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The Supreme Court Revisits Patent Eligible Subject Matter in *Alice v. CLS Bank*

The Supreme Court recently addressed the question of patent eligibility under Section 101 of the Patent Act, holding a software patent in the financial services industry invalid for failing to meet the minimum requirements of Section 101. This decision calls into question the value of software patents and reinforces Section 101 as a potentially powerful defense to infringement allegations directed to such patents. The decision has already had a significant impact, as courts around the U.S. have granted dispositive motions based on it.

An Overview of Patent Eligibility Under Section 101

The Patent Act states that "[w]hoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefore, subject to the conditions and requirements of this title." 35 U.S.C. § 101. There are, however, certain implicit exceptions to this grant. Specifically, Section 101 has been found to exclude protection for "[l]aws of nature, natural phenomena, and abstract ideas." *Diamond v. Diehr*, 450 U.S. 175, 185 (1981). This restriction has been put in place to avoid "monopolization of [the basic tools of scientific and technological work that]…might tend to impede innovation more than it would tend to promote it," thwarting the main objective of the patent laws. *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*, 566 U.S. ___, 132 S. Ct. 1289, 1293 (2012).

In recent years, the Supreme Court has addressed

(continued on page 2)

In Memory of Sam Shepherd

On July 15, Quinn Emanuel partner Sam Shepherd died of heart failure at age 48. He was far too young.

Sam was one of the firm's first summer associates, associates and partners in an era when the firm had 20 lawyers and one office. Twenty-three years later, the firm still benefits from Sam's influence. He was a unique person.

Sam grew up in the Boston area and was an avid athlete. One of his teammates on his high school basketball team was N.B.A. Hall of Fame center Patrick Ewing. Sam enjoyed telling people he was the only member of the team who could not dunk. After high school, Sam played one

(continued on page 4)

INSIDE

Practice Area Updates:

Quinn Emanuel Opens Office in Houston Led by Standout Trial Lawyer and White Collar Specialist David Gerger

The firm has opened an office in Houston, Texas, led by David Gerger, a top trial lawyer and white collar specialist. Mr. Gerger has represented clients in prominent matters across the U.S., including British Petroleum in the Deepwater Horizon oil spill and Enron. Mr. Gerger is joined by the other lawyers in his former firm, Shaun Clarke, Dane Ball, Samy Khalil, and David Isaak. Q

Kathleen Sullivan Named the "Outstanding Practitioner" by *Euromoney Legal Media Group*'s Americas Women in Business Law Awards

Kathleen Sullivan was recently honored as the "Outstanding Practitioner" at the third annual *Euromoney Legal Media Group* Americas Women in Business Law Awards. The annual event recognizes the top female lawyers in North America and Latin America. Honorees were selected based on their impact and success over the last 12 months. Q the line between a patent-ineligible "building block" and a patent-eligible transformation of this building block into something more.

The Court has addressed patent eligibility in relation to laws of nature and natural phenomena, particularly within the life sciences. For example, in *Mayo*, the Court addressed patent eligibility of the relationships between concentrations of certain metabolites in the blood and the likelihood that a thiopurine drug dosage will prove ineffective or cause harm. 132 S. Ct. at 1294. In *Association for Molecular Pathology v. Myriad Genetics, Inc.,* the Court addressed patent eligibility of a naturally occurring DNA segment. 559 U.S. __, 133 S. Ct. 2107, 2111 (2013).

The Court has also dealt with patent eligibility as it relates to known abstract ideas carried out through software running on a computer. For example, the Court has found patent claims reciting an algorithm for converting binary-coded decimal numerals into pure binary form ineligible for patent protection. *Gottschalk v. Benson*, 409 U.S. 63, 67 (1972). Patent claims directed to a mathematical formula for computing "alarm limits" in a catalytic conversion process have also been found patent ineligible. *Parker v. Flook*, 437 U.S. 584, 594-95 (1978). And in *Bilski v. Kappos*, the Court found a claim directed to how commodities buyers and sellers in the energy market can protect, or hedge, against the risk of price changes ineligible for patent protection. 516 U.S. 593, 599 (2009).

The Court Revisits and Refines the Application of Its Test for Patentability Under Section 101

Most recently, the Court again addressed the question of patent eligibility in *Alice Corp. v. CLS Bank Int'l.*, 573 U.S. __ , 134 S.Ct. 2347(2014). In *Alice*, the patentee was the assignee of several patents disclosing a scheme for mitigating "settlement risk"—i.e., the risk that one party to a financial transaction will not satisfy its obligations to the other party—by using a computer system as a third-party intermediary. The patents, which generally share a common specification, explain that the "invention relates to methods and apparatus, including electrical computers and data processing systems applied to financial matters and risk management." *Alice*, 134 S.Ct. at 2352.

The claims at issue in *Alice* recite a scheme designed to facilitate the exchange of financial obligations between two parties by using a computer system as a third-party intermediary. This intermediary creates "shadow" credit and debit records that mirror the balances in the parties' real-world bank accounts. The intermediary updates these records in real time as transactions are entered and limits allowable transactions to those "for which the parties' updated shadow records indicate sufficient resources to satisfy their mutual obligations." At the end of the day, the intermediary instructs the applicable financial institutions to implement the "permitted" transactions in accordance with the updated shadow records. By tracking parties' resources in real time and approving only those transactions for which the parties have sufficient resources, the risk that only one party will perform the agreed-upon exchange is mitigated. Claims directed to this scheme are presented in three formats: (1) a method for exchanging obligations; (2) a computer system configured to carry out the method for exchanging obligations; and (3) a computer-readable medium containing program code for performing the method for exchanging obligations. Each of these claims requires the use of a computer, either expressly recited or required for performance of applicable method steps.

Below, the district court, relying on *Bilski*, held that all of the claims of Alice's patents were patent ineligible under Section 101 because they are directed to the abstract idea of "employing a neutral intermediary to facilitate simultaneous exchange of obligations in order to minimize risk." 768 F. Supp. 2d 221, 252 (D.D.C. 2011). On appeal, a divided panel of the United States Court of Appeals for the Federal Circuit reversed, holding that it was not "manifestly evident" that Alice's claims were directed to an abstract idea. 685 F.3d 1341, 1352, 1356 (Fed. Cir. 2012). The Federal Circuit then granted rehearing *en banc*, at which time it vacated the panel opinion and affirmed the judgment of the district court. 717 F.3d 1269, 1273 (Fed. Cir. 2013). In affirming the district court, the Federal Circuit relied on the Supreme Court's decision in *Mayo*, reasoning that a court must first "identif[y] the abstract idea represented in the claim" and then determine "whether the balance of the claim adds 'significantly more.'" *Id.* at 1286. In this instance, the Federal Circuit found that the claims of Alice's patents did not; they were "drawn on the abstract idea of reducing settlement risk by effecting trades through a third-party intermediary" and the use of a computer to manage this risk by maintaining, adjusting, and reconciling shadow accounts added nothing of substance to this abstract idea. *Id.*

In addressing the Federal Circuit's holding, the Supreme Court applied the framework for distinguishing unpatentable laws of nature, natural phenomena, and abstract ideas from patent-eligible applications of those concepts that it established in *Mayo*. The *Mayo* framework calls, first, for a determination of whether the claims at issue are directed to a patent-ineligible concept. If so, a determination is made of "[w]hat else is there in the claims before us?" The question is answered by considering the elements of the claim both individually and "as an ordered combination" to determine whether the additions "transform the nature of the claim" into something that is patent-eligible; in other words, a determination is made whether an element or combination of elements is "sufficient to ensure that the patent in practice amounts to significantly more than a patent upon the [ineligible concept] itself." *Mayo*, 132 S. Ct. at 1294.

Petitioner argued that its claims, while describing intermediated settlement, do not recite an abstract idea. Specifically, Petitioner argued that abstract ideas are confined to "preexisting, fundamental truth[s]" that "exis[t] in principle apart from any human action." *Alice*, 134 S. Ct. at 2356. The Court rejected this argument, relying on *Bilski*. As was the case in *Bilski*, the Alice patents are directed to a "fundamental economic practice long prevalent in our system of commerce." *Id.* The Court further found that the use of a third-party clearing house was a "building block" of the modern economy. *Id.* As a result, the Court reasoned that the claimed "intermediated settlement" of the Alice patents is an abstract idea beyond the scope of Section 101. *Id.* at 2357.

Finding the Alice claims directed to an abstract idea, the Court then turned to the second step in the *Mayo* framework to identify whether the elements of the claim contain an "inventive concept" sufficient to "transform" the claimed abstract idea into a patent-eligible application. *Mayo*, 132 S. Ct. at 1299. Citing *Benson* and *Flook*, the Court acknowledge that "the introduction of a computer into the claims does not alter the analysis of *Mayo* step two," particularly where the computer implementation was "purely conventional." *Alice*, 134 S. Ct. at 2357. This was distinguished from the Court's holding in *Diehr*, in which a "'well-known' mathematical equation" was used in a computer-implemented process to solve a technological problem in "conventional industry practice." In that case, a thermocouple was used to record constant temperature measurements inside a rubber mold—a result that "the industry ha[d] not been able to obtain"—and a computer used these measurements to repeatedly recalculate remaining cure time using this mathematical equation. *Id.* at 2358 (citing *Diehr*, 450 U.S. at 177-78). Unlike in *Benson* and *Flook*, the additional steps in *Diehr* "transformed the process into an inventive application of the formula" as a function of their improvement on existing technological processes (and not their implementation on a computer). *Id.* (citing *Mayo*, 132 S. Ct. at 1299).

The Court reasoned that these cases demonstrate that neither the mere recitation of a generic computer, nor limiting the use of an abstract idea to "a particular technological environment," is sufficient to establish patent eligibility. *Id.* Merely taking an abstract idea and "apply[ing] it with a computer" does not make this idea patent eligible. *Id.* at 2350-51 ("wholly generic computer implementation is not generally the sort of 'additional feature' that provides any 'practical assurance that the process is more than a drafting effort designed to monopolize the [abstract idea] itself") (citing *Mayo*, 132 S. Ct. at 1297).). Applying this rationale, the Court found that Alice's claims do no more than simply instruct the practitioner to implement the abstract idea of intermediated settlement by virtue of generic computer functions carried out on a generic computer. The Court further found that the steps of the claims at issue amount to nothing more than the application of "electronic recordkeeping," which the Court refers to as "one of the most basic functions of a computer." *Id.* at 2359 (citing *Benson*, 409 U.S. at 65). And this generic application does not change when the individual claim limitations are taken "as an ordered combination," as again the claims in their entirety merely recite the performance of intermediated settlement on a generic computer.

The Court further found that Alice's system and computer-readable medium (or *Beauregard*) claims are patent ineligible for the same reasons as its method claims. The recitation of "specific hardware" configured to perform "specific computerized functions" does nothing to change the result. *Id.* at 2360. The "specific hardware"—e.g., a "data processing system" with a "communications controller" and "data storage unit"—is purely functional and generic. None of the recited hardware "offers a meaningful limitation beyond generally linking 'the use of the [method] to a particular technological environment,' that is, implementation via computers." *Id.* (quoting *Bilski*, 561 U.S. at 610-11). Thus, the Court found the system claims to be no different from the method claims, preventing any difference in result between the two. *Id.* (quoting *Mayo*, 132 S. Ct. at 1294 (This Court has long "warn[ed]…against" interpreting Section 101 "in ways that make patent eligibility 'depend simply on the draftsman's art'.")).

The Future of Software Patents?

The impact of the Court's decision has already been seen. A multitude of courts across the country, including the Federal Circuit, have already relied on the *Alice* decision to invalidate software patents under

Section 101. For example, in *Digitech Image Tech., LLC v. Electronics for Imaging, Inc. et al*, the Federal Circuit affirmed a lower court ruling that a patent directed to a device profile and a method for creating a device profile within a digital image processing system is invalid under Section 101. 758 F.3d 1344 (Fed. Cir. 2014); *see also BuySAFE, Inc. v. Google, Inc.,* No. 2013-1575, 2014 WL 4337771 (Fed. Cir. Sept. 3,2014) (invalidating under Section 101 methods and machine-readable media encoded to perform steps for guaranteeing a party's performance of its online transaction). Courts in Delaware, New York, California, Texas and Florida have also invalidated software patents under Section 101 since the Supreme Court's ruling. *See, e.g., Tuxis Tech., LLC v. Amazon.com, Inc.*, C.A. No. 13-1771-RGA (D. Del. Sept. 3, 2014); *Comcast IP Holdings I, LLC v. Sprint Communications Company L.P., et al.*, C.A. No. 12-205-RGA (D. Del. July 16, 2014); *Dietgoal Innovations LLC v. Bravo Media LLC*, 13 Civ. 8391 (PAE) (S.D.N.Y. July 8, 2014); *CMG Financial Services, Inc. v. Pacific Trust Bank, F.S.B.*, Case No. CV 11-10344 PSG (MRWx) (C.D. Cal. August 29, 2014); *Loyalty Conversion Sys. Corp. v. American Airlines, Inc.*, Case No. 2:13-cv-00655-WCB (E.D. Tex. Sept. 3, 2014); *Every Penny Counts, Inc. v. Wells Fargo Bank, N.A.*, Case No. 8:11-cv-2826-T-23TBM (M.D. Fla. Sept. 11, 2014). As illustrated in these cases, the analysis will be fact intensive, focusing on the ability of a patentee to adequately persuade a Court or jury that its software-based implementation is more than merely the performance of a known, manual procedure using a computer. This will include proof that the claimed invention is directed to a tangible, hardware based implementation as opposed to merely the underlying data itself. This inquiry is also likely to include an analysis of whether the method or system at issue improves upon a known procedure, providing a solution to a problem that had not previously been (or could not be) achieved without the invention at issue. While this decision is unlikely to signify the death knell of all software patents, one thing is clear—going forward, a Section 101 defense will likely be raised in any patent infringement in which software patents are being asserted. Q

In Memory of Sam Shepherd

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year of football at Southern Methodist University in Texas. He had dreams of playing for his beloved Dallas Cowboys in the National Football League, but the one year at SMU taught him that professional football was not in his future. He transferred to Bowdoin where he continued to play sports, but academics became his first priority. Sam graduated Phi Beta Kappa and was the class speaker at his graduation.

Sam was admitted to the joint JD/MBA program at the University of Chicago. He was proud of the fact that he paid for graduate school by working at an Irish pub that he owned. Many of his friends say that patrons came to the pub more to talk to Sam than to drink Guinness. That is not surprising because Sam had a magnetic personality that drew people to him. He graduated in 1992 and immediately started work at Quinn Emanuel.

Sam's performance as an associate at the firm was stellar. He assumed partner level responsibility almost immediately, making court appearances, taking depositions, and actually trying a case as a third year associate. Sam was elected partner when he was only four years out of law school—a firm record that stands to this day.

Sam was enthusiastic about everything he did—including legal work. He loved being a lawyer. He also loved the underdog. When he was just three years out of law school, Sam tried—and won—a case for a would-be sheriff's deputy who claimed he was discriminated against because he was colorblind. That was just one of Sam's unusual cases. He tried a case for a sports agent who claimed he had been bitten by a poisonous spider on an airplane. He once deposed a plaintiff in an employment case who kept a vial of her boss's blood around her neck. Because of Sam's charisma and gift for making friends, generating contacts and clients came naturally and he made many long-lasting and loyal business and personal relationships all over the U.S.

Sam loved children. Many Quinn Emanuel lawyers have fond memories of Sammy making their kids laugh and squeal with glee. Just four years ago he got his own child to play with when his daughter Shelby was born. Sam loved her. We all wish the two of them could have more time together.

Nobody who met Sam will forget him. He was an important contributor to Quinn Emanuel. We will miss him. Q

International Arbitration Update

Avoiding Litigation in the Host State's Courts in Investor-State Disputes After the* Urbaser *and* Teinver *Decisions. Previously, foreign investors whose investments have been damaged by governmental measures of the host country, such as changing tax or currency laws, other regulatory changes or forced liquidation, were required by some bilateral investment treaties ("BITs") to pursue court litigation in the host country before they could bring investment treaty arbitrations. To get around this requirement, foreign investors relied on the "Most Favored Nation" ("MFN") clause of BITs to argue that they need not observe the rule requiring them to pursue domestic court litigation first because other BITs did not contain that requirement. However, while some tribunals accepted the MFN workaround, other tribunals rejected it. Now, as a result of two recent ICSID decisions—*Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia Ur Partzuergoa v. Argentine Republic* ("*Urbaser*"), ICSID Case No. ARB 07/26, Decision on Jurisdiction (19 December 2012) and *Teinver S.A., Transportes de Cercanias S.A. and Autobuses Urbanos del Sur S.A. v. Argentine Republic* ("*Teinver*"), ICSID Case No. ARB/09/1, Decision on Jurisdiction (21 December 2012)—foreign investors may have another workaround to the domestic litigation requirement that avoids the MFN controversy.

At issue in both *Urbaser* and *Teinver* was whether a foreign investor was required to pursue domestic litigation *before* the foreign investor could file a request for international arbitration under the Argentina-Spain BIT. Article X(3) of the Argentina-Spain BIT states that a "dispute may be submitted to an international arbitral tribunal…when no decision has been reached on the substance 18 months after the judicial proceeding" in the host state began ("domestic litigation requirement"). By its plain meaning, Article X(3) requires a foreign investor to submit to the local courts of the host state for at least a period of 18 months before the foreign investor may pursue international arbitration.

Foreign investors have tried to get around the domestic litigation requirement by relying on the MFN clause in the Argentina-Spain BIT. The MFN clause states: "[i]n all matters governed by this Agreement, such treatment shall be no less favorable than that accorded by each Party to investments made in its territory by investors of a third country." Prior to *Urbaser* and *Teinver*, the five tribunals asked to decide, under the Argentina-Spain BIT, whether a foreign investor must submit its dispute to the local courts of the host state for a period of 18 months before pursuing arbitration concluded that a foreign investor did not by relying on the MFN clause to bypass the domestic litigation requirement. *See Emilio Agustín Maffezini v. Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction (25 January 2000); *Gas Natural SDG, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/10, Decision on Jurisdiction (17 June 2005); *Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v. Argentine Republic*, ICSID Case No. ARB/03/17, Decision on Jurisdiction (16 May 2006); *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/03/19, Decision on Jurisdiction (3 August 2006); and *Telefónica S.A. v. Argentine Republic*, ICSID Case No. ARB/03/20, Decision of the Tribunal on Objections to Jurisdiction (25 May 2006).

Nonetheless, the international community remains divided on this issue as some tribunals have rejected the MFN argument and refused to set aside the domestic litigation requirement. Even concerning BITs with similar wording, tribunals have reached different results. In *Vladimir Berschader and Moise Berschader v. The Russian Federation*, the Belgium/Luxembourg-Soviet Union BIT was at issue, which contained "all matters" language similar to the Argentina-Spain BIT. SCC Case No. 080/2004, Award (21 April 2006). However, the *Berschader* tribunal found that the "all matters covered by the present treaty" cannot be interpreted "literally" because the MFN clause could not be applied to several of the matters covered by the BIT.

Now, however, *Urbaser* and *Teinver* may provide another workaround that avoids the MFN controversy.

In *Urbaser*, the claimants were the holder of a concession for the provision of drinking water supply and sewage services in Argentina. The claimants submitted a request for arbitration alleging that the impact of the emergency legislation enacted during Argentina's economic and financial crisis violated the Argentina-Spain BIT. The tribunal side-stepped the question of whether the MFN clause applies to the jurisdictional provisions of the Argentina-Spain BIT by shifting the analysis to whether the domestic litigation requirement was inapplicable because the local courts of Argentina were unlikely to be able to issue a decision on the merits within the applicable time limit. The *Urbaser* tribunal reasoned that a host state cannot insist on an investor resorting to domestic courts if the host state is not able to offer courts capable of handling such disputes that may reasonably contemplate an adjudication on the substance of the dispute within 18 months. Accordingly, the claimants were permitted to proceed with arbitration.

In *Teinver*, the claimants alleged that the government of Argentina violated the Argentina-Spain BIT by unlawfully re-nationalizing and taking other measures regarding the claimants' investments in two Argentine airlines. In *Teinver*, proceedings had been instituted in the local courts of Argentina before the claimants filed for arbitration. Like *Urbaser*, the *Teinver* tribunal did not base its decision on the MFN controversy. The tribunal reasoned that "18 months have subsequently passed, and the local suit remains pending. As such, the core objective of this requirement, to give local courts the opportunity to consider the disputed measures, has been met." Accordingly, the claimants survived the respondents' jurisdictional objections.

Because the *Urbaser* and *Teinver* tribunals' approaches to the domestic litigation requirement could influence future tribunals, investors considering bringing investor state arbitrations should examine whether the host state's courts could reasonably resolve their disputes within the time frame that BITs may require for pursuing domestic litigation before deciding whether or not they actually need to incur the time and expense of litigation. Host states should be aware that if their courts are unable to address the claims of foreign investors within the time frames prescribed in the domestic litigation provisions of BITs, investors may be able to circumvent the domestic litigation requirement and proceed directly to investor-state arbitration.

Arbitration Award Set Aside*—Carr v. Gallaway Cook Allan *[2014] NZSC 75. The cornerstone of arbitration is the parties' agreement to confer jurisdiction upon an arbitral tribunal. Trouble can arise, however, where this agreement is based on incorrect assumptions as to available procedural rights. A recent New Zealand decision held that a specific agreement to arbitrate, which was conditional on procedural rights that were in fact unavailable as a matter of law, was invalid. The decision demonstrates the serious consequences which may result from a defective agreement to arbitrate: despite both parties having agreed to the arbitration clause, and having conducted the arbitration without complaint, the New Zealand Supreme Court exercised its discretion to set aside the resulting arbitral award. The decision is a lesson in the importance of considering domestic arbitration statutes when drafting arbitration agreements. It also highlights an issue worth re-checking whenever an adverse arbitral award is delivered.

In *Carr v. Gallaway Cook Allan* [2014] NZSC 75, a decision of New Zealand's Supreme Court (its highest court of appeal), Mr. Carr sued his former law firm, Gallaway Cook Allan, alleging that its negligence had caused a property transaction to fail. Mr. Carr and the firm agreed to submit the dispute to arbitration, pursuant to an arbitration agreement that gave the parties the right to appeal on "questions of law and fact." It is not clear from the judgment whether this was a specifically-negotiated agreement or a standard form. Both parties participated fully in the arbitration, and following a hearing, the arbitrator rendered a partial award in favor of the firm.

Mr. Carr sought to appeal the arbitral award to a domestic court on questions of fact. Only then, however, did the parties learn that the New Zealand *Arbitration Act 1996* (the Act) restricts judicial review of arbitral awards to questions of law.

Armed with the knowledge that he had agreed to an arbitration on the assumption of unavailable appeal rights, Mr. Carr changed tack, contending that the award should be set aside because the parties' agreement was invalid. This argument found favor at first instance, but was overturned by the intermediate appellate court. That court adopted a "pro enforcement" interpretation of the Act, finding that that the words "and fact" could be severed from the arbitration agreement.

Mr. Carr appealed to New Zealand's highest court, which by a 4:1 majority held that the agreement to arbitrate was invalid, and then exercised its discretion to set aside the arbitral award. The majority interpreted the right to appeal on questions of fact as being fundamental to the arbitration agreement. As such, the fact that this appeal right was not permitted by law meant that the intention to arbitrate was vitiated.

On the question of whether the unavailable appeal right could be severed from the arbitration agreement, the majority considered three United States decisions, *Kyocera Corp v. Prudential-Bache Trade Services, Inc* 341 F 3d 987 (9th Cir 2003); *Hall Street Associates, LLC v. Mattel, Inc.,* 113 Fed Appx 272 (9th Cir 2004) and *Hall Street Associates, LLC v. Mattel, Inc* 552 US 576 (2008). The majority noted that these decisions indicate that United States federal law does not permit parties to expand the review of arbitral awards beyond the grounds provided by statute. In those decisions, the expanded review rights were severed from the agreement. However, the majority held that the decisions do not establish any principle requiring severance, but instead are merely examples of where severance was appropriate. In this case, because the right to appeal was fundamental, its severance would have impermissibly changed the substance of what had been agreed. The majority went on to hold that the invalidity of the arbitration agreement was such a fundamental defect that it was proper for the award to be set aside. In dissent, Justice Arnold focused on the proper construction of the court's power under the Act to set aside an award, and held that that power should not be exercised.

This decision serves as another reminder of the importance of careful drafting in arbitration agreements. Often the focus in drafting is on capturing the parties' intention and providing a clear procedure for the invoking of arbitration. This decision shows that, even where the parties are agreed on a matter and such matter is clearly captured in the document, factors such as domestic law, and specifically statutory arbitration frameworks, may render the agreement to arbitrate void. Clearly, these factors are worth re-checking any time an adverse arbitral award is delivered. The outcome of the decision reaffirms the parties' agreement as the foundation of arbitration, illustrating that a defect therein can have dire consequences for the arbitration built upon it. The invalidity of an agreement to arbitrate, discovered after the parties have gone through the time and cost of arbitration and received an award, can render the whole process worthless, even where there has been no adverse finding in respect of the award itself.

Trial Practice Update

Amendments to the Federal Rules of Evidence on Hearsay Issues. The federal hearsay rules will undergo amendments later this year to (1) expand the scope of prior consistent statements such that they can be admitted as substantive evidence (that is, not to simply rehabilitate a witness); and (2) confirm the opponent of a business or public record bears the burden of showing lack of trustworthiness to get an otherwise-admissible record excluded under Rule 803. The amendments, endorsed by the Supreme Court earlier this year, will automatically become law on December 1, 2014 unless Congress takes affirmative action to override them.

Federal Rule of Evidence ("FRE") 801. FRE 801 is being amended to change how jurors can use prior consistent statements. Under the current rule, a fact-finder can only consider such statements for their truth if offered to rebut a charge that the declarant *recently* fabricated his testimony or acted from a recent improper influence or motive in testifying. The current version of the rule reads as follows in relevant part:

> (d) Statements That Are Not Hearsay. A statement that meets the following conditions is not hearsay: (1) A Declarant-Witness's Prior Statement. The declarant testifies and is subject to cross-examination about a prior statement, and the statement: . . . (B) is consistent with the declarant's testimony and is offered to rebut an express or implied charge that the declarant recently fabricated it or acted from a recent improper influence or motive in so testifying . . . .

If the statement does not counteract a charge of recent fabrication or improper influence, that statement can only be offered to rehabilitate the witness's testimony by showing consistency between his in-court and out-of-court statements; it cannot not be offered "substantively" to prove the truth of what was asserted in the prior consistent statement. *See generally* Seeking Consistency for Prior Consistent Statements: Amending Federal Rule of Evidence 8-1(d)(1)(B), 46 Conn. Law Rev. 3 (Feb. 2014); FRE 801(d) Advisory Committee Notes to 2014 Amendments (discussing "premotive" prior consistent statements under existing law, and that "[t]he intent of the amendment is to extend substantive effect to consistent statements that rebut other attacks on a witness—such as charges of inconsistency or faulty memory.").

FRE 801(d)(1)(B) will be amended to add the italicized text below:

> (d) Statements That Are Not Hearsay. A statement that meets the following conditions is not hearsay: (1) A Declarant-Witness's Prior Statement. The declarant testifies and is subject to cross-examination about a prior statement, and the statement: . . . (B) is consistent with the declarant's testimony and is offered: (i) to rebut an express or implied charge that the declarant recently fabricated it or acted from a recent improper influence or motive in so testifying***; or (ii) to rehabilitate the declarant's credibility as a witness when attacked on another ground . . . .***

With this new language, prior consistent statements need not rebut a charge of recent fabrication to be admissible for their truth. Thus, for example, a prior consistent statement offered to rebut a claim of longstanding bias would come in for its truth under the revised rule.

Federal judges have not expressed ringing endorsements of this amendment. When polled, 52% of judge respondents indicated that they believed the amendment was a "negative result." *See* Survey of District Court Judges on a Proposed Amendment to Federal Rule of Evidence 801(d)(1)(B) Concerning Prior Consistent Statements, Federal Judicial Center, at 12 (March 2, 2012) ("Rule 801(d)(1)(B) Survey"). At the same time, 69% of these polled judges also expressed belief that the admission of prior consistent statements for substantive purposes would have "little practical effect on juror deliberations"—apparently believing that jurors are unable or unwilling to adhere to the limiting instructions on use of rehabilitative statements under the current rule. *See id.* at 6-8.

FRE 803. FRE 803 is being changed to clarify that the *opponent* of a business or public record—which otherwise qualifies for admission under the hearsay rules—must show that the record is not trustworthy in order to keep it out of evidence. At least one court had interpreted these rules to require the party offering such a record to establish its trustworthiness as a precondition to admissibility. *See* Report of the Advisory Committee on Evidence Rules at (May 7, 2013) *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/

Reports/EV05-2013.pdf.

The current versions of FRE 803(6)-(8) will be amended to include the following language (in italics):

> (6) Records of a Regularly Conducted Activity. A record of an act, event, condition, opinion, or diagnosis if: (A) the record was made at or near the time by—or from information transmitted by—someone with knowledge; (B) the record was kept in the course of a regularly conducted activity of a business, organization, occupation, or calling, whether or not for profit; (C) making the record was a regular practice of that activity; (D) all these conditions are shown by the testimony of the custodian or another qualified witness, or by a certification that complies with Rule 902(11) or (12) or with a statute permitting certification; and *(E) the opponent does not show that the source of information or the method or circumstances of preparation indicate a lack of trustworthiness.*

(While we provide only the full text of the FRE 803(6), the italicized clause is to be similarly appended to FRE 803(7) and (8).) In proposing this amendment, the Advisory Committee expressed the view that the other requirements of the rules demonstrate the basic reliability of record-related evidence in the absence of any evidence to the contrary. *See* FRE 803(6) Advisory Committee Notes to 2014 Amendments. These changes to FRE 803(6)-(8) should re-establish uniformity among federal courts on the admissibility of business and public records over hearsay objections, and avoid placing an undue burden on a proponent of such evidence to independently establish the trustworthiness of each such record.

Patent Litigation Update

***Supreme Court Raises the Bar for Establishing Induced Infringement in* Limelight Networks, Inc. v. Akamai Technologies.** In *Limelight Networks, Inc. v. Akamai Techs, Inc.*, __ U.S. __, 134 S. Ct. 2111 (2014), the Supreme Court unanimously reversed an *en banc* Federal Circuit decision that lowered the bar for establishing induced infringement. Specifically, the Supreme Court reversed the Federal Circuit's ruling that inducement may be found where there was no single, direct infringer. The Court instead reaffirmed the Federal Circuit's earlier reasoning that inducement may be found only when there is a single, direct infringer.

Akamai Technologies is the exclusive licensee of a patent on a method of content delivery that requires a content delivery network ("CDN") to "tag" content to be stored on its own servers. Limelight Networks, the defendant in *Akamai*, operates a CDN but does not tag content stored on its servers. Instead, Limelight asks its users to tag their own content to be stored on its servers. Limelight performs each step of Akamai's patent except for tagging. At trial, the jury found Limelight liable for inducement and awarded $40 million in damages.

Soon after the jury's verdict, the Federal Circuit decided *Muniacuction, Inc. v. Thomson Corp.,* 352 F.3d 1318 (Fed. Cir. 2008), in which it found that inducement required an act of direct infringement and, further, that direct infringement "requires a single party to perform every step of a claimed method." *Id.* at 1329. Limelight moved for reconsideration of the jury's verdict in light of *Muniauction*, and the district court granted Limelight's motion. The Federal Circuit affirmed, explaining that a defendant (such as Limelight) that does not perform all the steps of a claimed method may only be liable for direct infringement if it directed or controlled the actions of other participating parties, or "when there is an agency relationship between the parties who perform the method steps or when one party is contractually obligated to the other to perform the steps." *Akamai Tech. v. Limelight Networks,* 692 F.3d 1301, 1320 (Fed. Cir. 2012). Since there was no evidence of an agency relationship or contractual obligation, there was no direct infringement and Limelight therefore could not have induced infringement.

Akamai sought rehearing *en banc*, which the Federal Circuit granted. The *en banc* court reversed, finding Limelight liable for induced infringement. It found that even though there was no single direct infringer, inducement could still be established if there was proof that multiple parties committed all the acts necessary to constitute infringement and a single party *could* have infringed: "[r]equiring proof that there has been direct infringement . . . is not the same as requiring proof that a single party *would* be liable as a direct infringer." *Id.* at 1308-09 (emphasis added). Thus, the Federal Circuit reasoned that a defendant can be liable for inducing infringement under §271(b) even if no one has committed direct infringement within the terms of §271(a).

The Supreme Court reversed the Federal Circuit, holding that, under the Federal Circuit's precedent, Limelight's conduct could not induce infringement under §271(b) because no direct infringement under §271(a) had occurred. The Court started with the well-established principle that "inducement liability may arise 'if, but only if [there is] . . . direct infringement,'" commenting that "[o]ne might think that this simple truth is enough to dispose of this appeal." *Akamai*, 134 S. Ct. at 2117. The Court continued, finding that "Limelight cannot be liable for inducing infringement that never came to pass." *Id.* at 2118. Notably, the Court's holding is limited to inducement actions where no one party's conduct has risen to the level of "directing or controlling" the actions of other entities who may perform some method steps. In cases where a central entity "directs or controls" others, direct infringement under §271(a) occurs and §271(b) liability may attach to an inducer.

One issue left open by the Court, however, is whether direct infringement requires an act of direct infringement by a single entity (or more than one entity controlled in some way by the defendant). In remanding the case, the Court specifically invited the Federal Circuit to revisit this question. The *Akamai* plaintiffs have announced their intention to argue on remand that, notwithstanding the Supreme Court's new standard for inducement under §271(b), Limelight should be liable for direct infringement under §271(a).

The impact of *Akamai* has already been seen in the district courts. In *Emblaze Ltd. v. Apple Inc.*, No. 5:11-cv-01078-PSG, 2014 WL 2772731 (N.D. Cal. June 18, 2014), defendants moved for summary judgment for noninfringement of certain claims based on *Akamai*, arguing that the plaintiff could not prove infringement because those claims required actions by multiple actors. *Id.* at *2. As there was no proof of any contractual or other control by defendant over the other actors, the court granted summary judgment. Other courts have been more reluctant to grant summary judgment where there is at least some evidence of a relationship between the defendant and other actors that performed some steps of the claims. *Digital Reg of Texas, LLC v. Adobe Systems, Inc.*, No. C-12-1971-CW, 2014 WL 2604324 (N.D. Cal. June 10, 2014).

Entertainment Litigation Update

ABC v. Aereo*: Supreme Court Holds that Aereo's System of Streaming Television Broadcasts via the Internet Infringes Copyrights in Programs Broadcast.* On June 25, 2014, the Supreme Court issued its opinion in the closely-watched case of *American Broadcasting Companies, Inc., et al. v. Aereo, Inc.*, 132 S. Ct. 2498 (2014). In a 6-3 opinion authored by Justice Breyer, the Court held that Aereo's system of streaming television broadcasts via the Internet violated the exclusive public performance rights in those programs held by the Petitioners. Although this decision protects the intellectual property rights of content providers, it could have a chilling effect on means for delivering multimedia content.

Aereo provided a system through which its subscribers could watch over-the-air television shows via the Internet, including on mobile devices, at virtually the same time the shows were being broadcast. When an Aereo subscriber selected a program, an antenna operated by Aereo at a central location would tune to that show. Aereo would then record the program and stream it to the subscriber's device with a delay of only a few seconds. Each of Aereo's thousands of antennas was devoted to only one user at a time, and each recording was streamed only to that one user.

Petitioners—television producers, distributors and broadcasters—claimed that such streaming violated their exclusive public performance rights under the Copyright Act of 1976. The Court had to determine, first, if Aereo's streaming constituted a performance and, second, if such a performance was "public." The majority answered yes to both questions.

Aereo contended that it did not "perform" any of the copyrighted works because it did "no more than supply equipment that emulate[d] the operation of a home antenna and digital video recorder (DVR)." It argued that its equipment simply responded to subscriber directives and, therefore, it was the subscribers who "performed" the work when streaming television programs. The Court flatly rejected this argument based on the legislative history of the Copyright Act. The Act was amended in 1976 to address community antenna television (CATV) systems (the precursor to modern cable systems) that had previously been deemed outside its scope. Aereo, like cable providers, used its equipment to receive programs that had been released to the public and transmit them to users via private channels. Due to what it called an "overwhelming likeness" between Aereo and cable companies—despite "technological difference[s]"—the Court determined that Aereo's streaming constituted a performance.

Aereo also claimed that it did not perform the works "publicly" (if they were performed at all) because each program was recorded for a specific subscriber and streamed only to that individual. The Court disagreed. Regardless of whether a particular recording was streamed to one user or multiple users, Aereo's conduct was found to fit within the meaning of a public transmission under the Copyright Act. The Court again relied on Aereo's similarity to cable TV providers, noting that technological innovations "do not render Aereo's commercial objective any different from that of cable companies. Nor do they significantly alter the viewing experience of Aereo's subscribers." Further, the Court held that a "public" performance could be received by different members of the public at different times.

The Court attempted to tailor its decision narrowly to the particular technology at issue, expressly avoiding a discussion of cloud computing, remote-storage DVRs or "other novel issues not before the Court." However, Justice Scalia noted in a dissent that this decision could "sow confusion for years to come" as to how the Copyright Act applies to new technologies that are challenging the traditional methods of transmitting content to consumers. Q

Victory over Auditors for Parmalat

On June 25, 2014, Quinn Emanuel obtained a major victory in the U.S. Court of Appeals for the Seventh Circuit on behalf of Dr. Enrico Bondi, the Extraordinary Administrator (akin to a U.S. bankruptcy trustee) of the estate of Parmalat. The Seventh Circuit reversed a judgment against Dr. Bondi and ordered that the case should proceed anew in Illinois state court.

Parmalat collapsed in 2003 after revelation of fraud undertaken by several high-ranking insiders. In 2004, the firm filed suit on Dr. Bondi's behalf in Illinois state court against Parmalat's auditor Grant Thornton S.p.A. and its affiliated U.S. and international entities. The suit asserted causes of action for, among other things, accounting malpractice in failing to detect and to report the fraud. Grant Thornton removed the case to the U.S. District Court for the Northern District of Illinois ("N.D. Ill.") as related to a Parmalat bankruptcy proceeding that was then pending in the U.S. District Court for the Southern District of New York ("S.D.N.Y."); Dr. Bondi's case was then transferred to S.D.N.Y. Although a federal statute, 28 U.S.C. § 1334(c)(2), provides for mandatory abstention and remand to state court of a case like Dr. Bondi's if it can be "timely adjudicated" in state court, S.D.N.Y. denied Dr. Bondi's motion for that relief. S.D.N.Y. then denied Dr. Bondi's request to take an immediate appeal. The case proceeded on the merits in S.D.N.Y., and, several years later, S.D.N.Y. granted summary judgment against Dr. Bondi on the ground that Illinois' *in pari delicto* (in equal fault) doctrine is a complete defense to Dr. Bondi's action; the court reasoned that the former Parmalat insiders had participated in the fraud on behalf of the company, and that Dr. Bondi stands in the company's shoes and cannot sue other alleged collaborators in the fraud.

Quinn Emanuel filed Dr. Bondi's appeal to the U.S. Court of Appeals for the Second Circuit, and persuaded the Second Circuit to reverse S.D.N.Y.'s judgment on the ground that S.D.N.Y. should have abstained from exercising jurisdiction; the Second Circuit instructed S.D.N.Y. to transfer the case back to N.D. Ill. so that court could in turn remand the case to Illinois state court. The case was transferred back to N.D. Ill., but, before that court remanded the case to Illinois state court, Grant Thornton filed a motion requesting N.D. Ill. to retain jurisdiction and to enter judgment in Grant Thornton's favor. Grant Thornton's asserted basis was that a recent decision by the Seventh Circuit had clarified what previously was unsettled Illinois law on *in pari delicto*.

The firm then filed another appeal on Dr. Bondi's behalf, this time to the Seventh Circuit. Dr. Bondi's brief argued that N.D. Ill. lacked authority to revise the Second Circuit's judgment; that the Second Circuit's mandatory abstention ruling is correct and not drawn into question by the recent Seventh Circuit decision; and that, on the merits (which the Second Circuit had not needed to reach), Dr. Bondi's case should survive summary judgment because, among other reasons, *in pari delicto* does not typically apply to bar a claim against a company's auditors. The case was argued on May 27, 2014, and, on June 25, 2014, the Seventh Circuit issued a published opinion (by Judge Posner) that accepted Dr. Bondi's argument that N.D. Ill. had erred in departing from the Second Circuit's instruction to send the case back to Illinois state court. The case is now active in Illinois state court.

Antitrust Victory for DIRECTV

A Los Angeles Superior Court Judge recently granted Quinn Emanuel client DIRECTV's Motion for Summary Judgment on a former retailer's antitrust claims brought under California's Cartwright Act. The Court concurrently denied the Motion for Summary Adjudication brought by plaintiff Basic Your Best Buy. The Complaint alleged that Basic was one of DIRECTV's largest retailers who, as of 2007, was selected by DIRECTV to be the only retailer allowed to advertise DIRECTV's products and services in telephone directory listings, such as yellow and white pages. Basic invested millions of dollars in these directory listings, which, according to Basic, generated 60,000 - 80,000 calls per month. In late 2008, DIRECTV terminated Basic as a retailer pursuant to the terms of the parties' agreement, at which time other DIRECTV retailers expressed interest in buying the calls or "sales leads" generated by Basic's directory listings, which used DIRECTV's trademarks and logos. According to the complaint, DIRECTV coerced its retailers into agreeing not to bid on or purchase Basic's sales leads under threat of termination, such that DIRECTV was the only potential purchaser for Basic's calls, which, according to Basic, DIRECTV was able to purchase at a reduced price. The Complaint alleged that had Basic been able to sell these calls to other retailers, it could have made nearly $30 million over the life of these directory listings and, therefore, Basic was seeking approximately $90 million after trebling.

In granting DIRECTV's Motion for Summary Judgment, the Court found that the case involved vertical restraints on intrabrand competition, which are tested under the rule of reason, requiring plaintiff to establish, among other things, an anticompetitive purpose, harm to interbrand competition, antitrust injury and market power in a relevant market. The Court found that plaintiff had failed to establish a triable issue of material fact for any of these elements. The Court also rejected plaintiff's "monopsony" theory (i.e., a single buyer with market power) as unsupported speculation. The Court rejected Basic's arguments that DIRECTV is in a horizontal relationship with its retailers and that its conduct should be treated as illegal *per se* based on theories of price fixing, finding the argument "unpersuasive."

Quinn Emanuel Reforms RMBS Indenture

In July 2014, Quinn Emanuel obtained a landmark victory on a question of first impression in New York regarding whether an RMBS indenture can be reformed nine years after execution to correct a scrivener's error that reversed the priority of two classes of notes. The case was initiated by Wells Fargo Bank, N.A., as Securities Administrator of the RMBS Trust governed by the Indenture, seeking judicial instruction on how to handle a discrepancy that had become apparent between the Indenture and the related marketing materials regarding the allocation of losses as between two classes of notes. The firm's client, Sceptre, LLC, had purchased Class I-A-2 Notes governed by the Indenture, which were intended to be senior to the Class I-A-3 Notes in the capital structure. Under the Indenture, the Class I-A-2 Notes and Class I-A-3 Notes received distributions of principal and interest on a *pari passu* basis and, consequently, such distributions created no difference in the risk profile of these two classes of Notes. The factor that differentiated the Class I-A-2 and Class I-A-3 Notes in terms of risk was the allocation of losses to these notes. The notes were marketed pursuant to offering materials, including a Prospectus Supplement, which provided that any losses attributable to these two classes of notes would be allocated first to the Class I-A-3 Notes and then to the Class I-A-2 Notes, evincing the intended seniority of the Class I-A-2 Notes. However, the Indenture governing the notes inadvertently reversed the loss allocation as between these two classes, allocating losses first to the Class I-A-3 Notes and then to the Class I-A-2 Notes, in apparent contradiction to the offering materials pursuant to which the notes were marketed and sold.

Quinn Emanuel successfully argued, over the course of a three-day bench trial, that the Indenture's loss allocation provision was the result of a scrivener's error and that the Indenture should be reformed to allocate losses first to the Class I-A-3 Notes and then to the Class I-A-2 Notes, in accordance with the Prospectus Supplement. Reformation was opposed by a Class I-A-3 Noteholder on the basis that the inconsistency between the Prospectus Supplement and the Indenture had been publicly-available in the market for years and that reformation was inappropriate now that secondary note purchasers had acquired the notes with knowledge of the inconsistency. Quinn Emanuel nonetheless convinced the court that there was "clear and convincing" evidence that the Indenture's loss allocation provision was the result of a scrivener's error that did not reflect the true intent of the deal and that there were no inequities to secondary market purchasers that would result from reforming the Indenture to correctly allocate losses as per the intent of the original dealmakers. The firm also successfully argued, and the Court concluded, that the Indenture, when read together with the offering materials, was ambiguous on its face and should be construed to provide for losses to be allocated first to the Class I-A-3 Notes and then to the Class I-A-2 Notes, as set forth in the Prospectus Supplement. Based on Quinn Emanuel's presentation at trial, the court issued a decision requiring the Securities Administrator to reform the Indenture to allocate losses first to the Class I-A-3 Notes and then to the Class I-A-2 Notes, as set forth in the Prospectus Supplement, thereby restoring the seniority of Sceptre, LLC's Class I-A-2 Notes. Q

quinn emanuel
865 South Figueroa Street, 10th Floor, Los Angeles, California 90017

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LOS ANGELES
865 S. Figueroa St., 10th Floor
Los Angeles, CA 90017
+1 213-443-3000

NEW YORK
51 Madison Ave., 22nd Floor
New York, NY 10010
+1 212-849-7000

SAN FRANCISCO
50 California St., 22nd Floor
San Francisco, CA 94111
+1 415-875-6600

SILICON VALLEY
555 Twin Dolphin Dr., 5th Floor
Redwood Shores, CA 94065
+1 650-801-5000

CHICAGO
500 W. Madison St., Suite 2450
Chicago, IL 60661
+1 312-705-7400

WASHINGTON, D.C.
777 6th Street NW, 11th Floor
Washington, DC 20001
+1 202-538-8000

HOUSTON
1001 Fannin St. Suite 1950
Houston, TX 77002
+1 713-224-4400

TOKYO
NBF Hibiya Bldg., 25F
1-1-7, Uchisaiwai-cho, Chiyoda-ku
Tokyo 100-0011
Japan
+81 3 5510 1711

LONDON
One Fleet Place
London EC4M 7RA
United Kingdom
+44 20 7653 2000

MANNHEIM
Mollstraße 42
68165 Mannheim
Germany
+49 621 43298 6000

HAMBURG
An der Alster 3
20099 Hamburg
Germany
+49 40 89728 7000

MUNICH
Oberanger 28
80331 Munich
Germany
+49 89 20608 3000

PARIS
6 rue Lamennais
75008 Paris
France
+33 1 73 44 60 00

MOSCOW
Paveletskaya Plaza
Paveletskaya Square, 2/3
115054 Moscow
Russia
+7 499 277 1000

HONG KONG
1307-1308 Two Exchange Square
8 Connaught Place
Central Hong Kong
+852 3464 5600

SYDNEY
Level 15
111 Elizabeth Street
Sydney, NSW 2000
Australia
+61 2 9146 3500

BRUSSELS
rue Breydel 34
1040 Brussels
Belgium
+32 2 416 50 00