June 2013

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Three Landmark Decisions for Insurers and RMBS Investors

Quinn Emanuel recently secured landmark rulings for its client MBIA Insurance Corporation ("MBIA") in three major decisions in MBIA's long-running lawsuit against Countrywide Home Loans, Inc. ("Countrywide"), various Countrywide affiliates, and Bank of America Corporation ("BAC") (on a successor liability theory). Each of these rulings played a critical role in securing a favorable settlement of the lawsuit for MBIA. Collectively, they have significantly reshaped the legal landscape for RMBS claims in a way that fundamentally alters how these claims will be litigated going forward and that will likely prove highly advantageous to RMBS insurers and investors, and to non-RMBS insurers as well.

MBIA brought suit in 2008 in New York State Supreme Court (Justice Eileen Bransten), alleging that (1) Countrywide fraudulently induced it to insure 15 residential mortgage-backed securitizations, (2) Countrywide materially and pervasively breached its contractual representations and warranties under the RMBS agreements, and (3) Countrywide breached its contractual obligations to repurchase materially defective loans. The representations and warranties made by Countrywide—which it affirmatively elected to provide in order to sell its RMBS, in turn reaping it huge profits—related to the characteristics of the loans underlying the RMBS, and thus to the likelihood that claims would be made under MBIA's policies. As Quinn Emanuel argued, MBIA required these representations and warranties because, as the originator of the loans underlying the transactions (approximately 380,000 loans across all 15 securitizations), Countrywide had vastly more knowledge about the loans than MBIA. Moreover, MBIA had no access to the loan

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Quinn Emanuel Applies to Open Office in Hong Kong, with Addition of Leading International Arbitration Advocate

The firm is pleased to announce that it will open a Hong Kong office, subject to the firm obtaining appropriate regulatory approval. Pending this approval, John Rhie will be joining the firm as managing partner of the Hong Kong office and Chair of the firm's Asian International Arbitration practice. Current firm partner Carey Ramos will be moving from New York City to join Mr. Rhie in Hong Kong as a senior partner, once the office obtains approval.

Mr. Rhie will join Quinn Emanuel from the Korean firm Kim & Chang. He has broad experience acting as both an arbitrator and advocate in arbitrations under the auspices of all major arbitration institutions, including HKIAC, LCIA, ICSID, SIAC and AAA. Mr. Rhie has lectured widely in the area of international arbitration and

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Quinn Emanuel Receives Top Award from *Managing Intellectual Property*

For the second year in a row, *Managing Intellectual Property*—a leading news source for global intellectual property developments—named Quinn Emanuel "Nationwide ITC Firm of the Year." The publication's annual North America Awards recognize attorneys, law firms and in-house teams for their accomplishments in intellectual property matters.

Top Products Trial Lawyers Mike Lyle and Eric Lyttle Join Quinn Emanuel in Washington, D.C.

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files prior to closing, and, in any event, it would have been highly inefficient for it to conduct a duplicative loan review of this huge volume of loans when such review was not only part of the sponsor's and broker dealer's standard due diligence responsibilities, but was specifically backed up by the sponsor's representations and warranties.

Recognizing these realities, the three decisions addressed below—one issued by the First Department and two by Justice Bransten—largely endorsed Quinn Emanuel's view of the case, and roundly rejected the principal legal obstacles Countrywide sought to raise to MBIA's claims.

First Department Decision on Loss Causation

Countrywide's primary defense to MBIA's claims—the same defense that has been raised by RMBS sponsors across the country facing claims of fraud and breach of warranty arising out of their misconduct during the housing boom—was that, whatever the merits of the claims, in order to establish common law fraud and breach of contract, MBIA had to prove that its losses were proximately caused by Countrywide's misrepresentations ("loss causation"), and MBIA could not make such a showing because the proximate cause of its losses was the so-called "housing crisis" rather than Countrywide's misconduct.

Leaving aside the significant role played by Countrywide's (and other RMBS sponsors') pervasive fraud in triggering the housing crisis, Countrywide's argument is wrong as a matter of law. Quinn Emanuel moved for partial summary judgment on this issue, and Justice Bransten agreed that, pursuant to New York Insurance Law §§ 3105 and 3106, an insurer—including a financial guaranty insurer—need not establish loss causation in order to prevail on a claim for fraud or breach of warranty; all the insurer need show is that it would not have issued its policy without the misrepresentation (§ 3105) or that the breach of warranty materially increased its risk under the policy (§ 3106).

On April 2, 2013, the First Department affirmed Justice Bransten's decision and held that a New York court is "not required to ignore the insurer/insured nature of the relationship between the parties to the contract in favor of an across the board application of common law," as urged by Countrywide. *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 963 N.Y.S.2d 21, 22 (1st Dep't 2013). The First Department not only affirmed the application of the insurance law causation rule to RMBS claims by a financial guaranty insurer, but expressly rejected Countrywide's argument that the insurance law rule applies only to claims for rescission, not damages. It held that the reference to "defeating recovery thereunder" in §§ 3105 and 3106 contemplates "the recovery of payments made pursuant to an insurance policy without resort to rescission." *Id.*

As Quinn Emanuel argued, the rationale for the application of the insurance law causation rule to claims by RMBS insurers, and specifically to claims seeking recovery of payments made under policies, not just claims for rescission, is clear. The Court of Appeals has repeatedly held that it is a fundamental principle of insurance law that all insurers have the right to select the risks they insure. Moreover, if an insurer had to prove loss causation to obtain relief from a policy it was induced to issue by fraud or breach of warranty—whether by way of rescission or through recovery of claims paid—there would be every incentive for an insurance applicant to misrepresent facts relevant to the insured risk: if the misrepresentations came to light, the applicant could still argue that they did not cause the claimed losses, and if the insurer were able to prove they did, the applicant would merely be denied recovery on a policy that would never have been issued had it told the truth.

Thus, the First Department's decision supports recovery of payments made under a policy by any insurer—not just an RMBS insurer—without resort to rescission and without proof of loss causation, if the insurer can show simply that it would not have issued the policy without the misrepresentation or that the breach of warranty materially increased its risk under the policy.

First Department Decision on Repurchase Claim

In a parallel argument, Countrywide sought to limit MBIA's recovery on its claims for breach of repurchase obligations by arguing that it was not contractually obliged to repurchase performing loans, on the basis that a breach of warranty did not materially and adversely affect MBIA's interests (the contractual standard for repurchase) unless it proximately caused the breaching loan to default. Quinn Emanuel argued, consistent with recent federal court decisions to the same effect and with the insurance law loss causation rule, that MBIA's interests were materially and adversely affected if the breaches merely increased its risk of loss under its policies, whether or not that loss actually materialized, and thus that performing loans were subject to the repurchase remedy. *Id.* at 22-23.

Again, the First Department accepted Quinn Emanuel's argument, holding that MBIA need not show that Countrywide's breaches of representations and warranties caused loans to default in order to obtain repurchase of those loans. While this holding is consistent with the insurance law causation rule, it was based simply on the language of the repurchase provision (a standard repurchase provision similar to that in many other RMBS contracts). The First Department held that there was nothing in this language that limited Countrywide's repurchase obligations to cases of default, and that if the parties had wanted such a limitation they would have said so. *Id.* Thus, this decision supports claims not only by RMBS insurers but also by trustees (on behalf of investors) seeking repurchase of defective loans pursuant to similar repurchase provisions.

Summary Judgment Decision on Fraud Claim

Countrywide further argued, in moving for summary judgment on MBIA's fraud claim, that MBIA could not show justifiable reliance on Countrywide's misrepresentations as a matter of law. Quinn Emanuel argued that Countrywide once again ignored the insurer-insured nature of the parties' relationship, and that an insurer's fraud claim, as informed by N.Y. Ins. Law § 3105, does not require proof of justifiable reliance; but that, in any event, even if it did, MBIA could show justifiable reliance.

On April 29, 2013, Justice Bransten agreed with Quinn Emanuel. *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 2013 N.Y. Misc. LEXIS 1774, 2013 NY Slip Op 30903(U) (N.Y. Sup. Ct. Apr. 29, 2013). She held that, under *Geer v. Union Mutual Life Ins. Co.*, 273 N.Y. 261 (1937), "the inquiry is not whether the insurer's reliance on the misrepresented information was justifiable but instead whether the insurer might have refused the application had it been aware of the truth of the misrepresentation." 2013 NY Slip Op 30903(U) at 9. This ruling, which again applies to insurers generally, not just RMBS insurers, means that an insurer is not required to meet a "reasonable insurer" standard to show that it would not have issued a policy. The test is simply whether *this* insurer would not have issued *this* policy had it known the true facts.

Justice Bransten further held, in a ruling subsequently echoed by the First Department in *CIFG Assurance North America, Inc. v. Goldman Sachs & Co.*, No. 652286/2011, 2012 WL 1562718 (1st Dep't May 1, 2012), that, even if MBIA did have to prove justifiable reliance, under common law fraud it was not precluded from doing so merely because of its admitted failure to review loan files, as Countrywide had argued. Citing *DDJ Mgmt., LLC v. Rhone Grp. L.L.C.*, 15 N.Y.3d 147, 154 (2010) ("[t]he question of what constitutes reasonable reliance is always nettlesome because it is so fact intensive"), she held that she could not conclude before trial that MBIA's failure to review loan files made its reliance unjustifiable, especially because, as Quinn Emanuel had argued, (1) MBIA did not have a right to review loan files before closing, and (2) MBIA obtained contractual representations and warranties as to the loans' characteristics. 2013 NY Slip Op 30903(U) at 12-15.

Summary Judgment Decision on Contract Claims

Countrywide also moved for summary judgment on MBIA's breach of contract. Again, Justice Bransten agreed with Quinn Emanuel in denying this motion. Most importantly, she rejected Countrywide's "sole remedy" and "breach notice" arguments—also raised by RMBS sponsors in numerous other lawsuits across the country—and upheld Quinn Emanuel's construction of a critical warranty in the transaction documents which is common to many other RMBS securitizations. Given the ubiquity of these issues in RMBS litigation generally, these rulings, too, will be broadly applicable to and will greatly facilitate RMBS claims by insurers and investors.

First, Justice Bransten agreed with Quinn Emanuel that certain "sole remedy" provisions in the transaction documents were inapplicable to MBIA's claims and did not bar any form of contract-based relief other than actual repurchase of breaching loans. She agreed that both the contractual language and the First Department's decision on loss causation clearly contemplated that MBIA might recover other relief, including compensatory damages. *Id.* at 23.

Second, she rejected Countrywide's argument that MBIA's repurchase claims must fail as a matter of law because MBIA had not provided individualized notice of breaches with respect to 95% of the loans in the securitizations. She agreed with Quinn Emanuel that (1) pool-wide repurchase was available in lieu of loan-by-loan repurchase; (2) under the contract language, there was no requirement that MBIA give notice of all breaches—rather, as in most RMBS transaction documents, it was sufficient if Countrywide merely "became aware" of the breaches; and (3) MBIA sufficiently alleged that Countrywide became aware of the breaches by asserting that Countrywide monitored the performance and likelihood of delinquency of the loans on an ongoing basis, and that it also became aware of a significant number of defective loans from MBIA's complaint, which disclosed that MBIA's reunderwriting review had discovered breaches in approximately 91% of the loans reviewed. *Id.* at 24-25.

Third, Justice Bransten accepted Quinn Emanuel's argument that the *"no default"* warranty in the transaction documents (warranting that "no default exists under any Mortgage Note," which in turn defined "default" to include any borrower misrepresentations) was breached where borrowers made factual misrepresentations, and that the language of the contract was sufficiently clear that there was no need to consider parole evidence. *Id.* at 57-58. In other words, she agreed that this "no default" warranty in effect incorporated a "no fraud" warranty. Given that many other RMBS transactions include a similar "no default" warranty, this holding, too, will facilitate RMBS claims by many other insurers and trustees.

Summary Judgment Decision on Successor Liability Issues

In addition to Countrywide's attempts to avoid primary liability for its fraud and breaches of warranty, BAC also moved for summary judgment on MBIA's successor liability claim. Justice Bransten denied BAC's motion and in holding that, if MBIA were able to prove its claims, BAC could be held liable for Countrywide's fraud and breach of warranty on two independent theories of successor liability: (1) that Countrywide had de facto merged with BAC; and (2) that BAC impliedly assumed Countrywide's liabilities. *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 2013 N.Y. Misc. LEXIS 1774, 2013 NY Slip Op 30904(U) (N.Y. Sup. Ct. Apr. 29, 2013).

With respect to MBIA's *de facto merger* claim, in a crucial threshold ruling, Justice Bransten agreed that New York, not Delaware, law governed MBIA's claim against BAC because New York choice of law principles favor a corporation's principal place of business (for BAC, New York) over its place of incorporation (for BAC, Delaware). *Id.* at 13-18.

She further agreed that, under New York law, a de facto merger is to be determined by the substance, not the form of the transaction, and she employed this flexible approach in considering whether the following "hallmarks" of a de facto merger existed: (i) continuity of ownership, (ii) cessation of ordinary business, (iii) continuity of management and general business operations, and (iv) assumption of predecessor's liabilities in the ordinary course of its business. *Id.* at 19-20. Thus, she held that BAC's multiple transactions with Countrywide should be viewed together to determine whether the first hallmark (continuity of ownership) existed, and she rejected BAC's argument that a strict asset for stock sale is necessary to establish such continuity. *Id.* at 23-26. Further, with respect to the fourth hallmark (assumption of liabilities), she rejected BAC's formalistic argument that liabilities were assumed by Bank of America, N.A., not BAC. *Id.* at 44-45. She also rejected BAC's similarly formalistic argument that a de facto merger finding would be barred merely because BAC paid "fair value" for Countrywide's assets. *Id.* at 46-47.

On the *implied assumption of liabilities* claim, which provides an alternative basis for successor liability, and which is generally established when conduct or representations by the successor party indicate an intention to pay the predecessor's debts, Justice Bransten again largely ruled for MBIA. *First*, she rejected BAC's argument that a finding of implied assumption of liabilities was precluded by express disclaimers of liability included in the transaction documents, holding that these disclaimers were not effective where there existed evidence of BAC's intent to pay Countrywide's debts. *Id.* at 50. *Second*, she rejected BAC's argument that the implied assumption of liabilities doctrine requires a showing that the third party creditor relied on the successor's implied assumption of the predecessor's debts. Thus, she held that it was irrelevant that MBIA had failed to demonstrate such reliance. *Id.* at 52-53.

These rulings have widespread application because they are relevant not only to the many other successor liability claims currently being brought against BAC arising out of Countrywide's misconduct, but also to any other successor liability claims brought in New York, both in the RMBS context and otherwise.

John Quinn, Kathleen Sullivan and Sheila Birnbaum Honored Among *The National Law Journal*'s "100 Most Influential Lawyers in America"

Quinn Emanuel partners John Quinn, Kathleen Sullivan and Sheila Birnbaum were named to *The National Law Journal*'s 2013 list of leading U.S. attorneys, legal scholars and law-centric government officials. Honorees were selected based on nominations from the legal community and independent research conducted by the publication itself. *The NLJ* honored John Quinn for his work in successfully representing numerous clients in high stakes cases. He and Ms. Sullivan were jointly recognized for their work overturning a $172.5 million trade secrets award for MGA Entertainment, Inc. on behalf of Mattel, Inc. Kathleen Sullivan, who was also recognized when the list was last published in 2006, was also applauded for her numerous appellate victories in state and federal courts. Sheila Birnbaum, honored in 2006 as well, was applauded for her high-profile class action repertoire, including cases on behalf of Dow Corning Corp., W.R. Grace & Co. and Pfizer Inc.

Shedding Light on a Bankruptcy Safe Harbor: Defining the Reach of Section 546(e)

Bankruptcy trustees and debtors routinely attempt to increase the amount of money available to creditors in a bankruptcy case by "clawing back" funds transferred by the debtor to another party. Several sections of the bankruptcy code, i.e., 11 U.S.C. §§ 547, 548(a)(1), and 544, grant the debtor or trustee the powers necessary to effectuate the claw back of transfers. Section 546(e), a so-called "safe-harbor" provision, limits most of these claw back powers by barring the avoidance of, for example, "transfer[s] . . . that [are] . . . settlement payments . . . made by or to (or for the benefit of) a . . . financial institution" or that are made ". . . in connection with a securities contract." The section 546(e) safe harbor was enacted to promote stability in financial markets and to prevent financial contagions by protecting securities transactions from being unsettled by a later bankruptcy. *See Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong., pt. 4, at 2406, 2412 (1976). In recent years, and even recent months, several courts have interpreted the scope of section 546(e), including in the context of avoiding redemptions from investors in Ponzi schemes.

In *Enron Creditors Recovery Corp. v. ALFA, S.A.B. de C.V.,* 651 F.3d 329 (2d Cir. 2011), for example, the debtor-in-possession sought to recover funds paid to investors to redeem Enron commercial paper prior to its maturity. The debtor-in-possession argued for a narrow construction of section 546(e), contending, among other things, that the redemption payments at issue were not settlement payments because "they did not involve a financial intermediary that took title to the transacted securities and thus did not implicate the risks that prompted Congress to enact the safe harbor." *Id.* at 335. The Second Circuit rejected the narrow definition of "settlement payments" advocated by the debtor-in-possession and held that section 546(e) precluded the transfers from being avoided. *Id.*

In a slightly different context, the Bankruptcy Appellate Panel for the Ninth Circuit, in *Hoskins v. Citigroup, Inc. (In re Viola),* 469 B.R. 1 (9th Cir. B.A.P. 2012), also took a broad view of this statutory safe harbor, holding that section 546(e) barred a trustee from recovering transfers received by a bank in connection with a Ponzi scheme, even though the bank was alleged to have facilitated the Ponzi scheme by "ignor[ing] multiple red flags and permit[ing] glaring regulatory violations." *Id.* at 6, 9-10. The panel noted the appeal of "[the trustee's] argument that 'Section 546(e) should not be used as a free pass to avoid liability in a scheme to defraud[,]'" but held that, where an exception for actual fraud already existed, it could not elect to expand the "clear statutory limits" of section 546(e). *Id.* at 10.

Similarly, in *In re Lancelot Investors Fund, L.P.,* No. 08-B-28225, slip op. (Bankr. N.D. Ill. Mar. 1, 2012), the chapter 7 trustee sought to avoid redemptions taken prior to bankruptcy by investors in a Ponzi scheme. The trustee argued that "the [safe harbor established by Section 546(e)] do[es] not shield payments and transfers tainted by fraud . . . ." *Lancelot Investors*, slip op. at 13. The court rejected this argument and concluded that, although Congress intended to protect only "legitimate transactions, not massive Ponzi schemes[,]" Congress had achieved that purpose by refusing to extend safe harbor protection to transfers representing actual fraud. *Id.* at 18. The court further held that "Congress did not . . . requir[e] defendants who seek the safe harbor of Section 546(e) to prove that avoidance of their transfers would cause market instability" and rejected the trustee's claim that the safe harbors were inapplicable because redemption payments were not made "'in connection with' the underlying contracts" or "on a public exchange." *Id.* at 20-23.

Like *Lancelot*, the Southern District of New York in *Picard v. Katz,* 462 B.R. 447 (S.D.N.Y. 2011), determined that section 546(e) barred the claw back of Ponzi scheme redemptions because the transfers that the trustee challenged were "made by or to (or for the benefit of) a . . . stockbroker, in connection with a securities contract . . . ." *Katz*, 462 B.R. at 451-52 (quoting 11 U.S.C. 546(e)). In *Picard v. Greiff*, 476 B.R. 715 (S.D.N.Y. 2012), the court affirmed *Katz*, holding that Bernard Madoff's securities firm qualified as a stockbroker as a result of its legitimate activities (*e.g.*, market-making) or, alternatively, because its customers had every reason to believe that the firm was engaged in securities transactions and were thus entitled to the protections afforded to stockbrokers' customers, including section 546(e). *Greiff*, 476 B.R. at 719-20. The court further found that the Madoff firm's transfers "clearly" involved securities contracts. *Id.* & n.6. In *In re Madoff Securities LLC*, Civ. No. 12 MC 0115 (JSR) (S.D.N.Y. Apr. 15, 2013), the trustee contended that section 546(e) was inapplicable where a transferee lacked "good faith." While the court affirmed its *Katz* and *Greiff* holdings and rejected the trustee's "good faith" contention, the court limited section 546(e) by holding that where a complaint sufficiently alleges facts establishing that the transferee

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Patent Litigation Update

First Sale Doctrine Applies to Copyrighted Works Made Abroad. In a recent 6-3 decision with potentially significant implications for the functionally analogous patent exhaustion doctrine, the Supreme Court held in *Kirtsaeng v. John Wiley & Sons, Inc.* that the first sale doctrine applies to copyrighted works that are lawfully made abroad. 133 S. Ct. 1351 (2013).

In *Kirtsaeng*, academic textbook publisher John Wiley & Sons, Inc. filed suit for copyright infringement under 17 U.S.C. §§ 106(3) and 602 against Kirtstaeng, a student whose friends and family in Thailand bought and sent him copies of foreign edition English-language textbooks, lawfully made and sold abroad, so that he could sell them at a profit in the United States. *Kirtsaeng,* 133 S. Ct. at 1356. Kirstaeng argued that his operation was permissible under the first sale doctrine, which provides that once a copyrighted work is lawfully sold, the copyright owner's interest in that particular copy of the work is exhausted, and the new owner may lawfully resell that copy without permission from the copyright holder. *Id.* at 1357 (discussing 17 U.S.C. § 109(a)). Rejecting this argument, the district court held that the first sale doctrine did not apply to "foreign-manufactured goods (even if made abroad with the copyright owner's permission)," and the Second Circuit affirmed, concluding that a geographical limit on the first sale doctrine existed because the phrase "lawfully made under this title" in § 109 did not include "American copyrighted works manufactured abroad." *Id.*

The Supreme Court reversed the Second Circuit, holding that § 109 did not support geographical limits on the first sale doctrine. *Id.* at 1371. Specifically, it noted that "§ 109(a)'s language, its context, and the common-law history of the 'first sale' doctrine, taken together, favor[ed] a *non*-geographical interpretation." *Id.* at 1358. It further doubted that Congress would have intended to geographically limit the scope of the first sale doctrine in a way that would "threaten ordinary scholarly, artistic, commercial, and consumer activities." *Id.* As such, the Supreme Court ruled that the first sale doctrine "applies to copies of a copyrighted work lawfully made abroad." *Id.* at 1356-57.

While *Kirtsaeng* may lead to wider availability of less expensive copyrighted materials from global markets, the decision may ultimately have more of an impact in the patent litigation context. The patent exhaustion doctrine is functionally analogous to the first sale doctrine—*i.e.,* when a patented item is "lawfully made and sold," the new owner may lawfully resell the item without the patent holder's permission. *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617, 618 (2008). Extending the reasoning in *Kirtsaeng* to the patent context, consumers (or competitors) could conceivably purchase and re-import lawfully produced foreign products without infringing domestic patents, resulting in far-reaching consequences for patent holders and licensees, particularly companies that price their foreign products at substantially reduced prices. For example, pharmaceutical companies have traditionally charged Americans higher prices than foreign consumers, partly due to the need to recover research and development costs. *See, e.g,* Paul Roderick Gregory, *Obama Care Will End Drug Advances and Europe's Free Ride (Unless China Steps in)*, Forbes Economics (July 1, 2012, 1:57 PM), http://www.forbes.com/sites/paulroderickgregory/2012/07/01/obama-care-will-end-drug-advances-and-europes-free-ride-unless-china-steps-in/ (estimating that "average prices for prescription drugs in the United States are 50 to 100 percent higher than in other industrialized nations . . . ."). Under the *Kirtsaeng* rationale, consumers (or competitors) could lawfully purchase foreign-produced pharmaceuticals, then re-import them into the United States for use or resale at lower prices. The net result could be lower prices for consumers, but likely also significant reductions in net profits for manufacturers, licensees, and developers of pharmaceuticals.

Securities Litigation Update

Supreme Court Rejects the Need to Prove "Materiality" for Class Certification in Securities Fraud Litigation. Resolving a split among several circuits, the U.S. Supreme Court in *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S.Ct. 1184 (2013), held that plaintiffs are not required to demonstrate that misrepresentations are material in order to obtain class certification.

Information has been defined as material if it would alter the total mix of information in the marketplace (*Id.* at 1203) or be significant to a reasonable investor. *Id.* at 1209, n.3 (*quoting TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). The Supreme Court affirmed that materiality is an element of a claim under Section 10(b) and of the Securities Exchange Act of 1934 and Rule 10b-5. *Id.* at 1191-92. The Court also confirmed that materiality is incorporated in the fraud on the market theory—that in efficient markets, security prices reflect all material, publically available information—the theory under which *Amgen* had been brought. *Id.* at 1192-93. But because materiality was an issue common to all members of the class, the Court held it need only be plausibly alleged—not proved—to establish class certification. *Id.* at 1191.

Amgen arose out of a putative class action brought by plaintiff Connecticut Retirement Plans against Amgen and its officers under section 10(b) of the Exchange Act. Plaintiff claimed Amgen misled investors about the safety, efficacy, and marketing of two of its flagship drugs, causing investors' losses when the truth about these drugs came to light. Plaintiff moved for class certification. Amgen asserted in its opposition that because plaintiff was invoking the fraud on the market theory, plaintiff must prove the materiality of the alleged misrepresentations to qualify for class-wide presumption of reliance and to avoid the predominance of individual issues. Amgen submitted evidence to the district court purporting to establish that the alleged misstatements could not have altered the total mix of publicly available information. The district court rejected this effort and the Ninth Circuit affirmed, contrary to some decisions in other circuits. *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 660 F.3d 1170 (9th Cir. 2011); *see also* Quinn Emanuel Business Litigation Report, *Securities Litigation Update* (Sept. 2012) at 8-10.

The Supreme Court agreed with the Ninth Circuit. Writing for the majority, Justice Ginsburg distilled the issue in the case into one basic question: "whether proof of materiality is needed to ensure that the questions of law or fact common to the class 'predominate over any questions affecting only individual members,'" a requirement for class certification under Federal Rule of Civil Procedure 23(b)(3). *Amgen*, 133 S.Ct. at 1191. The Court answered no for two reasons. First, because materiality is judged according to an objective standard, it can be provided through evidence common to the class. *Id.* (*citing TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 445). Second, a failure of proof on the common question of materiality would not result in individual questions predominating. *Amgen*, 133 S.Ct. at 1191. Instead, such a failure would end the case entirely because materiality is an essential element of a securities fraud claim. *Id.* Therefore, according to the Court, securities fraud classes are entirely cohesive on the issue of materiality: they will prevail or fall in unison. *Id.* To require proof of materiality precertification, the Court reasoned, would put the "cart before the horse" by requiring class plaintiffs to *first* establish that they "will win the fray." *Id.* Such a requirement would defeat the whole purpose of a Rule 23(b)(3) certification ruling, which is not to adjudicate the case—it is to select the "method" best suited to adjudication of the controversy "fairly and efficiently." *Id.* The Court also rejected Amgen's policy argument that a failure to require proof of materiality precertification would increase settlement costs for defendants, making it difficult to defend even cases with little merit. The Court noted that Congress can pass laws to address these policy considerations, and indeed has done so by enacting the PSLRA. *Id.* at 1200.

In declining to impose a barrier to class certification in securities fraud litigation, the Court in *Amgen* adopted a pragmatic approach. Subjecting putative class plaintiffs to preliminary evidentiary hearings at the pleading stage would impose an unconventional burden on plaintiffs and courts alike, and confining such hearings solely to materiality would be difficult. But the Court in *Amgen* also sidestepped several thorny questions vexing securities fraud litigants. In a concurring opinion, for example, Justice Alito suggested that it might be time for the Court to reconsider the validity of the fraud on the market theory, based on new research tending to show certain inefficiencies in the market. *Id.* at 1204. The majority in *Amgen*, however, declined to address this issue. *Id.* at 1197. Nor did the Court attempt to clarify and distinguish the concepts of materiality, reliance, and causation—concepts which are difficult to define and which tend to overlap in fraud on the market cases. While certainly an important decision in the area of securities fraud class action litigation, *Amgen* left unresolved fundamental issues likely to resurface in other fraud on the market cases.

Japan Litigation Update

Amendment to Employment Contract Act Changes Landscape for At-Will Employees. In what may be surprising to those familiar with the U.S. system, at-will contracts in Japan—in which a term of employment is not mentioned—are very favorable to the employee. Under Japanese employment law, an employer can terminate an employee only if it can show good cause (*i.e.*, have objectively "reasonable grounds") and that the termination is done for socially acceptable reasons (often translated as "appropriate in general societal terms"). Japanese courts have narrowly interpreted the terms "reasonable grounds" and "appropriate in general societal terms." Indeed, Japanese law makes it so onerous to terminate a contract without a defined employment term that most employees without a fixed term reasonably expect that their employment contracts will continue until their retirement. Accordingly, while fixed-term contracts operate as they do in many countries and are expected to expire at the end of the term, the "open" contract protects the worker.

On April 1, 2013, Japanese contract law was changed to further protect employees. Specifically, under an amendment to the Employment Contract Act, fixed-term contract employees whose contract periods continue more than five years in total may, at their option, convert their contracts to contracts without a definite period. The amendment also contains certain prohibitions on treating workers differently because of a fixed term. For example, employers cannot maintain an "unreasonable difference" in salary between a fixed-term contract employee and an at-will employee. This shift in worker protection for longer-term contracts will affect both workers' rights and future employment negotiations.

There is a phase-in period. The amended Act does not apply to fixed-term employment contracts that commenced before the date of enforcement, *i.e.*, April 1, 2013. The term of any such contract is not included in the calculation of the initial five-year period. As a result, no employee with a fixed-term employment contract will be able to convert to an "open" contract until April 1, 2018, thereby delaying the impact of the amendment. Still, companies conducting business in Japan should pay special attention to these changes in employment law.

Supreme Court Decision to Approve Online Drug Sales. In *Kenko.com Inc. and Wellnet v. Japan*, the Supreme Court of Japan affirmed that the government did not have authority to ban online sales of certain over-the-counter drugs.

The Pharmaceutical Affairs Act, which was amended in 2006 and became operative in 2009, classifies over-the-counter drugs into three categories based on the risk of certain side effects. Pursuant to what it believed to be its authority under the Act, the Ministry of Health, Labor and Welfare issued an ordinance prohibiting online sales of certain categories of drugs considered to have high-risk side effect.

Kenko.com and Wellnet, Japanese online drug retailers, filed a lawsuit against the Japanese government, seeking a declaratory judgment that the ordinance goes beyond the scope of the authority conferred by the Act, and is therefore illegal and void. The Tokyo District Court ruled against Kenko.com and Wellnet, upholding the ordinance. The Tokyo High Court (appellate court) repealed the decision, holding that the amended Pharmaceutical Affairs Act was not intended to prohibit online sales. On January 11, 2003, the Supreme Court affirmed the ruling of the Tokyo High Court, holding the Diet did not intend to prohibit online sales of certain kinds of drugs when amending the Act, and therefore the Act does not provide authority for the government to issue such an ordinance. The ordinance was held to be illegal and void. Although some online drug retailers immediately resumed selling the previously-prohibited drugs online after the Supreme Court decision, the Ministry of Health, Labor and Welfare announced that it would study new measures to govern online sales of over-the-counter drugs.

Entertainment Litigation Update

California Appeals Court Decides for Defendants in Idea Theft Case. While idea theft claims continue to proliferate in Hollywood, a recent decision from the California Court of Appeal bolsters defendants' chances for achieving summary judgment in such cases. Anthony Spinner, an experienced television producer, writer, and former studio executive, sued ABC, claiming it had stolen his ideas in developing the TV series "LOST." *Spinner v. American Broadcasting Companies, Inc.*, 2013 DJDAR 4477 (Cal. App. 2nd Dist. April 5, 2013). In 1977, Spinner wrote a script about a group of eight plane-crash survivors in the Himalayas who go through a mysterious tunnel in the mountain and emerge in a strange prehistoric world. ABC passed on the script. In 1991, Spinner resubmitted a revised version of the script, but ABC passed again. In 2009, Spinner sued ABC, claiming that ABC had access to and used his 1977 script to develop and produce the highly successful "LOST" series in 2003.

The Court of Appeal affirmed summary judgment for ABC. First, the court held that Spinner's proof of access was inadequate as a matter of law. Spinner argued that because ABC had a policy of putting all submitted scripts in a script library, the 2003 development team had access to his 1977 script. The court found that "mere corporate receipt" of the script was not sufficient proof of access. Spinner could not demonstrate any nexus between the ABC executives to whom Spinner submitted his scripts (who had left ABC long ago) and the creative team that ultimately developed "LOST." Second, the court rejected Spinner's argument that independent creation in idea theft cases must occur prior to the alleged access. Here, independent creation occurred after the alleged access (although the alleged access to Spinner's work was by ABC executives who had no involvement with "LOST"). Finally, the court found that ABC's uncontradicted evidence of independent creation rebutted any substantial similarity between the works. The Court of Appeal's decision demonstrates that the factual nature of the issues of access, substantial similarity, and independent creation does not necessarily preclude summary judgment for a defendant.

Ninth Circuit Requires Substantial Similarity of Protectable Elements for Copyright Claim

for “Cars.” On April 29, the United States Supreme Court denied certiorari in *Mandeville-Anthony v. Walt Disney Co.*, — S. Ct. —, 2013 WL 775455 (April 29, 2013), letting stand a decision by the Ninth Circuit affirming that Disney and Pixar did not steal writer Jake Mandeville-Anthony’s scripts and ideas for their animated films “Cars” and “Cars 2” and the spin-off series “Cars Toon.”

Mandeville-Anthony originally brought an action for copyright infringement and breach of implied contract in March 2011, alleging that Disney and Pixar’s successful “Cars” franchise was derived from, and substantially similar to, his scripts for “Cookie & Co.” and “Cars/Auto Excess/Cars Chaos,” which feature cartoon cars. *Mandeville-Anthony v. Walt Disney Co.*, 2012 WL 4017785 (C.D. Cal. July 28, 2011). Mandeville-Anthony claimed he had sent his scripts to defendants prior to the production of the first “Cars” film. Defendants brought a motion for judgment on the pleadings, claiming that the works at issue were not, as a matter of law, substantially similar in their protectable elements. The district court, in determining whether the works were substantially similar, applied the “objective extrinsic test,” which “focuses on articulable similarities between the plot, themes, dialogue, mood, setting, pace, characters and sequence of events.”

Mandeville-Anthony argued that the plots of the works were similar, as they “both revolve[d] around anthropomorphic cars, including lead characters interacting with other cars and finding themselves in a number of situations that bring about humor and romance, with the backdrop of a race.” Defendants argued that these basic plot ideas were not protectable and that, in any event, the plots, sequence of events, and pace were actually different. Defendants also claimed that the basic idea for real-life objects that can talk and have personalities had been a staple of cartoons for decades and that the mood and setting of the works were entirely different.

The district court accepted defendants’ arguments, finding that the protectable elements of the works were not substantially similar as a matter of law. The district court also granted defendants’ motion for judgment on the pleadings with respect to Mandeville-Anthony’s second cause of action for breach of implied contract on statute of limitations grounds. In July 2012, the Ninth Circuit affirmed. *See Mandeville-Anthony v. Walt Disney Co.*, 474 Fed. Appx. 651, 2012 WL 2951374 (9th Cir. July 20, 2012).

This decision confirms the propriety of summary adjudication of copyright claims, based on the objective extrinsic test, when the protectable elements of literary works are not substantially similar.

(The Firm Applies to Open Office in Hong Kong continued from cover)

is an adjunct professor at Seoul National University. He is highly ranked by legal publications such as *Chambers*, which recognized his “excellent assimilation of and detailed analysis of the facts.” In 2011, *Global Arbitration Review* listed Rhie as one of the top 45 international arbitration lawyers under the age of 45.

Carey Ramos, who has been ranked by *Chambers* and other legal publications for his media and intellectual property expertise, concentrates on complex business litigation, particularly in cross-border disputes and international arbitration. He has represented major Asian high tech, telecom, media and consumer electronics companies in intellectual property, antitrust, and other commercial disputes and has served as an arbitrator and advocate in major international arbitrations. Mr. Ramos will assist the firm’s Asian clients with respect to litigation in the U.S. and EU. He will also work with John Rhie in the development of the firm’s international arbitration practice in Asia.

Top Products Trial Lawyers Mike Lyle and Eric Lyttle Join Quinn Emanuel in Washington, D.C.

Michael Lyle and Eric Lyttle have joined the firm as partners in the Washington, D.C. office. Mr. Lyle heads the firm’s products liability team in Washington. He was previously the Managing Partner in Weil Gotshal’s Washington, D.C. office, a member of the firm’s Management Committee, and Co-Head of the Products Liability practice. Mr. Lyttle was a partner in the firm’s litigation department.

Both Lyle and Lyttle have deep experience working on complex products liability matters. Mr. Lyle was the Director of the White House Office of Administration in the Clinton Administration. Mr. Lyle has 25 years of trial and appellate experience in high-profile and high-stakes matters, including product liability and mass torts, trade secrets, class actions, trademarks, insurance coverage, consumer fraud and securities fraud litigation. Mr. Lyttle’s practice is focused on trying products liability actions, mass tort matters, class actions and other complex litigation. He has participated in numerous jury and bench trials, and has represented clients in some of the highest-profile mass torts and recent crises.

VICTORIES

Vermont Supreme Court Victory for Entergy

In January 2012, Quinn Emanuel persuaded a federal district court to invalidate as preempted Vermont statutes that required Entergy's Vermont Yankee Nuclear Power Station ("VY Station") to shut down on March 21, 2012. With those statutes invalidated, Entergy still had to obtain a new state license for post-March 21, 2012 operation from the Vermont Public Service Board. Entergy had applied to the Board for that new license in 2008, but due to the now-preempted Vermont statutes, the Board had not taken action on the application. In such circumstances, a "timely-renewal" statute provides that, if an applicant for a new license has timely submitted its application, yet the agency has not ruled on it before the expiration date of the old license, the old license continues in effect until the agency rules on the application for the new license. The applicability of this statute seemed clear to everyone: The district court cited it, and the Vermont Attorney General represented to the district court that the statute applied.

The Board disagreed, however, ruling that the timely-renewal statute does not apply and that Entergy's operation of the VY Station after March 21, 2012 would be in violation of state law. Although the Board stopped short of ordering the plant to shut down, an intervenor party, the New England Coalition, brought an original complaint before the Vermont Supreme Court seeking such a shutdown by invoking a seldom-used procedure that allows private parties to enforce Board orders.

Quinn Emanuel moved to dismiss the action and the Vermont Supreme Court granted the motion, issuing a published decision in our favor, dismissing New England Coalition's complaint and thus ensuring that Entergy can continue for the time being to operate the plant. Quinn Emanuel continues to represent Entergy before the Board, the Second Circuit, and the U.S. District Court for the District of Vermont.

Securities Class Action Victory for Pitney Bowes

Quinn Emanuel recently obtained a dismissal, with prejudice, of a securities class action complaint against our client, Pitney Bowes Inc. Plaintiff was represented by Robbins Geller, one of the largest plaintiffs' securities class action firms. The firm took over the litigation from prior counsel shortly before plaintiff filed its second amended complaint.

In October 2007, Pitney Bowes announced that it had missed its earnings and revenue predictions for the third quarter of 2007, causing its stock price to fall 15% in a single day. The share price has never fully recovered. Plaintiffs seized on these events, alleging not only that Pitney Bowes knew its projections were unattainable due to undisclosed adverse business conditions, but that these conditions—including the decline in regular mail—were causing a fundamental and lasting change in the client's business. In other words, plaintiff alleged that Pitney Bowes painted an overly rosy picture of its prospects by touting its successes and omitting to disclose the "thorns." Plaintiff bolstered its allegations by relying on 14 former employees who held various positions throughout the Company as confidential witnesses. According to the complaint, these confidential witnesses attested to adverse conditions at the Company, including the failure to meet internal sales targets, lower-than-anticipated revenues from the change to digital postal meters, and rampant customer departures.

By carefully parsing the allegations, Quinn Emanuel was able to explain to the Court that the Company's public statements were predominantly forward-looking statements that are protected by the securities laws, and that plaintiff's allegations about the Company amounted to only scattered anecdotes by mid-level managers that were insufficient to allege with specificity any impact on the projections of a company with $6 billion in annual revenue.

The 77-page decision adopted nearly all of Quinn Emanuel's arguments. The Court concluded that the Company's public statements were protected by the PSLRA Safe Harbor because the client's extensive cautionary language warned investors not only about important risk factors, but about the very factors that plaintiff alleged caused its loss; that plaintiff failed to allege scienter with any kind of particularity as the confidential witnesses were several levels removed from the individual defendants, and general allegations that financial information "rolled up through finance" were insufficient; and that claiming business segments were declining without alleging how much, or when the decline began or took place, was insufficient to show that any statements were actually false. The Court noted that the Company made yet additional arguments that defeated plaintiff's claim, but the Court had no need to address them.

Summary Judgment Victory for Google, Motorola Mobility, HTC, and Samsung

Quinn Emanuel won summary judgment of non-infringement for several clients, Google, Motorola Mobility, HTC, and Samsung, in a patent case in the Eastern District of Texas. The litigation concerned the defendants' Android devices. In October 2010, the plaintiff, Gemalto S.A., a French digital security company with billions of dollars in revenue, filed suit. In the 1990's, Gemalto's predecessor-in-interest developed the "Java Card" which allows Java-based applications to run on smart cards and microcontrollers, and was granted three patents in connection with that development. The patents were directed to the compiling and converting of computer "byte codes" to allow high-level languages like Java to run on microcontrollers and smart cards. Gemalto claimed that each of defendants' Android devices (there were over 100 accused) infringed its patents and sought damages and an injunction.

The first step to achieving victory was to get a favorable claim construction order, which Quinn Emanuel obtained in the summer of 2012. Plaintiff alleged that the microprocessors in the accused devices met the "microcontroller" and other related claim limitations. The Court, however, construed "microcontroller" such that it was clear defendants' microprocessor-based Android devices did not infringe the patents-in-suit. Gemalto nevertheless continued to litigate the case. In November 2012, defendants moved for summary judgment of non-infringement of each of the patent claims asserted against them.

On February 25, 2013, Magistrate Judge John D. Love issued a Report and Recommendation granting summary judgment of non-infringement, adopting Quinn Emanuel's arguments on behalf of defendants. Judge Love found that Gemalto's theory of infringement "impermissibly recasts the Court's construction" and "manufactures an infringement theory by circumventing the Court's unambiguous claim construction order." On April 15, 2013, Chief Judge Leonard Davis adopted Judge Love's Report and Recommendation and granted defendants' motion for summary judgment of non-infringement of all asserted claims. The following day, the Court entered final judgment, dismissing all claims against defendants. Q

(Noted With Interest continued from page 5)

had *actual knowledge*, "not [just] mere suspicions," of the underlying fraud, a transferee cannot prevail on a motion to dismiss on section 546(e) grounds. *Madoff Securities*, slip op. at 3, 7-8.

Finally, in *Grede v. FCStone, LLC,* No. 09 C 136, slip op. (Bankr. N.D. Ill. Jan. 4, 2013), the court was asked to determine whether section 546(e) barred avoidance of transfers made to a class of customers where (1) only one class of customers received any distribution of funds and (2) certain of the funds received by this class had previously been allocated to another class of customers who received nothing. The bankruptcy court concluded that section 546(e) did *not* bar the trustee from avoiding these transfers because (1) applying the safe harbors would "create the very type of systemic market risks that Congress sought to prevent with its passage [and (2)] failing to apply the safe harbor . . . w[ould] not result in the unwinding of completed securities and commodities transactions that Congress sought to protect." *Id.* The court also found that applying section 546(e) to uphold the inequitable distribution of customer funds was at odds with the intent underlying enactment of the section 546(e) safe harbor. *Id.*

With the exception of *Grede*, each of these courts, when analyzing the reach of section 546(e), refused to sharply limit the breadth of the statutory language. The broad interpretative approach employed in these cases suggests that courts are willing to apply section 546(e) to significantly limit trustees' or debtors' powers to claw back redemptions even where an investor *unknowingly* received transfers from a Ponzi scheme.

Notwithstanding the apparent judicial willingness to apply section 546(e) broadly, courts have not embraced the broad application of section 546(e) where its application would potentially lead to inequity. The holdings in *Grede*, where applying section 546(e) would have allowed some investors to receive a healthy distribution while other, similarly situated investors bore the burden of losses, and *Madoff Securities*, where the safe harbor was held inapplicable to investors with actual knowledge of a fraud, reflect a reluctance to extend the reach of section 546(e) to bar claims against investors who would otherwise enjoy obvious—and unfair—windfalls. There is disagreement in this context, to be sure: while the courts in *Grede* and *Madoff Securities* grafted an unwritten limit onto the reach of section 546(e), the *Viola* court flatly rejected limiting section 546(e) where a limit was not in the statutory text. Taken together, these recent decisions indicate that although courts are willing to flexibly apply section 546(e), this flexibility is unlikely to extend to cases where use of the safe harbor will reward or facilitate fraud or inequity. Q

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