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## Good Faith Participation in Mediation: Recent Decisions in New York and California

### Introduction

In an effort to alleviate the growing congestion of court dockets around the country, judges increasingly require parties to engage in alternative dispute resolution, particularly mediation, prior to trial. Mediation is designed to be a confidential process lacking the formality and adversarial nature of court proceedings. However, participation in any court-ordered mediation is ultimately monitored by a judge. As a general rule, courts require parties to participate in mediation in good faith, and judges have the authority to sanction parties that fail to do so. The judge's authority to impose sanctions for mediation conduct is grounded in the court's inherent authority to regulate proceedings before it, and is further supported by local rules, Federal Rule of Civil Procedure 16(f) (requiring good faith participation) and statutes such as 28 U.S.C. § 1927 (prohibiting unreasonable or vexatious litigation). As in other areas of the law, however, "good faith" is not well defined.

This article examines some recent decisions by federal courts in New York and California enforcing the requirement of "good faith" participation in mediation. While it is well settled that a court may compel a party to mediate, it cannot compel a party to settle. Moreover, courts take care to protect the confidential nature of

mediation proceedings. Accordingly, the requirement of "good faith" in mediation has clear limits. Federal courts in New York and California appear unwilling to probe into specific conduct at the mediation, in light of concerns over confidentiality and undue influence.

### New York

Federal courts have broad authority to regulate participation in mediation under Federal Rule of Civil Procedure 16, 28 U.S.C. § 1927, and the inherent power of courts to regulate proceedings. In New York, some federal courts also codify in their local rules the requirement of good faith participation in mediation. The Western and Northern Districts have an explicit requirement that the parties participate in mediation in good faith. *See, e.g.*, NDNY L.R. 83.11-5(c) ("Parties and counsel shall participate in good faith, without any time constraints, and put forth their best efforts toward settlement."); WDNY ADR Plan 5.8(G) ("All parties and counsel shall participate in mediation in good faith. Failure to do so shall be sanctionable by the Court."). The local rules for the Southern and Eastern Districts previously included an explicit requirement that the parties mediate in good faith, but that requirement was removed in the July 2011 update to the rules. *See* Local Civil Rule 83.8.

(continued on page 2)

## INSIDE

California Court Signals Potential *In Pari Delicto* Doctrine Split with New York and Other Items Noted With Interest  
Page 4

Trial Lawyer Stephen Swedlow Joins QE  
Page 5

### Litigation Updates:

London  
Page 6

Japan  
Page 7

Trademark and Copyright  
Page 8

Complete Defense Victory for Micron at Multi-Billion Dollar Antitrust Trial and Other Victories  
Page 10

## Kathleen Sullivan Wins Gould Award for Outstanding Appellate Advocacy

Kathleen Sullivan received the 2011 Gould Award for appellate advocacy from the Office of the Appellate Defender in New York. The prestigious award is presented annually to the top advocate in honor of legendary advocate Milton S. Gould. Ms. Sullivan, the former Dean

of Stanford Law School and Chair of Quinn Emanuel's Appellate Practice, was recognized for her outstanding appellate work, including recent victories before the U.S. Supreme Court, the federal courts of appeals, and state high courts. [Q](#)

## Manisha Sheth Named "Top Minority 40 Under 40"

Quinn Emanuel partner Manisha Sheth has been named to *The National Law Journal's* 2011 "Minority 40 Under 40" list, an annual recognition that honors attorneys who have wielded national influence in their practice areas. Ms. Sheth was recognized for her contributions in representing the Federal Housing Finance Agency in suits

(continued on page 5)

Court-Annexed Mediation (Eastern District Only); Local Civil Rule 83.9. Alternative Dispute Resolution (Southern District Only). In practice, however, courts seem to apply the good faith requirement whether or not it is expressly included in local rules.

In March 2011, the Southern District of New York shed some light on the good faith requirement. See *In re A.T. Reynolds & Sons, Inc.*, 452 B.R. 374 (S.D.N.Y. 2011). The *A.T. Reynolds* Court reversed an order of the Bankruptcy Court sanctioning Wells Fargo for failure to participate in mediation in good faith. In doing so, the Court rejected a subjective approach to good faith determinations. See *id.* at 376. The Bankruptcy Court had ordered the parties to participate in mediation. The mediator informed the Court that one of the parties, Wells Fargo, was participating in bad faith. *Id.* In particular, the mediator pointed to Wells Fargo's demands to clarify the issues in dispute prior to mediation, and to know in advance the identity of party representatives that would be attending. The mediator also noted that the Wells Fargo representative apparently lacked authority to settle, and failed to engage in risk analysis regarding the available options. *Id.*

The Bankruptcy Court found that Wells Fargo was in violation of General Order M-390 of the United States Bankruptcy Court, Southern District of New York. *In re A.T. Reynolds & Sons, Inc.*, 424 B.R. 76, 78 (Bankr. S.D.N.Y. 2010). That order provided that "the mediator shall report any willful failure to attend or to participate in good faith in the mediation process of conference. Such failure may result in the imposition of sanctions by the court." *Id.* The mediator not only filed such a report, but testified at a hearing in front of the Bankruptcy Court regarding Wells Fargo's behavior.

The Bankruptcy Court held that Wells Fargo violated the good faith requirement for three reasons. First, in the Court's view, the representative sent by Wells Fargo lacked sufficient authority to settle the case. The Court noted that the representative had to make a phone call to move beyond a predetermined dollar amount, and was only prepared to discuss an inappropriately limited set of predetermined legal theories. *Id.* at 89. Second, while the Court acknowledged that parties are free to adopt a "no pay" position, he faulted Wells Fargo for "enter[ing] the mediation to assert the supremacy of its legal argument, and not to contemplate risk analysis." *Id.* at 91. Finally, the Court found that Wells Fargo attempted to improperly control the mediation by demanding, prior to the mediation, that the discussion be limited to specific topics and that the identities of the representatives attending be disclosed in advance.

*Id.* at 91-92. For these reasons, the Court found Wells Fargo in contempt of the Mediation Order. *In re A.T. Reynolds & Sons, Inc.*, 424 B.R. 76, 95 (Bankr. S.D.N.Y. 2010). The judge ordered Wells Fargo to bear the costs of mediation.

On appeal, the District Court acknowledged the Bankruptcy Court's power to sanction parties that fail to comply with its orders, but rejected that Court's application of a subjective test of good faith. The District Court expressed concern about intruding into confidential dispute resolution, and declined to endorse the Bankruptcy Court's subjective inquiry into the quality of Wells Fargo's participation in the mediation. The Court was also concerned that admonishment of a party's "no pay" position, or a requirement that a party engage in risk analysis, could run afoul of well-settled law that "a court cannot force a party to settle, nor may it invoke 'pressure tactics' designed to coerce a settlement." *In re A.T. Reynolds & Sons, Inc.*, 452 B.R. 374, 382 (S.D.N.Y. 2011). In the Court's view, a party satisfies the good faith requirement if it attends mediation, provides pre-mediation memoranda and, when appropriate, produces organizational representatives with sufficient settlement authority. *Id.* at 384.

The District Court also addressed the Bankruptcy Court's conclusion that Wells Fargo had failed to send a representative with sufficient settlement authority, and found that the lower court applied an "unworkable and overly stringent standard" in requiring "the ability to (1) settle this case for any amount, including an amount greater than the amount in controversy; (2) discuss any theory of legal liability; and (3) enter into undefined 'creative solutions.'" *Id.* at 384. Instead, a party need only send "a person with authority to settle for the anticipated amount in controversy and who is prepared to negotiate all issues that can be reasonably expected to arise." *Id.* The District Court also found no issue raising concerns with the mediator, pre-mediation, regarding both the scope and anticipated attendance of the mediation. *Id.*

The *AT Reynolds* District Court decision is consistent with prior decisions by other New York district courts finding violations of the duty to mediate in good faith, and imposing corresponding sanctions on a party. In all prior cases finding a violation, the courts identified an objective failure on the part of one party that amounted to an actual or constructive failure to appear at the mediation. For example, in *Kerestan v. Merck & Co. Long Term Disability Plan*, the court sanctioned the plaintiff \$1,600 for failing to appear in person—not through counsel—at the settlement conference as ordered, "despite ample

warning.” 2008 U.S. Dist. LEXIS 50166 (S.D.N.Y. July 2, 2008). The plaintiff’s failure to appear at the mediation meant plaintiff’s counsel had no authority to engage in settlement discussions, and the Court found sanctions were warranted. *Id.* In *Outar v. Greno Indus.*, the plaintiff physically attended the mediation, but failed to participate in the proceedings, even after being requested to do so by his counsel. 2005 U.S. Dist. LEXIS 34657 (N.D.N.Y. Sept. 27, 2005). While the plaintiff pled ignorance of the legal system when faced with the prospect of sanctions, the court found that his “clinging ignorance of the process, refusal to listen to more knowledgeable professionals, and his level of distrust are of his own doing.” *Id.* As such, his conduct amounted to abuse of the process and warranted sanctions. New York courts also take a dim view of attorneys who demonstrate a lack of respect for a scheduled mediation and fail to notify the mediator and other parties of changed circumstances.

In *Fisher v. Smithkline Beecham Corp.*, the defendant filed a motion for summary judgment on the eve of mediation, while the plaintiffs and their counsel were en route to Buffalo, where the mediation would take place. 2008 U.S. Dist. LEXIS 76207, 20-21 (W.D.N.Y. Sept. 29, 2008). Once at the mediation, the defendant’s participation was limited to presenting plaintiff’s counsel with a copy of the motion that had been filed the previous evening. *Id.* at 18. The Court found the defendant’s failure to inform other parties of a motion that had clearly been contemplated well in advance of the mediation session, and had the predictable effect of hindering mediation efforts, caused the plaintiffs to unnecessarily incur expenses, was not in good faith, and warranted sanctions. *Id.* at 20-21.

### California

Consistent with the District Court’s decision in *AT Reynolds*, and decisions by other New York district courts, federal courts in California generally look to objective criteria when determining whether a party’s participation in mediation was in good faith. What sets California apart is that each federal district court has adopted local rules setting forth objective guidelines to be followed by parties in mediation and settlement discussions. The local rule guidelines do not refer to a “good faith” requirement. Instead, the local rules generally require at least the following: submission of a written mediation statement; appearance by a party representative with full authority to settle the case; and appearance by lead trial counsel. See CD Cal Local Rule 16-15; ND Cal ADR Local Rule 6; ED Cal Local Rule 270, 271; SD Cal Local Rule 600.

In contrast to the court in *AT Reynolds*, and other courts in New York, courts in California have adopted a stringent view of the requirement that each party be represented at the mediation by someone with authority to settle the case. For example, courts in the Central and Eastern Districts have explicitly defined the term “full authority to settle” as meaning that “the individuals attending the mediation conference must be authorized to fully explore settlement options and to agree at that time to any settlement terms acceptable to the parties.” See e.g. *Buenrostro v. Sahota*, 2011 U.S. Dist. LEXIS 127313 (E.D. Cal. Nov. 2, 2011); *Meyer v. Portfolio Recovery Assocs., LLC*, 2011 U.S. Dist. LEXIS 53778 (S.D. Cal. May 18, 2011) And both Districts have approvingly cited cases from jurisdictions outside of California for the proposition that sending a representative with rigid limitations on their ability to settle a case may run afoul of the court’s requirements. See, e.g. *Pittman v. Brinker Int’l, Inc.*, 216 F.R.D. 481, 485-86 (D. Ariz. 2003), *amended on recon. in part, Pitman v. Brinker Int’l, Inc.*, 2003 U.S. Dist. LEXIS 26202, 2003 WL 23353478 (D. Ariz. 2003) (requiring that the individual with full authority to settle have “unfettered discretion and authority” to change the settlement position of the party, if appropriate.); *Nick v. Morgan’s Foods, Inc.*, 270 F.3d 590, 596-97 (8th Cir. 2001) (an authorization to settle for a limited dollar amount or sum certain can be found not to comply with the requirement of full authority to settle). However, while California courts have expressed skepticism about representatives with authorization to settle for a limited amount, it is not clear that the courts would demand more than authority to settle up to the amount in controversy, as is required under *AT Reynolds* in New York.

Notwithstanding the local rules, California courts do not completely ignore the concept of “good faith” in mediation. See, e.g., *Skylark Inv. Props., LLC v. Navigators Ins. Co.*, 2010 U.S. Dist. LEXIS 12834 (S.D. Cal. Feb. 11, 2010) (“General statements that a party will ‘negotiate in good faith’ is not a specific demand or offer contemplated by this Order. It is assumed that all parties will negotiate in good faith.”); *Olam v. Congress Mortg. Co.*, 68 F. Supp. 2d 1110, 1116 (N.D. Cal. 1999) (noting that mediation participants are expected to participate in good faith, “but that ‘good faith participation’ does not mean that [a participant] would have to ‘cave in’ or agree to anything.”). However, the requirement of good faith by itself has not been applied in California to impose sanctions for mediation conduct; in all cases imposing sanctions, the determination was based on the objective criteria set forth by the local rules.

## California Court Signals Potential *In Pari Delicto* Doctrine Split with New York

The common law doctrine of *in pari delicto* bars recovery by plaintiffs who share culpability for wrongdoings alleged in a complaint. Subject to certain exceptions, a corporate plaintiff's claims are barred by the *in pari delicto* doctrine where its employees or agents participated in the alleged wrongdoing. *In pari delicto* defenses may be asserted where corporate plaintiffs assert claims against third parties that conspired with the corporation's former employees or agents to harm the corporation and its shareholders.

Different jurisdictions have applied the *in pari delicto* doctrine in a variety of different ways, and have crafted various exceptions to the general rule. For example, some jurisdictions recognize exceptions to the general rule that acts by a corporation's agents are imputed to the corporation. Recent decisions from courts in New York and California illustrate divergent approaches regarding the "imputation exception" to the *in pari delicto* defense. The New York Court Appeals (the state's highest court) has held that the *in pari delicto* doctrine may bar claims unless the wrongful acts of an employee are shown to have been beyond the scope of his authority and adverse to the plaintiff's interests. On the other hand, a recent decision from San Francisco Superior Court appears to allow such claims where at least some of the corporation's officers or directors were not complicit in the wrongful acts. This appears to contradict New York's stringent interpretation of the doctrine. Thus, practically speaking, California may be more preferable than New York for plaintiffs where some, but not all, of the plaintiff's officers or directors committed or were complicit in wrongdoing relating to the lawsuit, to the arguable benefit of the company. Several types of disputes may hinge on this forum choice, including actions against a company's auditors or financiers, and many types of litigation springing from litigation trusts in bankruptcy.

### **New York: The *In Pari Delicto* Doctrine After *Kirschner v. KPMG***

In both California and New York, courts recognize the common law *in pari delicto* doctrine, which "dictates that when a participant in illegal, fraudulent, or inequitable conduct seeks to recover from another participant in that conduct, the parties are deemed *in pari delicto*, and the law will aid neither, but rather, will leave them where it finds them." *Casey v. U.S. Bank Nat'l Ass'n*, 127 Cal. App. 4th 1138, 1143 n.1 (2005); see also *Kirschner v. KPMG LLP*, 15 N.Y.3d

446, 464 (2010) ("The doctrine of *in pari delicto* mandates that the courts will not intercede to resolve a dispute between two wrongdoers.").

A recent high profile decision from New York, *Kirschner v. KPMG LLP*, affirmed dismissal of a bankruptcy trustee's claims against the estate's outside auditors on *in pari delicto* grounds. *Kirschner* dealt with the spectacular implosion of Refco, a leading provider of brokerage and clearing services, that declared bankruptcy when it was discovered that the company's President and CEO covered up hundreds of millions of dollars in uncollectible debt for the better part of a decade. After the ensuing bankruptcy, the bankruptcy court appointed a Litigation Trustee, who brought suit in the U.S. District Court for the Southern District of New York on behalf of Refco's estate against, among others, Refco's outside auditors for their roles in the company's years-long efforts to manipulate the company's financial reporting and to hide the company's debts from the public and regulators. *Id.* at 457-59.

The auditors moved to dismiss the lawsuit on several grounds, including *in pari delicto*. The Court granted this motion because, *inter alia*, the complaint was allegedly "saturated by allegations that Refco received substantial benefits from the [Refco] insiders' alleged wrongdoing." *Kirschner v. Grant Thornton LLP*, 2009 WL 1286326, at \*6 (S.D.N.Y. Apr. 14, 2009). On appeal, the U.S. Court of Appeals for the Second Circuit certified a series of questions regarding the scope of the *in pari delicto* doctrine to the New York Court of Appeals, the state's highest court.

In finding for the auditors on the Second Circuit's certified questions, the New York Court of Appeals noted that acts of a corporation's agents are traditionally imputed to the corporation itself. See *Kirschner*, 15 N.Y.3d at 465-66. Extending this precedent to the case at hand, the *Kirschner* Court found that actions taken to bolster a corporation's healthy image should be imputed to the corporation and that there were no exceptions or public policies militating against this finding. *Id.* at 466-69, 474-77. Accordingly, the Court found that the Litigation Trustee, suing on behalf of Refco, was subject to the *in pari delicto* doctrine and could not sue Refco's outside auditors for their part in its demise. *Id.* at 476-77.

### **California: The Apparent Rejection of *Kirschner v. KPMG* in *Paron v. RKC***

In a similar case, *Paron Capital Management, LLC, et al. v. Rothstein, Kass & Company, P.C., et al.*, CGC-11-510203 (Cal. Sup. Ct. S.F. Cty.), a California court declined to apply the standard set forth



in *Kirschner*. In *Paron*, two of the plaintiff hedge fund's three partners, Peter McConnon and Timothy Lyons, hired Rothstein, Kass & Company ("RKC") to audit the trading records of their third partner, James Crombie. Investors in *Paron* required such an audit before they agreed to invest money in the hedge fund. RKC validated Crombie's trading records in November 2010 but, five months later, the National Futures Association ("NFA") instigated a new audit of *Paron* that led McConnon and Lyons to discover that Crombie had provided them with falsified records. When McConnon and Lyons reported this information to the NFA and *Paron*'s clients, the fund experienced mounting withdrawals that led to its demise shortly thereafter. *Paron*, McConnon, and Lyons subsequently sued RKC and other parties in San Francisco Superior Court for the losses they sustained due to, among other things, the faulty audit of Crombie's records. RKC moved to dismiss the plaintiffs' complaint on *in pari delicto* grounds.

RKC's motion to dismiss relied heavily on the reasoning in *Kirschner* and argued that Crombie's fraud was properly imputed to *Paron*, which therefore barred the fund from suing RKC on *in pari delicto* grounds. *Paron* responded by pointing out that, "[u]nder California law, *in pari delicto* is never applied to innocent parties, and the doctrine would only be appropriate if 'the complaint alleges that every

decision maker in the company was involved in the misconduct.'" As the facts demonstrated—according to *Paron*—the plaintiffs were the *victims* of Crombie's fraud, not its beneficiaries. Accordingly, *in pari delicto* did not apply.

The Court agreed with *Paron*'s analysis, denied RKC's motion and reinstated claims that had previously been dismissed on *in pari delicto* grounds. Implicit in this decision was a holding that the complaint did *not* have to allege facts that "show that Crombie's conduct was completely adverse to the company's interest and outside the scope of authority," which was the basis of the prior dismissal. *Paron*'s case thus proceeds in spite of New York's *Kirschner* opinion.

Plaintiffs should be wary of relying too heavily on the *Paron* court's decision for their forum selection analysis. At this stage, it is a trial court decision that may be subject to reversal on appeal. However, the decision is an encouraging sign for plaintiffs and may presage a split in how the *in pari delicto* doctrine is applied in New York and California. **Q**

(*Manisha Sheth Named "Top Minority 40 Under 40" continued from cover*)

against Eighteen of the world's largest financial institutions for selling subpar mortgage-backed securities to Fannie Mae and Freddie Mac. She is specifically spearheading the cases against Merrill Lynch & Co. Inc. and Barclays PLC, and is also working on the suits against Citigroup Inc. and JPMorgan Chase & Co. *The National Law Journal* also recognized Ms. Sheth for her work on behalf of MBIA Insurance Corp. in another significant RMBS case against Countrywide Financial Corp. and Bank of America Corp. Prior to joining the firm, Ms. Sheth served as a federal prosecutor in the Criminal Division of the U.S. Attorney's Office in Philadelphia. During her five years in the office, she lost only one trial. **Q**

## Trial Lawyer Stephen Swedlow Joins Quinn Emanuel

Stephen Swedlow has joined the firm as a partner in its Chicago office. Mr. Swedlow has fifteen years of trial and appellate experience representing clients including public corporations, individuals and classes in high-profile, complex and high-stakes matters. He has first-chaired jury trials, managed large litigation teams, and argued important appeals, including several before state Supreme Courts. He works primarily in the areas of intellectual property, class action, and complex commercial litigation. He

led the trial team that obtained a \$10 billion trial verdict against Philip Morris USA on behalf of a class of consumers who were defrauded by the plaintiff's marketing of Marlboro Lights cigarettes. Mr. Swedlow has also been retained to advise on tobacco litigation and regulation. He has been repeatedly selected as a "Top Attorney" by *Legal News* and was selected as a Trial Lawyer of the Year Finalist in 2003 by the Trial Lawyer for Public Justice. **Q**

# PRACTICE AREA UPDATES

## London Litigation Update:

**Liquidator Ordered to Disclose Documents to Creditor for Use in Arbitration:** In *Sunwing Vacation Inc v. E-Clear (UK) plc* [2011] EWHC 1544 (Ch), 3 June 2011, the U.K. High Court of Justice Chancery Division considered whether Section 155(1) of the 1986 Insolvency Act, which requires the disclosure of an insolvent company's papers to its creditors, also required the disclosure of documents to a creditor for use in a separate arbitration against a third party. The applicants, Sunwing Vacations Inc. and Vacances Sunwing Inc. (collectively "Sunwing") applied for an order against E-Clear (UK) plc (E-Clear), a company in voluntary liquidation of which they were creditors, and E-Clear's liquidators for the disclosure of documents for use in arbitration proceedings in Germany. The German arbitration involved claims by Sunwing that relate to E-Clear's debt to Sunwing.

Under Section 112(1) of the Insolvency Act 1986 (IA 1986), a creditor of a company in liquidation (but not being wound-up by a court) may request that a court exercise its power as if the company were being wound-up by the court. One such power is set forth in Section 155(1) IA 1986, which provides that a court "may, at any time after making a winding-up order, make such order for inspection of the company's books and papers by its creditors and contributors as the court thinks just; and any books and papers in the company's possession may be inspected by creditors and contributories accordingly, but not further or otherwise." It has been held that the exercise of power under Section 155(1) must be for the purpose of the winding up a company (per Millett J in *Re DPR Futures Ltd* [1989] 1 WLR).

The main issue in *Sunwing* was whether the action sought by Sunwing under Section 155(1) was for the purpose of winding up E-Clear. The Court noted that, if Sunwing was successful in the German arbitration, it would reduce the recovery sought by Sunwing from the wind-up of E-Clear. The Court found that the exercise of power under section 155(1), *i.e.*, disclosure of the documents, could benefit E-Clear and its creditors generally. As a result, the Court held that, the requested order was for the purposes of winding up.

This decision confirms that a creditor can apply for disclosure of an insolvent company's papers for use in any proceedings where the creditor may obtain a benefit that reduces its claim in the insolvency.

**Sovereign Immunity:** Could an affiliate of a New York-based hedge fund seize Argentina's assets in

Britain using a \$284 million U.S. court judgment it had against the South American nation? In *NML Capital v Argentina*, the U.K. Supreme Court held that the hedge fund was entitled to do so.

The claim arose out of New York law governing sovereign bonds issued by Argentina and bought, at a significant discount, by NML Capital in the early 2000s. When Argentina failed to pay the requisite interest on the bonds, NML Capital called an event of default and obtained a New York judgment against Argentina for over US\$284 million. NML then sought to have the judgment recognized and enforced in England under the common law (there was no reciprocal enforcement legislation between the UK and the US). Argentina argued that it was a sovereign state and had immunity under the U.K. State Immunity Act 1978 ("SIA"), which grants general immunity to states unless specific exceptions apply. The U.K. Court of Appeal found in Argentina's favor in February 2010.

Before the U.K. Supreme Court, NML Capital raised three points: *first*, that one of the exceptions in the SIA was that a state could not enjoy immunity for "a commercial transaction" it entered into; *second*, the Civil Judgments and Jurisdiction Act 1982 ("CJJA") stated that foreign judgments against a sovereign state could not be enforceable unless two conditions were met: (a) the state would not be immune if English law applied (*i.e.*, the SIA above); and (b) that the judgment satisfied enforceability criteria under English law; *third*, that under the terms of the bonds, Argentina had waived immunity and had submitted to the jurisdiction of the national courts for enforcement.

On the first issue, the Justices were split 3-2. While there was no dispute that the bonds would constitute a commercial transaction, the issue was whether proceedings to enforce judgments could be considered a "commercial transaction." The majority were of the view that such proceedings fell into the category of "commercial transactions" because of Parliament's intention at the time the legislation was drafted and market practice at the time in international capital markets. However, on the second issue, because all the Justices felt that NML could prevail on the CJJA to strip Argentina of its immunity. Lord Phillips, summarizing the effect of the CJJA on this particular case, stated: "State immunity cannot be raised as a bar to the recognition and enforcement of a foreign judgment if, under the principles of international law recognized in this jurisdiction, the state against whom the judgment was given was not entitled to immunity in respect of the claim." Thus, if the state would not have enjoyed immunity under the

laws of the jurisdiction in relation to the underlying claim, there is no reason why the judgment should not be recognized or enforced. On the third issue, the U.K. Supreme Court found that, on the specific terms of the bonds, Argentina's submission to New York jurisdiction meant it had waived its right to object to jurisdiction for the purposes of subsequent enforcement proceedings.

**Common Sense and Contract Interpretation:** In *Rainy Sky SA v. Kookmin Bank* [2011] UKSC 50, The U.K. Supreme Court recently gave important guidance on the English courts' approach to contractual interpretation. The fundamental rule under English law is that the purpose of contractual interpretation is to determine what the parties meant by the language they used. This is an objective enquiry – it involves ascertaining how a reasonable person, with all of the background knowledge available to the parties at the time of the contract, would construe the document.

The question in *Rainy* concerned the role played by considerations of “business common sense” in determining what the parties meant. Delivering the Supreme Court's judgment, Lord Clarke said that “where the parties have used unambiguous language, the court must apply it.” Even if the result compelled by that language strikes the court as commercially absurd or unfair, English law takes the view that loyalty to the text of a commercial contract is the paramount principle of interpretation.

However, Lord Clarke said that where a clause in a contract was ambiguous (meaning it is capable of two or more meanings), it is appropriate for the court to apply the construction that is most consistent with, in the court's view, commercial common sense. Accordingly, if there is contractual ambiguity, litigants can employ more creative arguments exploring the underlying commercial purpose of the transaction. Otherwise, if there is no contractual ambiguity, litigants in the English courts are invariably stuck with the words.

***Lucasfilm v Ainsworth* [2011] UKSC 39 (the ‘Stormtrooper Helmet’ case):** England's highest Court has held that Star Wars Stormtrooper helmets are not “sculptures,” much to the chagrin of Lucasfilm. In doing so, it also found that an action for copyright infringement based on activity outside the EU (in this case the United States) could be brought in England against someone residing in the United Kingdom over whom the English courts have personal jurisdiction.

There was no dispute that Mr. Ainsworth had infringed Lucasfilms' U.S. copyrights in the United

Kingdom by placing advertisements for his Star Wars Stormtrooper helmets in U.S. publications, operating a website in the United States, and sending his products to American customers from the United Kingdom. Default judgment for infringement of copyrights had been entered against Mr. Ainsworth in California, but he remained in the United Kingdom. The English Court therefore had to consider whether jurisdiction existed for an infringement action of an American copyright.

Previously, the Court of Appeal in England had held that European legislation requires English courts to hear copyright infringement actions against defendants over which they have jurisdiction, even if the infringement took place elsewhere in the European Union. However, until *Lucasfilm*, it was generally accepted that this principle did not extend beyond the European Union. Indeed this was the stance taken by the (lower) Court of Appeal in the case.

The Supreme Court, however, swept aside this view, ruling that the claim for infringement of a U.S. copyright in breach of U.S. copyright law is a claim over which the English courts can accept jurisdiction if there is jurisdiction over the defendant (in this case, he was domiciled in the United Kingdom). This is arguably the Supreme Court's upholding of *forum necessitatis* considerations, allowing English courts to assert jurisdiction in instances where claimants would otherwise be bereft of a suitable forum in which to litigate. The Supreme Court emphasized that this applied to copyright infringement, not validity or registration issues, but the case nevertheless may have wide-ranging implications, and shows an increased willingness of the English Courts to consider U.S. copyright infringement claims.

### Japanese Litigation Update:

#### ***Japanese Record Labels Sue YouTube Downloader***

**Site:** The Recording Industry Association of Japan (RIAJ), an organization representing the Japanese music recording industry, issued a press release stating that 31 Japanese record labels filed a collective lawsuit on August 19<sup>th</sup> in Tokyo District Court against local firm MusicGate. According to the lawsuit, the defendant MusicGate operates an internet site called Tubefire that enables free downloads of music videos posted on YouTube. The labels are demanding 230 million Yen (around \$3 million) in damages from MusicGate. RIAJ states that Tubefire attracts more than 2.2 million visitors a month, and that a huge volume of music video files have been illegally downloaded through the site. RIAJ claims that Tubefire replicated music video

(continued on page 8)



files on its server and made them available for users without permission of the copyright owners, which violated Japanese Copyright Law by infringing on the reproduction and distribution rights of the copyright owners. According to a RIAJ survey of Tubefire users, files protected by the labels' copyrights were illegally replicated around 10,000 times a month. Based on the results, the labels calculated damages equal to the amount they would have earned if the music files were bought from official distributors. Although Tubefire has already ceased operations, several other websites still provide the same service. A RIAJ survey estimates that about 1.2 billion music files are illegally downloaded annually, while legitimately purchased music during 2010 amounted to about only 0.44 billion. At the first hearing, held on October 12th, MusicGate sought dismissal of the claims against it.

**Canon Wins Ink Cartridge Patent Infringement Suit in the Japanese Supreme Court:** Canon Inc. had sued six other ink cartridge makers claiming that their products, which are compatible with Canon-manufactured ink-jet printers infringe one of Canon's patents. The defendant makers imported and sold allegedly infringing ink cartridges manufactured in Hong Kong. They were widely sold at lower prices than genuine Canon cartridges. The Intellectual Property High Court recognized that the defendants' products had infringed the Canon patent and ordered the defendants to stop importing and selling those products. The defendants appealed, but the Japanese Supreme Court upheld the ruling of the High Court on September 29th. This case represents a major victory in the battle printer manufacturers have waged in recent years -- in Japan, the U.S. and Europe -- against the manufacturers of consumables made for use in their printers.

**New Regulation Against Organized Crime Group Takes Effect in Tokyo:** In October, the Tokyo Metropolitan Government introduced a new regulation against organized crime groups (commonly known as "Yakuza"). Although similar regulations had already taken effect in other prefectures, the enforcement in the capital city of Japan has a substantial impact. Yakuza was listed as one of four significant transnational criminal organizations in U.S. President Barack Obama's July 25<sup>th</sup> executive order authorizing new sanctions against criminal cartels (the others are Los Zetas, Camorra and the Brothers' Circle). The principal intent of this regulation is to weaken the economic power of members of such organizations (which are defined by the act as "gangsters") by

encouraging companies in their efforts to refrain from entering into contracts with them. Three important aspects of the regulation should be noted. First, whenever entering into a contract, companies must make their efforts to make sure the other party is not a "gangster" under the Act. In addition, companies are strongly encouraged to include contract clauses enabling them to cancel a contract if they find later find cause to believe that the other party qualifies as a "gangster" under the Act. Second, companies must not provide any "profits" to covered "gangsters." Third, companies should watch for "gangsters by association" -- the act makes clear that a "gangster" includes those who have a "close relationship" with other "gangsters," in addition to official members of organized crime groups.

It is not clear yet, however, how courts will interpret the term "profit" or what is a "close relationship" with gangsters. If companies are not able to determinations as to issues related to the regulation, consultation with police may be warranted.

## Trademark and Copyright Litigation Update:

**Ninth Circuit Abandons "Internet Troika" For Assessing Trademark Infringement:** In *Network Automation v. Advanced Systems Concepts*, 638 F.3d 1137 (9th Cir. 2011), the Ninth Circuit clarified that analysis of trademark infringement claims in the Internet context, as with other trademark infringement cases, must be tailored to fit the specific facts of each case. In so doing, the Ninth Circuit rejected the so-called "Internet troika" analysis, which focused on three and only three factors for Internet-related trademark infringement. In place of this abbreviated, plaintiff-friendly standard, *Networks Automation* requires a "flexible" approach when applying the traditional multi-factor *Sleekcraft* test for assessing likelihood of confusion -- a far more defendant-friendly standard.

In *Networks Automation*, Advanced Systems Concepts, which sells software under the trademark ActiveBatch, sought an injunction against Network Automation, one of its competitors. Network Automation was bidding on keywords such as "ActiveBatch" in connection with advertising on search engines, including Google and Bing. A search for these keywords would deliver search results that included links to web pages for plaintiff's ActiveBatch products, as well as defendant's ads, which could also appear above or to the right of the search results.

The district court found that Advanced System Concepts proved a likelihood of confusion under




the “Internet troika” factors: (1) the similarity of the marks; (2) the relatedness of the goods; and (3) the marketing channel used. The Ninth Circuit reversed. In so doing, it distinguished keyword advertising from the meta-tagging and banner advertising scenarios of *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*, 174 F.3d 1036, 1054 (9th Cir. 1999), and *Playboy Enterprises, Inc. v. Netscape Communications Corp.*, 354 F.3d 1020, 1024 (9th Cir. 2004). The Ninth Circuit held that its analysis in *Brookfield* and *Playboy* was both due to the increasing “degree of consumer care” of online consumers since its earlier decisions, as well as the different appearance of the ads at issue in the present case. Network Automation’s advertisements were labeled as separate and distinct from natural search results; for example, they were delivered to different regions of the search results webpage and clearly identified the defendant in the advertised link. Squaringly rejecting the “Internet troika” analysis, the Ninth Circuit found two of the three “troika” factors were particularly *unlikely* to favor a finding of confusion in the keyword advertising context. First, the “appearance of the advertisements and their surrounding context” on the screen did not support a confusion finding, given the nature of the search results page. Likewise, the “similarity of the marks” factor did not favor a confusion finding where the consumer was not confronted with two distinct trademarks, and instead received advertisements that clearly identified the defendant using the defendant’s own name. 638 F.3d at 1150-51, 1154. Additionally, it reasoned that “the shared use of a ubiquitous marketing channel does not shed much light on the likelihood of consumer confusion” given that “[t]oday, it would be the rare commercial retailer that did not advertise online.” *Id.* at 1151.

Other circuit courts also have rejected the “Internet troika” in the sponsored link context. *Tiffany (NJ) Inc. v. eBay Inc.*, 600 F.3d 93 (2d Cir. 2010); *College Network, Inc., v. Moore Educational Publishers, Inc.*, 378 Fed.Appx. 403, 2010 WL 1923763 (5<sup>th</sup> Cir. 2010).

***Logos, Emblems, and Characters Given Trademark Protection Reprieve as Ninth Circuit Withdraws and Supersedes Earlier Controversial Aesthetic Functionality Decision:*** In our July 2011 Newsletter, we reported on an important and controversial trademark decision from the Ninth Circuit, *Fleischer Studios, Inc. v. A.V.E.L.A., Inc.*, 636 F.3d 1115 (9th Cir. 2011), which affirmed the dismissal of copyright and trademark infringement claims related to the defendant’s licensing of the Betty

Boop image on various products. As we reported in July, the Ninth Circuit reasoned – that the defendant’s use of the Betty Boop image – “never designat[ing] the merchandise as ‘official’ [Fleischer] merchandise or otherwise affirmatively indicat[ing] sponsorship [by Fleischer]” 636 F.3d at 1124 – was not the kind of source-designating use as a trademark forbidden by the Lanham Trademark Act. Rather, the Ninth Circuit reasoned, the defendants merely employed the Betty Boop image as a “functional and aesthetic” characteristic of their licensed products: “Even a cursory examination, let alone a close one, of ‘the articles themselves, the defendant’s merchandising practices, and any evidence that consumers have actually inferred a connection between the defendant’s product and the trademark owner,’ reveal that A.V.E.L.A. is not using Betty Boop as a trademark, but instead as a functional product.” 636 F.3d at 1123.

On August 19th, the Ninth Circuit responded to the controversy its opinion created by taking the unusual step of simply withdrawing its February opinion and superseding it with a new opinion: *Fleischer Studios, Inc. v. A.V.E.L.A., Inc.*, 654 F.3d 958 (9th Cir. 2011). The new opinion remands part of the plaintiff’s trademark cause of action, but abandons the prior analysis that the use of the Betty Boop image was aesthetically functional and that the Supreme Court’s decision in *Dastar Corp. v. Twentieth Century Fox Film Corp.*, 539 U.S. 23 (2003) required dismissal under the Copyright Act. Indeed, the August opinion is entirely silent on the issue of aesthetic functionality.

The August opinion continues to express skepticism about Fleischer’s claims, finding again that it failed to present timely evidence of its trademark registration in the image of Betty Boop and refusing to take judicial notice of the registration. *Fleischer*, 654 F.3d at 966. It also reiterates that the “uncorroborated, and clearly self-interested testimony” of Fleischer’s CEO is insufficient to establish a triable issue regarding secondary meaning. *Id.* However, the new opinion held that remand was necessary because the previously dispositive fact that other entities held valid copyrights in Betty Boop is insufficient in and of itself to support a determination that Fleischer could not prove secondary meaning in the Betty Boop word trademark. *Id.* at 968. 

# VICTORIES

## Complete Defense Victory for Micron at Multi-Billion Dollar Antitrust Trial

After over six years of litigation and a three-month jury trial in San Francisco Superior Court, the firm obtained a complete defense verdict for Micron Technology, Inc., the last remaining U.S. manufacturer of dynamic random access memory (“DRAM”) chips, in a true “bet the company” antitrust case against Rambus Inc. Indeed, on the day of the verdict, Rambus’ stock sank 61% and Micron’s rose 23%.

In 2004, Rambus filed a complaint against Micron and other memory manufacturers alleging a conspiracy to boycott RDRAM, Rambus’ DRAM technology, in violation of the Cartwright Act, one of California’s antitrust laws; a conspiracy to monopolize the market for DRAM technologies in violation of the Cartwright Act; intentional interference with prospective economic advantage from Rambus’ relationship with Intel; and unfair competition under California’s Unfair Competition Law. Rambus alleged that Micron conspired with Hynix, Infineon, and Samsung to restrict the production of RDRAM, to raise the price of RDRAM, and to lower the price of DDR, defendants’ DRAM chips, in order to drive RDRAM from the market and to convince Intel to terminate its relationship with Rambus. Rambus argued, among other things, that defendants should be held liable, because Hynix and others had previously pled guilty to fixing the price of certain DRAM products. Rambus sought approximately \$4 billion in compensatory damages, trebled to \$12 billion under the Cartwright Act, as well as other relief.

At trial, Micron presented evidence that RDRAM failed as a mainstream memory as a result of its inherent deficiencies and Rambus’ flawed business practices, and not as a result of any conduct by defendants. At the conclusion of the trial, the jury rejected Rambus’ claims and awarded no damages.


This is the third case tried by the firm on behalf of Micron in Rambus’ ongoing litigation campaign against Micron and other memory manufacturers. It is also believed to be one of the largest antitrust cases tried to a jury verdict, and one of the biggest defense verdicts in terms of the stakes and impact on an industry.

## Patent Victory in Preliminary Injunction Proceeding in Germany

The firm recently secured denial of a preliminary injunction against its client, Servona GmbH (“Servona”), a leading supplier of medical products in Germany. The plaintiff, Atos Medical AB (“Atos”), sought a preliminary injunction in the District Court

of Munich based on the alleged infringement of two medical patents related to tracheostoma valves. Prior to Servona retaining Quinn, the Court had granted an *ex parte* preliminary injunction based on one of the two asserted patents.

The preliminary injunction prevented Servona from distributing and marketing its new product. German law, however, allows a defendant in such a case to appeal the Court’s decision. The appeal is before the same court, but is an *inter partes* proceeding, where both sides are permitted to file briefs and present oral argument. In its pre-hearing briefs, Servona attacked Atos’ overly- broad construction of certain claim terms as being unsupported by the plain language of the claims. Servona also presented noninfringement arguments that highlighted core differences between the accused device and the claimed invention. Servona also further explained how its products were fundamentally different from the patent’s claim even under Atos’ own theory. These arguments were supported by the results of tests produced on very short notice.

At the hearing, the Court made clear that it was reconsidering its prior holding and was leaning towards adopting the narrower claim construction. Only a few hours later, the Court reversed its prior decision, denied Atos’ requests for injunctions, and ordered Atos to pay Servona’s attorney fees. 

(lead article continued from page 3)

As noted in the commentary to Northern District of California ADR Local Rule 2-4, parties are encouraged to use the informal resolution procedure set forth in the ADR Local Rules, but under *Zambrano v. City of Tustin*, 885 F.2d 1473 (9th Cir. 1989), the district court may impose fee shifting sanctions for a violation of a local rule only on a finding of bad faith, willfulness, recklessness, or gross negligence. For example, such sanctions have been imposed for, at least in part, a failure to attend the mediation absent good cause. In *Lial v. County of Stanislaus*, the District Court found that an award of attorney's fees was appropriate where the plaintiff offered what was, in the Court's view, a disingenuous reason for cancelling a scheduled mediation. 2011 U.S. Dist. LEXIS 4435 (E.D. Cal. Jan. 11, 2011). After spending over 11 hours speaking with the mediator in advance of the scheduled mediation, the plaintiff cancelled the mediation on less than a week's notice, allegedly because she did not have sufficient vacation time to attend. *Id.* The Court noted disapprovingly that the plaintiff took a vacation the day after the date the mediation was originally scheduled for. *Id.*

In contrast, although a party may be required to attend a mediation, good faith does not necessarily guarantee unfettered access by the mediator to the party. In *EEOC v. ABM Industries Inc.*, the defendants brought a motion for sanctions against plaintiffs based on plaintiffs' counsel's refusal to allow the mediator direct access to the plaintiffs. 2010 U.S. Dist. LEXIS 24570, 3-4 (E.D. Cal. Mar. 3, 2010) ("ABM argues that they are entitled to sanctions because, in essence, 'good faith' mediation efforts required the mediator to be able to directly persuade the plaintiffs to the wisdom of the defendants' position.") EEOC countered that the plaintiffs were Spanish speakers, and that the mediator's suggestion, given that the mediator did not speak Spanish, would have required counsel for plaintiffs to act as an interpreter and could easily give rise to confusion as to who was advocating a particular position. *Id.* The Court recognized that it had general authority under Federal Rule of Civil Procedure 16 (f) to impose sanctions for failure to obey a scheduling order, and under 28 U.S.C. § 1927 to sanction attorneys who act in bad faith, but declined to impose any sanctions.

As an initial matter, the district court in *EEOC* noted that this was not a mandatory mediation, and the parties appeared by agreement. But this does not appear to have affected the court's analysis of what it means for a party to participate in good faith. In particular, the court criticized the defendant for failing to request direct access to the parties by the

mediator before the ground rules for mediation were entered. The court also found that good faith efforts at mediation do not require attorneys to give up their role as counselor to their clients. In fact, "in the Court's view a primary reason that people hire lawyers is so that they are not pressured into doing something that may not fully serve their interests. The plaintiffs were entitled to rely upon the advice of their counsel and the attorneys were duty-bound to zealously advocate for them." *Id.* at 14-15.

The adoption by all California district courts of local rules codifying objective criteria to assess participation in mediation proceedings may be intended to ensure compliance with state laws, and state Supreme Court precedent, relating to the confidentiality of mediation proceedings and restrictions regarding the information that can be disclosed to the court. *See, e.g., Benesch v. Green*, 2009 U.S. Dist. LEXIS 117641, 11-12 (N.D. Cal. Dec. 17, 2009) ("The broad policy of mediation confidentiality contained in the statutes is strictly enforced and the California Supreme Court has refused to allow implied exceptions: 'Where no express waiver of confidentiality exists, judicially crafted exceptions to mediation confidentiality are not appropriate.'") (citing *Foxgate Homeowners' Assn. v. Bramalea California, Inc.*, 26 Cal. 4th 1, 15 (Cal. 2001)). Limited exceptions are recognized in each district's local rules, but these generally relate to the ability to report failure to comply with an express local rule to the Magistrate overseeing the ADR program, not to the judge presiding over the case. *See, e.g., ND Cal ADR Local Rule 6-12. See also CD Cal Local Rule 16-15.8* ("All settlement proceedings shall be confidential. No part of a settlement proceeding shall be reported, or otherwise recorded, without the consent of the parties, except for any memorialization of a settlement and the Clerk's minutes of the proceeding").

### Conclusion

While courts continue to cite a duty to mediate in "good faith," it is unclear what, if any, requirements that places on a party beyond the specific provisions set forth in a court order. When faced with a court-ordered mediation, participants should make sure that they are represented at least by counsel and someone with full authority to settle the matter. Any anticipated change in circumstances should be promptly notified to the mediator and to all parties, particularly if cancellation or postponement of the mediation may be necessary. 📍



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