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Legal Issues Raised by the Driverless Vehicle Revolution – PART 2

Part 1 of this article, published in the December 2015 Business Litigation Report, described emerging driverless vehicle technology and related patent and patent ligation issues. Part 2 continues this discussion with the potential impact of the driverless vehicle revolution on products liability law and data security.

Despite the potential of driverless and driver-assisted vehicles to dramatically reduce the frequency and severity of accidents, there is cause for concern that these vehicles may "*increase* the liability exposure of vehicle manufacturers." Gary E. Marchant & Rachel A. Lindor, *The Coming Collision Between Autonomous Vehicles and the Liability System*, 52 Santa Clara L. Rev. 1321, 1149 (2012) (emphasis in original). As automation increasingly supplants the driver's role in avoiding and mitigating accidents, liability for accidents can be expected to shift from drivers to automobile manufacturers. Thus, over the next 25 years, personal automobile insurance lines may shrink while commercial and products liability lines expand – perhaps dramatically. KPMG, *Keeping Up with the Pace of Change: Demands by Customers Are Driving the Property & Casualty Agenda*, at 20, available at http://bit.ly/1R5ojsj.

The driverless vehicle revolution could disrupt the generally accepted assumption that accidents are "a frequent and inevitable contingency of normal automobile use." *Larsen v. Gen. Motors Corp.*, 391 F.2d 495, 502 (8th Cir. 1968). Indeed, Toyota described the "ultimate goal" of its driverless car program as creating "a car that cannot be responsible for a collision." Richard Waters, *CES 2016: Toyota poaches Google exec to help lead AI effort*, Fin. Times, Jan. 5, 2016, at 15. As automobile accidents become less frequent and are no longer perceived as inevitable, their mere occurrence could be perceived as a strong indication of a product defect. Historically, such paradigm shifts have resulted in increased liability exposure. For example, the commercial availability of automobiles gave rise to modern products liability law and improvements in automobile safety spawned the "crashworthiness" doctrine. This article recalls these significant landmarks from the history of automobile products liability law, explores the current legal landscape, and attempts—despite low visibility conditions—to survey the driverless road ahead.

Two Landmarks in the History of Automobile Products Liability Law.

Modern automobile products liability law began a century ago with *MacPherson v. Buick Motor Co.*, 217 N.Y. 382 (1916). In *MacPherson*, the plaintiff sued an

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Quinn Emanuel Honored in Inaugural *Asialaw* Asia-Pacific Dispute Resolution Awards

The firm was named "Best in IP" in *Asialaw*'s inaugural Asia-Pacific Dispute Resolution Awards, an honor based on the significant IP contributions of Asia-based partners Ryan Goldstein, Wayne Alexander, John Rhie, and Carey Ramos. The firm was also recognized for its work on *Samsung Electronics v. Apple Inc.*, which was named as the "Matter of the Year." The firm was selected from a wide pool of possible nominees and described as a "foremost leader" in litigation and a "team…dedicated to providing excellence." Quinn Emanuel's Hong Kong and Tokyo partners were honored for their legal brilliance and influence in the region. Q

Quinn Emanuel Elects Nine New Partners

The firm announced the election of nine new partners to its partnership, effective January 1, 2016. Managing Partner John B. Quinn said: "We believe we have the best young lawyers anywhere. That we elect so many partners year in and year out is just a reflection of that." ***see page 11***

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automobile manufacturer for injuries sustained in an accident caused by a latent defect in his car's steering wheel. Although a third party had supplied the steering wheel, the manufacturer could have discovered the defect through a reasonable inspection prior to sale. Before *MacPherson*, the plaintiff would have been expected to sue the dealer—with whom he was in privity of contract—rather than the manufacturer. And even against the dealer, recovery would not have been assured because products liability was generally limited to "inherently dangerous" products like poisons or explosives. Yet Judge Cardozo upheld judgment for the plaintiff in an opinion that, in one fell swoop, eliminated the privity requirement and deemed automobiles to be ordinary products that *become* "inherently dangerous" when negligently designed or manufactured. *MacPherson* thus established the central principles of modern automobile products liability doctrine and triggered what some commentators called a "liability explosion." Lawrence M. Friedman, *Law in America: A Short History* (2002), at 129-30.

More than 50 years later, the "crashworthiness" doctrine marked another expansion of automobile products liability law. In 1968, the Eighth Circuit held in *Larsen v. Gen. Motors Corp.* that an auto manufacturer has "a duty to use reasonable care in the design of its vehicle to avoid subjecting the user to an unreasonable risk of injury in the event of a collision." 391 F.2d at 502. This doctrine applies regardless of what caused the collision and allows recovery for "enhanced injuries"—i.e., injuries over and above what would have occurred had the vehicle been crashworthy—even if the collision itself was the plaintiff's fault.

In the wake of *Larsen*, a majority of states explicitly adopted the crashworthiness doctrine. *See* Larry E. Coben, *Crashworthiness Litigation* § 1:2 (2d ed.). Likewise, the implied warranty of merchantability has since "been held to embrace some measure of 'crashworthiness'," as first recognized in *Larsen*. 18 Williston on Contracts § 52:112 (4th ed.).

The *MacPherson* and *Larsen* courts thus expanded products liability law in response to evolving consumer expectations and emerging automotive technologies. Whether courts will respond similarly to autonomous vehicle technology, however, is uncertain. To date, courts have consistently recognized the general principle stated in *Larsen* that "an automobile manufacturer is under no duty to design an accident-proof or fool-proof vehicle." 391 F.2d at 502.

But just as *MacPherson* and *Larsen* fundamentally altered the products liability landscape, this general principle too could change, possibly ushering in a new era of automobile products liability. Indeed, our acceptance of auto accidents as inevitable may one day be viewed "as a historical aberration, present only during the century or so when technology enabled the mass production of cars, but not of highly automated systems to help drive them safely and reliably." John Villasenor, Brookings Institution, *Products Liability and Driverless Cars: Issues and Guiding Principles for Legislation*, at 3 (April 24, 2014). Ironically, a sharp *decline* in auto accidents could provide fertile ground for the next landmark products liability decision.

The Current Landscape of Safety Regulation and Products Liability.

The laws and regulations governing the safety of autonomous vehicles are, unsurprisingly, in their infancy. While the federal government has the authority to regulate the design and operation of vehicles used on public roadways, it has yet to formally regulate autonomous vehicle technology. Administrative agencies, however, have signaled their interest in this area. For example, in 2013 the NHTSA first outlined its plans to make recommendations as to the testing, licensing, and regulation of autonomous vehicles. And in December 2015, the NHTSA announced that it plans to revise its 5-star safety rating to take into account whether vehicles are equipped with active crash-avoidance technologies and to evaluate the performance of those technologies. These revised ratings should begin to appear with 2019 model year vehicles.

A majority of states have considered legislation governing driverless cars, and a handful—including California, Florida, Michigan, Nevada, Tennessee, and the District of Columbia—have already passed legislation. The state bills generally track legislation first enacted in Nevada and share several common features, including definitions of what qualifies as an autonomous vehicle and who is considered its "driver." These bills also typically authorize testing of autonomous vehicles on state roads, while requiring a driver capable of taking over manual operation of the vehicle, certain minimum insurance coverage, and the ability to comply with state traffic laws.

Many of the passed and proposed state statutes contain safe harbor provisions under which manufacturers of vehicles converted to autonomy by a third party are not liable for an injury that results from that conversion unless the defect that caused the injury was present in the vehicle as originally manufactured. However, these safe harbor provisions typically do not protect commercial sellers or distributors, whose status in the stream of commerce has traditionally

made them subject to various theories of liability for damages caused by product defects, including strict products liability. Standard defenses, such as product modification, product misuse, or lack of causation, remain available to sellers or distributors.

The Road Ahead: Products Liability Issues in the Coming Age of Driverless Vehicle.

Traditional Products Liability Principles. In most instances of a driverless vehicle crash, personal injury claimants will likely rely on traditional legal theories. Garden variety automotive accident claims almost universally sound in negligence. But the negligence framework, which assesses the reasonableness of the driver's actions, is ill-suited for claims involving autonomous driving technology, which is designed to supplant the driver's actions and judgment. Consequently, plaintiffs in accident cases involving autonomous vehicles are more likely to claim (and may have no choice but to claim) that the accident was caused by a software or hardware defect in the autonomous system rather than by driver error. Thus, accident cases that would have previously been brought only against the driver might also give rise to—or be replaced by—products liability claims against automobile manufacturers.

There is always some uncertainty as to how existing legal frameworks can be applied to emerging technologies. When presented with novel technologies, courts often try to make analogies to legal constructs governing existing technologies. Here, however, cases involving the most analogous existing technologies—autopilot systems for airplanes and navigation systems for long-distance maritime vessels—apply standard products liability legal constructs with little variation. Accordingly, at least early on, we can expect courts to apply the familiar principles of products liability law to address issues raised by driverless vehicles.

Who Will Be Held Liable. The unanswered question of who will be held liable for autonomous driving accidents is perceived by many as a potential roadblock to the development and eventual widespread adoption of the technology. Some early innovators in driverless technology have decided to try to address this concern proactively: for instance, Google, Mercedes Benz, and Volvo have all stated that they will accept responsibility for any accident that is caused by a flaw in their autonomous driving technology. While such statements do not prevent plaintiffs from suing drivers or vehicle owners, they may provide some comfort to consumers and thus encourage the purchase and use of driverless technology.

Despite these proactive measures by certain automobile manufacturers and technology companies, there can be little doubt that "[a]utonomous vehicles will complicate the already complicated entanglements between insurance providers, plaintiffs, drivers/owners named as defendants, and manufacturers." John Villasenor, Brookings Institution, *Products Liability and Driverless Cars: Issues and Guiding Principles for Legislation*, at 15 (April 24, 2014). To be sure, though, until full autonomy is achieved, auto accident litigation involving autonomous driving where the driver still plays a role will present "complex questions of liability shared by both the human driver and autonomous vehicle technology providers." *Id.* at 15.

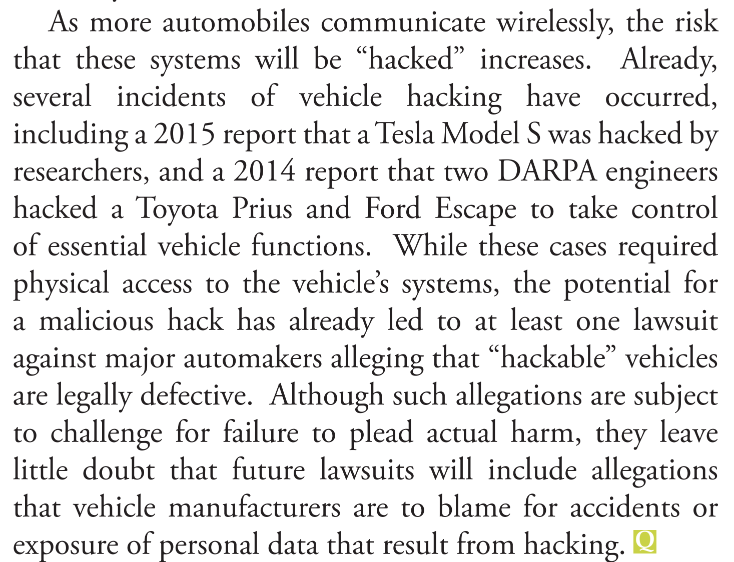
Tesla, the Northern California-based electric car company, has suggested a toe-in-the-water approach to offering automated driving technologies while making a human driver responsible for the safe exercise of that technology: drivers will have to activate their turn signal to trigger their vehicle's autonomous passing function. The Tesla proposal contemplates making drivers responsible for the timing of passing maneuvers, while the execution of those maneuvers would be fully automated. In theory, by choosing when to engage the turn signal, the driver "acknowledges road conditions are appropriate for a passing maneuver and … takes responsibility for the consequences." Mike Ramsey, *Who's Responsible when a Driverless Car Crashes? Tesla's Got an Idea*, Wall St. J., May 13, 2015.

It should be noted that even manifest driver error in an accident may not fully exculpate the autonomous technology provider. For example, some crash-avoidance technologies—such as lane departure warning and blind-spot detection—are designed not to substitute for the driver, but rather to monitor driver behavior, detect driver inattention, and alert the driver when necessary. Depending on the nature of the accident, it may be possible to characterize some instances of driver error as a failure of those technologies to operate as they should, thus reducing—or perhaps even eliminating—driver liability. Savvy lawyers will no doubt make such arguments in defense of their clients.

Given the uncertainty over the issue of to whom to assign liability for autonomous vehicle-involved accidents, it should come as no surprise that no states have rescinded their requirements that, to date, owners of automotive vehicles carry at least certain amounts of liability insurance. In fact, many of the state statutes that have been enacted to govern autonomous vehicle technology not only require drivers to carry insurance, but also specify the minimum amounts of insurance that must be maintained to use driverless vehicles on state roads.

"No Injury" Products Liability Claims and Class Actions. Suppose a driverless or driver-assisted vehicle is involved in an accident that arguably should have been prevented by the vehicle's autonomous safety features. Could owners of the same vehicle model invoke that accident as proof of a design defect and sue for economic damages even though the defect had not manifested in their own cars? The majority rule of products liability rejects such "no injury" claims. In one leading case, the plaintiffs alleged that their anti-lock braking systems were defectively designed. Although their brakes had not actually failed, plaintiffs sought economic damages for overpayment and lost resale value. The Eighth Circuit affirmed dismissal, holding that "[w]here … a product performs satisfactorily and never exhibits an alleged defect, no cause of action lies." *Briehl v. Gen. Motors Corp.*, 172 F.3d 623, 628 (8th Cir. 1999). However, a minority of courts in other circuits have recognized such claims and even allowed them to proceed as class actions. *See, e.g.*, *Chamberlan v. Ford Motor Co.*, 369 F. Supp. 2d 1138, 1147 (N.D. Cal. 2005).

Data Security and Breach. To perform many of their functions, driverless cars will need to communicate wirelessly with vehicle manufacturers and technology



providers, and ultimately with other vehicles and roadside resources. The Department of Transportation is currently involved in developing standards for vehicle-to-vehicle communications and the FCC has dedicated a specific bandwidth range to enable vehicles to communicate wirelessly with one another and with roadside infrastructure.

As more automobiles communicate wirelessly, the risk that these systems will be "hacked" increases. Already, several incidents of vehicle hacking have occurred, including a 2015 report that a Tesla Model S was hacked by researchers, and a 2014 report that two DARPA engineers hacked a Toyota Prius and Ford Escape to take control of essential vehicle functions. While these cases required physical access to the vehicle's systems, the potential for a malicious hack has already led to at least one lawsuit against major automakers alleging that "hackable" vehicles are legally defective. Although such allegations are subject to challenge for failure to plead actual harm, they leave little doubt that future lawsuits will include allegations that vehicle manufacturers are to blame for accidents or exposure of personal data that result from hacking.

NOTED WITH INTEREST

Second Circuit Holds Google Books Is Fair Use

In a much anticipated decision, handed down in October of last year, the Second Circuit held Google Books to be a fair use of the copyrighted works Google digitized, catalogued, and offered for on-line searching. The Second Circuit's decision upheld a grant of summary judgement dismissing copyright infringement claims brought by a group of authors (the "Authors Guild"). *Authors Guild v. Google, Inc.*, No. 13-4829-cv (2d Cir. Oct. 16, 2015). The decision provides important guidance on how fair use will be analyzed for digitizing and cataloging copyrighted media.

The Authors Guild brought a putative class action suit against Google in 2005, alleging Google Books infringed the authors' copyrights. Pursuant to agreements with major libraries, Google scanned books from the libraries' collections, created searchable texts, and provided digital copies to each library of the books from its own collections. In addition, Google made the digital copies publicly searchable on Google Books. The search results reported the number of times the word or term selected by the searcher appears in a book and displayed "snippets" of approximately one-eighth of a page showing the search query in its surrounding context. (But Google disabled snippet view entirely for types of books for which a single snippet would likely satisfy the searcher's present need for the book, such as dictionaries, cookbooks, and books of short poems.)

Fair use is an affirmative defense to copyright infringement that requires consideration of four statutory factors: (1) "the purpose and character of the use;" (2) "the nature of the copyrighted work;" (3) "amount and substantiality of the portion used;" and, (4) "the effect of the use upon the potential market for or value of the copyrighted work." 17 U.S.C. § 107. Courts analyze and weigh these factors together, but Factors One and Four are often considered more important to the outcome.

Factor One: The Purpose and Character of Google Books is Transformative. The Second Circuit found that both Google Books' search and snippet functions are transformative. Following the Second Circuit's decision in another copyright case brought by the Authors Guild against an entity formed by libraries participating in the Google Books project (*Authors Guild, Inc. v. HathiTrust*, 755 F.3d 87 (2d Cir. 2014), the court had "no difficulty concluding that Google's making of a digital copy . . . for the purpose of enabling a search for identification of books

containing a term of interest to the searcher involves a *highly transformative purpose*[.]" *Authors Guild* at 21 (emphasis added). To provide searches of the complete text—noted to be of great help to researchers—copying the entire book "was essential to permit searchers to identify and locate the books in which words or phrases of interests to them appeared." *Id.* (citing *HathiTrust*, 755 F.3d at 97). The purpose and character of the use is to allow researchers to identify certain of a book's attributes.

The Second Circuit rejected the Authors Guild's argument that Google Books' display of a snippet view was not transformative because Google had a commercial motivation. The court held that the snippet view has a transformative purpose because it allows a searcher to determine whether the keyword searched for, in context, matches the purpose of the search and not just the search term. The court also found that "Google's overall profit motivation should [not] prevail as a reason for denying fair use over its highly convincing transformative purpose,[]" observing: "Many of the most universally accepted forms of fair use, such as news reporting and commentary, quotation in historical or analytic books, reviews of books, and performances, as well as parody, are all normally done commercially for profit." *Id.* at 26.

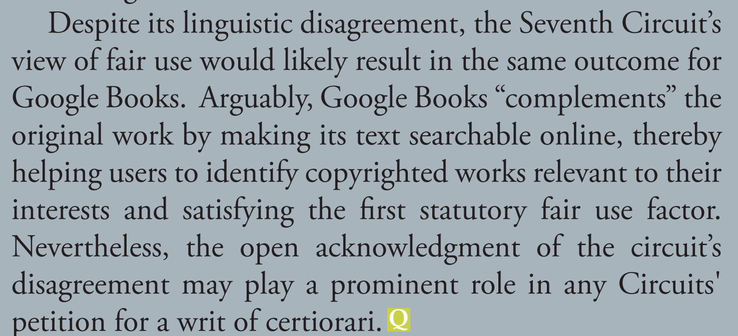
<u>Factor Two: Nature of Digitized Books.</u> The Second Circuit held that "[n]othing in this case influences us one way or the other with respect to the second factor considered in isolation." *Id.* at 28.

<u>Factor Three: Amount of Work Used By Google Books.</u> The Second Circuit found that the amount and substance of the potions used by Google Books weighed toward finding fair use. The court was not persuaded that Google's copying of the entirety of the book was a justification for denying fair use, reasoning that the amount of copying was "reasonably appropriate to Google's transformative purpose" (*id.* at 30), as the entire book must necessarily be scanned in order for users to be able to search the full text of digitized copies. The court also noted that Google Books only made excerpts of the work available to users, and those excerpts were "arbitrarily and uniformly divided by lines of text, and not by complete sentences, paragraphs, or any measure dictated by content," rendering them "of little substitutive value" for the original work. *Id.* at 32-33.

<u>Factor Four: Google Books' Effect on Value.</u> The Second Circuit found that Google Books did not diminish the value of the copyrighted materials or create a competing substitute. The court recognized that Google Books could cause some loss of sales, but that this potential loss did not result in a "meaningful or significant effect" on the market, noting that these losses would likely be due to interests unprotected by copyright, such as confirming historical facts. Weighing this factor with the other three, the Second Circuit found that Google Books was a fair use of the copyrighted materials.

The Second Circuit's transformative use analysis creates at least a superficial tension with its summary rejection of the Authors Guild's derivative rights claim. By statute, a copyright holder retains exclusive rights to derivative works. The statute defines derivative works as "any other form in which a work may be recast, *transformed*, or adapted." 17 U.S.C. §§ 101, 106(2) (emphasis added). But although the Second Circuit's fair use holding emphasized the "transformative" nature of Google Books it flatly rejected the Authors Guild's argument that this transformation rendered Google Books a derivative work, stating "[t]here is no merit to this argument." *Id.* at 37. It contrasted Google's transformative use with "[p]aradigmatic examples of derivative works," such as the translation of a novel into another language, the adaptation of a novel into a movie or play, or the recasting of a novel as an e-book or an audiobook, which "do not involve the kind of transformative *purpose* that favors a fair use policy." *Id.* at 19 (emphasis added).

As the Second Circuit acknowledged, the Seventh Circuit has criticized the "transformative purpose" analysis for fair use as incompatible with copyright owners' rights in derivative works. *Id.* at 20 n. 18)). The Seventh Circuit notes that "transformative purpose" does not appear in § 107's list of factors to determine fair use. In addition, "[t]o say that a new use transforms the work is precisely to say that it is derivative and thus, one might suppose, protected under § 106(2). . . . [T]he Second Circuit do[es] no[t] explain how every 'transformative use' can be 'fair use' without extinguishing the author's rights under § 106(2)." *Kienitz v. Sconnie Nation LLC*, 766 F.3d 756, 758 (7th Cir. 2014), *cert. denied* 135 S. Ct. 1555 (2015). Instead, the Seventh Circuit analyzes whether the allegedly infringing work is a complement or substitute and focuses on the market effect of the work. The *Authors Guild* court shot back, critiquing the Seventh Circuit's analysis of "complementary" uses as not "particularly helpful" and expressing concern the "[t]he term would encompass changes of form that are generally understood to produce derivative works, rather than fair uses, and, at the same time, would fail to encompass copying for purposes that are generally and properly viewed as creating fair uses." *Authors Guild* at 20 n.18.



Despite its linguistic disagreement, the Seventh Circuit's view of fair use would likely result in the same outcome for Google Books. Arguably, Google Books "complements" the original work by making its text searchable online, thereby helping users to identify copyrighted works relevant to their interests and satisfying the first statutory fair use factor. Nevertheless, the open acknowledgment of the circuit's disagreement may play a prominent role in any Circuits' petition for a writ of certiorari. Q

Trial Practice Update

DOJ's New Policies Target Executives of Corporate America. The United States Department of Justice has raised the stakes in corporate criminal investigations, and general counsel, corporate executives, and board members should take note. In September 2015, the DOJ issued a policy memorandum regarding corporate executives in criminal investigations, and two months later in November, it revised the Principles of Federal Prosecution of Business Organizations to limit the ability of corporations under investigation to obtain credit for cooperating with the government. These two developments have significantly changed the legal landscape for both corporations and corporate employees who become subjects of criminal investigations.

The "Yates Memo." On September 9, 2015, Deputy Attorney General Sally Yates released a policy memorandum entitled, "Individual Accountability for Corporate Wrongdoing." (http://www.justice.gov/dag/file/769036/download/.) Immediately dubbed the "Yates Memo" (following a longstanding DOJ tradition of eponymous memos by senior officials), this memo represents the Department's response to harsh criticism that the government has been too lenient on white collar criminals in cases where their companies pay huge settlements to the government. In the wake of the mortgage-backed securities scandal, and the resulting recession that began in 2008, the DOJ and other federal agencies racked up billions in corporate settlements, but many observers criticized Main Justice for not criminally prosecuting the responsible *individuals* who participated in, or directed, those companies' misdeeds.

One such observer, the Hon. Jed Rakoff, U.S. District Judge in the Southern District of New York, described the Department's decision not to bring criminal charges against Wall Street executives as no less than a complete failure of the criminal justice system itself. (Jed S. Rakoff, J. (S.D.N.Y.), *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, New York Rev. of Books, Jan. 9, 2014, *available at* http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions/.) Similarly, U.S. Senator Elizabeth Warren (D. Mass.) asserted that "if you're caught with an ounce of cocaine, . . .you're going to go to jail . . . for the rest of your life. But evidently if you launder nearly a billion dollars for drug cartels . . . your company pays a fine and you go home and sleep in your own bed . . . ." (*Too Big to Jail* (excerpt from the transcript of the March 7, 2013 Senate Banking Committee hearing), Harper's, May 2013, at 23-24, *available at* http://harpers.org/archive/2013/05/too-big-to-jail/.) Even officials from other regulatory agencies pointed out that the decision to file criminal charges rested with DOJ, not them. Just as big banks were "too big to fail," it seemed corporate executives were "too big to jail." (*Id.*)

As the first major DOJ policy pronouncement since Attorney General Loretta E. Lynch took office in April 2015, the Yates Memo mandates prosecution of individual executives and requires corporations to turn in culpable employees or face prosecution themselves. The overarching theme of the memo is: "There's a new Sheriff in town," and it lays out the following "six key steps" intended to promote the effective pursuit of "the individuals responsible for corporate wrongs." (*See* Yates Memo at 2-7.)

(1) <u>A corporation will not receive any "cooperation credit" unless it provides the DOJ with all relevant facts about the individuals involved in misconduct.</u> Previously, corporations could receive substantial credit for cooperating with DOJ, even if they never identified individual employees who had committed criminal misconduct. According to Deputy AG Yates, those "rules have just changed." (*Deputy Att'y Gen. Sally Quillian Yates Delivers Remarks at New York University School of Law Announcing New Policy on Individual Liability in Matters of Corporate Wrongdoing*, Sept. 10, 2015, *available at* http://www.justice.gov/opa/speech/deputy-attorney-general-sally-quillian-yates-delivers-remarks-new-york-university-school/.) Now, "to be eligible for *any* credit for cooperation, the company *must* identify *all* individuals involved in or responsible for the misconduct at issue, regardless of their position, status or seniority." (Yates Memo at 3 (emphasis added).) The corporation must further provide DOJ with "*all* facts relating to that misconduct." (*Id.* (emphasis added).) In a presentation at the American Bar Association Criminal Justice Section's Global White Collar Crime Institute in Shanghai last month, Deputy Assistant AG Sung-Hee Suh explained to the white collar bar that, whereas previously DOJ told corporations they "may" provide evidence inculpating their own employees, under the Yates Memo "may has become must." (Address of Sung-Hee Suh, November 19, 2015, ABA Global White Collar Crime Institute, Shanghai, People's Republic of China.)

(2) <u>Both criminal and civil investigations should focus on individuals from the start.</u> Under the Yates Memo, the DOJ's official position is that using the Department's resources to investigate individual misconduct both civilly and criminally is "the most efficient and effective way" to root out corporate misconduct. (Yates Memo at 4.)

(3) <u>Government attorneys handling criminal and civil investigations should routinely communicate with one another.</u> The Yates Memo emphasizes the importance of early communication and coordination between criminal and civil attorneys to effectively take action against individual wrongdoers. (*Id.* at 5.)

(4) <u>Except in "extraordinary circumstances," the DOJ should not agree to a corporate resolution that also dismisses</u>

charges against, or provides immunity for, individual officers or employees. The Yates Memo states that, absent extraordinary circumstances (*or approved departmental policy*), the DOJ should not release any claims giving rise to either civil or criminal liability against individuals. (*Id.* at 5.) However, exactly what those "extraordinary circumstances" might be remains to be seen—the Yates Memo does not provide any examples. Is it the size of a financial settlement the company is willing to make? The importance of the company or industry to the economy or national security? Proof problems in the case? The resources required to charge and try the individual(s)? Only time will tell. Whatever the basis, an Assistant AG or U.S. Attorney must now approve in writing any corporate resolution that immunizes or releases any individuals. (*Id.*)

(5) Corporate investigations should not be resolved until a clear plan exists to resolve individuals' cases. Under the Yates Memo, any decision to decline prosecution of an employee as part of a corporate plea deal or deferred prosecution must now be documented in a declination memorandum. (*Id.* at 6.)

(6) DOJ's civil attorneys should consider suits against individual employees, not just their companies. Under the Yates Memo, an individual's inability to pay a money judgment, standing alone, should no longer prevent the DOJ from bringing a civil suit against individuals. (*Id.* at 6.) Rather, in making this decision, other factors should be considered, "such as whether the person's misconduct was serious, whether it is actionable, whether the admissible evidence will probably be sufficient to obtain and sustain a judgment, and whether pursuing the action reflects an important federal interest." (*Id.* at 6-7.)

In November, the Principles of Prosecution of Business Organizations were revised, as the Yates Memo indicated they would be, further to codify these policy initiatives in the Memo. (*See* U.S. Dep't of Just., United States Attorneys' Manual 9-28.010 (Nov. 2015), *available at* http://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations.)

Potential Implications. Although the Yates Memo seems grounded in laudable policy goals, in practice it may result in unintended consequences that are inimical to the pursuit of justice. Here are just a few:

Whither the Attorney-Client Privilege? Companies under investigation usually learn facts about potential misconduct through a comprehensive internal investigation, the results of which are protected from disclosure by the attorney-client privilege and the attorney work product doctrine. The Yates Memo and the Revised Principles repeatedly state (almost to the point of "protest[ing] too much," with apologies to Shakespeare) that companies will ***not*** be required to waive privilege under the new regime; instead, the Memo and Revised Principles explain that corporations merely have to disclose all the facts and the names of culpable employees. But aren't "all the facts" learned in the course of a privileged investigation themselves privileged, as are the thoughts, opinions, and impressions of counsel and investigators conducting the investigation? Of course, source documents and data that are not themselves privileged could be disclosed, but the statements of employees and the inferences and conclusions of the company's attorneys and investigators are privileged—and that is precisely the information DOJ will want; the government can use investigative tools such as grand jury subpoenas and search warrants to obtain such information.

It seems inevitable that, to effectuate the steps laid out in the Yates Memo, the government will not be content to settle for names whispered in its ear; it will want the underlying evidence and analysis giving rise to the conclusions that specific individuals are to blame. Company lawyers, however, cannot disclose the results of a privileged investigation if their client has not waived attorney-client privilege. (*Upjohn Co. v United States*, 449 U.S. 383; *Commodity Futures Trading Commission v. Weintrab (1981)*, 471 U.S. 343 (1985).) Likewise, they cannot share their own opinions and impressions without waiving work product. And what company under investigation will voluntarily authorize such waivers?

How this issue is resolved will be critical to the implementation of the Yates Memo going forward. Turning over physical evidence or preexisting non-privileged documents is different, of course, but in our experience corporate executives rarely leave behind written confessions; the Yates Memo itself notes how difficult it is to determine which employee(s) had the requisite intent and conduct to be charged criminally. (*See* Yates Memo at 2.) One thing, however, is clear: accepting the cavalier but incorrect assertion that no waiver is necessary to offer up names and "facts" to investigators is perilous for corporations and their counsel. If the Department really means what is says—that companies should not be required to waive privilege (and sound legal and public policy arguments can be made that the government should not be in the business of forcing companies waive privilege)—a more refined approach should be promulgated.

"All or Nothing." Separate and apart from the substantial privilege issues described above, the Yates Memo's all-or-nothing directive may ultimately *discourage* companies from cooperating at all. Under the Yates Memo, companies cannot receive *any* cooperation credit unless they "completely disclose" all relevant facts about individual misconduct. (*Id.* at 3.) Who decides whether disclosure has been complete? DOJ. So companies now must weigh more carefully than ever before the risks and potential rewards of disclosure, considering the possibility (likelihood?)

that DOJ may still conclude that the company's level of cooperation was less than "complete" and thus insufficient to receive cooperation credit. This binary approach may ultimately bedevil both corporations and the government, particularly when compared to the prior policy of giving corporate cooperation the weight it deserved under the totality of circumstances of each case.

Investigations Underway Before September 2015. The Yates Memo states that it applies to all ongoing, preexisting investigations as well as investigations yet to incept, "to the extent it is practicable to do." (*Id.*) The Department, however, has yet to offer any guidance as to the contours of this "practicability" standard, leaving open the question of just how far back the Yates Memo's reach will extend.

Continuing Obligations. Under the Revised Principles, prosecutors may not settle a case against a company if a related investigation of employees of the company is still ongoing, without a clearly stated plan to resolve the individual cases in the future. (*See* U.S. Dep't of Just., United States Attorneys' Manual 9-28.210 (Nov. 2015), *available at* http://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations.) In her September speech, Deputy AG Yates clarified that "[i]n most instances, this will mean that we resolve cases with individuals before or at the same time that we resolve the matter against the corporation." The Yates Memo thus favors the resolution of individual cases *before* the resolution of parallel corporate investigations, which may ultimately impose significant continuing obligations on companies and, as stated above, act as a disincentive to cooperate in a timely fashion.

Under this new approach, companies may be forced to cooperate for unusually long periods while prosecutors attempt to gather enough evidence to resolve individual cases. This is particularly concerning for public companies, which have a duty to disclose ongoing legal issues to shareholders. A greater likelihood of continuing obligations also exists because, "absent extraordinary circumstances," prosecutors may not "agree to a corporate resolution that includes an agreement to dismiss criminal charges against, or provide immunity for, individual officers or employees," whether in civil or criminal matters. (Yates Memo at 5.) Indeed, even in instances where the DOJ agrees to settle a corporate case before a related individual case, the Yates Memo makes clear that "there may be instances where the company's continued cooperation with respect to individuals will be necessary post-resolution." (*Id.* at 4.)

It is too early to tell how willing companies will be to settle investigations without the assurance that the settlement will "stop the bleeding," so to speak. Companies know that every time a current or former employee is charged, the company's name will almost certainly make headlines too.

Conclusion. The Yates Memo represents the official policy of the Department of Justice and each of the 92 US Attorneys' offices, until amended or superseded. It will no doubt be modified by future administrations, and eventually will join its forebears, the Thompson Memo, the Holder Memo, and other superseded policy directives now presumably residing in the basement of DOJ in Washington D.C. For the foreseeable future, though, companies will continue to need counsel experienced in criminal investigations and in dealing with DOJ at the first hint of potential civil or criminal misconduct to help ensure the best resolution possible in the most timely way when the government comes calling.

U.K. Competition/Antitrust Litigation Update

The new Competition Appeal Tribunal Fast-Track Procedure for Small- and Medium-Sized Enterprises. On October 1, 2015, significant competition law reforms took effect in the United Kingdom under the Consumer Rights Act of 2015. In addition to providing for opt-out collective (class) actions for competition claims, the reforms also include provisions establishing a new fast-track procedure ("FTP") for competition damages claims brought before the Competition Appeal Tribunal ("CAT"). Importantly, the new FTP could facilitate the ability of small- and medium-sized enterprises ("SMEs") that are alleging an abuse of dominance to seek injunctions against large corporations, thereby posing significantly increased litigation risks for potential defendants.

The new rules allow the CAT to order that competition proceedings are, or cease to be, subject to the FTP at any time, either following an application of a party or on its own motion. In practical terms, the allocation of proceedings to the FTP will have three key consequences: (1) the main substantive hearing will be fixed to commence as soon as possible following the CAT's order—and in any event within six months (2) recoverable costs will be capped at a level to be determined by the CAT and (3) the CAT will have the power to grant an interim injunction without requiring (or by capping) a cross undertaking as to damages.

Types of claims that may be allocated to the FTP. While the FTP is not expressly limited to claimants of any particular size, its stated purpose is to enable simpler cases brought by SMEs to be resolved more quickly and at a lower cost. When deciding whether to allocate a proceeding to the fast track, the CAT will likely take account of all factors it considers relevant, including as a threshold matter, whether one or more of the parties (*i.e.*, potentially only the claimant) is an individual, a micro enterprise, or an SME. The other factors the CAT will likely take into account when making this determination are:

- whether the final hearing is estimated to take three days or less;

- the complexity and novelty of the issues involved;
- whether any additional claims have been or will be made in accordance with rule 39 (*i.e.*, counterclaims and additional claims for contribution and indemnity);
- the number of witnesses involved, including expert witnesses, if any;
- the scale and nature of the documentary evidence involved;
- whether any disclosure is required and, if so, the likely extent of such disclosure; and
- the nature of the remedy being sought and, in respect of any claim for damages, the amount of any damages claimed.

Bearing in mind these factors—in particular, the length of the hearing, complexity, number of witnesses involved, and disclosure—the types of conduct that seem to lend themselves more readily to claims under the FTP are abuse of dominance cases, such as predatory pricing, refusals to deal, and tying or bundling claims. In practice, the procedure is expected to be used to restrain abusive conduct of this sort through injunctive relief. Moreover, despite their complexity, these types of claims are less likely to involve extensive witness evidence and disclosure than allegations against multiple defendants in respect of anticompetitive collusion. However, even with less complex competition litigation matters, resolving claims within a six-month timetable (compared to the average competition claim, which often requires at least 12 to 18 months) is more likely to result in a system of "rough and ready," rather than perfect, justice.

Practical and strategic considerations. The new FTP procedure may offer a significant advantage to claimants, who typically have as much time as they need to prepare their arguments in advance, to gather evidence, and to decide when to file a claim. By contrast, a defendant may not have much, if any, advanced notice of the claim and thus may find itself quickly on the back foot. If a claim is then ordered to proceed under the fast track from the first case management hearing, the defendant will have less than six months in which to prepare a reasoned and robust defence—a daunting challenge for any legal team. Irrespective of the particular merits of any action, large companies will want to avoid the risk of being tagged as dominant because of the implications that such a finding carries, in particular in terms of restricting its conduct. Defendants faced with a fast-track claim will therefore need to defend the claim in the manner that they would defend an investigation by a competition authority, which can take years and involve substantial volumes of evidence.

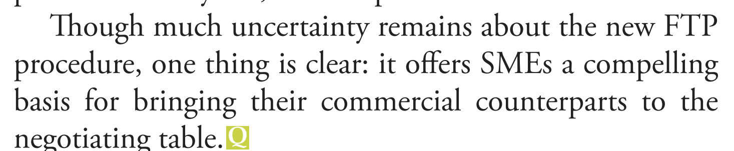
The new FTP procedure presents other significant advantages for claimants as well. For example, the cap on recoverable costs under the FTP is to be set by the CAT on a case-by-case basis, and figures as low as £25,000 have been suggested. Having a case against a large multinational allocated to the fast track may therefore be advantageous for a claimant in terms of limiting the usual risks of exposure to adverse recoverable costs that are associated with the loser-pays rule in English litigation. This limited exposure may be particularly attractive where the claimant is less than confident of success, thus presenting a potential risk that more speculative actions will be filed under the new rules. In practice, however, the earliest stage at which the parties will know whether the claim may be fast-tracked and what the level of the cap on costs will be is the first case management conference. By that time, the parties may have already incurred significant costs and adverse costs exposure, and the cap will likely apply to those costs incurred prior to the FTP determination.

The FTP may also be attractive to claimants who seek to obtain an interim injunction, given that allocation to the fast track will require only a capped (or possibly no) cross-undertaking as to damages. This has the potential to limit—or even eliminate—one of the major disincentives claimants face when seeking an injunction to restrain alleged abuses of dominance.

With these considerations in mind, the new FTP presents SMEs with significant opportunities to take action against suppliers that they consider are imposing unreasonable terms. The new procedure thus exposes large companies to the risk of strategic litigation on the part of their customers who desire better commercial terms. It also poses a risk that a large company may encourage SMEs to pursue fast-track claims against one of its large competitors and, in so doing, force that competitor to change its commercial practices to the benefit of the large company instigating the litigation. Companies with a large market share that could cross the threshold for dominance need to be aware of this risk and determine whether to take proactive steps to be able to defend any fast-track claims properly.

The First FTP Application. The first application for designation to the FTP was made in a claim lodged on December 17, 2015 by the National Compliance & Risk Qualifications against the Institution of Occupational Safety and Health, alleging an abuse of dominance by a failure and refusal to grant accreditation for its qualifications. The claimant sought damages and an interim injunction. However, before the injunction hearing scheduled for early January 2016 could take place or a ruling from the CAT on whether to allocate the claim to the FTP, the defendant agreed to the claimant's demand for accreditation for a period of three years, and the parties settled.

Though much uncertainty remains about the new FTP procedure, one thing is clear: it offers SMEs a compelling basis for bringing their commercial counterparts to the negotiating table.



Victory in Trademark Jury Trial for DIRECTV

The firm recently obtained a complete victory for DIRECTV in an unfair trade practices lawsuit brought by Exclaim Marketing. Exclaim is a marketing service that sells customer leads to third-party satellite television retailers. Part of its business strategy relied on listing its phone number under the name "DIRECTV" in phone books across the country. After DIRECTV instructed its third-party retailers to stop doing business with Exclaim due to the infringement, Exclaim sued DIRECTV for unfair and deceptive business practices.

After a seven-day trial, the jury agreed with our argument that DIRECTV's instructions to its retailers were true or based on legitimate business interests. Notwithstanding that finding, the jury still awarded Exclaim $760,000 in damages, which was subject to trebling. The jury however, also found that Exclaim had willfully infringed DIRECTV's trademark and awarded DIRECTV $25,000 in damages.

In post-trial motions, we argued that Exclaim's damages award could not stand because, given the jury's finding that DIRECTV was protecting its business interests, DIRECTV's conduct was not actionable as a matter of law. We further argued that the court should invoke its equitable discretion to increase the jury's damages award to DIRECTV and should also issue DIRECTV a permanent injunction against Exclaim.

The court agreed with each of our post-trial arguments. It granted DIRECTV's motion for judgment as a matter of law and vacated the jury's $760,000 damages award to Exclaim. It also increased DIRECTV's damages award from $25,000 to over $600,000, adopting DIRECTV's argument that it was entitled to Exclaim's profits. Last, the court granted DIRECTV's proposed nationwide permanent injunction, which requires Exclaim to affirmatively request removal of any of its listings containing DIRECTV's mark in any phone book directory in the country.

By the end of the lawsuit, the firm took the case from one where DIRECTV faced $30 million in damages to one where Exclaim got nothing and DIRECTV got over $600,000, as well as a sweeping injunction.

Quinn Emanuel Prevails in Bet-The-Company Trial

After a five-day Delaware trial, the firm secured a complete defense verdict for its clients Vincent Vertin, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt, J. Eric Wagoner (the "Athilon Board"), Athilon Capital Corp. ("Athilon"), and Athilon Structured Investment Advisors LLC ("ASIA"). The firm defeated claims brought by derivative plaintiff debtholder Quadrant Structured Products Company, Ltd. ("Quadrant") that sought $200 million in damages and attempted to force Athilon to liquidate its assets and shut down its business. The Delaware Court of Chancery denied all requested relief, and permitted Athilon to continue executing the long-term business strategy that Quadrant challenged at trial.

Quadrant alleged that (1) the 2008 financial crisis left Athilon, which had operated as a credit derivative products company ("CDPC"), insolvent, and, (2) that Athilon's current equity holders, a series of funds managed by Merced Capital, L.P. ("Merced"), were operating Athilon solely to benefit themselves as owners of the Athilon junior notes, the equity, and ASIA, while the company had no business or prospect of returning to solvency.

We first challenged Quadrant's claims based on failure to comply with the no-action clause in Athilon's indentures, which limited debtholders' ability to bring claims that affected all debtholders ratably. Following multiple appeals over three years, this defense pared back Quadrant's action, and, on Athilon's motion to dismiss, the court rejected Quadrant's assertion that Athilon's governing documents prevented it from entering into transactions outside of the CDPC business.

Following these adverse rulings, Quadrant amended its complaint in April of last year to challenge Athilon's purchase of so-called XXX securities (a type of securitization of life insurance) from the Merced funds and Athilon's repurchase of $194.6 million of debt held by the Merced funds in January at 92 percent of the face amount. The trial focused on these claims.

After five days of trial, Vice Chancellor Laster rejected Quadrant's claims across the board. *First*, the Vice Chancellor found that the Athilon indenture imposed no restrictions on Athilon's business activities so long as the company followed the proper procedures, which it had. *Second*, the Vice Chancellor found that the debt repurchase did not violate the indenture. *Third*, the Vice Chancellor held that Athilon's XXX investments, combined with strategic debt cancellation (including of the junior notes that were the subject of some of Quadrant's claims) and the improvement of Athilon's book, had rendered the company solvent no later than July 2014. Thus, by the time Quadrant filed its amended complaint in April 2015, it lacked standing to assert derivative claims as a creditor and could not challenge the transactions as fraudulent transfers.

In all respects, this was a true bet-the-company case for Athilon. Quadrant not only sought an order requiring Athilon to shut down, but also sought findings of breach of fiduciary duty against each member of the Athilon Board *personally*. Quadrant got neither. Instead, we secured a complete victory by vindicating Athilon's business strategy—XXX investments and strategic management of its insider debt—which Quadrant had made the centerpiece of its suit. Q

Quinn Emanuel Elects Nine New Partners

The newly elected partners are as follows:

Jordan R. Jaffe is based in the firm's San Francisco office. His practice focuses on technology-based litigation with an emphasis on patent, trade secret, and other intellectual property disputes. Jordan received a B.A. in computer science and politics from Lake Forest College and a J.D., *cum laude*, from University of San Francisco School of Law, where he was Executive Editor of the Law Review.

David S. Mader is based in the firm's New York office. His practice focuses on complex commercial disputes of all kinds, including the litigation and appeal of claims relating to financial markets and instruments, energy and resource delivery contracts, and environmental response actions. David received a Bachelor of Arts, with first class honours, from McGill University, and a J.D., with high honors, from the University of Texas, where he was an articles editor of the Law Review. Prior to joining the firm, David clerked for Judge T.S. Ellis III on the United States District Court for the Eastern District of Virginia, and for then-Chief Judge Dennis Jacobs on the United States Court of Appeals for the Second Circuit.

Ben O'Neil is based in the firm's Washington, D.C. office. Ben is a trial lawyer focused on the representation of domestic and overseas companies, boards of directors, and senior executives in investigations, crises, and litigation involving the federal government and its agencies. He received a B.A. from the University of Virginia and graduated *magna cum laude* from Georgetown University Law Center.

Matthew D. Robson is based in the firm's New York office. His practice focuses on complex commercial litigation and patent litigation. Matthew received a B.E., *summa cum laude*, from The Cooper Union and a J.D., *cum laude*, from Harvard Law School, where he was an editor of the Harvard Law Review.

Daniel Salinas-Serrano is based in the firm's Washington, D.C. office. His practice focuses on international arbitration with particular emphasis on investor-state arbitrations, including those administered by the International Centre for Settlement of Investment Disputes (ICSID). He also has represented clients in arbitrations administered under the UNICTRAL rules, the International Court of Arbitration of the International Chamber of Commerce (ICC) and the International Centre for Dispute Resolution (ICDR/AAA). Daniel received a J.D. from Harvard Law School and clerked for the Hon. Juan M. Perez-Gimenez of the U.S. District Court for the District of Puerto Rico.

Maaren A. Shah is based in the firm's New York office. Her practice focuses on complex commercial litigation, arbitration, and appeals with an emphasis on business and finance matters, and she has extensive experience advising clients on strategic resolution of commercial disputes. She received a B.A. in both economics (with honors) and Spanish from the University of Pennsylvania, where she graduated *magna cum laude*. She holds a J.D. with distinction from Stanford Law School and clerked for the Honorable Robert D. Sack of the U.S. Court of Appeals for the Second Circuit.

Epaminontas Triantafilou is based in the firm's London office. His practice focuses on international commercial and investment treaty arbitration, as well as public international law. Previously he has served as Legal Counsel at the Permanent Court of Arbitration, and as Legal Assistant to the Hon. Charles N. Brower. Epaminontas holds B.A. and M.A. degrees from Brandeis University and a J.D. from the University of Chicago Law School, where he was an Onassis Scholar, a McQuistion Scholar, and Comments and Developments Editor of the Chicago Journal of International Law.

Mark Tung is based in the firm's Silicon Valley office. He is a trial lawyer specializing in patent litigation, and has experience in intellectual property disputes in federal courts and in the United States International Trade Commission encompassing copyright, trademark, trade dress, and trade secret. Mark received a J.D. from Harvard Law School, a Ph.D. in Physics from the University of California at Berkeley, and a B.S. in Physics from the Massachusetts Institute of Technology.

Duncan Watson is based in the firm's Sydney and Hong Kong offices. He is dual qualified (Australia and England & Wales), and his practice focuses on domestic Australian litigation and international commercial and treaty arbitration. He received an LLB with first class honours from the University of Queensland and a BCL with distinction from Oxford University.

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