, at *2 fn. 3 (S.D.N.Y. Mar. 6, 2012) (same); *Plumbers' & Pipefitters' Local No. 562 Supp'l Plan & Trust v. J.P. Morgan Acceptance Corp. I*, No. 08-cv-1713, 2012 WL 601448, at *10 (E.D.N.Y. Feb. 23, 2012) (same).

While the concept of "inquiry notice" now appears all but dead in federal securities claims, courts have reached mixed results in extending *Merck* to state law claims. A federal court in Ohio recently applied *Merck* to Ohio's blue sky law, drawing a comparison between the statutory language of the 1934 Act and the Ohio law, which requires knowledge of "facts" related to defendants' wrongdoing. *In re Nat'l Century Fin. Enter., Inc.*, 755 F.Supp.2d 857, 869-72 (S.D. Ohio 2010). But a Texas appellate court declined to apply *Merck* to the Texas Securities Act, "[i]n light of the differences in the language of the statutes' limitations provisions," particularly because intent is not at issue in the Texas statute. *Allen v. Devon Energy Holdings, L.L.C.* No. 01–09–00643–CV, 2012 WL 880623, *26 fn. 62 (Tex. App. Mar. 9, 2012). An Indiana appellate court likewise declined to apply *Merck* to the Indiana Uniform Securities Act, finding that *Merck* is not controlling and distinguishable on its facts, because plaintiffs were on notice of defendant's wrongdoing "all along." *Paddock v. Maikranz*, No. 82A05–1010–CT–6362011 WL 3849439, *4 fn. 6 (Ind. App. Aug. 31, 2011).

How Specific Must Information Be to Start the Clock?

Other courts dealing with RMBS cases have not felt the need to reach the *Merck* question. In so doing, they have established another clear statute-of-limitations trend: that, at the pleading stage at least, general information *about the industry in question* is insufficient to show the statute of limitations began with respect to *the plaintiff's particular securities.*

Defendants in RMBS cases typically cite newspaper articles, filed complaints, and other public sources in arguing that plaintiffs were on notice of their claims outside of the limitations period. Plaintiffs push back, arguing that none of that information relates to *their specific securities*, and much of it does not even have to do with *the specific defendants at issue*. Courts have almost uniformly sided with plaintiffs, rejecting the sufficiency of materials untethered to the specific securities at issue. *See, e.g., Mass. Mut. Life Ins. Co. v. Residential Funding Co., LLC*, No. 11-cv-30035, 2012 WL 479106, *10-*11 (D. Mass. Feb. 14, 2012) (public information "did not directly relate to the misrepresentations and omissions alleged"); *N.J. Carpenters Vacation Fund v. Royal Bank of Scotland Grp.*, 720 F. Supp. 2d 254, 267 (S.D.N.Y. 2010) ("Although defendants point to a number of publicly-available documents generally related to the weakening and outright disregard for underwriting guidelines by subprime originators, this information alone does not 'relate directly' to the [offerings] specifically at issue."); *In re Wells Fargo Mortgage-Backed Cert. Litig.*, 712 F. Supp. 2d 958, 967 (N.D. Cal. 2010) (whether press coverage was sufficient to put a reasonable investor on notice of its claims was a factual question not appropriate for resolution on a motion to dismiss).

For example, in *Plumbers' & Pipefitters v. J.P. Morgan*, the court concluded:

> [N]one of the newspaper articles proffered by defendants "refer to the offerings, the Certificates, or tie the originators to securities offered by the defendants. Of the stories that do refer to an originator, most describe the high rate of default experienced by subprime mortgages . . . . This information would put a potential plaintiff on notice merely that their mortgage-backed securities were likely to decline in value. But, default on subprime loans could be caused by any number of broad economic factors . . . . Even if this were enough to cause a reasonable investor to investigate, it would not establish that their offering documents contained material misstatements and omissions.

2012 WL 601448, at *11.

Courts that have dismissed RMBS claims as being untimely have done so where there were *security-specific*—or, at least, highly *defendant-specific*—facts publicly available. For instance, in *In re Morgan Stanley Mortgage Pass-Through Certification Litigation*, the securities had been downgraded twenty times prior to the relevant cutoff of May 2008. 2010 WL 3239430, at *8 (S.D.N.Y. 2010). And in *Boilermakers National Annuity Trust Fund v. WaMu Mortgage Pass-Through Certificates, Series AR1*, the trigger for finding that the period there had begun by August 2008 was a class-action complaint, filed against common defendants, that focused "almost exclusively" on the exact same offering materials being sued on in the later action. 748 F. Supp. 2d 1246, 1258 (W.D. Wash. 2010). Similarly, the court's analysis in *Stichting Pensioenfonds ABP v. Countrywide Financial Corporation* turned heavily on facts made public by multiple, defendant-specific, overlapping cases that had been filed before the 2008 limitations cutoff. 802 F. Supp. 2d 1125, 1136-37 (C.D. Cal. 2011). Indeed, while the court in *Stichting* found claims were time-barred as of February 2008, the same court denied a motion to dismiss other claims where the cutoff period was December 2007, noting that "the period between December 27, 2007 and February 14, 2008 was an important time in the Countrywide saga." *Allstate Ins. Co. v. Countrywide Financial Corp.*, No. 11-cv-05236, 2011 WL 5067128 (C.D. Cal. Nov. 21, 2011), at *14.

The RMBS cases dismissing claims as being untimely are thus the exceptions that prove the rule, that securities claims are only untimely if investors knew of the facts as to their specific investments.

How to Apply American Pipe

Another way that RMBS cases have shined a light on important statute of limitations questions—even if, here, it has not yet brought clarity to the issue—is in their repeated assessment of how to apply *American Pipe.*

In recent years, institutional investors have argued that the one-year statute of limitations and three-year statute of repose under the Securities Act of 1933 can be tolled by prior class actions that name overlapping securities. Tolling has the potential to extend the limitations periods for such claims by several years. Plaintiffs rely on the tolling rule announced in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 554 (1974), that "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action." If potential class members' claims were not tolled, the Supreme Court held, they would be induced to file placeholder complaints and motions, which would undermine the "efficiency and economy" of class actions. *Id.* at 553.

One question that courts have grappled with is whether *American Pipe* can toll statutes of repose. In *Footbridge Limited Trust v. Countrywide Financial Corp.*, 770 F. Supp. 2d 618, 624-27 (S.D.N.Y. 2011), Judge Castel of the Southern District of New York concluded that the three-year statute of repose is "absolute" and not subject to tolling, although he noted extensive case law to the contrary and conceded that "many of the policy considerations present in *American Pipe* would support tolling of a statute of repose." Judge Kaplan of the Southern District followed the *Footbridge*

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Bankruptcy & Restructuring Update

***In re Lancelot Investors Fund, L.P.*:** A bankruptcy judge in Illinois recently determined that the Bankruptcy Code's "safe harbor" provisions (11 U.S.C. § 546(e), (g)) apply to payments made to innocent investors who unwittingly put money into a "Ponzi" scheme. In *In re Lancelot Investors Fund, L.P.*, No. 08-B-28225, slip op. (Bankr. N.D. Ill. Mar. 1, 2012), the debtor was a hedge fund that purportedly used investors' money to invest in the sale of electronics. In fact, as with typical Ponzi schemes, early investors were merely being repaid with the money received from later investors. In *Lancelot*, the question was whether 'early' investors who had been 'repaid' pre-petition had to return those funds to the trustee for the benefit of the overall estate (i.e., the other Ponzi victims). The Bankruptcy Court held the 'early' investors could keep the funds received from their exercise of redemption rights, as long as such transfers otherwise met the facial requirements of the safe harbor provisions. The Court held that the safe harbor provisions applied because the plain meaning of the safe harbor provisions protected transfers that were themselves legitimate, even if they were the end result of a larger fraudulent scheme.

***Statek Corporation v. Development Specialists, Inc., Plan Administrator for Coudert Brothers LLP*:** The Second Circuit recently shed light on how bankruptcy courts should apply choice-of-law rules to state law claims. In *Statek Corporation v. Development Specialists, Inc., Plan Administrator for Coudert Brothers LLP (In re Coudert Brothers LLP)*, No. 10-2723-bk (2d Cir. February 28, 2012), a former client of Coudert Brothers filed a pre-bankruptcy malpractice suit in Connecticut state court. The action was stayed when Coudert Brothers filed for bankruptcy in New York. The malpractice plaintiff then perfected its claim in bankruptcy, but the plan administrator moved to disallow it. The bankruptcy court disallowed the claim, finding that New York law applied and that the claim was time-barred under the New York statute of limitations. The district court affirmed, but the Second Circuit reversed, holding that a bankruptcy court should look to the choice of law rules of the state where the underlying prepetition complaint was filed, not the choice-of-law rules of the state in which the bankruptcy court sits.

London Litigation Update

***The Enforceability of "Best Endeavours" Clauses*:** Clauses requiring parties to use 'best' or 'reasonable' endeavours are common place in commercial contracts. They make sense to parties at the time of contracting, where typically there is goodwill and a belief that the parties will operate under such clauses in the spirit of good faith. Frequently, however, that goodwill does not last and a dispute emerges. In this context, courts have had to wrestle with the meaning of these somewhat uncertain obligations.

In *Jet2.com v. Blackpool Airport Limited* [2012] EWCA Civ 417, the Court of Appeal considered a contract between Jet2.com ("Jet2"), a low cost airline that operates between various United Kingdom and European destinations, and Blackpool Airport Limited ("BAL"), which owns and operates a commercial airport on the outskirts of Blackpool, England. In 2005, Jet2 and BAL executed a letter agreement setting out the terms on which Jet2 would operate from Blackpool Airport over the course of the following 15 years. Clause 1 of the letter agreement provided that "*Jet2 and BAL will cooperate together and use their best endeavours to promote Jet2's low cost services from Blackpool Airport and BAL will use all reasonable endeavours to provide a cost base that will facilitate Jet2's low cost pricing*."

The dispute concerned Blackpool Airport's operating hours. Although the airport's normal operating hours were 7:00 am to 9:00 pm, Jet2 regularly operated flights outside of those hours for the first four years of the contract. However, in October 2010, in order to reduce its costs, BAL notified Jet2 that Blackpool Airport would not accept departures or arrivals scheduled outside normal operating hours. In response, Jet2 brought proceedings against BAL on the grounds that clause 1 of the letter agreement obliged BAL to accept aircraft movements outside of normal hours. The High Court ruled in Jet2's favour, and BAL appealed.

All three judges on the Court of Appeals agreed that being able to ascertain the object of a best endeavours clause is critical in deciding whether the contractual commitment is sufficiently definite to be legally enforceable. The majority ruled that, in the circumstances, BAL's actions amounted to a breach of contract, because the wording "best endeavours to promote Jet2's low-cost services" was sufficiently certain so as to include keeping the airport open to accommodate flights outside normal hours ([31 and 71]). However, given the uncertainty about future events, the majority was not prepared to issue a broad declaration that BAL could never refuse aircraft movements ([33]).

Relevant to Their Lordships' decisions were the following propositions: (a) *An obligation to use best endeavours is not unenforceable merely because it requires a party to act contrary to its commercial interests*. Rather, the extent to which parties can have regard to their own financial interests will very much depend on the nature and terms of the contract in question, which in BAL's case included incurring costs to facilitate Jet2's use of the airport ([32]). (b) *The claimant had produced considerable evidence as to the object of the clause, namely promoting low-cost airline services,* which included that low-cost airlines relied on obtaining maximum use of their aircraft by operating schedules under which plane movements occur early in the morning and late at night ([17]). (c) *There was criteria by which it was possible to assess whether best endeavours could be, and had been, used*, specifically, that BAL had allowed Jet2 to use the airport outside of normal hours since the beginning of the contract, and had changed that stance suddenly and without a justifiable explanation ([72]).

For completeness, Lewison LJ dissented because His Lordship considered that, on the facts of the case, there was insufficient clarity as to the object of clause 1 and because such clarity as there was in the case could only be gained by ignoring the usual rules of contract interpretation as to the relevance of background facts and the admissibility of parties' subsequent conduct ([57 – 62]).

***UK Supreme Court Rules on Lehman Client Money Case*:** In *In the matter of Lehman Brothers International (Europe) (In Administration) and In the matter of the Insolvency Act 1986* [2012] UKSC 6, the Supreme Court considered another case in the long running fallout from the collapse of Lehman Brothers. The case concerned "client money" received and held by Lehman Brothers International (Europe) ("LBIE") on behalf of its clients in relation to particular investments, which was then pooled together with other funds in mixed accounts.

The Supreme Court held unanimously that the relevant rules in chapter 7 of the Clients' Assets Sourcebook ("CASS") issued by the Financial Services Authority ("FSA") under the Financial Services and Markets Act 2000, create statutory trusts for clients' money held by firms. Those statutory trusts arise at the time financial institutions receive client money, rather than when client money is segregated from the other monies that firms might hold ([62-63 and 182-183].

A majority of the Supreme Court (Lords Clarke, Dyson and Collins) also ruled that: (1) The rate at which each client participates in a notional client money pool is determined by the amount of client money that should have been segregated at the date of a pooling event ([159]): it is not necessary for client money to have already been segregated prior to a pooling event in order for it to be considered part of a notional client pool ([160]). (2) The primary pooling arrangements prescribed in the CASS apply to in house accounts, such that, if a firm becomes insolvent, client money in those accounts should be distributed in accordance with the FSA rules ([167]). Again, it is not necessary for client money to be held in segregated accounts in order for the distribution rules to apply ([166]).

An important consideration for the Lords in the majority was that the client money rules are intended to protect all the clients' money received prior to a pooling event, and the distribution rules are intended to protect all clients' money following a pooling event. Accordingly, where there is a choice of interpretations for those FSA rules, the courts should adopt the one that affords a high degree of protection for all clients ([147]). Ruling that clients' monies must be segregated before clients can participate in a notional client money pools would be contrary to that policy, as would excluding identifiable client money in house accounts from the regime.

***Disclosure of Spouses' Emails*:** In *McKillen v Misland (Cyprus) Investments Ltd & Otrs* [2012] EWHC 866 (Ch), the High Court dealt with the novel question of whether a party can be compelled to disclose emails sent or received by that party's spouse at his or her request.

The claimant in the case applied for order that the wife of one of the defendants disclose emails that she had sent or received for the defendant, who did not use email himself. The claimant argued that the emails were within the defendant's control because: (a) the email accounts were jointly held by the defendant and his wife; and (b) in sending and receiving the emails, the defendant's wife was acting as an agent for the defendant, such that he could now request that she provide him with copies of them for the purposes of disclosure.

The High Court rejected the first ground on the facts ([9]). As to the second ground, David Richards J was not convinced that, when a person sends or receives emails for his or her spouse, it gives rise to an agency relationship with a continuing obligation to provide copies, at a later date, of the emails sent or received from that account ([18]). His Lordship considered that requests to send emails are fairly commonplace between husbands, wives, partners, friends and work colleagues, and that, in the absence of any express agreement, those people would be surprised if they were under a continuing obligation ([19]). Given that the defendant's wife had only sent approximately 40 emails at the request of her husband over an 18 month period, an agency relationship should not be implied ([20]).

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Accordingly, the application for further disclosure was dismissed. The Judge left open the possibility that a spouse could be an agent in these circumstances, but indicated that the facts would need to disclose a clear course of dealing to this effect ([20]).

***Libellous Tweets on Twitter*:** In *Cairns v Modi* [2012] EWHC 756 (QB), the High Court considered a libel action by Chris Cairns, a former captain of the New Zealand cricket team, against Lalit Modi, the former Chairman and Commissioner of the Indian Premier Cricket League. It was the first case before English Courts that concerned alleged libellous "Tweets."

On 5 January 2010, Modi "Tweeted" that Cairns had been removed from the Indian Premier League auction list (from which teams purchase players) because of his (alleged) past record of match fixing. On the same day, Modi suggested to an online cricket magazine, *Cricinfo*, that there were strong grounds to suspect that Cairns was guilty of (alleged) match fixing. *Cricinfo* published briefly an article on its website in which Modi's suggestion was repeated.

Cairns brought proceedings, and the High Court ruled in his favour, noting that Modi "singularly failed to provide any reliable evidence that Cairns was involved in match fixing, or even that there were strong grounds for suspicion that he was" ([118]).

Two rulings in the case will be relevant to future libel claims involving social media:
(1) *Although Modi did not publish the "Tweet" from England, Bean J ruled that the case was properly before the English courts.* Bean J's reasoning was that Cairns had previously lived in England; by the time of the proceeding, Modi was living in England; and a trial in India would have involved very long delays ([3]). (2) *Damages should not be reduced to trivial amounts simply because publication was limited.* The Court found that only about 65 followers of Modi's Twitter account would have viewed the "Tweet," and only about 1000 people would have viewed *Cricinfo*'s online article. However, Bean J referred to longstanding authority to the effect that the "real" damage of libellous statements cannot be ascertained because it is impossible to track the scandal and to know what quarters the "poison" may reach. Bean J was of the view that "this remains true in the 21st century, except that nowadays the poison tends to spread far more rapidly" ([123]).

Copyright Litigation Update

***Supreme Court Confirms U.S. Copyright Protection for Foreign Works Previously in Public Domain*:** On January 18, 2012, a 6-2 majority of the U.S. Supreme Court affirmed the constitutionality of the Uruguay Round Agreements Act (URAA), granting copyright protection to certain foreign works that had previously been in the public domain in the U.S. In so doing, the Supreme Court affirmed the Tenth Circuit's decision in *Golan v. Holder*, 609 F.3d 1076 (10th Cir. 2010).

In this case, a group of orchestra conductors, musicians, publishers and others brought an action challenging the URAA on the grounds that Article I, § 8, Cl. 8 of the Constitution (the "Copyright Clause"), together with the First Amendment, restricted the ability of Congress to grant copyright protection to works that had previously been in the public domain. Codified at 17 U.S.C. § 104A and 109(a), the URAA extends copyright protection to works that obtained copyright protection in their countries of origin, but had no such protection in the United States for one of three reasons: (i) an absence of copyright relations between the country of origin and the United States at the time of publication; (ii) the lack of protection for sound recordings fixed before 1972; and (iii) a failure to comply with statutory formalities peculiar to the Copyright Act in the U.S. The petitioners contended that the URAA violated the "limited Times" language of the Copyright Clause because it extended protection to existing public domain works rather than incentivizing the creation of new works, an argument rejected by the Court.

Writing for the majority, Justice Ginsburg noted that the Court's decision in *Eldred v. Ashcroft*, 537 U.S. 186 (2003)—a decision that had confirmed the ability of Congress to extend the term of copyright for preexisting works—foreclosed the petitioners' "limited Times" challenge: "The Copyright Clause does not demand that each copyright provision, examined discretely, operate to induce new works … the Clause 'empowers Congress to determine the intellectual property regimes that, overall, in that body's judgment, will serve the ends of the Clause.'" *Golan v. Holder*, 132 S.Ct. 873, 888 (2012). The majority found the petitioners' First Amendment argument similarly unavailing: "[s]ome restriction on expression is the inherent and intended effect of every grant of copyright," and "[n]othing in the historical record, congressional practice, or our own jurisprudence warrants exceptional First Amendment solicitude for copyrighted works that were once in the public domain." *Id.* at 889-90. Justice Breyer, joined by Justice Alito, dissented from the majority's opinion, stating that the URAA's effect of removing material from the public domain meant that "the Copyright Clause, interpreted in the light of the First Amendment, does not authorize Congress to enact this statute." *Id.* at 912.

The dissent notwithstanding, the majority opinion confirms the broad scope of Congressional power to define the boundaries of copyright protection.

***Ninth Circuit Affirms Strength of DMCA Safe Harbor Provisions*:** On December 20, 2011, the Ninth Circuit affirmed a district court grant of summary judgment to an operator of a publicly accessible website enabling users to share digital videos with other users. The Court's opinion in *UMG Recordings, Inc. v. Shelter Capital Partners LLC*, 667 F.3d 1022 (9th Cir. 2011) confirms the strength of the safe harbor provisions of the Digital Millennium Copyright Act ("DMCA"), codified at 17 U.S.C. § 512(c), for internet service providers faced with allegations of copyright infringement by publishers and artists.

In this case, despite efforts by the website operator to prevent copyright infringement on its system, some of its users were able to download unauthorized videos containing music for which the plaintiff owned the copyright. In September of 2007, the plaintiff publisher brought suit against both the website owner and three of its investors, alleging direct, vicarious and contributory copyright infringement, as well as inducement of copyright infringement. The district court granted summary judgment in favor of the defendants on the basis of the DMCA's safe harbor provision. The safe harbor protects service providers who (i) control systems or networks on which copyrighted material is posted without their actual knowledge; (ii) do not receive a financial benefit directly attributable to the infringing activity; and (iii) take down such material upon notice from the copyright owner.

The Ninth Circuit affirmed, noting first that facilitating access to content, if done at the direction of a user, falls within the ambit of the "storage" language of the safe harbor: "We hold that the language and structure of the statute, as well as the legislative intent that motivated its enactment, clarify that [the safe harbor] encompasses the access-facilitating processes that automatically occur when a user uploads a video []." *UMG Recordings*, 667 F.3d at 1031. The Court noted that the defendants' system, allowing user-submitted content to be processed and recast in a readily accessible format, satisfied the safe harbor requirement that the content submission be "user-directed." *Id.* at 1035. The Court also noted that general knowledge that one's services *could* be used to share infringing material is insufficient to meet the "actual knowledge" standard of the DMCA safe harbor: According to the Court: "[m]erely hosing a category of copyrightable content, such as music videos, with the general knowledge that one's services could be used to share infringing material, is insufficient to meet the actual knowledge requirement under [the DMCA safe harbor]." *Id.* at 1038, 1042. As to the investor defendants, the Court held they were not liable for secondary copyright infringement because there was no allegation that they "agreed to work in concert" to induce the alleged infringement in question—the mere funding of the plaintiffs' enterprise is not enough to support secondary liability. *Id.* at 1047.

By affirming the district court grant of summary judgment on the copyright infringement claims, the Ninth Circuit re-affirmed the broad scope of the safe harbor protections of the DMCA for digital service providers and their investors.

***Second Circuit Adopts Ninth Circuit Reasoning Regarding "Actual Knowledge" For DMCA Safe Harbor Provisions*:** In a related development, on April 5, 2012, the Second Circuit issued its opinion in *Viacom Intern., Inc. v. YouTube, Inc.*, Nos. 10-3270-cv and 10-3342-cv, 2012 WL 1150851 (2d Cir. Apr. 5, 2012). In that case, the Court was presented with a question similar to the one tackled by the Ninth Circuit in *UMG Recordings v. Shelter Capital Partners LLC*, 667 F.3d 1022 (9th Cir. 2011)—namely, what level of specificity is required of a service provider's knowledge of infringement before its conduct falls outside the safe harbor provisions of the DMCA. Rejecting the plaintiff's contention that objective knowledge of "facts and circumstances" is enough to meet the "actual knowledge" standard of 17 U.S.C. § 512(c), the Court adopted the reasoning of the Ninth Circuit in holding that the statute requires "[a]ctual knowledge or awareness of facts or circumstances that indicate specific and identifiable instances of infringement [to] disqualify a service provider from the safe harbor." *Viacom Intern., Inc.* at *7. According to the Second Circuit, subjective knowledge of facts and circumstances of the specific infringement is required by the actual knowledge standard. *Id.* at *6. In adopting the reasoning of the Ninth Circuit on this point and confirming the necessity of subjective knowledge in order to remove a service provider from the benefits of the DMCA safe harbor provisions, the Second Circuit has further confirmed the strength of these provisions for digital service providers.

***Ninth Circuit Reverses Summary Judgment For Major Apparel Retailer; Holds That Erroneous Inclusion of Published Works in Unpublished Collection Does Not Invalidate Copyright Registration*:** On April 9, 2012, the Ninth Circuit Court of Appeals handed down its ruling in the copyright case of *L.A. Printex,*

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Industries, Inc. v. Aeropostale, Inc., No. 10-56187, 2012 WL 1150273 (9th Cir. Apr. 9, 2012). The plaintiffs (copyright owners of a small floral design) alleged that a major apparel retailer and manufacturer infringed their copyright by using the design on shirts bearing the apparel retailer's trademark. The district court granted the apparel retailer's motion for summary judgment, but the Ninth Circuit reversed. On the question of access, the Ninth Circuit held that the plaintiffs had raised a genuine issue of material fact by presenting evidence that they had sold more than 50,000 yards of fabric bearing the copyrighted design to fabric converters, many in the Los Angeles area—the same location of the defendant who had provided the design to the major apparel retailer. This was enough to avoid summary judgment on the question of access: "A reasonable jury could find that [the copyrighted design] was widely disseminated in the Los Angeles-area fabric industry, and hence that there was a 'reasonable possibility' that Defendants had an opportunity to view and copy L.A. Printex's design."

The Ninth Circuit also took issue with the district court's view that the differences between the copyrighted work and the apparel retailer's shirts were enough to grant summary judgment for the defendant. According to the Court: "[a] copyright defendant need not copy a plaintiff's work in its entirety to infringe that work. It is enough that the defendant appropriated a substantial portion of the plaintiff's work." *L.A. Printex* at *7. The Court also rejected defendants' contention that an error in the plaintiffs' copyright registration precluded the suit. Although 17 U.S.C. § 411(b)(1) provides that the knowing inclusion of inaccurate information in a copyright registration can render the certificate incapable of supporting an infringement action, the Ninth Circuit disagreed that the inaccuracy in this case met this standard of invalidity. The Court noted, "[t]here is no evidence that L.A. Printex knew that the two designs had been published at the time it submitted its application for copyright registration," and that the Copyright Office's issuance of a certificate of supplementary registration when the plaintiffs noticed the error and corrected the registration "shows that the error was not one that 'if known, would have caused the Register of Copyrights to refuse registration.'" *L.A. Printex* at *9.

This decision emphasizes both the difficulty that copyright defendants face in winning on summary judgment and the reluctance of federal courts to invalidate copyright registrations. Q

Former Novartis GC Dr. Thomas Werlen Joins Quinn Emanuel Europe

Former Novartis Group General Counsel and Executive Committee member Thomas Werlen joined Quinn Emanuel in February as a partner. Thomas divides his time between London and Zurich. A truly international lawyer with a thorough background in both common and civil law, Thomas has practiced in the US, UK, Germany and Switzerland. In addition to English, he is fluent in German, French, Italian and Spanish. He will become part of our worldwide life sciences, white collar and international arbitration groups, among others.

Thomas has broad experience across multiple disciplines from products liability to intellectual property to white collar and government investigations to commercial litigation and arbitration. He has particular expertise in the life sciences and pharmaceutical industries. Prior to joining Novartis, Thomas was a partner at Allen & Overy (in London) and before that he worked at Cravath, Swaine & Moore (in New York and London). While at Allen & Overy and Cravath, he represented clients in all types of international banking and capital markets transactions, including complex financial transactions such as derivatives, CDOs and other structured-finance products. He was also involved in regulatory matters before the SEC, the CFTC, and other capital markets regulators. Thomas has also advised governments all over the world regarding the implementation of new bankruptcy legislation. Thomas has been repeatedly recognized by journals like the *IFLR* as one of the top capital markets lawyers globally, and he is a member of the panel of experts of P.R.I.M.E. Finance.

Thomas is a *summa cum laude* law graduate from the University of Zurich (Ph.D.) and holds a Master of Laws degree (LL.M.) from Harvard Law School. He is a member of the New York and the Swiss bars. He is a seasoned lecturer on finance, banking and securities law, and corporate law and corporate governance. He has published a number of books and articles in the areas of derivatives, capital markets and corporate governance. Q

(Lead Article continued from page 3)

decision in *In re Lehman Bros. Sec. & ERISA Litig.*, 800 F.Supp.2d 477, 481-83 (S.D.N.Y. 2011), but likewise acknowledged that "most courts that have addressed this issue have concluded that *American Pipe* does apply to toll statutes of repose" and that his holding "is in tension with the policies animating the *American Pipe* decision." *Id.* at 482-83. Other courts have since rejected the reasoning of *Footbridge* and *In re Lehman*, finding that the statute of repose can be tolled under *American Pipe*. *See, e.g., Maine State Ret. Sys. v. Countrywide Fin. Corp., 722 F.Supp.2d 1157, 1166 (C.D. Cal. 2010); In re Bear Stearns*, 2012 WL 1076216, at *16; *Plumbers' & Pipefitters' Local No. 562 Supplemental Plan & Trust v. J.P. Morgan Acceptance Corp. I*, No. 08-cv-1713, 2011 WL 6182090, at *4-*5 (E.D.N.Y. Dec. 13, 2011); *Int'l Fund Mgmt. S.A. v. Citigroup Inc.*, No. 09-cv-8755, 2011 WL 4529640, at *5-*8 (S.D.N.Y. Sept. 30, 2011).

Another question that has repeatedly come up is whether class members can rely on *American Pipe* even if the named plaintiffs are later found to have lacked standing to bring the claims. The Third and Eleventh Circuits addressed the issue in the non-RMBS context, both finding that the principles of *American Pipe*—that the initial suit put defendants on notice of their claims, and creating ambiguity will result in an unnecessary flood of protective suits—require the doctrine's application even if the named plaintiff is later found to lack standing. *See Haas v. Pittsburgh National Bank*, 526 F.2d 1083, 1086 (3d Cir. 1975); *Griffin v. Singletary*, 17 F.3d 356, 356 (11th Cir. 1994). Many RMBS courts have followed such rulings, applying *American Pipe* even if the relied-on class action was later narrowed due to a lack of standing. *See, e.g., In re Morgan Stanley Mortg. Pass-Through Certificates Litig.*, 810 F. Supp. 2d 650, 669-70 (S.D.N.Y. Sept. 15, 2011) ("In cases where the law on standing was anything less than crystal clear, potential class members would be taking a tremendous risk by delaying intervention."); *Genesee County Emp.' Ret. Sys. v. Thornburg Mortg. Secs. Trust 2006-3*, 2011 WL 5840482, *61-*64 (D. N.M. Nov. 12, 2011) ("putative class members should not have to predict how the Court would decide the standing issues" but instead should be able to rely on filed class actions). Other courts have reached the opposite conclusion, fearing that recognizing such a rule would invite abuse by the class-action bar. *See Stichting Pensioenfonds ABP v. Countrywide Fin. Corp.*, 802 F. Supp. 2d 1125, 1131 (C.D. Cal. 2011), *appeal docketed*, No. 11-56642 (9th Cir. Sept. 22, 2011).

The Statute of Limitations in Repurchase Claims

Most RMBS lawsuits allege fraud arising from misrepresentations in offering materials, but a subset allege breach of contract arising from the failure to repurchase non-compliant loans—so-called "putback" litigation. The contracts that govern RMBS trusts allow the trustee or other parties to the contracts to demand that the seller, sponsor, or other responsible party cure or repurchase defective loans in the RMBS trust. Investors arguably cannot make such a demand directly, but if they meet specific contractual requirements, they can direct the trustee to obtain the loan files, then analyze the files to identify breaches of representations and warranties, and then direct the trustee to demand the repurchase of defective loans.

The issue in these cases is whether the statute of limitations begins to run when the defendant refuses a repurchase request or when the alleged underlying misrepresentations were made. In *Securitized Mortgage Trust 1997-2 v. Daiwa Fin. Corp.*, No. 02 Civ. 3232, 2003 WL 548868, *2 (S.D.N.Y. Feb. 25, 2003), an early mortgage-backed securities case, the court found that the defendant's "false warranties and representations breached the contract at its inception," as alleged in the complaint, and therefore the statute began to run when the contract was made (i.e. the closing date). The court rejected the argument that the statute of limitations only began to run later, when a demand was made, because the plaintiff could have made its demand earlier. *Id*. More recently, a Washington court applying New York law found that the failure to repurchase cannot constitute an independent breach for limitations purposes and, where two related breaches are alleged, the limitations period begins to run from the first breach. *Lehman Bros. Holdings, Inc. v. Evergreen Moneysource Mortg. Co.*, 793 F.Supp.2d 1189, 1193-94 (W.D. Wash. 2011).

These holdings notwithstanding, plaintiffs can and will argue, with much force, that the failure to repurchase is a separate breach of contract, independent of the underlying breaches of representations and warranties. If the breaches are separate, the statute of limitations for the failure to repurchase should begin to run only when a repurchase demand is made and refused. Some RMBS offerings also include accrual provisions which provide that claims do not accrue until a repurchase demand is made and refused, but such provisions are still untested in the courts. RMBS lawsuits arising from repurchase claims are a small but growing area of RMBS litigation, and the courts' rulings on the applicable statute of limitations will continue to develop.

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Summary of the Implications of Recent RMBS Case Law

The Supreme Court's decision in *Merck*, and the decisions that have followed it, have far-reaching implications for securities claims. Most of the decisions raise defendants' burden for dismissal on a motion to dismiss—either by applying *Merck* even to 1933 Act claims, stressing the importance of *security-specific* information, or both. Given the principles of fairness to plaintiffs, who arguably should not have their clocks begin before they could even successfully bring a claim, is a universal concern, we may soon see courts re-assessing the application of "inquiry notice" standards even to common-law claims (though the courts have thus far split on whether *Merck* should govern state blue sky limitations periods).

The RMBS cases have also raised important questions regarding the application of *American Pipe*. Unless and until such questions as its applicability to the statute of repose and whether investors are protected are finally settled, one can expect prudent investors to file protective "opt-out" suits unless the named plaintiffs' standing is beyond dispute. Though such would undermine the efficiency purposes of class-action litigation, that is the unfortunate side effect of those minority rulings that have read *American Pipe* narrowly. Q

Quinn Emanuel Expands Washington, D.C. Office

The firm has continued to expand its presence in Washington, D.C. with the addition of three more partners. Since prominent white-collar defense lawyer William Burck joined in January to co-manage the office with partner Jon Corey, the firm has added Derek Shaffer, Jeffrey Gerchik, and David Orta as partners.

Derek Shaffer has litigated a wide range of complex matters, particularly those involving governmental bodies and unsettled questions of constitutional and statutory law. Prior to joining Quinn Emanuel, Shaffer was a partner at Cooper & Kirk PLLC, where he was lead attorney or otherwise played central roles in many high-profile trial and appellate matters. To date, he has represented clients, including six States, before numerous tribunals, including the U.S. Supreme Court, U.S. courts of appeals and district courts, state supreme courts, administrative tribunals and the NCAA. Shaffer graduated first in his Class of 1996 from the College of Industrial and Labor Relations at Cornell University. He then graduated first in his Class of 2000 from Stanford Law School as its Nathan Abbott Scholar, before clerking for Chief Judge Douglas Ginsburg on the D.C. Circuit.

Jeff Gerchick is an intellectual property litigation specialist who has litigated scores of U.S. district court cases as well as International Trade Commission Section 337 investigations. He joins Quinn Emanuel from the Washington, D.C. Office of Kenyon & Kenyon LLP where he was a partner. Gerchick, who has an Electrical Engineering degree from the University of Michigan, has litigated patent infringement cases covering a wide range of technologies, including wireless and wired networking, cellular mobile communications, computer hardware and software, consumer electronics, digital audio formats, and automotive technologies. He has represented consumer electronics and telecommunications companies such as Sony, Sony Computer Entertainment, Sony Ericsson Mobile Communications (now Sony Mobile Communications), and Barnes & Noble, as well as automotive companies such as Toyota. Mr. Gerchick is co-author of one of the leading treatises on Section 337 investigations, *Unfair Competition and the ITC*.

David Orta is an international arbitration specialist, making him the third such international arbitration specialist to join the firm in the last nine months. He was previously a partner in the Washington, D.C. office of Arnold & Porter LLP. Orta has represented clients in arbitrations under the auspices of many different arbitral forums including the International Centre for Settlement of Investment Disputes (ICSID), UNCITRAL, the ICC and the International Centre for Dispute Resolution (ICDR/AAA). Fluent in Spanish, he has been particularly active representing Latin American companies and countries in investment treaty and commercial arbitration disputes. He has also handled matters relating to Central and Eastern Europe, the Caribbean and Africa. *Chambers Global*, *Chambers Latin America* and *Global Arbitration Review* have all recognized Orta for his international arbitration work. Orta also regularly participates in conferences and seminars on subjects of international law and has published in the field. He is affiliated with various arbitral associations and institutions around the world.

With these recent additions, Quinn Emanuel's Washington, D.C. office has grown to 22 lawyers, including 8 partners. Q

Class Action Victory for Toyota

The firm recently obtained a complete dismissal of all class claims in a consumer class action for its client Toyota Motor Sales. The case, originally filed in L.A. Superior Court in 2008 as a putative national class action, alleged that model year 2007 Toyota FJ Cruisers suffered from one or more defects that caused their windshields to crack, that defendant was aware and failed to inform potential purchasers of the defects, and that defendant attempted to limit its liability for the defect through an unconscionable new car warranty. Earlier in the case, Quinn Emanuel convinced the court on a motion to strike to dismiss the plaintiffs' national class allegations. The firm also prevailed on a demurrer which limited the class to those whose vehicles had manifested defects; that is, to those windshields that had already actually cracked. The court allowed plaintiffs the opportunity to amend the complaint to allege an acceptable class. The plaintiffs responded with an amended complaint which significantly narrowed their claims, alleging only a California class of those whose windshields had cracked. Even so, the firm again successfully demurred, convincing the court to dismiss the class action claims for lack of predominance, this time with no opportunity to amend the complaint, ending the class action. This case is the third class action the firm has successfully defended for Toyota.

Patent Victory for Tredegar

The firm recently secured a stipulation of non-infringement on all claims of all patents asserted by 3M against our client, Tredegar, a major supplier to the private label diaper market. At issue in the case were two families of patents, each detailing specific features related to the texturing and stretching of elastomeric laminates. While the original complaint accused Tredegar of infringement with respect to three of its product lines, 3M amended its complaint four times and eventually accused 18 Tredegar products of infringing 30 claims of the four 3M patents.

In the face of a rapidly expanding list of accused products, the firm honed in on a number of very strong non-infringement positions found in the prosecution histories of the patents at issue, as well as the re-examination of 3M's favorite patent. *Markman* (patent claim construction) briefing took place in early 2011 and the Court held its *Markman* hearing the day after Labor Day. On November 30, the Court entered a 54-page Order, adopting virtually every important claim construction advocated by Quinn Emanuel. The Court took great pains to explain why 3M's positions on key claim terms were without merit, including one of 3M's primary infringement positions. With the writing on the wall, 3M stipulated to entry of judgment of non-infringement in order to appeal the claim construction rulings. 3M's appeal is currently pending.

First Amendment Victory in Online Libel Case

On behalf of our client, a renowned media company, the firm recently obtained a dismissal with prejudice of a novel libel action in Washington state court. The plaintiff, a college student, brought suit for libel arising from the posting of plaintiff's photograph on the client's website alongside a news article about the prosecution of coffee baristas for prostitution. The plaintiff alleged she had never been a prostitute and had no other connection with the article. In her complaint, she alleged that because of the offending posting, her picture now came up in Google searches regarding prostitution. The article and plaintiff's picture had both been posted on the client's website by a prolific user of the client's community-generated news forum, in which users can post and comment on various news stories they find on the web.

Quinn Emanuel immediately moved to dismiss the suit based on Section 230 of the Communications Decency Act, which immunizes website operators from liability for content created by third parties. Plaintiff contended that there were issues of fact as to the client's responsibility for the posting, contending that the user who posted the image was the client's agent, or, alternatively, that the client should be responsible for soliciting and encouraging the posting of news articles by its users. The court rejected these arguments, ruling that all of plaintiff's claims were barred in their entirety by Section 230, and dismissed the case with prejudice on the first round of motion practice. The firm also precluded any pre-motion discovery through the effective use of Washington's Anti-SLAPP statute. Q

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business litigation report

quinn emanuel urquhart & sullivan, llp

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