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When the Deal Goes Bad: Thinking Twice About Using Deal Counsel as Litigation Counsel

"*We trust our intuitions even when they are wrong.*"
- Nobel Laureate Daniel Kahneman

Your corporate attorney may be a great deal lawyer—the lead on dozens of major transactions, head of a talented team, and attentive to your every business need. And the terms of the deal are exactly what you wanted. But even the most carefully crafted deal can end up in litigation. One 2018 study found that 85 percent of merger deals struck in 2017 attracted litigation; 73 percent in 2016; and 89 percent in 2015. Matthew D. Cain, et al., *The Shifting Tides of Merger Litigation*, 71 U. Pa. L. Rev. 603 (2018). Private equity firms, which take on a myriad of roles as shareholders, directors, buyers, bidders, sellers, and lenders, are all too often seen as deep pocket targets, making expensive litigation an unavoidable cost of doing business.

If the deal ends up in litigation, should a client hire the deal firm to represent it? Or is the client better served with a separate firm as litigation counsel? The initial reaction may be that litigation counsel should be from the same firm as the deal lawyer, under the theory that the firm is already on the scene and the intuition that there will be a shorter learning curve, easier coordination between deal lawyers and litigation counsel, and the firm will have a greater investment in

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INSIDE

Jury Awards $1.1 Billion in Damages For Caltech in Patent Infringement Case Against Apple and Broadcom

After a two-and-one-half-week jury trial in the Central District of California, a jury returned a unanimous $1.1 billion patent infringement verdict for Quinn Emanuel's client the California Institute of Technology ("Caltech") against Apple and Broadcom. The jury found all asserted claims of the three patents in the case infringed by both Apple and Broadcom and awarded the full damages requested by Caltech as fair compensation for Apple and Broadcom's years of unauthorized use of Caltech's technology.

In early 2000, Caltech invented a revolutionary type of error correction coding that performed at or near theoretical perfection. The technology was also efficient, which meant it could be used commercially. Error correction technology prevents and corrects errors that occur when sending information, like texts, pictures, or videos, across information channels, like Wi-Fi. Caltech's technology meant that electronic data could be transmitted faster, in larger quantities, and more accurately, all while conserving battery life. It dramatically improves performance of technologies like Wi-Fi.

The technology was invented by Professor Robert McEliece and two of his graduate students, Hui Jin and Aamod Khandekar, and was ahead of its time. Many of its applications, including to Wi-Fi, were nascent fields at the time. Years after the invention, Apple and Broadcom began incorporating this technology in every Wi-Fi product they made, including iPhones, iPads, iMacs, MacBooks, Apple watches, AirPort routers, and Wi-Fi chips. Q

defending the client's position.

There are, however, multiple pitfalls inherent in this "one firm" approach. Using the same firm for deal litigation can constrain the strategies adopted for the litigation and for any possible settlement. Using one firm also raises a thicket of potential ethical problems that can lead to expensive and time-consuming side disputes. The acts or omissions of the deal firm itself can be the focus of the litigation. At worst, litigation counsel may be tainted or disqualified, resulting in the client's forced restart with new counsel after the litigation has been long underway.

Below we give specific examples of why using litigation counsel from your deal firm should not be a "given" and why an independent firm merits serious consideration.

I. The Strategic Benefits of Independent Litigation Counsel

When a dispute erupts over a transaction, the person who ultimately has to determine which side prevails, and on what terms and conditions, is someone who had nothing to do with the deal: a neutral decision-maker, such as an arbitrator, a panel of arbitrators, or a judge. A client may be better served by a lawyer who, like the judge, has some distance from the deal and can make an experienced judgment about the best strategy, witnesses, and approaches to meet the client's business goals and positioning of the case. In all cases, choosing litigation counsel, like choosing a surgeon, should be an intentional choice designed to ensure that the client is employing the best one for the job, not merely the closest at hand.

A. Deal Lawyers and Their Firm May—Likely Will—Be Affected by Unconscious Bias

All of us use mental shortcuts or "heuristics" to make critical decisions. Nobel-prize winning psychologists Daniel Kahneman and his colleague Amos Tversky developed the term "framing effect" to describe how seemingly rational choices may be in fact distorted or "framed" through subjective presentation. *The Framing of Decisions and the Psychology of Choice*, 211 Science 453 (1981). Another heuristic they identify is "anchoring bias," that is, a cognitive bias towards an initial estimate or starting point, which ultimately weighs heavily in the outcome of a decision. *Judgment and Uncertainty: Heuristic and Biases*, 185 Science 1124 (1974). These types of heuristics affect everyday decisions, including decisions made in business and law. As Daniel Kahneman noted: "By their very nature, heuristic shortcuts will produce biases."

Deal lawyers, in particular, tend to have "confirmation bias": strong views, which are not objective, about what documents mean and why they did a good job. *Oxbow Carbon LLC Unitholder Litigation*, 2017 WL 3207155, at *6 (Del. Ch. July 28, 2017) ("Motivated reasoning, motivated remembering, and confirmation bias are part of the human condition."). Confirmation bias can mean favoring a position early on and giving undue weight to evidence that supports that early conclusion. Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 Rev. of Gen. Psychol. 175 (1998). That is why judges admonish the trier of fact to "keep an open mind." *Id.* The same concept applies to the attorneys preparing the strategies and approaches for a courtroom dispute.

"False consensus" bias is another risk, where deal lawyers believe that their interpretation of an agreement based on what they intended and what they thought they accomplished is the only sensible interpretation, even if the cold words on the page are susceptible to different meanings. Lawrence Solan, et al., *False Consensus Bias in Contract Interpretation*, 108 Colum. L. Rev. 1268 (2008).

Another level of bias is that a litigation partner may be inclined to believe that his or her corporate partner did a good job. A client deserves a litigation team that is unconstrained from asking the hard questions about the deal lawyer's work: What is the plain meaning of the contractual language? Is it arguably ambiguous? Would the client's interests be best advanced by relying on parol evidence or commercial context? Are the right arguments being made? Is the client being well served in discussions about whether to litigate the dispute or is the client being steered towards settlement to avoid throwing deal counsel's work into the crucible of litigation? Is an attractive solution being avoided because the deal firm would have to admit its own potential liability?

An additional risk with the "one firm" approach is that the corporate partners may have too much influence about key litigation decisions, such as who from the deal team should testify, whose opinion is most important, whether the other side's positions have merit, and what is the best approach for presenting the client's case to a mediator, arbitrator, or judge. A client may be better served with an independent litigator who can more easily say, "No offense, but that construction of the wording makes no sense," or "Your position goes against current law and we need to find a way to resolve this quickly." Reframing the work of the deal lawyers is a delicate conversation to have under the best of circumstances, and is more likely to proceed well with lawyers from a separate firm. Ultimately, the natural tendency to engage in framing raises the potential for biased decisions—the opposite of what a client needs when defending a lawsuit. In the words of Professor Kahneman, the ideal advisor is "a person who likes you and doesn't care about your feelings."

B. Deal Lawyers and Their Firm May Be Motivated by Self-Protection

When engaging litigation attorneys from the same firm as the deal lawyers, there is an almost inevitable tendency

to offer litigation theories and strategies that protect the firm as much as the client—and it is possible that those theories and strategies may not be entirely consistent. Litigation counsel can face internal pressure to justify the deal language, the negotiations, the documents, and the advice given by their deal partners. Particularly when the deal lawyer is the firm's main client contact (the partner who literally puts work on the litigator's desk for this client and others), it may be difficult, if not impossible, for the litigator to tell the deal partner that the contract has flaws, or that the strategy has to be repositioned, or that a term is ambiguous and that it is important to rethink what the parties meant.

In disputes over deals gone bad, the deal lawyers can end up as witnesses about what they did and why. An independent firm can more easily send the message: "It's important that you testify despite the fact that you don't want to." Or, "No offense but you are not the best person to testify about that topic." Of course, this concept is not *only* limited to deal litigation. For example, it is a well-accepted norm that patent lawyers who prosecute a patent should not litigate it.

Independent outside counsel is better suited to do the "tough preparation" with a witness before they testify. Independent counsel will enhance the deal witness's (and hence the client's) credibility because, at the very least, the difference in firms gives the appearance that someone who is removed from the deal is asking the hard questions. This is a critical, if often overlooked, factor which we expect is at play in many cases where the nature of the "team" advising a client can make a difference to the finder of fact. The long-term business interests of the client can also favor employing a different litigation firm. Even though parties are in litigation, the opposing deal lawyers may be working together sooner or later, whether on redoing the same deal in dispute or other deals for the same or other clients. By using litigation counsel from a firm that is not the usual deal counsel, a client can take an aggressive, no holds barred approach during the litigation and reduce the level of ill will directed against the client or its outside deal counsel.

II. The Deal Firm May Be "Materially Limited" in Representing the Client

ABA Model Rule 1.7—which along with the other ABA Model Rules has been adopted by many states and is a staple of federal court ethics rulings—prevents lawyers from taking a representation that "involves a concurrent conflict of interest." A concurrent conflict of interest exists if "there is a significant risk that the representation of one or more clients will be *materially limited* by the lawyer's responsibilities to another client, a former client or a third person or by a *personal interest of the lawyer*." *Id.* (emphasis added). A competing "personal interest of the lawyer" includes risks to the lawyer's partners or his or her firm. Such conflicts may extend to the firm as a whole. ABA Model Rule 1.10. When litigation and deal counsel are from one firm, there are multiple ways in which representation of a client may be "materially limited."

A. Pursuing Litigation Theories That Favor the Deal Lawyer

Concern by litigators about the reputation of their firm's corporate lawyers can "materially constrain" the representation. Many deals, especially those involving private equity, raise complicated legal and regulatory issues. If the litigation firm is also the deal firm, the client runs the risk of not receiving unfettered advice about what went wrong with the deal and whether the advice and actions of the deal firm itself may have been a factor.

In one case, recently shared by a major private equity firm, the deal firm's litigators deliberately decided not to seek production of emails from the other side's lawyers because they did not want to subject their own email communications to scrutiny under a reciprocal request. Similarly, in *Veras Inv. Partners, LLC v. Akin Gump Strauss Hauer & Feld LLP*, 52 A.D.3d 370, 372 (1st Dep't 2008), the law firm did not assert an advice-of-counsel defense when its hedge fund clients were investigated by regulatory authorities about their market timing and late trading practices—allegedly because the law firm placed its own interest in defending its deal advice above the interests of representing the clients before the regulators. *See also Ultrapak, LLC v. Laninver USA, Inc.,* 2019 WL 244492, at *19-21 (W.D.N.Y. Jan. 17, 2019)(disqualifying deal lawyer who had "direct personal interest" in choosing interpretations of the governing agreement that minimized his personal responsibility for the alleged damage); Milan Markovic, *The Sophisticates: Conflicted Representation and The Lehman Bankruptcy*, 2 Utah L. Rev. 903 (2012) (a law firm's interest in preserving its reputation with key government agencies undermined its legal representation of an investment bank and may have contributed to Lehman's bankruptcy). Ultimately, where the deal firm's interest is to minimize its own role in the challenged deal, it may point the finger at others—including, potentially, its own client.

B. Deal Lawyer as Witness

The possibility that a deal lawyer will appear as a fact witness is another basis for disqualification of the deal firm as litigation counsel. *See* ABA Model Rule 3.7 (referring to the "lawyer as witness" rule); *see also Domain Prot., LLC v. Sea Wasp, LLC*, 2019 WL 3219939, at *7-8 (E.D. Tex. Nov. 19, 2019) (discussing Model Rule 3.7 and the "unseemly and ineffective position" of an attorney in a dual role as witness and trial counsel). There are any number of specific facts about the background and negotiation of the deal that could be the basis of testimony, although they

may be hard to anticipate at the beginning of the case. The actions that the deal firm took—or failed to take—can easily become a focus of discovery and testimony, and can lead to disqualification of the deal firm. *See, e.g., Eurocom, S. A. v. Mahoney, Cohen & Co.,* 522 F. Supp. 1179, 1180 (S.D.N.Y 1981).

In the same vein, when the deal lawyer is a witness and the litigation attorney is from the same firm, the other side can dispute whether their conversations are covered by attorney-client privilege, given that the deal lawyer was a "participant in the underlying events." *See, e.g., Hertzog, Calamari & Gleason v. Prudential Ins. Co.*, 850 F. Supp. 255, 255 (S.D.N.Y. 1994) (communications remain privileged if the individual in question is acting as an attorney rather than someone who participated in the underlying events).

The bottom line is this: your opponent may demand that the deal lawyers give evidence about their underlying work. A dispute about such evidence can be a costly and time consuming issue to litigate, and can result in disqualification of the litigators.

C. Impact on Credibility of Trial Counsel

A trial lawyer's greatest asset with a fact finder is his or her credibility. To persuade, the trial lawyer must be credible. To be credible, the trial lawyer must be able to take positions based on the evidence without apparent bias. If the trial lawyer is seen not only as an advocate for their client, but for his or her partner and their work or work product on the deal at issue, that will affect credibility. In such circumstances, the trial lawyer may be perceived to have a personal stake in the litigation.

D. Crossover Roles

In some instances, a deal lawyer may "cross over" and be deemed litigation counsel—for example, by conducting an investigation well before any litigation is filed. Disqualification of the entire firm is a possible result, although the issue can take literally years to resolve. *See, e.g.*, *FDIC v. United States Fire Ins. Co.,* 50 F.3d 1304, 1317 (5th Cir. 1995) (district court disqualified firm whose lawyer conducted pre-dispute investigation along with his firm; four years later, appellate court reversed the disqualification). This is not to say that disqualification motions are routinely granted, as most federal and state courts have set a high bar for granting them. *See, e.g.*, *Murray v. Metropolitan Life Ins. Co.*, 583 F.3d 173, 178 (2009). Nonetheless, such motions are frequently filed, bringing the risk of disqualification and, at best, an unnecessary and costly distraction.

E. Recommendations About Settlement

One-firm representation can affect litigation counsel's advice about the scope of settlement or even the possibility that the case will settle. The risk is heightened when the deal firm has a financial interest in the outcome as a result of, for example, a success fee or kicker contingent upon closing the challenged transaction. The litigation attorney's financial interest as a partner of the deal firm would be affected by the outcome of the dispute, including such factors as when and for how much the dispute is resolved. As one court put it, "the parties are entitled to advice on that subject from counsel who are entirely uninhibited by any personal involvement of their own in the merits." *Eurocom*, 522 F. Supp. at 1180.

Equity billing, such as receiving shares of stock, is another way that a firm may have direct financial interest in the client's business, including any deal negotiated by the law firm. The consequent financial or reputational risks can trigger potential conflicts such as the bar on business dealings between attorney and client (ABA Model Rule 1.8) and the reasonableness of attorney's fees (ABA Model Rule 1.5).

F. Whether There Is a Meaningful Conflict Waiver

The foregoing conflicts require a sufficient waiver, which must be specific and in writing. *See* Model Rule 1.7(b)(4). The client must be made aware of the relevant circumstances and of the material and reasonably foreseeable ways that the conflict could have adverse effects on the client's interests. And the client must agree to a "proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct." *Bd. of Regents of the Univ. of Neb. v. BASF Corp.*, 2006 WL 2385363, at *7 (D. Neb. August 17, 2006) (quoting the Comments to Rule 1.7).

III. Final Thoughts

There are sound legal and practical reasons to consider someone other than your deal lawyer's firm to handle complex disputes arising from a transaction. Although it may be tempting to choose those familiar with the deal to handle the matter, the potential conflicts and the impact of biased decision-making can undermine strategies and actions that best serve the client's interests. Lawyers who drafted the deal, and their partners, may be unable or reluctant to challenge accepted wisdom or think outside the box, creating an "echo-chamber" effect that can lead to less than desirable outcomes in litigation.

Ultimately, if a client chooses to hire the deal firm to litigate a dispute over the transaction, a labyrinth of risks and rules must be navigated. The risks often outweigh any of the presumed benefits of retaining one firm for both roles. At best, the client may get a constrained view of the litigation options and potentially an expensive and time-consuming sideshow over which firm will be its trial counsel. Worse outcomes are possible. Efficiency and prudence usually favors an independent law firm to help a client develop the most effective litigation defense, try the case, or negotiate a strong settlement.

SEC Proposes First Amendments to Proxy Rules in 65 Years

On November 5, 2019, a divided Securities and Exchange Commission proposed amendments to Exchange Act Rule 14a-8, the shareholder-proposal rule. Rule 14a-8 requires companies that are subject to the federal proxy rules to include shareholder proposals in their own proxy statements to shareholders, subject to certain procedural and substantive requirements. Rule 14a-8 is meant to enable shareholder-proponents inexpensively and easily to present their proposals to all shareholders and to have proxies solicited for their proposals, while preventing excessive or inappropriate use of the system. The comment period for the proposed amendments ended on February 3, 2020.

The proposed amendments to Rule 14a-8 affect the following five requirements and limitations related to shareholder proposals:

Ownership Requirements: Rule 14a-8(b) currently states that in order to be eligible to submit a proposal, a shareholder must have continuously held at least $2,000 in market value or 1% of the company's securities for one year prior to the submission. The proposed amendments increase these ownership requirements, conditioning eligibility to submit a proposal on a shareholder continuously holding: (1) $2,000 of the company's securities entitled to vote on the proposal for at least three years; or (2) $15,000 of the company's securities entitled to vote on the proposal for at least two years; or (3) $25,000 of the company's securities entitled to vote on the proposal for at least one year.

Documentation Requirements: Rule 14a-8 does not currently address a shareholder's ability to submit a proposal for inclusion in a company's proxy materials through a representative. Instead, this practice has been governed by state agency law. The proposed amendments add a variety of documentation requirements for shareholders using a representative to submit a proposal, including that documentation: (1) identifies the company to which the proposal is directed; (2) identifies the annual or special meeting for which the proposal is submitted; (3) identifies the shareholder-proponent and the designated representative; (4) includes the shareholder's statement authorizing the designated representative to submit the proposal; (5) identifies the specific proposal to be submitted; (6) includes the shareholder's statement supporting the proposal; and (7) is signed and dated by the shareholder.

Company Engagement Requirements: Rule 14a-8 also does not currently require that a shareholder engage with the company before submitting a proposal. The proposed amendments add a shareholder engagement component to the eligibility criteria. Specifically, a shareholder must submit a statement that he or she is able to meet with the company in person or via telephone between 10 and 30 calendar days after submission of the shareholder's proposal, the shareholder's contact information and day and times when the shareholder is available for discussions with the company.

Limitation on Number of Proposals: Rule 14a-8(c) currently limits "each shareholder" to one proposal per shareholders' meeting. The proposed amendments would apply the one-proposal rule to "each person" rather than "each shareholder."

Limitation on Resubmissions: Rule 14a-8(i)(12) currently permits companies to exclude from their proxy materials resubmitted proposals if the proposal received (1) less than 3 percent of the vote if proposed once within the preceding five calendar years; (2) less than 6 percent of the vote on its last submission if proposed twice previously within the preceding five calendar years; or (3) less than 10 percent of the vote on its last submission if proposed three times or more within the preceding five calendar years. The proposed amendments would replace the resubmission thresholds of 3, 6, and 10 percent with new thresholds of 5, 15, and 25 percent, respectively. They would also add a new provision to the rule that would allow companies to exclude proposals that have been submitted at least three times in the preceding five years if they received less than 50 percent of the vote and support declined by more than 10 percent when the proposal was last voted on.

SEC Chairman Jay Clayton stated that the proposed amendments are meant to modernize regulations, some of which have not been updated for decades, to adjust to market developments. Specifically, the Chairman noted that over the last 20 years, large and multi-faceted proxy voting advice businesses have formed to provide services to investment advisers managing trillions of dollars in assets for retail investors, making the proxy advisers third-party market participants with influence similar to auditors, rating agencies and research analysts. The Chairman also stated that in the 65 years since the resubmission requirements have been updated, the split of retail and institutional shareholders has flipped from 90 percent retail / 10 percent institutional to 20 percent retail / 80 percent institutional, and communications technology has developed to allow broad and costless dissemination and instant access and contact. In light of these changes, the proposed amendments seek to rebalance the benefits

and burdens to all shareholders while retaining the ability of small, medium and long-term shareholders to continue to enter and engage in the shareholder proposal process.

Commissioners Jackson and Lee voted against the proposal stating that the proposal "shields CEOs from accountability to investors" and "would operate to suppress the exercise of shareholder rights."

Issuers broadly expressed approval for the proposed amendments, which the SEC's analysis stated would reduce the number of proposals by about 37% and save public companies tens of millions of dollars a year in corporate expenses.

Institutional investors' reactions were markedly less favorable. In a public comment submitted to the SEC, one investment manager objected to the proposed rules as limiting the rights of shareholders to engage with corporations and having the potential to prevent relevant issues from being raised, to the detriment of companies, shareholders, broader stakeholders, and the public at large.

Proxy advisers shareholder organizations were also critical of the proposal. The President of Institutional Shareholder Services, a proxy advisory firm, noted that institutional investors, which hire proxy advisers, had not called for the new, more onerous rules, and that the SEC should listen to and address the concerns of investors it is charged with protecting. The Shareholder Rights Group urged the SEC to reject the proposed amendments to Rule 14a-8, stating the amendments, and the proposed amendments to proxy rules for proxy voting advice, would be harmful to the interests of investors, pose systemic risk, and jeopardize progress on sustainable and responsible business practices in the U.S. and global economy.

The proposed amendments may shift the balance of power in engagements between shareholders and companies over environmental, social, and governance (ESG) issues. In recent years, investors have become increasingly engaged in ESG issues such as deforestation, workplace discrimination, water risk, and climate change. Shareholder proposals are a primary mechanism used by investors to engage corporate management and to communicate their views on corporate ESG risks. A significant proportion of shareholder proposals are voluntarily withdrawn in return for commitments from the company to address the issue of concern. Reducing the abilities of shareholders to submit proposals risks making such proposals a less effective strategy in disputes with companies over ESG issues.

When the SEC will adopt the proposed amendments to Rule 14a-8 is not currently known. The issues have inspired significant interest from market participants. Many commenters thus far simply asked that the Commission extend the comment period for 120-days, which it has not done. It is clear that however the Rule is ultimately modified, there will be robust opinions offered for the staff's consideration. In 2019, the average amount of time between a proposed rule and final rule was approximately 13 months.

PRACTICE AREA NOTES

Energy Litigation Update

The Kids Are (Not) Alright: Parent-Child Well Interference

Oil and gas industrialists often refer to the initial well drilled in a sector as the "parent well"; whereas, the subsequent wells drilled in the sector will be known as the "child wells." In recent years, producers have found that tight well-spacing can (and often does) reduce output from the parent wells and the later-drilled child wells. While changing practices as a result of this revelation may protect future reserves, many companies may have already impaired enormous amounts of producing reserves by pursuing drilling programs that use tight well-spacing, likely giving rise to increasing litigation over an important legal question: Who should bear the cost of the losses caused by these failed drilling strategies?

E&P companies typically construct yield forecasts for a sector by drilling a parent well and extrapolating the future performance of the sector from yield models based on the parent well's production. In large part, however, those production models rely on historic data from conventional plays—*i.e.*, large subterranean pools of oil and gas, recoverable by vertical drilling activity. However, E&P companies are discovering that historic conventional data provides unreliable guidance for analyzing reserves available in unconventional plays—*i.e.*, small pockets of oil and gas trapped in shale rock, recoverable by horizontal drilling activity and hydraulic fracturing. Notably, tight well-spacing affects production from unconventional plays significantly more than production from conventional plays.

Over the past several years, tight well-spacing has been the modus operandi of many producers in the most active oil and gas plays. *See* Matthew Insley, *Down Spacing: The Next Chapter in the U.S. Oil Boom*, Daily Reckoning (Sept. 23, 2013). By concentrating their drilling activity, producers theorized that they would be able to maximize the volume of minerals that they can extract from the

reservoirs in a short period of time. The unintended consequence of tightening the well-spacing, commonly referred to as downspacing, came in the form of reduced well performance for both parent and child wells. *See* Trent Jacobs, *Three Trends Shaping Global Production: US Well Spacing, Argentine Shale, and Middle East Conventionals*, J. Petroleum Tech. (Nov. 20, 2018). When drilled too close to the parent well, child wells often cannibalize the parent well's projected production. Participants in the oil and gas markets refer to this phenomenon as well interference. *See* Connor McLean, *Changes in Permian Spacing to Strand DUCs?*, BTU Analytics (Oct. 3, 2019).

Already, E&P companies have started to abandon the model of drilling many tightly spaced wells that once prevailed in the SCOOP and STACK of Oklahoma and the Permian Basin of Texas. Concho Resources, Devon Energy, Continental Resources, Centennial Resource Development, and other E&P companies active in those areas have acknowledged that tighter well-spacing has caused declines in production. *See* Sven Del Pozzo, *Analyst Commentary: Concho…*, Connect Upstream Insight (Oct. 31, 2019); Trent Jacobs, *Shale Executives Address Investor Concerns Over Production, Frac Hits, Up-Spacing*, J. Petroleum Tech. (Feb. 27, 2019). Some of these producers insist that the effects are localized; nevertheless, well interference has already caused significant losses in today's major oil and gas plays. *See* Del Pozzo, Analyst Commentary.

Where there are losses, litigation will surely follow. Well interference threatens to spark disputes in the oil patch, including litigation between E&P companies and their stakeholders—securities holders and royalty interest holders.

Disputes with Securities Holders

In some circumstances, suspected well interference has already led to litigation. Market reports indicated that Alta Mesa Resources experienced setbacks from well interference. *See* Jacobs, *Shale Executives Address Investor Concerns*. Shortly after these reports surfaced, a plaintiff-side securities litigation firm announced its investigation of the producer. *See Securities Class Action Has Been Filed Against Alta Mesa Resources, Inc.*, Globe Newswire (Jan. 31, 2019). Weeks later, a second plaintiff-side firm filed suit against Alta Mesa Resources in the District Court for the Southern District of Texas, alleging that the company overstated the value of assets acquired during a business combination with Alta Mesa Holdings, LP. *See Camelot Event Driven Fund v. Alta Mesa Resources, Inc.*, No. 19-cv-00957 (S.D. Tex. Mar. 14, 2019). The securities litigation was stayed when Alta Mesa and many of its affiliates filed voluntary petitions for bankruptcy relief on September 11, 2019. *See In re Alta Mesa Resources, Inc.*, No. 19-35133 (Bankr. S.D. Tex. Sept. 11, 2019).

With well interference causing producers to write down assets across the Permian Basin, the SCOOP, and the STACK, we can expect further securities litigation. We will likely see E&P companies defend their use of downspacing as a reasonable application of the best geophysical science of the early fracking boom; whereas, plaintiff-side advocates will likely develop theories accusing executives of sacrificing long-term production for short-term gains—eviscerating asset values in the process.

Disputes with Royalty Interest Holders

Substantially all E&P companies hold their mineral interests subject to royalty obligations: upon producing minerals, the E&P company must tender all royalty payments before taking any sale proceeds. A royalty interest generally amounts to one-eighth (1/8) of the sale proceeds of the produced minerals.

Under the laws of most states, an operator of an oil or gas lease owes an implied duty to royalty owners to operate with reasonable care while producing minerals. *See, e.g., Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 567 & n.1 (Tex. 1981) (discussing the covenant to operate with reasonable care); *Union Texas Petroleum v. Corp. Comm'n of the State of Oklahoma*, 651 P.2d 652, 668 (Okla. 1981) (discussing economic waste in the context of well-spacing). Some states regulate well-spacing by imposing minimum spacing requirements. *See* Order No. 213539, Okla. Corp. Comm'n (Apr. 16, 1982) (establishing 640-acre drilling and spacing units for the production of gas from the Mississippian, Woodford, Hunton, Viola, and Arbuckle formations in Garvin County, Oklahoma). Other states, including Texas, do not.

As the consequences of well interference ripple through the oilfield, royalty interest holders may attempt to hold E&P companies accountable for the failed experiment of downspacing. Perhaps royalty holders will allege that producers breached their duty of reasonable care by pursuing untested production methods like downspacing; perhaps the producers' efforts to extract as much volume as quickly as possible will survive allegations of economic waste. Although regulatory rulings may be probative of reasonable care, no case on point holds that compliance with those rulings is dispositive. Only one thing can be certain: any litigation on this point will test the contours of several areas of law, including oil and gas law, business torts, and regulatory law.

Conclusion

When an unforced error erodes asset values, litigation generally follows. Well interference and its effect on the values of oil and gas assets will likely follow this rule, rather than falling within an exception. Whether engaged on the defense side or the plaintiff side, Quinn Emanuel's oil and gas trial attorneys understand the legal and economic issues involved with downspacing and well interference. Get us

on your side.

Note: Quinn Emanuel Urquhart & Sullivan, LLP represented Kingfisher Midstream, LLP and affiliates against Alta Mesa Holdings, LP and affiliates in an adversary proceeding within the Alta Mesa bankruptcy cases. Quinn Emanuel guided Kingfisher to win summary judgment against Alta Mesa Holding on the precedent-setting issue of whether certain disputed gathering agreements created real covenants under Oklahoma law. No confidential information has been included in this article.

White Collar Litigation Update

Key Developments in the FCPA Corporate Enforcement Policy in 2019 and Assessing Potential "Agency" Exposure Post-*Hoskins*

Since its inception as a pilot program in 2016 and its formalization in November 2017, the Department of Justice's FCPA Corporate Enforcement Policy (the "Policy") has provided an incentive for companies to mitigate their criminal exposure under the FCPA while bolstering the DOJ's ability to successfully prosecute individuals responsible for criminal misconduct. *See* Law360.com, *Justice Dept. Launches FCPA Cooperation Initiative* (Apr. 5, 2016). In the two years since, the DOJ has codified certain important changes to the Policy. In March 2019, the DOJ revised the Policy by: (1) relaxing the prohibition against ephemeral communication and messaging platforms; (2) providing a more relaxed and business friendly position on mergers and acquisitions by giving explicit assurances that companies undergoing mergers or acquisitions can rely on policy to mitigate potential exposure; (3) providing clarity that the DOJ will not take steps to affirmatively direct a company's internal investigation efforts, despite the DOJ's ability to request that the company refrain from taking specific actions for de-confliction purposes; and (4) relaxing the requirement that companies must provide information on all employees "involved" in the company's misconduct, only requiring that companies disclose individuals "substantially involved" in or "responsible for" the wrongdoing. *See* Quinn Emanuel Firm Memorandum, *DOJ's Quiet Changes to the FCPA Corporate Enforcement Policy Likely to Have a Significant Impact on Corporate Investigations* (Mar. 2019). And in November 2019, the DOJ announced two additional updates to the Policy: (1) permitting self-disclosure based on preliminary investigations; and (2) clarifying that a company is only required to identify for the DOJ relevant evidence outside of the company's possession that "it is aware of" in order to receive full cooperation credit. *See* JM §§ 9-47.120(3)(a), 9-47.120(3)(a),n1, and 3(b), FCPA Corporate Enforcement Policy.

However, at the same time that the government has been extending a proverbial carrot to corporate actors, it has steadily and significantly increased enforcement against individuals—actions which, de jure, result in vicarious legal liability for individuals' employers. The DOJ's recent victory in the closely watched *U.S. v. Hoskins* case, where the government prevailed on an "agency" theory of liability against a foreign executive, is no exception and signals a continuation of aggressive individual enforcement actions. *See U.S. v. Lawrence Hoskins*, Case No. 3:12-cr-238, Dkt. 538 (D. Conn., Nov. 8, 2019).

I. The Case Against Lawrence Hoskins

In July 2013, the DOJ announced an indictment of Lawrence Hoskins, a former senior vice president of French power and transportation company Alstom S.A. ("Alstom"), for conspiring to violate the FCPA, launder money, and other substantive FCPA and money laundering violations. Dep't of Justice, *Former Senior Executive of French Power Company Charged in Connection with Foreign Bribery Scheme* (Jul. 30, 2013). According to the charges, Hoskins engaged in a conspiracy to pay bribes to government officials in Indonesia in exchange for assistance in securing a $118 million contract for an Alstom subsidiary, Alstom Power Inc. of Connecticut ("Alstom CT"), and its consortium partner to build power plants in Indonesia (the "Tarahan Project"). *Id.*

Hoskins was not a US citizen, not employed by a US company, and apparently never set foot in the US while working for Alstom. Although prohibited from proceeding on a FCPA conspiracy/complicity theory alone *(see United States v. Hoskins*, 902 F.3d 69, 97 (2d Cir. 2018)), the government nevertheless put Hoskins on trial in 2019 on the theory that Hoskins acted *as an agent* to Alstom CT and thus may be held criminally liable because the FCPA's prohibitions on issuers and domestic concerns apply to "any officer, director, employee, *or agent of*" the entity. *See* 15 U.S.C. §§ 78dd–1(a), 78dd–2(a)*; see also Hoskins*, 902 F.3d at 98 (2d Cir. 2018)(emphasis added). According to the government, Hoskins and his co-conspirators retained two consultants ostensibly to provide legitimate consulting services for Alstom CT in connection with the Tarahan project, but were in fact used to conceal the bribes to the Indonesian officials. *See* Dep't of Justice, *Former Senior Alstom Executive Convicted at Trial of Violating the Foreign Corrupt Practices Act, Money Laundering and Conspiracy* (Nov. 8, 2019). Moreover, the government alleged that Hoskins and his co-conspirators retained a second consultant to "more effectively bribe" the officials, and after Alstom CT and its consortium partner secured the Tarahan project, subsequently made payments to the officials through the consultants. *See id.*

II. Application of Agency Theory in *Hoskins*

In order to prove that Hoskins acted as an agent to Alstom CT, US District Judge Janet Atherton required that the government show: (1) a manifestation by the principal

that the agent will act for it; (2) the agent's acceptance of an "undertaking," that is, "acts or services" for the principal; and (3) an understanding that the principal is "in control" of those acts or services. Moreover, Judge Atherton clarified that "one may be an agent for some business purpose and not others," and in this case, agency must be "in connection with the specific events related to the contract known as the Tarahan project."

As noted above, Hoskins's repeated rallying cry to the jury was his status as a foreign national with no meaningful contacts in the US for FCPA purposes. To rebut that narrative, in its bid to establish agency, the government relied in part on a former senior executive at Alstom CT who managed the Tarahan project and, according to the government, helped establish that Alstom CT in fact "controlled the strategy and approach" of the deal and "called the shots." The government also relied on testimony from a former Alstom executive who told the jury that if Alstom CT did not agree to the terms and conditions of the payments for the consultants, Hoskins was in charge of renegotiating with the consultants on behalf of Alstom CT, despite the fact that Hoskins committed the alleged acts from "his office in Paris and hotels in Indonesia." After a two-week trial, including just over a day of deliberation, the jury found that Hoskins had acted as an agent of Alstom CT under Judge Atherton's instruction and convicted him of six counts of violating the FCPA, three counts of money laundering, and two counts of conspiracy. *See U.S. v. Lawrence Hoskins*, Case No. 3:12-cr-238, Dkt. 538 (D. Conn. Nov. 8, 2019).

III. Potential Implications of Hoskins on Agency Liability

Following the *Hoskins* verdict, concern over the potentially vast scope of the definition of "agency" in the FCPA context swirled. However, in fairly short order, the Assistant Attorney General for the DOJ's Criminal Division, Brian Benczkowski, signaled that federal prosecutors do not view *Hoskins* as an opportunity to "stretch the bounds of agency principals beyond recognition, or even push the FCPA statute towards its outer edges." *See* Assistant Attorney General Brian Benczkowski, Remarks at the American Conference Institute's 36th International Conference on the FCPA (Dec. 4, 2019). Benczkowski warned, however, "if the Department were to find evidence of the use of corporate structures to shield a parent from criminal liability, or the use of agents to shield a high-level individual executive from accountability, the Department likely would strongly favor prosecution in those instances." *Id.*

Although it will take time to see how the *Hoskins* decision affects the DOJ's propensity to bring FCPA enforcement actions against non-US citizens involved with entities that have minimal connections to the US, there is an undeniable trend in that direction. Against a backdrop of aggressive individual enforcement, boards of directors, special committee members and corporate executives alike must now think more broadly about their potential corporate exposure under an agency theory of liability in light of the potentially sweeping application of *Hoskins* on FCPA enforcement. If necessary, individuals with potential corporate exposure should work with experienced counsel to weigh the costs and benefits of disclosure under appropriate circumstances and to proactively address and mitigate any potential issues.

Class Action Litigation Update

Consumer Privacy Rights of Action in California: What Businesses Can Do to Prepare

Cybersecurity incidents are a question of "when," not "if," for any business that collects and stores large amounts of sensitive consumer personal information. The brand-new California Consumer Privacy Act ("CCPA"), Cal. Civ. Code §§1798.100 *et seq.*, contains, among other things, a private right of action for any California consumer whose nonencrypted and nonredacted personal information is subject to a data breach. Cal. Civ. Code § 1798.150. This provision took effect on January 1, 2020. The statutory penalties are steep: $100 to $750 per consumer; injunctive or declaratory relief; and any other relief the court deems proper. Cal. Civ. Code § 1798.150(a). However, there are several best practices to keep in mind that go a long way towards eliminating or at least mitigating liability.

First, redact or encrypt consumer personal information. The private right of action does not lie where the stolen or disclosed data is encrypted or redacted. Cal. Civ. Code § 1798.150(a). Although the term "nonencrypted" is not defined in the CCPA, "encrypted" is defined in the related California Civil Procedure Code §1798.82(i)(4) to mean "rendered unusable, unreadable, or indecipherable to an unauthorized person through a security technology or methodology generally accepted in the field of information security." There are useful industry standards for encryption such as those in the National Institute of Standards and Technology's ("NIST") Advanced Encryption Standard, available at https://nvlpubs.nist.gov/nistpubs/fips/nist.fips.197.pdf.

Second, evaluate the type of consumer personal information a business maintains. Only a theft or disclosure of "personal information" as defined in California Civil Code § 1798.81.5(d)(1)(A) will give rise to the private right of action. As defined in that Section, "personal information" means an individual's first name (or first initial) and the individual's last name in combination with one or more of the certain data elements, such as social security number, driver's license number, account number, credit or debit card number, medical information,

health insurance information, or biometric data. Personal information can also mean an account number in combination with a password (or security question that would allow access). Therefore, redaction or encryption can be applied on a selective basis to the above information to ensure that unprotected data does not fall into the wrong hands—and thus forestall liability under the CCPA.

Third, institute and maintain "reasonable" security practices. The CCPA's private right of action is further limited only to situations where the data breach was a result of a business's violation of its duty to implement and maintain reasonable security procedures and practices appropriate to the nature of the information to protect the personal information. Cal. Civ. Code § 1798.150(a)(1). The CCPA does not define "reasonable security." However, there are several resources business can draw on to formulate reasonable practices. For example, the former California Attorney General's 2016 *California Data Breach Report* cited to the International Organization for Standardization's 27002 series and the NIST's cybersecurity framework, both of which are available at https://www.iso27001security.com/html/27002.html and https://www.nist.gov/cyberframework, as reputable frameworks for businesses to follow. Notably, in its 2019 court-approved settlement of data-breach related claims, Yahoo! Inc. agreed that its information security program would be compared against the NIST or similar cybersecurity framework as part of the remedial efforts. A few of the most salient steps that these frameworks recommend include the following:

(1) Documenting data security policies, procedures and practices in a written information security plan ("WISP"), which is a document memorializing the administrative, technical and physical safeguards businesses use to protect the privacy of the personally identifiable information it stores.

(2) Training employees on cybersecurity and data security issues and hiring a Chief Information Security Officer. The CCPA already requires employees who handle consumer inquiries about a business's privacy practices or compliance to be informed of various CCPA requirements. *See* Cal. Civ. Code § 1798.130(a)(6). The purpose of hiring a Chief Information Security Officer is to ensure that security policies and procedures are robust, conform to industry norms, and are being followed.

(3) Conducting regular risk assessments. Businesses should regularly conduct information security risk assessments and utilize a third party vendor to evaluate the information security program. These risk assessments, at a minimum, will consider risks associated with: (i) employee training and management; (ii) software design and testing; and (iii) vendor data management and security practices. A business should then evaluate and adjust, as reasonably necessary, its systems on which and by which customers' personal information is stored in light of: (i) the results of the testing and monitoring required by the settlement agreement; (ii) any material changes to its operations or business arrangements; or (iii) any other circumstances that it knows or has reason to know may have a material impact on the effectiveness of its security program.

The CCPA's private right of action provides a powerful tool to plaintiffs in the event of a data breach. However, the above steps, if taken proactively, can help to eliminate or at least limit liability for a business.

Quinn Emanuel Earns Top Marks in 2020 Corporate Equality Index

Quinn Emanuel received a score of 100 percent on the Human Rights Campaign Foundation's 2020 Corporate Equality Index (CEI), the nation's premier benchmarking survey and report measuring corporate policies and practices related to LGBTQ workplace equality. The Human Rights Campaign Foundation is the educational arm of America's largest civil rights organization working to achieve equality for lesbian, gay, bisexual, transgender and queer people. The CEI rates companies and top law firms on detailed criteria falling under five broad categories: non-discrimination policies, employment benefits, demonstrated organizational competency and accountability around LGBTQ diversity and inclusion, public commitment to LGBTQ equality, and responsible citizenship.

Life Sciences IP Virtuoso Angus Chen Joins New York Office

Angus Chen has joined the firm as a partner in the New York office. Angus was previously at Haug Partners, where he was Chair of Life Sciences. Angus's practice has focused on pharma and biopharma litigation for clients such as Chiesi, Takeda (Shire and Baxalta), and The Medicines company. He has a Ph.D. from Mt. Sinai School of Medicine in biochemistry. In addition to extensive trial experience in pharma and biopharma cases, Angus has extensive experience in PTAB proceedings, appellate work, and advising clients on patent and regulatory strategies, product lifecycle management, and complex settlement agreements.

VICTORIES

QE Defeats $2 Billion Suit by Mississippi Attorney General Against Entergy Mississippi

Quinn Emanuel recently obtained summary judgment for Entergy Mississippi and its affiliates in a long-standing case in which the Mississippi Attorney General (AG) sought more than $2 billion in damages.

Entergy Mississippi is an electric utility that provides electricity to homes, businesses and governments in the western part of Mississippi. Entergy Mississippi and its affiliates in Arkansas, Louisiana, and Texas form the Entergy System, which is able to take advantage of certain economies of scale in serving their customers in these states. Because the Entergy System involved sales of energy and transmission in the wholesale interstate market across state lines, it is subject to the oversight of the Federal Energy Regulatory Commission ("FERC"). At the same time, the rates charged by the Entergy affiliates to their in-state customers were regulated by the respective states' public utility commissions.

In a complaint filed in 2008, the Mississippi AG alleged that Entergy Mississippi and its affiliates relied too much on supposedly expensive electricity from their own power plants, and purchased too little allegedly cheaper electricity from independent power producers. The AG alleged causes of action for fraud, violation of the Mississippi Consumer Protection Act, and the Mississippi Antitrust Act. With interest, the AG sought to recover more than $2 billion in damages.

In 2017, after the case had been pending for nearly a decade, Entergy hired Quinn Emanuel. Quinn Emanuel filed a motion for summary judgment arguing that the AG's case was within the exclusive jurisdiction of FERC. At the same time, Quinn Emanuel developed the factual record showing that the AG was wrong on the merits because while third-party energy may appear cheaper on an average hourly basis, it was typically not offered or sold on a flexible basis that would allow for the second-by-second adjustments in quantity needed to keep demand and supply in balance, which is necessary to avoid massive outages in the region. The district court found that the issues implicated in the summary judgment briefing required a complete airing of the dispute at trial, and set the matter for a bench trial. Then, just three days into trial, the district judge found that the federal court lacked subject matter jurisdiction (despite that fact that the prior federal judge assigned to the case had found the federal court did have subject matter jurisdiction) and remanded the case back to Mississippi Chancery Court where it had initially been filed.

Back in Chancery Court, Quinn Emanuel renewed its motion for summary judgment based on federal preemption. In particular, we focused on the similarity between Entergy Mississippi's case and a case that Entergy Texas had won. The Entergy Texas case had also been originally filed in state court, removed to federal court, and remanded. And on remand in the Entergy Texas case, the state court held that the case was within FERC's exclusive jurisdiction. We argued that the same result was warranted for Entergy Mississippi, and the Mississippi chancery judge agreed. The court granted our motion for summary judgment in full, finding that the AG's claims were preempted by federal law, and ended more than a decade of litigation. Q

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business litigation report

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- We are a business litigation firm of more than 800 lawyers — the largest in the world devoted solely to business litigation and arbitration.
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- When we represent defendants, our trial experience gets us better settlements or defense verdicts.
- When representing plaintiffs, our lawyers have garnered over $70 billion in judgments and settlements.
- We have won five 9-figure jury verdicts and one 10-figure jury verdict.
- We have also obtained forty-three 9-figure settlements and nineteen 10-figure settlements.

Prior results do not guarantee a similar outcome.

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