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Inter Partes Review and the ITC: The Benefits and Risks of Filing IPR on Patents Asserted in an ITC Investigation

Since the advent of the America Invents Act ("AIA") in 2012, parties accused of patent infringement in district court cases have taken advantage of the newly established *Inter Partes* Review ("IPR") procedure for challenging the validity of patents. IPRs allow an accused infringer in a pending litigation to separately challenge the validity of a patent to the Patent Trial and Appeal Board ("PTAB"), a division of the United States Patent and Trademark Office ("PTO"). IPRs are an appealing alternative, in part because the standard for invalidating a patent in an IPR—preponderance of the evidence—is lower than the clear and convincing standard applied in district court actions. 35 U.S.C. § 316(e). Moreover, district court judges are often willing to stay the district court action until the IPR is complete. Indeed, recent reports indicate that district courts are granting or granting-in-part stays of cases pending the completion of an IPR at a rate of over 72%. *See* El-Gamel, Samuel, Siddoway, *The New Battlefield: One Year of Inter Partes Review Under the America Invents Act*, 42-1 AIPLA QUARTERLY JOURNAL, 39, 55 (2014) ("*The New Battlefield*").

But while the benefits of filing an IPR in a district court litigation are clear, in the ITC the benefits are less apparent. Operating under a mandate that ITC investigations conclude "at the earliest practicable time" after an investigation is filed, patent litigation in the ITC typically runs less than two years. And the ITC has never stayed a case pending an IPR. Thus, an ITC case will likely conclude before an IPR is resolved.

This article will consider the potential benefits and risks of filing an IPR concurrent with an ITC action.

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Charles Eskridge Joins Quinn Houston Office

Charles Eskridge, a former partner at Susman Godfrey, has joined Quinn Emanuel's Houston office as partner. Mr. Eskridge is an experienced trial lawyer and appellate advocate. He has tried a wide range of complex commercial matters and argued numerous appeals in both federal and state courts. His professional experience includes matters involving such diverse areas as antitrust, intellectual property (including patents and trade secrets matters), aviation disasters, securities fraud, the First Amendment, ERISA, and asbestos bankruptcy litigation, along with state law issues concerning complex contractual disputes, accounting and legal malpractice, fraud, employment and trade secret issues, and insurance coverage. Mr. Eskridge received his B.S., magna cum laude, from Trinity University and was the valedictorian of his graduating class from Pepperdine University School of Law. Mr. Eskridge joins Karl Stern and David Gerger, two other leading lawyers who joined the firm's Houston office in the last several months. Q

John B. Quinn Named to *The National Law Journal*'s List of "Litigation Trailblazers & Pioneers"

John B. Quinn was recently named one of *The National Law Journal*'s "Litigation Trailblazers & Pioneers." This honor recognizes Mr. Quinn's contribution to change in the practice of litigation through the firm's unique practice model and exportation of that model internationally. The profile also describes Mr. Quinn's early work with General Motors, his more recent representations of cell phone manufacturers such as Samsung, Motorola, and HTC, and Mr. Quinn's long-standing relationship with the Academy of Motion Picture Arts and Sciences, for which he has been general counsel since 1987. Q

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A. The Interplay Between *Inter Partes* Review and an ITC Action

1. Inter Partes *Review and Potential Estoppel*

An IPR is initiated by an accused infringer in a patent infringement action. The purpose is to challenge the validity of the asserted patent or patents. If considering an IPR, an accused infringer must file an IPR petition within one year of the filing date of the patent infringement action. 35 U.S.C. § 315(b). The IPR validity challenge must be based on prior art patent(s) or printed publication(s); it cannot be based on a commercial device or system. 35 U.S.C. § 311(b). Preparation of an IPR will usually take a few months as the accused infringer will need to identify the best prior art and prepare the petition, including one or more expert declarations. The cost of an IPR is not insubstantial—in many ways it's a "mini-litigation" of its own, with its own hearing, and the combination of attorneys' fees and expert fees can approach seven figures.

An accused infringer often seeks a stay of pending litigation upon filing an IPR, at least for district court actions. Courts have granted or granted-in-part more than 72% of such stay requests. *The New Battleground* at 55. District courts are more likely to grant a stay at an early stage of the litigation. *See, e.g., Robert Bosch Healthcare Sys., Inc. v. Cardiocom, LLC*, 2014 WL 3107447, at *2 (N.D. Cal. 2014). The ITC, however, has never granted a stay of an ITC investigation based on an IPR petition.

The timeline for an IPR "start to finish" is approximately two years. *See* 37 C.F.R. §§ 42.100(c), 42.107(b), and 35 U.S.C. § 314(b). After an accused infringer files its IPR petition, it takes about six months for the PTAB—the government entity that evaluates IPRs—to grant or deny the petition. 37 C.F.R. § 42.107(b); 35 U.S.C. § 314(b). The PTAB's standard for institution is the "reasonable likelihood that [the] petitioner would prevail." 35 U.S.C. § 314(a). In contrast, the standard for an *ex parte* reexamination is whether a "substantial new question of patentability" has been shown. 37 C.F.R. § 1.510(b)(1). The PTAB initially granted most of the petitions it received, but lately it has become more selective and has rejected a growing number of petitions. *See, e.g.,* AIA Progress Statistics, http://www.uspto.gov/ip/boards/bpai/stats/aia_statistics_1_1_2015.pdf (87% in FY13 declining to 75% in FY14). Assuming the PTAB grants the petition, it then takes between 12-18 months for the PTAB to reach a final decision on the merits of the petition. 37 C.F.R. § 42.100(c).

The final decision may invalidate some or all of the claims, subject to appeal to the Federal Circuit. Once the PTAB renders a final decision, however, the accused infringer is estopped from asserting in the pending litigation the prior art alleged in the IPR or art that the accused infringer "raised or reasonably could have raised" in the IPR. 35 U.S.C. § 315(e)(2). The accused infringer is similarly estopped from asserting any such art in a future litigation involving the same patent. *Id.* Thus, a final decision means the accused infringer will effectively be precluded from relying on patent or publication prior art in the pending litigation. *Id.* The accused infringer may, however, rely on system or device prior art not raised in the IPR. 35 U.S.C. § 311(b).

The invalidity standard of proof in an IPR is not as stringent as a district court action or ITC investigation: preponderance of the evidence instead of clear and convincing evidence. 35 U.S.C. § 316(e). Not surprisingly, accused infringers have had more success challenging patents in IPRs than in district court actions or ITC investigations. *See* Jonathan Engler, *Patent Litigation Outcomes At ITC Vs. District Courts*, (February 25, 2013, 12:31 PM), http://www.law360.com/articles/413428/patent-litigation-outcomes-at-itc-vs-district-courts; Daniel F. Klowdowski & Jonathan R.K. Stroud, *Claim And Case Disposition*, http://www.aiablog.com/claim-and-case-disposition/. Indeed, as of December 1, 2014, IPRs resulted in invalidating claims over 74% of the time. *See* Klowdowski, *Claim And Case Disposition*. This number, however, is slowly decreasing for granted petitions, suggesting that the PTAB may be cognizant of the high percentage of patents being invalidated. *Id.* In any event, accused infringers have embraced IPRs as a preferred option for invalidating patents as opposed to through district court actions or ITC investigations.

2. ITC 337 Investigation

A patent-based ITC investigation begins when a patentee files a complaint based on patent infringement. 19 C.F.R. § 210.8; 35 U.S.C. § 1337. The ITC reviews the complaint, 19 C.F.R. § 210.9, and typically institutes the investigation within 30 days after the complaint is filed. 19 C.F.R. § 210.10(a)(1). The ITC assigns an Administrative Law Judge ("ALJ") soon after institution of the investigation. 19 C.F.R. § 210.10(b). Depending on the number of asserted patents, the ALJ will set a "target date" for completion of the investigation, with a schedule from "start to finish" of roughly 16-19 months from institution, and an evidentiary hearing or "trial" about 10-12 months after institution. The ALJ can extend the investigation (subject to approval by the ITC) based on a party request or for other reasons, but this will usually add no more than a few months to the schedule. The ITC's final decision—called a "Final Determination"—will usually result in either

termination of the investigation (no infringement and/or invalidity) or an exclusion order (infringement). An exclusion order is a form of injunctive relief, administered by U.S. Customs, that excludes infringing imports from the United States. 19 U.S.C. § 1337(d)(1). An exclusion order from the ITC is subject to an additional 60-day "Presidential Review," in which the United States Trade Representative, acting under authorization from the President of the United States, can disapprove the exclusion order for policy reasons. 19 U.S.C. § 1337(j)(2). The President has only disapproved ITC remedial orders six times, and only once since 1987; it is rare indeed for a President to take such an action. Thus, an ITC investigation will typically end within two years of the initial filing.

The patentee can also seek money damages through a companion (but separate) district court action, typically filed at the same time as the ITC complaint but stayed as a matter of right until completion of the ITC investigation (including appeals). 28 U.S.C. § 1659.

B. Considerations for Filing an IPR During an ITC Investigation

There are many factors for an ITC respondent to consider in determining whether to file an IPR concurrent with the ITC action. This article provides a non-exhaustive analysis of some of those factors. Each case of course is unique and other factors may come into play in determining whether to proceed with an IPR.

1. No Stay in an ITC Action

In the context of IPRs, the primary distinction between a district court action and an ITC investigation is the likelihood of a stay. In a district court action, the accused infringer has a decent chance for a stay so long as it files the IPR relatively early in the litigation. Because the initial pleading stage for a district court case can typically last 3-6 months, a party can easily draft and file an IPR well before fact discovery even begins. In an ITC action, however, fact discovery usually commences a little over a month after the complaint is first filed (*i.e.*, after institution of the investigation); the clock begins ticking right away. And as noted above, the ITC has never granted a stay based on an IPR. Thus, even if a party can prepare and file an IPR within a month of the complaint—very unlikely—the IPR clock will not even begin to run until a month has already passed in the ITC timeline, with little chance for a stay.

2. ITC Investigation Likely over Before the IPR Concludes

An ITC respondent can reasonably ask why it would want to file an IPR if the ITC investigation will be over before the IPR is complete. This is a particularly germane question considering the immediate and continuous pressure of an exclusion order facing an ITC respondent throughout the investigation. The respondent (and potentially its customers) often immediately recognize that they must succeed on the merits and/or design around the asserted patent(s) before the ITC reaches its final determination, meaning within about 18 months if not sooner. An IPR will be of little immediate help. Indeed, the threat of an exclusion order will likely dictate action right away. The attorneys' fees and costs associated with an IPR are not insubstantial, meaning an ITC respondent may prefer to allocate resources differently in defense of the suit.

3. Lower Invalidity Standard of Proof for an IPR

There are, however, a few possible benefits for an ITC respondent to consider when deciding whether to file an IPR concurrent with the ITC investigation. First, because of the lower evidentiary standard, an IPR may represent the best opportunity to invalidate a patent. Indeed, the invalidity success rate for granted IPR petitions exceeds that of invalidity challenges in an ITC investigation. *Compare* Engler, *Patent Litigation Outcomes At ITC Vs. District Courts with* Klowdowski, *Claim And Case Disposition*.

If the ITC investigation is delayed in any material way, the IPR could finish before the end of the investigation. This is relatively rare, however. The IPR would certainly overlap with the ITC's companion district court action, which is usually stayed until the ITC investigation is complete (including appeals). But companion cases rarely go forward, in part because the stay remains in place through a Federal Circuit Appeal. As a result, the parties can fairly predict the final outcome. Such clarity often results in settlement rather than further litigation.

4. IPR Could Impact a Federal Circuit Appeal

The IPR could also become a factor in a Federal Circuit appeal. If the ITC initially found a patent to be valid and infringed, but the PTO later found the same patent to be invalid via an IPR, the Federal Circuit could merge the appeals and consider the PTO's finding under the lesser preponderance standard. *See* 35 U.S.C. §§ 315(e)(2), 316(e). Moreover, if the IPR decision came very soon after the conclusion of the ITC investigation, the accused infringer could rely on the IPR in asking the Federal Circuit to stay the injunction/exclusion order pending appeal. With the unpredictability of the timing and result of an IPR, however, an accused infringer facing an exclusion order will most likely design around the patent or settle with the patentee. A Federal Circuit finding of invalidity would be a hollow victory if the

accused infringer previously needed to change its product to avoid an exclusion order.

5. Leverage in Settlement Negotiations

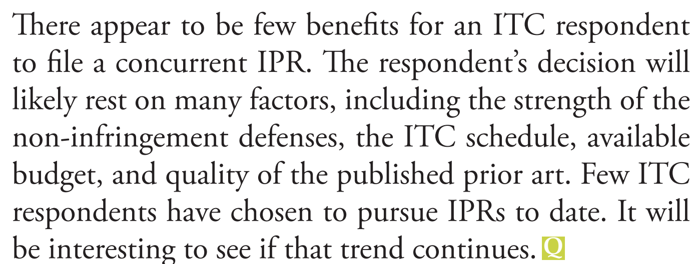
An IPR could also provide some leverage to an accused infringer in settlement negotiations. The patentee may wish to assert the patent against other competitors. An ITC victory followed by invalidation of the patent could be akin to the proverbial "winning the battle but losing the war."

6. Risk of Overturning a Successful Finding of Invalidity at the ITC

One risk to an ITC respondent in separately pursuing an IPR while defending an ITC action is the possibility of invalidating the patent in the ITC investigation but soon thereafter obtaining the opposite result in the IPR. This could nullify the ITC's invalidity finding depending on the timing, or prompt the patentee to re-file the ITC complaint. *See* 37 C.F.R. §§ 42.100(c), 42.107(b); 35 U.S.C. §§ 314(b), 315(e)(2). But the likelihood of this result is low due to the ITC's higher clear and convincing standard versus the IPR's preponderance standard. For the ITC to invalidate a patent that the PTAB endorses would be highly unusual.

Conclusion

There appear to be few benefits for an ITC respondent to file a concurrent IPR. The respondent's decision will likely rest on many factors, including the strength of the non-infringement defenses, the ITC schedule, available budget, and quality of the published prior art. Few ITC respondents have chosen to pursue IPRs to date. It will be interesting to see if that trend continues. Q



NOTED WITH INTEREST

Securities Act Claims Limitations Clarified

Ruling in favor of Quinn Emanuel client the Federal Housing Finance Agency, Judge Denise Cote of the Southern District of New York recently shed new light on how courts should apply the statute of limitations to claims brought under Sections 11 and 12 of the Securities Act of 1933. These statutes, which hold defendants strictly liable for making false statements to investors in offering materials, have a short limitations period—one year "after the discovery of the untrue statement … or after such discovery should have been made by the exercise of reasonable diligence." 15 U.S.C. § 77m. Before 2010, the Second Circuit interpreted the "should have been made" portion of this statute as requiring "inquiry notice"—a claim accrued "when public information would lead a reasonable investor to investigate the possibility of fraud." *City of Pontiac Gen. Emps.' Ret. Sys. v. MBIA, Inc.*, 637 F.3d 169, 173 (2d Cir. 2011). But in 2010, in *Merck & Co., Inc. v. Reynolds*, the Supreme Court held that a claim under Section 10(b) of the Securities Exchange Act of 1934 accrued upon the earlier of actual discovery or "when a reasonably diligent plaintiff would have discovered the facts constituting the violation[.]" *Merck*, 559 U.S. 633 at 637. Since then, litigants have disagreed about whether the *Merck* standard applies to Securities Act claims.

A recent decision by Judge Denise Cote in *Federal Housing Finance Agency v. Nomura Holding America, Inc.*,--- F.Supp.3d --, 2014 WL 6462239 (S.D.N.Y. 2014) ("*Nomura*"), held that *Merck* does apply to Section 11 and 12 claims, and provides the most extensive example to date of how that standard governs Securities Act claims. Judge Cote issued this ruling in the blockbuster litigation brought by the Federal Housing Finance Agency, as conservator of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (together referred to as the government-sponsored enterprises or "GSEs") against the world's largest banks over tens of billions of dollars of residential mortgage-backed securities ("RMBS") that the banks sold to the GSEs. FHFA alleged that the banks falsely represented, among other things, that the loans underlying the relevant RMBS complied with originators' guidelines.

Two years earlier, in a 2012 ruling, Judge Cote had held that *Merck* governed FHFA's Securities Act claims, *FHFA v. UBS Americas*, 858 F. Supp. 2d 306, 320 (S.D.N.Y. 2012) ("*UBS I*"), but when FHFA moved for summary judgment on the statute of limitations defense in 2014, the remaining defendants argued that, after *UBS I*, the Second Circuit had refused to extend *Merck* to non-Exchange Act claims in *Koch* v. *Christie's Int'l, PLC*, 699 F.3d 141, 152 (2d Cir. 2012). Judge Cote disagreed. She held that *Koch* "merely held that *Merck* did not disturb the discovery accrual rule applicable where the governing statute of repose does not address accrual"—as is the case the statute governing limitations for Section

10(b) claims under the Exchange Act. *Nomura* at *19, n. 34. The statute governing limitations for Section 11 and 12 claims under the Securities Act "is a similar statutory exception," Judge Cote held, "as it provides that accrual is triggered by 'the discovery of the untrue statement or omission.'" *Id.* (citing and quoting 15 U.S.C. § 77m).

Invoking *Merck* and its Second Circuit progeny, Judge Cote held that the limitations period for Securities Act claims "commences not when a reasonable investor would have *begun* investigating, but when such a reasonable investor conducting such a timely investigation *would have uncovered* the facts constituting [the] violation." *Nomura*, 2014 WL 6462239, at *19 (citing *City of Pontiac Gen. Emps. Ret. Sys. v. MBIA, Inc.*, 637 F.3d 169, 174 (2d Cir. 2011)) (emphasis added). For these purposes, a fact is "discovered" when "a reasonably diligent plaintiff would have sufficient information about that fact to adequately plead it in a complaint" that would "survive a motion to dismiss." *Id.* (quoting *City of Pontiac*, 637 F.3d at 174). In applying this objective standard, it was irrelevant "whether the *actual plaintiff* undertook a reasonably diligent investigation." *Id.* (citing *Merck*, 559 U.S. at 653).

Pre-*Merck* law still determined when a reasonably diligent would have begun an investigation—when information is "specific enough to provide [a reasonably diligence] investor with indications of the probability (not just the possibility) of misrepresentations. *Id.* at *20 (citing *Staehr*, 547 F.3d at 430). But the requirement that the misconduct "be probable, not merely possible" means that "information that does not, on its face, indicate the misconduct, and that is consistent with a perfectly likely innocent explanation, is unlikely to trigger a duty of inquiry." *Id.* (citing *Newman v. Warnaco Grp., Inc.*, 335 F.3d 187, 193 (2d Cir. 2003)).

Judge Cote's application of this law in the *Nomura* case offers several lessons to clients interested in defending Securities Act claims against a limitations challenge .

First, non-specific information does not trigger accrual. The statute creating FHFA provided that the limitations period for their claims expired on September 7, 2007, *Nomura*, 2014 WL 6462239, at *4 and n.4, and Defendants argued that the GSEs should have begun investigating potential Securities Act claims based on upheaval in the RMBS market in the end of 2006 and 2007—specifically including public accusations of irresponsible origination practices by the mortgage lenders whose loans backed the RMBS at issue. *Id.* at *22. Judge Cote held that these general trends did not trigger a duty to investigate, because they did not indicate to the GSEs that the Defendants had failed to conduct due diligence on the specific loans backing the relevant bonds before securitizing them. *Id.* at *22.

Second, information reflecting disclosed risks does not trigger accrual. Defendants pointed out, after the GSEs bought the bonds but before the limitations date, the GSEs received reports of: (1) negative property variances (reports of a decline in value of the homes backing some of the underlying loans; (2) a high-level of early payment defaults (borrowers defaulting on mortgage payments in the first few months of the loans). These events also did not trigger a duty to investigate, Judge Cote held, because they did not "suggest anything more than that the disclosed credit risks of subprime and Alt-A loans were realized after the national housing bubble burst"—they did not indicate the undisclosed risks that the originators had not complied with their guidelines in making these risky loans. *Id.* at *23.

Third, negative information offset by other factors does not trigger accrual. Judge Cote also held that the GSEs' duty to investigate was not triggered by credit analysts' downgrades of other "tranches" of four of the RMBS at issue. Monthly payments by the borrowers of the loans underlying the RMBS were combined into a single cash flow that ran down through tranches within each RMBS that were ranked by order of seniority. The most senior tranche was entitled to full payment of principal and interest before the next most senior tranche, which was in turn entitled to full payment before the next tranche, and so on. In July 2007, the credit ratings agencies downgraded the ratings of some of the most junior tranches in the RMBS—those designed to take losses before the senior tranches. Judge Cote held that these downgrades also did not trigger a duty to investigate, because the downgrades did not indicate that the most senior tranches, which backed the GSE's bonds, might suffer. As she put it, "the GSE's' Certificates had so much credit protection that the risk of loss was remote and their credit quality remained unchanged." *Id.* at *25.

Finally, Defendants will have the burden of showing how long it would take for inquiry to turn into discovery and pleading. Judge Cote noted that "Defendants have offered no evidence of the length of time it took the GSEs to investigate its claims here, or of how long it would take a reasonably diligent investor in the GSEs' position to investigate the claims such that it could adequately plead them." *Id.* at *26. Accordingly, even if they had been able to point to some information that should have triggered an investigation, Defendants were not able to show when a reasonably diligent investor would have completed that investigation and prepared a complaint that would have survived a motion to dismiss—thus failing the *Merck* test. *Id.* Q

Trademark/Copyright Litigation Update

Supreme Court Confirms Jury Role in Trademark "Tacking." Issuing its first substantive trademark decision in a decade, the Supreme Court unanimously held in January 2015 that the question of whether two trademarks are legal equivalents under the "tacking" doctrine is one for a jury. *Hana Financial, Inc. v. Hana Bank*, No. 13-1211, 574 S.Ct. ___(2015) ("Op."). Resolving a split among appellate courts, the Court affirmed the holding of the Ninth Circuit Court of Appeals that, since the tacking doctrine assesses the similarity of two trademarks' commercial impressions from the perspective of an ordinary consumer, this evaluation is squarely within the competence of a jury. *Id.* at 3-4. Though the doctrine is not frequently invoked, the decision indicates that the Court may be poised to empower juries in other trademark determinations that are also evaluated with consumers' perceptions in mind.

The tacking doctrine recognizes that, in some cases, trademark owners should be able to modify their trademark without losing priority status. *Id.* at 1, 3-4. Priority status can be important because the right to use a mark in many cases, such as where a trademark is inherently distinctive, flows from actual use of the mark in commerce, and seniority in such use may establish an ownership right. *Blisscraft of Hollywood v. United Plastics Co*., 294 F.2d 694, 700 (2d Cir. 1961). Unless the seniority of the subsequent modified mark "tacks" to that of the original mark, a trademark owner who has modified its mark is vulnerable to a claim that it abandoned the original mark, giving up its priority status. Op. at 1. Under such circumstances, the seniority of the modified mark yields to that of a mark created by another party prior to the modification. *Id.*

The tacking doctrine resolves this quandary in favor of the initial owner in the narrow circumstances where both the original and modified marks create a continuing commercial impression such that the consuming public would regard the marks as the same. *Id.* Where so, the modified mark is "clothe[d]" with the original mark's priority status. *Id.* In *Hana*, for example, the defendant initially used the mark "Hana Bank," then modified the mark to "Hana Overseas Korean Club," then again modified it to "Hana World Center," and finally reverted back to "Hana Bank." *Id.* at 2-3. The plaintiff, however, began use of its mark, "Hana Financial," after the defendant's first use of "Hana Bank," but before the defendant ultimately returned to using the same mark. On appeal, the question was whether the determination of a modified mark's commercial impression is a question of fact for a jury to decide, or whether it is a legal question for the court.

Writing for the Court, Justice Sotomayor reasoned that a jury, not a judge, must determine whether a modified mark creates the same commercial impression as the original to ordinary consumers, and thus may "tack" to the earlier mark's priority. *Id.* at 1. Though tacking involves mixed questions of law and fact, it requires a fact-intensive inquiry. *Id.* at 5. More importantly, because the inquiry requires the perspective of an ordinary consumer, the "'mixed' analysis" is no different from that undertaken by juries deciding tort or contract claims through the lens of an ordinary person or community. *Id.* at 6-7. Further, the Court rejected the argument that allowing juries to make the tacking determination would deprive the public of precedential decisions to "guide future tacking disputes," reasoning again that it was "not at all clear . . . why a tacking determination in a particular case will 'create new law' any more than will a jury verdict in a tort case, a contract dispute, or a criminal proceeding." *Id.* at 6. The Court's decision underscores that the "commercial impression that a mark conveys must be viewed through the eyes of a consumer." *Id.* at 4.

Importantly, the Court acknowledged that judges may still decide tacking when warranted on summary judgment or where parties forfeit a jury trial. Nevertheless, this decision reinforces that in trademark cases, factual issues like tacking—even when mixed with legal issues—generally are to be resolved by juries. *Id.* at 5. It remains to be seen if, and how, lower courts might interpret and apply this decision outside of the tacking context.

Energy Litigation Update

Drilling Contracts and Rig Maintenance. Drill rig contracts, which take a similar format around the world, have for years been construed by many as entitling contractors to be paid a day rate while fixing equipment failures caused by their poor maintenance practices. This is not only dangerous but counter-intuitive. It has also now been held to be wrong by the London Commercial Court in a judgment which should have repercussions through the offshore oil and gas drilling industry: *Transocean Drilling UK Ltd v. Providence Resources Plc.*

The dispute arose under a contract by which Providence Resources hired a rig from Transocean to drill a well off the south coast of Ireland in 2012. One of the critical pieces of safety equipment on a rig is its blowout preventer (BOP). The BOP sits on the seabed and serves as the primary barrier to a pressure surge from the well. Its components are operated electronically and hydraulically to close the well down. If it fails to work, the consequences can be catastrophic.

A vivid recent example of a BOP not working was on Transocean's rig at Macondo in the Gulf of Mexico in 2010. The disastrous consequences of that blow out,

both as to loss of life and the financial liabilities faced by BP as a result, are well known. In a recent judgment on Macondo, a Texas court found that the BOP had failed to work on the Deepwater Horizon because it had not been properly maintained by Transocean.

Despite the Macondo tragedy, and the lessons that should have been learned from it, the rig Transocean delivered to Providence in late 2011 was found by a judge also to have had a defective BOP. This was again due to a lack of maintenance, a fact which the Judge held that Transocean later concealed from Providence in a doctored report on the root causes of the BOP failures.

Fortunately, there was no blow out and no disaster on this occasion. But when the fault was discovered, the BOP had to be raised to the surface and repaired before drilling could proceed. Weeks were lost and during this time Providence paid for the backup services required by the rig which could not be used. Such costs are known in the industry as "spread costs".

The delivery of a rig with a defective BOP was a breach of the drilling contract, but Transocean maintained that it could still claim day rates during the period of delay and that it was not liable for any spread costs by virtue of an exclusion clause in the contract. As to the day rates, Transocean argued that the contract contained a "complete code" which provided for the rates payable per day in all eventualities, including periods when the rig was broken down and being repaired. It did not matter, Transocean said, that the repair was required because it had failed to maintain the BOP properly. Providence, on the other hand, argued that Transocean could not benefit from its own breach of contract. It cannot have been intended that Transocean could actually earn more from the contract by breaching it and then collecting day rates during a period of repairs necessitated by Transocean's own poor rig maintenance. (For the principle that a contract will not be construed as enabling a party to benefit from its own breach, see: *Alghussein Establishment v. Eton College* [1988] 1 WLR 587.)

Mr. Justice Andrew Popplewell agreed with Providence. He also held that the exclusion clause did not cover the spread costs. If it did, and Transocean were also entitled to day rates, Transocean would never have any liability, or ever be held to account for any breach of the contract.

This is a landmark decision for the industry. Certainly, day rates for an offshore drilling rig can be enormous—$250,000 per day in this case—but the significance of this decision goes much further, or at least it should. If contractors have little or no liability for the consequences of their actions, they will have less incentive to take due care. And if, as Transocean argued in its case against Providence, the contract entitled it to earn more by failing to maintain the rig properly, the incentive is reversed. The consequences of such a reverse incentive for safety and the environment are obvious.

It is to be hoped that the decision in the Providence case will help re-balance the incentives for contractors to maintain rigs properly. While their ability to insure against losses must be taken into account in apportioning the risks of a failure, they should neither be wholly insulated from liability nor have an economic incentive to under-maintain equipment, with potentially catastrophic consequences.

White Collar Litigation Update

Implications of the U.S. Department of Justice's Increased Pursuit of Corporate Guilty Pleas and Stringent Settlement Terms. In recent years, the U.S. Department of Justice ("DOJ") has become increasingly aggressive in prosecuting and resolving corporate crimes within the financial services industry. This trend was likely precipitated by public demands to hold financial institutions accountable for misconduct following the 2008 financial crisis. This trend reflects a stricter enforcement stance against white-collar crime in general and has important consequences for companies under criminal investigation as well as associated individuals.

Trends in Recent DOJ Settlements. DOJ's increasingly aggressive prosecution of corporate crime marks a shift from its approach over the past decade, where criminal investigations were generally concluded by non-prosecution agreements ("NPA") or deferred prosecution agreements ("DPA"). An NPA or DPA allows a corporation to avoid pleading guilty to criminal conduct in exchange for cooperating with the government's investigation, agreeing to make reforms, and paying financial penalties.

From DOJ's perspective, these agreements enable DOJ to obtain admissions of misconduct, while simultaneously avoiding the potentially disastrous consequences corporate guilty pleas can cause. As context, in 2002, Arthur Andersen LLP, an accounting firm, collapsed after its indictment and conviction for obstruction of justice in connection with the Enron scandal. At the time, it employed approximately 85,000 people and had generated $9.3 billion in revenue in 2001.

The DOJ's unwillingness to pursue guilty pleas from large financial institutions likely stemmed from its concern about the serious harm to the economy and global financial markets that could otherwise result. Over the past three years, however, DOJ has begun to condition settlements of major investigations on guilty pleas and has imposed record-breaking penalties. This practice represents a significant break from its previous approach towards financial institutions, and an escalation of its approach in other industries.

Guilty Pleas—DOJ has obtained numerous guilty pleas from corporations in recent years. For example, two Swiss banks pleaded guilty to aiding and abetting tax evasion: (1) Wegelin & Co. in 2012; and (2) Credit Suisse AG in 2014. Additionally, two other financial institutions recently pleaded guilty to manipulating the London Interbank Offered Rates ("LIBOR"): (1) UBS Securities Japan Co., a subsidiary of UBS AG, in 2012; and (2) RBS Securities Japan Limited, a subsidiary of the Royal Bank of Scotland plc, in 2013.

Outside of the financial services industry, corporate guilty pleas over the past decade were not unheard of, but this practice has continued and intensified in parallel with DOJ's increased aggressiveness towards financial institutions. Indeed, DOJ has required many guilty pleas in recent years to settle corporate criminal investigations in a variety of industries. For example, Alstom S.A., a French power and transportation company, pleaded guilty in 2014 to violating the Foreign Corrupt Practices Act. Bridgestone Corporation, an automotive parts manufacturer, pleaded guilty in 2014 to participating in a conspiracy to fix prices. Several pharmaceutical companies have pleaded guilty in recent years for fraud in the healthcare industry, including a subsidiary of Johnson & Johnson in 2013, and GlaxoSmithKline plc in 2012. As stated above, the increase in the number of pleas in these other industries is a less novel development but nonetheless illustrates DOJ's heightened enforcement efforts.

Financial Penalties—Recent DOJ settlements have also included larger financial components, including multiple settlements over $1 billion.

For example, in addition to pleading guilty, BNP Paribas paid $8.9 billion in 2014 to resolve criminal liability for violations of U.S. trade sanctions, while Credit Suisse paid $2.8 billion in total to settle charges related to offshore tax evasion. In 2012, GlaxoSmithKline paid $3 billion to DOJ in connection with criminal and civil charges that it unlawfully promoted certain prescription drugs. At least 11 criminal settlements since 2012 have included total financial penalties greater than $1 billion.

Driving Forces Behind Recent Trend. DOJ's increased pursuit of guilty pleas and more stringent settlement requirements is part of a more aggressive enforcement environment for white-collar crime generally.

Financial institutions have been among the most visible targets of DOJ's recent enforcement trend. This appears to be a direct result of the substantial public pressure to hold the financial services industry accountable for criminal conduct and to deter future misconduct in the wake of the 2008 financial crisis. Indeed, Congress has closely scrutinized and criticized DOJ's efforts in investigating and prosecuting domestic and foreign financial institutions over recent years. For instance, in a February 2014 hearing related to DOJ's investigation of Credit Suisse, the Senate Permanent Subcommittee on Investigations pressured DOJ to be more aggressive in prosecuting Swiss banks and their employees for aiding and abetting tax evasion by U.S. taxpayers. Shortly thereafter, Credit Suisse entered into a guilty plea and paid $2.8 billion to settle investigations by DOJ and related state and federal authorities.

DOJ is also facing increased scrutiny and pressure from the courts. In February 2015, a federal judge in Washington, D.C. rejected a proposed DPA between DOJ and Fokker Services BV, a Dutch aerospace company. The proposed agreement was intended to resolve criminal liability stemming from violations of U.S. economic sanctions against Iran, and required Fokker Services to pay a $21 million penalty and reform its compliance programs. In rejecting the agreement, however, the judge stated that the DPA's terms were "grossly disproportionate" to the defendant's conduct and that "it would undermine the public's confidence in the administration of justice and promote disrespect for the law for it to see a defendant prosecuted so anemically . . . ." In particular, the judge criticized the DPA because (1) the proposed penalty was not "a penny more" than the revenue Fokker Services had earned through the illegal activity; (2) numerous employees involved in the misconduct were allowed to stay at the company; and (3) the DPA did not require an independent compliance monitor.

Practical Implications. DOJ's aggressive enforcement approach towards corporate criminal wrongdoing has several important consequences.

Negative Impact on Business—Most obviously, a guilty plea brings immediate negative publicity and attention for the settling corporation, and has repercussions on its ability to conduct business.

Notably, however, recent guilty pleas have not resulted in fatal consequences. This may be attributable to a number of factors, including the timing and context of the guilty plea. For example, Arthur Andersen LLP was indicted by a grand jury and collapsed even before being convicted at trial. Similarly, Wegelin was indicted by a grand jury and dissolved before pleading guilty months later. By contrast, Credit Suisse, Alstom, Bridgestone, and the subsidiaries of UBS and RBS had reached settlements with DOJ prior to the filing of criminal charges. They pleaded guilty to charges in a criminal information, not preceding indictment, announced as part of a negotiated settlement with DOJ.

With respect to Credit Suisse, moreover, various measures mitigated the potential for harmful collateral

consequences. For instance, Credit Suisse paid a penalty to the New York Department of Financial Services, which in turn, agreed to not revoke Credit Suisse's banking license. In announcing the settlement, DOJ explained that coordination with other regulators, including the Department of Financial Services, was crucial because "criminal charges involving a financial institution have the potential to trigger serious follow-on actions by regulatory agencies."

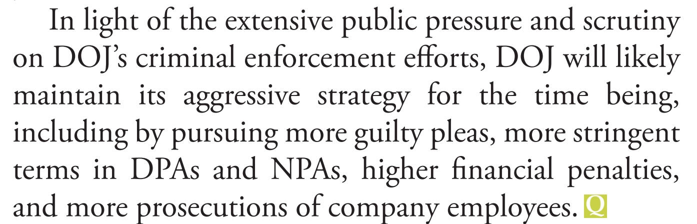
In addition, as discussed above, in the LIBOR cases of RBS and UBS, only their subsidiaries were required to plead guilty, while the parent companies reached more favorable and less stigmatizing resolutions: an NPA for UBS and a DPA for RBS. DOJ likely structured the settlements in this way to avoid the damaging reputational and regulatory consequences that could result if the parent companies were required to plead guilty.

Even where not fatal, however, a guilty plea may have other harmful consequences, including loss of business, loss of regulatory approvals, and, for publicly-traded entities, a reduction in share price. As an example, in parallel with its DOJ settlement, BNP Paribas entered into a settlement with the Department of Financial Services, pursuant to which it agreed to suspend certain U.S. dollar clearing services for one year.

Increased Importance of Cooperation—The level of cooperation with the government remains a key factor to the ultimate settlement outcome. For instance, Alstom did not fully cooperate with DOJ's investigation until after DOJ had publicly charged several Alstom executives. In announcing the settlement, DOJ explicitly stated that Alstom's failure to voluntarily disclose and failure to fully cooperate for several years were among the key factors that led to the outcome. Similarly, Credit Suisse's high penalty and guilty plea are attributable in part to its lack of cooperation and failure to conduct a thorough internal investigation.

Increased Costs for Resolving Liability—Another practical consequence of the new enforcement environment is that the costs of resolving corporate criminal liability have increased. High penalty amounts have become more prevalent, as discussed above. Further, as DOJ's settlement demands and a corporation's settlement expectations diverge, the time and expenses necessary to successfully advocate for and negotiate a satisfactory settlement have correspondingly increased.

Corollary Risks for Individuals—Finally, DOJ's aggressive approach towards corporate wrongdoing has had spillover effects on individuals. Prosecutions of individual employees have become more common. For example, in connection with DOJ's investigation into the manipulation of LIBOR by financial institutions, DOJ has also prosecuted several individuals, including six employees of the Dutch bank Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. In addition, many individuals, including those without a direct risk of prosecution, have suffered severe professional consequences. Just months after BNP Paribas settled with DOJ, its chairman resigned. Similarly, Credit Suisse's chief executive officer stepped down less than a year after the bank's settlement.



In light of the extensive public pressure and scrutiny on DOJ's criminal enforcement efforts, DOJ will likely maintain its aggressive strategy for the time being, including by pursuing more guilty pleas, more stringent terms in DPAs and NPAs, higher financial penalties, and more prosecutions of company employees.

VICTORIES

U.S. Supreme Court Victory in Important Jury Deliberations Case

The firm won a unanimous victory on December 9, 2014, in the United States Supreme Court in the case of *Warger v. Shauers*, in which the Court agreed with the firm that Federal Rule of Evidence 606(b) prohibited use of juror testimony to impeach a fellow juror's honesty in voir dire. This victory is particularly important because it resolves a long-standing circuit split regarding the application of Rule 606(b), which generally prohibits testimony of jurors about statements made during deliberations when the testimony is offered in "an inquiry into the validity of a verdict or indictment." In the case, Petitioner appealed a jury verdict finding that the defendant was not negligent in an automobile accident in which Petitioner suffered injuries. In challenging the verdict, Petitioner sought to introduce an affidavit of a juror alleging a fellow juror was dishonest during voir dire. In its unanimous opinion, the Supreme Court held that Rule 606(b) prohibits using juror testimony of purported juror dishonesty during voir dire to attempt to overturn a jury verdict and seek a new trial. Partner Sheila L. Birnbaum successfully argued the case before the Supreme Court.

Quinn Emanuel Obtains String of Favorable Rulings in Nationwide Class Action Leading to Modest Settlement of Few Remaining Individual Claims

Quinn Emanuel recently obtained a major victory for defendant ADT Security Services, securing rulings limiting a putative class action with California, Maryland, and nationwide claims to a small set of individual actions that were settled for a nominal amount.

Plaintiffs alleged that the fees ADT charges customers who prematurely cancel a term contract were both deceptively disclosed and unlawful liquidated damages provisions under California and Maryland law. They further alleged that ADT's contracts were subject to and did not comply with the federal Truth in Lending Act.

First, at summary judgment, Quinn Emanuel obtained a ruling that ADT's contract cancellation fees were not subject to California liquidated damages law. On April 7, 2014, the Central District of California ruled that these charges should instead be analyzed as alternative means of performance to fulfilling the full contract term. Under alternative means of performance doctrine, the Court found the cancellation fees presented consumers with a rational choice when viewed from the outset of the contract, and it held ADT's cancellation fees lawful.

Second, on supplemental summary judgment briefing, Quinn Emanuel obtained a ruling that the cancellation fees were properly disclosed. On June 16, 2014, the Court held that the challenged provisions of ADT's customer contracts were not likely to confuse reasonable consumers and therefore were lawful under various California consumer protection statutes.

Finally, with the California claims removed from the case, Quinn Emanuel obtained a ruling that the remaining plaintiffs had missed their deadline and therefore forfeited their opportunity to move for class certification. As a result, the putative nationwide class action became a handful of individual claims, and Quinn Emanuel resolved the entire action for a nominal sum.

Arbitration Win for Japanese Textile Machinery Manufacturer

Quinn Emanuel represented a Japanese textile manufacturer against a U.S. company purportedly specializing in the growth and manufacture of carbon nanotube fibers in a dispute over the joint development of machinery for the spinning of carbon nanotube yarns. In a 2007 contract, the two parties agreed to work together exclusively and share their technology, expertise, and raw materials to develop cutting-edge carbon nanotube spinning machines. The U.S. company represented to Quinn Emanuel's client that it had developed proprietary methods for growing high-quality carbon nanotubes and pulling them into individual fibers with more desirable qualities (e.g., strength, flexibility, conductivity) than had ever been recorded. Quinn Emanuel's client was enlisted to use its textile expertise to develop machinery to spin these individual fibers into yarn on a commercial scale. Had this arrangement been successful, the carbon nanotube yarn produced with this machinery would have had myriad commercial and industrial applications and been the source of massive profit for both companies.

Once the agreement was signed, however, Quinn Emanuel's client discovered its ostensible partner did not have any of the technology or capabilities that had been the basis for the contract. It could not provide raw materials, technological information, or development support. Quinn Emanuel's client put in its best efforts for over two years, but ultimately decided to terminate the agreement and proceed with development independently. The U.S. company, based on a 20-year exclusivity provision in the contract that explicitly survived termination, refused to release

Quinn Emanuel's client from its obligations. Instead, it threatened litigation if Quinn Emanuel's client sold carbon nanotube spinning machinery to anyone else during the agreement's 20-year term.

Facing the prospect of being unable to release its carbon nanotube spinning technology to the public, Quinn Emanuel's client demanded arbitration, claiming fraud and material breach by its former collaborator. Quinn Emanuel's client sought rescission of the agreement or a finding of material breach, either of which would release it from any remaining obligations. After a three-day hearing, the arbitrator awarded the requested relief. The reasoned award enumerated virtually every factual finding in Quinn Emanuel's client's favor, found that the U.S. company had materially breached the contract, and issued declaratory relief specifically stating that Quinn Emanuel's client was no longer bound by the exclusivity provision in the contract. The sole arbitrator found that the U.S. company had knowingly deceived Quinn Emanuel's client about its capabilities. Quinn Emanuel's client is now able to freely develop and sell carbon nanotube machinery; all barriers to its technological innovation have been lifted.

New York Appellate Court Victory Holding That Entergy's Indian Point Energy Center Is Exempt from Review Under New York's Coastal Management Program

The firm obtained an important victory for its client Entergy when, on December 11, 2014, a New York state appellate court unanimously held that the Indian Point Energy Center is exempted under the New York Coastal Management Program ("CMP") from review for consistency with the CMP's policies. The ruling removes a potential hurdle to Entergy's ability to obtain a federal renewal license to operate Indian Point for another twenty years.

Indian Point, a power generating facility that was constructed at a cost of $2.45 billion and supplies a fifth of southeastern New York's power, is located on the Hudson River, an area considered a coastal region by the federal Coastal Zone Management Act ("CZMA"). Under the CZMA, New York State potentially could force denial of the federal renewal license by objecting to Entergy's certification that Indian Point complies with the policies in the New York CMP. Specifically, the CZMA provides that if a state has obtained federal approval for a CMP, a federal license applicant must certify that its proposed project complies with the policies in the CMP. The state has the ability to object to the applicant's certification and if it does, the federal agency is precluded from granting the license, unless the federal Secretary of Commerce overrides the objection.

New York's CMP also contains a grandfathering clause, which provides that the CMP will not be applied to any plant that has undergone an environmental review prior to a particular date, before New York's CMP was enforceable. Entergy contended that, because Indian Point had undergone an environmental review prior to the relevant date, it should have been grandfathered and should not have to be reviewed for consistency with New York's CMP. Represented by a different law firm, Entergy's argument was rejected by the relevant New York agency (the New York State Department of State) and then by the New York Supreme Court, Albany County.

Quinn Emanuel was brought in to handle Entergy's appeal to the Appellate Division, Third Department, one of New York's intermediate appellate courts. The firm argued that the plain language of the grandfathering exemption dictated that Indian Point must be grandfathered from review for compliance with New York's CMP and also assuaged any concerns that a finding of grandfathering would exempt Indian Point from other reviews related to the re-licensing process. That strategy succeeded. On December 11, 2014, the Third Department reversed the agency's and Supreme Court's determination and "agree[d] with [Entergy] that the [State's] reading of the [grandfathering] exemption offends the plain meaning of its language, is irrational and cannot be sustained." *Entergy Nuclear Operations, Inc. v. New York State Dep't of State*, No. 518510, 2014 WL 6978224 (3d Dep't Dec. 11, 2014). As a result of the firm's winning argument, the court declared that Indian Point is exempt from review under New York's CMP.

The decision is significant because it removes a substantial uncertainty from the renewal licensing process for Indian Point and allows the company to focus on other pending aspects of re-licensing. The continued operation of Indian Point is key to sustained and reliable provision of electrical power to New York City and the surrounding areas without significant emissions of greenhouse gases and without increased costs to consumers. Q

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