June 2014

quinn emanuel

quinn emanuel urquhart & sullivan, llp | business litigation report

los angeles | new york | san francisco | silicon valley | chicago | washington, d.c. | tokyo | london | mannheim | hamburg | munich | paris | moscow | hong kong | sydney | brussels

Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.) – Bankruptcy Court Takes Unusual Steps to Declare Corporate Restructuring a Fraudulent Transfer

Companies that have valuable assets but also face significant liabilities will sometimes engage in restructurings to isolate, or "ring-fence," the good assets from the liabilities. Often the companies are able to accomplish their shuffling of assets without judicial interference, especially if they proceed over a period of years and justify the transactions with analyses from independent professionals and industry observers.

But every once in a while, a court will put a stop to such actions if they harm creditors, especially when the companies proceeded quickly and without creditor involvement. In December 2013, in *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.)*, 503 B.R. 239 (Bankr. S.D.N.Y. 2013), Judge Allan Gropper, a bankruptcy judge in the influential United States Bankruptcy Court for the Southern District of New York, issued a lengthy opinion that avoided billions of dollars of transfers involving such "ring-fencing" efforts. Judge Gropper made preliminary findings of a range of net damages of at least $5.15 billion. The parties subsequently settled, meaning that the decision will not undergo appellate review. Nevertheless, the opinion may have a wide-ranging impact on what steps companies with long-term liabilities can take to preserve value for shareholders by separating valuable assets from such liabilities, and may open the floodgates for bankruptcy estates and unsecured creditors to challenge transactions that occurred years earlier.

Among the interesting rulings in *Tronox* are the court's decision to reach back to avoid transfers that occurred nearly a decade before the companies filed for bankruptcy, its heavy criticism of defendants' use of market data to justify the transfers, and its decision to permit avoidance of transfers even where the value of the avoided transfers exceeded what was necessary to pay creditors in full. The decision discusses a number of issues important to insolvency practitioners, investors in distressed debt, and private equity sponsors. For companies like Ceasar's and Sears and their equity sponsors—which recently have engaged in arguably

(continued on page 2)

INSIDE

Appellate Star Lori Alvino McGill Joins Quinn Emanuel's Washington, D.C. Office

Appellate specialist Lori Alvino McGill has joined the firm as a partner in its Washington, D.C. office. Ms. Alvino McGill has represented clients in high-profile civil and criminal appeals involving a wide range of constitutional and other issues in a variety of contexts, including securities, intellectual property, First Amendment, criminal law and procedure, the law of federal class actions, and the law of federal jurisdiction. She has also been involved in appeals involving administrative agencies, including the Federal Communications Commission, the Securities and Exchange Commission, the Surface Transportation Board, and the Board of Immigration Appeals. Before entering private practice, Ms. Alvino McGill was a Bristow Fellow in the Office of the Solicitor General of the United States. She also clerked for Justice Ruth Bader Ginsburg, Associate Justice of the Supreme Court of the United States. Q

Quinn Emanuel Partners Jay Neukom, Melissa Baily, and Lori Alvino McGill Named *Law360* "Rising Stars"

San Francisco partners Jay Neukom and Melissa Baily, and Washington, D.C. partner Lori Alvino McGill were named 2014 "Rising Stars" by *Law360*. Chosen from a pool of more than 1,000 nominees, Mr. Neukom and Ms. Baily were recognized for their achievements in intellectual property, and Ms. Alvino McGill was selected for her appellate work. *Law360* cited Mr. Neukom's victory on behalf of Fortinet Inc., Ms. Baily's work on behalf of Google Inc., Samsung, and Johnson & Johnson, and Ms. Alvino McGill's high-profile "Baby Veronica" case before the U.S. Supreme Court. Q analogous transactions to unlock value for equity security holders in the face of substantial debt—*Tronox* could be worrisome because it gives hedge funds, distressed debt traders, and bankruptcy counsel roadmaps on how to challenge transactions that most industry professionals previously would have viewed as untouchable. *Tronox* is also important for companies seeking to restructure their long-term environmental and tort remediation liabilities.

To set the stage for his rulings, Judge Gropper reviewed a lengthy chronology of the transactions of Kerr-McGee Corporation from 2000 to 2006. Kerr-McGee had “enormous legacy environmental and tort liabilities” from 2,700 environmental sites (including at least seven “Superfund” sites). Beginning in 2000, the company, with input from financial and legal professionals, started developing a plan to separate certain of its valuable businesses from its legacy liabilities to make the businesses more attractive to investors and acquirers. Over a six-year period, the company engaged in numerous transactions that resulted in its valuable businesses being separated from the entities liable for the legacy environmental and tort liabilities. These included an initial public offering for Tronox, Inc., entry into a secured credit facility, and an issuance of unsecured notes.

In 2002 the most valuable business was transferred to a new entity, the so-called “New” Kerr-McGee, leaving a chemical business and legacy liabilities with “Old” Kerr-McGee, which was renamed Tronox Worldwide LLC. Three years later, in 2005, Tronox incurred approximately $450 million in secured bank debt and issued unsecured notes of $350 million. All but $40 million of the proceeds from these transactions were paid to New Kerr-McGee. Later in 2005, Tronox was taken public in an initial public offering, resulting in $225 million in proceeds that were also paid over to New Kerr-McGee. Finally, in March 2006, New Kerr-McGee distributed the Tronox stock to its shareholders, completing the spin-off of the Tronox assets (and liabilities) and establishing Tronox as an independent company. Within a few weeks of the last transaction, Anadarko acquired New Kerr-McGee for $18 billion in an all-cash transaction.

Even though it had interim financial difficulties, Tronox did not file for bankruptcy until January 2009. A few months later, the bankruptcy estate filed a complaint in the bankruptcy court against Anadarko and other beneficiaries of the transfers, alleging actual and constructive fraudulent transfers and a variety of common law claims. The complaint sought billions in compensatory and punitive damages, attorneys’ fees, and interest.

The bankruptcy court dismissed the common law claims before trial, but permitted the case to proceed to trial in mid-2012 on the fraudulent transfer claims. Judge Gropper issued his 166-page opinion on December 12, 2013, finding that New Kerr-McGee and its subsidiaries had received actual and constructive fraudulent transfers of Old Kerr-McGee’s/Tronox’s assets. Anadarko was dismissed as a defendant, although Judge Gropper noted that it could be held liable in the future, were it found that Old Kerr-McGee/Tronox assets had been transferred to Anadarko. Within days of the ruling, Anadarko’s share price and value of its bonds dropped precipitously.

Although the opinion raises numerous important issues for bankruptcy practitioners, several of the court’s rulings easily could have chilling effects on ongoing restructuring and will give unsecured creditors more leverage in their efforts to block equity sponsors from separating good assets from bad liabilities. In particular, the court held that the transfers, made over a six-year period between 2000 and 2006, collectively constituted an actual fraudulent transfer, one made “with actual intent to hinder, delay, or defraud” creditors. Judge Gropper found “clear and convincing” evidence of actual intent to hinder or delay the legacy environmental and tort creditors. He rejected the defendants’ contentions that they believed Old Kerr-McGee/Tronox would survive, and that there were legitimate business purposes for the transaction. It is highly unusual for a bankruptcy court to hold that a multi-stage set of corporate transactions, involving sophisticated business representatives, law firms, and other professionals, constitutes an actual fraudulent transfer.

Judge Gropper also held that the transactions constituted a constructive fraudulent transfer, one that made for less than reasonably equivalent value while the debtor was (or was rendered) insolvent, undercapitalized, or unable to pay its debts as they came due. Judge Gropper found that Old Kerr-McGee/Tronox had received less than reasonably equivalent value for its valuable businesses that were separated from the entity liable for the legacy liabilities, and that it was (or was rendered) insolvent, undercapitalized, or unable to pay its debts as they came due.

In reaching his constructive fraudulent transfer conclusion, Judge Gropper found that the net value of the assets transferred from Old Kerr-McGee/Tronox to New Kerr-McGee was $14.459 billion. In exchange for this substantial net flow of value to New Kerr-McGee, Judge Gropper found that Old Kerr-McGee/Tronox did not receive reasonably equivalent value. He also rejected the defendants’ contention that value had to be measured on an entity-by-entity basis, holding that value could be netted because the debtors had always treated their financials on a consolidated basis, and fraudulent transfer laws look at substance, rather than form. Normally, courts will not ignore separate corporate structures as Judge Gropper did.

Next, Judge Gropper had to determine that, at the time of the transfers, the liabilities of Old Kerr-McGee/Tronox exceeded the value of its assets. Judge Gropper stated that the key issue on the liability side was "the amount of Tronox's environmental and tort liabilities," which were disputed, unliquidated, and contingent. The court observed that valuing such liabilities "is what this case is all about." Valuing contingent liabilities as part of a solvency determination is relatively rare, although it should have been obvious to the defendants that the contingent environmental liabilities would be a critical issue. Judge Gropper characterized as a "major failure of proof" that the defendants did not provide a comprehensive environmental liability analysis.

The court also rejected the defendants' heavy reliance on market data as a basis for determining that Old Kerr-McGee/Tronox was solvent, even though Old Kerr-McGee/Tronox was able to raise approximately $750 million from an IPO and financings in 2005 and had survived for several years following the spin-off. Before *Tronox*, courts in the leading bankruptcy forum—the Southern District of New York and the District of Delaware—had embraced market data approaches used to prove solvency. *See VFB LLC v. Campbell Soup Co.*, 482 F.3d 624 (3d Cir. 2007); *Iridium Operating LLC v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283 (Bankr. S.D.N.Y. 2007); *In re Old CarCo, LLC*, 454 B.R. 39 (Bankr. S.D.N.Y. 2011). But Judge Gropper was not persuaded by the so-called market data. He found that investors were provided with overly optimistic financials that had unrealistic EBITDA projections and did not adequately reserve for the legacy liabilities. He also rejected the defendants' claims that third-party investors were willing to buy Old Kerr-McGee/Tronox, finding that none of the offers was binding and that none of the investors had been willing to accept responsibility for the full amount of the legacy liabilities. It was the failure to account for contingent liabilities properly that led the court to conclude:

> There is thus much evidence in the record regarding the insufficiencies of the Tronox financials used in the IPO. Nevertheless, it is not necessary for Plaintiffs to prove that the IPO financial statements were false and misleading. Plaintiffs have clearly overcome the presumption of market efficiency because this case is not about Tronox's earning power, or its ability to maintain its position as the world's third-largest TiO2 producer . . . . This case is about the legacy liabilities that Kerr-McGee imposed on Tronox and their impact on Tronox's solvency.

503 B.R. at 300-01.

The opinion also involves important statute of limitations issues concerning fraudulent transfer claims, arguably expanding the time for bankruptcy estates (in bankruptcy) and creditors (outside of bankruptcy) to challenge transactions. Typically, constructive fraudulent transfer claims may be brought within four years of the subject transfer, and the Oklahoma state law the parties argued governed applied such a four-year limitations period. But Judge Gropper held that all of the transfers could be avoided, even though the largest transfers of assets out of Old Kerr-McGee/Tronox occurred in 2002 and the bankruptcy occurred in 2009.

Judge Gropper further found that transactions more than six years before the bankruptcy could be avoided because (i) the transactions could be "collapsed" into a single scheme spanning from 2000 to 2005, (ii) the federal government itself was a creditor, and thus the Federal Debt Collection Practices Act provided a six-year statute of limitations, which was further extended by a tolling agreement, and (iii) the fraudulent transfer causes of action did not accrue (and thus the four-year period did not commence) until the separation was completed and New Kerr-McGee stopped supporting Old Kerr-McGee/Tronox, and the creditors suffered injury. In making these rulings, the court emphasized the importance of elevating substance over form.

These conclusions may be surprising to equity sponsors, directors, and officers considering multi-stage "ring-fencing" transactions over a period of years. Statutes of limitations are, in one sense, arbitrary: they are the embodiment of form over substance by creating hard and fast deadlines. But *Tronox* injects uncertainty as to when a statute of limitations actually begins to run. Moreover, the decision is unusual given the long period of time between the first "step" and the last "step" (every case the court cited involved multi-stage transactions occurring over a far shorter period of time), and its rejection of the colorable argument that each subject transaction was not dependent on the other in order to be consummated.

Finally, Judge Gropper held that damages would not be capped at what the legacy creditors were still owed. Although not settled law, prior to *Tronox* a common view of fraudulent transfer claims in bankruptcy was that fraudulent transfers could be set aside to the extent necessary to pay creditors in full, but not to a greater extent to provide creditors or equity holders a windfall. For example, if a debtor owed creditors $500,000 and had fraudulently transferred $1 million in value, the transfer would be avoided only to the extent necessary to pay the $500,000 owed. But Judge Gropper held that the transfers could be avoided in their entirety, even though the value of the transfers no doubt exceeded what was necessary to pay creditor claims in full. Bankruptcy Code section 550(a) requires that recovery of an avoided transfer be "for the benefit of the estate," but it does not require that recovery be limited to what is necessary to pay the estate's creditors. There is no statutory prohibition on creditors receiving a "windfall" from a fraudulent transfer recovery.

Tronox creates significant risks for companies and their equity holders, directors, and officers when there are efforts to isolate valuable assets from potential liabilities. Transactions occurring over many years, with the advice of respected professionals and tested by market participants, now face the risk of avoidance. But risk for one set of interested parties presents opportunities and leverage for others. *Tronox* opens the door for unsecured creditors to challenge a broader array of transactions over a longer period of time by seeking to collapse transactions that are not directly linked, but that can be characterized as part of a common scheme. Q

Fred Bennett and Kevin Johnson Receive ILO Client Choice Awards

Los Angeles partner Fred Bennett and Silicon Valley partner Kevin Johnson were honored at the 2014 International Law Office (ILO) Client Choice Awards recognizing attorneys around the world who excel in both client care and service. Mr. Bennett was recognized for the second time as the outstanding U.S. international arbitration practitioner—one of the few practitioners to be twice selected. Mr. Johnson was recognized for his outstanding achievements in intellectual property and patent law. The ILO Client Choice Awards are based on peer reviews from approximately 2000 in-house counsel and eminent arbitration practitioners worldwide. Q

NOTED WITH INTEREST

The Scope of Copyright Protection over Sherlock Holmes Characters Is Far from "Elementary"

The copyright clause of the U.S. Constitution incentivizes the creation of original works of art by granting authors exclusive rights in such works for "limited Times." U.S. Const. art. I, § 8, cl. 8. The idea is to strike a balance by providing sufficient exclusive rights to foster artistic creation, while limiting that exclusivity temporally to avoid impeding the free flow of ideas and information with thickets of licensing arrangements. While it is an elegant proposition, striking that balance has proven messy in practice. The Founding Fathers' language is still being parsed, as reflected in the recent Northern District of Illinois case *Klinger v. Conan Doyle Estate, Ltd.*, 2013 WL 6824923 (N.D. Ill. Dec. 23, 2013), which grappled with the extent of copyright protection that applies to the iconic characters of Sir Arthur Conan Doyle's famous Sherlock Holmes stories.

The question of the extent of copyright protection over fictional characters that is at the heart of the *Klinger* case has a rich history of jurisprudence. But before arriving at that question, courts had to decide whether a copyright could protect a fictional character at all, and if so, for how long.

Copyright protection is commonly associated with a precisely defined and easy-to-copy artistic creation that is fixed in a tangible medium of expression—such as a poem, a video recording of a television series, or a painting. Courts have also found copyright protection over fictional characters that are defined in a broader and more fluid sense—such as by mannerisms, a style of dress, or behavioral tendencies. Characters defined *too* broadly are ineligible for protection, allowing anyone to incorporate a stock character into a story (*e.g.*, the tweed-wearing, absent-minded professor). But an artist can protect a readily identifiable and unique creation—for instance, a certain British secret agent with a penchant for fast cars, tuxedos, high-tech gadgetry, and memorable catch phrases. *See MGM v. Honda*, 900 F. Supp. 1287 (C.D. Cal. 1995).

These ground rules were established almost a century ago in *Nichols v. Universal Pictures Corp.*, 45 F.2d 119 (2d Cir. 1930), where the famed Judge Learned Hand based his rationale on the established tenet that abstract ideas are not copyrightable while their particularized expression is:

If Twelfth Night were copyrighted, it is quite possible

> that a second comer might so closely imitate Sir Toby Belch of Malvolio as to infringe, but it would not be enough that for one of his characters he case a riotous knight who kept wassail to the discomfort of the household, or a vain and foppish steward who became amorous of his mistress. These would be no more than Shakespeare's "ideas" in the play, as little capable of monopoly as Einstein's Doctrine of Relativity, or Darwin's theory of the Origin of Species. It follows that the less developed the characters, the less they can be copyrighted[.]

Id. at 121. More recently, Judge Posner of the Seventh Circuit applied Judge Hand's analysis in holding that a comic-book character need only be drawn, named, and given speech to be a sufficiently distinctive and copyrightable character. *Gaiman v. McFarlane*, 360 F.3d 644, 660 (7th Cir. 2004). Judge Posner also recognized, however, that even this seemingly bright-line standard will not always be perfectly implemented. *See id.* ("As long as the character is distinctive, other authors can use the stock character out of which it may have been built without fear (well, without too much fear) of being accused as infringers.").

Assuming that copyright protection applies to a fictional character, the next question is the duration of that protection. This question may be complex and require the interpretation of several provisions of the Copyright Act, 17 U.S.C. § 301, *et seq.*, including those regarding the manner in which the work that introduced the character was "published." In general, however, works published before 1923 are no longer subject to any copyright protection, and are therefore in the public domain. Works published after 1923 and before 1978 are entitled to a maximum of 95 years of protection if the copyrights in the works were properly renewed.

With these rules in mind, the *Klinger* court was called upon to decide the extent of copyright protection that applies to fictional characters that appear in a series of works that span the 1923 threshold, such that the copyrights in the pre-dating works have expired already, while the copyrights in the post-dating works remain valid until at least 2018. The underlying dispute arose when the plaintiff, Leslie Klinger, sought to publish two anthologies of short stories by contemporary authors featuring characters from Doyle's original series of stories. Doyle's stories comprise sixty volumes of novels and novellas of which fifty were published before 1923, and thus indisputably in the public domain, while ten (the "Ten Stories") were published after 1923, and thus remain, at least in part, under copyright protection for several more years. Before publishing the anthologies, Doyle's estate demanded licenses from the publishing houses. Klinger therefore filed suit seeking a judicial declaration that story elements and characters that were first introduced in Doyle's pre-1923 works have entered the public domain. In response, Doyle argued that because the Sherlock Holmes and Dr. Watson characters continued to be developed in stories that were first published after 1923, those characters remain subject to copyright protection.

On the merits, Chief Judge Rubén Castillo relied on the Second Circuit's landmark decision in *Silverman v. CBS, Inc.*, 870 F.2d 40 (2d Cir. 1989), to conclude that Klinger and the public may use any pre-1923 story elements without seeking a license, but that any post-1923 story elements constituting "increments of protection" are protected by copyright. *Klinger*, 2013 WL 6824923 at *6-7. The *Silverman* court had previously applied this test, which derives from the Copyright Act's protection of "derivative works," to hold that copyrighted radio scripts for the "Amos 'n' Andy" program were protected only to the extent they included "increments of expression" further delineating the characters and story beyond what is contained in the public domain works. *Silverman*, 870 F.2d at 50; *see* 17 U.S.C. § 103(b) ("The copyright in a compilation or derivative work extends only to the material contributed by the author of such work, as distinguished from the preexisting material employed in the work, and does not imply any exclusive right in the preexisting material"). In reaching its conclusion, the *Klinger* court rejected Doyle's argument that *Silverman* applies only to two-dimensional, "flat characters," and not to complex, three-dimensional characters such as Sherlock Holmes and Dr. Watson, explaining that Doyle's approach fails to offer a workable standard for determining whether a character is three-dimensional and protected. *Klinger*, 2013 WL 6824923 at *7.

As a result of the *Klinger* ruling, which is presently on appeal to the Seventh Circuit, the public is free to develop new works around the Sherlock Holmes or Dr. Watson characters provided that those works do not incorporate story elements from the Ten Stories that remain under protection—such as Dr. Watson's second wife and his background as a rugby player, and Sherlock Holmes' retirement from his detective agency. It remains to be seen whether the practical effect of the *Klinger* ruling will be to encourage more uses of the public elements of Doyle's or others' similarly-situated works in a series, or discourage such uses where it is difficult to distinguish between public and copyrighted story elements that apply to the same fictional character. What is virtually certain is that the *Klinger* decision will not be the final time that a court is called upon to address this quirk of the Copyright Act. Q

Appellate Practice Update

Comparison of Circuits' Local Rules. While the Federal Rules of Appellate Procedure ("FRAP") set high-level ground rules for appellate practice in the federal courts of appeals, practice in those courts is in fact far from uniform. Changes in FRAP govern all federal appeals; for example, recent amendments to FRAP streamlined the required sections of an appellate brief by eliminating the requirement that an appellate brief include separate sections on the case's procedural history and its facts. But much like local rules of civil procedure in federal district courts, each circuit has promulgated its own set of Local Rules, which substantially modify or even replace the standard FRAP according to each circuit's unique preferences. We discuss here those differences for three parts of an appeal that an appellant will almost certainly encounter: the notice of appeal and the docketing statement, the briefing schedule, and the contents of the appendix.

The best place to begin is at the beginning, when a lawyer seeks to initiate an appeal. FRAP suggests that this is a straightforward process: the appellant must file a notice of appeal with three pieces of information—the party taking the appeal, the judgment or order being appealed, and the name of the court to which the appeal is taken (FRAP 3(c)(1))—plus a short docketing statement naming the parties the lawyer represents (FRAP 12(b)). Some circuits require little more than that: the Ninth Circuit, for example, also requires the parties to fill out the Ninth Circuit Mediation Questionnaire, which is used by the Ninth Circuit's Mediation Office. 9th Cir. R. 3-4(a). Other circuits require much more. The Federal Circuit, for example, requires the appellant to file its corporate disclosure information within 14 days of docketing, as well as to list the names of every lawyer who has appeared on behalf of the appellant, both in the Federal Circuit and the court or agency below. Fed. Cir. R. 47.4(a)(4). The D.C. Circuit requires that the appellant list all relevant statutes at issue, and, months before the briefs are due, provide a preliminary statement of the issues that will be raised. D.C. Cir. R. 12; D.C. Internal Operating Procedures IV.A.3. The Seventh Circuit focuses on its jurisdiction, requiring an appellant to lay out in detail why the appellant believes the Seventh Circuit has the power to hear the case. 7th Cir. R. 3(c)(1), 28(a). But perhaps no circuit asks more of appellants at the very outset of the appeal than the Second Circuit, which asks for all of the above, as well as the issues to be raised and the applicable appellate standard of review for each proposed issue, within 14 days of the appeal being docketed. 2d Cir. R. 12(b)(1); 2d Cir. Civil Appeal Pre-Argument Statement.

Once the appeal is docketed, the next question is almost always "how long do I have to write this brief?" Again, the FRAP appears simple. Once the district court files the record with the court of appeals (within 14 days after the notice of appeal is filed (FRAP 10(b)(1)), the appellant has 40 days to file its opening brief, the appellee has 30 days to answer, and the appellant has 14 days to reply, although the reply must be filed within 7 days of the case's oral argument date. FRAP 31(a)(1). But the Local Rules again contain substantial deviations, both in how long a party has to prepare its brief and how those deadlines are even established. The Seventh Circuit follows FRAP, except that the appellant's 40 days are measured from when the appeal is docketed, not when the record is received. 7th Cir. R. 31(a). The Second Circuit, in contrast to its demanding requirements for the notice of appeal and docketing statement, is the most flexible to the parties, allowing the appellant to choose its own due date so long as it is within 91 days of when the record is complete, with the appellee getting similar flexibility. 2d Cir. R. 30(a)(1)(A), (B). The Federal Circuit gives the appellant 60 days for its opening brief, but gives the appellee only 40 days for its answering brief. Fed. Cir. R. 30(a)(1)(A), (a)(2). Both the D.C. Circuit and the Ninth Circuit take the question out of the parties' hands entirely, informing them via a scheduling order when the briefs will be due. 9th Cir. R. 31-2.1(a); D.C. Cir. R. 31(a). The Ninth Circuit, moreover, offers a near-automatic 30-day extension for each brief that may be obtained by selecting an option on the Ninth Circuit's CM/ECF system without even filing a form or written motion.

It is the third topic that most reveals the vast differences in the circuits' Local Rules—the procedures for filing appendices to the briefs. FRAP is quite general: while it prohibits the inclusion in an appendix of any memo of law (FRAP 30(a)(2)), it requires just the relevant docket entries, the relevant portions of the pleadings, the order or decision at issue, and other parts of the record to which the parties wish to direct the court's attention (FRAP 30(a)(1)). Parties can also use the "deferred appendix" method if so desired, in which the appendix is not submitted until the briefing is complete. FRAP 30(c). But the circuit courts have their own views on what should be submitted, and how. The Second Circuit strongly encourages joint appendices filed by all parties, but also requests that the parties assemble a "special appendix" that contains only the orders or opinions being appealed and the text and citations of any significant rule of law at issue. 2d Cir. R. 32.1(c). The Ninth Circuit, by contrast, does away with joint appendices altogether, and instead uses an "Excerpts of Record" ("ER") system in which each party files its own ER or supplemental or further ER along with each brief it submits (9th Cir. R. 30-1.4, 30-1.7, 30-18), and encourages the parties to organize their ERs in reverse chronological order except for the decision at issue, which comes first (9th Cir. R. 30-1.6(a)). The Federal Circuit takes a third route, strongly preferring the deferred appendix method that includes only the portions of the record cited in the briefs. Fed. Cir. 30(a)(2)(B). And unless the appellee is the United States, the deferred appendix is the only chance a party will get to have a document from the record included in the appendix, because in the Federal Circuit only the United States can move to file a supplemental appendix. Fed. Cir. R. 30(f).

Thus, no matter what circuit an appeal arises in, the best advice is to always read the Local Rules in addition to FRAP. And if you happen to be an appellant or an appellee with procedural issues, do not forget that you can always ask the circuit's clerk's office. Those offices have knowledgeable staff who are often able to save you a significant amount of time and stress.

Class Action Litigation Update

"Ascertainability" Emerges as Key Battleground in Class Actions Involving Low-Cost Consumer Goods. Grocery store shelves have emerged as the favored hunting ground of the plaintiff's consumer class action bar, which has attacked labels on virtually every category of food and beverage, cosmetics, and over-the-counter medications. A defining feature of these cases is that they involve low-cost consumables sold in large volumes. As discussed below, this combination leads to high aggregate exposure, but makes identifying putative class members virtually impossible.

A growing number of federal courts have seized on this identification problem as a basis to find that plaintiffs fail to meet the so-called "ascertainability" requirement. Many courts have recognized that a class, in order to be properly certified, must be "readily ascertainable based on objective criteria." *Marcus v. BMW of N. Am., LLC*, 687 F.3d 583, 592 (3d Cir. 2012) (listing cases). In applying this ascertainability requirement, certain courts focus only on the plaintiff's express definition of the class, holding that if the definition appears to be based on objective criteria, then the class is ascertainable. *See, e.g., Guido v. L'Oreal, USA, Inc.*, CV 11-1067 CAS JCX, 2013 WL 3353857 (C.D. Cal. July 1, 2013) (holding that class was ascertainable where definition included all purchasers who bought shampoo after a certain date). But other courts require more and look beyond the class definition at whether the plaintiffs have evidence, such as purchase receipts, that would prove which class members meet the class definition.

The Third Circuit has staked out the most aggressive pro-defense stance in applying the ascertainability requirement to deny certification of consumer class action claims. Last year, it reversed an order certifying a class of purchasers of multivitamin supplements, holding that neither retailer records nor class member affidavits would suffice to ascertain class membership. *Carrera v. Bayer Corp.*, 727 F.3d 300, 308 (3d Cir. 2013). The plaintiff alleged that defendant Bayer Healthcare had falsely claimed that WeightSmart, a multivitamin supplement, enhanced metabolism by including a green tea extract. *Id.* at 304. The plaintiff defined the class as all people who purchased WeightSmart in Florida. *Id.* It was undisputed that the buyers did not have "documentary proof of purchase, such as packaging or receipts," and Bayer had "no list of purchasers because . . . it did not sell WeightSmart directly to consumers." *Id.*

The plaintiffs offered two types of evidence to satisfy the ascertainability requirement. *Id.* at 308. First, they argued that they could establish class membership using "retailer's records of sales made with loyalty cards, e.g., CVS ExtraCare cards, and records of online sales." *Id.* Although the court said that "[d]epending on the facts of a case, retailer records may be a perfectly acceptable method of proving class membership," the plaintiffs failed to introduce evidence in support of their class certification motion showing that the retailer at issue actually had such records. *Id.* at 308–09. The court therefore required more than a theoretical basis to establish class membership and required evidence that the method was feasible. *See id.*

Second, the plaintiffs proposed using affidavits from potential class members attesting they had bought the product. *Id.* at 309. The court rejected this approach also because an affidavit would not address a core concern of ascertainability, which is "that a defendant must be able to challenge class membership." *Id.* The plaintiffs argued that because Bayer's liability was based on total sales and did not depend on the number of individual claims, unreliable affidavits would not affect Bayer's total liability. *Id.* But the court held that fraudulent affidavits would harm other class members by reducing their recovery, which could also harm Bayer if class members argued they were not bound by the settlement due to inadequate representation. *Id.* The court also rejected the plaintiffs' claim that the class-action administrator, a consultant hired by the plaintiffs, could weed out fraudulent claims, stating that the administrator's method was not "specific to this case" and plaintiffs had "no way to determine the reliability of such a model." *Id.* at 311. Based on this reasoning, the Third Circuit reversed the district court's certification order, but directed the district court to give the plaintiffs limited discovery on the issue of ascertainability and another opportunity to meet the ascertainability requirement. On May 2, 2014, the Third Circuit denied a petition for rehearing en banc.

Several district courts have also recently denied class certification for similar reasons. In *Astiana v. Ben & Jerry's Homemade, Inc.*, the plaintiff alleged that Ben & Jerry's had falsely marketed its ice cream as "all natural" even though it contained "alkalized cocoa" produced with "synthetic" agents and sought to certify a class of California consumers who had bought Ben & Jerry's ice cream. 2014 WL 60097, at *1 (N.D. Cal. Jan. 7, 2014). The court denied certification because, among other reasons, the plaintiff had "not shown that a method exists for determining who, among the many California purchasers of Ben & Jerry's, fits within the proposed class." *Id.* at *3. Ben & Jerry's used alkalized cocoa from 15 different suppliers, and not all the alkalized cocoa was produced using a synthetic ingredient. *Id.* Because the plaintiff had not identified any method to determine which consumers had bought ice cream with the synthetic ingredient and which had not, the court held the class was not ascertainable. *Id.*

The defendant in another case, *Karhu v. Vital Pharmaceuticals, Inc.*, manufactured and marketed a dietary supplement called VPX Meltdown Fat Incinerator, claiming that it could "burn fat" and help consumers lose weight quickly. 2014 WL 815253, at *1 (S.D. Fla. Mar. 3, 2014). The plaintiff alleged the product was ineffective, and sought to certify a nationwide class of buyers. *Id.* The court held that the class was not ascertainable because consumers "probably have not retained their receipts" and the manufacturer sold only to retailers and therefore did not have records of consumers purchases. *Id.* at *3. Affidavits from class members were also inadequate because they "would deprive [the defendant] of its due process rights to challenge the claims of each putative class member" or, if the defendant were allowed to challenge the affidavits, would "require a series of mini-trials and defeat the purpose of class-action treatment." *Id.*

The court in *In re POM Wonderful LLC*, 2014 WL 1225184 (C.D. Cal. Mar. 24, 2014) decertified a class because, among other reasons, the putative class members would not have retained records of their purchases of a consumer juice product. *Id.* at *5–6. In doing so, the court identified three factors relevant to the ascertainability inquiry: (1) the price of the product; (2) the range of potential or intended uses of a product; and (3) the availability of purchase records. *Id.* at *6. The court applied this standard and held that the case fell "well toward the unascertainable end of the spectrum." *Id. See also Sethavanish v. ZonePerfect Nutrition Co.*, 2014 WL 580696, at *4–6 (N.D. Cal. Feb. 13, 2014) (denying class certification in a case involving an "all natural" nutrition bar because there were no records of consumer purchases").

This defense-oriented trend has not been universal. In *Ebin v. Kangadis*, Judge Rakoff of the Southern District of New York certified a class of olive oil buyers. 2014 WL 737960 (S.D.N.Y. Feb. 25, 2014). Although he acknowledged that "ascertainability difficulties" were "formidable" and that potential class members likely had no objective evidence of their purchases, he found that the class was ascertainable because to hold otherwise "would render class actions against producers almost impossible to bring." *Id.* at *5.

As ascertainability comes to the fore as a ground to deny class certification, we expect additional circuit courts to weigh in. It remains to be seen if they will join the Third Circuit or create a split that could make the plaintiffs' chosen forum outcome-determinative in these cases.

Life Sciences Litigation Update

Combination Drug Product Patent Validity. Pioneer pharmaceutical companies may have been reluctant to make the significant research and development investments required to bring combination drug products to market based on the perception that patents covering the combination would be vulnerable to attack. This perception of vulnerability stemmed from a 2007 opinion of the Supreme Court, holding that "a combination of familiar elements according to known methods is likely to be obvious when it does no more than yield predictable results." *KSR Int'l Co. v. Teleflex Inc.*, 550 U.S. 398, 401 (2007). But the principle articulated in *KSR* does not end the validity inquiry.

In two recent cases, the Federal Circuit has upheld the validity of claims to combinations of known agents, in view of evidence that the combination provides unexpected, significant advantages over the prior art. In addition, the District of Delaware recently sustained the validity of combination drug patents in a case where the patentee was represented by the Firm. Together, these opinions may encourage companies to invest in combination drug products, leading to improved therapies for patients.

In April 2014, the Federal Circuit upheld the validity of a patent claiming the combination of an ACE inhibitor (trandolapril) and calcium channel blocker (verapamil hydrochloride) for the treatment of hypertension, in *Sanofi-Aventis Deutschland GmBH v. Glenmark Pharmaceuticals Incorporated, USA*, No. 12-1489, __ F.3d __, 2014 WL 1552167 (Fed. Cir. Apr. 21, 2014). The court held that substantial evidence supported the jury verdict that the alleged infringer had not proved the patent-in-suit obvious even though combinations of ACE inhibitors and calcium channel blockers were disclosed in the prior art as possible treatments for hypertension. *Id.* at *4-5. While the court noted that the structural dissimilarity between trandolapril and prior art ACE inhibitors supported the jury's verdict, *id.* at 6, the court placed particular emphasis on the surprising evidence that the claimed combination product was superior to the prior art, noting that the combination demonstrated a better side effect profile and longer-lasting efficacy than prior art combinations of the same class of compounds at more frequent dosing intervals. *See id.* at *4-5.

The unexpectedly superior properties of the claimed combination distinguished Sanofi's patent from others. *See id.* at *5 (distinguishing *Richardson-Vicks Inc. v. Upjohn Co.*, 122 F.3d 1476 (Fed. Cir. 1997), holding a patent claim to a combination drug product obvious in the absence of unexpected results, from *Pozen Inc. v. Par Pharmaceutical, Inc.*, 696 F.3d 1151 (Fed. Cir. 2012), holding a patent claim to a combination drug product nonobvious when the combination produced greater efficacy than each active ingredient on its own).

The rationale in *Sanofi* tracks another recent opinion of the court in *Allergan Incorporated v. Sandoz Incorporated*, 726 F.3d 1286, 1294 (Fed. Cir. 2013). There, the Federal Circuit sustained the validity of a claim to a method of treating glaucoma or ocular hypertension with a combination of brimonidine and timolol, relying primarily on evidence that the claimed combination was surprisingly no less effective, and had a better side effect profile, at the claimed reduced dosage amounts (twice daily administration instead of three times per day). *Id.* at 1293-94.

The Federal Circuit rejected the appellant's arguments that certain disclosures in the prior art, i.e., brimonidine and timolol as single agent treatments for glaucoma in the same concentrations claimed in the patent, *id.* at 1290; and concurrent administration of brimonidine and timolol dosed twice per day, warranted finding the patent to be obvious. *Id.* at 1294. The court noted that the prior art lacked any evidence that either active ingredient in the combination produced greater efficacy or better side effects, when combined with an active from the same class of compounds as the second ingredient to the combination. *See id.* ("[W]e see no reason why the success of unrelated drugs would make it obvious to one of ordinary skill that a fixed combination of brimonidine and timolol could be dosed twice per day without loss of efficacy.").

In April 2014, the Firm was also able to obtain a significant victory for innovator pharmaceutical company, Avanir Pharmaceuticals, Inc., when the company asserted its patents that covered the use of its Nuedexta® product, a combination of previously known single agents dextromethorphan (DM) and quinidine (Q) that had previously been used in combination, albeit at higher doses, by relying upon unexpected results. After a six-day bench trial before Judge Leonard P. Stark in the District of Delaware, the Court ruled in Avanir's favor, crediting the evidence the Firm presented that skilled artisans would not have expected the use of the claimed amounts of DM and Q to be effective in treating PBA where "the dose of Q administered was reduced approximately 80-93%" from the prior-art dose, and the treatment unexpectedly remained efficacious and exhibited a better side effect profile.

The two Federal Circuit cases and the recent decision obtained by the Firm provide insight into how pioneer pharmaceutical companies can develop more solid patent protection for combination drug products before litigation ensues. The cases also provide a significant roadmap to litigation when the product covered by such patents come under attack. Q

Quinn Emanuel Knocks Out China Suit Against Cisco

In the year since the Supreme Court decided *Kiobel v Royal Dutch Petroleum Co.*, 133 S. Ct. 1659, 1669 (2013), which held that the Alien Tort Statute ("ATS") does not provide relief for "violations of the law of nations occurring outside the United States" (in a win obtained for Shell by Quinn Emanuel), many district courts have faced new questions about what remaining ATS suits may still be brought against corporations doing business abroad. In one notable such case, the firm recently obtained dismissal of an action in which the plaintiffs had sought to hold Cisco Systems Inc. and its CEO liable for the alleged use of Cisco technology by Chinese government officials in China. *Daobin v. Cisco Systems, Inc.*, No. 11-1538, -- F.Supp.2d ---, 2014 WL 769095 (D. Md. Feb. 24, 2014).

In the complaint, several Chinese residents alleged that they had been apprehended by Chinese authorities using Cisco networking equipment that Cisco had lawfully sold in China under U.S. export rules, and on this basis argued that Cisco was liable for physical injuries the Chinese police and prison officials later allegedly inflicted. The complaint asserted international law claims under the ATS, as well as various state-law tort claims. The district court dismissed the complaint with prejudice on multiple independent grounds:

First, the court held the Complaint nonjusticiable under the political question doctrine, reasoning that its adjudication would intrude into the Executive and Legislative branches' "finely balanced approach to foreign relations and human rights" in China, *id.* at *6, and would impermissibly "require the Judiciary to determine whether the U.S. rules and regulations surrounding the export of products to China are sound," *id.* The court additionally found the complaint nonjusticiable under the act-of-state doctrine, holding that its adjudication would unacceptably require a U.S. court to second-guess the sovereign acts of the Chinese government in enforcing Chinese law against Chinese citizens in China. *Id.* at *7.

Second, as an independent ground for dismissal, the district court held that the plaintiffs had not plausibly alleged that Cisco acted with the purpose of facilitating Chinese officials' wrongdoing or in a manner that substantially assisted such wrongdoing. *Id.* at *10. As the Court explained, "[f]rom all that appears, Cisco technology remains a neutral product that can be used in innumerable non-controversial ways," and the plaintiffs had failed "to indicate with any logic what it means to customize technology that would permit" the alleged wrongdoing at issue. *Id.* at *11.

Third, the Court dismissed all claims against Cisco's CEO for lack of personal jurisdiction, *id.* at *4, and all state tort-law claims for lack of federal supplemental jurisdiction once all the federal claims were dismissed, *id.* at *11.

The decision thus provides important new guidance for U.S. companies facing similar ATS suits post-*Kiobel*, and shows that numerous grounds for dismissal remain in addition to extraterritoriality based on *Kiobel* itself.

Complete Defense Verdict for Google in Delaware Patent Jury Trial

The firm won a complete defense verdict for Google Inc. in a patent case in the District of Delaware. The litigation concerned Google's search and advertising systems, and YouTube. In 2009, the plaintiff Personalized User Model, LLC ("PUM") filed suit. PUM alleged that Google infringed three of its patents relating to personalization services. Over the course of the litigation, PUM claimed that seven different Google products infringed these patents, and multiple different functionalities within those products. Google won summary judgment of non-infringement of one of the three asserted patents, and PUM dropped its claims against several of the accused products. At the time of trial, PUM was accusing Google Search, Search Ads, Content Ads, and YouTube of infringing 11 claims of the two remaining patents.

In addition to arguing non-infringement, the firm responded to PUM's infringement claims by asserting that the asserted claims are invalid as anticipated by the prior art, and obvious in light of the prior art. On behalf of Google, the firm also filed parallel *inter partes* re-examinations with the Patent & Trademark Office. At the time of trial, every single asserted claim stood rejected by the PTO on many grounds. Quinn Emanuel further brought a breach of contract claim against one of the named inventors for failure to assign the patent to his former employer SRI International, after Google acquired SRI's rights to the patents-in-suit and related causes of action.

The jury unanimously agreed with Quinn Emanuel and Google on all issues. The jury found that the inventor breached his employment agreement with SRI by failing to assign the patents, that not one of Google's accused products infringed a single asserted claim, that the asserted claims are invalid as anticipated by three different prior art references, and the asserted claims are invalid as obvious in light of the prior art.

Quinn Emanuel Continues Historic Settlement Victories for the Federal Housing Finance Agency

The firm's historic partnership with the Federal Housing Finance Agency ("FHFA"), as Conservator for Fannie Mae and Freddie Mac, has continued to produce unprecedented settlements with numerous financial institutions for their conduct in the run-up to the 2008 mortgage crisis. As we've previously mentioned in these pages, the firm filed fourteen complaints against most major investment banks, asserting billions of dollars of damages from federal and state "strict liability" statutory claims, as well as in certain cases common law fraud claims. The complaints allege that these fourteen financial institutions misrepresented the quality of the mortgage loans underlying the residential mortgage-backed securities that the banks sold Fannie Mae and Freddie Mac from 2005 to 2007.

After a series of legal victories in 2013, including a unanimous ruling from the Second Circuit that FHFA's claims were timely, Quinn Emanuel has worked closely with FHFA to reach satisfactory settlements of ten of the fourteen cases. In 2013 alone, the firm reached a $5.1 billion settlement with J.P. Morgan (which included claims against Bear Stearns and Washington Mutual), a $1.925 billion settlement with Deutsche Bank, an $885 million settlement with UBS, and a $250 million settlement with Citigroup.

The firm's successes have accelerated in the first half of 2014: in March 2014 the firm reached a $9.5 billion settlement with Bank of America, Countrywide, and Merrill Lynch, as well as an $885 million settlement with Credit Suisse, followed by a $280 million settlement with Barclays and a $110 million settlement with First Horizon in April 2014. All told, the firm has helped FHFA recover over $20 billion for U.S. taxpayers, and Quinn Emanuel continues to litigate the remaining four cases.

Victory for Allstate in RMBS Motion to Dismiss

In 2010 and 2011, Quinn Emanuel filed eight lawsuits for Allstate Insurance Company arising from Allstate's losses on residential mortgage-backed securities ("RMBS") sold by Wall Street banks. Five of the cases—against J.P. Morgan, Deutsche Bank, Citigroup, Goldman Sachs, and GMAC/Residential Funding—have been favorably resolved. Only three cases are pending, against Credit Suisse, Countrywide, and Merrill.

Allstate has defeated defendants' motions to dismiss in five lawsuits, winning every motion that has reached a decision. Most recently, in a January 2014 decision, Justice Marcy Friedman of New York's Supreme Court denied Credit Suisse's motion to dismiss. Allstate purchased over $200 million in RMBS from Credit Suisse. Allstate alleges that Credit Suisse fraudulently misrepresented the quality and characteristics of the mortgage loans underlying the securities. The court rejected all of the defendants' arguments, finding that Allstate's claims were timely and that Allstate adequately pled misrepresentations, Credit Suisse's knowledge, reasonable reliance, and causation.

Justice Friedman's decision is consistent with the large body of law upholding RMBS investors' fraud claims at the pleading stage. The court declined to hold that Allstate was on notice of its claims before February 2008. The defendants argued that disclosures in the offering materials negated Allstate's misrepresentation claims, but the court held that the disclosures did not squarely address Allstate's claims that the loan underwriting guidelines were abandoned and the statistics in the offering materials were false. The defendants also argued that certain representations were mere opinions, but Allstate adequately alleged that the defendants knew the "opinions" were false. The Court also found that Allstate sufficiently tied its allegations to the securities at issue, citing to a loan-level analysis that Allstate performed on the loans. Allstate also sufficiently pled reasonable reliance based on its allegations that it did not have access to the raw data about the loan collateral underlying the offering materials.

The case against Credit Suisse is now proceeding to full discovery. Allstate is seeking internal Credit Suisse documents that will prove its case, and will also "reunderwrite" a sample of the mortgage loans underlying its investments to show they were misrepresented. Q

quinn emanuel
865 South Figueroa Street, 10th Floor, Los Angeles, California 90017

business litigation report

quinn emanuel urquhart & sullivan, llp

Published by Quinn Emanuel Urquhart & Sullivan, LLP as a service to clients and friends of the firm. It is written by the firm's attorneys. The Noted with Interest section is a digest of articles and other published material. If you would like a copy of anything summarized here, please contact David Henri at 213-443-3000.

- We are a business litigation firm of more than 650 lawyers — the largest in the world devoted solely to business litigation and arbitration.
- As of June 2014, we have tried over 2311 cases, winning 88.4% of them.
- When we represent defendants, our trial experience gets us better settlements or defense verdicts.
- When representing plaintiffs, our lawyers have garnered over $39 billion in judgments and settlements.
- We have won five 9-figure jury verdicts.
- We have also obtained fifteen 9-figure settlements and nine 10-figure settlements.

Prior results do not guarantee a similar outcome.

LOS ANGELES
865 S. Figueroa St., 10th Floor
Los Angeles, CA 90017
+1 213-443-3000

NEW YORK
51 Madison Ave., 22nd Floor
New York, NY 10010
+1 212-849-7000

SAN FRANCISCO
50 California St., 22nd Floor
San Francisco, CA 94111
+1 415-875-6600

SILICON VALLEY
555 Twin Dolphin Dr., 5th Floor
Redwood Shores, CA 94065
+1 650-801-5000

CHICAGO
500 W. Madison St., Suite 2450
Chicago, IL 60661
+1 312-705-7400

WASHINGTON, D.C.
777 6th Street NW, 11th Floor
Washington, DC 20001-3706
+1 202-538-8000

TOKYO
NBF Hibiya Bldg., 25F
1-1-7, Uchisaiwai-cho, Chiyoda-ku
Tokyo 100-0011
Japan
+81 3 5510 1711

LONDON
One Fleet Place
London EC4M 7RA
United Kingdom
+44 20 7653 2000

MANNHEIM
Mollstraße 42
68165 Mannheim
Germany
+49 621 43298 6000

HAMBURG
An der Alster 3
20099 Hamburg
Germany
+49 40 89728 7000

MUNICH
Oberanger 28
80331 Munich
Germany
+49 89 20608 3000

PARIS
25 rue Balzac
75008 Paris
France
+33 1 73 44 60 00

MOSCOW
Paveletskaya Plaza
Paveletskaya Square, 2/3
115054 Moscow
Russia
+7 499 277 1000

HONG KONG
1307-1308 Two Exchange Square
8 Connaught Place
Central Hong Kong
+852 3464 5600

SYDNEY
Level 15
111 Elizabeth Street
Sydney, NSW 2000
Australia
+61 2 9146 3500

BRUSSELS
rue Breydel 34
1040 Brussels
Belgium
+32 2 416 50 00