May 2012

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After the Fallout: Recent Trends in Residential Mortgage-Backed Securities Litigation

Two governmental reports released this past year confirmed that the issuance and securitization of risky residential mortgage loans were critical factors in causing and fueling the financial crisis. *See* U.S. Senate Subcommittee on Investigations, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse* (Apr. 13, 2011); Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, *The Financial Crisis Inquiry Report* (Jan. 2011). The risks associated with these toxic loans were passed on to investors worldwide when they purchased the resulting residential mortgage-backed securities ("RMBS") in reliance on misleading offering materials and inflated credit ratings. Investors lost billions when the loans defaulted in massive quantities and the value of the securities plummeted.

To recover their losses, investors began filing lawsuits in 2008 against the banks that sold RMBS or originated, acquired, and securitized the underlying mortgage loans. As more evidence of underwriting violations emerged, lawsuits increased. This past year saw a surge in RMBS lawsuits by large, well-known investors, such as Allstate Insurance Co., American International Group, Massachusetts Mutual Life Insurance Company, the National Credit Union Administration Board, and the Federal Housing Finance Agency, as receiver for Fannie Mae and Freddie Mac. These lawsuits and others have resulted in the issuance of a number of opinions by courts that have defined the parameters for RMBS litigation. This article discusses the developments in RMBS litigation over the past year.

Typical Misrepresentation Claims That Have Been Asserted by RMBS Investors

RMBS investors have asserted a variety of claims under federal and state law based on alleged

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INSIDE

Managing IP Honors Charles Verhoeven as IP Practitioner of the Year

The firm recently received top honors at *Managing IP's* annual North America Awards in Washington, D.C. Charlie Verhoeven, Co-Chair of the firm's IP Practice, was recognized as "2012 IP Practitioner of the Year" for his ongoing involvement as lead counsel for Google, Samsung, HTC, and Motorola in smartphone patent litigation against Apple and Microsoft in more than a dozen disputes venued in various district courts and in the ITC. The firm additionally received awards for "Best Patent Litigation Group–West" and "Best ITC Litigation Practice Group." This past September, the firm opened an office in Washington, D.C., its sixth office in the U.S., to better facilitate representation of clients in Section 337 investigations before the International Trade Commission and in IP matters on the East Coast. Q

Ivan Marisin Receives Top Ranking in Russia

Moscow partner Ivan Marisin was recently named one of the "100 Best Lawyers in Russia," for the second year in a row, and a "Top Lawyer" in the area of arbitration and mediation by *Vedomosti*, the leading Russian business daily (joint-venture of *The Wall Street Journal* and *Financial Time for Russia*) as part of its annual rankings. Marisin, also highly ranked by *Chambers Global,* has represented both Russian and international clients in more than one hundred major litigations and

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misrepresentations in connection with the sale of the securities. The claims have typically included:

• *Claims under Sections 11 and 12(a)(2) of the Securities Act of 1933 (the "1933 Act")*: These claims may be brought only by investors that purchased securities as part of the initial public offering (rather than on the secondary market or in a private transaction). *See* 15 U.S.C. § 77k; *Gustafson v. Alloyd Co*., 513 U.S. 561, 583-84 (1995). The claims do not require any proof that an investor relied on the misrepresentation or that a defendant acted with scienter or even negligence. A Section 11 claim may be asserted only against those persons identified in the statute (*e.g.*, those who signed the registration statement and underwriters), 15 U.S.C. § 77k, and a Section 12 claim may be asserted only against the "sellers" of the securities. Pinter v. Dahl, 486 U.S. 622, 645-47 (1988). The statute of limitations for Section 11 and 12(a)(2) claims is one year after the misrepresentation was discovered or should have been discovered in the exercise of reasonable diligence, and in no event more than three years after the sale. *See* 15 U.S.C. § 77m.

• *Claims under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 (the "1934 Act")*: These claims may be brought by any purchaser of securities that can show a material misrepresentation in connection with a purchase of securities; reasonable reliance on the misrepresentation; that a defendant acted with scienter; and that the misrepresentation was the cause of the loss. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005). The statute of limitations is two years after the facts constituting the violation were discovered or should have been discovered in the exercise of reasonable diligence, and in no event more than five years after the violation. *See* 28 U.S.C. § 1658(b).

• *Claims under various state securities laws (or "blue sky laws")*: A number of states, including California, Massachusetts, Ohio, and Virginia, have blue sky laws that create civil liability for misrepresentations in connection with the sale of securities in that state. Because the civil liability provisions are typically modeled off Section 12(a)(2) of the 1933 Act, claims do not ordinarily require a showing of reliance or scienter, but they can be asserted only against the sellers of securities. The statute of limitations for blue sky claims varies from state to state. For example, California uses the same two-year/five-year limitations period that appears in the 1934 Act, while Massachusetts provides that the statute of limitations is four years after the facts constituting the violation were discovered or should have been discovered in the exercise of reasonable diligence. An investor may typically assert claims under the blue sky laws of any state in which the offer originated or the sale occurred.

• *Claims for common law fraud or negligent misrepresentation*: Finally, RMBS investors have asserted claims for common law fraud or negligent misrepresentation. The statute of limitations for these claims depends on which state's law governs the claims, which is ordinarily determined by an interest analysis that considers where the injury occurred, among other factors. The statute of limitations varies widely by state. The California statute of limitations, for example is three years after the facts constituting the fraud were discovered or should have been discovered, while the New York statute of limitations is two years after discovery of the facts constituting the fraud or six years after the claim accrued, whichever is greater.

The Importance of the Statute of Limitations

The statute of limitations has become an important impediment on the misrepresentation claims that can be maintained by RMBS investors. Two dates are relevant to a statute of limitations analysis – the date when the sale of securities occurred and the date when the facts constituting the claim were discovered or should have been discovered.

RMBS investors have typically asserted claims based on sales of securities that occurred between 2005 and 2007. Because claims under Sections 11 and 12(a)(2) of the 1933 Act are time-barred if brought more than three years after the sale, many courts are dismissing these claims at the pleading stage based on the statute of limitations. *See, e.g.*, *Stichting Pensioenfonds ABP v. Countrywide Fin. Corp.*, 802 F. Supp. 2d 1125, 1130-31 (C.D. Cal. 2011). Some investors have been able to save their claims from dismissal by showing that their claims "relate back" to earlier-filed complaints under the tolling doctrine set forth in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974). Courts will toll the statute of limitations for claims based on RMBS transactions at issue in earlier-filed class actions in which the investor was a putative class member. To receive the benefit of tolling, some courts are requiring an investor to show that its claims are based on not only the same RMBS transactions at issue in a prior class action, but also on the same specific classes (or tranches) of securities at issue, under the theory that each tranche is a separate security. *See, e.g.*, *Me. State Ret. Sys. v. Countrywide Fin. Corp.*, No.

2:10-cv-0302, 2011 WL 4389689, at *4-*5 (C.D. Cal. May 5, 2011). Thus, an investor that purchased securities in Class 2 of the 2006-17 Countrywide transaction, for example, may not receive the benefit of tolling if a prior class action asserted claims only on behalf of purchasers of securities in Class 1. Investors are finding that *American Pipe* tolling does not cover a majority of their holdings, and they have had to rely on claims other than Section 11 and 12(a)(2) claims for recovery.

In addition to the date of sale, the date when an investor discovered or should have discovered the facts constituting its claims is important to the statute of limitations. A number of defendants have argued that RMBS investors should have discovered their claims in 2007 and 2008 based on news articles that reported increasing delinquencies and defaults in mortgage loans, borrower fraud, bankruptcies of large lenders, and similar information that defendants have asserted is relevant to underwriting misrepresentations. Courts have consistently rejected these arguments at the pleading stage, especially because almost all of the articles cited by defendants are general articles that do not mention the specific defendants or securitizations at issue in the particular action. *See, e.g.*, *Mass. Mutual Life Ins. Co. v. Residential Funding Co., LLC*, -- F. Supp. 2d --, 2012 WL 479106, at *10-*11 (D. Mass. Feb. 14, 2012); *Genesee Cnty. Emps.' Ret. Sys. v. Thornburg Mortg. Sec. Trust 2006-3*, -- F. Supp. 2d --, 2011 WL 5840482, at *65 (D.N.M. Nov. 12, 2011). The notable exceptions are the Countrywide cases pending in the multi-district litigation before Judge Mariana Pfaelzer in the Central District of California. She has held, at the pleading stage, that investors in Countrywide RMBS should have discovered their claims by late 2007 or early 2008, and has dismissed claims based on a February 14, 2008 discovery date. *See Stichting*, 802 F. Supp. 2d at 1137.

Based on these decisions, investors that filed suit in early 2010 have typically been able to maintain claims subject to a two-year discovery statute of limitations, including claims under Section 10(b) and Rule 10b-5. Investors that filed suit in late 2010 or 2011, on the other hand, have faced dismissal of those claims as untimely, especially if the claims relate to Countrywide RMBS. Nevertheless, these investors have been able to maintain claims with lengthier statutes of limitations, including certain blue sky claims and common law fraud claims.

Actionable Misrepresentations That Support a Claim

Investors have supported their misrepresentation claims by alleging different categories of misrepresentations. The categories have typically included misrepresentations about the underwriting standards that were used to originate the underlying mortgage loans, false loan-to-value ("LTV") ratios for the loans, false owner-occupancy rates for the loans, and false credit ratings for the securities. Courts have typically concluded that investors have stated claims based on misrepresentations about the applicable underwriting standards. Investor have had mixed success with the other categories of misrepresentations.

- *Underwriting Misrepresentations*: To allege underwriting misrepresentations, investors have identified specific statements in the offering materials about the applicable underwriting standards and have alleged that the statements were false because the banks systematically abandoned those standards. Courts have analyzed whether investors have alleged a plausible abandonment of underwriting standards for the specific loans at issue. When an investor has supported its allegations only with reports of general underwriting violations in the industry, courts have dismissed the claims as conclusory. *See, e.g.*, *N.J. Carpenters Health Fund v. Novastar Mortg., Inc.*, No. 08 Civ. 5310, 2011 WL 1338195, at *10-*11 (S.D.N.Y. Mar. 31, 2011). When, however, an investor has supported its allegations with a sharp drop in the credit ratings for the securities at issue and facts specific to the banks at issue, courts have typically allowed the claims to proceed. *See, e.g.*, *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 773-74 (1st Cir. 2011) ("*Nomura*"); *Mass. Mutual*, 2012 WL 479106, at *5; *Genesee*, 2011 WL 5840482, at *68-*69.

Some courts have demanded still more specificity, requiring investors to link the allegations about the banks with the specific mortgage loans at issue. *See N.J. Carpenters Health Fund v. Novastar Mortg., Inc.*, No. 08 Civ. 5310, slip op. at 11-12 (S.D.N.Y. Mar. 29, 2012). To increase the specificity in their complaints, some investors have retained forensic analysis firms with access to certain data for the underlying mortgage loans, and have supported their allegations of underwriting abandonment with an analysis of actual loan-level data. Courts have accepted this analysis at the pleading stage. *See, e.g.*, *Mass. Mutual*, 2012 WL 479106, at *7; *Allstate Ins. Co. v. Countrywide Fin. Corp.*, -- F. Supp. 2d --, 2011 WL 5067128, at *18 (C.D. Cal. Oct. 21, 2011).

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The Board Still Knows Best: "Say-on-Pay" Vote Does Not Trump a Board of Directors' Business Judgment

A recent federal district court decision represents a growing trend by courts to limit the enforceability of a shareholder oversight provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July 2010 as a response to the financial crisis. Section 951 of the Dodd-Frank Act requires public companies to conduct a non-binding shareholder vote on executive compensation at least once every three years. 15 U.S.C. § 78n-1. Congress intended the "say-on-pay" provision to give shareholders "the ability to hold executives accountable, and to disapprove of misguided incentive schemes." 156 Cong. Rec. S5902–01, S5916 (2010) (statement of Sen. Jack Reed).

The provision provokes no controversy when a board of directors follows the shareholder vote in authorizing executive compensation. But what happens when a majority of shareholders disapprove of executive compensation and the board disregards the shareholder vote? Section 951, by its terms, does not create a new cause of action: it expressly states that the shareholder vote is not binding and "may not be construed . . . to create or imply any change to the fiduciary duties" or "to create or imply any additional fiduciary duties." 15 U.S.C. § 78n-1(c). Shareholders have therefore attempted to enforce the provision by filing derivative actions on behalf of the corporation asserting traditional claims for breach of fiduciary duty against a board of directors that disregards the say-on-pay vote.

In *Laborers' Local v. Intersil*, No. 5:11-cv-04093, 2012 WL 762319 (N.D. Cal. Mar. 7, 2012), the Northern District of California dismissed claims arising from disregard of a say-on-pay vote at the pleading stage for failure to make a demand on the board or plead demand futility, a requirement for maintaining a shareholder derivative action. In *Laborers' Local*, the board of directors of Intersil, a Delaware corporation headquartered in California, approved increases in compensation for the chief executive officer, the chief financial officer, and three senior vice presidents by an average of 41.7 percent and submitted the increases to a shareholder vote pursuant to Section 951 of the Dodd-Frank Act. *Id.* at *1 & n.1. Fifty-six percent of voting shareholders rejected the increases. *Id.* at *1. After the board disregarded the say-on-pay vote and allowed the compensation increases, the shareholder plaintiff filed a derivative action asserting claims for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and unjust enrichment against the board, several executives, and the board's compensation advisory firm. *Id.* at *2.

The court analyzed the threshold question of whether the plaintiff had satisfied the demand requirements for bringing a derivative suit, which are determined by the law of the state of incorporation (in Intersil's case, Delaware). *Id.* at *4. Because the plaintiff admittedly had not made a demand on the board, the court considered whether the plaintiff had sufficiently pleaded demand futility under Delaware law. *Id.* Failure to make a demand under that law may be excused if a plaintiff can plead particularized facts demonstrating either that a majority of the board is interested or not independent, or that the challenged act was not a product of the board's valid exercise of business judgment. *Id.*

The court first held that the plaintiff had failed to plead facts demonstrating that a majority of the board was interested. *Id.* at *5. Directorial interest exists under Delaware law whenever divided loyalties are present, when the director will receive a personal financial benefit from a transaction that is not equally shared by the shareholders, or when a corporate decision will have a "materially detrimental impact" on a director but not on the corporation or its shareholders. *Id.* The court held that the plaintiff had failed to meet this test because only one director (the chief executive officer) had received any financial benefit from the challenged compensation increases, and there were no facts alleged that this one director so dominated the board as to make a majority of the board not independent. *Id.*

The court next held that the plaintiff had failed to plead facts demonstrating that the board's allowance of the executive compensation increases after the negative say-on-pay vote was not a product of its valid exercise of business judgment. *Id.* at *6-*8. Under Delaware's version of the business judgment rule, a corporate action is presumed to be a valid exercise of the board's business judgment unless a plaintiff can rebut the presumption by pleading particularized facts raising a reasonable doubt whether the board was adequately informed before taking the action or whether the action was taken honestly and in good faith. *Id.* at *6. Because the plaintiff had failed to plead any facts suggesting that the board was not adequately informed, the question turned on whether the board's allowance of the compensations increases after a majority of shareholders rejected them was taken honestly and in good faith. *Id.* The court rejected the plaintiff's argument that the negative say-on-pay shareholder vote was always sufficient to rebut the business judgment rule presumption. *Id.* at *7-*8. Instead, the court held that a say-on-pay vote under the Dodd-Frank Act "has substantial evidentiary weight" and "*may*" be used by a court in determining whether a plaintiff has rebutted the business judgment rule presumption. *Id.* at *8 (emphasis in original).

The court applied its holding to the facts alleged in *Laborers' Local*, in which only one director stood to benefit from the compensation increases and 56 percent of voting shareholders disapproved of the increases, and concluded that the shareholder vote alone was not enough to rebut the presumption of the business judgment rule. *Id.* The court did not indicate whether a more resounding disapproval (by 85 percent of voting shareholders, for example) would be sufficient to rebut the presumption.

The opinion in *Laborers' Local* represents a growing trend by courts to dismiss derivative claims based on negative say-on-pay shareholder votes at the pleading stage for failure to plead demand futility. Courts in at least three recent cases have done so. In *Weinberg v. Gold*, -- F. Supp. 2d --, 2012 WL 812348 (D. Md. Mar. 12, 2012), the District of Maryland dismissed derivative claims on behalf of a Maryland corporation for failure to plead demand futility under Maryland law. In *Plumbers Local No. 137 Pension Fund v. Davis*, No. 03:11-633-AC, 2012 WL 104776 (D. Or. Jan. 11, 2012), the District of Oregon dismissed claims on behalf of an Oregon corporation for failure to plead demand futility under Delaware and Oregon law. And in *Teamsters Local 237 Additional Security Benefit Fund v. McCarthy*, No. 2011-cv-197841 (Fulton County, Ga. Superior Court Sept. 16, 2011), the Georgia Superior Court dismissed claims on behalf of a Delaware corporation for failure to plead demand futility under Delaware law.

The only court that has reportedly allowed such claims to proceed is the Southern District of Ohio in *NECA–IBEW Pension Fund v. Cox*, No. 11-cv-4512011, WL 4383368 (S.D. Ohio Sept. 20, 2011), which applied Ohio law and held, contrary to well-established Delaware law, that the threat of personal liability faced by the directors for their involvement in approving and recommending the compensation increases was sufficient to plead demand futility. *Id.* at *4. Courts are consistently refusing to follow this decision. *See Plumbers Local No. 137*, 2012 WL 104776, at *5 (criticizing the decision for the court's apparent lack of subject matter jurisdiction, the plaintiff's failure to disclose contrary authority, and circular logic of the argument); *Laborers' Local*, 2012 WL 762319, at *6 n.5 (same).

PRACTICE AREA NOTES

White Collar Litigation Update

Going to Trial on FCPA Charges—The Percentage Play: The DOJ's Foreign Corrupt Practices Act ("FCPA") trial woes continue. On February 21, a federal judge in Washington, D.C. dismissed the remaining sixteen defendants in a high-profile FCPA prosecution, criticizing the case as a "long and sad chapter in the annals of white collar criminal enforcement." An FBI sting operation had led to charges being filed against twenty-two defendants alleging that they all participated in a scheme to bribe the defense minister of the small African nation of Gabon with $1.5 million to win a lucrative $12 million defense contract. Such bribes to foreign officials to obtain or retain business are prohibited by the FCPA. The dismissals in the Washington case came after a pair of trials in which three codefendants were acquitted while the jury could not reach unanimous verdicts against seven others. Three defendants had earlier pled guilty, although their guilty pleas may now be in jeopardy in light of the court's dismissal of charges against the last sixteen defendants in the case.

The United States Department of Justice treats prosecutions of individuals in FCPA cases as a "cornerstone" of its FCPA enforcement strategy according to remarks made by Lanny Breuer, Assistant Attorney General for the Criminal Division, at a national FCPA forum in November 2009. While most recent FCPA cases against companies have been resolved short of trial, through non-prosecution or deferred prosecution agreements, where the company accepts responsibility and agrees to institute additional compliance measures, many cases against individuals are resolved through plea agreements in which the individuals are required to plead guilty to one or more criminal charges.

Only two companies appear to have ever put the government to its proof at trial on FCPA charges, and neither case ended with glory for the government. The first company, Harris Corporation, a defense contractor accused of paying bribes earmarked for

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Colombian officials to obtain government business, was acquitted in 1991 by the San Francisco federal judge hearing the case without the case even being submitted to the jury. Then, just last year, Lindsey Corporation, accused of paying bribes intended to win contracts from Mexican officials, was first convicted at trial in Los Angeles federal court, only to have the convictions thrown out by the presiding judge due to apparent misconduct by agents and prosecutors in the investigation and prosecution of the case.

In light of The DOJ's usual unwillingness to resolve FCPA cases against individuals on the same favorable terms usually extended to their corporate employers, it is unsurprising that individuals have proceeded to trial considerably more frequently than corporations have. At least recently, that has been a very wise strategy. Aside from the acquittals and mistrials in the African sting operation cases in Washington, another individual, John O'Shea, never even saw his FCPA charges submitted to the jury in Houston in January; instead, the district judge granted his motion for judgment of acquittal during trial, finding that the government's chief witness had provided "abstract and vague" answers and the government had failed to meet its burden of proof. Before those inauspicious results, the government had seen its convictions against the individual defendants in the Lindsey case in Los Angeles thrown out along with the convictions of the corporation in a case that the judge described as having "gone badly awry."

While a spokesperson for the Department of Justice recently defended its FCPA prosecutions of both individuals and companies since enforcement was stepped up beginning in 2009, and over the last five to ten years, individual defendants in FCPA cases have not fared very well at trial, the last three months have revealed that the government's FCPA cases against individuals are anything but airtight. For the individual defendant facing FCPA charges, pleading guilty is by no means a foregone conclusion. Between scrutinizing the government's investigative and prosecutorial conduct and attacking the government's proof of actual knowledge and intent to bribe or cause to be bribed an actual foreign government official, real opportunities may exist to put the government to its proof at a trial.

Appellate Litigation Update

Supreme Court to Review Patient Protection and Affordable Care Act: In one of the most important and closely watched cases in recent memory, the Supreme Court this Term will decide the constitutionality of the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010) (the "Act"). The Act is designed to achieve universal health-insurance coverage through a multi-step legislative strategy: it first restricts health insurers' ability to drop insureds from their rolls or to deny coverage on grounds of a "pre-existing condition"—thus ameliorating an "adverse selection" problem that ordinarily pervades health insurance. But this solution creates a "free rider" problem: if a patient knows that he cannot be denied coverage, he is likely to wait until he is on the way to the hospital to buy insurance. To solve that problem, the Act requires every American to obtain health insurance or to pay a penalty under the tax code.

This latter requirement, the so-called "individual mandate," has been the subject of a series of challenges. Three courts of appeals declined to consider the case's merits, ruling instead that they lacked jurisdiction. *Liberty Univ. v. Geithner*, --- F.3d --- (4th Cir. Sept. 8, 2011); *Virginia* ex rel. *Cuccinelli v. Sebelius*, 656 F.3d 253 (4th Cir. 2011); *Baldwin v. Sebelius*, 654 F.3d 877 (9th Cir. 2011); *New Jersey Physicians, Inc. v. President of the United States*, 653 F.3d 234 (3d Cir. 2011).

Other courts have proceeded to consider the merits of the case. The Eleventh Circuit ruled that the individual mandate exceeded Congress's lawmaking authority. *Florida ex rel. Att'y Gen. v. U.S. Dep't of Health and Human Servs.*, 648 F.3d 1235 (11th Cir. 2011). The court first concluded that Congress's power to regulate the economy under the Commerce Clause did not extend to mandating that Americans buy health insurance. Such a requirement was an "unprecedented" "regulat[ion of] conduct [that] is defined by the *absence* of both commerce or even 'the production, distribution, and consumption of commodities.'" *Id.* at 1288, 1293 (quoting *Gonzalez v. Raich*, 545 U.S. 1, 25 (2005)). In other words, failure to obtain insurance is not an economic activity, even though the aggregation of many such failures by individuals throughout the economy may have a substantial effect on interstate commerce by driving up insurance premiums and medical costs. *Id.* at 1292-93. The court thus held that the mandate is not a constitutionally authorized form of economic regulation. *Id.* at 1307. The court also held that neither the Necessary and Proper Clause nor the Taxing and Spending Clause could sustain the mandate.

By contrast, both the Sixth and District Columbia Circuits have issued prominent opinions upholding the Act. *Seven-Sky v. Holder*, 661 F.3d 1 (D.C. Cir. 2011); *Thomas More Law Center v. Obama*, 651 F.3d 529 (6th Cir. 2011). There is thus a well-developed conflict of authority among the federal courts of appeals.

The Supreme Court granted petitions for certiorari review of the Eleventh Circuit's decision, and heard argument over the course of an unusually long three-day period in late March. In addition to the question of the individual mandate's constitutionality, various other questions are presented:

• Whether lawsuits challenging the Act are barred by the Anti-Injunction Act, which strips the federal courts of jurisdiction to hear cases challenging a tax before the tax has been imposed.

• Whether the individual mandate is "severable" from the remainder of the Act such that invalidating the mandate would not require invalidating the Act's other provisions.

• Whether the Act's expansion of the Medicaid program violates the Constitution by coercing states into complying with provisions of the Act by threatening to withhold funding unless those conditions are met.

A host of *amicus curiae* briefs have been filed on all sides of the various issues. Quinn Emanuel has filed an *amicus curiae* brief in support of reversal of the Eleventh Circuit's ruling on the individual mandate, on behalf of The California Endowment, a private foundation that works to expand access to affordable health care to Californians in underserved and low-income communities. The brief marshals empirical evidence concerning the cost of the "uncompensated care" that results from individuals who lack health insurance consuming services that they cannot afford but that hospitals are bound by law and medical ethics to provide. Those costs, amounting to some $43 billion annually, are ultimately spread across the whole of the population in the form of higher costs and increased insurance premiums. According to Endowment-funded research, full implementation of the Act will expand the pool of insured individuals in California alone by nearly two million by 2019, simultaneously spreading costs over a larger group (thereby reducing them for each individual insured) and reducing the quantity of uncompensated care. The result, according to one analysis, will be a reduction in insurance premiums by more than 20 percent for individuals and more than 10 percent for families. The brief relies on this data to establish a "tangible link" between the Act and interstate commerce, which would satisfy the test set forth in Justice Kennedy's concurring opinion in the recent case of *United States v. Comstock*, 130 S. Ct. 1949 (2010).

A decision is expected by the end of June 2012.

Class Action Litigation Update

Data Breach Class Actions—Courts Treat Theft Differently From Mere Loss: Any company that stores or processes consumers' personal information is at risk of suffering a data breach—and, potentially, defending a class action lawsuit. Class actions based on data breaches are increasingly common and attractive to plaintiffs' lawyers because of the enormous class sizes that often result from a single breach. But despite their favor with the plaintiffs' bar, some defendants can obtain dismissals at the pleading stage due to absence of an injury in fact resulting from the breach.

The Ninth Circuit has held that increased risk of identity theft resulting from a data breach establishes Article III standing. *Krottner v. Starbucks Corp.*, 628 F.3d 1139 (9th Cir. 2010). *Krottner* involved a laptop stolen from Starbucks that contained the names, addresses, and social security numbers of about 97,000 Starbucks employees. Although several plaintiffs had not alleged they had suffered identity theft or any other financial harm, someone had tried to open a bank account with one of the plaintiff's information. Under these circumstances, the court held increased risk of future harm sufficed to confer standing. *Id.* at 1143.

The Seventh Circuit has come to the same conclusion. In a case involving a "sophisticated, intentional and malicious" data breach, the court held that the increased risk of future harm resulting from breach established standing. *Pisciotta v. Old Nat'l Bancorp*, 499 F.3d 629, 634 (7th Cir. 2007).

The Third Circuit, however, recently drew a line between intentional breaches and mere loss of information. In *Reilly v. Ceridian Corp.*, 664 F.3d 38 (3d Cir. 2011), the court held that the plaintiffs would only be injured if a series of speculative harms actually came true:

> Appellants' contentions rely on speculation that the hacker: (1) read, copied, and understood their personal information; (2) intends to commit future criminal acts by misusing the information; and (3) is able to use such information to the

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> detriment of Appellants by making unauthorized transactions in Appellants' names. Unless and until these conjectures come true, Appellants have not suffered any injury; there has been no misuse of the information, and thus, no harm.

Id. at 42. The court distinguished *Krottner* and *Pisciotta*, saying that the threats in those cases were "significantly more 'imminent' and 'certainly impending' than the alleged harm here." *Id.* at 44. The court reasoned that, "[h]ere, there is no evidence that the intrusion was intentional or malicious," and the plaintiffs "alleged no misuse, and therefore, no injury." *Id. Cf. Lambert v. Hartman*, 517 F.3d 433, 437 (6th Cir. 2008) (stating that although risk of future identity theft was "somewhat 'hypothetical' and 'conjectural,' [plaintiff's] actual financial injuries are sufficient to meet the injury-in-fact requirement").

The Ninth Circuit also recently embraced this distinction in *Whitaker v. Health Net of Cal., Inc.*, No. CIV S-11-0910 KJM, 2012 WL 174961 (N.D. Cal. Jan. 20, 2012). In *Whitaker*, Quinn Emanuel successfully dismissed a data-breach class action involving allegedly lost hard drives that contained 800,000 California residents' personal and medical information. There was no evidence of hacking, theft, or misuse of the plaintiffs' personal information.

Quinn Emanuel argued that mere loss of data—as opposed to hacking or theft—was insufficient to establish standing. Judge Mueller of the Eastern District of California accepted our argument. Because "*Krottner* . . . arose from the theft of information, not its loss," the court held that it did not control the outcome. *Whitaker*, 2012 WL 174961, at *2. The plaintiffs failed to "explain how the loss here has actually harmed them or threatens to harm them," and so the court held that "[a]ny harm stemming from their loss thus is precisely the type of conjectural and hypothetical harm that is insufficient to allege standing." *Id.*

Thus, in cases of lost rather than stolen data, *Whitaker* is obviously extremely helpful precedent. But even when plaintiffs allege someone has hacked or stolen their data, the Third Circuit's decision in *Reilly* may still provide a basis for dismissal where there are no allegations of concrete harm to any plaintiff. Q

(Ivan Marisin Receives Top Ranking in Russia continued from cover)

international arbitrations worldwide. The firm's Moscow office, launched this past December, follows the same litigation-only model the firm has in the U.S., UK, and Germany serving clients in both domestic Russian and international litigations, particularly arbitrations and litigations involving Russian companies and Russian citizens in the U.S. and London. Q

Eric Winston Named "Outstanding Young Restructuring Lawyer" for 2012 by *Turnarounds & Workouts*

Quinn Emanuel Partner Eric Winston has been recognized by *Turnarounds & Workouts* as one of the nation's twelve "outstanding young restructuring lawyers" for 2012. *Turnarounds & Workouts* acknowledged Mr. Winston for his involvement in Quinn Emanuel's representation of Hildene Capital in the Zais Investment Grade Limited VII case—the first-ever bankruptcy filing involving a CDO entity. Mr. Winston was also recognized for his work in SK Foods, SemGroup, Bernard L. Madoff Investment Securities, and Trident Microsystems. Q

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• *LTV Ratios*: Investors also have alleged that the represented LTV for the underlying loans were false because the property values used to calculate the LTV ratios were materially inflated. These values were supposed to have been determined by objective appraisals conducted in accordance with the standards disclosed in the offering materials, but were instead determined by what value was needed to justify the loan. Courts have almost universally held that property values and the resulting LTV ratios are opinions that are actionable only if an investor can allege that the defendant did not honestly believe the opinion or knew that it bore no reasonable relationship to the actual facts. *See, e.g.*, *Tsereteli v. Residential Asset Securitization Trust 2006-A8*, 692 F. Supp. 2d 387, 393 (S.D.N.Y. 2010). Investors have been successful by alleging facts sufficient to show that one of these two bases exists. *See, e.g.*, *Mass. Mutual*, 2012 WL 479106, at *6-*7. Investors also have been successful in separating the disclosed appraisal practices from the resulting LTV ratios and alleging that defendants did not follow the disclosed appraisal practices, a misrepresentation of fact. *See, e.g.*, *id.* at *6; *Emps.' Ret. Sys. of the Gov't of the Virgin Is. v. J.P. Morgan Chase & Co.*, -- F. Supp. 2d --, 2011 WL 1796426, at *9 (S.D.N.Y. May 10, 2011).

• *Owner-Occupancy*: Investors have alleged that the owner-occupancy rates for the mortgaged properties were false because substantially fewer homes were owner-occupied than what was represented in the offering materials. Investors typically have not been successful in maintaining claims based on this category of misrepresentation. Many offering materials disclosed that the owner-occupancy rates were based on the representations of borrowers regarding their intended use of the property. Courts have held that when this disclosure appears in the offering materials, there was no misrepresentation; the offering materials accurately reported the representations of borrowers. *See, e.g.*, *Mass. Mutual*, 2012 WL 479106, at *7-*8; *Footbridge Ltd. v. Countrywide Home Loans, Inc.*, Civ. A. No. 09-4050, 2010 WL 3790810, at *9 (S.D.N.Y. Sept. 28, 2010).

• *Credit Ratings*: Finally, investors have alleged that the credit ratings for the securities were false and misleading because, for example, the ratings were generated based on outdated models or false information. Investors have attempted to state claims not only against the banks involved in the securitizations, but also against the ratings agencies. Credit ratings are considered opinions and are therefore actionable only if an investor can allege that a defendant did not honestly believe the ratings or knew that they bore no reasonable relationship to the underlying facts. *See Nomura*, 632 F.3d at 775. Courts have typically dismissed claims against the ratings agencies, finding that the facts were insufficient to show that the ratings agencies did not honestly believe the ratings at the time they were given. *See id.*; *Genesee*, 2011 WL 5840482, at *98. Claims against the banks involved in the securitizations have met with slightly more success because investors have been able to allege that these defendants provided the false information to the ratings agencies and knew the ratings bore no reasonable relationship to the underlying facts. *See, e.g.*, *Allstate*, 2011 WL 5067128, at *15-*16.

The Future

This past year has seen significant developments in RMBS litigation. Many investors have been able to survive pleading challenges on at least some of their claims. In response, some banks have entered into settlement with investors, including Deutsche Bank's and Citigroup's recent settlement with the National Credit Union Administration Board. As discovery in these cases proceeds, there will likely be substantially more settlements. Q

VICTORIES

"The Last Samurai" Jury Trial Victory

On behalf of the director and two of the writers and producers of the motion picture, "The Last Samurai," the firm prevailed in a jury trial in the United States District Court on a breach of implied-in-fact contract claim in connection with creation and development of the movie.

The firm represents The Bedford Falls Co. and its two principals, Edward Zwick (director of "Glory," producer of "Traffic" and "Shakespeare in Love") and Marshall Herskovitz (along with Zwick, the creator of "thirtysomething" and "My So-Called Life"). Zwick directed "The Last Samurai" and Zwick and Herskovitz were writers and producers.

The Plaintiffs claimed that they submitted their own script, also entitled "The Last Samurai," to Bedford Falls and that our clients used the script to write and produce the movie that grossed hundreds of millions of dollars. In 2005, they filed an action for copyright infringement and breach of implied contract in the District Court. Their claims were based not only on the identical movie titles but also on the fact that they had allegedly submitted a complete screenplay to our clients within weeks of our clients' development of their own outline for the movie. Nevertheless, we obtained summary judgment on both claims. On appeal, the Ninth Circuit affirmed as to the copyright infringement claim but reversed as to the implied-in-fact contract claim and remanded the claim to the District Court for trial.

At the trial, the firm persuaded the jury that there was no implied agreement to pay for any use of the Plaintiffs' script because, among other things, Plaintiffs could not prove that they submitted their script to Bedford Falls. We also persuaded the Court that there were no substantial similarities between the script and the movie – called one of the Plaintiffs' testimony on the subject "delusional."

The jury deliberated for about five hours and returned a unanimous verdict in favor of our clients, affirming that they created and developed "The Last Samurai" on their own.

Victory in ITC Against Rambus

The firm obtained a complete victory for its clients before the ITC in *In the Matter of Certain Semiconductor Chips and Products Containing Same*, Invest. No. 337-TA-753. Rambus, Inc. had asserted six patents allegedly covering fundamental semiconductor clocking and pre-emphasis technology against firm clients Broadcom Corp., MediaTek Inc., nVidia Corp.; STMicroelectronics, Cisco Systems, Inc., and Motorola Mobility, Inc. Rambus sought an order excluding importation of thousands of products, which potentially could have resulted in the loss of several billions of dollars by our clients. On March 2, 2012, Administrative Law Judge Theodore R. Essex issued his initial determination, finding no violation with respect to the asserted patents, holding all six patents invalid over several prior art references. In addition, Rambus was barred from enforcing the asserted Barth I patents due to unclean hands stemming from its intentional destruction of documents in bad faith.

Rambus sought an ITC exclusion order against any products that use DDR-type memory controllers or PCI Express/DisplayPort transmitters based on two families of patents, the Barth I family of patents, which Rambus had previously litigated successfully against the industry at the ITC before ALJ Essex, and the Dally family of patents, for which Rambus purported to have acquired rights from MIT. Significant product lines were implicated by these two families of patents, including chips used in computers, digital televisions, DVD players, mobile phones and servers. All told, several billion dollars of our clients' revenue was potentially at stake.

The Barth I family of patents stem from a 1995 application that Rambus filed while it was a member of JEDEC. In 1996, Rambus resigned from JEDEC but over the following years filed continuations and divisionals based on the 1995 specification in an attempt to cover technologies under development at JEDEC during those periods and now allegedly incorporated in controllers for JEDEC-standardized DDR-type memory. Rambus had asserted the Barth I patents in a previous ITC investigation against a DRAM controller manufacturer and its customers. In that investigation, in which ALJ Essex presided, the validity of the patents was upheld and the accused products were found to infringe. The Dally patents, which were not developed at Rambus, were asserted against the use of a technique called preemphasis, which is incorporated in several standards including those for the PCI Express and DisplayPort transmitter interfaces. Rambus' assertion of the Dally patents was based on an agreement with MIT, although Broadcom, MediaTek, nVidia, and STM contested Rambus' standing to assert the Dally patents.

The case was tried before ALJ Essex in October 2011. ALJ Essex's March 2, 2012 initial determination provided a complete victory for our clients. Although ALJ Essex had previously upheld the validity of the asserted Barth patents in a prior investigation in which the firm was not involved, this time he found all three Barth patents invalid over numerous prior art references. He also invalidated all three asserted Dally patents over multiple prior art references.

ALJ Essex's initial determination was significant as the first decision to hold Rambus' patents unenforceable for spoliation of documents in light of the Federal Circuit's opinions in the *Micron* and *Hynix* cases. Rambus has been litigating its patents against the DRAM industry for more than a decade. As set forth in several Federal Circuit opinions, Rambus embarked on a course of litigation after carrying out a plan to patent technologies related to various industry DRAM standards. As part of that plan, which involved targeting both DRAM and DRAM controller manufacturers, Rambus engaged in a planned campaign of document destruction, which began in the late 1990s. Rambus' much-publicized spoliation activities have been the subject of government scrutiny, including antitrust investigations initiated by the FTC and the EU Commission. The EU required Rambus to agree to a set of license commitments that extend to some of the patents at issue in these cases. Several district courts, following a recent remand from the Federal Circuit in Rambus' cases against DRAM manufacturers, *Micron* and *Hynix*, are currently considering the appropriate sanctions for this intentional spoliation. In concluding that Rambus had engaged in unclean hands, ALJ Essex's 387-page opinion painstakingly documents Rambus' intentional destruction of documents in anticipation of litigation and provides a detailed commentary on the veracity of the testimony offered by several former senior Rambus executives.

Federal Circuit Victory for Wireless Router Manufacturers

The firm recently won affirmance at the Court of Appeals for the Federal Circuit, confirming our victory in a patent case on behalf of four major players in the wireless network space: Cisco, Belkin, NETGEAR and D-Link. The plaintiff accused our clients' home and small business wireless routers of infringement, seeking substantial damages. The firm obtained a complete defense verdict at summary judgment in the Northern District of California, in which the court agreed with our key claim construction and noninfringement positions. The district court further held the asserted claims invalid as obvious in light of two third-party prior art products.

The plaintiff appealed to the Federal Circuit, seeking to overturn several of the district court's claim construction rulings and separately requesting that the appeals court vacate and remand the noninfringement and invalidity verdicts. On behalf of defendants, we urged the appellate court to uphold the District Court's rulings. On March 7, 2012, after full briefing and oral argument, the Federal Circuit affirmed the district court's claim constructions and judgment of noninfringement and invalidity in favor of the defendants.

Federal Circuit Victory for Genentech

The firm recently won an important victory in the Federal Circuit for our client Genentech in patent litigation initiated by Sanofi-Aventis Deutschland. At issue in the case were Genentech's products Rituxan® and Avastin®, both multi-billion dollar anti-cancer therapeutics. In a unanimous panel decision, the Federal Circuit affirmed the Northern District of California's summary judgment of non-infringement on all claims of two patents asserted by Sanofi.

Sanofi originally filed its suit in the Eastern District of Texas, alleging that Genentech infringed its patents by manufacturing Rituxan® and Avastin® using a genetic sequence from human cytomegalovirus known as an "enhancer." After the court denied Genentech's motion to transfer, Genentech successfully petitioned the Federal Circuit for a writ of mandamus transferring the case to the Northern District of California, in the now oft-cited *In re Genentech* opinion.

Following claim construction proceedings—in which the firm prevailed across the board—the firm moved for summary judgment of non-infringement. The court agreed that Genentech's products were non-infringing and entered final judgment. Sanofi appealed to the Federal Circuit, claiming reversible error in the district court's claim construction and summary judgment orders. The Federal Circuit rejected Sanofi's claims of error and affirmed the district court's holding of non-infringement in its entirety. Q

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business litigation report
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