July 2016

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Increase in Vertical Price Restraint Enforcement in China

In recent months, Chinese anti-monopoly enforcement actions scrutinizing and penalizing pricing-related issues have noticeably increased. A growing number of foreign companies in consumer-facing industries have received significant penalties for setting pricing restrictions—usually minimum resale prices—on contractual counterparties down the supply chain. A particular target of the enforcement authorities has been the automotive industry, which has been the subject of numerous regulatory actions, but cases in this area are not limited to that sector; the authorities have also taken action in the liquor and healthcare industries.

The most recent development is that on April 15, 2016, the Shanghai Pricing Bureau, a provincial-level authority for pricing-related anti-monopoly enforcement actions, imposed a fine of USD 340,000 on South Korean tire company Hankook. *See* Shanghai Price Bureau Administrative Penalty Decision (Shanghai Hankook Tires), Case No. 2520160001 (April 12, 2016). The decision found that Hankook established minimum resale price restraints through its agreements with its distributors, under which Hankook had implemented minimum price lists, "market norm" security deposits, and warning letters when distributors offered prices below the minimum. This penalty was just one in a series of administrative decisions penalizing vertical price restraints in the automotive industry in the last 18 months. To date, Chinese anti-monopoly law enforcement authorities (the "AMEAs;" including National Development and Reform Commission, the State Administration of Industry and Commerce, and the Ministry of Commerce) have imposed fines totaling more than RMB 2 billion (approximately USD 300 million) on major automakers and spare-parts suppliers; five out of seven actions are related to vertical price restraints. (*See* Liu Weiyan, *Anti-Monopoly Guidelines for the Auto Industry Targets Resale Price Maintenance and Presumptive Exemptions Remain Difficult*, National Business Daily (April 25, 2016).)

In addition, on the legislative front, during March 23 to April 12, 2016, China's National Development and Reform Commission ("NDRC"), a ministry-level agency under the State Council (national executive) solely responsible for pricing-related anti-monopoly enforcement, released the Draft Anti-Monopoly Guidelines for the Automotive Industry (the "Draft Guidelines") for public comment. As China's first industry-specific anti-monopoly guideline, the Draft

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INSIDE

Quinn Emanuel Partners Named "Rising Stars" by *Law360* and the *New York Law Journal*

Quinn Emanuel led the pack with eight *Law360* "Rising Stars" in 2016—more than any other firm. The "Rising Star" award is given to top legal talent under 40 years of age. The firm's 2016 "Rising Stars" are: Chris Kercher (Banking), Patrick Curran (Intellectual Property), Joe Paunovich (Intellectual Property), Andrew Chalson (Life Sciences), Eric Lyttle (Product Liability), Jeremy Andersen (Securities), Stephen Hauss (White Collar), and Ben O'Neil (White Collar). In addition, partner Maaren Shah was named a "Rising Star" by the *New York Law Journal*. Q

Quinn Emanuel Named London *Legal Business*' "U.S. Law Firm of the Year"

London publication *Legal Business* named Quinn Emanuel "2016 U.S. Law Firm of the Year" at its annual *Legal Business* Awards ceremony. This award recognizes the U.S. firm that has achieved the most outstanding results for clients in London. Quinn Emanuel's London office, which launched in 2008, has now won this award three times (in 2012, 2014, and 2016). Q

Guidelines aims to provide further clarifications regarding vertical price restraints in the automotive industry.

Both the Draft Guidelines and recent ramp-up in enforcement activities signal the Chinese government's proactive ongoing efforts to target and deter vertical monopolistic activities, especially in the automotive industry. The materials below will give an overview of notable recent cases and the key provisions of the Draft Guidelines, highlighting the key practical issues and implications for anti-monopoly enforcement.

Vertical Price Restraints Enforcement Overview

The key body of law in China governing vertical price restraints is found in China's Anti-Monopoly Law (the "AML"). Older Chinese statutes, such as the Anti-Unfair Competition Law, Price Law, and Contract Law also address aspects of vertical price restraints in China. The key AML provision addressing vertical price restraints would be Article 14 which, together with Article 15 on statutory exemptions for monopoly agreements, creates a "prohibition/exemption" structure. The language in Article 14 is cautiously worded but explicitly forbids monopoly agreements with counterparties that fix the price or set a minimum price for the prospective resale of products—two statutorily specified types of vertical price restraints. In addition, Article 14 (3) delegates to AMEAs the authority to identify and outlaw other types of vertical monopoly agreements.

For the prohibitions under Article 14, the AML also enumerates a set of statutory exemptions in Article 15. These include enhancement of product efficiency, quality, or standardization, and improvements to the competitive efficiency of small and medium-size businesses, in all cases imposing the burden of proof on the defendant, plus in most cases (including those just outlined) an additional burden of showing there is no serious harm to overall competition and consumers share in the benefits created.

The AML took effect on August 1, 2008. However, publicized enforcement actions against vertical price restraints are a more recent development. This activity began with one incident of private enforcement action arising out of the AML—*Rainbow v. Johnson & Johnson,* the first and, so far, only published case of private enforcement, which was litigated in the Shanghai courts in 2012 to 2013. *See Beijing Ruibang Yonghe Technology Trade Co. Ltd. v. Johnson & Johnson Medical (Shanghai) Co. Ltd., Johnson & Johnson Medical (China) Co. Ltd.*, Shanghai Higher People's Court (2013), CLI.C.2134356. Administrative enforcement of the AML soon followed in 2013 and has been ramping up since. Of the five sets of administrative decisions publicized to date, the two most recent sets of decisions were in cases against the automotive industry and the most notable enforcement actions have all been in consumer-facing industries:

- On February 22, 2013, the provincial-level NDRCs in Guizhou and Sichuan provinces imposed fines totaling USD 70.5 Million on Chinese liquor distilleries Kweichow Moutai (Guizhou Moutai) and Wuliangye Group. The distilleries produced *baijiu*, a popular and usually expensive local liquor in China. (*See* Press Release, PRC Central People's Gov't, Moutai and Wuliangye Are Given the Largest Fines in Our Country's Antimonopoly History (Feb. 22, 2013).) According to the government releases, these two entities violated the AML by imposing pricing controls and geographical sales restrictions on distributors. This enforcement action was notable in part because it was taken against prominent local companies, which is generally considered less common.
- On August 7, 2013, the national-level NDRC imposed fines totaling USD 105 Million on nine suppliers of infant formula powder, mostly those of foreign brands. (*See* Press Release, NDRC, Biostime and Other Milk Powder Manufacturers Are Fined a Total of RMB 668.73 Million for Anti-Competitive Behavior in Breach of the Anti-Monopoly Law (Aug. 7, 2013).) The enforcement sweep came after the melamine scandal affecting local infant formula powder suppliers in 2008, which led to a prolonged increase in demand and price for foreign formula powder. In the 2013 actions, the NDRC waived fines for entities that cooperated in the investigation by providing evidence and voluntarily reducing prices. However, all entities were denied eligibility for AML exemptions, on the basis of a finding that a serious impediment to competition among brands had occurred.
- On May 29, 2014, the national-level NDRC imposed fines totaling USD 2.98 Million on various contact lens suppliers, most of whom were foreign. (*See* Press Release, NDRC, A Portion of Eyeglass Lens Manufacturers Are Penalized for Resale Price Maintenance Conduct (May 29, 2014).) Contact lenses have historically been an industry with high profit margins. Penalties were set based on the seriousness of anti-competitive effects, and some were mitigated on the basis of the degree of cooperation.

- Between late 2014 and late 2015, various provincial-level NDRCs or their Pricing Bureaus announced a set of four similar decisions against foreign auto manufacturers of luxury and high mid-range vehicles: Chrysler (USD 4.98 Million), Volkswagen Group (USD 37.7 Million), Mercedes Benz (USD 55 Million), and Nissan (USD 3 Million). (*See* Press Release, PRC Central Gov't, Chrysler Is Fined RMB 31.68 Million for Implementation of Price Monopolies (Sept. 11, 2014); Press Release, PRC Central Gov't, Volkswagen Is Fined RMB 240 Million for Implementation of Price Monopolies (Sept. 11, 2014); Press Release, PRC Central Gov't, Mercedes Is Fined RMB 350 Million for Implementation of Price Monopolies in Jiangsu (April 23, 2015); Press Release, Guangdong Development and Reform Commission, Nissan Is Fined for Implementing Price Monopolies in Guangdong Province (Sept. 10, 2015).) Three of the four decisions cite vertical price restraints in the aftersales auto parts markets, which may suggest that one of the key interests in the enforcement actions was ensuring that the spare parts and service and repairs markets were leveled for more competition.
- On April 15, 2016, as a part of the same case discussed above in the introduction, Shanghai provincial-level NDRC imposed a fine of USD 340,000 on South Korea's Hankook Tires.

Enforcement Highlights and Implications

Given the lack of specificity and definition in the AML's construction and with the broad discretionary power granted to enforcement authorities in China, the published cases present a set of key practical issues that deserve attention and careful analysis. Fortunately, the Draft Guidelines appear to provide some clarity with respect to application in specified circumstances, and recent enforcement actions help to highlight some noteworthy implications for foreign enterprises in China.

<u>Recommended Prices: Disguised Resale Price Maintenance?</u> Through the recent AML enforcement cases, Chinese courts and regulators have shown vigilance in identifying and penalizing vertical price restraints disguised as recommended resale prices. In the 2014 case against the contact lens suppliers, the national-level NDRC first found that the suppliers had enforced recommended prices in such a way that it was clear they were actual price restrictions rather than optional recommendations. Later in that year, Chrysler was also found to have illegally implemented hardline vertical price restraints despite having contractually stipulated "recommended" resale prices. In both cases, it is evident that, on the matter of pricing, function prevails over form. To avoid any doubt, the Draft Guidelines clarify that the AMEAs will take an "actual effect" approach to determine, on a case-by-case basis, whether recommended prices violate the AML.

<u>Types of Prohibited Vertical Monopoly Agreements.</u> The recent enforcement cases also indicate that other types of vertical monopoly agreements, such as geographic restraints, may also be on the Chinese regulators' radar. In those cases, although the findings of liability were all limited to vertical price restraints under AML Article 14 (1) or (2), several decisions did include findings of contractual geographical restrictions on distributors, preventing them from selling outside of authorized districts. While geographic restraints are not an express part of AML vertical restraint law, the use of AML Article 14 to incidentally cover vertical geographic restraints has been common in previous NDRC enforcements. It is possible that the NDRC, the administrative authority in these cases, was only granted enforcement authority against pricing-related violations. It is also likely that the AMEAs, despite their delegated authority, tend to refrain from enforcing against vertical restraints not explicitly prohibited by Article 14 (1) or (2).

Going a step further, the Draft Guidelines specifically delineate other types of prohibited vertical monopoly agreements, including certain types of geographic and customer-based restraints. This not only provides more clarity on how Chinese courts and regulators will evaluate the legality of vertical restraints, but also signals a more comprehensive enforcement effort.

<u>Anti-Competitive Effect: Is Vertical Monopoly Agreement *Per Se* Illegal?</u> One of the more elusive issues under the AML is whether Article 14 prohibits all vertical monopoly agreement regardless of their anti-competitive effects. The AML Article 13 explicitly defines monopoly agreement as any agreement, decision, or other concerted action that eliminates or restricts competition. Thus, in theory, a finding of anti-competitive effect is a necessary and contestable element of liability. However, in practice, there appears to be a jurisdictional split in enforcement.

In the private action, *Rainbow v. Johnson & Johnson,* the Shanghai courts held that anti-competitive effect is an essential element of any claim against vertical monopoly agreements. Furthermore, in these types of private litigation, it is the plaintiffs who bear the burden of proof and there is no presumption that it has been satisfied. However, the NDRC has been sending out a very different message. The Director General of NDRC's Price Supervision and Anti-Monopoly Bureau has indicated that the agency will take a rather simplistic "prohibition plus exemption" approach. In the case against Hankook, the documents included only very cursory and conclusory remarks about anti-competitive effects. Some of the previous government releases did provide more detail, but the nearly-formulaic description of anti-competitive effects in the Hankook case may indicate that there was no meaningful investigation into whether Hankook's restraints created any appreciable anti-competitive effects.

Unfortunately, the Shanghai courts' line of reasoning on the elements of a claim and presumption has never been tested against an administrative enforcement action. Although the AML Article 53 grants the People's Courts the power of review, to date, no defendant has ever requested judicial review of an administrative determination on vertical price restraints. After all, in China, a defendant who prevails in a civil litigation action may nonetheless be subject to administrative penalties on the same set of facts.

Statutory Exemptions. At a glance, the AMEAs appear to have taken a hardline stance against vertical price restraints by limiting the contestability of anti-competitive effect, but further observation actually indicate that regulators may be open to expanding eligibility considerations for statutory exemptions, at least for the automotive industry. Building on the "prohibition plus exemption" structure outlined by the AML, the Draft Guidelines provides considerably more detailed guidance and further specification, essentially moving to a more finessed approach that may include presumptive exemptions and case-by-case exemptions. For example, with respect to geographic and customer-based restrictions, the Draft Guidelines discuss presumptive exemptions for any entity without "clear market power," which defined as less than a 25%-30% market share (under normal circumstances). It is worth noting that these proposed presumptive exemptions are strikingly similar to the European Commission's Block Exemption Regulations.

On vertical price restraints, the Draft Guidelines describe specific scenarios that should qualify for AML Article 15 case-by-case exemptions in the automotive industry, including resale price maintenance during the rollout phase of new energy vehicles (e.g. the initial nine months), when the distributor is a true agent, during government procurement tender bidding, and when e-commerce platforms are being used merely as an intermediary to facilitate completion of sales with end customers. With respect to case-by-case exemptions, the NDRC has also circulated for public comment the Draft Guidelines on the General Conditions and Procedures for Monopoly Agreement Exemptions. These aim to provide detailed guidance on the conditions and procedures for monopoly agreement exemptions, as successful exemptions have been a rarity in the eight years since the AML came into effect.

Conclusion

In sum, vertical price restraint administrative enforcements have so far, either by accident or design, mostly targeted foreign companies and industries with high profit margins. Historically, vertical price restraints have been a widespread practice across industries in China, and the policy drivers behind the recent scrutiny by regulators may be part of a broader government push against practices that increase prices for consumers. In any event, for the time being, vertical price restraints appear to be high on the enforcement agenda for Chinese regulators and should be accounted for in MNC compliance planning for China operations. Q

NOTED WITH INTEREST

Supreme Court to Clarify Test for Copyright Protection of Useful Articles

On May 2, 2016, the Supreme Court granted certiorari from the United States Court of Appeals for the Sixth Circuit to resolve a multi-circuit split over "the appropriate test to determine when a feature of a useful article is protectable under § 101 of the Copyright Act." *Star Athletica, L.L.C. v. Varsity Brands, Inc.*, No. 15-866, 2016 WL 98761, at *1 (U.S. May 2, 2016); *Petition for a Writ of Certiorari*, *Star Athletica, L.L.C. v. Varsity Brands, Inc.*, (No. 15-866) (U.S. petition for cert. filed Jan. 5, 2016), 2016 WL 94219, at *i. Although the specific question in *Varsity Brands* concerns the copyright protection afforded to designs on cheerleading uniforms, the broader question of when a design feature of a useful article is subject to copyright protection is long considered one of the most vexing questions in copyright law, and the Supreme Court's decision could fundamentally alter the intellectual property landscape for numerous business sectors, including the $330 billion per-year fashion industry.

The legal background of the dispute in *Varsity Brands* is the limited scope of copyright protection that applies to articles that have a utilitarian function. To enjoy copyright protection, "an original work[] of authorship" must fall within one of the subject matters enumerated in 17 U.S.C. § 102, which generally exclude articles that have a utilitarian function. However, the pictorial, graphic, or sculptural features of an article may be protectable to the extent they "can be identified separately from, and are capable of existing independently of," the article's utilitarian aspects. 17 U.S.C. § 101. The question of whether such features are entitled to copyright protection is determined by the "conceptual separability" test, which considers whether an article's aesthetic and utilitarian elements are separable. As illustrated in *Varsity Brands*, this question has proven very elusive to answer given the many different ways that courts approach it.

In *Varsity Brands, Inc. v. Star Athletica, LLC*, 799 F.3d 468 (6th Cir. 2015), Varsity Brands, Inc. brought suit against Star Athletica, LLC, alleging that Star Athletica's cheerleading uniforms infringed its copyrights. Varsity Brands' copyrights consisted of "two-dimensional artwork" sketches depicting stripes, chevrons, zigzags, and color blocks on cheerleading uniforms. *Id.* at 471. The district court granted summary judgment for Star Athletica on its infringement claims, holding that Varsity's designs were not conceptually separable from the utilitarian function of "cloth[ing] the body in a way that evokes the concept of cheerleading." *Varsity Brands, Inc. v. Star Athletica, LLC*, No. 10-2508, 2014 WL 819422, at *8-9 (W.D. Tenn. Mar. 1, 2014).

On appeal, to analyze Varsity Brands' infringement claim, the Sixth Circuit first determined the appropriate conceptual separability test to apply. While all courts that have addressed whether useful articles are entitled to copyright protection employ some form of the conceptual separability test, many unique versions of the test exist, resulting in substantial inconsistencies in the results that courts have reached. To wit, the Sixth Circuit noted nine distinct ways for determining if a pictorial, graphic, or sculptural feature qualifies as copyrightable subject matter:

1. ***The Copyright Office's approach*** considers whether the aesthetic feature and useful article could "exist side by side and be perceived as fully realized, separate works—one an artistic work and the other a useful article." *Compendium of U.S. Copyright Office Practices* § 924.2(B) (3d ed. 2014).
2. ***The "Primary-Subsidiary" approach*** considers whether the aesthetic feature is primary to the article's subsidiary utilitarian function. *Kieselstein-Cord v. Accessories by Pearl, Inc.*, 632 F.2d 989, 993 (2d Cir. 1980).
3. ***The "Objectively Necessary" approach*** considers whether the aesthetic feature is necessary to the performance of the article's utilitarian function. *Carol Barnhart Inc. v. Econ. Cover Corp.*, 773 F.2d 411, 419 (2d Cir. 1985).
4. ***The "Ordinary-Observer" approach*** considers whether the article stimulates in an observer's mind "a concept that is separate from the concept evoked by its utilitarian function." *Carol Barnhart Inc. v. Econ. Cover Corp.*, 773 F.2d 411, 422 (2d Cir. 1985) (Newman, J., dissenting).
5. ***The "Design-Process" approach*** considers whether design elements of the article reflect the designer's artistic judgment exercised independently of functional influences. *Brandir Int'l, Inc. v. Cascade Pac. Lumber Co.*, 834 F.2d 1142, 1145 (2d Cir. 1987).
6. ***The "Stand-Alone" approach*** considers whether the useful article's functionality remains intact when the copyrightable material is separated. *Pivot Point Int'l, Inc. v. Charlene Products, Inc.*, 372 F.3d 913, 934 (7th Cir. 2004) (Kanne, J., dissenting).
7. ***The "Likelihood-of-Marketability" approach*** considers whether there is a substantial likelihood that "even if the article had no utilitarian use it would still be marketable to some significant segment of the community simply because of its aesthetic qualities." *Galiano v. Harrah's Operating Co.*, 416 F.3d 411, 419 (5th Cir. 2005) (quoting 1 *Nimmer on Copyright* § 2.08[B][3]).
8. ***Patry's approach*** considers whether the aesthetic feature can be identified separately from the article's utilitarian aspects, and is capable of existing as an intangible feature independent of those aspects. 2 *Patry on Copyright* § 3:146. If the form or function of the article's utilitarian aspects dictate the way that the pictorial, graphic, or sculptural work appears, it is incapable of independent existence. *Id.* Patry's approach emphasizes that an article's aesthetic features must be separable from its *utilitarian aspects*, but not from the article itself. *Id.*

9. ***The "Subjective-Objective" approach*** considers the degree to which the designer's subjective process was influenced by aesthetic as opposed to functional concerns, and whether the article's design was objectively dictated by its utilitarian function. Barton R. Keyes, *Alive and Well: The (Still) Ongoing Debate Surrounding Conceptual Separability in American Copyright Law*, 69 Ohio St. L.J. 109, 141 (2008).

Surveying the aforementioned tests, the Sixth Circuit combined several approaches in formulating its own five question conceptual separability test: "(1) Is the design a pictorial, graphic, or sculptural work? (2) If the design is a pictorial, graphic, or sculptural work, then is it a design of a useful article[?] . . . (3) What are the utilitarian aspects of the useful article?" *Varsity Brands*, 799 F.3d at 487. Of note, the Sixth Circuit held that "[p]ortraying the appearance of the useful article" and "conveying information" are two utilitarian functions that courts may not use to determine conceptual separability. *Id.* at 487 (quoting 17 U.S.C. § 101) (alterations omitted). Once the article's utilitarian aspects are established, the Sixth Circuit's test then requires an inquiry into (4) whether those aspects can be identified separately from the article's aesthetic aspects, and (5) whether the article's aesthetic features can exist independently of the utilitarian aspects. *Varsity Brands*, 799 F.3d at 488. The Sixth Circuit also noted that the Copyright Office's approach to conceptual separability would be helpful to answer questions (4) and (5), and that the Objectively Necessary and Design-Process approaches could help to answer question (5). *Id.* at 488-89.

Applying its newly crafted test, the Sixth Circuit reversed the district court and held that the graphic features of Varsity Brands' sketches were conceptually separable from the utilitarian aspects of cheerleading uniforms and thus qualified as copyrightable subject matter. *Id.* at 492. To reach this conclusion, the court answered question (3) of its test by holding that the utilitarian function of cheerleading uniforms is to "cover the body, wick away moisture, and withstand the rigors of athletic movements," but not, as Star Athletica argued, to identify the wearer as a cheerleader. *Id.* at 490. Identifying the wearer, the Sixth Circuit reasoned, was a function that merely conveyed information and could not be considered for purposes of determining separability. *Id.* The Sixth Circuit also rejected Star Athletica's argument that the "decorative function" of the uniforms was utilitarian, because such a holding "would render nearly all artwork unprotectable." *Id.* The Sixth Circuit listed numerous works that enjoy copyright protection despite serving a decorative function, such as paintings, designs on laminate flooring, and fabric designs, and concluded that the presence of a decorative function does not defeat conceptual separability. *Id.*

On questions (4) and (5) of its test, the Sixth Circuit held that the graphic features of Varsity Brands' designs—"the arrangement of stripes, chevrons, zigzags, and color-blocking"—could exist and be identified separately from the three features it had deemed utilitarian in question (3), namely the cheerleading uniform's capacity to cover the body, wick away moisture, and withstand athletic movements. *Id.* at 491. The court reasoned that Varsity Brands' designs did not enhance these particular functions and, to the contrary, evidence showed that the designs were transferable to other articles of clothing or among cheerleading uniforms. *Id.* Employing the "Objectively Necessary" approach, the Sixth Circuit concluded that the designs were "wholly unnecessary" to the cheerleading uniforms' utilitarian functions and thus conceptually separable. *Id.* at 492 (quoting *Carol Barnhart*, 773 F.2d at 419).

The outcome of *Varsity Brands* turned not on the particular separability test employed, but on "how function is defined," as the dissent noted. *Varsity Brands*, 799 F.3d at 496 (McKeague, J., dissenting). Indeed, the dissent agreed with the majority's approach, but argued that the utilitarian function of a cheerleading uniform is to "identify the wearer as a member of a particular cheerleading squad." *Id.* at 494-95. Having defined function differently from the majority, the dissent would have concluded that the graphic features of Varsity Brands' designs were not conceptually separable from their utilitarian aspects. *Id.* at 495.

The Supreme Court's decision in *Star Athletica* will likely establish a uniform conceptual separability test that, hopefully, will clarify the intellectual property status of useful articles across many industries. The Court is also likely to provide guidance concerning the aspects of clothing that can properly be considered "utilitarian." If the Supreme Court follows the Sixth Circuit, copyright protection for fashion designs would expand significantly because two functions of clothing—portraying its appearance and conveying information—would be broadly excluded from such aspects. Accordingly, the fashion and other industries that are affected by the status of intellectual property rights relating to clothing designs are watching the Supreme Court's decision closely. Q

Appellate Practice Update

The Effects of an Eight-Justice Supreme Court. Since Justice Scalia's passing in February, the Supreme Court has operated with only eight justices, and it will continue to do so for as long as the Senate declines to consider a nominee. Having only eight justices undoubtedly will have an impact on the Court's decisions. These effects are likely to be most profound in politically-charged cases, and less so in the cases that are most relevant to the business community.

The Constitution provides that the President "shall nominate," and "by and with the Advice and Consent of the Senate, shall appoint … Judges of the supreme Court," U.S. Const. art. II, § 2, but does not provide for a specific number of justices. In passing the Judiciary Act of 1789, Congress established a Supreme Court with six justices—a chief justice and five associate justices. As the United States expanded and Congress established new judicial circuits, Congress added more justices. In 1807, Congress added a seventh justice and in 1837, an eighth and a ninth. In 1863, Congress grew the Supreme Court to ten justices, corresponding to establishment of the Tenth Circuit. Congress then reduced the size of the Court to seven justices in the 1866, but only three years later passed the Judiciary Act of 1869, which created independent circuit judgeships and enlarged the Supreme Court to "consist of the Chief Justice … and eight associate justices, any six of whom shall constitute a quorum." The Court has had nine justices—and a six-justice quorum rule—ever since.

While lengthy Supreme Court vacancies were commonplace in the 19th Century (one vacancy lasted 841 days), there have been only two extended periods during which the Court functioned with only eight justices in the 20th or 21st Centuries, until now. The longest such vacancy occurred when Justice Fortas resigned in May 1969. The resulting vacancy lasted 391 days until Justice Blackmun, who was appointed by President Richard Nixon after the Senate rejected two prior nominees, was sworn in. The second-longest lasted 237 days following Justice Powell's retirement in June 1987. His successor, Justice Kennedy, was appointed by President Ronald Reagan, again after the Senate rejected his first two nominees.

If Congress does not vote on Judge Merrick Garland's nomination to the current Court, the vacancy caused by Justice Scalia's death will likely be the longest since the 19th Century—Justice Scalia died on February 13, 2016, and the next president's term will not even begin until late-January, 2017. Many if not all of the cases on the Court's docket for the October 2016 term would be argued and decided with only eight justices. And out of 93 total cases on the docket for the October 2015 Term, only 21 were decided before Justice Scalia's passing. This means that, if Congress refuses to act on Judge Garland's nomination, the vast majority of cases heard in the October 2015 and 2016 Terms are likely to be decided by an eight-justice court. And that creates the possibility of a four-four tie, resulting in an affirmance by equally divided vote—a decision lacking precedential force which may leave important circuit splits unresolved. Indeed, as Justice Scalia himself wrote, an eight-Justice Supreme Court raises the "possibility that, by reason of a tie vote, [the Court] will find itself unable to resolve … significant legal issue[s] presented by [a] case." *Cheney v. U.S. Dist. Ct. for Dist. of Columbia*, 541 U.S. 913, 915 (2004) (mem. of Scalia, J.).

The Court appears to have deadlocked three times already since Justice Scalia's passing. The first apparent split came in *Friedrichs v. California Teachers Association*, No. 14-915. Described as "the most important labor union controversy to reach the Supreme Court in years," *Friedrichs* presented the question whether requiring public employees who do not join a union to pay "agency" fees—fees used to cover costs incurred by the union—violates the First Amendment. Ultimately the Court divided evenly and the Ninth Circuit's decision upholding agency fees was affirmed in a one-sentence, per curiam ruling.

Later in the Term, the Court split evenly in another politically charged case, *United States v. Texas*, No. 15-674. There, the Court considered the constitutionality of an Executive Branch program permitting unauthorized immigrants who are the parents of citizens or lawful permanent residents to apply for work permits and avoid deportation. A number of states challenged the program as violating the Take Care Clause by failing to "faithfully execute" laws passed by Congress. Because the case ended with a tie vote, the Fifth Circuit's ruling, which affirmed a preliminary injunction enjoining the program, remains intact.

Another case that received considerable publicity, *Zubik v. Burwell*, No. 14-1418, resulted in a per curiam opinion that commentators speculated was also the result of a 4-to-4 tie. *Zubik* presented the question whether federal regulations under the Affordable Care Act requiring employers to cover certain contraceptives as part of their health plans, unless the employer provides notice of religious objection to the insurer or the Federal Government, violated the Religious Freedom Restoration Act. Rather than resolve that issue, the Court took the unusual step of vacating and remanding in light of a "feasible" compromise which "the parties on remand should be afforded an opportunity" to consider.

But it appears that the Court's shorthandedness is more likely to affect politically-charged cases than ones involving traditional business litigation issues. In what are probably the highest-profile business litigation cases from the October 2015 Term—the consolidated *Stryker Corp. v. Zimmer*, No. 14-1520, and *Halo Electronic v. Pulse Electronics*, No. 14-1513, cases—the Court unanimously struck down the Federal Circuit's two-part test for enhanced patent damages as inconsistent with the text of 35 U.S.C. § 284. In another patent litigation case, *Cuozzo Speed Technologies v. Lee*, No. 15-446, the Court unanimously affirmed the United States Patent and Trademark Office's "broadest reasonable construction" standard for construing patent claims in *inter partes* review proceedings. And in *RJR Nabisco v. European Community*, the Court unanimously held that RICO applies to conduct outside the United States where the predicate act forming the basis of the RICO violation itself occurs outside the United States. If the unanimous portions of the Court's decisions in *Stryker*, *Halo*, *Cuozzo*, and *RJR Nabisco* are any indicator, a deadlock in other cases that could have profound effects on business litigation—but which are not the most politically charged—appears unlikely.

Product Liability Litigation Update

Curbing False Claims Act Liability for Off-Label Promotion. As class actions have become harder to certify following *Wal-Mart v. Dukes* and *Comcast v. Behrend*, the plaintiffs' bar has increasingly turned to qui tam litigation under the False Claims Act, 31 U.S.C §§ 3729-3733, as an alternate means of aggregating claims. Qui tam actions offer private litigants and their attorneys the ability to aggregate claims from a single source, the federal government, without the necessity of amassing hundreds or even thousands of individual, relatively low value, damages claims. And unlike traditional class actions, qui tam litigants may recover treble damages, attorneys' fees, and statutory penalties.

The turn to qui tam litigation has been notable in suits involving off-label marketing of pharmaceutical products and medical devices. For example, in several related cases, *U.S. ex rel. Thorpe, et al. v. GSK, et al.*, Nos. 11-10398, 03-10641, 11-10741, 11-10921, 12-cr-10206 (D. Mass. 2012), the relators alleged that GSK employed a number of improper marketing tactics to promote several medications, including Paxil, Wellbutrin, and Zofran. Specifically, relators contended that GSK promoted these medications for off-label uses, misrepresented related safety data, and paid illegal kickbacks. This wrongful activity, relators asserted, caused doctors to write improper prescriptions for these medications, which ultimately resulted in the submission of false claims for reimbursement to Medicaid and other federal health care programs. GSK settled the cases for three billion dollars. In *U.S. ex rel. Kruszewski v. AstraZeneca Pharmaceuticals L.P.*, No. 06-4004 (E.D. Pa. 2010), the relator similarly alleged that AstraZeneca marketed Seroquel for off-label uses and misrepresented safety data, resulting in the submission of false claims. AstraZeneca settled the case for 520 million dollars. *See also United States ex rel. Osiecki et al. v. Amgen, Inc., et al.,* Civil Action No. CV-05-5025 (E.D.N.Y. 2012) (Amgen settling criminal and civil FCA claims arising out of relator's allegations of off-label promotion for $762 million)*; United States ex rel. Steven Woodward et al. v. Eli Lilly & Co.,* Case No. 06-5526 (*E.D. Pa. 2009)* (Eli Lilly & Co. settling similar claims for 1.415 billion dollars).

But a recent Second Circuit victory by Quinn Emanuel may help turn the tide and become a potent tool for obtaining dismissal at the pleading stage of qui tam actions premised on off-label marketing claims. In *United States ex rel. Polansky v. Pfizer*, 2016 WL 286510, No. 14-4774 (2d. Cir. May 17, 2016), Dr. Jesse Polansky, a former medical director at Pfizer, brought a qui tam suit against the company under the FCA, as well as an analogous state cause of action. Dr. Polansky alleged that Pfizer promoted Lipitor, its top-selling cholesterol-lowering medicine, "off-label," and sought to recover on behalf of the government for payments for millions of Lipitor prescriptions. Specifically, he alleged that Pfizer sales representatives and marketing materials promoted Lipitor for use by certain patients whose cholesterol levels were not low enough to warrant treatment based on national cholesterol guidelines. And because the guidelines were referenced in the labels for Lipitor, Polansky claimed that they imposed a mandatory restriction on the approved uses for Lipitor, and thus a restriction on how Pfizer could market the medicine.

A unanimous panel of the Second Circuit affirmed the dismissal of Dr. Polansky's FCA claims on the ground that the guidelines summarized in the label merely "provide[d] advice and (unsurprisingly) guidance, 'not mandatory limitation.'" Not only did the Second Circuit reject Polansky's entire theory of "off-label" marketing of Lipitor, but it also questioned whether the conduct alleged—off-label marketing by sales representative or through promotional materials—could even constitute a false claim to the government. The Court reasoned that under Polansky's theory:

> it is unclear just whom Pfizer could have caused to submit a 'false or fraudulent' claim: The physician is permitted to issue off-label prescriptions; the patient follows the physician's advice, and likely does not know whether the use is off-label; and the script does not inform the pharmacy at which the prescription will be filled whether the use is on-label or off.
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> The False Claims Act, even in its broadest application, was never intended to be used as a back-door regulatory regime to restrict practices that the relevant federal and state agencies have chosen not to prohibit through their regulatory authority." *Polansky II*, 914 F. Supp. 2d at 266. It is the FDA's role to decide what ought to go into a label, and to say what the label means, and to regulate compliance. We agree with Judge Cogan that there is an important distinction between marketing a drug for a purpose obviously not contemplated by the label (such as, with respect to Lipitor, "to promote hair growth or cure cancer") and marketing a drug for its FDA-approved purpose to a patient population that is neither specified nor excluded in the label. *Id.* at 265.

Although dicta, this language in the *Polansky* decision is a step in the right direction to narrow whether and how off-label marketing to physicians can constitute a false claim to the government. A line of previous cases had held that, if the chain between the off-label marketing and the claim seeking Medicare reimbursement is foreseeable, there is a sufficient link between the conduct and the claim to impose False Claims Act liability. *See, e.g., United States ex rel. Franklin v. Parke-Davis, Div. of Warner Lambert Co.*, 147 F. Supp. 2d 39 (D. Mass 2001); *United States ex rel. Galmines v. Novartis Pharmaceuticals Corp,* 2013 WL 2649704 (E.D. Pa. Mar. 26, 2014); *Strom ex rel. United States v. Scios, Inc.,* 676 F. Supp. 2d 884 (N.D. Cal. 2009); *United States ex rel. Kennedy v. Aventis Pharmaceuticals, Inc*., 610 F. Supp. 2d 938 (N.D. Ill. 2009). But *Polansky* suggests that might not be true in circumstances where the drug could be *legitimately* prescribed for the alleged off-label use. *Polansky* thus advises that False Claims Act liability should be limited to off-label marketing and promotion that is *actually false*. Truthful and non-misleading statements that are made with the knowledge that doctors may prescribe the drug for off-label uses to some patients as an exercise of their medical judgment is arguably not enough for False Claims Act liability.

The *Polanksy* decision could have far reaching implications because it supports the argument that a qui tam relator alleging an FCA claim based on alleged off-label marketing must establish a nexus between the marketing and the submission of the false claim to the government. Given the heightened pleading standard for alleging an FCA claim, this requirement could become a potent tool for obtaining dismissal at the pleading stage. Q

Antitrust Trial Star and Former DOJ Assistant Chief, Ethan Glass, Joins the Firm

Ethan Glass has joined the firm as a partner based in its Washington, D.C. office. Previously, Mr. Glass had been an Assistant Chief at the U.S. Department of Justice, Antitrust Division. During his time at the Department of Justice, Mr. Glass led investigation, litigation, and trial teams on many large-scale, high profile antitrust matters. He has been lead counsel in matters involving many industries including major appliances, credit cards, financial exchanges, motion pictures, music, newspapers, sports and recreation, and real estate. He was the recipient of the Attorney General's Distinguished Service Award (Department of Justice's second highest performance award) and two AAG Awards (Antitrust Division's top performance award). Mr. Glass received his J.D. from the University of Minnesota Law School, *magna cum laude*, and his B.A. from the University of Arizona. He clerked for United States District Judge Fern M. Smith in the Northern District of California and practiced at both Heller Ehrman and Robins Kaplan before joining the Department of Justice. Q

VICTORIES

Appellate Victory Knocks Out Hundreds of Asbestos Claims

In a unanimous published decision, the Maryland Court of Special Appeals affirmed summary judgment for Quinn Emanuel's client Pfizer in an asbestos case alleging that Pfizer was the "apparent manufacturer" of products made by its former subsidiary, Quigley Company, Inc. By holding that Pfizer was not an "apparent manufacturer" as a matter of Maryland law, this decision effectively ends more than 500 cases pending in Maryland state court that are based on this same theory of liability.

This appeal has a long history that dates back to Quigley's declaration of bankruptcy in 2003. Quigley had manufactured specialized industrial products, particularly for the steel mill industry, since 1916. A few of these products contained relatively small amounts of asbestos. After the health effects of asbestos became known, plaintiffs filed tens of thousands of lawsuits against Quigley, many of which also named Pfizer—which had purchased the company in 1969—as a co-defendant. The majority of these suits were concentrated in Maryland and Pennsylvania where Quigley products had been used in steel mills for many decades.

The bankruptcy reorganization plan that was ultimately confirmed contained a "channeling injunction" that channeled all asbestos claims against Quigley and Pfizer (if they involved a Quigley product) to a $965 million trust fund set up and funded by Pfizer to compensate asbestos claimants. Despite the injunction, one of the largest asbestos plaintiffs' firms in the country—the Peter G. Angelos Law Firm—sued Pfizer in state court alleging that Pfizer was the "apparent manufacturer" of Quigley's products, and that the channeling injunction did not enjoin "apparent manufacturer" claims. Under the apparent manufacturer doctrine, a company can be held liable for a defective product that it does not manufacture if it holds itself out to the purchasing public as the manufacturer through its advertising or product labeling. Angelos argued the channeling injunction did not bar apparent manufacturer claims against Pfizer because they did not depend on Pfizer's prior ownership of Quigley. The district court agreed and the Second Circuit affirmed, potentially opening up a floodgate of asbestos claims that were supposed to have been resolved in the bankruptcy proceeding.

Angelos picked *Stein* as his test case and brought it on his home turf, the Circuit Court for Baltimore City. Cherry-picking documents from decades of litigation against Quigley and Pfizer, Angelos argued that Pfizer was an apparent manufacturer of Quigley products because the Pfizer logo appeared next to the Quigley logo on the packaging and promotional materials for Quigley products. Summary judgment on substantive issues is a rarity in asbestos cases in Baltimore City, but Quinn Emanuel moved for it anyway. After extensive briefing and argument, the trial court granted Pfizer's motion for summary judgment, holding that the fact that Pfizer's logo was affixed to Quigley product brochures did not establish that Pfizer was an apparent manufacturer of Quigley products. The parties agreed to stay the hundreds of other apparent manufacturer cases against Pfizer while the *Stein* case was being appealed.

Last year, Quinn Emanuel partner Sheila Birnbaum argued this appeal before the Maryland Court of Special Appeals in a two-hour session. During argument, the judges demonstrated extensive knowledge of the long and winding history of common law apparent manufacturer jurisprudence, which has its roots in cases from the early 20th century. On the one year anniversary of that argument, the court issued a published, 40-page opinion affirming the trial court's order and adopting Quinn Emanuel's positions in full. The well-researched, comprehensive opinion accepted, affirmed that Pfizer was not an apparent manufacturer of Quigley products as a matter of law.

This is a major victory for Pfizer. The ruling effectively ends over 500 current apparent manufacturer cases against Pfizer in Maryland. It also makes it significantly less appealing for other plaintiffs' attorneys to bring apparent manufacturer claims against Pfizer in other parts of the country.

Complete Victory in Dismissal of False Claims Act Case

The firm recently obtained a complete dismissal, with prejudice, of a federal False Claims Act lawsuit against American International Group, Inc. ("AIG") pending in the Southern District of New York. The suit alleged a multi-billion dollar fraud on the U.S. Treasury and Federal Reserve in connection with the bailout during the financial crisis of 2008. The district court adopted every one of our arguments, dismissed the complaint, and denied leave for the plaintiff to try to rescue the complaint through further amendments and supplements. With this victory, AIG is one giant step closer to ending a years-long saga involving federal and state regulatory investigations and multiple lawsuits.

The essential allegation in all these cases is that former AIG foreign insurance subsidiaries ALICO and AIA had, for decades, practiced unlicensed insurance business by holding meetings with potential clients in New York and then concealed the conduct from regulators. These companies turned out to be key to AIG's survival during the financial crisis because they served as collateral for the tens of billions of dollars in aid AIG received from the federal government. AIG transferred its ownership of these companies to the Federal Reserve in exchange for a $25 billion reduction in the debt AIG accumulated during the financial crisis.

The litigation began when ALICO's former head of human resources brought a sealed case under the federal False Claims Act alleging that AIG had deliberately lied to the Federal Reserve and Treasury and concealed the allegedly illegal insurance business at ALICO and AIA during negotiations over debt reduction, meaning that the federal government may have overpaid by potentially billions of dollars. He also informed prosecutors at the U.S. Attorney's Office in the Southern District of New York, the New York Department of Financial Services, the Manhattan District Attorney's Office, and the New York Attorney General.

After the Justice Department began investigating, we convinced prosecutors that the case was meritless and that the Justice Department should decline to intervene in the suit. But the relator forged ahead on his own, focusing his allegations on admissions made by MetLife—which purchased ALICO subsequent to AIG's debt-reduction transactions—when it settled with New York insurance regulators and admitted guilt for the same underlying conduct. Although the plaintiff attempted to marshal the admissions contained in MetLife's public settlements against AIG, we focused the court on the fact the plaintiff had zero basis to establish that anyone at AIG *knowingly* made any false statements to the U.S. government during the negotiations over ALICO and AIA. Because it was AIG that received the debt relief, the plaintiff needed to prove that someone *at AIG* knew that ALICO and AIA had been conducting insurance business without a license for decades.

The district court agreed entirely, but it did not stop there. It also concluded that the plaintiff could not sufficiently plead any false statement in the first place, because he could not identify a single instance of actual unlicensed insurance conduct, even though he had had several chances to do so in amended complaints. Moreover, the court concluded that even if AIG knowingly concealed the illegal insurance activity and lied about it (it had not), it was not material in the context of a $25 billion transaction that, after all, was designed to help AIG reduce its debt and the save company, not to mention the global financial system.

The result was a complete dismissal, with prejudice, of a long-running, high-stakes False Claims Act case and a public rejection of the source of myriad investigations into AIG by federal and state authorities.

Pro Bono Immigration Victory

Andre Mulder is a legal permanent resident of the U.S. and adopted son of an American citizen. He was born in Brazil and abandoned as a young child. After wandering the streets of Sao Paolo, the Brazilian police placed him in a Brazilian orphanage; Andre spent the next few years of his life in that orphanage, where he was abused by fellow children and the administrators of the orphanage. Thankfully, Andre was adopted by an American citizen and he moved with her to the U.S., growing up in Detroit, Michigan. As a result of his childhood, he suffered permanent brain damage and that resulted in severe mental impairment. He has an IQ of 56 and the mental abilities of an eight-year-old child, cannot read or write, and failed to complete any special education classes after the tenth grade.

In mid-2015, a misdemeanor crime conviction (which was bumped up to a felony under Michigan's criminal statutes) resulted in a removal hearing. Andre was unable to afford an attorney and the right to an attorney is not guaranteed in immigration courts, so he represented himself *pro se*. At the hearing, the immigration judge found that Andre was mentally competent to represent himself without any of the procedural safeguards that are required for mentally incompetent immigrants. Based on that hearing, the immigration judge ordered that Andre be removed back to Brazil, a country he no longer remembered, and without the ability speak Portuguese.

Quinn Emanuel was contacted by a non-profit immigrants' right organization who were looking for an attorney to handle Andre's appeal to the Board of Immigration Appeals (BIA). We persuaded the Board of Immigration Appeals to vacate the decision to remove Andre and remand for reconsideration of his competency and to reconsider the legality of Andrew's removal. Q

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business litigation report

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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 Becca Voake at 213-443-3165.

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