June 2016

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# Federal Circuit Recognizes New, but Limited, Privilege for Patent Agent Communications

***Introduction***

Patent agents are licensed to practice before the United States Patent and Trademark Office ("USPTO"), and perform the same duties as patent attorneys in proceedings before the USPTO, including preparing and prosecuting patent applications and rendering opinions on whether certain inventions are patentable. Paul R. Rice, et. al., Attorney-Client Privilege in the U.S. § 3:19 (2015 ed.). However, patent agents, who are not members of the bar, are not considered attorneys. *See* Robert A. Matthews, Jr., Annotated Patent Digest § 42:24 (2016). Whether communications with patent agents should be protected under the attorney-client privilege has long been an open question for the courts, and one that, until recently, did not have a clear answer.

In March 2016, in a case of first impression, the Federal Circuit recognized a "patent-agent privilege," which protects communications between a non-attorney patent agent and his or her client during the course of the patent agent's authorized practice before the USPTO. Before the Federal Circuit's decision in *In re Queen's University at Kingston*, 2016 WL 860311, —F.3d— (Fed. Cir. Mar. 7, 2016), district courts were divided as to whether patent agent communications were privileged.

***The Patent Agent's Role:* Sperry v. State of Fla. ex. rel. Fla. Bar, *373 U.S. 379 (1963)***

The question of whether client communications with patent agents should be privileged stems from the patent agent's unique role. Although not a licensed

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## INSIDE



## Quinn Emanuel and Charles Verhoeven Honored in *The Recorder*'s 2016 "Litigation Department of the Year" Competition

Quinn Emanuel was named a finalist—one of the top three firms—in *The Recorder*'s 2016 "Litigation Department of the Year" competition. This award recognizes California firms that delivered outstanding results in the most significant litigations of the year. Quinn Emanuel was selected from 150 firms for its defense jury verdict on behalf of Google in an E.D. Texas patent case filed by plaintiff SimpleAir and for its landmark representation of the Federal Housing Finance Agency in residential mortgage-backed securities litigation against the major Wall Street banks in which the firm recovered over $20 billion for the American taxpayer. San Francisco partner Charles Verhoeven was also honored with *The Recorder*'s "Game Changer" award, recognizing "a lead lawyer who won big after prior counsel had lost." In addition to leading the team that secured the defense jury verdict for Google against SimpleAir, Mr. Verhoeven obtained a reversal of a $85 million verdict against Google in another patent case brought by SimpleAir that had been handled by other counsel. Q

## General Counsels Name Quinn Emanuel "Most Innovative" Law Firm

Quinn Emanuel has been named to a list of eight law firms deemed "most innovative" by corporate counsel. BTI Consulting reported that the firm earned a reputation among general counsel of undertaking new approaches to remain ahead in the ever-changing legal landscape. Quinn Emanuel, the publication states, is among "the 'best of the best' at leading the way in creating new legal services and setting a standard that clients will expect moving forward." Q attorney, a patent agent engages in the practice of law before the USPTO. In *Sperry v. State of Fla. ex. rel. Fla. Bar*, 373 U.S. 379, 381 (1963), a seminal case that described the role of a patent agent, the State of Florida argued that it could enjoin the activities of a non-attorney patent agent because his work constituted the "unauthorized" practice of law. The United States Supreme Court disagreed. The Court began its analysis by recognizing that the patent agent's work "constitutes the practice of law." *Id.* at 383 (citations omitted). As the Court explained, the preparation and prosecution of patent applications requires that a patent agent advise clients concerning the patentability of inventions under applicable statutory criteria, and participate in the drafting of patent claims and specifications, among other things. *Id.*

The Court also held that although Florida could properly prohibit non-attorney patent practitioners from practicing law in the state, because the right of non-attorney patent agents to practice before the USPTO is conferred by federal law, Florida does not have the authority to regulate or enjoin those activities. *Id.* at 385. As the Court explained, Congress gave the Commissioner of Patents the power to "authorize practice before the Patent Office by non-lawyers, and the Commissioner has explicitly granted such authority." *Id.* at 385. Therefore, "by virtue of the Supremacy Clause, Florida may not deny to those failing to meet its own qualifications the right to perform the functions within the scope of the federal authority." *Id.* Looking to legislative history of the Patent Office and Administrative Procedure Act, the Court found that non-attorneys have been practicing before the Patent Office since "its inception, with the express approval of the Patent Office and to the knowledge of Congress." *Id.* at 388.

While *Sperry* recognized a non-attorney patent agent's right to practice law before the USPTO, it did not discuss whether patent agent communications with clients are privileged.

***Split in Case Law***

Lacking clear guidance from the Supreme Court, federal district courts were divided on the issue of whether patent agent communications were protected in the same manner as attorney client communications. Some courts found that communications with non-attorney patent agents fell outside the protections of the attorney client privilege. For example in *In re Rivastigmine Patent Litigation*, 237 F.R.D. 69, 102 (S.D.N.Y. 2006), the Court held that *Sperry* never intend to treat patent attorneys and patent agents as equals. Therefore, the Court declined to extend attorney-client privilege to communications between patent agents and their clients. *Id.* ("it does not follow that because the agent is permitted to engage in this defined subuniverse of legal practice, his activities are therefore equivalent to those of a practicing attorney."). *See also Joh A. Benckiser G. m. b. H., Chemische Fabrik v. Hygrade Prods. Corp.*, 253 F. Supp. 999, 1001 (D.N.J. 1966) ("In patent law, as in other fields, the rule is simply that communication between a client and an administrative practitioner who is not an attorney are not privileged.").

On the other hand, in *In re Ampicillin Antitrust Litigation*, *supra*, the Court found that the *Sperry* Court sought to protect a client's freedom to choose between a patent attorney or a patent agent to represent the client in proceedings before the USPTO. That freedom of selection would "be substantially impaired if as basic a protection as the attorney-client privilege were afforded to communications involving patent attorneys but not to those involving patent agents." 81 F.R.D. at 393. The Court therefore found that communications with a registered patent agent would be protected by attorney client privilege. *Id. See also Buyer's Direct Inc. v. Belk, Inc.*, 2012 WL 1416639 (not reported) (C.D. Cal. April 24, 2012) (attorney-client privilege applies to communications between client and registered patent agent as along as the communications related to presenting and prosecuting applications before the USPTO).

Other courts adopted a hybrid rule of sorts, holding that the attorney-client privilege applies to patent agents communications, but only if the patent agent was working under the direct supervision of an attorney. *See Golden Trade, S.r.L. v. Lee Apparel Co.*, 143 F.R.D., 514, 519 (S.D.N.Y. 1992) (communications with a patent agent are protected when made at the direction of a lawyer); *Cuno, Inc. v. Pall Corp.*, 121 F.R.D. 198, (E.D.N.Y. 1988) ("In any event, the weight of authority holds that the privilege applies to confidential communications with patent agents acting under the authority and control of counsel") (citations omitted). However, because the attorney client privilege protects communications between the attorney's agent and the client, these courts did not extend the attorney client privilege, but instead treated patent agents as any other non-attorney.

***Creation of Patent-Agent Privilege:* In re Queen's University at Kingston**

In *In re Queen's University at Kingston*, the Federal

Circuit resolved this split in the district courts by creating a new, limited privilege. In that case, plaintiffs Queen's University and PARTEQ (together, "Queen's University") withheld documents from discovery on the grounds that the documents reflected privileged communications between its employees and its patent agent. *Queen's University*, 2016 WL 860311, at *1. The magistrate judge granted defendant's motion to compel, "finding that the communications between Queen's University employees and their non-attorney patent agents are not subject to the attorney-client privilege and that a separate patent-agent privilege does not exist." *See id.* (citing Minute Entry for Proceedings Held Before Magistrate Judge Roy S. Payne, *Queen's* (E.D. Tex. June 17, 2015), ECF No. 149). The district court overruled Queen's University's objection to the order, but stayed the ruling pending review by the Federal Circuit. *Id.*

The Federal Circuit stated that whether patent agent communications were privileged was one of first impression for that court and acknowledged that while it had the authority to define new privileges, it must do so with caution in light of the general presumption against creating new privileges. *Id.* at *5 ("Indeed, the Supreme Court has warned that evidentiary privileges 'are not lightly created nor expansively construed, for they are in derogation of the search for truth.'") (quoting *United States v. Nixon*, 418 U.S. 683, 710 (1974)).

The Federal Circuit began its privilege analysis by recognizing that courts have consistently refused to protect as privileged communications between clients and other non-attorney client advocates, such as accountants, or jailhouse lawyers. *Id.* at *6. (citations omitted). However, the Court found that the "unique roles of patent agents," their authority to engage in activities constituting the practice of law, and the "current realities of patent litigation" distinguished patent agent communications from those of other non-attorney advocate communications, and weighed in favor of creating a new patent-agent privilege. *Id.* ("To the extent, therefore, that the traditional attorney-client privilege is justified based on the need for candor between a client and his or her legal professional in relation to the prosecution of a patent, that justification would seem to apply with equal force to patent agents.") (*Id.* at *7.)

The *Queen's University* Court then looked to the *Sperry* Court's examination of the legislative history behind the creation of the Patent Office and found that because Congress had authorized patent agents to "engage in the practice of law before the Patent Office, reason and experience compel [it] to recognize a patent-agent privilege that is coextensive with the rights granted to patent agents by Congress." *Id.* at *9. The Court explained that a patent-agent privilege was necessary to preserve a client's reasonable expectation that communications in connection with preparing and prosecuting a patent application will remain privileged. "Whether those communications are directed to an attorney or his or her legally equivalent patent agent should be of no moment." *Id.*

***Potential Pitfalls—Scope of the Privilege***

Determining the parameters of the newly created patent-agent privilege is likely to be the subject of future litigation. The burden of determining which communications come within the privilege "rests squarely on the party asserting the privilege." *Id.* at *11. In attempting to define the scope of the privilege, the Federal Circuit looked to the regulations that set forth a patent agent's ability to practice before the USPTO. *Id.* Specifically, 37 C.F.R. § 11.5(b)(1) provides that practice before the USPTO includes: preparing and prosecuting patent applications, consulting or advising clients in connection with filing a patent application or other document with the USPTO, drafting patent applications (including the specification or claims) and any amendments to the applications, and communicating with the USPTO regarding patent applications or related documents.

According to the Federal Circuit, communications between a client and a non-attorney patent agent that are in furtherance of the tasks described in Section 11.5(b)(1) are protected. *Id.* Also protected are communications "which are reasonably necessary and incident to the preparation and prosecution of patent applications or other proceedings before the Office involving a patent application or patent in which the practitioner is authorized to participate" [citations omitted]. *Id.* at *12. However, tasks that are not listed in C.F.R. § 11.5(b)(1) and "are not reasonably necessary and incident to the prosecution of patents before the Patent Office [will] fall outside the scope of the patent-agent privilege." *Id.* Thus, a client's communications with a patent agent concerning litigation matters, such as non-infringement of a third-party patent, are not within the scope of patent-agent privilege. Similarly, it is likely that patent agent communications related to licensing or other similar transactions would not fall within the scope of the newly created privilege.

The dissent in *Queen's University* argued that the newly created privilege was both complicated and uncertain. For example, the dissent pointed out that, according to the majority, communications with a patent agent who opines on the validity of another's patent in contemplation of litigation or in connection with the sale or purchase of a patent or on infringement, are not privileged. *Id.* at *16. However, federal regulations also state that, in certain circumstances, such communications would fall within the scope of a patent agent's practice, thus making the communications arguably privileged, depending on the client's intent in seeking the opinion from the patent agent. *Id.* The dissent also states that another gray area involves drafting contracts for assignments while patent applications are still pending, because, in some circumstances, whether or not such conduct is part of the patent agent's authorized practice (and thus within the privilege) will depend on the law of the state in which the patent agent is practicing. *Id.* at *17. The dissent also notes that advising the client as to the scope of the patent-agent privilege would not be within the patent agent's authorized scope of practice before the USPTO, thereby requiring the client to hire an attorney to determine the application of the newly created patent-agent privilege. *Id.*

In short, while clients may find some solace in the protections offered by the patent-agent privilege, the privilege is not absolute. Only those communications with patent agents that are related to the patent agent's authorized practice before the USPTO will fall within the scope of the privilege. Other communications, including those related to litigation issues, remain discoverable. Q

# NOTED WITH INTEREST

## Australia: An Increasingly Attractive Plaintiffs' Forum for Securities Class Actions

The United States has long been the primary home for securities class actions around the world. This trend, however, was curtailed to some degree with the Supreme Court decision in *Morrison v. National Australia Bank*, 130 S. Ct. 2869, 2886 (U.S. 2010), which made it more difficult for international litigants in securities class actions to sue in the United States. This has paved the way for the growth of Australia's securities class action regime.

*Morrison* involved a claim by a foreign investor against a foreign company, listed on a foreign Securities Exchange for alleged misconduct in breach of Rule 10b-5 and Section 10(b) of the Securities Exchange Act (anti-fraud provisions). Although National Australia Bank (NAB) shares did not trade directly in the United States, they were available on the secondary market by way of American Depository Receipts. The plaintiffs were Australian citizens seeking to represent a class of foreign purchasers. They claimed that a mortgage servicing company purchased by NAB and located in Florida had knowingly manipulated the firm's financials.

The critical legal issue in the case was whether the conduct alleged by the plaintiffs had a sufficient nexus to American law. The decision of the Supreme Court turned on the proper interpretation of a statutory provision that is silent about whether it applies extraterritorially. In ruling that the provision has no extraterritorial application on the basis of a general presumption against extraterritoriality, the Court overturned more then 40 years of lower court authority and established a new transactional test confirming that the anti-fraud provisions apply only to the purchase or sale of securities listed on a U.S. exchange or where the purchase or sale occurred in the U.S. This substantially limits the scope for foreign investors to use the U.S. courts to bring claims against foreign issuers to recover losses from purchases on foreign securities exchanges. As a result, securities claims are now more likely to be brought in non-U.S. jurisdictions. Australia is an attractive jurisdiction to bring such claims.

Australia's class-action regime is notoriously plaintiff-friendly, and has been described as "one of the most liberal class action regimes in the entire world" (Professor G. Miller, 'Some Thoughts on Australian Class Actions in light of the American Experience' in the Hon. Justice K. E. Lindgren (ed), Investor Class Actions, Ross Parsons Centre of Commercial, Corporate and Taxation Law (2009) 2 at 4). In brief, class actions are generally commenced under the Federal Court of Australia's (FCA) "representative proceeding" regime set out in section 33C of the FCA Act 1976 (Cth), which provides that where: (i) seven or more persons have claims against the same person; and (ii) the claims of all those persons are in respect of, or arise out of, the same, similar or related circumstances; and (iii) the claims of all those persons give rise to a substantial common issue of law or fact; a proceeding may be commenced by one or more of those persons as representing some or all of them.

The Australian class action procedure has no certification requirement. Instead, plaintiffs commence the suit as a representative action and define the parameters of the class themselves (so long as they meet the threshold requirements listed above); the onus is on the defendant to show that the case should not proceed as a class action. Australia's "opt out" provision is one of the cornerstones of its class action system—once the representative plaintiff defines the class, every person who falls within the class definition is a group member unless and until he or she opts-out of the proceedings. If, after receiving notice of the right to "opt out," a member fails to do so by the specified date, he or she remains a group member in and will be bound by the outcome of the class action. Shareholder class actions in Australia are typically premised on allegations that a company's disclosure (or non-disclosure) of material information was misleading or deceptive and in breach of its continuous disclosure obligations under Australian law. Australia's corporate regulations require companies to "immediately" disclose all information that a reasonable person would expect to have a material effect on the price or value of the company. This obligation of continuous disclosure means that a plaintiff is not required to establish that a failure to disclose was intentional (subject to certain exceptions, including confidentiality). Under the ASX Listing Rules, a company is "aware" if a director or executive officer "has, or ought reasonably to have, come into possession of the information in the course of the performance of their duties as director or executive officer of that entity" (Rule 19.12).

Claims based on a failure to comply with disclosure obligations are generally accompanied by a corresponding action for breach of the statutory prohibition of misleading and deceptive conduct. This is a powerful claim: there is no need to demonstrate intention, negligence, fraud, or dishonesty.

***Reliance and "Market-Based Causation"***

In U.S. law, the "fraud on the market" theory is a rebuttable presumption that shareholders can rely on the integrity of the market price when making investment decisions in open market transactions (*Basic v. Levison* (1988)). Reliance and causation are presumed: i.e., any misstatement to the market is presumed to affect the price of the stock. Any "showing that severs the link between the alleged misrepresentation and either the price paid or price received or his [or her] decision to trade at a fair market price will rebut the presumption of reliance." By dispensing with the need for proof of individual reliance, the "fraud on the market" theory also enables security class actions to be certified (Federal Rules of Civil Procedure).

Plaintiffs in Australia have sought to adopt the same approach. Until recently, it was not known whether Australian courts would embrace the "fraud on the market" theory because all previous securities class actions have settled before judgment. The recent first instance decision of *HIH Insurance Ltd (In Liquidation) & Ors* [2016] NSWSC 482 (*HIH Insurance*), suggests that Australia is willing to embrace this approach. In that case, Brereton J ruled that direct reliance need not be established where: (i) an entity has overstated its financial results to the market; (ii) the market was deceived into a misapprehension that being the entity was trading more profitably than it really was and had greater net assets than it really had; (iii) that shares traded on the market at an inflated price; and (iv) investors paid that inflated price to acquire their shares, and thereby suffered loss. In such cases, the burden falls upon the defendant to prove that a plaintiff knew the truth about, or was indifferent to the contravening conduct but proceeded to buy the shares nevertheless.

Given the plaintiff-friendly aspects of Australia's representative proceedings, and the recent developments in other jurisdictions, like the U.S., Australia is now poised to become a forum of choice for plaintiffs seeking redress in the world of securities class actions. Q

## Former Quinn Emanuel Partner Manisha Sheth Appointed Executive Deputy Attorney General of the Economic Justice Division for the New York Attorney General's Office

Former New York partner Manisha Sheth was appointed to the position of Executive Deputy Attorney General for Economic Justice. In her new role, Ms. Sheth leads over 250 employees in the Division's five litigation bureaus: Investor Protection, Antitrust, Consumer Frauds, Internet & Technology, and Real Estate Finance. At the firm, Ms. Sheth handled a wide range of commercial litigation, including structured finance and derivatives litigation, securities litigation, healthcare litigation, government investigations, and white collar defense and internal investigations. Ms. Sheth's appointment continues the long tradition of public service by partners of the firm. Q

## Trial Practice Update

***Jury Selection*—Batson v. Kentucky *Is Alive and Well.*** Last month the United States Supreme Court issued its long-awaited decision in *Foster v. Chatman*, 578 U.S. __ (2016), reaffirming its 30-year-old decision in *Batson v. Kentucky*, 426 U.S. 79 (1986), which prohibited the use of peremptory jury challenges that were racially motivated. *Foster* reaffirmed the Constitution forbids striking even a single prospective juror for a discriminatory purpose. Justice Roberts, writing for a 7-1 majority in *Foster*, emphatically stated, “two peremptory strikes on the basis of race are two more than the Constitution allows” 578 U.S. __ (2016).

Racially motivated use of peremptory challenges in selecting a jury has a long history. The right to a jury trial has been one of the bedrocks of the common law since King John was forced at sword point in a field in Runnymede, England to sign the Magna Carta and this right to jury trial was incorporated into the United States Constitution in the Bill of Rights as Amendments 6 and 7. No one can doubt its value in our society. However, with that right came the time-honored tradition of peremptory challenges.

Under common law, peremptory challenges allow litigants the unfettered discretion to remove a juror without explaining to anyone what the reasons were. The basis for such a right was in the assumption that no one truly knew a case and a client as well as the attorneys and the clients involved in litigation. The number of peremptory challenges is limited and varies by jurisdiction. These challenges differed from unlimited challenges based on cause, which allow the court to decide whether a juror should be disqualified because of bias, prejudice, knowledge of the parties, or other applicable circumstances. However, as with any good idea, the devil is in the details.

As the United States became more urbanized and trial lawyers no longer knew the people in their communities, these peremptory challenges often became based, not on any reasoned approach, but on ethnic, racial, and stereotypical assumptions. Even the great Clarence Darrow summarized his philosophy of jury selection as follows:

> Never take a German; they are bull-headed. Rarely take a Swede; they are stubborn. Always take Irish or a Jew; they are the easiest to move to emotional sympathy. Old men are generally more charitable and kindly disposed than young men. They have seen far more of the world and understand it.

Oxford Book of Legal Anecdotes, 101 (M. Gilbert 1986).

Still, these abuses went on for several years until 1986 when the United States Supreme Court concluded that peremptory challenges based on predominately racial grounds deprived criminal defendants of their due process rights under the 14th Amendment to the United States Constitution. 476 U.S. 79 (1986).

A new jury selection procedure was developed whereby when one side would move to strike a prospective juror, opposing counsel would make a *Batson* challenge where he was required to make a prima facie case showing the striking of this juror was based on racial grounds. This then shifted the burden of persuasion to the party seeking to disqualify a juror to explain a race-neutral reason for his exercise of the peremptory challenge, and then the opposition would have an opportunity to argue that such a proffered reason was purely pretextual. The Court would then rule whether the party making the challenge had established an impermissible reason. This procedure seemed to make sense to Appellate Courts and in the classroom, however those practicing criminal law knew that the procedure was still fraught with risks and did not eliminate racially biased use of peremptory challenges. Indeed, one does not have to look further than the recent TV mini-series *People vs. O.J. Simpson* to see prosecutors and defense counsel jostling to try and retain or excuse jurors based solely on race. The then L.A. County District Attorney was quoted as recently as two months ago criticizing the actual trial line prosecutor because she “didn’t heed the advice of our trial consultant who told her not to pick African-American women—particularly black mothers—for that jury,” he said, noting eight black women ended up on the panel. *New York Post*, April 10, 2016.

The recently decided case of *Foster v. Chatman* gave the Court an opportunity to revisit *Batson*. *Chatman* has particularly egregious facts. Foster, a 19-year-old African-American was charged with strangling a 79-year-old white woman in her home. Over *Batson* challenges, the prosecution struck all four of the black prospective jurors on the panel, and Foster was convicted and sentenced to death by an all white jury. The conviction was affirmed by the Georgia Supreme Court. On a state habeas petition, a subpoena was issued for the prosecutor’s notes which led to the discovery that the prosecutor had capital “B”s in big letters written next to the name of each potential African-American juror it dismissed and ranked them Bl, B2, and B3. The notes also contained a list of “definitive NO’s” which had all prospective black jurors at the top. The prosecutor also described his race-neutral reasons for striking the black jurors due to his belief that various combinations of the jurors were "confused," easily swayed," irrational," "incoherent" and demonstrated "bad body language," or lived too close to the victim or the defendant. The Georgia trial court was not swayed by this new evidence of racial animus and denied the habeas petition. The reviewing court denied it as well.

The Supreme Court saw two issues it needed to decide: 1) whether after the case was heard and upheld four times by various Georgia state courts, did the Supreme Court have the ability to review; and 2) on the merits, was there sufficient evidence to conclude the prosecutor's several race-neutral explanations for his strikes of the African American jurors were a pretext for constitutionally improper use of peremptory challenges.

As to the jurisdictional issue, the State argued that since this case was fully litigated all the way to the Georgia Supreme Court, *res judicata* precluded review. The Supreme Court acknowledged that it did not have the ability to review a state court judgment that was "independent" of the merits of a federal claim and that there was an "adequate" basis for the state court decision. However, the *Foster* Court ruled that since the *Batson* challenge was based on federal constitutional rights, the Georgia decision overruling the challenge was not "independent" of federal law and jurisdiction for review existed.

When reaching the second issue of whether the prosecutor's proffered race-neutral explanations were in fact pretextual, the Court had little trouble concluding they were. The Court concluded that "in reviewing a ruling claimed to be *Batson* error, all of the circumstances that bear on the issue of racial animosity must be consulted." After a careful factual analysis, the Court found the supposed race-neutral reasons are "difficult to credit" because many of the white jurors exhibited many of the same factors and were not stricken. The Court concluded that the focus on race in the prosecutor's file clearly demonstrated a concerted effort to remove African Americans from the jury. The Court then reversed the 30-year-old conviction and remanded back to the State court for further proceedings.

While some trial practitioners will argue that *Foster* was so fact based with such rare documentary evidence on racial motivation resulting in an unfair result, it should be narrowly construed. Others will assert that *Foster* makes clear that a pattern or practice of racial exclusion is not necessary and that one impermissible use of a peremptory challenge is a violation of the Federal Constitution. *Foster* is also sure to be used to urge trial court's to conduct a much deeper inquiry into the supposed "race-neutral" explanation to see if it is sincere or pretextual. Since the holding of *Batson* has been extended to civil cases in *Edmonson v. Leesville Concrete Company,* 500 U.S. 614 (1991), and to discrimination based on a juror's sex in *J. E. B. v. Alabama ex rel.*, 511 U.S. 127 (1994), new issues will undoubtedly arise, and this area of the law will continue to be more fully developed.

## Energy Litigation Update

***Bankruptcy Judge's Decision in* Sabine Oil & Gas *Alters the Relationships and Value Allocations Between Oil Producers and Midstream Companies.*** The hottest area in restructuring in 2016 is oil and gas. In the first five months of 2016, dozens of companies have sought bankruptcy protection in the wake of the substantial decline in oil prices and balance sheets burdened with hundreds of millions, and even billions, in funded debt. The bankruptcy cases often are fights over allocation of valuation among first lien secured lenders, second lien secured lenders, and unsecured bondholders, with little involvement of (or value left over for) trade creditors and contract counterparties. Often the companies have substantial operations and property in Texas.

Now, a recent decision by the influential United States Bankruptcy Court for the Southern District of New York in *In re Sabine Oil & Gas* creates a strategic reason for struggling companies to file for bankruptcy and escape performance under burdensome contracts—the ability to reject gas-gathering agreements as executory contracts. While using bankruptcy to reject burdensome contracts and leases is as old as the Bankruptcy Code, the ability to reject gas-gathering agreements and override previously held expectations about real property interests granted by such contracts may give producers a leg up, and midstream companies new risks, in the efforts to restructure.

In *Sabine*, the debtor, Sabine Oil & Gas Corp., sought court approval allowing it to "reject" certain gas gathering and handling agreements that it had with two counterparties. Rejection under Bankruptcy Code section 365 permits a debtor to cease performing under an "executory contract" or lease, and leaves the counterparty with a pre-bankruptcy general unsecured claim for rejection damages. Sabine argued that these contracts were burdensome to maintain. For one contract, Sabine claimed it was no longer shipping enough fuel to meet its minimum commitments under the agreement and would have to pay the counterparty \$35 million over the life of the contract to make up the difference. Sabine also asked the court to permit it to reject agreements with a second pipeline operator, arguing that it would save as much as $80 million and avoid sinking money into unprofitable wells the company would be required to drill under the agreement.

What made this dispute unique was that the agreements (governed by Texas law) were drafted to create a property right known a "real covenant" that "runs with the land," which normally cannot be invalidated through the bankruptcy contract rejection process. In other words, rejection itself would not change the economic burdens the debtor faced because the counterparties' rights under the contracts were real property interest that were not capable of being rejected.

On May 3, 2016, Bankruptcy Judge Shelley Chapman, who is overseeing the *Sabine* case, issued a decision permitting the debtor to reject gas-gathering and related agreements with two midstream companies. In doing so, Judge Chapman resolved two important issues involving Texas oil and gas law. First, Judge Chapman addressed whether the agreements provided for covenants running with the land. The court explained that "under Texas law, a covenant runs with the land when (1) it touches and concerns the land; (2) it relates to a thing in existence or specifically binds the parties and their assigns; (3) it is intended by the original parties to run with the land; and (4) the successor to the burden has notice." In her initial ruling in March 2016 (which is attached to her published decision), Judge Chapman held that because minerals extracted from the ground cease to be real property under Texas law, the right to gather and process such extracted minerals was not a right that touched and concerned the land. In her final ruling, Judge Chapman held that because the agreements contained language indicating that fees for the gathering services were triggered by the receipt of gas at times other than the extraction of the gas from the ground, the subject of the agreements was minerals extracted from the ground rather than minerals in the ground. The Court concluded that the covenants did not "touch and concern" the land and thus did not create valid real covenants as required under Texas law.

The second issue the court addressed was whether Sabine was in "horizontal privity of estate" with each of the midstream companies involved. The concept of horizontal privity means that a real covenant is not valid unless it is created simultaneously with the conveyance of a recognized property right. Acknowledging that Texas law was unclear on the issue, Judge Chapman held that the parties were not in horizontal privity because there was no such conveyance.

This ruling applies only to agreements under Texas law, and it is certainly possible to limit the ruling to the specific language used in the agreements. Nonetheless, given the number of E&P companies in distress with operations in Texas, this ruling has sent shockwaves through the midstream industry—an industry already reeling by the repeated bankruptcy filings of E&P companies. Within days of the preliminary ruling, *The Wall Street Journal* reported: "[P]roducers are already asking for breaks on fees and volume commitments, and some experts said the ruling could set a new tone for those discussions. The closely watched case is likely to upend the once symbiotic relationship between companies that pump fuel and those that spent billions to lay thousands of miles of pipelines to move it." One E&P company in bankruptcy, Magnum Hunter Resources, quickly commenced proceedings to reject a gas purchase agreement, and touted its ability to use rejection to renegotiate approximately a dozen midstream and downstream contracts.

## Antitrust Litigation Update

***DOJ Antitrust Division Annual Update.*** On April 8, 2016, the Antitrust Division of the United States Department of Justice issued its 2016 Spring Update. The update highlights recent developments and trends in the Division's enforcement activities, and shows that the Division has continued to take a more active enforcement approach, including through litigation and trial.

***Enforcement Statistics.*** The Division reported its enforcement statistics. In its 2015 fiscal year, the Division filed 60 criminal cases, charged 66 individuals and 20 corporations, and obtained $3.6 billion in criminal fines and penalties. These numbers reflect a 33% increase in the filing of criminal cases and a 50% increase in the charging of individuals from the prior fiscal year. The amount of criminal fines and penalties was a new record. This increase in enforcement activity parallels the increased focus on enforcement against individuals, as directed in the memorandum issued by Deputy Attorney General Sally Yates on September 9, 2015.

***Trial Activity.*** The Division highlighted the successful conclusion of its litigation against Apple for orchestrating a per se illegal conspiracy of five of the largest publishers to raise the price of e-books. In June 2015, the Second Circuit upheld the Division's trial victory against Apple, and in March 2016, the Supreme Court denied Apple's petition for writ of certiorari. The denial of Apple's petition triggered its obligation to pay $400 million to consumers under its settlements with state attorneys general and private class plaintiffs. The publishers had elected to settle for $166 million before trial, but Apple had chosen to proceed alone. These results demonstrates the Division's willingness and ability to pursue its enforcement activities through trial and appeal.

The Division also highlighted its successful effort through trial to prevent the merger of the appliance businesses of General Electric and Electrolux. In July 2015, the Division filed a lawsuit to block the merger, and in December 2015, four weeks after the start of the trial and one day before the close of evidence, General Electric exercised its option to abandon the merger and to pay a termination fee of $175 million. This victory followed the Division's successful efforts to prevent other significant mergers, including the mergers of Comcast and Time Warner, Applied Materials and Tokyo Electron, and Chicken of the Sea and Bumble Bee.

***Litigation Activity.*** The Division also highlighted other litigation successes. On March 16, 2016, Tribune Publishing, publisher of the *Los Angeles Times*, won the bankruptcy court auction to purchase Freedom Communications, publisher of the Orange County *Register* and the Riverside *Press-Enterprise*. The sale was to be approved by the bankruptcy court on March 21. On March 17, the Division filed a complaint, and the next day, it filed a fully briefed request for a temporary restraining order ("TRO") blocking the purchase. The request was granted that evening. On March 19, Freedom Communications recommended an alternative purchaser, and on March 21, the bankruptcy court approved the sale to that purchaser. This result demonstrates the Division's willingness and ability to marshal and mobilize rapidly the resources necessary to pursue a TRO.

In addition, on November 15, 2015, the Division filed a lawsuit to block United Airline's acquisition of 24 takeoff and landing spots at Newark Liberty International Airport from Delta Air Lines. In April 2016, after several months of litigation, United Airlines abandoned the acquisition.

***Cartel Enforcement.*** The Division continued its cartel enforcement activities in cooperation with foreign agencies around the world. In 2015, the Division continued its investigation into unlawful bid rigging and price fixing conspiracies in the ocean shipping industry. The ongoing investigation has resulted in the charging of seven individuals and three companies and $136 million in criminal fines. In cooperation with enforcement agencies in more than ten jurisdictions including Australia, Brazil, Switzerland, and the UK, the Division also continued its investigation into unlawful collusive activity targeted at manipulating the foreign currency exchange spot market. Four of the largest financial institutions have agreed to parent-level guilty pleas to felony price-fixing charges and to approximately $2.5 billion in criminal fines, including three of the highest criminal fines for a violation of the Sherman Act.

***Conclusion.*** As shown by its 2016 Spring Update, the Division has continued to pursue a more active enforcement approach, which has resulted in litigation and trial against the Division. This approach also may result in an increase in investigations and actions by foreign and state enforcement agencies. It may also lead to class and direct actions by private plaintiffs following the Division's investigations, and may provide additional relief to the remedies pursued by the Division. This more active enforcement approach confirms the need for the retention of counsel experienced with litigation and trial, as well as investigation, in the event of a potential antitrust violation. Q

## Chad Johnson, Former Chief of Investor Protection at the New York Attorney General's Office, Joins in New York

Chad Johnson has joined the firm as a partner in the New York office. Mr. Johnson was previously a member of the New York Attorney General's leadership team, where he served first as Deputy Attorney General and Senior Trial Counsel, and then as Chief of Investor Protection. In the NYAG's office, he advised the New York Attorney General on securities fraud and other Wall Street-related matters. He also ran the bureau with primary responsibility for enforcing New York's Martin Act. Mr. Johnson led many of the largest and most complex matters handled by the NYAG, including enforcement actions related to dark pools, foreign currency practices, residential mortgage backed securities, and auditing practices. Mr. Johnson had previously been a partner at Bernstein Litowitz Berger & Grossmann and Latham & Watkins. Mr. Johnson has been counsel in some of the largest private shareholder actions in history and represented large financial institutions, individuals, and companies in high-stakes commercial litigation. Q

## Complete E.D. Texas Jury Trial Victory for Alcatel-Lucent

The firm recently won a complete trial victory for its client Alcatel-Lucent in the Eastern District of Texas. Alcatel-Lucent was sued in 2012 along with three of its largest customers—AT&T, Verizon, and Sprint—for allegedly infringing five patents owned by the patent assertion entity Adaptix, Inc. The asserted patents were purchased for more than $150M as part of a portfolio directed to technologies in the LTE standard. Before this trial, Adaptix had been successful in licensing this portfolio, receiving well over $50M in licensing fees from major technology companies such as Microsoft, Samsung, Nokia, Motorola, Sharp, ZTE, Huawei, and Blackberry. Unlike those companies, Alcatel-Lucent rejected Adaptix's inflated settlement offers.

During discovery, the firm was able to build strong non-infringement and invalidity cases against each of the asserted patents. Based on this work, Adaptix was eventually forced to drop four of its five asserted patents before trial. This not only narrowed the scope of its damages claims, but also the issues that Alcatel-Lucent could present to the jury. But even for infringement of that single patent, Adaptix asked the jury for more than $100M in past and future damages.

At trial, Alcatel-Lucent presented a compelling case that the inventor did not actually invent the allegedly infringing technology. Alcatel-Lucent had secured key admissions in deposition that the inventor understood his invention as something very different from Alcatel-Lucent's technology and from the claimed invention in the patent. Alcatel-Lucent also presented evidence that a prior patent disclosed the very same invention that was claimed in the Adaptix patent, and that the invention was a simple combination of known techniques and that would have been obvious to a person having ordinary skill in the art to make such a combination. The jury accepted all three invalidity arguments and found the patent invalid.

Alcatel-Lucent also presented evidence that, even if the patent were valid, the claimed technology was significantly different than the technology in the accused products, and therefore that Alcatel-Lucent could not infringe the asserted patent. Because the technology was extremely complex (defying an in depth discussion here), Alcatel-Lucent simplified its presentations to the most basic disputed elements in the case. The jury also agreed with this argument, finding that Alcatel-Lucent did not infringe any of the asserted claims.

Finally, Alcatel-Lucent showed that Adaptix was overreaching with its damages claim and that based on the settlement agreements with other technology companies, Adaptix was entitled to less than 1/50 of its damages claim, if it was entitled to anything at all. Alcatel-Lucent turned Adaptix's outrageous damages claims against it, portraying Adaptix as a greedy company that was looking to doubly or triply recover on its initial purchase of the patent portfolio.

## Victory in the English High Court

The firm gained a complete victory in the English High Court (Chancery Division) for its clients Mrs. Angela Shamoon and her daughter Ms. Alexandra Shamoon, successfully challenging the jurisdiction of the English Court to hear a major claim against them. The firm succeeded in every aspect of the challenge to jurisdiction, in one of the few reported cases successfully applying article 1(2)(a) of the Brussels Regulation. Additionally, the clients have been awarded their legal costs, some of those on the indemnity basis (awarding costs on the indemnity basis is used by the English Court as a tool to punish bad behavior by a party to litigation).

The claim was brought by Mr. Peretz Winkler, formerly the CFO and manager of an Israeli conglomerate called Yakhin Hakal, and his Panamanian company against the firm's clients, Mrs. Angela Shamoon and Ms. Alexandra Shamoon, the widow and daughter respectively of the late Israeli billionaire Mr. Sami Shamoon ("Mr. Shamoon"), and the residual legatees under his will. In his claim, Mr. Winkler alleged that, prior to his death, Mr. Shamoon had orally promised to transfer to him certain valuable shares in the holding company of Yakhin Hakal as reward for past and incentive for future services. On the basis of the alleged promise, and certain statements allegedly made by the firm's clients after Mr. Shamoon's death, Mr. Winkler claimed declarations from the English Court against Angela and Alexandra Shamoon as to his entitlement to the shares (which Angela and Alexandra were (and are) due to receive as residual legatees under Mr. Shamoon's will).

Angela, who is a resident of Israel, and Alexandra, who is resident in the UK, challenged the jurisdiction of the English Court to hear the claim on numerous grounds. First, they contested jurisdiction on the basis that the claim was a matter relating to "succession" within article 1(2)(a) of the Brussels Regulation and therefore fell outside its scope. As a result, the issue of jurisdiction fell to be considered under the English common law rules and, pursuant to the common law rules, the English Court had no jurisdiction in respect of the claim and, in any event, England was not the natural or appropriate forum for the dispute. Secondly, Mrs. Angela Shamoon contended that she was not domiciled in England for the purposes of Article 59 of the Brussels Regulation or, therefore, validly served with the claim in the UK. Mr. Winkler contested both points and also alleged that, in any event, by taking certain limited steps in the proceedings before issuing their jurisdiction challenge, Angela and Alexandra Shamoon had submitted to the jurisdiction.

To account for the possibility that the Court would determine Mrs. Angela Shamoon not to be domiciled in the UK, Mr. Winkler also brought a protective application for permission to serve Mrs. Angela Shamoon out of the jurisdiction (in Israel). The application to serve out was brought on the grounds that there was a claim against Ms. Alexandra Shamoon (who, it was not disputed, is resident in the UK) to which Mrs. Shamoon was a "necessary and proper party" within the jurisdictional gateway of Civil Procedure Rules Practice Direction 6B paragraph 3.1(3). Mrs. Angela Shamoon contested this application to serve out on the grounds that there was no "real issue" between the Claimants and the "anchor defendant"—Ms. Alexandra Shamoon—and that it was not reasonable for the English Court to try that issue (CPR 6.37 (1)(a) and PD 6B paragraph 3.1(3)(a)).

In his judgment handing victory to the firm's clients in all respects, Mr. Justice Carr declared that the English Court has no jurisdiction to hear the claim because: (1) the claim was one relating to "succession" and therefore fell outside the scope of the Brussels Regulation (and, pursuant to English common law rules, England was not the natural or appropriate forum for the claim); (2) Mrs. Angela Shamoon is resident in Israel, and not in England, and was therefore not properly served with the claim within the jurisdiction; and (3) Angela and Alexandra Shamoon had not submitted to the jurisdiction of the English Court. The judge also dismissed the protective application to serve Mrs. Shamoon out of the jurisdiction on the grounds that the claim did not meet the requirements of the jurisdictional gateway. First, the Judge held that there was no claim with realistic prospects of success against the anchor defendant. Secondly, the Judge held that, even if he had concluded that there was a claim with realistic prospects of success against her, he would have concluded that it was not one which it was reasonable for the English court to try.

The case has potentially wider significance as it considered the issue of the "succession" exception to the Brussels Regulation. There was virtually no law on this issue until now and this judgment will add some clarity to the scope of the exception going forward. The Claimants declined to appeal the Judgment of Mr. Justice Carr, which is therefore now final.

## Victory for Client Hudson

The firm achieved an important victory for client The Hudson Group, a retailer that operates hundreds of stores in airports throughout the United States. Several years ago, Hudson entered into license agreements with Kitson, a trendy Los Angeles retailer, to use the Kitson brand and marks in two stores operated and leased by Hudson in Los Angeles International Airport. These agreements allowed Hudson to call the stores "Kitson" stores and to sell Kitson products, but to retain control of the underlying retail space and to use Hudson employees to operate the stores.

The relationship between Hudson and Kitson soon proved to be dysfunctional. Not long after the opening of the first Kitson-branded airport store, Mr. Fraser Ross, Kitson's founder, began to visit and to repeatedly engage in erratic outbursts and abusive behavior, including swearing at Hudson employees and threatening to fire them. Meanwhile, Kitson made clear it had staked its financial future on taking over the two airport spaces controlled by Hudson. Kitson began to lobby the airport authority and the Office of the Los Angeles Mayor to usurp control of the two retail locations from Hudson, smearing Hudson's name and reputation in the process. When those tactics failed to achieve the desired result, Kitson launched an aggressive media campaign against the airport authority and Mayor Eric Garcetti, even going so far as to sell t-shirts with the slogan "Mayor GAR-SHADY." When officials refused to take a side in the dispute, Kitson accused them of corruption and collusion, causing the airport authority to refer the matter to the City Attorney.

Hudson hired Quinn Emanuel, which quickly took the offensive, filing suit against Kitson for breach of contract. Meanwhile, Hudson began plans to discontinue operating the stores as Kitson stores and to bring in another retailer. To stop Hudson from doing that, Kitson sought an immediate preliminary injunction and obtained an ex-parte temporary restraining order preventing Hudson from taking further action until the court could conduct a thorough evidentiary hearing. At that later hearing, the court adopted all of the firm's arguments and dealt a devastating blow to Kitson, lifting the temporary restraining order and permitting Hudson to rebrand its stores and stop doing business with Kitson. The judge also held that Kitson had breached the license agreements and was subject to a liquidated damages provision. Having lost its revenue stream from the airport stores and its claim to the airport leases, and subject to a potentially devastating damages award, Kitson ultimately was forced into insolvency. It dropped its claims against Hudson and agreed to settle Hudson's claims for 80% of their value. Q

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# business litigation report
# quinn emanuel urquhart & sullivan, llp

Published by Quinn Emanuel Urquhart & Sullivan, LLP as a service to clients and friends of the firm. It is written by the firm's attorneys. The Noted with Interest section is a digest of articles and other published material. If you would like a copy of anything summarized here, please contact Becca Voake at 213-443-3165.

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