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Insider Trading After *United States v. Newman*, the Second Circuit's Landmark Decision Limiting Liability of Downstream Recipients of Insider Information

The Second Circuit recently dealt a major setback to federal prosecutors' recent crackdown on insider trading, overturning two high-profile convictions and simultaneously placing the most significant new limits on insider trading liability in decades. The classic tipper-tippee scenario in insider trading prosecutions involves a corporate insider (the tipper) who, in exchange for a personal benefit, discloses material nonpublic information to an outsider (the tippee), who subsequently trades on the basis of this information (or passes the information to another tippee). For years, courts have permitted increasingly remote tippees to become ensnared, based on increasingly vague "personal benefits" allegedly received by tippees.

The Second Circuit's decision in *United States v. Newman* addressed both issues. It substantially reduced the potential liability of remote tippees by holding that a tippee cannot be convicted unless the tippee "knows of the personal benefit received by the insider in exchange for the disclosure." In addition, *Newman*

held the "personal benefit" received by the tipper "must be of some consequence" and must be a true *quid pro quo*, rejecting the notion that mere friendship and association could meet this requirement.

Supported by the SEC, the government sought reconsideration and re-hearing *en banc*, but the Second Circuit has denied both requests. Barring Supreme Court review or action by Congress, the *Newman* decision will guide insider trading actions for the foreseeable future.

An Overview of Tipper-Tippee Insider Trading Liability

In recent years, federal investigators from both the SEC and DOJ have substantially increased their scrutiny of alleged insider trading. In 2014 alone, the SEC filed insider trading actions against 111 individuals or entities, while the DOJ brought related criminal charges against 20 individuals or entities. The Government has been overwhelmingly successful in

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Quinn Emanuel Ranked Number Seven in *Global Arbitration Review's* List of the Top 30 Firms

Quinn Emanuel was recognized as one of *Global Arbitration Review's* Top 30 Firms. This prestigious ranking appears in the 2015 edition of the *GAR 100* and honors the world's preeminent international arbitration practices. The firm made its debut on the Top 30 list last year and rose nine places this year. Emerging at number seven on the 2015 list, over the course of a mere two years, Quinn Emanuel has established itself firmly within the Top 10. [Q](#)

Philippe Selendy Named "Northeast Litigator of the Year" at the 2015 *Benchmark Litigation Awards*

Philippe Selendy, Chair of the firm's Securities and Structured Finance practice, was named "Northeast Litigator of the Year" at the 2015 *Benchmark Litigation* annual awards. This award honored a top litigator who excelled over the past year by engaging in significant cases and revealing talent, intellect, and dedication in his or her work. Selendy, dubbed by *The Financial Times* as "The Man Who Took on Wall Street," has achieved national prominence for his successful representation of the Federal Housing Finance Agency against some of the world's largest banks. Selendy's accomplishments have been widely recognized by other leading legal publications, including *The Legal 500*, *Chambers*, and *Law360*. [Q](#)

this pursuit, including against high-profile defendants like The Galleon Group's Raj Rajaratnam and S.A.C. Capital Advisors' Mathew Martoma. From 2009 through July 2014, U.S. Attorneys for the Southern District of New York did not suffer a single trial defeat in insider trading actions. Todd Newman and Anthony Chiasson's convictions in *United States v. Newman* continued this winning streak.

The insider trading theory advanced by prosecutors in *Newman* and similar cases rests on the Supreme Court's 30-year-old decision in *Dirks v. SEC*, 463 U.S. 646 (1983). Under *Dirks*, a tipper's liability is grounded in breaching a fiduciary duty by receiving a personal benefit in exchange for the disclosure of material, nonpublic information. In other words, "absent some personal gain, there has been no breach of duty" and thus no tipper liability. *Dirks*, 463 U.S. at 662. *Dirks* also made clear that the tippee's liability is derivative. That is, a tippee is liable for insider trading only if (1) the tipper breaches his fiduciary duty *and* (2) the tippee "knows or should know" about this breach. *Id.* at 660.

However, the Second Circuit's recent decision in *United States v. Newman* reversed course and evidenced concern by the courts about potential prosecutorial overreach. Rebuking the "doctrinal novelty of [the Government's] recent insider trading prosecutions, which increasingly target[...remote tippees many levels removed from corporate insiders," the Second Circuit vacated Newman and Chiasson's convictions and imposed substantial new burdens in proving insider trading allegations.

The Second Circuit Limits and Clarifies Tipper-Tippee Liability

Factually, *United States v. Newman* fits the prototypical securities fraud profile—two high-profile New York hedge fund managers charged with trading in and profiting from Dell and NVIDIA stock on the basis of insider information, with profits from the trades in excess of \$72 million. The tip concerning the Dell stock originated from a Dell insider who disclosed the company's nonpublic earnings to a third party analyst, who then disclosed the information to another analyst, who in turn shared the tip with defendant Newman and another third party, who then passed the information along to defendant Chiasson. Newman and Chiasson were thus very remote tippees, three and four levels removed from the initial tipper at Dell. The NVIDIA tip weaved its way through a similar maze of intermediaries, with Newman and Chiasson once again four levels removed from the insider-tipper at NVIDIA.

The Government brought charges against Newman and Chiasson, arguing that as "sophisticated traders," Newman and Chiasson either knew or should have known the insider-tippers at Dell and NVIDIA had disclosed material nonpublic information in breach of their fiduciary duties to Dell and NVIDIA. Newman and Chiasson argued that the insiders at Dell and NVIDIA did not breach their fiduciary duties because they did not receive any benefit in exchange for their tips, and that even if they had received a personal benefit, there was no evidence that defendants had any knowledge of it. Defendants asked the trial judge to instruct the jury that any tippee liability was contingent on proof of defendants' knowledge of the tippees receiving personal benefits in exchange for the insider information they disclosed.

Judge Richard Sullivan of the United States District Court for the Southern District of New York denied defendants' requested jury instruction. Judge Sullivan instead charged that defendants could be found guilty if they "knew the information [they] obtained had been disclosed in breach of a duty." Separately, Judge Sullivan instructed the jury that the Government had to prove the insiders "breached [the fiduciary duty] of trust and confidence by disclosing material, nonpublic information." Critically, this latter instruction made no reference to the connection between a fiduciary breach and the receipt of a personal benefit. Under these instructions, if the Government could prove beyond a reasonable doubt that defendants had knowledge of the insiders' fiduciary breaches—which was simply defined as the act of disclosing material, nonpublic information—the jury must find defendants guilty. The jury so found, and Newman and Chiasson appealed.

On appeal, Newman and Chiasson argued the district court erred by failing to instruct the jury that the Government must prove the defendants had knowledge of the tippees' personal benefit, and argued there was insufficient evidence supporting the alleged personal benefits the Dell and NVIDIA tippees received.

The Government argued the convictions should be upheld if Newman and Chiasson merely possessed knowledge that an insider-tipper disclosed information in breach of a duty of confidentiality, and that the "specificity, timing, and frequency" of the information provided to Newman and Chiasson about Dell and NVIDIA "were so overwhelmingly suspicious" that defendants "must have known, or deliberately avoided knowing" that the tips originated with corporate insiders who disclosed the information in exchange for a personal benefit. In the Government's

view, this constructive or imputed knowledge of the tippers' benefits sufficed to prove even the knowledge requirement. As to the sufficiency of the evidence regarding a personal benefit, the Government argued the tippers at Dell and NVIDIA had received "career advice" and reputational benefits, which the Government argued was sufficient under a recent Second Circuit case holding that "personal benefit is broadly defined to include not only pecuniary gain but also, *inter alia*, any reputational benefit that will translate into future earnings." *United States v. Jiau*, 734 F.3d 147,153 (2d Cir. 2013).

The Second Circuit largely accepted defendants' arguments, holding that "a tippee's knowledge of the insider's breach necessarily requires knowledge that the insider disclosed confidential information in exchange for personal benefit." The Court also rejected the Government's theory that the information defendants obtained was sufficiently suspicious to support constructive knowledge of the insiders' disclosures and benefits. Although the Court acknowledged that "information about a firm's finances could certainly be sufficiently detailed and proprietary" to support an inference of knowledge, it found no such evidence existed in *Newman*.

In addition, the Court concluded that the insider-tippers did not actually receive any personal benefit in exchange for their tips. Rejecting the Government's showing as to personal benefits received by the insiders, the Second Circuit concluded that if generalized career advice and friendship were sufficient personal benefits, "practically anything would qualify." The Court instead held that the law requires "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." Put more directly, the Government must establish a relationship between the tipper and tippee that "suggests a *quid pro quo* from the latter."

The Broader Impact of United States v. Newman

Newman was a resounding victory for insider trading defendants, and its impact is already being felt. By requiring proof of a "consequential" personal benefit given in *quid pro quo* for an insider's tip, the Second Circuit heightened the evidentiary burden necessary to establish a tipper's fiduciary breach and thus liability. Moreover, a tippee must now be shown to possess knowledge of the tipper's personal benefit, a further hurdle to tippee-based insider trading convictions. The impact of this latter ruling is particularly significant, as remote tippees are unlikely to even know the tipper's identity, let alone whether the tipper actually received a benefit in exchange for his tip.


The pool of potential insider trading defendants is thus dramatically reduced. Corporate law scholar Stephen Bainbridge has opined that *Newman* not only "finally put a judicial cap on [the prosecutor's] quest to expand the definition of insider trading to capture virtually every information asymmetry," but also derailed "highly aggressive 'interpretations' of the law that lacked a firm foundation in existing law."

Newman also raises new questions that have yet to be answered. For example, the Second Circuit provided little guidance as to what precisely constitutes a "personal benefit" for purposes of liability. Lawyers and judges will continue to wrestle with the meaning of a "consequential" benefit for years to come. Furthermore, though the court rejected the Government's theory of constructive knowledge in this specific case, it did not foreclose constructive knowledge as a basis for liability in future cases involving "overwhelmingly suspicious" information. This vague dicta, too, will surely be contested in subsequent litigations.

Recognizing the significance of *Newman* on future prosecutions, the Government sought reconsideration and requested en banc review. On April 4, 2015, the Second Circuit denied both requests. It is expected that the Government will seek review by the Supreme Court, its last procedural option to undo the *Newman* decision. In the meantime, district courts have begun to apply *Newman* to pending insider trading cases. Judge Jed S. Rakoff of the Southern District of New York recently avoided answering a key post-*Newman* question: whether *Newman* applies to criminal prosecutions only, or also to SEC civil enforcement actions. In *SEC v. Payton*, Judge Rakoff held that, regardless of whether *Newman* applies to civil enforcement actions, the SEC's complaint satisfied *Newman* by alleging "a meaningfully close personal relationship" and that the tipper "disclosed the inside information for a personal benefit sufficient to satisfy the *Newman* standard." --- F. Supp. 3d ---, 2015 WL 1538454 (S.D.N.Y. April 6, 2016).

Concurrently, members of Congress have responded to *Newman* with proposals to overturn it and even to expand insider trading law further. Representative Stephen F. Lynch (D-MA) has proposed a bill that would completely eliminate the requirement that a tipper receive a personal benefit in exchange for his or her tip. This would expand the law even beyond the pre-*Newman* state, exponentially expanding the universe of potential insider trading defendants. A separate bill proposed by Senators Jack Reed (D-RI) and Robert Menendez (D-NJ) would make it illegal to trade on any information that is "not publicly available" except for "information that the person

has independently developed from publicly available sources.” Accordingly, these two proposals seek far more than the mere overturn of *Newman*; rather, they attempt to vastly redefine the contours of tipper-tippe liability in particular, and insider trading liability more generally. These bills are in the early stages and whether, and in what form, they might actually become law remains uncertain.

However, these prompt and aggressive proposals signify Congressional dissatisfaction with the Second Circuit’s decision, and suggest that the victory in *Newman*, even if not disturbed by the Supreme Court, may ultimately be pyrrhic. 

NOTED WITH INTEREST

Bribery Settlements in 2014: A Record-Setting Year

Corporations facing bribery charges under the U.S. Foreign Corrupt Practices Act (“FCPA”) will pay significantly higher fines to resolve their cases, at least if recent settlements are a reliable guide. Last year, FCPA settlements averaged \$157 million – the highest average since the statute was enacted in 1977 – and totaled \$1.6 billion. In 2014, the U.S. Department of Justice (“DOJ”) imposed the second largest penalty ever in an FCPA case – \$772 million – and settled four cases for over \$100 million each. These large, unprecedented settlements demonstrate a significant trend in FCPA enforcement and provide guidance for corporate clients with FCPA exposure.

Overview

The FCPA prohibits (1) companies and individuals from bribing foreign officials to obtain or retain business; and (2) false accounting related to such bribery. See 15 U.S.C. §§ 78m(b)(2), 78dd-1 to -3. The statute is prosecuted by the DOJ and the U.S. Securities and Exchange Commission (“SEC”). Bribes can be offers, even if rejected, and need not be money, goods, or services. See, e.g., § 78dd-1(a) (“anything of value”). “Foreign official” is also defined broadly. See *United States v. Esquenazi*, 752 F.3d 912, 925-26 (11th Cir. 2014) (providing a multi-factor test subject to interpretation for a foreign official as an “instrumentality” of a foreign government). For example, a bribe to a foreign official could be an offer of an internship at an American company to the relative of an employee at a foreign government-owned company. See *Bank of N.Y. Mellon Corp.*, Current Report (Form 8-K) at 2 (Jan. 23, 2015) (discussing recommended FCPA action against a bank for similar conduct).

The FCPA applies to foreign companies that issue U.S. securities or commit an act violating the FCPA in the United States, including through an agent. See §§ 78dd-1(a), -3(a). In addition, as demonstrated by the 2014 settlement with Japan-based Marubeni Corp., foreign

companies that conduct business with U.S. companies may face FCPA exposure under U.S. conspiracy laws. Eight of the ten largest FCPA settlements since 1977 involved foreign companies.

Record-Breaking Settlements

2014 saw the second largest penalty ever imposed by the U.S. government in an FCPA case in *United States v. Alstom Grid, Inc.*, No. 3:14-cr-247 (D. Conn. Dec. 22, 2014). Alstom S.A. (“Alstom”), a French power company, pleaded guilty to violating the FCPA accounting provisions in connection with bribes paid by Alstom “consultants” to foreign officials in several countries, including Indonesia, Saudi Arabia and Egypt. As part of the plea agreement, Alstom agreed to pay a \$772 million fine, which was over two and half times its profit from the bribery. Along with the corporate prosecution, the DOJ charged four Alstom executives with conspiracy and direct violations of the FCPA.

Three other FCPA cases settled in 2014 for more than \$100 million each. In what is the sixth largest FCPA settlement in history, Alcoa World Alumina LLC, a subsidiary of Alcoa Inc. (“Alcoa”), a global aluminum producer, pleaded guilty to violating the FCPA anti-bribery provisions in connection with bribes paid by the subsidiary’s agent to foreign officials in Bahrain. As part of the settlement, Alcoa and its subsidiary paid \$384 million in fines and returned profits to the DOJ and the SEC.

ZAO Hewlett-Packard A.O., a Russian subsidiary of Hewlett-Packard Co. (“HP”), the California technology company, pleaded guilty to conspiracy and direct violations of the anti-bribery and accounting provisions of the FCPA. In addition, HP subsidiaries in Poland and Mexico entered into deferred prosecution and non-prosecution agreements with the DOJ. As part of the settlement, the entities paid \$108 million.

Avon Products (China) Co., a subsidiary of Avon

Products Inc. (“Avon”), the New York-based cosmetics company, pleaded guilty to conspiring to violate the FCPA accounting provisions. As part of the settlement, Avon and its subsidiary paid \$135 million.

Court filings for these settlements acknowledge the companies’ (1) comprehensive internal investigations; (2) improved internal compliance functions; (3) remedial measures, including taking appropriate disciplinary action against responsible employees; and (4) cooperation with the DOJ.

Overall, the U.S. government collected \$1.6 billion in fines and penalties in ten FCPA actions against corporations in 2014. (See Table 1 below.)

Other Trends

In addition to the record-breaking fines, the 2014 settlements suggest that the U.S. government is increasingly focused on (1) individuals in FCPA actions; and (2) cooperation by companies in FCPA investigations.

In 2014, the U.S. government indicted or unsealed charges against 11 individuals for FCPA-related violations. Nine individuals pleaded guilty or consented to FCPA-related charges. William Burck and Juan Morillo of Quinn Emanuel’s Washington, D.C. office and William Price of the firm’s Los Angeles office represent one of the indicted individuals, an executive of PetroTiger Ltd., a British Virgin Islands oil and gas company. The trial is scheduled to begin on June 1, 2015.

In addition, statements by the DOJ in connection with the 2014 settlements suggest that cooperation, coupled with a voluntary disclosure of FCPA violations, may lead to reduced fines and non-prosecution or deferred prosecution agreements. For example, in the press release for the Bio-Rad Laboratories Inc. settlement, the DOJ stated that it entered into a non-prosecution agreement

due “in large part” to the company’s voluntary disclosure and cooperation.

Despite the DOJ’s emphasis on cooperation in FCPA investigations, the benefits are unclear. If the 2014 settlements are a reliable indicator, companies that cooperate with the U.S. government will still pay high fines and may be required to enter guilty pleas. Moreover, in contrast to the DOJ Antitrust Division’s Corporate Leniency Policy, which sets forth specific guidelines as to how the government quantifies and values cooperation for settlement purposes, there are no such guidelines in FCPA investigations. Accordingly, there is no mechanism in the FCPA context for companies to adequately predict the value, if any, of cooperating with U.S. authorities. Furthermore, even if a company obtains a reduced fine or avoids prosecution by cooperating with U.S. authorities (1) the company may suffer reputational harm and lost business; (2) its employees may be indicted; and (3) shareholders, competitors and foreign enforcement agencies may initiate legal actions.

Based on the record-breaking settlements in 2014 and the controversy surrounding the benefit, if any, of cooperating with the U.S. government, companies with FCPA exposure should: (1) conduct a comprehensive internal investigation; (2) improve internal compliance functions, particularly with respect to foreign subsidiaries and agents; (3) implement remedial measures, if warranted, including taking appropriate disciplinary action against responsible employees; and (4) weigh the advantages and disadvantages of voluntary disclosure or cooperation with the U.S. government.

While 2014 was a record-setting year in terms of FCPA enforcement, there is every indication that the trends toward increased fines and a focus on individuals will continue in the coming year. **Q**

Table 1: Corporate FCPA Settlements in 2014

| Company | Date | Prosecuting Entity | Main Resolution | Countries Involved | Amount |
|------------------------------|---------------|--------------------|---|--|---------------|
| Alstom S.A. | December 2014 | DOJ | Guilty plea to accounting provisions | Indonesia, Saudi Arabia, Egypt and other countries | \$772 million |
| Alcoa World Alumina LLC | January 2014 | DOJ & SEC | Guilty plea to anti-bribery provisions | Bahrain | \$384 million |
| Avon Products (China) Co. | December 2014 | DOJ & SEC | Guilty plea to accounting provisions | China | \$135 million |
| ZAO Hewlett-Packard A.O. | April 2014 | DOJ & SEC | Guilty plea to anti-bribery & accounting provisions | Russia, Poland, Mexico | \$108 million |
| Marubeni Corp. | March 2014 | DOJ | Guilty plea to anti-bribery provisions | Indonesia | \$88 million |
| Bio-Rad Laboratories Inc. | November 2014 | DOJ & SEC | Non-Prosecution Agreement | Russia, Vietnam, Thailand | \$55 million |
| Dallas Airmotive Inc. | December 2014 | DOJ | Deferred Prosecution Agreement | Brazil, Peru, Argentina | \$14 million |
| Layne Christensen Co. | October 2014 | SEC | Settled Administrative Proceeding | Several African countries | \$5.1 million |
| Bruker Corp. | December 2014 | SEC | Settled Administrative Proceeding | China | \$2.4 million |
| Smith & Wesson Holding Corp. | July 2014 | SEC | Settled Administrative Proceeding | Pakistan, Indonesia and other countries | \$2.0 million |

PRACTICE AREA NOTES

Appellate Practice Update

Inconsistent Access to Federal Appellate Arguments.

Public access to appellate proceedings has been a hot topic recently, with many in the news media and the general public clamoring for the U.S. Supreme Court to allow video recording or even live Internet streams of arguments in important cases. The Court has thus far rebuffed all such requests, with Justice Antonin Scalia notably explaining that releasing video of its proceedings would “mis-educate the American people,” many of whom (he said) would see only “30 second, 15 second take-outs from our argument, and those take-outs would not be characteristic of what we do.” Yet the Court does provide public access by posting transcripts to its website on the same day as an argument, and audio recordings (though not video) on the following Friday. In important cases, the Court will sometimes even provide same-day audio, as it recently announced it will do for the same-sex marriage cases.

But while Supreme Court arguments are often of great interest to the public, many business litigants and their counsel have far greater interest in obtaining access to arguments before the federal courts of appeals—which decide vastly more cases than the 70 annual merits cases heard by the Supreme Court. In those courts, argument recordings can be vital resources to litigants and advocates alike, and yet access to those arguments varies widely among the federal circuits—a fact that is unlikely to change in the near future, as the federal Judicial Conference’s Committee on Court Administration and Case Management has recently denied a request that it adopt a uniform policy of releasing argument audio on the same day as the hearing. See Letter from Hon. Wm. Terrell Hodges to Mr. Gabe Roth (Feb. 19, 2015), available at <http://www.openscotus.com/wp-content/uploads/2015/02/15-02-09-ltr-J.-Hodges-to-Roth-re-courts-of-appeals-audio-files.pdf>. In this respect, the federal appellate courts lag behind some state appellate courts; for example, the New York Court of Appeals supplies a live webcast and an archive of argument videos, as do the Supreme Courts of Illinois and Ohio, to name a few.

Among the federal courts of appeals, the Ninth Circuit provides the most expansive access to its proceedings, supplying live streaming video of its arguments and maintaining a YouTube channel with video of recent proceedings. The court also posts audio and video recordings to its website on the day after argument. No other federal court of appeals yet provides regular video of arguments, though some will, upon request, permit news media to broadcast hearings in important cases. But most circuits—the First, Third, Fourth, Fifth,

Sixth, Seventh, Eighth, D.C., and Federal Circuits—do provide audio recordings on the same day as argument, or shortly thereafter.

The three remaining circuits, however, have not adopted an online system for providing audio recordings. In those courts, obtaining argument audio can be inconvenient and time-consuming. The Second Circuit will prepare a CD of an oral argument, but only upon written request and payment of a \$30 fee. The clerk’s office can take several days or even weeks to prepare the CD. The Eleventh Circuit likewise requires purchase of a CD for \$30, and warns interested parties that recordings are only available for arguments held after August 1, 2012, and that they are destroyed after the Court has finished using them. And while the Tenth Circuit posts recordings of some arguments perceived to be of public interest on its website, it does so only on an *ad hoc* basis. In most cases, the local rules require a person seeking a recording to file a motion stating the reasons for seeking access—a potentially burdensome procedure requiring an attorney with Tenth Circuit electronic filing privileges.

Readier access to oral arguments in all the federal circuits would be most useful. Review of argument recordings can be helpful tools for argument preparation, giving invaluable insight into the questioning styles of judges who might be on one’s panel. And argument recordings are an excellent tool for analyzing the likely outcome of a case after argument. In the absence of a nationally uniform policy, it is to be hoped that all circuits adopt the approaches pioneered by the Ninth Circuit and the most technology-friendly state high courts.

Class Action Litigation Update

The New Role of Social Media in Class Action Notice Programs.

In the early 2000s, the suggestion of providing class notice through a social networking site would have been laughable. As recently as 2010, no published authority approved the use of text messages or social network mediums for providing class notice. This is no longer true. In the last decade, social networking has changed the way American adults obtain information and communicate with each other, often at the expense of traditional media. (The Pew Research Center reports that as of January 2014, 74-percent of online adults use social networking sites. Social Networking Fact Sheet, Pew Research Center, available at <http://www.pewinternet.org/fact-sheets/social-networking-fact-sheet/> (last visited March 10, 2015)). The ubiquitous use of social media has increasingly led plaintiffs distributing class notice to seek approval to use social media sites such as Facebook and Twitter. When faced with these requests, courts must determine whether distributing class notice through social media constitutes “the best notice that is practicable

under the circumstances.” FED. RULE CIV. P. 23(c)(2)(B). Several courts have answered this question in the affirmative, approving the use of social media to disseminate class notice, both as an addition to and a replacement for more traditional methods. In *Kelly v. Phiten USA, Inc.*, the court evaluated the sufficiency of notice in determining whether to grant final approval of a class action settlement. 277 F.R.D. 564, 569 (S.D. Iowa 2011). Among other methods of distribution, “[n]otice was displayed on Phiten’s Facebook page, which delivered individual e-mail notifications to its more than 75,000 fans and also appeared on each fan’s Facebook homepage.” *Id.* The Court found that the plaintiff had “provided sufficient notice, which was reasonably calculated, under the circumstances,” to apprise settlement class members of the pendency of the action and their rights under the settlement agreement. *Id.* at 570. Similarly, in *Evans v. Linden Research, Inc.*, the court approved a notice distribution program that included posting class notice on Facebook “targeting individuals who have expressed an interest in” the internet role-playing virtual world that was the subject of the litigation. No. C-11-01078 DMR, 2013 WL 5781284, at *3 (N.D. Cal. Oct. 25, 2013). Recognizing that it must “ensure that the parties’ notice plan provides for the best notice that is practicable under the circumstances,” the Court found that the notice distribution plan, including the targeted internet publication on Facebook, met the standards of Rule 23. *Id.* at *5 (internal quotations omitted). These examples show that courts are increasingly willing to use social media where the social media notice proposals are reasonably calculated to reach potential class members and comport with the established purposes of Rule 23. Proposals that do not meet these standards will be rejected.

Most recently, on March 5, 2015, the Court in *Mark v. Gawker Media LLC* denied the plaintiffs’ proposed notice distribution plan, which included notice via Facebook and Twitter, only months after conditionally approving the use of social media to notify potential members of their right to join the collective action. No. 13-cv-4347 (AJN) (S.D.N.Y. Mar. 5, 2015). The Court denied the plaintiffs’ proposed social media postings, finding that they were “substantially overbroad” for the purpose of providing notice to potential opt-in plaintiffs and appeared “calculated to punish” Gawker rather than provide notice of opt-in rights. *Id.* The Court said the plaintiffs’ proposals to post notices on Reddit and Tumbler pages such as ‘r/OccupyWallStreet’ and ‘r/Progressive’ lacked “any realistic notion of specifically targeting its notice to individuals with opt-in rights, and instead would call attention to the lawsuit mostly of individuals with no material connection to the lawsuit whatsoever.”

Id. The Court also rejected the plaintiffs’ proposed use of Twitter, LinkedIn, and Facebook as overbroad, stating that it had approved the use of social media notice on the understanding that such notice would contain private, personalized notification sent to identified potential plaintiffs who may not otherwise be reachable, and not public-facing notices such as general tweets and publicly accessible groups as the plaintiffs had proposed. *See id.*

The Court in *Flynn v. Sony Electronics, Inc.* reached a similar conclusion, denying the plaintiff’s proposal to reach class members for whom the defendant did not have direct contact information via, among other methods, a case-specific Facebook site. No. 09-cv-2109-BAS (MDD), 2015 WL 128039, at *1, *4 (S.D. Cal. Jan. 7, 2015). The defendant opposed the proposal, arguing that the Facebook page did not comply with the purpose of notice and that it was overbroad because the ability to ‘friend’ or ‘like’ the page would not be limited to class members. *See id.* at *4. The Court concurred, stating that the purpose of the class-action notice requirement is to apprise class members of the action and given them an opportunity to opt out; by contrast, the plaintiff’s reason for the proposed Facebook page was to allow class members to become ‘friends’ or ‘like’ the page and be able to receive updates and posts related to the litigation. *See id.* Further, the notice plan did not provide for the case-specific Facebook page to be published or noticed anywhere, so that class members would likely have to actively seek it out. *See id.* Finding that “[c]lass members actively searching for notice is not what was intended by requiring notice in a class action,” the Court held that the proposed case-specific Facebook page did not comply with the purpose of class action notice under Rule 23 and denied the proposal. *Id.* at *4.

As the number of social networking sites and users continues to grow, we expect courts to further develop additional innovations and parameters for the role of social media in Rule 23.

Product Liability Litigation Update

Defenses to Public Nuisance Claims in Pharmaceutical Products Litigation. For many years, plaintiffs have asserted the tort of nuisance to address purported harms from all sorts of products—including firearms, lead paint, chemicals, and energy products—that are alleged to endanger the “health, morals, safety, comfort, convenience, or welfare of the community.” Recently, nuisance has been asserted on behalf of governmental entities to address alleged harms arising from pharmaceutical products. As discussed below, these claims are subject to a variety of defenses.

The new nuisance lawsuits have been brought on behalf of governmental entities alleging wrongdoing

in connection with prescription pain medications manufactured or distributed by a number of pharmaceutical defendants. In separate actions, the City of Chicago and two California counties are suing the drug industry for its “aggressive marketing” of opioid pain medications, which they allege has led to an epidemic of addiction that has cost taxpayers millions of dollars in insurance claims and other healthcare costs, criminal use of the medications, and an expanded market for heroin. *E.g.*, Compl. at 94-97, *California v. Purdue Pharma LP*, No. 30-2014-00725287-CU-BT-CXC (Cal. Super. Ct. May 21, 2014); Compl. at 126-55, *City of Chicago v. Purdue Pharma L.P.*, No. 14-cv-04361 (N.D. Ill. Oct. 21, 2014).

Federal preemption may be a significant defense to public nuisance suits brought against pharmaceutical manufacturers. Long a staple defense in pharmaceutical products liability litigation, preemption has also been held to bar public nuisance claims in other contexts. For example, the Fourth Circuit held that air pollution claims were barred by the Clean Air Act’s “system for accommodating the need for energy production and the need for clean air,” *N. Carolina, ex rel. Cooper v. Tenn. Valley Auth.*, 615 F.3d 291, 296 (4th Cir. 2010), and the Supreme Court has held that federal common law nuisance claims regarding carbon dioxide emissions alleged to cause global warming were displaced by the Clean Air Act. *Am. Elec. Power Co. v. Connecticut*, 131 S. Ct. 2527 (2011).

Defendants may assert that preemption similarly bars or substantially limits public nuisance claims against pharmaceutical companies. At the outset, defendants may argue that any claims involving generic medications would be significantly curtailed by the Supreme Court’s decisions in *PLIVA, Inc. v. Mensing*, 131 S. Ct. 2567 (2011), and *Mutual Pharmaceutical Co. v. Bartlett*, 133 S. Ct. 2466 (2013), because federal law requires generic manufacturers to use both the same labeling and design as the branded medication and limits communications to physicians regarding generic medications. Further, to the extent these actions are based on alleged violations of the Federal Food, Drug, and Cosmetic Act (“FDCA”) requirements, defendants may argue that they would be barred by *Buckman Company v. Plaintiffs’ Legal Committee*, 531 U.S. 341 (2011), contending that the enforcement of those requirements is the exclusive prerogative of the federal government. And to the extent such public nuisance claims address reimbursement for prescription medications under state Medicaid programs, defendants may argue that these claims impermissibly conflict with federal law governing Medicaid programs. Moreover, even to the

extent these claims were not found to be preempted, defendants may argue that the courts should defer to the FDA in resolving these matters under the doctrine of primary jurisdiction, which generally provides that issues committed to an administrative body should be addressed by it before being litigated.

In addition to preemption, defendants in these actions also may argue a failure of proximate causation due to the attenuated nature of the harm the plaintiffs allege. To the extent the suits are prosecuted in federal court, defendants may assert that the issue of causation may affect not only the merits of the action, but also the court’s jurisdiction, due to the plaintiffs’ lack of standing to bring the action in the first place. For example, courts generally have rejected public nuisance claims against producers of fatty foods for lack of standing on the ground that plaintiffs could not trace any health harm to those specific products, much less show that isolated uses of those products had caused harmful effects. *Simpson v. Cal. Pizza Kitchen, Inc.*, 989 F. Supp. 2d 1015, 1022, 1025 (S.D. Cal. 2013). With similar reasoning, some judges have stated that global warming nuisance claims fail because the alleged harmful effects cannot be fairly attributed to particular defendants. *Kivalina v. ExxonMobil Corp.*, 696 F.3d 849, 868 (9th Cir. 2012) (Pro, J. concurring). Pharmaceutical defendants may similarly contend that the harm alleged in the opioid nuisance litigation—increased healthcare costs to taxpayers from addiction—is not traceable to the defendants given the large number of factors that can cause or contribute to addiction. Defendants may also argue that an alleged link between the alleged conduct and injury was broken by other factors, including the criminal actions of third parties.

Finally, defendants may assert that public nuisance claims against pharmaceutical defendants fail because they do not allege interference with a “public right,” which is one of “those indivisible resources shared by the public at large, such as air, water, or public rights of way.” *State v. Lead Indus. Ass’n, Inc.*, 951 A.2d 428, 453 (R.I. 2008); *City of Chicago v. Am. Cyanamid Co.*, 823 N.E.2d 126, 131 (Ill. App. Ct. 2005). Courts generally have rejected nuisance claims against the firearms industry due to the lack of a public right to be “free from unreasonable jeopardy to health, welfare and safety . . . caused by the presence of illegal weapons.” *City of Chicago v. Beretta U.S.A. Corp.*, 821 N.E.2d 1099, 1114 (Ill. 2004); *accord City of Philadelphia v. Beretta U.S.A., Corp.*, 126 F. Supp. 2d 882, 909, 911 (E.D. Pa. 2000), *aff’d*, 277 F.3d 415 (3d Cir. 2002). Pharmaceutical defendants may assert that the new nuisance actions are on similar footing, because they

allege harm due to illegal, not legal, use of the products. Defendants should continue to monitor the assertion of public nuisance claims against the pharmaceutical industry and be prepared to develop these and other potential defenses to such claims.

Trial Practice Update

Admissibility of Third Party Postings on Social Media Pages. This article focuses on whether statements posted by a third party on a person's Facebook "wall" or similar social media page are admissible for their truth against the person on whose page they appear.

Facebook posts often embed or convey statements made by other individuals, usually by the use of a username, hashtag, or @ symbol followed by the other author's text ("third party posts"). Users of Facebook have a "wall" wherein other users—typically Facebook "friends"—can post content to the user's "page." This content then becomes visible when a person visits that user page and it is incorporated into their online profile. Other users can even "comment" on the post, and these comments can also become visible to the user's other visitors. The user retains ultimate authority over posted content, however, and can delete and "curate" the online profile as desired. Because the posts are out-of-court statements, their admissibility raises hearsay issues.

Some situations may present a non-hearsay basis for admitting third party posts. For instance, the proponent of the evidence might offer a post to show that the party on whose wall it was posted—or the poster—was on notice of or aware of the content of the post, regardless of its truth. The post could also be offered to show the poster's state of mind, which qualifies as a hearsay exception under FRE 803(3).


Where the post is offered to prove the truth of the matter asserted, however, it constitutes inadmissible hearsay, unless an "exception" applies. One commonly used hearsay exception, party admission, does not apply to this example, because the party against whom it is being offered did not author the statement. A potential avenue for admission is as an *adopted* admission. Federal Rule of Evidence 801(d)(2)(B) treats statements that might otherwise be hearsay as non-hearsay when the statement is offered against the opposing party and "is one the party manifested that it adopted or believed to be true."

Although courts have not addressed the issue of adopted admissions in the social media posting context, courts have addressed the issue of adopted admissions in the context of forwarded emails. The Ninth Circuit in *Sea-Land Serv., Inc. v. Lozen Int'l, LLC.*, 285 F.3d 808,

821 (9th Cir. 2002) held that when a forwarding party commented on a forwarded email and "incorporated and adopted the contents of [the] original message," the forwarding party "manifested an adoption or belief in [the] truth" of the information contained in the original e-mail," rendering it an adoptive admission. *Lozen* reasonably suggests that merely forwarding an email is insufficient to signify an intent to adopt the statements therein, and that some additional action endorsing the message is required before it can be offered for its truth against the forwarding party.

Emails and social media posts differ in ways that can impact the analysis of intent to adopt. For example, while emails cannot typically be deleted remotely by the sender from the recipients' email boxes, a Facebook wall owner retains control over a post and can delete it without the poster's consent. Thus, by allowing third party posts to remain visible on the wall, the owner is potentially expressing his adoption of the statement through inaction. Courts have recognized that *silence* can be an adoptive admission, and thus the "inaction" of allowing a post to remain up could be viewed as evidencing an intent to adopt. *See United States v. Joshi*, 896 F.2d 1303, 1311 (11th Cir. 1990) ("First, the statement must be such that an innocent defendant would normally be induced to respond. Second, there must be sufficient foundational facts from which the jury could infer that the defendant heard, understood, and acquiesced in the statement . . . The first criterion, [] is of particular relevance in cases involving silent acquiescence."). Facebook and other social media posts typically communicate to a much larger group of people than an email sent to discrete group. This willingness to allow the statement to be seen by a much larger group could indicate a lack of concern on the part of the owner with being associated with the contents of the post.

The circumstance surrounding the posting and its retention will also factor into an adopted admission analysis. For example, the extent to which the owner monitors the content of the wall, as well as the length of time a particular post has been up, would likely bear on whether inaction manifests an intent to adopt a third party post.

Although courts have not yet issued opinions on the admissibility of third party posts, courts will face these and other novel evidentiary questions as social media use continues to proliferate. Prior decisions will provide some guidance on the issues, but courts must also recognize that unique characteristics of social media will require courts to adapt traditional evidence rules. 

VICTORIES

Standards-Essential Patent Victory for Marvell

On March 3, 2015, the firm achieved a complete defense victory for Marvell Semiconductor over France Telecom. Judge Orrick in the Northern District of California granted Marvell's motion for judgment as a matter of law (JMOL) of no infringement. France Telecom had asserted that certain Marvell communications processors infringed U.S. Patent No. 5,446,747, which allegedly covered a type of error correction code widely used in telecommunications known as "turbo" codes. France Telecom had declared the patent essential to the 3G wireless standard and argued that any device compatible with that standard necessarily infringed. Likely because of the widespread use of turbo codes and France Telecom's standards-essential declaration, dozens of companies had declined to challenge the '747 patent and instead acquiesced to a license with exorbitant fees under France Telecom's licensing program.

The firm won many victories during the two year journey to trial. First, in late 2012, Judge Rakoff granted Marvell's motion to transfer the case out of the Southern District of New York to the Northern District of California (Marvell is headquartered in Santa Clara, California). Judge Rakoff was persuaded by the firm's arguments and agreed that "every relevant factor except the plaintiff's choice of forum supports transfer." Second, in March 2014, the firm won a favorable claim construction for a key claim term. Third, in April 2014, the firm won partial summary judgment on damages that excluded from the damages base all foreign sales, including all sales by a non-party Marvell affiliate based in Singapore. Judge Orrick agreed with the firm's arguments that the Marvell affiliate was a separate legal entity and that there could be no liability under United States patent law for allegedly infringing acts occurring abroad. Finally, in August 2014, Marvell won motions *in limine* excluding key evidence from trial. Although he issued a preliminary order denying Marvell's motion, after oral argument Judge Orrick agreed with the firm's position, granting the motion to preclude arguments of infringement under the doctrine of equivalents and that the asserted claim covered the 3G standard. Judge Orrick also rejected attempts by France Telecom to argue that the mere act of importing a system embodying a claimed method into the United States can infringe a method claim. Judge Orrick agreed with the firm's argument that, under controlling precedent, one can only directly infringe a method claim by use—that is, by performing each and every step of the claimed method

in the United States.

During the two-week trial that ensued, the jury heard from the named inventor of the patent, Professor Claude Berrou, who had received the Marconi Prize in telecommunications—a technology award some equate to winning a Nobel prize—for his work on turbo codes. The jury also heard how prominently turbo codes were used in many telecommunications standards, including the 3G wireless standard. France Telecom even introduced scientific textbooks that included entire chapters devoted to turbo codes and their benefits on noisy communications channels. France Telecom claimed damages of \$10 million plus enhancements due to alleged willful infringement. The firm mounted a spirited defense that included attacks on infringement and validity of the '747 patent, as well as on numerous facets of France Telecom's damages case. In fact, the firm's cross examination of France Telecom's damages expert proved so devastatingly effective that it was reported by *Law 360* under the headline "Marvell Shreds France Telecom's Expert In \$10M Chip IP Trial." Although the jury found direct infringement, it rejected France Telecom's claims of indirect and willful infringement and awarded damages of only \$1.7M. This award was equal to Marvell's expert's lowest damages figure.

Following a hearing on post-trial briefs, Judge Orrick issued an order granting Marvell's JMOL of no infringement—which amounts to a complete defense victory for the firm's client. Marvell is now seeking its costs and attorneys fees.

Second Circuit Arbitration Victory

The firm obtained an important victory for its client Abu Dhabi Investment Authority ("ADIA") when, on January 14, 2015, a panel of the Second Circuit (Circuit Judges Wesley, Hall, and Lynch) unanimously held that the All Writs Act, 28 U.S.C. § 1651, cannot be used to enjoin an arbitration on the grounds that the claims were or should have been raised in a prior arbitration.

ADIA commenced an arbitration against Citigroup, alleging breach of a contract between the parties concerning a substantial investment ADIA had made in Citigroup. Citigroup then filed suit in the U.S. District Court for the Southern District of New York, arguing that ADIA was barred from bringing claims that were, or could have been, raised in an earlier arbitration between the parties, and seeking to enjoin the current arbitration under the court's extraordinary All Writs Act power. Relying on several Second Circuit precedents, ADIA argued that any preclusion argument

advanced by Citigroup could be addressed only by the arbitrators in the second arbitration, not by a court, given the parties' contractual agreement to arbitrate all disputes. The district court agreed with ADIA and dismissed Citigroup's complaint.

Citigroup appealed to the Second Circuit, emphasizing that precedents upon which ADIA and the district court had relied had not specifically addressed the All Writs Act. Indeed, the Second Circuit had arguably left the issue open in a 2011 decision. In a published opinion, authored by Circuit Judge Hall, the Second Circuit affirmed the district court's judgment dismissing Citigroup's complaint. In addition to citing its own prior precedent, the Second Circuit relied on several decisions by other Circuits, as well as the general policy in favor of submitting to arbitrators (rather than a court) issues in dispute, where the parties' contract contains a broadly worded arbitration clause.

Complete Defense Victory for Michael Milken

The firm won a complete defense victory for its client Michael Milken against plaintiffs Scantron Corporation and Harland Clarke Holdings Corp., companies owned and controlled by Ronald O. Perelman. Mr. Perelman and his companies sought over \$135 million, plus tens of millions more in compensatory damages and punitive damages, for alleged fraud and related claims arising from the sale of an educational software company, GlobalScholar. In a summary judgment issued by the United States District Court for the District of Delaware, the firm defeated each of the plaintiffs' claims.


In 2010, Mr. Perelman and one of his companies, Scantron, expressed interest in acquiring GlobalScholar and ultimately offered to acquire the company for approximately \$135 million. The transaction was consummated by heavily negotiated contracts, including a sales agreement between Scantron and the seller, KUE Digital International, LLC. More than two years later, Scantron and Harland Clarke sued in Texas state court in San Antonio, claiming GlobalScholar was worthless and asserting claims for fraudulent inducement and securities fraud. Plaintiffs postured the complaint to avoid removal to federal court and to avoid the limitations on permissible claims set forth in the transaction agreements by suing our client personally, along with non-diverse entities, and by suing based solely on non-contractual state law claims.

The firm removed the case to the United States District Court for the Western District of Texas on the

grounds that plaintiffs had fraudulently joined entities in an effort to defeat diversity jurisdiction. Plaintiffs moved to remand, and the firm opposed. At the same time, based on a contract provision requiring disputes to be filed in Delaware courts, the firm brought suit in Delaware Chancery Court to enjoin plaintiffs from pursuing any further Texas state court litigation. Facing both the Chancery Court action and a possible fraudulent joinder finding, plaintiffs voluntarily dismissed the non-diverse defendants and withdrew their motion for remand, conceding jurisdiction in the Western District of Texas.

With the case pending in the Western District of Texas, the firm then filed a motion for transfer to the District of Delaware, which was the forum provided for in the underlying transaction agreements. Plaintiffs opposed the motion by arguing that the contacts did not govern because Mr. Milken and one of the plaintiffs were not parties to them and because plaintiffs' claims were not for breach of contract, but for fraud-in-the-inducement. United States District Judge Xavier Rodriguez, Western District of Texas, granted the motion to transfer, agreeing with Quinn Emanuel that Mr. Milken was a beneficiary of the transaction agreements, that both plaintiffs were bound by the transaction agreements, and that plaintiffs' fraud and other non-contract claims were subject to the transaction agreements, including their forum selection and non-recourse provisions.

Once in the District of Delaware, the firm sought summary judgment, seeking to dispose of plaintiffs' entire case. The motion argued plaintiffs' claims were completely barred by the transaction agreements, for reasons including that the plaintiffs had agreed not to sue Mr. Milken and had also agreed not to rely on the alleged representations on which plaintiffs' claims were based. Plaintiffs opposed, arguing that Mr. Milken was not entitled to enforce the transaction agreements, that the agreements' limitations were inapplicable to plaintiffs' fraud and related claims, and that the agreements were unenforceable.

On March 4, 2105, United States District Judge Gregory M. Sleet, District of Delaware, granted summary judgment in Mr. Milken's favor on all claims, agreeing with each of the grounds Quinn Emanuel had raised. The Court ruled that plaintiffs had breached the transaction agreements by suing Mr. Milken and that plaintiffs' fraud and related claims were barred by the transaction agreements, including their no-recourse clauses and their provisions barring plaintiffs' reliance on the alleged misrepresentations. Accordingly, the Court ruled that the transaction agreements barred plaintiffs' lawsuit against the firm's client entirely. 

business litigation report

quinn emanuel urquhart & sullivan, llp

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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

SEATTLE

600 University Street, Suite 2800
Seattle, WA 98101
+1 206 905 7000

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