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Bespoke Litigation: An Alternative to Traditional Arbitration?

In theory, arbitration can offer an attractive alternative to traditional litigation. With discovery, motion practice, and judicial review limited, arbitration is intended to provide a cheaper, more efficient alternative to litigation. Unfortunately, arbitration of complex matters sometimes fails to achieve those goals. If not controlled by the arbitration panel, arbitration of complex disputes can take as long or longer than court adjudication of matters of similar complexity. The increasing prevalence of motion practice and broad discovery in arbitration is exacerbating the problem. Sophisticated parties and practitioners therefore often negotiate customized agreements that seek to limit the scope and contours of any arbitration. Others, leaving arbitration altogether, are inserting bespoke litigation clauses that seek to curtail some of the perceived inefficiencies of judicial proceedings.

Arbitration's Challenge in Dealing with Complex Disputes

If arbitrations run off the rails, the wreck is often contributable to the complexity of the dispute. Sophisticated outside counsel bring the same tools of zealous advocacy to arbitration that they employ in traditional litigation, making arbitration procedures and practice complex and drawn out. The result is that—unless controlled by the arbitration panel—the scope and complexity of discovery can be similar to that undertaken in traditional litigation. Even motion practice, which traditionally is minimized in arbitration, can become a focus of pre-hearing activity in an arbitration. *See*, *e.g.*, Richard H.C. Clay and J. Tanner Watkins, *Methods for Cost Efficient Resolution in Arbitration*, For the Defense, August 2010, at 2.

Of course, the cost of treating arbitrations as litigations by a another name is exacerbated when, as is typical, the arbitrators are paid by the hour. Some cynical critics note that arbitrators have an incentive to extend or delay the process to increase their own compensation. One oft-cited arbitration was conducted for 45 days, spread over 18 months, and topped $5 million in legal fees, with each arbitrator taking home $480,000. Mary Swanton, *System Slowdown: Can Arbitration Be Fixed*? Inside Counsel, May 2007, at 51.

In addition to paying for the arbitrators, the parties must also pay overhead costs. In court, taxpayers foot much of the bill, but in an arbitration the parties are responsible for all costs. In long arbitrations, those costs can be substantial. Expenses increase further when the parties first litigate whether a resistant party can be compelled to arbitrate. As one general counsel put it, a party can spend more than a year and substantial legal fees "simply to enforce in court [its] right not to go to court." Lou Whitman, *Arbitration's*

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Patent Trial Lawyer David Radulescu Joins New York Office

Patent litigator David Radulescu recently joined Quinn Emanuel as a partner in the New York office. With a Ph.D. in electrical engineering, Dr. Radulescu specializes in cases requiring a deep understanding of the interplay between technology and legal issues. He often works on matters in which patent litigation is the most important risk facing a client, typically in the context of a multi-patent, multi-jurisdiction dispute with a primary competitor. Dr. Radulescu was previously a partner at Weil Gotshal & Manges.

Before becoming a trial lawyer, Dr. Radulescu represented hundreds of inventors before the United States Patent and Trademark Office in the preparation and prosecution of patent applications. Dr. Radulescu received his Ph.D. in electrical engineering from Cornell University, where he authored over 25 publications in the area of semiconductor devices and materials. At Columbia University School of Law, he was a co-recipient of the 1991 graduating class Harper Prize in Intellectual Property Law. Q

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Fall From Grace, Law.com, July 13, 2006.

The extra expenses attributable to the parties' attempts to incorporate litigation practices into their arbitration does not yield any benefit for the loser in the arbitration. Under each domestic law (as embodied in the Federal Arbitration Act and the arbitration acts of various states) and international law (as embodied in the New York Convention on the Enforcement of Foreign Arbitral Awards), the grounds for vacating an award are extremely narrow—as compared with the grounds for vacating a judgment.

Bespoke Arbitration

Sophisticated parties therefore are increasingly experimenting with ways to incorporate provisions into arbitration agreements intended to limit cost and delay, a practice known as "bespoke arbitration." Lawyers now more frequently advise their clients "to be very specific in their arbitration clauses, limiting the number of depositions each side is allowed, when documents should be turned over and how many days of testimony there should be." Gina Passarella, *Litigators Losing Love of Arbitration Argue for Trials*, Law.com, September 1, 2010. Businesses are turning to customized arbitration agreements to realize the cost savings that traditional arbitration had originally promised.

Such provisions often seek to limit discovery (particularly the scope of electronic discovery), depositions and motion practice. Other provisions attempt to limit strictly the length of the arbitration, or narrow individual aspects such as discovery. That can be done either by carefully drafting the rules under which the parties agree to arbitrate or through a general directive to the arbitrator. For example, a California federal court recently upheld an arbitration agreement in which the defendants had included a provision requiring that "[o]ne arbitrator shall use all reasonable efforts to minimize discovery and . . . render a written decision within thirty (30) calendar days of the hearing." *Wolf v. Langemeier*, 2010 WL 3341823, at *3 (E.D. Cal. Aug. 24, 2010). The court enforced the agreement while acknowledging that it might significantly curtail the parties' right to full discovery. As a New Jersey federal court recently confirmed, "it is well-established that an arbitration panel may limit discovery in keeping with the terms of the agreement between the parties." *Walzer v. Muriel Siebert & Co.*, 2010 WL 4366197, at *13 (D.N.J. Oct. 28, 2010).

Bespoke Litigation

Some practitioners have turned away from arbitration altogether. Instead of opting out of the public dispute resolution system (as arbitration and modified arbitration do), they believe that parties should embrace the courts as the means to resolve any dispute, but within the confines of self-imposed conditions and limitations designed to curtail the delay and expense typically associated with traditional litigation. By waiving the right to a jury, agreeing to curtail discovery and deposition practice, and even limiting motion practice by prior agreement, they hope to achieve the cost savings and efficiency promised by arbitration while avoiding some of the risks associated with arbitral decision making.

Although not as developed as customized arbitration clauses, tailoring litigation to the parties' specific needs—known as "bespoke litigation"—is not a new concept. Courts routinely enforce choice-of-law and forum-selection clauses, *see, e.g., Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991), as well as waivers of objection to personal jurisdiction. *See, National Equipment Rental, Ltd. v. Szukhent*, 375 U.S. 311, 315-16 (1964). Similarly, pre-dispute jury trial waivers and bench trial agreements which, with some exceptions, are generally enforceable, are increasingly utilized as alternatives to arbitration clauses. *See e.g.*, Jane Spencer, *Companies Ask People to Waive Right to Jury Trial*, Wall. St. Journal, Aug. 17, 2004 (noting the rapid rise of jury trial waivers both among businesses and between businesses and consumers).

Such waivers should be valid. The United States Supreme Court concluded in *United States v. Mezzanatto*, 513 U.S. 196, 203 (1995), that in criminal proceedings, at least in the federal system, there is a "background presumption that legal rights . . . are subject to waiver by voluntary agreement of the parties." If this is the rule in criminal litigation, where life and liberty are at stake, it should certainly apply to civil disputes. Indeed, courts already enforce private agreements that alter the rules of evidence, such as waivers of hearsay objections, objections to the authenticity of documents, and other evidentiary rules. *See, e.g.*, *United States v. Bonnett*, 877 F.2d 1450, 1458–59 (10th Cir. 1989) (enforcing agreement waiving hearsay objections); *Tupman Thurlow Co. v. S.S. Cap Castillo*, 490 F.2d 302, 309 (2d Cir. 1974) (enforcing agreement waiving objection to authenticity of documents).

Unlike the rights to a jury trial or the enforcement of evidentiary rules, the procedural rules governing discovery typically direct parties to confer to determine the scope and limits of their own dispute. By requiring the parties to confer concerning the scope of discovery, for example, Rule 26 of the Federal

Rules of Civil Procedure explicitly contemplates that the parties will tailor the scope of discovery to their particular needs. Likewise, Rule 29 allows parties to limit or modify the discovery process. *See, e.g.*, Fed. R. Civ. P. 29 (parties may by written stipulation modify procedures governing discovery, with few exceptions). In short, the Federal Rules affirm the parties' control of the discovery process and should support the enforceability of discovery limitations made in pre-dispute agreements.

There are, however, some clear limits on bespoke litigation. Courts uniformly agree, for example, that subject matter jurisdiction cannot be forfeited or waived. *Mitchell v. Maurer*, 293 U.S. 237, 244 (1934) ("[L]ack of federal jurisdiction cannot be waived or be overcome by an agreement of the parties"). Because the standard rules of contract law apply, the underlying agreement setting forth the relevant provisions must also be enforceable. If the agreement is not enforceable, the provisions seeking to adjust the manner in which the dispute will be litigated are not enforceable either.

Conclusion and a Caution

For those who are skeptical that arbitration of a complex dispute will be cost effective or efficient, customizing arbitration agreements, or even agreeing to bespoke litigation, are two alternatives to achieve a faster and more efficient dispute resolution.

Before taking either path, however, counsel should consider carefully whether a particular provision will limit the ability to fully develop an available claim or defense. Although bespoke litigation can be more efficient and less costly than other forms of dispute resolution, the savings will hardly matter if a party cannot effectively litigate its claims or defenses. Q

Uncertain Times: Three Distinct Approaches to Ongoing Patent Royalties

The Supreme Court's 2006 decision in *eBay Inc. v. MercExchange* overturned decades of Federal Circuit precedent by rejecting the Federal Circuit's "general rule" of granting a permanent injunction upon a finding of patent infringement. 547 U.S. 388 (2006). Any court that declines to grant a permanent injunction must now decide whether and how to award an "ongoing royalty rate" for future damages following a verdict of patent infringement. In the absence of Federal Circuit precedent, district courts have crafted three different approaches to the ongoing royalty issue, each of which presents benefits and drawbacks.

***The "General Rule" Prior to* eBay v. MercExchange**

Prior to the Supreme Court's decision in *eBay v. MercExchange*, courts traditionally granted a permanent injunction following a finding of infringement. As the Federal Circuit explained in *Smith Int'l Inc. v. Hughes Tool,* 718 F.2d 1573 (Fed. Cir. 1983), denying an injunction would "seriously undermine" the constitutional purpose of patent rights and curtail the patentee's right to exclude. *Smith*, 718 F.2d at 1578. The Federal Circuit went on to state in *Richardson v. Suzuki Motor Co. Ltd*, 868 F.2d 1226, 1247 (Fed. Cir. 1989), that "[i]t is the general rule that an injunction will issue when infringement has been adjudged, absent a sound reason for denying it." District courts applied this general rule almost without exception, and any prevailing patentee could expect to obtain a permanent injunction barring post-verdict infringement.

eBay v. MercExchange *and the Four Factor Test*

The Supreme Court's decision in *eBay* abolished the Federal Circuit's general rule. The patentee in that case, MercExchange, initially sought a permanent injunction following a jury verdict finding that *eBay* infringed MercExchange's business method patents. The district court applied a traditional four-prong analysis by considering (i) whether the plaintiff would suffer irreparable harm in the absence of an injunction; (ii) whether the plaintiff had inadequate remedies at law; (iii) whether the balance of hardships weighed in favor of issuing an injunction; and (iv) whether the public interest would be harmed if an injunction issued. Examining these factors, the district court denied MercExchange's request for a permanent injunction. *eBay,* 547 U.S. at 390.

The Federal Circuit reversed, citing its "general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances." *Id.* at 391. On appeal, the U.S. Supreme Court unanimously vacated the Federal Circuit's judgment, holding that a plaintiff seeking injunctive relief must satisfy the traditional four-prong analysis for a permanent injunction.

In the wake of *eBay*, courts can no longer automatically impose a permanent injunction upon a determination of infringement, but must now satisfy the traditional four-prong analysis. As a result, district courts have been less inclined to issue permanent injunctions following a finding of infringement. *See* Stephen M. Ullmer, 24 Berkeley Tech. L.J. 75, 76 (2009). Accordingly, parties began to ask district

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Are Auditor Work-Papers Discoverable? The D.C. Circuit Joins the Fray

In the United States, the "work-product" doctrine ensures that attorneys can effectively prepare for litigation and trial by protecting their notes, preparatory materials, and internal analyses from discovery. The Supreme Court recognized long-ago that giving opposing counsel access to such work product would cause serious problems:

> [M]uch of what is now put down in writing would remain unwritten. An attorney's thoughts, heretofore inviolate, would not be his own. Inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial. The effect on the legal profession would be demoralizing. And the interests of the client and the cause of justice would be poorly served.

Hickman v. Taylor, 329 U.S. 495, 511 (1947). At the federal level, the work-product doctrine was subsequently partially codified in Federal Rule of Civil Procedure 26(b)(3), which states that, ordinarily, "a party may not discover documents and tangible things that are prepared in anticipation of litigation" by the opposing party or its representative.

Unlike the protection afforded by the attorney-client privilege, voluntary disclosure of attorney work-product to an independent third party does not necessarily waive work-product protection. *See, e.g.*, *United States v. American Telephone & Telegraph Co.*, 642 F.2d 1285, 1299 (D.C. Cir. 1980). Generally, voluntary disclosure waives the work-product protection only when it is inconsistent with the disclosing party's expectation of secrecy from its adversary. *Rockwell International Corp. v. U.S. Department of Justice*, 235 F.3d 598, 605 (D.C. Cir. 2001).

One area in which application of the work-product doctrine can be particularly important, and controversial, is auditor materials. Especially in securities, tax, and financial fraud cases, auditor workpapers can constitute critical evidence. Before June 2010, the two circuit courts to address the issue had held that tax workpapers in the possession of auditors were *not* protected from discovery by the work-product doctrine, even if they addressed potential litigation and reflected attorney advice.

In *United States v. Textron Inc.*, 577 F.3d 21 (1st Cir. 2009) (*en banc*), *cert. denied*, *Textron v. United States*, 130 S. Ct. 3320 (2010), the IRS issued an administrative summons to Textron to allow the IRS to examine books, papers, and other data that might be relevant to its inquiry. 577 F.3d at 24. Textron refused to produce certain workpapers, including spreadsheets showing (1) amounts in controversy, (2) the estimated probability of a successful challenge by the IRS, and (3) resulting reserve amounts, as well as supporting e-mail messages and notes. *Id.* at 25. Textron admitted to having shown the withheld documents to its independent auditor, but it had physically retained them. *Id.*

The district court had rejected the IRS's attempt to enforce the summons. It held that the documents were work product because they included legal analysis and were prepared "because of" the prospect of litigation. *Id.* at 25-26 (*citing United States v. Textron Inc.,* 507 F. Supp. 2d 138, 150 (D.R.I. 2007)). On appeal, a divided three-judge panel of the First Circuit affirmed that ruling. *Id.* at 26. However, an *en banc* panel reversed the three-judge panel, holding that the workpapers were *not* protected because they were created as part of an independent audit, not for "potential use in litigation." *Id.* at 30.

The Fifth Circuit earlier reached the same conclusion in *United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982). There, the IRS sued to enforce summonses seeking "all analyses prepared by the El Paso Company regarding potential tax liabilities and tax problems." *Id.* at 533. The company refused to produce any documents, asserting, among other things, work-product protection. The district court enforced the summons and the Fifth Circuit affirmed, requiring El Paso to produce tax accrual workpapers that it had prepared internally and shared with its independent auditor. The Fifth Circuit recognized that creating the workpapers "involve[d] weighing legal arguments, predicting the stance of the IRS, and forecasting the ultimate likelihood of sustaining El Paso's position in court." *Id.* at 543. Nevertheless, the court found that the workpapers were not protected by the work-product doctrine because they were not prepared primarily "to ready El Paso for litigation over its tax returns," but "to anticipate, for financial reporting purposes, what the impact of litigation might be on the company's tax liability." *Id.* at 543.

United States v. Deloitte

But in June 2010, the D.C. Circuit reached the opposite conclusion in *United States v. Deloitte LLP*, 610 F.3d 129 (2010). In 2005, Dow Chemical Company filed suit in Louisiana, challenging IRS adjustments to tax returns filed by four Dow subsidiaries. During discovery, the IRS subpoenaed documents from Dow's outside auditor, Deloitte & Touche USA, LLP. Because the IRS required the production of documents in the District of Columbia, the subpoena issued from that district court. At Dow's request, however, Deloitte withheld three documents on the basis of the work-product doctrine. They were (1) a memorandum prepared by Deloitte that summarized a meeting between

Dow employees, Dow's outside counsel, and Deloitte employees concerning the possibility of litigation, and the necessity of accounting for such a possibility in an ongoing audit; (2) a memorandum prepared by Dow's in-house counsel and given to Deloitte; and (3) a tax opinion prepared by Dow's outside counsel and also provided to Deloitte. The IRS moved to compel their production.

The district court denied the motion. It held that the memorandum prepared by Deloitte was work product, having been "prepared because of the prospect of litigation with the IRS over the tax treatment of [one of the subsidiaries]." *United States v. Deloitte & Touche USA LLP*, 623 F. Supp. 2d 39, 40 n.1 (D.D.C. 2009). Even though Deloitte prepared the document, not Dow or its counsel, "its contents record[ed] the thoughts of Dow's counsel regarding the prospect of litigation." *Id.* The district court rejected the IRS's argument that Dow's disclosure of the three documents to Deloitte waived work-product protection, finding that the disclosure was not inconsistent with maintaining secrecy of the documents. Deloitte was not a potential adversary, and nothing suggested that it was unreasonable for Dow to expect Deloitte to maintain confidentiality. *Id.* at 41.

On appeal, the IRS argued that the Deloitte memorandum could not be work product because it was created by Deloitte, not Dow or its representative, and it was generated as part of the routine audit process, not in anticipation of litigation. The D.C. Circuit disagreed. Under *Hickman*, the relevant question is not *who* created the document, but rather *whether the document contains work product*, i.e., "the thoughts and opinions of counsel developed in anticipation of litigation." *Deloitte*, 610 F.3d at 136. Because the Deloitte memorandum recorded the thoughts of Dow's counsel, the fact that it was prepared by Deloitte did not foreclose work-product protection. *Id.*

The court then turned to a more difficult question: whether the Deloitte memorandum was entitled to work-product protection even though it was generated as part of an annual audit. Writing for the majority, Chief Judge Sentelle opined that Federal Rule of Civil Procedure 26(b)(3) only partially codifies the work-product doctrine. While Rule 26(b)(3) addresses "documents and tangible things," the doctrine prescribed by the Supreme Court was much broader, extending to "'intangible' things" such as theories, mental impressions, and opinions. The "work product" is not documents, but the mental impressions and opinions memorialized in documents. Therefore, the "in anticipation of litigation" inquiry should focus not on the function of the document, but on its contents. "[A] document can contain protected work-product material *even though it serves multiple purposes*, so long as the protected material was prepared because of the prospect of litigation." *Id.* at 138 (emphasis added). Because the district court had not reviewed the Deloitte memorandum *in camera* to determine whether any of it was prepared because of the prospect of litigation, the D.C. Circuit remanded to the district court to make this determination.

The court then turned to the IRS's argument that Dow had waived any claim to work-product protection over the remaining two documents—which the IRS conceded were protected in the first instance—when it disclosed them to Deloitte. Whether disclosure to an outside auditor constitutes waiver of the work-product doctrine was an issue of first impression at the federal appellate level.

The IRS argued that Deloitte was a potential adversary or conduit to other adversaries and, therefore, disclosure to Deloitte was inconsistent with the maintenance of secrecy from Dow's adversaries. The court disagreed. In considering whether Deloitte was a potential adversary, the court focused not on whether Deloitte could be Dow's adversary *in any conceivable future litigation*, but on whether Deloitte could be Dow's adversary *in the sort of litigation the Dow documents addressed*. Because the Dow documents were prepared in anticipation of a dispute with the IRS—not with Deloitte—Deloitte could not be considered a potential adversary. Nor was Deloitte a conduit to other adversaries because, as an independent auditor, it was obliged not to disclose Dow's confidential information. The D.C. Circuit therefore found that Dow had a reasonable expectation of privacy in the documents, and their disclosure to Deloitte did not waive work-product protection.

***Deloitte*'s Implications**

In light of the split between the First and Fifth Circuits on the one hand, and the D.C. Circuit on the other, *Deloitte* is unlikely to be the last word on the application of the work-product doctrine to tax workpapers. Many commentators have suggested that the *Deloitte* decision increases the likelihood that the Supreme Court will take up this issue. For now, however, *Deloitte* represents a formidable weapon against attempts by the IRS and private litigants to compel production of tax documents that reflect or incorporate the thoughts or impressions of a party's attorney. Further, because the U.S. Tax Court is bound to follow the decisions of the D.C. Circuit on evidentiary issues (*see* Tax Court Rule 143(a)), *Deloitte*'s impact is likely to be widely felt. But until the Supreme Court weighs in, taxpayers must still remain cautious about disclosure of legal analysis to their outside auditors and should not assume that such documents will necessarily be protected from discovery. Q

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courts to impose ongoing royalties if the court declined to issue a permanent injunction. Given the longstanding general rule that imposed permanent injunctions almost automatically, there was little precedent to guide district courts in deciding whether to award ongoing royalties.

The Federal Circuit's Initial Foray into the Post-*eBay *World

The Federal Circuit's first post-*eBay* decision addressing ongoing royalties, *Paice LLC v. Toyota Motor Corp*., 504 F.3d 1293 (Fed. Cir. 2007), established some guiding principles, but failed to prescribe a uniform approach. In *Paice,* the Federal Circuit vacated the district court's award of ongoing royalties because it failed to articulate reasoning to support its award, leaving the Federal Circuit "unable to determine whether the district court abused its discretion in setting the ongoing royalty rate." *Id.* at 1315. The Federal Circuit explained that the district court must provide an indication of why the chosen royalty rate was appropriate and suggested that it consider the effect of the infringer's ongoing use of the patent on the patentee. While vacating, the Federal Circuit went out of its way to state on remand that "the district court may wish to allow the parties to negotiate a license amongst themselves . . . before imposing an ongoing royalty." *Id.* The Federal Circuit also suggested the district court "take additional evidence if necessary to account for any additional economic factors arising out of the imposition of an ongoing royalty. . . ." a process that would "allow the parties the opportunity to present evidence regarding an appropriate royalty." *Id.* at 1315, n.15.

Two guiding principles emerged from *Paice.* First, parties should be given the opportunity post-judgment to reach agreement on an ongoing royalty. Second, if they fail to reach agreement, district courts can impose an ongoing royalty but must articulate a rationale justifying the award. *Paice* did not, however, provide guidance on how to determine the ongoing royalty, but acknowledged this would require additional fact-finding.

This first principle is somewhat impractical. Parties who take a patent dispute to trial likely will not be willing to reach agreement following a finding of infringement. *See Presidio Components Inc. v. American Technical Ceramics Corp.,* 2010 WL 3070370, *3 (S.D. Cal. 2010) ("In light of the parties' strongly held positions in this cases, and in light of their extremely divergent views as to the appropriate royalty rate, the Court is convinced that requiring them to negotiate is not likely to be fruitful."). In most cases, district courts will simply need to decide the appropriate ongoing royalty.

Three Potential Approaches

Perhaps unsurprisingly, given the lack of guidance from the Federal Circuit, district courts in the wake of *eBay* have developed three different approaches for deciding the appropriate ongoing royalty: 1) hold a post-trial evidentiary hearing; 2) require the plaintiff to file a new complaint seeking post-verdict damages; or 3) require the parties to present evidence and testimony regarding an ongoing royalty during the initial trial on infringement. Each approach has a distinct impact on efficiency, Seventh Amendment rights, and the determination whether post-verdict infringement should be considered willful and therefore subject to treble damages.

1. Post Trial Evidentiary Hearing

Most courts, including the *Paice* court on remand, have decided ongoing royalties by holding a post-trial evidentiary hearing. *See e.g., Presidio Components* 2010 WL 3070370, at *1; *Paice LLC v. Toyota Motor Corp.,* 609 F. Supp. 2d 620, 631 (E.D. Tex. 2009) (holding post-trial hearing on remand). These hearings are often, as in *Paice*, preceded by limited discovery to allow the court to take into account both the effect of the verdict and any changes in the market that might affect the amount of ongoing royalties, such as new non-infringing alternatives or recent commercial success of the patented technology. *See e.g., Paice*, 609 F. Supp. 2d at 625-31 (considering effect of jury's finding of infringement and changes in market such as increased price of oil). This approach is efficient because the jury is not presented with evidence regarding royalties that would become moot following a verdict of non-infringement or invalidity.

Nonetheless, any post-trial hearing will likely involve additional discovery, thereby increasing delay, uncertainty, and expense for litigants. The hearing could also be challenged under the Seventh Amendment's guarantee of a right to trial by jury "in suits at common law, where the value in controversy shall exceed twenty dollars." U.S. Const. Amend. VII. Though the Federal Circuit summarily dismissed this argument in *Paice*, other courts could be more receptive. *See* Lisa M. Tittemore, *The Controversy Over "Ongoing Royalty" Awards in the Evolving Landscape of Remedies for Patent Infringement*, Fed. Law., 29, 37 (2009) (hereinafter *"Evolving Landscape")*. Finally, a district court that does use a post-trial hearing to determine an ongoing royalty must also decide whether post-verdict infringement is willful. *Id.*

2. File A New Complaint

Some courts have altogether severed the issue of ongoing royalties and required the plaintiff to file a new complaint to recover them. For example, in *z4 Technologies Inc. v. Microsoft Corp.,* 434 F. Supp. 2d 437 (E.D. Tex. 2006), to determine "an efficient method for z4's recovery of future monetary damages post-verdict," the court severed z4's claims for post-verdict infringement and ordered z4 to file a new complaint. *Id.* at 444.

Courts may choose not to address the issue of ongoing royalties at all by simply denying an injunction and deciding only pre-verdict damages. *See Evolving Landscape* at 36. This approach allows a plaintiff to file a lawsuit for post-verdict infringement when and if such infringement occurs. It also avoids any Seventh Amendment issue because the plaintiff can request a jury on filing a new complaint. It also provides the plaintiff with reasonable grounds to allege willful infringement because any post-verdict infringement will likely be held willful. *See id.* at 37.

This approach, however, is inefficient because it forces litigants to incur additional time and expense to resolve their dispute. Indeed, other courts have considered and rejected this approach on grounds of judicial economy. *See e.g., Hynix Semiconductor Inc. v. Rambus Inc.,* 609 F. Supp. 2d 951 (N.D. Cal. 2009). Citing *z4*, the defendants in *Hynix* asked the court to require that patentee file a new complaint to obtain damages for post-verdict infringement. 609 F. Supp. 2d 951, 986 (N.D. Cal. 2009). The *Hynix* court declined because it did "not believe that requiring Rambus to file a supplemental complaint would serve any benefit." *Id.* Likewise in *Voda*, the court found "no reason for severance of a cause of action for the post-verdict damages as there would be no issues for decision except simple mathematical calculations based on defendant's sales." *Voda v. Cordis Corp.*, No. CIV-03-1512-L, 2006 U.S. Dist. LEXIS 63623, *20-21 (W.D. Okla. Sept. 5, 2006).

3. Judge Clark's All-at-Once Approach

Judge Clark of the Eastern District of Texas has developed a third approach by requiring parties to present evidence regarding ongoing royalties during the trial itself. *See e.g., Cummins-Allison Corp., v. SBM Co., Ltd.,* 584 F. Supp. 2d 916, 917 (E.D. Tex. 2008); *Ariba Inc. v. Emptoris inc.,* 567 F. Supp. 2d 914, 916 (E.D. Tex. 2008). Following the parties' presentation of evidence and expert opinions regarding ongoing royalties, he instructs the jury to provide an advisory opinion on the issue.

This approach is meant to be efficient and avoid problems with Seventh Amendment rights or willful infringement. Judge Clark has explained that "[i]n many cases it makes sense to combine consideration of past and future damages because, to some extent, many of the factors to be analyzed are similar or even identical," and this approach "may avoid the need for a later bench trial on this issue, conserving the time and resources of the court and the parties." Order at 2, *Ariba Inc. v. Emptoris Inc.,* No. 9:07-CV-90 (E.D. Tex. July 9, 2008). Because the issue of ongoing royalties is presented to the jury, this approach avoids any Seventh Amendment issue. Another court has noted Judge Clark's approach is efficient and "recognizes the vital role of the jury as fact finding partner." *See Amgen Inc. v. F. Hoffman-La Roche Ltd.*, 581 F. Supp. 2d 160, 210 n.12 (D. Mass. 2008).

Not all, however, have been happy with this all-at-once approach. Some parties, including the plaintiff in *Ariba*, have argued that evidence regarding a future royalty rate would confuse the jury, increase the time and expenses of trial preparation, and endanger its right to seek injunctive relief. Moreover, the efficiency of this approach may be overstated because it requires the jury to consider evidence that may become moot upon a finding of non-infringement or invalidity.

Conclusion

While the Federal Circuit has not expressed its own preference regarding these three approaches, its opinion is eagerly anticipated by both litigants and the district courts. Q

Commercial Litigator Robert Hickmott Joins London Office

Highly rated commercial litigator Robert Hickmott has joined Quinn Emanuel as a partner in the London office. Mr. Hickmott joins the firm from CMS Cameron McKenna, where he was a partner in the firm's banking and insolvency litigation group. Mr. Hickmott has acted on numerous landmark insolvency-related disputes during his career, including Lehman, TXU, Swissair and Enron, and is recognized as a leading lawyer by *Legal 500* and *Chambers*. Mr. Hickmott is currently acting for the liquidator in the high profile, cross border litigation surrounding the UK assets of alleged fraudster Allen Stanford.

The addition of Robert Hickmott continues the pattern of steady growth in the London office. The firm also launched its first continental European office in Germany this year with the recruitment of a five-lawyer team, led by Dr. Marcus Grosch, from Allen & Overy. Q

Bankruptcy Practice Update

New York Bankruptcy Court Restricts Scope of Automatic Stay in Chapter 15 Cases: On August 23, 2010, the Bankruptcy Court for the Southern District of New York held that in an ancillary proceeding commenced under chapter 15 of the Bankruptcy Code, the automatic stay of actions against a debtor and its property applies only to proceedings in the United States unless the foreign proceeding to be stayed would affect property in the United States. *See In re JSC BTA Bank*, No. 10-10638 (JMP) (Bankr. S.D.N.Y. Aug. 23, 2010) [Docket No. 34].

Typically, the filing of a bankruptcy case under the United States Bankruptcy Code results in the application of an "automatic stay" under section 362 of, among other things, actions against the debtor and its property. Case law considering the extraterritorial application of the stay generally holds that it applies to any proceeding worldwide that would affect the debtor or the debtor's assets, irrespective of the location of the assets or the proceeding.

Chapter 15 of the Bankruptcy Code enables recognized foreign representatives who have commenced foreign proceedings outside the United States to commence an ancillary chapter 15 case in the United States to aid or assist the administration of the foreign proceeding. Once the foreign representative establishes that recognition of its status (and the status of the foreign proceeding) is warranted, certain provisions of the Bankruptcy Code, such as the automatic stay, are available with respect to assets, property and persons in the United States.

In *In re JSC BTA Bank*, the court denied a motion for sanctions brought by BTA Bank, a Kazakhstan bank, against BIC-BRED, the Swiss branch of a French bank, based on BIC-BRED's refusal to stay an arbitration proceeding pending against BTA Bank in Switzerland. The sanctions motion was premised on BTA Bank's assertion that the court's prior entry of an order recognizing BTA Bank's foreign proceeding as a "foreign main proceeding" under chapter 15 gave rise to a stay against any proceeding in the world that would impact on BTA Bank or its assets. In denying the motion, the court concluded that the automatic stay does not have extraterritorial application in a chapter 15 case. It reasoned that although the section 362 stay ordinarily freezes proceedings against the debtor worldwide, a broad application of the stay would ignore chapter 15's territorial limitation to the protection of assets within the United States. The court noted that it "would be contrary to the essential purposes and structure of a chapter 15 case for recognition of a foreign main proceeding to stay a commercial arbitration proceeding as remote as this one . . . that has no connection to the United States or to any property of the chapter 15 debtor 'that is within the territorial jurisdiction of the United States.'" The court concluded that damages awarded in the Swiss arbitration would have no effect on BTA's assets in the U.S. and, accordingly, that there was no basis to stay the Swiss arbitration.

New York Bankruptcy Court Grants Rule 12(b) Motion to Dismiss Fraudulent Transfer Claims: In a ruling issued July 27, 2010, the United States Bankruptcy Court for the Southern District of New York dismissed fraudulent transfer claims brought by the liquidating trust (the "Trust") established in the Chrysler LLC bankruptcy case. The court granted the defendants' motion, brought pursuant to Rule 12(b) of the Federal Rules of Civil Procedure, before the commencement of discovery. The defendant argued that the facts alleged failed to state claims upon which relief could be granted, and the court agreed. *See The Liquidation Trust v. Daimler, AG, (In re Old Carco LLC (f/k/a Chrysler LLC))*, 2010 WL 2925997 (Bankr. S.D.N.Y. 2010).

In a complaint filed in August 2009, the Trust asserted that Daimler AG and certain of its affiliates (collectively, "Daimler"), which were the prior owners of the Chrysler assets, had "orchestrated a scheme to strip valuable assets away" from Chrysler before the car company was sold to Cerberus Capital Management, LP ("Cerberus"). The Trust further alleged that corporate restructuring activities undertaken by Daimler immediately prior to the sale to Cerberus should be viewed separately from the sale, such that the consideration received through these restructuring transactions could not constitute reasonably equivalent value for the sale.

Daimler argued in response that the restructuring transactions and the sale had to be viewed together as part of a single, integrated, transaction for purposes of analyzing the fraudulent transfer claims. The significance of analyzing the transaction in its entirety, according to Daimler, was that it showed that Chrysler did, in fact, receive reasonably equivalent value in the sale. Specifically, Daimler argued that the consideration had to be reviewed by examining all parts of the transaction, not just individual transfers. It argued that the complaint's allegations showed that Chrysler ultimately received reasonably equivalent value for the assets.

The bankruptcy court noted that the complaint had alleged that the transaction, viewed in its entirety, involved a $7 billion cash infusion by Cerberus, repayment of a $920 million intercompany loan owed to Chrysler, cancellation of approximately $3 billion in intercompany debt, and other significant consideration. Agreeing with Daimler, the bankruptcy court held that the complaint itself had acknowledged that the pre-sale restructuring and the sale itself "were parts of a single integrated transaction," and reflected on its face reasonably equivalent value for the transfers. Concluding that the Trust had failed to present particularized facts to show actual fraud, the court also dismissed the Trust's actual fraudulent transfer claims.

Structured Finance Litigation Update

Waivers Not Always a Bar to Claims: Judge Scheindlin of the Southern District of New York dealt a blow to defendants in securities fraud cases in an October 29, 2010 decision in *King County v. IKB Deutsche Industriebank*. The court denied defendant Morgan Stanley's motion to dismiss, holding that fraud claims against Morgan could proceed despite liability and reliance waivers in securities disclosures because "the information required to confirm or disprove the validity of the [representations] was peculiarly within Morgan Stanley's knowledge." The court also rejected Morgan Stanley's argument that, because it had no direct contact with the plaintiffs during the marketing or sale of the securities, it could not possibly be responsible for any misstatements the plaintiffs relied upon. Invoking the so-called "group pleading doctrine," which permits third parties intimately involved in a fraud to be treated as insiders with primary liability rather than as secondary actors shielded from liability for aiding and abetting federal securities fraud under *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), the court held that Morgan Stanley had been so intimately involved in the structuring, marketing and rating of the securities at issue that it was responsible for statements made in the securities filings.

The court also allowed allegations of common law fraud to proceed, finding that the plaintiffs had sufficiently pled a claim that Morgan Stanley, due to its actual knowledge of the alleged fraud and provision of "substantial assistance" to further the alleged scheme, had aided and abetted the primary fraud alleged against IKB and the ratings agencies. The plaintiffs originally brought a class action against IKB, a German bank, its CEO, and the rating agencies alleging fraud in connection with the collapse of Rhinebridge, a structured investment vehicle created, managed, and issued by IKB. Morgan Stanley, the co-arranger and placement agent on Rhinebridge, was added as a defendant in an amended complaint filed in June. The plaintiffs allege that the defendants fraudulently misrepresented the value of Rhinebridge and its debt securities, and were aware that the high credit ratings presented to investors were fraudulent and the mortgage-backed assets were likely to default. Judge Scheindlin denied motions to dismiss filed by IKB and the ratings agencies earlier this year. *See King County v. IKB Deutsche Industriebank, AG*, No. 09-cv-8387 Slip Op. (S.D.N.Y. Oct. 29, 2010).

Fraud and Contract Claims in CDS Case Survive Motion to Dismiss—"Peculiar Knowledge" Strikes Again: New York Supreme Court Judge Scheinkman handed plaintiff MBIA, represented by our own Peter Calamari and Philippe Selendy, a victory in an August 19, 2010 opinion denying defendant Royal Bank of Canada's motion to dismiss fraud and breach of contract claims. The case concerns RBC's marketing of a credit default swap (CDS) on the Logan III CDO, which RBC arranged, as well as contractual claims in connection with two other RBC CDOs. The court upheld MBIA's fraud claims because, although the contracts and marketing materials contained disclaimers, MBIA sufficiently alleged that RBC had "peculiar knowledge" of essential facts regarding the collateral's quality. In particular, MBIA sufficiently alleged that RBC had "access to crucial loan information, which Plaintiffs may [have] been able to discover but only through extraordinary effort or great difficulty." The court accepted MBIA's argument that it lacked first-hand access to the data and that it was not standard in the industry to perform "a complete loan-level, forensic reevaluation" of a CDO's collateral prior to entering a CDS, as would have been required to verify RBC's representations. The court also found that the collateral's credit ratings were not simply statements of opinion, but were actionable statements of fact regarding the supposed creditworthiness of the collateral. In upholding MBIA's contract claims, the court sustained MBIA's allegation that RBC provided collateral "that was not qualified to be AAA rated, as promised," even though the credit default swaps bore AAA ratings. The court also held that Deutsche Bank's "verification" of RBC's credit event notices "did not relieve RBC of its obligations under the agreements," in part because MBIA alleged, pursuant to the contracts, that Deutsche Bank's verifications reflected "manifest error." *See MBIA Insurance Corp. v. Royal Bank of Canada*, No. 12238/09 (N.Y. Super. Ct. Westchester County, Aug. 19, 2010).

(Continued on page 11)

VICTORIES

Patent Victory

The firm secured an important victory for Ortho-McNeil, a Johnson & Johnson subsidiary, against Affymax in an arbitration involving inventorship and ownership of two patent families related to new biological drugs for the production of red blood cells. The patent families at issue concerned Affymax's HEMATIDE product, which is projected to achieve annual sales of over $1 billion following its launch in 2011. Johnson & Johnson already sells a multi-billion dollar pharmaceutical drug for red blood cell production.

In April 1992, Affymax and Ortho entered into a research and development agreement for the purpose of finding a next-generation drug for red blood cell production. Two broad inventions resulted from their collaborative research. Based on the inventive contributions, the parties jointly filed one set of patent applications directed to the first invention and Ortho filed solely on the second invention. Despite the success of the research, no commercial drug was ever developed. Affymax continued researching in the area and is now in the process of getting FDA approval for HEMATIDE. Affymax's only problem was that its new drug potentially infringes Ortho's solely-filed patents.

In 2004, Affymax initiated litigation in the United States and Germany to obtain ownership of Ortho's solely-filed patents on the second invention. Ortho counterclaimed for joint inventorship and ownership of the patents issued from the first set of applications.

Based on procedural limitations in the German litigation, Ortho moved to compel arbitration and dismiss the court actions. Judge Kennelly of the Northern District of Illinois granted the motion and ordered Affymax to dismiss the German action.

After two sets of hearings, the Arbitration Panel granted Ortho a complete victory—sole inventorship/ownership over the second set of patents, and joint inventorship/ownership on the first set patents.

Summary Judgment Victory

The firm won summary judgment on a declaratory relief action brought by Satyam Computer Services, Ltd., against its former client, Upaid Systems, Ltd., arising out of a prior lawsuit between the parties. In the underlying action, brought in the Eastern District of Texas, Upaid alleged that Satyam had breached its contractual obligations and committed fraud by failing to properly transfer certain intellectual property rights during the course of the parties' commercial relationship. To settle the underlying action, Satyam agreed to make payments to Upaid totaling $70 million. The parties also agreed that Satyam would make "no other payments at any time." The Settlement Agreement provided that Satyam, an Indian corporation, could make payments to Upaid, which was incorporated in the British Virgin Islands, through an Indian escrow account.

Satyam deposited into escrow the full $70 million it owed to Upaid under the Settlement Agreement. However, under the Indian Tax Code, Satyam was required to withhold taxes from any payment it made to Upaid. When Satyam requested information from Upaid necessary to determine the proper rate of withholding, Upaid refused, demanding that Satyam remit the full $70 million without deducting the Indian taxes. If Satyam complied, it would be on the hook for Upaid's taxes under Indian law, which Satyam estimated to be as much as $30 million. If it did not, Upaid would resume litigation in Texas.

Placed in this untenable situation, Satyam sought a declaration from a New York state court that settlement funds could be disbursed only after Satyam paid applicable withholdings under Indian law; that Satyam's liability under the Settlement Agreement was limited to $70 million; and that Upaid was required to bear the burden of its own taxes under Indian law. Satyam then successfully moved for summary judgment, asking that Upaid provide the necessary information required to withhold taxes from the $70 million settlement. In support of summary judgment, Satyam argued because payment under the Settlement Agreement was subject to Indian law, the parties were required to comply with Indian tax law requiring Satyam to withhold Upaid's taxes on the settlement amounts. Satyam successfully asserted that there was no evidence that Satyam had agreed to "gross up" payments to Upaid and that Upaid had breached the agreement – not Satyam – by refusing to provide the basic tax information, thereby preventing payment under the terms of the Settlement Agreement. Q

(Practice Area Updates continued from page 9)

Failure to Satisfy Purchaser Requirement Leads to Dismissal: Ruling that a federal securities class action may not include claims related to securities the named plaintiffs did not buy, Judge Mariana R. Pfaelzer of the Central District of California dismissed a putative class action accusing Countrywide Financial Corp. of fraud related to over 400 pools of residential mortgage-backed securities (RMBS). The plaintiffs, led by the Maine State Retirement System, claimed that Countrywide had made false and misleading statements or omissions concerning its loan origination practices in public offering documents. The court granted plaintiffs 30 days to file an amended complaint.

In addition to limiting the case to claims on securities actually in the portfolio of the named plaintiffs, Judge Pfaelzer held that those wishing to sue individually on claims dismissed from the class action for lack of standing could not benefit from tolling of the statute of limitations under the so-called *American Pipe* doctrine, which tolls the statute of limitations on a claim covered under a putative class action. Under this interpretation of *American Pipe,* the claimants face increased uncertainty because they could lose the benefit of tolling if the class action claim they are relying upon is also dismissed for lack of standing.

Judge Pfaelzer ordered the plaintiffs to amend their complaint to eliminate those securities for which the named plaintiffs do not have standing to bring claims, and, for the remaining claims, to more specifically allege which claims should benefit from tolling under *American Pipe* and why. See *Maine State Retirement System v. Countrywide Financial Corp.,* No. 10-cv-00302, (C.D. Cal. Nov. 4, 2010).

Trial Practice Update

Judge's Disparagement of Attorney Warrants Reversal: The New York Court of Appeals granted a new trial in the appeal by a defendant convicted of attempted car-jacking. The basis for the conviction's reversal was the repeated comments made by the trial judge about defense counsel in front of the jury. At various times, including while cutting off defense counsel's cross-examination of a prosecution witness, the judge referred to the lawyer's conduct as "clown"-like and "silly." The Court of Appeals found that these comments tainted the jury's verdict and violated the defendant's due process right to a fair trial. Of greater general applicability, the Court of Appeals took the opportunity to set forth the desired manner by which a trial court should reprimand counsel for perceived misconduct. It advised that the matter should be addressed directly with counsel outside the presence of the jury. Moreover, should the judge recognize that any comments made in front of the jury might be inappropriate, the court should give the jury a curative instruction. *See People v. Leggett*, 76 A.D. 3d 860, 908 N.Y. S. 2d 172 (Sept. 14, 2010)

Court Provides Guidance on Spoliation: The Chief United States Magistrate for the District of Maryland recently published an opinion that surveys the state of the law in various jurisdictions regarding when a party or counsel can be sanctioned for spoliation of evidence. *Victor Stanley, Inc. v. Creative Pipe, Inc.* 2010 U.S. Dist. LEXIS 93644 (D. Md. Sept. 9, 2010). In surveying the widely disparate treatment among different federal courts on spoliation issues, the court took it upon itself to discuss the differences and offer its opinion as guidance to lawyers on the state of the law and document preservation obligations. According to the court, the touchstone for any sort of unifying theory of spoliation analysis is "reasonableness and proportionality." Thus, a threshold question in determining sanctions for the destruction of evidence is assessing culpability and differentiating among negligent destruction, grossly negligent destruction, and intentional destruction. Only when the spoliation resulted from gross negligence or intentional spoliation should the relevance of the missing data be presumed. If relevance—and therefore prejudice to the opposing party—exists, either by proof or by presumption, the sanctions still must be proportional to the conduct. When warranted, the sanctions should both punish the perpetrator (through fines or even referral for criminal prosecution) and seek to place the litigants in a fair position for the case to be adjudicated, through evidentiary or other sanction.

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