April 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

DOJ's Use of Expansive Legal Theories Broaden FCPA Jurisdiction

Enacted in 1977 in response to the revelation of widespread bribery of foreign officials by U.S. companies, the Foreign Corrupt Practices Act ("FCPA" or "the Act") was "intended to halt those corrupt practices, create a level playing field for honest businesses, and restore public confidence in the integrity of the marketplace." *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, U.S. Department of Justice ("DOJ") and the Enforcement Division of the U.S. Securities and Exchange Commission ("SEC"), Nov. 14, 2012, at 2 ("FCPA Guidance"). To that end, Congress included an anti-bribery provision in the Act that prohibits companies and their employees and agents from paying bribes to foreign officials in order to obtain or retain business.

For decades following its enactment, FCPA enforcement was largely non-existent. It was not until the early 2000s when, following the second amendment of the Act, enforcement activity proceeded in earnest. Since that time, FCPA enforcement has been rampant, peaking at 74 actions initiated by either DOJ or SEC in 2010, as compared to five actions in 2004. *See* Melissa Aguilar, *2010 FCPA Enforcement Shatters Records*, Compliance Week (Jan. 4, 2011).

Despite the government's increased enforcement of the FCPA, the actions are seldom litigated in federal court. The government increasingly enters into non-prosecution agreements ("NPAs") and deferred prosecution agreements ("DPAs") with companies in which the government agrees not to prosecute in exchange for proof of continuing compliance. Actions not resolved through NPAs or DPAs are typically

(continued on page 2)

INSIDE

Quinn Emanuel Wins *Law360*'s "2013 Practice Group of the Year" Award in Four Practice Areas

Law360 selected Quinn Emanuel as "2013 Practice Group of the Year" in four practice areas: Appellate, Banking, Insurance, and Intellectual Property. For 2013, *Law360* editors received nearly 675 submissions from 130 law firms vying for "Practice Group of the Year." Winners were chosen based on the significance, complexity, and quantity of litigation wins or deals by each firm between November 1, 2012 and November 1, 2013. Q

Quinn Emanuel Selected as One of *The American Lawyer*'s "Top Firms for Diversity"

For the third year in a row, Quinn Emanuel has been selected as one of *The American Lawyer*'s "Top Firms for Diversity." The annual ranking surveys the country's largest firms, with 228 participants in 2013. The firm is committed to diversity and is proud to have been recognized by *The American Lawyer* again this year. Q

Beau Deleuil Joins Quinn Emanuel Sydney

Beau Deleuil, former Global Head of Disputes Resolution at King & Wood Mallesons, has joined Quinn Emanuel's Sydney office as partner. Mr. Deleuil specializes in commercial litigation with a focus on insolvency, banking, professional indemnity, and competition law. His professional experience includes acting in continuous disclosure prosecutions, energy and resources matters, internal and external fraud investigations, access and regulatory claims, and claims, prosecutions, and proceedings under trade practices legislation. He is consistently recognized as a leading individual in insolvency, restructuring, and litigation by a range of publications including *IFLR1000*, *Chambers Global Guide*, and *Best Lawyers*. Q resolved through plea agreements or settlements, usually accompanied with large criminal or civil monetary penalties. There is very little case law interpreting the breadth of the Act, leaving DOJ and SEC free to pursue aggressive legal theories that have been largely untested in federal court. This article discusses some of the government's most recent theories and examines the increased expansion of the FCPA's scope.

"Foreign Official" Under the FCPA

DOJ and SEC have taken an expansive view of who qualifies as a "foreign official" under the FCPA. In general, the anti-bribery provision of the Act prohibits the payment of money or anything of value to a foreign official in order to influence any act or decision of the foreign official in his or her official capacity or to secure any other improper advantage in order to obtain or retain business. *See* 15 U.S.C. § 78dd. "Foreign official" is defined, in part, as "any officer or employee of a foreign government or any department, agency or instrumentality thereof." §§ 78dd-2(h)(2)(A).

The Act does not define the term "instrumentality." Without any formal legislative guidance, DOJ and SEC have affixed their own definition to the term, interpreting it to include state-owned or state-controlled enterprises ("SOEs"). By classifying SOEs as an "instrumentality" of a foreign government, DOJ and SEC consider individuals employed by SOEs to be "foreign officials" under the Act.

DOJ and SEC Expansion of the Term "Instrumentality"

Over the past few years, DOJ and SEC have focused on illicit payments to employees of SOEs. For example, in 2010, DOJ charged Alcatel-Lucent with making improper payments to employees of a Malaysian telecommunications company, Telekom Malaysia Berhard ("TMB"). The payments were made in exchange for non-public information relating to ongoing public tenders for which an Alcatel-Lucent subsidiary was competing. Although TMB was only 43 percent owned by the Malaysian government, DOJ still considered it to be an "instrumentality" of the Malaysian government. Specifically, DOJ's criminal information claimed that the Malaysian Ministry of Finance had veto power over all of TMB's major expenditures and made important operational decisions. DOJ also claimed that the Malaysian government owned its interest in TMB through the Minister of Finance, who had the status of a "special shareholder." Furthermore, DOJ claimed that most senior TMB officers were political appointees. Based on these factors, DOJ deemed the employees of TMB to be "foreign officials."

DOJ's action against TMB reflects the government's most expansive position on when an entity qualifies as an instrumentality of a foreign government. *See* Mike Koehler, *Foreign Official Limbo . . . How Low Can It Go?* FCPA Professor (Jan. 10, 2011). That is, never before had DOJ or SEC ever taken action against a commercial enterprise as an "instrumentality" of a foreign government that was only 43 percent owned by that foreign government. Now, in the wake of TMB, corporations are left to wonder exactly how much "ownership" must a foreign government have in a given enterprise for the government to consider it "state-owned." While the exact answer to that question remains unclear, DOJ and SEC have stated that ownership, *per se*, is not the determining factor; rather, the focus should be on elements of "control, status, and function to determine whether a particular entity is an agency or instrumentality of a foreign government." FCPA Guidance at 20.

Challenges to DOJ and SEC Interpretation of "Instrumentality"

Recently, several targets of DOJ and SEC enforcement actions have moved to dismiss criminal indictments on the basis that employees of SOEs could not qualify as a "foreign official." These challenges, however, have been largely unsuccessful. In fact, of the five cases challenging the government's expansive interpretation of "foreign official," three were summarily denied. *See e.g.*, *United States v. Esquenazi, et al.*, 1:09-cr-21010 (S.D. Fla. 2009); *United States v. O'Shea*, No. 09-00629 (S.D. Tx. 2009); *United States v. Nguyen*, No. 2:08-cr-00522 (E.D. Pa. 2008). The two remaining cases, *United States v. Carson*, No. 09-77 (C.D. Cal. 2009) and *United States v. Noriega*, No. 10-1031 (C.D. Cal. 2010), resulted in opinions that affirmed DOJ and SEC's enforcement theory that employees of SOEs can be "foreign officials" under the FCPA.

In *Carson,* executives of Control Components, Inc. were charged with allegedly paying approximately $4.9 million in corrupt payments to employees of state-owned customers in China, Korea, Malaysia, and the United Arab Emirates. The defendants moved to dismiss on the basis that employees of SOEs could never be "foreign officials" under the FCPA. *See United States v. Carson*, 2011 WL 5101701, *1 (C.D. Cal. May 18, 2011). Although the court denied the defendants' motion, it nevertheless observed "that the question of whether state-owned companies qualify as instrumentalities under the FCPA is a question of fact." *Id.* That "a company is wholly owned by the state is insufficient for the Court to determine as a matter of law whether the company constitutes a government 'instrumentality.'" *Id.* As such, the court went on to identify:

> [s]everal factors that bear on the question of whether a business entity constitutes a government instrumentality, including: [1] [t]he foreign state's characterization of the entity and its employees; [2] [t]he foreign state's degree of control over the entity; [3] [t]he purpose of the entity's activities; [4] [t]he entity's obligations and privileges under the foreign state's law, including whether the entity exercises exclusive or controlling power to administer its designated functions; [5] [t]he circumstances surrounding the entity's creation; and [6] [t]he foreign state's extent of ownership of the entity, including the level of financial support by the state (e.g., subsidies, special tax treatment, and loans).

Id. at 3-4. Based on these factors, the court concluded that the SOEs were instrumentalities of foreign governments. *Id.* Therefore, the payments made by the executives of Control Components to the employees of the various SOEs implicated the FCPA.

Carson is a pivotal case in FCPA "foreign official" jurisprudence because the court embraced the government's position that elements of control, status, and function are relevant to the determination of when, and under what circumstances, an SOE may be considered an instrumentality of a foreign government. Notwithstanding this guidance, cultural considerations can make this determination a challenge. Indeed, the government has acknowledged that "when a foreign government is organized in a fashion similar to the U.S. system, what constitutes a government department or agency is typically clear" but when "governments [are] organized in very different ways" spotting an SOE can be more difficult. FCPA Guidance at 20. For example, in Asia, state-ownership and state-control of commercial enterprises are quite common, though not always outwardly apparent. Specifically, in China, the vast majority of hospitals are SOEs, likely rendering the doctors, nurses, and hospital administrators as "foreign officials" under the government's expansive interpretation of the Act. This could cause potential FCPA problems for foreign drug companies that sell their drugs in Chinese hospitals where "it is well known in China that doctors who prescribe drugs in state-operated hospitals are often given a 'kickback' in the form of a commission by the supplier of the drugs." Daniel Chow, *China Under the Foreign Corrupt Practices Act*, 2012 WIS. L. REV. 573, 585 (2012).

With so much uncertainty about when, and under what circumstances, an SOE may be considered an instrumentality of a foreign government, further judicial guidance on this issue is necessary. Last fall, a U.S. appellate court (the Eleventh Circuit) heard oral arguments in *United States v. Esquenazi*, No. 11-15331-C, concerning the propriety of the government's enforcement theory that employees of SOEs can be foreign officials under the FCPA. That decision, which is expected this spring, will provide guidance on the continued viability of the government's expansive interpretation of the term "instrumentality."

"Territorial Jurisdiction" Under the FCPA

DOJ and SEC have also taken an expansive view of the "territorial jurisdiction" provision of the Act. As the global economy rapidly expanded following the passage of the Act, U.S. companies complained that the FCPA created a competitive disadvantage for them by failing to curtail corrupt practices among foreign actors. To that end, Congress amended the Act in 1998 to, among other things, add a "territorial jurisdiction" provision. Under this provision, foreign entities, other than issuers (*i.e.*, companies that have securities registered in the U.S. or that are required to file reports with SEC) and foreign individuals, are subject to the FCPA if they "corruptly . . . make use of the mails or any means or instrumentality of interstate commerce," or if they commit "any other act in furtherance of" a corrupt payment "while in the territory of the United States." 15 U.S.C. § 78dd-3(a). Thus, any action taken "while in the territory of the United States," irrespective of the nationality of the individual actor, or the place of domicile of the corporation, confers U.S. jurisdiction.

DOJ and SEC Correspondent Bank Transfers Theory

DOJ and SEC have taken an expansive view of what it means for conduct to have taken place "while in the territory of the United States"—to the point that physical presence in the U.S. is not required. For instance, DOJ has taken the position, albeit in conjunction with other jurisdictional bases, that territorial jurisdiction extends to those who cause foreign funds to be transferred through correspondent bank accounts in the U.S. *See e.g.*, *United States v. Technip S.A.*, No. 10-cr-00439 (S.D. Tx. filed June 28, 2010); *United States v. Kellogg Brown & Root LLC*, No. 09-cr-00071 (S.D. Texas. filed Feb 6, 2009). Correspondent bank transfers occur when a foreign transaction is denominated in U.S. dollars. The foreign currency must be converted into U.S. dollars and for the conversion to take place, the foreign currency must pass through a correspondent bank in the U.S. According to DOJ, this fleeting contact with U.S. banking institutions occurs "within the territory of the United States."

In one recent FCPA action, JGC Corporation, a Japanese company, agreed to pay approximately $218 million for its role in a conspiracy to bribe Nigerian officials as part of a joint venture with other corporations that themselves were charged with FCPA violations. JGC was neither a domestic concern nor an issuer, and was not alleged by DOJ to have been an agent of a domestic concern or issuer. Nevertheless, DOJ asserted jurisdiction because JGC's co-conspirators were either issuers or domestic concerns. While the conspiracy and aiding-and-abetting bases for the action were apparently adequate to proceed in the JGC matter, DOJ nevertheless included allegations suggesting that FCPA liability could also be based on a "territorial jurisdiction" theory because of the use of correspondent bank accounts.

Conclusion

Using these and other expansive legal theories, DOJ and SEC have extracted nearly $5 billion in civil and criminal penalties from individuals and corporations alleged to have violated the FCPA since 2009. *See* Robert Cassin, *2013 FCPA Enforcement Index*, FCPA Professor (Jan. 2, 2014). Accordingly, if the government continues to be aggressive in its FCPA enforcement, individuals and corporations may be less likely to acquiesce to the government's settlement demands and more likely to litigate against DOJ's and SEC's expansive legal theories. Q

NOTED WITH INTEREST

Proposed Amendments to the Federal Rules Aim to Lessen Burden of Discovery

Proposed amendments to the Federal Rules of Civil Procedure are set to take effect on December 1, 2015, with significant changes to the scope of discovery and the duty to preserve relevant evidence. The amendments are aimed at reducing the burden of discovery, primarily by requiring that discovery be proportional to the needs of each case and by heightening the showing required to obtain sanctions for the failure to preserve evidence. The amendments implement proportional discovery by substantially altering Rule 26(b), which governs discovery scope and limits. The current Rule 26(b) has a broad scope and few limitations on discovery, allowing discovery of (1) "any nonprivileged matter that is relevant to any party's claim or defense," (2) of "any matter relevant to the subject matter involved in the action" upon a showing of good cause, and (3) of inadmissible information "if the discovery appears reasonably calculated to lead to the discovery of admissible evidence." Many courts have broadly interpreted this rule, particularly the clause allowing discovery that "appears reasonably calculated to lead to the discovery of admissible evidence," permitting discovery into virtually anything that might lead to admissible evidence.

The proposed amendments to Rule 26(b) place new limits on the scope of discovery, restricting discovery to that which is "proportional to the needs of the case." The proposed rule states as follows:

> Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense and proportional to the needs of the case, considering the amount in controversy, the importance of the issues at stake in the action, the parties' resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the proposed discovery outweighs its likely benefit. Information within this scope of discovery need not be admissible in evidence to be discoverable.

Preliminary Draft of Proposed Amendments to the Federal Rules of Bankruptcy and Civil Procedure (Aug. 2013), at 289 (available at http://www.uscourts.gov/rulesandpolicies/rules.aspx) ("Proposed Amendments").

While the current version of Rule 26(b)(2)(C)(iii) addresses considerations regarding the costs and benefits of discovery, that subsection requires a court order to limit the scope of discovery. The amended rule moves these considerations into the subsection of Rule 26(b) that defines the scope of permissible discovery in the first instance. As the Committee on Rules of Practice and Procedure explains, "[a]lthough the considerations are familiar, and have measured the court's duty to limit the frequency or extent of discovery, the change incorporates them into the scope of discovery that must be observed by the parties without court order." Proposed Amendments at 296.

In addition to adding this language, the amended Rule 26(b) deletes two clauses. The first allowed a court, for good cause, to order "discovery of any matter relevant to the subject matter involved in the action," regardless of whether it was relevant to a claim or defense. Fed. R. Civ. P. Rule 26(b). And the second allowed discovery of relevant but inadmissible information "if the discovery appears reasonably calculated to lead to the discovery of admissible evidence. *Id.* The deletion of these two clauses does not mean that discovery along these lines will necessarily be prohibited. Instead, according to the Committee notes, such discovery is allowed as long as it is "otherwise within the scope of discovery, namely that which is relevant to a party's claim or defense and proportional to the needs of the case." Proposed Amendments at 297.

It is difficult to predict the precise effect these rules will have on the scope and burden of discovery, but certainly the new rules will provide support for litigants that favor more narrowly tailored discovery. The new rules also provide an incentive to parties to decide, at an early stage, which areas of discovery are most important to their claims and defenses and adjust their discovery requests accordingly. The proposed amendments do not take effect until December 2015, but in the meantime, litigants should consider placing greater emphasis on the proportionality limitations already present in Rule 26(b)(2)(C)(iii), as these arguments may have more traction given the impending rule changes.

In addition to changing the scope of discovery, the proposed rules replace completely Rule 37(e), which addresses sanctions for the failure to preserve discoverable information. The new Rule 37(e) provides clearer and more uniform guidance to courts and litigants regarding which evidence must be preserved and under what circumstances sanctions are appropriate.

The current Rule 37(e) states that "[a]bsent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system." The Committee, in its notes explaining its new version of this rule, states that it "has been repeatedly informed of growing concern about the increasing burden of preserving information for litigation, particularly with regard to electronically stored information." Proposed Amendments at 317. Because federal courts across the country have developed divergent interpretations of the rule, "potential parties cannot determine what preservation standards" will apply and have resorted to "[e]xtremely expensive overpreservation" in order to avoid the risk of sanctions. *Id.*

The new Rule 37(e) addresses these concerns by providing clearer, uniform guidance about parties' preservation obligations and the requirements for sanctions, allowing courts to order limited remedies for minor violations and reserving harsher sanctions for egregious violations. Under the proposed rule, a court may impose sanctions on a party for failing to comply with its preservation obligations only if the court finds that the party's actions either (1) "caused substantial prejudice in the litigation and were willful or in bad faith" or (2) "irreparably deprived a party of any meaningful opportunity to present or defend against the claims in the litigation." *Id.* at 314-15. The possible sanctions are set forth in current Rule 37(b)(2)(A) and include striking claims or defenses, striking pleadings, staying proceedings, dismissing the action, ordering a default judgment, or holding a party in contempt. But in the absence of willfulness, bad faith, or irreparable harm to the opposing party's case, the court may impose milder remedies, including permitting additional discovery, ordering curative measures, or ordering the party to pay reasonable expenses and fees caused by the failure to preserve. *Id.* at 314-15.

In determining whether a party should have preserved the information at issue and whether the party's conduct was willful or in bad faith, the proposed rule requires courts to consider "all relevant factors," including (1) the extent to which the party was on notice of the litigation; (2) the reasonableness of the party's efforts to preserve the information; (3) whether the party received a request to preserve information, whether the request was clear and reasonable, and whether the parties consulted in good faith about the scope of preservation; and (4) whether the party timely sought the court's guidance on any disputes regarding preservation. *Id.* at 316-17. Although the new rule will not provide any bright lines for determining what potential litigants should and should not preserve, the Committee states that the "amended rule is designed to ensure that potential litigants who make reasonable efforts to satisfy their preservation responsibilities may do so with confidence that they will not be subjected to serious sanctions should information be lost despite those efforts." *Id.* at 318.

Other proposed amendments that may lessen the burden of discovery include reducing the length of depositions from seven to six hours under Rule 30, reducing the number of interrogatories from twenty-five to fifteen under Rule 33, and limiting parties to twenty-five requests for admission under Rule 36.

The public comment period for the proposed amendments closed on February 15, 2014. The proposed amendments, however, have not yet been approved by the Committee, the Judicial Conference, or the Supreme Court of the United States, all of which must approve the proposals before they take effect. Q

Insurance Litigation Update

New York Court of Appeals Answers Important Questions About Whether an Increased Risk of Harm Constitutes a Physical Injury. Over the past fifteen years, the question of whether tort claims for medical monitoring fall within the scope of commercial general liability ("CGL") policies when the claims are based solely on an allegedly increased risk of disease has been one of the most evolving, and frequently litigated, questions in insurance law. The standard CGL policy provides coverage for "sums which the insured shall become legally obligated to pay as damages because of bodily injury." (*See* 1973 Standard ISO CGL Agreement.) In a typical medical monitoring case, however, the members of the plaintiff class have not been diagnosed with any disease, do not exhibit any symptoms, and do not claim to have suffered any traditionally defined injury. Rather, the class of plaintiffs alleges that they are at an "increased risk" of disease due to exposure to some toxic substance and seek recovery of the costs of monitoring for any future medical problems. Insurance companies are frequently forced to wrestle with the question of whether tort claims that are based on an "increased risk of disease" constitute "bodily injury" under the standard CGL policy.

The stakes are high. The damages sought in such cases frequently run into the several millions of dollars and medical monitoring class actions have been growing in frequency. The putative class actions often involve tens of thousands (or in some cases hundreds of thousands) of proposed claimants in cases as diverse as tobacco use, pharmaceuticals, medical implants, lead paint-coated toys, and even oil spills. Moreover, given the increasingly heightened public concern over alleged toxicity in numerous products, the likelihood that medical monitoring cases will result in more proposed multi-million dollar class actions—and more coverage litigations—seems not just significant, but inevitable.

On December 17, 2013, the New York Court of Appeals issued a products liability decision in an action captioned *Caronia v. Philip Morris*. *Caronia*, a case in which Quinn Emanuel submitted an *amicus* brief, was a huge victory for products manufacturers. It is, however, also likely to impact the way courts, policy holders, and insurance companies define injury in future medical monitoring cases. In *Caronia*, the Court of Appeals was asked to determine whether current or former smokers who had not "been diagnosed with a smoking-related disease" and were not then "under investigation by a physician for such a suspected disease" could "pursue an independent equitable cause of action for medical monitoring for such a disease." The Court of Appeals determined that no such independent cause of action existed under New York law. That decision has important implications for insurance carriers concerning the duty to defend such cases in New York and will likely have a broader impact in other jurisdictions that may follow the reasoning of the Court of Appeals, which held that "[a] threat of future harm is insufficient to impose liability against a defendant in a tort context." (Slip Op. at 4.)

The *Caronia* decision is important because in those jurisdictions that allow medical monitoring claims based on allegations of increased risk of disease, the Court of Appeals' ruling will likely impact how courts will view the obligations of insurance companies to provide indemnification under their CGL policies. In other contexts, the vast majority of courts to interpret the meaning of the phrase "bodily injury" in CGL policies have recognized that "bodily injury" results from "physical injuries to the body and consequences thereof." *See* Keri Farrell-Kolb, General Liability Coverage for Claims of Emotional Distress—An Insurance Nightmare, 45 Drake L.R. 981, 985 (1997) (collecting case). The important open question for insurance companies and policy holders is whether courts in the jurisdictions that allow such claims will view claims based on allegations of an "increased risk" of disease as a claim for physical injury. If courts in those jurisdictions follow the reasoning of the New York Court of Appeals and hold that an "increased risk" of developing a disease does not rise to the level of "physical harm," then *Caronia* will be one of the most important insurance cases of 2013.

EU Litigation Update

License Agreements Under Scrutiny—A New Challenge for Non-Challenge Clauses. In general, license agreements are deemed pro-competitive. Licensing leads to the dissemination of technology and promotes (follow on) innovation (cf. European Commission Regulation on Technology Transfer Agreements of 27 April 2004, para 5). Furthermore, if third-party technology can be licensed, research and development expenditures can be used more efficiently. Finally, commercializing goods via licensing is one of the key privileges of any intellectual property right. It is the very essence of an exclusive right, such as patents and copyrights, to permit the use of that property by others in exchange for consideration. As is also true for property in physical objects, however, the execution of this exclusive right is subject to restrictions set by competition law.

Recently, a growing number of provisions regularly found in license agreements have attracted the special attention of Europe's competition authority, in particular provisions prohibiting the licensee from challenging the validity of the licensed intellectual property right. From a competition law perspective, invalid intellectual property rights may have anti-competitive effects to the extent that the access to (invalidly) protected technology is unjustly limited. The fear is that unjustified monopolization of a specific technology may result in undue royalty payments, ultimately harming competition. Any serious competitive analysis has to acknowledge the uncertainties that parties negotiating intellectual property licenses encounter with regard to the validity of intellectual property rights. In fact, parties will typically only know after litigation that an intellectual property right is considered valid by the courts. Before litigation, parties will only be able to make probability judgments in this regard. These probability judgments may change in the course of negotiations or even litigation, depending on the quality of prior art or other invalidity evidence the counterparty relies on.

In its revised set of rules governing the antitrust implications of license agreements—the Technology Transfer Block Exemption Regulation or TTBR—the European Commission promulgates a strict stance against restrictions that challenge the validity of intellectual property rights. This revised regulation, replacing the earlier TTBR dated 27 April 2004, is planned to become effective as of 1 May 2014. As was the case with its predecessor, the revised regulation provides a framework for assessing whether technology licensing agreements violate Article 101—the provision dealing with anti-competitive agreements—of the Treaty on the Functioning of the European Union (TFEU).

Still in line with its predecessor, the revised TTBR excludes non-challenge clauses from the safe harbor (Article 5 Nr. 1 b). Pursuant to a non-challenge clause, a licensee is prohibited from challenging the validity of the licensed intellectual property (*e.*g., by filing a nullity complaint). The practical purpose of such provisions is to gain patent peace between the parties. The parties agree to consider the licensed intellectual property as (bilaterally) valid, thus gaining certainty with regard to their mutual obligations and ensuring that no litigation will be initiated by either party to question the essence of the agreement (*i.e.*, the legal existence of the licensed intellectual property).

However, such a non-challenge clause does not benefit from the safe harbor established by the TTBR. The underlying rationale, as described in the Commission's revised guidelines (para. 123), is a stipulated public interest in eliminating invalid intellectual property rights. "Invalid intellectual property stifles innovation rather than promoting it." Since the licensees would in many cases be best placed to determine the validity of the intellectual property right, they should not be excluded from bringing validity challenges before the competent courts. Consequently, the Commission considers (costly) litigation between private entities that could result in the elimination of a potentially invalid intellectual property right to be beneficial to the market in general, even if the intellectual property right had been awarded by a public authority in the first place (such as patents or registered design rights). This is close to being at odds with the presumption that patents are valid because of the thorough analysis conducted by the patent office during prosecution.

Going even further, the Commission intends to exclude provisions from the scope of the TTBR's safe harbor that stipulate a *right to terminate* a license agreement if the licensee challenges the validity of the licensed intellectual property (Article 5 Nr. 1 b of revised TTBR). Again, it is the stipulated public interest in using the licensee as a "litigation vehicle" to challenge potentially invalid intellectual property rights that is put forward as justification. According to the Commission, termination rights can have the same effect as a non-challenge clause, in particular where the licensee has already incurred significant sunk costs for the production of the contract products or is already producing the contract products (revised guidelines, para. 125). Potentially, licensees may be deterred from challenging the validity of the licensed intellectual property as they would risk termination of the license agreement. However, if the licensees consider their invalidity arguments to be convincing, why should they then fear termination of the license agreement?

Any competitive analysis of non-challenge clauses has to take account of the practical purpose of license agreements. License agreements grant a licensee the right to use a specific technology. Superficially, this transfer will only make sense to the extent that the licensor has any rights to grant, *i.e.*, the licensed intellectual property is valid. Also, the licensee will only be interested in licensing a patent if the licensee actually uses (or intends to use) the patented technology. Thus, from a superficial perspective, it seems that validity and infringement of the licensed patent are the basis of any license agreement. Although this conclusion may be persuasive in concept, it falls short both of practical requirements and the very doctrinal nature of license agreements. In fact, parties to a licensing negotiation will hardly ever be *certain* as to infringement and validity of the respective intellectual property rights. Unlike in a litigation context, the outcome of a licensing negotiation will not likely involve an agreement between the licensor and licensee either that an intellectual property right is infringed and valid or non-infringed and invalid.

The reason for this is simple. When analyzing the technical value of a patent, parties to a negotiation *predict* the outcome of a hypothetical litigation. However, predictions can never be certain—not only against the backdrop of possible value judgments by lay or professional judges but also because of prior art that the prospective licensee may have up its sleeve. In fact, any intellectual property right granted by public authorities, in particular patents, are only *presumably* valid. This entails the possibility of the patent being invalid. The probability judgments regarding validity and invalidity are subject to dynamics of negotiations and litigation proceedings. For instance, once validity has been confirmed by a neutral third party (*i.e.*, a court), the probability is usually perceived as being higher than at the beginning of the negotiations.

Both parties to a licensing negotiation are thus faced with uncertainties as to the outcome of hypothetical litigation proceedings. It is a business decision whether a party wishes to endure these uncertainties. If it does, litigation is the route to go. If it does not, it is a license agreement that will create certainty. The licensee is certain not to infringe the respective intellectual property right and the licensor is certain to obtain the payment of royalties. Needless to say that this is a trade-off for both parties, depending on the respective probabilities of winning in court. Consequently, uncertainties are usually priced into the royalty rate or other consideration agreed to by the parties. A license agreement, therefore, results from bargaining based on probabilities. The same is true for settlement agreements, where parties to litigation proceedings bargain based on the perceived probabilities of losing or winning the case.

Challenging the validity of the intellectual property right after the license agreement has been concluded throws the parties' bargaining give-and-take out of balance. The licensee claims both the chances of defeating the licensor in court and the certainty of having a right to use the technology at the same time—a classic case of having one's cake and eating it too. Consequently, many license agreements include a termination clause for exactly these reasons. If the licensee chooses to litigate (*i.e.*, challenge the patent), the licensor should have the mirror opportunity (*i.e.*, to seek damages exceeding the royalty rate or to obtain a cease and desist order). There is hardly anything anti-competitive about such a provision. It is a fair balance of interests on which parties might choose to agree. And, it prevents the licensee from obtaining the benefits of the parties' respective bargaining based on probabilities and then later challenging the basis of the parties' probability judgments.

Somewhat surprisingly, but ultimately correctly, the Commission seems to share this view when it comes to settlement agreements. The Commission states in its revised guidelines (para. 226):

> "*In the context of a bona-fide settlement agreement, non-challenge clauses are generally considered to fall outside Article 101(1). It is inherent in such agreements that the parties agree not to challenge ex post the intellectual property rights which were the centre of the dispute. Indeed, the very purpose of the agreement is to settle existing disputes and/or to avoid future disputes*."

The Commission is correct in noting that one of the fundamental purposes of settlements is to avoid future disputes. Accordingly, even the Commission assumes that agreements ending a dispute are not anti-competitive, even if they include a non-challenge clause. But why should sophisticated parties wait until litigation is actually pending before being allowed to conclude an agreement that would efficiently avoid future disputes? There is no practical difference between a settlement agreement ending litigation and a license agreement entered into to avoid litigation in the first instance. In both situations, the parties anticipate their respective risks and chances of winning the already pending or anticipated proceedings.

The discussion about non-challenge clauses is clearly not at an end. Ultimately, the Court of Justice of the European Union will have to decide questions regarding the scope and validity of such clauses. Until then, it is critically important to evaluate potential competition law issues involving non-challenge clauses when negotiating intellectual property license agreements.

ITC Litigation Update

***Inducement in the ITC Following* Suprema?** A split Federal Circuit panel held in *Suprema, Inc. v. ITC* (Dec. 13, 2013) that an exclusion order issued by the International Trade Commission ("ITC") under Section 337 "may not be predicated on a theory of induced infringement . . . where direct infringement does not occur until *after* importation of the articles the exclusion order would bar." *Id.* at 4. Rather, an exclusion order can "bar only those articles that infringe . . . at the time of importation." *Id.*

In the underlying investigation, the ITC found that Korean respondent Suprema manufactures and imports fingerprint scanners into the United States. After importation, a domestic respondent Mentalix installs software onto the scanners. Complainant Cross Match alleged that this combination of hardware and software infringed its patent, including several method claims. The ITC agreed, finding that because Suprema was willfully blind to Cross Match's patent and actively encouraged Mentalix to install software on the Suprema scanners, Suprema induced infringement of Cross Match's patent claims.

Suprema appealed the ITC's decision to the Federal Circuit, arguing that its imported scanners infringe only *after* they are domestically combined with Mentalix's software. Suprema thus contended that because the imported scanners do not infringe the asserted method claims at the time they are imported, there can be no violation within the meaning of Section 337.

The Federal Circuit panel majority agreed with Suprema, reasoning that because the ITC's authority only extends to "the importation, sale for importation, or sale within the U.S. after importation," the correct interpretation of Section 337 is that the ITC is "powerless to remedy acts of induced infringement" when the underlying direct infringement occurs *post-importation*. *Id.* at 13. According to the majority, the "focus is on the infringing nature of the articles *at the time of importation*, not on the intent of the parties with respect to the imported goods." *Id.* at 16. On that basis, the majority vacated the ITC's induced infringement determination, reasoning as follows: Direct infringement is a prerequisite for induced infringement, and because Suprema's scanners did not directly infringe at the moment of importation, it follows that no induced infringement could have occurred at the moment of importation.

In a strongly-worded dissent, Judge Reyna stated that the majority's interpretation of Section 337 will harm US patent holders because it enables circumvention of the ITC's authority to halt unfair acts at the border. In particular, "an importer could import disassembled components of a patented machine, or import an article capable of performing almost all of the steps of a patented method, but reserve final assembly of the last part or performance of the last step for the end-user in the United States and, under the majority's holding, fall outside the [ITC's] statutory reach because direct infringement would not have occurred until after importation. . . . Section 337 should not be interpreted in a manner that enables this form of circumvention." *Dissent* at 11-12. Expanding on its example, the dissent finds that "the majority legalizes the most common and least sophisticated form of circumvention, importation of the article in a disassembled state." *Dissent* at 13.

The dissent further contends that the majority's holding leaves contributory infringement as the *only* possible way of enforcing method-of-use claims at the ITC. Notably, the dissent does not discuss whether contributory infringement is an *effective* way of enforcing method patents at the ITC. It remains to be seen how and to what extent the *Suprema* decision will impact the viability, effectiveness, and popularity of the ITC as a forum for litigating method claims. Perhaps the current *Suprema* decision will be short-lived and have no effect at all. Indeed, on February 21, 2014, the ITC filed a petition for panel rehearing and rehearing *en banc*. Q

Susheel Kirpalani Named One of *Turnarounds & Workouts*' Outstanding Restructuring Lawyers of 2013

Susheel Kirpalani was named one of *Turnaround & Workouts*' Outstanding Restructuring Lawyers of 2013. The award honors restructuring lawyers who are leaders in the industry with significant and notable engagements from the past year. Susheel was recognized in particular for his ongoing representation of Eike Batista as controlling shareholder in the Brazilian restructurings of OGX and OSX, oil and gas and related shipping and equipment companies. Susheel was also recognized for his leadership role representing RMBS litigation creditors of ResCap in global mediation with numerous other Chapter 11 participants, including Ally Financial and most of the other major creditor constituencies. Finally, 2013 saw the successful conclusion of Jefferson County, Alabama's Chapter 9 case, in which Susheel had represented Syncora Guarantee. Q

Quinn Emanuel Helps Pro Bono Client, a Decorated Marine, Receive Honorable Discharge in a Mishandling of Classified Information Case

The firm represented former Marine Major Jason Brezler in a separation proceeding before a military Board of Inquiry. Brezler faced six charges related to the mishandling of classified information. Brezler is a highly-decorated Marine Reserve officer and New York City fireman (in one of its most elite units). On his third combat tour in 2009-2010, Brezler fired a senior Afghan police official for serious human rights abuses, corruption, and ties to the Taliban. The Afghan police official unaccountably returned to power in 2012, and Marines serving there sought to learn more about his background. On July 24, 2012, Brezler, attending graduate school as a civilian, received a request to send a specific document outlining his concerns about the official. Brezler immediately sent that document, at which point a Marine officer in Afghanistan claimed that Brezler had sent him classified information and had ignored the confidentiality warnings that the document contained. Brezler reported sending the document to his chain of command, but tragically an abuse victim of the corrupt Afghan police official murdered three Marines in their base gymnasium on August 10, 2012.

This email spurred two investigations, and, as a result, the Marines charged Brezler with six offenses related to improper storage of classified information, the use of that classified information in a manuscript he wrote, and the sending of the email. The prosecution produced evidence that substantiated that Brezler had, in fact, illegally retained the classified information, copied this information into a manuscript he was working on, and sent a classified e-mail on an unclassified system.

Brezler faced the possibility of criminal punishment, and the loss of his military benefits if his service was negatively characterized in "general" or "other than honorable" terms. To combat the prosecution's evidence, Quinn Emanuel came up with a strategy that invoked core Marine values and had Brezler take responsibly for his actions. In addition, the firm compiled and submitted over sixty character statements and produced a number of witnesses to rebut the prosecution's case.

The Board of Inquiry acted with leniency and rejected all but the lightest punishment. As a result, Brezler received an honorable discharge and retained all of his military benefits. Brezler still desires to remain in the Marine Reserves, and the firm will seek that relief upon review. Quinn Emanuel created a solid record with possible grounds for relief including the argument that Brezler was facing unconstitutionally selective prosecution as a result of his exercise of his First Amendment right to petition Congress for redress in his case, as well as the exercise of unlawful command influence in connection with the Board proceeding.

Subpoena TRO in *Mirra v. Jordan*

Quinn Emanuel represents Raymond A. Mirra, Jr. in a defamation action in federal court against his former spouse and business partner, Gigi Jordan, based on defamatory statements she made to a reporter for the *New York Daily News*. Ms. Jordan is currently incarcerated at Rikers Island pending trial for the murder of her own son. The firm recently learned that Ms. Jordan's attorney had been serving subpoenas to non-parties without providing prior notice to our client or the firm, which the firm believed she was using to obtain information for her criminal case. The very next day, the firm went to court on an order to show cause and quickly obtained a TRO and injunction restraining opposing counsel from issuing further subpoenas.

Lead Counsel Appointment in Credit Default Swaps Antitrust MDL

The firm was recently appointed as lead class counsel in a massive antitrust case against banks that sold credit default swaps, defeating attempts by the defendants and a group of rival plaintiffs lawyers to derail Quinn Emanuel's bid.

The multi-district litigation, which has been consolidated before Judge Denise Cote in the Southern District of New York, concerns the banking industry's anticompetitive activity in the market for credit default swaps. CDS are traded over-the-counter and that market is controlled by major banks that operate as market-makers. The basic allegation is that the defendant banks collectively blocked efforts by several major exchanges and clearinghouses to move CDS trading from over-the-counter to an electronic exchange trading platform—a move that would have narrowed bid/ask spreads, improved liquidity, promoted transparency, and ultimately cut out the banks as middlemen in a multi-trillion dollar market.

Given the serious nature of the banks' conduct—conduct that prompted investigations by the Department of Justice and the European Commission—over a dozen law firms filed class actions against these major banks. These firms formed coalitions and adopted aggressive strategies to try to defeat Quinn Emanuel's lead counsel bid. Ultimately, though, at a hearing in December where Judge Cote indicated she would only select one or two of these firms to represent the class, Judge Cote selected Quinn Emanuel. Judge Cote explained that Quinn Emanuel is "the only single firm with the expertise and resources to handle this litigation without assistance essentially," that "it has a track record, a knowledge of the CDS market and antitrust litigation," and it is "well equipped with trial lawyers who can actually go to court and try a case" along with "extraordinary strengths with respect to appellate litigation." Going forward Quinn Emanuel will represent the class against these major financial institutions in what will surely be an important case for both the CDS industry and the development of antitrust law.

NFL and Baltimore Ravens Move Fair Use Goal Post Toward Greater Free Expression in Important Fourth Circuit Victory

Nearly seventeen years after Frederick Bouchat first alleged that the NFL Baltimore Ravens' 1996 inaugural season logo infringed his drawings, the Ravens, represented by Quinn Emanuel, have scored another appellate victory in this long-running copyright litigation. Last December, the United States Court of Appeals for the Fourth Circuit, affirming the district court, held that the NFL's "fleeting and infrequent" use of the 1996 logo in videos broadcast on its network and online, as well as in displays and highlight reels at the Ravens' stadium, was fair use. *Bouchat v. Baltimore Ravens Ltd. P'Ship*, 737 F.3d 932, 935-36 (4th Cir. 2013).

With a jury finding in 1998 that the Ravens' "Flying B Logo" ("the logo") infringed Bouchat's drawing but awarding him no monetary damages, Bouchat has pursued a steady course of subsequent copyright claims over the years. Though the Ravens ceased using the logo two years after introducing it, the NFL and the Ravens have sometimes included it in depictions of the period during which the logo was in use. The latest dispute involved three videos produced by the NFL for viewing on the NFL Network and online. *Id.* at 937-38. Two of the videos feature a top-ten countdown of memorable NFL moments, while a third provides "viewers with an inside look at the sights and sounds of the NFL." *Id.* at 938. Each video includes the logo incidentally; for example, in one video, it is "possible to catch a glimpse of [the logo] on the player's helmet if one chances to look at it for the fraction of a second it is visible." *Id.* Bouchat also brought claims regarding uses of the logo in displays and highlight reels throughout the club level of the Ravens' stadium. *Id.* at 945. One display, a timeline of Ravens' history, begins with the year 1881, and the logo is included in a "segment for a single year—1996," on a reproduction of the game-day program and ticket. *Id.* at 945-46.

Emphasizing no fewer than ten times that these uses of the logo were "fleeting," the court's fair use analysis focused on the transformative nature of the use. *Id.* at 940. The videos presented "a narrative about some aspect of Ravens or NFL history," and the use of the logo thus differed from its original purpose "as the brand symbol for the team, its on-field identifier, and the principal thrust of its promotional efforts." *Id.* Rather, the videos used the logo "as part of the historical record to tell stories of past drafts, major events in Ravens history, and player careers." *Id.* As such, the logo as used by the NFL served "no expressive function at all, but instead act[ed] simply as a historical guidepost." *Id.* And while there was "no doubt" the videos were created for commercial gain," that the use was "substantially transformative" meant that "the NFL's profit-seeking weigh[ed] much less strongly against a finding of fair use." *Id.* at 942. Similarly, the court reasoned that the stadium uses depict the logo "as a historical artifact," an "incidental reproduction" that "would seem almost unavoidable" if "Baltimore's football history [was] to be accurately depicted." *Id.* at 948.

Although acknowledging that the "NFL may not arouse sympathies in the way that a revered artist does," the court noted that "[s]ociety's interest in ensuring the creation of transformative works incidentally utilizing copyrighted material is legitimate no matter who the defendant may be." *Id.* at 945. The alternative outcome—that, to tell its story, the NFL Ravens might have to blur-out pieces of footage and thereby present an incomplete picture of its past—gave the court reason for pause. *Id.* at 943-46. The court reasoned that Bouchat's position would "chill the very artistic creation that copyright law attempts to nurture" because, under that view of fair use, copyright owners "could 'simply choose to prohibit unflattering or disfavored depictions.'" *Id.* at 944-45. The court's decision has broad-reaching implications for filmmakers and documentarians of all stripes, who can rest assured that the insubstantial use of a copyrighted work for a reflective, historical purpose will be protected, and that they need not "receive permission from copyright holders for fleeting factual uses of their works." *Id.* at 944. 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 700 lawyers — the largest in the world devoted solely to business litigation and arbitration.
- As of April 2014, we have tried over 2247 cases, winning 88.5% of them.
- When we represent defendants, our trial experience gets us better settlements or defense verdicts.
- When representing plaintiffs, our lawyers have garnered over $27 billion in judgments and settlements.
- We have won four 9-figure jury verdicts.
- We have also obtained thirteen 9-figure settlements and seven 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 West 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