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Circuit Courts Align to Shield SEC Administrative Proceedings from Collateral Constitutional Attack

In response to the financial crisis of the late 2000s, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) in 2010. Previously the SEC could pursue civil penalties only against non-regulated entities and individuals in actions filed in federal district court. Dodd-Frank expanded the remedies available to the SEC in administrative proceedings. *See* Pub.L. No. 111-203, § 929P, 124 Stat. 1376, 1862-65. The intent was clear—make the SEC’s authority in administrative proceedings “coextensive with its authority to seek penalties in Federal court.” H.R. Rep. No. 111-687, at 78 (2010). Likely as a result of its increased success in administrative proceedings, the SEC has recently and dramatically increased the use of such proceedings. *See* Jean Eaglesham, *SEC Wins with In-House Judges*, Wall St. J., May 6, 2015. (From October 2010 through March 2015, the SEC prevailed in 90% of administrative proceedings while during the

same time period its success rate in federal court was 69%. Whereas in 2012 55% of enforcement actions were filed administratively, in 2014 this rose to 78%.) These results have prompted numerous respondents in SEC administrative proceedings to file collateral Constitutional challenges in federal district court.

Overview of SEC Administrative Proceedings

The SEC may take one of two routes to enforce the federal securities laws in a civil proceeding. It can bring a civil action in federal district court or it can commence an administrative enforcement proceeding. *See, e.g.*, 15 U.S.C. §§ 78u(d), 78u-2, 78u-3. Administrative actions commence when the SEC serves the respondent with an Order Instituting Proceedings (“OIP”). SEC administrative proceedings differ from federal district court actions in several important respects: the Federal Rules of Civil Procedure and Evidence do not apply in an administrative proceeding, nor does

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Global Disputes Star Paul Friedman and Competition Specialist Kate Vernon Join the London Office

Paul Friedman and Kate Vernon have joined the firm as partners in the London Office. Mr. Friedman was previously a partner at Clyde & Co. where he specialized in complex commercial litigation for large global companies. He has represented numerous global investment banks, private equity houses, high net worth individuals and companies all over the world, including in the UK, Europe, China, India, Japan, Israel and the US. Mr. Friedman also has experience acting for clients in international arbitrations. Mr. Friedman has been widely recognized for his successes by leading legal publications, including *Chambers & Partners* and *Legal 500*. He resides in Israel and commutes to London.

Kate Vernon joined the firm from DLA Piper where she was head of its UK Competition team. She adds to Quinn Emanuel’s fast-growing competition practice in London, as well as to the competition work the firm does in Brussels and globally. Ms. Vernon has represented clients in both follow-on and standalone competition claims in the English High Court and in the Competition Appeal Tribunal. She has also done appeals from and judicial reviews of decisions of competition and regulatory authorities in London and Luxembourg. She has represented clients in competition investigations, both infringement and sector inquiries, and provided general counseling advice. Ms. Vernon is recognized by many of the leading legal directories, including *Chambers & Partners*. [Q](#)

the respondent have the right to a jury trial. Instead, administrative proceedings are governed by the SEC's Rules of Practice, 17 C.F.R. § 201.100 *et seq.*, which severely constrain typical federal court discovery. For example, under the Rules of Practice, depositions occur at the Commission's discretion, only after a finding that the witnesses will be unavailable to testify at the administrative hearing. *Id.* §§ 201.233(b), 201.234(a). Additionally, the Rules of Practice do not provide for typical document discovery, instead requiring the parties to request that the Administrative Law Judge ("ALJ"), whom the SEC typically designates to preside over an evidentiary hearing and render an initial decision, issue subpoenas. *See id.* §§ 201.360(a)(1), (b), 201.232. Administrative actions proceed relatively quickly and along a timeline set by the rules. *See id.* § 201.360(a)(2).

Once the ALJ renders an initial decision, either party may appeal to the SEC or the SEC may review it *sua sponte*. *Id.* §§ 201.410, 201.411(c). The SEC's review authority is broad—it may “affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part . . . and may make any findings or conclusions that in its judgment are proper and on the basis of the record.” *Id.* § 201.411(a). Absent appeal or *sua sponte* review, the ALJ's initial decision becomes final. 15 U.S.C. § 78d-1(c). The SEC then must issue a final order. An adverse order allows the aggrieved party to seek review in the United States Court of Appeals either for the Circuit wherein he resides or has his principal place of business, or for the District of Columbia Circuit. 15 U.S.C. § 78y(a)(1). The aggrieved party may also request that the SEC stay enforcement of the order pending appellate review. 17 C.F.R. § 201.401. Section 78y provides a detailed framework for Circuit court review, whose exclusive jurisdiction is triggered upon filing. 15 U.S.C. § 78y(a)(1), (3). Section 78y then details how a final order of the Commission should be reviewed. Like the SEC, the Circuit court is granted broad authority and can “affirm or modify and enforce or [] set aside the order in whole or in part.” *Id.* § 78y(a)(3). While the court must accept the SEC's factual findings which are supported by substantial evidence, the court may also remand the case to the SEC for additional findings. *Id.* § 78y(a)(4)-(5). Unless there was “reasonable ground” for failing to raise an objection to the final order before the SEC, the Circuit court is precluded from considering new objections. *Id.* § 78y(c)(1). The appellate court may also stay enforcement of the SEC's order pending its review “to the extent necessary to prevent irreparable injury.” *Id.* § 78y(c)(2).

Circuit Court Decisions

Bebo v. SEC, 799 F.3d 765 (7th Cir. 2015), *cert. denied*, 136 S. Ct. 1500 (2016). The Seventh Circuit was the first appellate court to consider whether a federal district court had jurisdiction over constitutional claims brought by a respondent in an ongoing SEC administrative proceeding. In *Bebo*, the SEC commenced an administrative cease-and-desist proceeding against Bebo, alleging she violated federal securities laws by manipulating internal books and records, making false representations to auditors, and making false disclosures to the SEC. In response, Bebo asserted various affirmative defenses in her answer, including that the proceeding violated the equal protection clause, the due process clause, and Article II by interfering with President's obligation to ensure faithful execution of the laws. *Id.* at 768. Rather than await a final order in the administrative proceeding, Bebo filed suit in federal district court alleging her same constitutional claims. *Id.* The district court granted the SEC's motion to dismiss for lack of subject matter jurisdiction. *Id.*

On Bebo's appeal, the Seventh Circuit explained that in order to “find congressional intent to limit district court jurisdiction, [it] must conclude that the claims at issue ‘are of the type Congress intended to be reviewed within th[e] statutory structure’” *Id.* at 769. To make that determination, the Seventh Circuit explained that courts look to the factors set forth in *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200 (1994), i.e. whether: (1) “a finding of preclusion could foreclose all meaningful judicial review,” (2) the suit was “wholly collateral to a statute's review provisions,” and (3) the plaintiffs' claims were “outside the agency's expertise.” *Id.* (quoting *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477, 489 (2010)). Fatally for Bebo, the Seventh Circuit interpreted the *Thunder Basin* factors not according to what it saw as the “broader reading” of *Free Enterprise*, but the narrower, more recent interpretation in *Elgin v. Dep't of Treasury*, 132 S. Ct. 2126, 2136-40 (2012). *Bebo*, 799 F.3d at 771. Seemingly putting all of the weight on the first factor, the Seventh Circuit affirmed the dismissal of Bebo's Constitutional challenge in district court on jurisdictional grounds, holding that as a participant in an ongoing administrative action, Bebo had the opportunity to have her Constitutional objections addressed and, upon the conclusion of the administrative proceeding, “meaningful judicial review in an Article III court.” *Id.* at 774, quoting *Elgin*, 132 S. Ct. at 2137.

The Seventh Circuit's decision is problematic because it affords no weight to the second *Thunder Basin* factor

and does not substantively address the third factor at all. *See Bebo*, 799 F.3d at 773-774. Indeed, the court's opinion that "the second and third *Free Enterprise Fund* factors, although relevant to the determination, are not controlling," while the first factor *is* controlling, is not well supported. *See id.* at 774. Additionally, because of the way the court distinguished *Free Enterprise*, it presumably would find subject matter jurisdiction over these claims if an administrative proceeding had yet to be commenced. *See id.* ("The key factor in *Free Enterprise Fund* that rendered § 78y inadequate is missing here. To have her constitutional objections addressed, *Bebo* does not need to 'select and challenge a Board rule at random' . . . [s]he is already the respondent in a pending enforcement proceeding.") The Supreme Court, however, denied *Bebo*'s petition for writ of certiorari. *Bebo v. SEC*, 136 S. Ct. 1500 (2016).

Jarkesy v. S.E.C., 803 F.3d 9 (D.C. Cir. 2015). Just over a month after the Seventh Circuit's decision in *Bebo*, the D.C. Circuit "reach[ed] the same conclusion for many of the same reasons." *Jarkesy*, 803 F.3d at 15. Days before his hearing in the administrative proceeding was to commence, Jarkesy filed an action in federal district court, alleging various Due Process and Equal Protection violations. Focusing on the availability of judicial review, the district court dismissed the case, reasoning Congress had implicitly precluded concurrent subject-matter jurisdiction in the district court. *Id.* at 12. Jarkesy appealed and the D.C. Circuit affirmed, concluding that Congressional intent requiring respondents to proceed exclusively through the statutory scheme of administrative and judicial review was "fairly discernible in the statutory scheme" and Jarkesy's claims were of the type Congress intended to be reviewed within the statutory structure. *Id.* at 15-16.

For the D.C. Circuit, the SEC's ability to choose the forum made the "fairly discernible" question relatively straightforward. In other words, if Congress gave the SEC the choice to pursue violations in either district court or administrative proceedings, respondents in administrative proceedings should not have the ability to countermand that choice by filing in district court. *Id.* at 17. Instead, the court focused its analysis on whether Jarkesy's claims were of the type that Congress intended to be reviewed within the statutory structure. To make that determination, the court applied the *Thunder Basin* factors. *Id.* Unlike the Seventh Circuit, the D.C. Circuit believed all the various factors were "guideposts for a holistic analysis" and did not assess "whether the capacity for meaningful review would alone suffice to negate [district court] jurisdiction." *Id.*

at 22.

As to the first factor, whether Jarkesy would be deprived of meaningful judicial review, the D.C. Circuit held he would not because he could present his Constitutional claims to the ALJ, and, if necessary, the SEC, and a federal appellate court. *Id.* at 19. Like the Seventh Circuit, the D.C. Circuit distinguished *Free Enterprise Fund* on the basis that Jarkesy was already involved in a proceeding in which he could press his claims. *Id.* at 20. As to the second factor, whether the claims are wholly collateral, the court held they were not because they were the "vehicle by which" Jarkesy seeks to prevail in his administrative proceeding." *Id.* at 23, quoting *Elgin*, 132 S.Ct. at 2139-40. As to the third factor, whether the claims were outside the SEC's expertise, the D.C. Circuit pointed out that *Elgin* "clarified" that "an agency's relative level of insight into the merits of a constitutional question is not determinative" and found no basis to conclude that Congress intended to exempt Jarkesy's Constitutional claims from the administrative scheme. *Id.* at 28-29.

While the Seventh Circuit in *Bebo* seemed to imply that subject matter jurisdiction in the district court may exist if an administrative proceeding had yet to be commenced, the D.C. Circuit went a step further, explicitly stating that "[t]he result might be different if a constitutional challenge were filed in court before the initiation of any administrative proceeding (and the plaintiff could establish standing to bring the judicial action)." *Id.* at 23. The court, however, did not explain its statement. Similarly, the D.C. Court's reasoning that the Constitutional claims are not wholly collateral, because the proceeding is ongoing and prevailing on those claims would end the proceeding, makes it difficult to understand whether any claims would ever be viewed as collateral.

Tilton v. SEC, No. 15-2103, 2016 WL 3084795 (2d Cir. June 1, 2016). The SEC initiated an administrative proceeding against Tilton and certain investment firms for alleged violations of the Investment Advisers Act. *Tilton*, 2016 WL 3084795, at *2. Two days later, Tilton filed suit in federal district court alleging constitutional violations, including that the ALJ conducting the proceeding was impermissibly insulated from Presidential removal and not appointed in accordance with the Appointments Clause. *Id.* The district court dismissed for lack of subject matter jurisdiction. *Id.* at *1. Tilton then appealed to the Second Circuit. A divided Second Circuit affirmed the district court's dismissal, holding that Tilton must await the SEC's final order before a federal court had jurisdiction to hear his claims. *Id.* at *11.

As with the Seventh and D.C. Circuits, the Second

Circuit applied the *Thunder Basin* factors to determine whether the claims were of the type that Congress intended to be reviewed within the statutory structure. *Id.* at *3. As to the first factor, meaningful judicial review, the court found that post-proceeding judicial review did not deprive Tilton of meaningful review of his claims and any attendant financial or emotional costs are “simply the price of participating in the American legal system.” *Id.* at *6. As to the second factor, whether the Appointments Clause claim was “wholly collateral” to the administrative proceeding, the court held that, because Tilton raised it as an affirmative defense, it was “procedurally intertwined” with the administrative proceeding. *Id.* at *8. As to the third factor, whether the claim was outside the SEC’s expertise, the court held that while a “close question,” Tilton’s claim did not fall outside the SEC’s expertise because the SEC “routinely considers” accompanying statutory claims that could be resolved in Tilton’s favor, thus mooting the Constitutional questions.

In dissent, Judge Droney took issue with the majority’s application of each of the *Thunder Basin* factors. First, he pointed out that forcing defendants to conclude an administrative proceeding before bringing a constitutional challenge in federal court is not truly meaningful review because “they will already have suffered the injury that they are attempting to prevent.” *Id.* at *17. Second, Judge Droney argued the majority misinterpreted *Thunder Basin*, *Free Enterprise*, and *Elgin* because under the majority’s interpretation, no claim could be “wholly collateral” “as long as the claim could somehow serve to end administrative proceedings in a [respondent’s] favor.” *Id.* at *14. Finally, Judge Droney criticized the majority’s interpretation of the “expertise” factor because “as long as a proceeding is ongoing . . . [that] factor *must* weigh against jurisdiction—because any time a proceeding has commenced there is of course some possibility that a plaintiff may prevail on the merits.” *Id.* at *15.

Hill v. SEC, Nos. 15-12831, 15-13738, 2016 WL 3361478 (11th Cir. June 17, 2016). In consolidated cases, the Eleventh Circuit recently joined other circuits in holding that federal district courts do not have subject matter jurisdiction over constitutional challenges from respondents facing ongoing or prospective SEC administrative proceedings. *Hill*, 2016 WL 3361478, at *13. The SEC commenced an administrative proceeding against Hill for unlawfully profiting from non-public information regarding a corporate merger. *Id.* at *2. After the SEC scheduled a hearing before an ALJ, Hill filed motions to dismiss in the administrative proceeding, claiming various Constitutional violations, including that the


proceeding violated the removal protections of Article II, the non-delegation doctrine under Article I, and his Seventh Amendment right to a jury trial. *Id.* at *3. While the ALJ denied Hill’s motion, he concluded he lacked authority to rule on the constitutionality of the Exchange Act. *Id.* Hill then sought relief in the federal district court—his complaint repeated his prior arguments and added claim that the ALJs’ appointment violated the Appointments Clause. *Id.* The district court judge granted Hill’s motion and a similar motion by investment adviser Gray Financial, which had preemptively filed its Constitutional claims in district court before the SEC commenced an administrative proceeding. *Id.* at *3-4. In both cases, the district court found it had subject matter jurisdiction to hear the claims and that ALJs’ appointments violated Article II. *Id.* at *4.

The SEC appealed the district court rulings and the 11th Circuit vacated the injunctions and instructed the district court to dismiss both cases for lack of jurisdiction. *Id.* at *13. The 11th Circuit relied heavily on “the detail in § 78y [which] indicates that Congress intended to deny aggrieved parties another avenue for review,” to find it was “fairly discernible,” that Congress intended the respondents’ claims to be resolved exclusively in the administrative proceeding, the final order from which could then be appealed to a federal appellate court. *Id.* at *6. Like *Bebo*, the 11th Circuit emphasized the importance of first *Thunder Basin* factor, opportunity for meaningful judicial review. *Id.* at *8. The 11th Circuit tracked the reasoning of *Bebo*, *Jarkesy*, and *Tilton*, finding that enduring an unwanted administrative proceeding is not an irreparable injury such that subsequent judicial is not meaningful. *Id.* Furthermore, because Hill was already a respondent in the administrative proceeding, he did not need to initiate a proceeding just to test his claims. *Id.* at *10. In closing the timing loophole which the prior Circuit cases arguably left open, the 11th Circuit held it did not matter that Gray filed her action before the SEC commenced an administrative proceeding against her, reasoning that because the SEC intended to do so, she had ample opportunity for meaningful review of her claims. *Id.* The 11th Circuit gave only brief consideration to the second and third *Thunder Basin* factors, holding, like the other Circuits, that the SEC’s expertise was implicated because resolution of the securities violations would obviate the need to reach the Constitutional questions. *Id.* at *11-12. The court then examined the wholly collateral factor and reasoned that because the Constitutional claims were not a vehicle by which they seek to prevail on the merits, the claims could be characterized as

wholly collateral, but it did not matter in the face of the conclusion that administrative proceedings guarantee meaningful judicial review. *Id.* at *12-13.

Conclusion

Although the D.C. Circuit may soon decide a fully ripe Constitutional challenge to SEC administrative proceedings, *Lucia v. SEC*, No. 15-1345 (D.C. Cir., argued May 13, 2016), because four Circuit courts have held that federal district courts lack jurisdiction to hear Constitutional challenges to SEC administrative

proceedings, it is unlikely the Supreme Court will consider the jurisdictional issue anytime soon, especially considering it denied certiorari in *Bebo*. As a result, there will likely be increasing pressure on respondents to SEC administrative proceedings to settle rather than endure the disruption and expense of litigating fully just to gain access to federal court at the end of the road. Accordingly, it is imperative to seek the advice of counsel as soon as it appears the SEC may commence an administrative proceeding. 

NOTED WITH INTEREST

Seizures as a Remedy Under the New Federal Trade Secrets Act

On May 11, 2016, President Obama signed the Defend Trade Secrets Act (DTSA), creating a new federal cause of action for the misappropriation of trade secrets. Prior to the DTSA, trade secret claims were governed by state law. State trade secret laws, except in Massachusetts and New York, are based on the Uniform Trade Secrets Act (UTSA). Because the DTSA is also based on the UTSA, much of it is similar to existing states' laws. One significant difference, however, is that the DTSA adds a new remedy that allows for *ex parte* seizures of products embodying misappropriated trade secrets.

Under the DTSA, seizure may be authorized if: 1) other forms of equitable relief would be inadequate to prevent the dissemination of the trade secret; 2) immediate and irreparable injury will occur if the seizure is not ordered; 3) the harm to the applicant of denying the application outweighs the harm of granting the application to the person against whom seizure would be ordered and substantially outweighs the harm to any third parties; 4) the applicant is likely to succeed on the merits; 5) the person against whom the seizure would be ordered actually has possession of the trade secret and any property to be seized; 6) the applicant describes the matter to be seized with reasonable particularity and identifies its location when reasonable; 7) the person against whom the seizure would be ordered would make the matter inaccessible if the applicant were to proceed on notice to the person; and 8) the applicant has not publicized the requested seizure. 18 U.S.C. § 1836(b)(2)(A)(ii).

The DTSA further requires that a seizure order must provide for the narrowest seizure of property to prevent dissemination of the trade secret, have an accompanying order protecting the seized property from disclosure,

clearly delineate the authority of seizing officials, set a date for a hearing as early as possible, and require a security deposit from the applicant against any excessive or wrongful seizure. 18 U.S.C. § 1836(b)(2) (B).

Though the DTSA expressly does not preempt state trade secret law, 18 U.S.C. § 1836(f), it adds a potentially important new tool for plaintiffs because most states do not provide for seizures of trade secrets. For example, under the California Uniform Trade Secrets Act (CUTSA), a party may seek equitable relief through an injunction to prevent the actual or threatened use of a trade secret. To decide whether to grant an injunction, a court must weigh “the likelihood the moving party ultimately will prevail on the merits against the relative interim harm to the parties from the issuance or nonissuance of the injunction.” *DVD Copy Control Ass'n Inc. v. Bunner*, 10 Cal. Rptr. 3d 185, 191 (2004). However, under California law, evidence of the misappropriation of a trade secret, on its own, has long been held to be insufficient to support the issuance of an injunction. *Cont'l Car-Na-Var Corp. v. Moseley*, 24 Cal. 2d 104, 107 (1944).

Notably, while injunctive seizures of trade secrets are almost unheard of in California, in the past courts would enjoin “[a]ctual or threatened misappropriation” by prohibiting a former employee from working for a competitor, reasoning that trade secrets will inevitably be disclosed during the course of employment. *Electro Optical Indus., Inc. v. White*, 76 Cal. App. 4th 653, 90 Cal. Rptr. 2d 680, 683 (1999), *ordered not to be officially published* (Apr. 12, 2000). More recently, California courts have conclusively rejected this “inevitable disclosure” doctrine. See, e.g., *Whyte v. Schlage Lock Co.*, 101 Cal. App. 4th 1443, 1446 (2002).

As under California law, the DTSA rejects the inevitable disclosure doctrine. Nonetheless, by providing a specific means to provisionally recover allegedly misappropriated trade secrets, plaintiffs will now have a means for seeking the return of valuable materials that have been taken by ex-employees or others with access to those materials.

Likewise, as another example, the DTSA's seizure provisions will potentially provide an important new tool for New York plaintiffs, who previously also had to rely upon injunctive relief when seeking a provisional remedy for misappropriated trade secrets. In the past, applying New York's trade secret common law, lower courts held that evidence of misappropriation may be sufficient to establish a presumption of irreparable harm and support an injunction. However, more recently, in *Faiveley Transp. Malmö AB v. Wabtec Corp.*, the Second Circuit Court of Appeal vacated an injunction because, even though there was ample evidence that the defendant was using the plaintiff's trade secret, there was no evidence that the defendant was disseminating or irreparably impairing "the value of the secrets." 559 F.3d 110 (2d Cir. 2009). Accordingly, the court held that there was no evidence of irreparable harm to support the injunction. *Id.* at 118. Similarly, recent New York decisions considering

the "inevitable disclosure" doctrine have held that, by itself, the doctrine cannot support injunctive relief unless the employee is also subject to an enforceable non-competition agreement. Compare *Payment Alliance Int'l, Inc. v. Ferreira*, 530 F. Supp. 2d 477, 482 (S.D.N.Y. 2007) (enforcing restrictive covenant under "inevitable disclosure" doctrine) with *Janus et Cie v. Kahnke*, 2013 WL 5405543 (S.D.N.Y. 2013) (refusing to enforce "inevitable disclosure" doctrine in absence of agreement).

The DTSA potentially fills in these gaps in New York state law by providing that an aggrieved plaintiff can seek the immediate return of misappropriated trade secret materials. Indeed, with its new *ex parte* seizure provisions, the DTSA could very well provide a powerful provisional remedy for trade secrets plaintiffs in every state. As the courts begin to interpret the DTSA, new case law regarding the use and implementation of these seizure provisions will provide much needed insight into what impact these seizure provisions will ultimately have. [Q](#)

PRACTICE AREA NOTES

Bankruptcy & Restructuring Litigation Update

Delaware Bankruptcy Court Disagrees with Second Circuit on Implied Preemption of State-Law Fraudulent Transfer Claims Brought by Creditors.

In recent years, several bankruptcy and district courts have addressed whether the safe harbor provision of the Bankruptcy Code, 11 U.S.C. § 546(e), bars constructive fraudulent transfer claims brought directly by unsecured creditors under state law. While courts have uniformly held that the plain language of the safe harbor extends to constructive fraudulent transfer claims brought *by the trustee* under the *Bankruptcy Code*, 11 U.S.C. § 548(a)(1)(B) or § 544, courts are split as to whether the statute also *preempts* constructive fraudulent transfer claims brought *by creditors* under *state law*. The safe harbor itself is silent regarding state-law avoidance claims brought by individual creditors. This preemption issue has arisen in several bankruptcy cases when creditors or their assignees assert constructive fraudulent transfer claims arising

from failed leveraged buyouts ("LBOs") involving securities transactions that potentially implicate the safe harbor.

In a controversial decision that is subject to a pending petition for panel and *en banc* rehearing, a panel of the Second Circuit recently ruled that the safe harbor impliedly preempts state-law fraudulent transfer claims of creditors to the same extent that a trustee would be barred from bringing such claims in bankruptcy. *In re Tribune Co. Fraudulent Conveyance Litig.*, 818 F.3d 98, 105 (2d Cir. 2016) ("*Tribune II*"). By its express terms, the safe harbor limits fraudulent transfer claims brought by a bankruptcy "trustee" under certain federal avoidance statutes, not those brought by a debtor's creditors under state law. 11 U.S.C. § 546(e). The crux of the *Tribune II* decision is that, nevertheless, there is "ambiguity" in § 546(e), 818 F.3d at 111-18, and that ambiguity should be resolved in favor of implied preemption of all state-law avoidance claims because the presumption against preemption does not apply in bankruptcy (*id.* at 109-12), and

because the legislative history and federal policies that motivated the enactment of the safe harbor support broad preemption (*id.* at 119-24).

Although not entirely unprecedented, the *Tribune II* decision was contrary to the decisions of most lower courts that had previously considered the issue and rejected attempts to dismiss creditors' state-law fraudulent transfer claims as barred by the safe harbor. See *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 503 B.R. 348, 358 (Bankr. S.D.N.Y. 2014) ("*Lyondell*") (finding no implied preemption), *In re Tribune Co. Fraudulent Conveyance Litig.*, 499 B.R. 310, 325 (S.D.N.Y. 2013) ("*Tribune I*") (same), *Development Specialists, Inc. v. Kaplan (In re Irving Tanning Co.)*, No. 12-01024, Doc. 43 at 7 (Bankr. D. Me. Feb. 7, 2013) (same), *PHP Liquidating, LLC v. Robbins*, 291 B.R. 603, 607 (D. Del. 2003) (same). But see *Whyte v. Barclays Bank PLC*, 494 B.R. 196, 200 (S.D.N.Y. 2013) (finding implied preemption).

Following *Tribune II*, the bankruptcy court for the District of Delaware specifically considered and rejected the preemption holding of *Tribune II* shortly after it was decided. *PAH Litigation Trust v. Water Street Healthcare Partners, LP (In re Physiotherapy Holdings, Inc.)*, No. 15-51238, Doc. 250 at 16 (Bankr. D. Del. June 20, 2016) ("*Physiotherapy*"). In *Physiotherapy*, the bankruptcy court concluded that "[a]lthough *Tribune II* settled the split in the Second Circuit, it is nevertheless not binding on the Court. The Court finds the reasoning [of the Southern District bankruptcy court] in *Lyondell* more persuasive and therefore adopts its holding." *Id.*

In concluding that the safe harbor does not preempt state-law fraudulent transfer claims brought by creditors, *Physiotherapy* found that (1) the presumption against preemption does apply because "[s]tates have traditionally occupied the field of fraudulent transfer law" (*id.* at 16); (2) the plain language of the safe harbor only limits a trustee's ability to bring certain fraudulent transfer claims under the Bankruptcy Code (*id.* at 20); (3) Congress used express preemption language in related Code provisions when it intended to preempt similar state-law avoidance claims (*id.* at 20-21); (4) the legislative history of the safe harbor does not support broad preemption of all state-law avoidance claims (*id.* at 18); and (5) the federal policies that motivated the enactment of § 546(e) were focused on "systemic risk," not "finality for individual investors," and this narrow focus is inconsistent with broad preemption of state-law avoidance claims that have no "destabilizing effect on the financial markets" (*id.* at 16-20).

Given the significance of the issue in the context of bankruptcy-related litigation and interplay between

federal and state law, we expect that the United States Supreme Court will be called upon to be the final arbiter of the implied preemption issue either on review of *Tribune II* or perhaps in the future after another Court of Appeals contributes an opinion.

Securities & Structured Finance Litigation Update

Relation Back in RMBS Putback Cases. In a recent RMBS putback case in the Southern District of New York, Quinn Emanuel won a ruling that the plaintiff trustee's expert reports, served nearly three years after the litigation commenced, satisfied the contractual requirement of loan-level breach notice and "related back" to the original complaint such that the statute of limitations did not bar any of the trustee's claims. *MASTR Adjustable Rate Mortgages Trust 2006-OA2 v. UBS Real Estate Securities ("MARM")*, 2016 WL 1449751 (S.D.N.Y. Apr. 12, 2016). This ruling almost doubled the number of loans at issue in the action under a notice theory, and thus substantially increased the potential recovery. If followed, this ruling should vitiate defendants' attempts to bar putback claims relating to loans that were not the subject of pre-suit breach notices, as long as timely claims were brought as to some portion of the loans in the relevant trust.

The trustee sought recovery from the sponsor of three RMBS securitizations for the sponsor's breaches of representations and warranties concerning the characteristics of securitized loans that it made in Pooling and Servicing Agreements ("PSAs") governing the securitizations. The PSAs provided that the sponsor had to cure or repurchase materially defective loans within 90 days after receiving written notice of or discovering such breaches. The courts have held that no suit can be brought to enforce a repurchase obligation as to any loan until the cure or repurchase period for that loan has ended, and that, under the statute of limitations, any such suit must be commenced within six years of the closing of the securitization. See *ACE Securities Corp. v. DB Structured Products, Inc.*, 25 N.Y.3d 581 (2015) ("*ACE*"). RMBS sponsors have repeatedly argued that, under *ACE*, no repurchase claims can be made with respect to *any* loans that were not specifically noticed prior to suit unless the defendant independently discovered the breaches, and that any attempt to notice claims after the commencement of suit is barred by the statute of limitations.

This argument was rejected in *Nomura Home Equity Loan, Inc., Series 2006-FM2 v. Nomura Credit & Capital, Inc.*, 133 A.D.3d 96 (1st Dep't 2015) ("*Nomura*"). There, the First Department affirmed the lower court's refusal to dismiss "claims relating to

loans that plaintiffs failed to mention in their breach notices or that were mentioned in breach notices sent less than 90 days before plaintiffs commenced their actions.” *Id.* at 108. The court distinguished *ACE* on the basis that no timely claims as to any loans were ever filed in *ACE*. By contrast, the plaintiffs in *Nomura* brought timely claims as to a portion of the loans at issue and any amendment to the complaint adding claims as to later-noticed loans would relate back to the timely claims and thus be timely. The court held that the allegations in the pre-suit letters put the defendant on notice that the plaintiffs may discover more defective loans. This, coupled with the complaint’s allegations that defendants discovered defective loans through their own due diligence, was sufficient to meet New York’s relation back standard.

In *MARM*, only 4,460 of the 17,082 loans in the trusts at issue were identified as materially defective in pre-suit breach notices. However, the trustee’s re-underwriting expert ultimately determined that 10,000 loans were materially defective. In August 2015, nearly three years after the complaint was filed, the trustee served its expert’s written report as to these 10,000 loans on UBS. UBS argued that because these loans were not identified in pre-suit breach notices, the trustee’s claims as to these loans based on a notice theory were untimely. The court disagreed, holding that the expert report provided written notice of all materially defective loans, and that because the trustee had brought timely claims as to at least some of these loans which had been the subject of pre-suit breach notices that warned that investigation of the loans was ongoing, under *Nomura*, the trustee’s claims as to later-noticed loans in the same trusts related back to these timely claims, and were themselves timely. *MARM*, 2016 WL 1449751, *4 (S.D.N.Y. Apr. 12, 2016). The court further held that UBS suffered no prejudice from an amendment adding claims for these additional loans, because, contrary to UBS’s assertion, the complaint did allege that UBS independently discovered *all* materially defective loans, and thus “UBS was on notice that all loans were potentially in play.” *Id.* Quinn Emanuel’s successful application of *Nomura* more than doubled the number of loans for which the *MARM* trustee could pursue a notice-based theory, significantly easing its burden of proof.

Life Sciences Litigation Update

Enfishing for Guidance: The Federal Circuit’s Recent Section 101 Jurisprudence. As two recent decisions from the Federal Circuit demonstrate, the law on patent-eligible subject matter, 35 U.S.C. § 101, remains largely unsettled. These decisions, *Enfish* and *TLI*

Communications, represent some of the Federal Circuit’s most recent attempts to grapple with the appropriate application of § 101. Although these decisions are both software patent cases, they speak to issues that affect § 101 jurisprudence across a wide range of technologies, from software to diagnostic procedures to molecular biology protocols. In particular, *Enfish* and *TLI Communications* embody the recent judicial tendency to collapse the § 101 inquiry into the novelty inquiry under 35 U.S.C. §§ 102 and 103.

A trio of Supreme Court cases, *Alice*, *Mayo*, and *Myriad*, has left the district courts and the Federal Circuit with little concrete guidance on how to fashion the law going forward. This trio of cases has established a two-part test for patent eligibility under § 101. As a threshold inquiry, the court must determine whether the claims at issue “are directed to a patent ineligible concept.” Laws of nature, natural phenomena, and abstract ideas are not patentable. If the threshold requirement is satisfied, the court must then assess whether additional claim elements transform the claim into one that covers patent-eligible subject matter.

Enfish and *TLI Communications* center on the issue of whether the threshold inquiry is met and whether the potentially patent-ineligible material at issue is an abstract idea. The problem is that many patents covering technical subject matter embody abstract ideas. The Federal Circuit noted in *Enfish* that, while many patents may “involve” a patent ineligible abstract idea, the Supreme Court test asks not only whether the claims “involve” patent ineligible subject matter, but also whether they are “directed to” such subject matter. See *Enfish, LLC v. Microsoft Corp.*, No. 2015-1244, 2016 WL 2756255, at *4 (Fed. Cir. May 12, 2016). Although on its face, this analysis does not appear to implicate issues of novelty, the Federal Circuit cited supporting precedent involving an inquiry “into ‘the focus of the claimed advance over the prior art.’” *Id.* (citing *Genetic Techs. Ltd. v. Merial L.L.C.*, 2016 WL 139573, at *5 (Fed. Cir. 2016)) (emphasis added). But that standard sounds a lot like the novelty analysis of §§ 102 and 103.

In fact, the entire *Enfish* analysis appears to have been driven by the Federal Circuit’s view that the claims at issue were directed to “an *improvement* to the way computers operate,” and therefore did not impermissibly claim an abstract idea. *Id.* at *5 (emphasis added). The key element of the patent claims at issue was a “self-referential table” for data storage and retrieval, which allowed new columns to be added to the table by adding rows specifying the fields or parameters for each new column. The Federal Circuit distinguished these claims from prior software claims that had been


found patent ineligible on the grounds that those earlier claims could be understood “as simply adding conventional computer components to well-known business practices.” *Id.* at *7. In contrast, according to the Federal Circuit, the claims at issue in *Enfish* were “directed to an improvement in the functioning of a computer.” *Id.* Again, the analysis contrasted ineligible “conventional” computer components with the patent-eligible “improvement” claims. The Federal Circuit held that the claims in *Enfish* were patent eligible because they were not directed to an abstract idea.

The *TLI Communications* decision, issued the following week, applies a similar analysis to reach the opposite conclusion. Here, the Federal Circuit found “that the claims are directed to the abstract idea of classifying and storing digital images in an organized manner and fail to add an inventive concept sufficient to confer patent eligibility.” *In re TLI Communications LLC Patent Litigation*, No. 2015-1372, 2016 WL 2865693, at *1 (Fed. Cir. May 17, 2016). The claims at issue in *TLI Communications* involved assigning classification data (a date or time stamp) to digital images and sending them to a server, which then extracts the classification data and stores the images, “taking into consideration the classification information.” *Id.* at **1-2.


In its analysis, the Federal Circuit gave a nod to its new *Enfish* standard, stating, “We recently clarified that a relevant inquiry at step one is ‘to ask whether the claims are directed to an improvement to computer functionality versus being directed to an abstract idea.’” *Id.* at *3 (citing *Enfish*). But in *TLI Communications*, the Federal Circuit held the claims to be directed to the abstract idea of “classifying and storing digital images in an organized manner.” *Id.* at *5. According to the Federal Circuit, “attaching classification data, such as dates and times, to images for the purpose of storing those images in an organized manner is a well-established ‘basic concept’ sufficient to fall under *Alice* step 1.” *Id.* As in *Enfish*, the subtext of novelty appears to inform the § 101 analysis.

Moving on to step two, the Federal Circuit in *TLI*

Communications rejected the argument that fact finding was necessary to determine whether the additional claimed elements were “conventional.” *See id.* at *6. Instead, the Federal Circuit relied on the specification to find that the claimed elements, including a “telephone unit” and “server,” failed to add an inventive concept to the claimed abstract idea. *See id.* The Federal Circuit stressed the absence of sufficient detail to carry out the abstract idea to which the claims were directed. *Id.* at *7. Holding the claimed subject matter patent ineligible, the Federal Circuit concluded, “In sum, the recited physical components behave exactly as expected according to their ordinary use.” *Id.*

The extent to which *Enfish* carved out a class of patent-eligible software claims remains to be seen. More recently, the Federal Circuit vacated a decision of the Northern District of Texas invalidating a software patent on § 101 grounds, and remanded for further proceedings. *See Bascom Global Internet Services, Inc. v. AT&T Mobility LLC*, No. 2015-1763 (Fed. Cir. June 27, 2016). The patent claims at issue in *Bascom* involved a method of filtering content on the internet using filters customized to a given user at a remote server. According to the Federal Circuit, this case presented a “closer call” than *Enfish* in terms of step one of the § 101 analysis, the “abstract idea” inquiry. *See id.* at 13. The court therefore reached step two, the “inventive concept” inquiry. *See id.* The Federal Circuit found that the concept of installing a filtering tool at a location remote from end users with customizable filtering features specific to each end user, was inventive. *See id.* at 16. Therefore, because this inventive concept transformed the abstract idea of filtering content into a “particular, practical application of that abstract idea,” the claims were patent eligible. *See id.* at 20. For students of § 101 jurisprudence across a wide range of technologies, the takeaway continues to be that the more novel and detailed the claims, the less “abstract,” and the more patent eligible they will be. 

Tara Lee Receives 2016 Partner in Justice Award

Partner Tara Lee was honored with the Center for Justice and Accountability’s 2016 Partner in Justice Award for her achievements in human rights litigation. The Center for Justice and Accountability recognized Ms. Lee for her work on behalf of Somali victims of the Barre regime abuses in the 1980s. From 2003 to 2016, in two now landmark cases, *Yousuf v. Samantar* and *Warfaa v. Ali*, Ms. Lee’s evidentiary work in Somaliland and her appellate work at the Fourth Circuit has resulted in some of the most significant precedents of the decade in human rights litigation. 

VICTORIES

Victory for Shell in Benzene Patent Appeal

The firm recently won a victory for Shell Oil Company in the U.S. Court of Appeals for the Federal Circuit, affirming a district court ruling that Shell's process for benzene purification did not infringe the asserted patent claims as a matter of law.

Plaintiff David Netzer Consulting Engineer had sued Shell in the U.S. District Court for the Southern District of Texas, accusing Shell's benzene-purification process of infringing its patent. Shell's trial counsel won an early summary judgment of non-infringement—but the district court failed to conduct a formal claim construction analysis and dismissed the case in a two-page summary judgment opinion. Quinn Emanuel was retained to defend this victory on appeal to the Federal Circuit.

On May 27, 2016, the Federal Circuit issued a unanimous precedential opinion adopting the firm's arguments in full and affirming the judgment of non-infringement. The firm first had to persuade the court to adopt Shell's construction of the sole contested limitation in the asserted patent claims. Specifically, the claims required "fractionating" an intermediary product (pyrolysis gasoline) to form a purified benzene product of at least 80% benzene. The plaintiff argued that "fractionating" means any kind of separation. The firm persuaded the court that "fractionating" in the patent should be construed to require separating compounds based on "distillation" or boiling-point differentials, not generic separating by any means. The key to persuading the court of this construction was highlighting passages in the patent specification discussing how "fractionation" can be frustrated by "azeotropes," which are liquid mixtures with a uniform boiling point whose components cannot be separated based on their own differences in boiling point. Writing for the court, Judge Alan Lourie (who holds a Ph.D in chemistry) walked through the firm's "azeotrope" argument at length, discussing how the azeotrope-based passages in the patent compel a conclusion that, in this patent, "fractionating" is limited to boiling-point separation.

Based on this construction, Judge Lourie and his colleagues (Chief Judge Prost and Judge Taranto) agreed that Shell's accused process could not infringe as a matter of law because Shell used solubility-based separation, not boiling-point separation, to take its benzene products over the critical 80% purity level.

IPR Victory

The firm continued its success before the United States Patent & Trademark Office's Patent Trial & Appeals

Board ("PTAB"), this time successfully defending Japanese client Anest Iwata Corporation against an *inter partes* review petition filed by its competitor, Sata GmbH. Anest designs and manufactures industrial paint spray guns. In 2013, Sata filed a petition for *inter partes* review challenging one of Anest's key patents covering the spray gun technology. Represented by prior counsel, Sata prevailed on an earlier petition, and invalidated numerous claims of the Anest patent. In 2015, Sata filed a second petition seeking to invalidate the remaining claims. Anest hired Quinn Emanuel to defend against the second petition, and the firm filed a Patent Owner's Response arguing that the petition should be denied. Substantively, the firm explained that many of Sata's invalidity arguments were based on flawed mathematical assumptions that lacked evidentiary support. Quinn Emanuel also argued that the second petition was procedurally improper because, while styled differently, the arguments were ones already raised in the first petition. The PTAB agreed with the firm and denied the petition in full. Sata filed a Request for Rehearing, which the PTAB also denied. As a result, Anest's patent is secure, and its competitive position in the spray gun industry remains strong.

Major First Amendment Trial Victory

On April 21, 2016, following a bench trial, Judge Manuel Real in the Central District of California permanently enjoined California Attorney General Kamala Harris from requiring that Quinn Emanuel client, the Americans for Prosperity Foundation, a 501(c)(3) charitable organization, disclose a list of the names and addresses of its major donors. This marks an important First Amendment victory.

To protect its donors from threats, harassment, and violence, the Foundation keeps the identities of its donors highly confidential. In October 2014, however, the Attorney General told the Foundation that unless it turned over its donor list to her within 30 days, it would face fines and lose the ability to fundraise in California.

In stepped Quinn Emanuel. The firm filed a complaint and motion for a preliminary injunction, alleging that the Attorney General's demand violated the First Amendment. This looked to be an uphill fight as, just a few months earlier, a different federal district court in California had denied a preliminary injunction in a case brought by another charity, the Center for Competitive Politics ("CCP"), that likewise challenged the Attorney General's demand for its donor list on First Amendment grounds.

However, by emphasizing the compelling facts and

record unique to the case, Quinn Emanuel was able to distinguish the CCP case and secure a preliminary injunction for its client in February 2015. Trial commenced in February 2016. By then, Quinn Emanuel had amassed a factual record that thoroughly undercut every defense the Attorney General could muster.

The Attorney General's primary justification was that collecting the donor lists of every charity in her state helped her office stamp out fraud and abuse. Yet, the Attorney General's witnesses conceded in cross-examination that they almost never used these donor lists, and even in the few instances where they had, they could obtain the relevant information through other means less invasive of First Amendment interests. This led the Court to find: "The record before the Court lacks even a single, concrete instance in which pre-investigation collection of a [donor list] did anything to advance the Attorney General's investigative, regulatory or enforcement efforts."

Notwithstanding the Attorney General's repeated promises that she would keep confidential all the donor lists she was collecting, Quinn Emanuel had discovered that she had, in fact, published more than 1750 donor lists on her public website. These lists revealed the names and addresses of donors for hundreds of charities—including controversial charities, such as Planned Parenthood, that had good reason to protect donors' identities. The Court found that the Attorney General's longstanding lackadaisical approach to confidentiality "obviously and profoundly risks disclosure" of any donor list the Foundation might submit.

Against this record of government incompetence, witnesses for the Foundation attested to the personal threats and harassment they have encountered because of their public affiliation with the Foundation. Having heard their testimony, the Court was "not prepared to wait until [a Foundation] opponent carries out one of the numerous death threats made against its members" before granting permanent relief.

Based on these facts, the Court found a constitutional violation, granted the firm's client relief, and held that "[t]he Attorney General's requirement that [the Foundation] submit its [donor list] chills the exercise of its donor[s'] First Amendment freedoms to speak anonymously and to engage in expressive association. Among other things, plaintiffs have demonstrated that the . . . disclosure requirement places donors in fear of exercising their First Amendment right to support [the Foundation's] expressive activity; the effect then is to diminish the amount of expressive and associational activity by [the Foundation]." Now the fight will

move up to the Ninth Circuit, to which the Attorney General has appealed.

Criminal Law Victory

The firm won a complete dismissal of a federal money laundering indictment in Houston, persuading the court that the DOJ's interpretation of the criminal statute of limitations was fatally flawed.

The general statute of limitations for most federal crimes is "5 years": "[N]o person shall be prosecuted . . . unless the indictment is found or the information is instituted within five years next after such offense shall have been committed." 18 U.S.C. § 3282. The Fifth Amendment to the U.S. Constitution requires a grand jury indictment in felony cases. But can the Department of Justice meet that deadline by filing a "Criminal Information" within 5 years followed by an "Indictment" shortly after the 5-year deadline? Quinn Emanuel moved to dismiss such an indictment, and the federal court in Houston ruled that the Indictment itself must be filed before limitations expires. The case is *United States v. Sharma*, No. 4:14-cr-00061 (S.D. Tex.) and was handled by the firm's Houston office.

The issue had never arisen in the Fifth Circuit, but the government found support in a Seventh Circuit case, which itself had been strongly criticized by district courts. Judge Kenneth Hoyt in Houston decided to "part company with the Seventh Circuit where it appears to suggest that the government can 'willy-nilly' file an Information at the end of the limitations period as a means of extending it." Instead, unless the defendant waives indictment pursuant to the Federal Rules of Criminal Procedure, the government may not institute a felony case by filing an Information.

This decision caps a remarkable six-month period for Quinn Emanuel's White Collar group in Houston. First, the firm represented Khosrow Afghahi, who received a Presidential Pardon in January 2016 as part of a U.S.-Iran prisoner "swap" during negotiations over American sanctions. All charges were dismissed as a result of the pardon. Second, Quinn Emanuel led the defense of Bob Kaluza, the BP engineer accused of causing the *Deepwater Horizon* blow out, leading to federal criminal charges of "negligent manslaughter," "reckless manslaughter," and "negligent oil pollution." Over a multi-year battle, all 22 manslaughter charges were dismissed, leaving the oil pollution case for trial. At that trial last February, the jury acquitted the firm's client shortly after closing argument, the final step in his complete exoneration in the case. And third, the firm's victory in *Sharma* was announced on May 19, 2016. Q

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business litigation report

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