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The Law Debenture Trust Corporation p.l.c. v. Ukraine

Quinn Emanuel Achieves Major Legal Victory for Ukraine in the English Court of Appeal Against the Russian Federation in Politically-Charged US $3 Billion Eurobonds Dispute

Background: Politics Sets the Scene

It is well known that the Russian Federation considers Ukraine as being within its "sphere of interest," despite Ukraine's independence since 1991. Although both nations were expected to maintain close ties after the collapse of the Soviet Union, in fact, there were growing tensions between the countries in the 1990s and early 2000s over trade, gas disputes, the use of Ukraine's Sevastopol port (where the Russian Black Sea fleet came to be stationed) and its increased cooperation with NATO. In 2010, after Mr. Viktor Yanukovych took over as Ukraine's President, Russia pushed to increase her influence over Ukraine.

In 2009, the EU launched an Eastern Partnership aimed at forging closer ties with former Soviet countries. Following years of negotiations, in 2012, the European Union ("EU") and Ukraine initiated the process for concluding an Association Agreement. The process was to conclude with the signing of the agreement at a summit in Vilnius, Lithuania, on November 28-29, 2013. But throughout 2013, Russia launched a campaign of intense economic and political threats and aggression against Ukraine, going as far as to threaten Ukraine's territorial integrity. At the eleventh hour, President Yanukovych capitulated to Russian threats and abandoned the proposed agreement with the EU, turning back towards Russia instead. The Presidents of Russia and Ukraine agreed that, in exchange for Ukraine not signing the Association Agreement, Russia would take steps to remove the restrictions on trade with Ukraine that it had imposed during 2013, lend Ukraine up to $15

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INSIDE

The Firm Continues China Expansion with Addition of Xiao Liu

Xiao Liu has joined the firm as a partner in the Shanghai office. Mr. Liu was formerly with Skadden Arps in Beijing. He has deep experience representing Chinese clients in commercial disputes in federal and state courts in the United States. He has also represented Chinese companies and citizens in government regulatory investigations and enforcement proceedings in the United States, as well as foreign companies being examined by Chinese regulators as liaison counsel. Mr. Liu received his J.D. from Harvard Law School, his L.L.M. from Cambridge University, and his L.L.B. from Peking University Law School.

The Firm Recruits Veteran Trial Lawyer for Tokyo Office

York Faulkner, a former partner at Finnegan, Henderson, Farabow, Garrett & Dunner, LLP, has joined the firm's Tokyo office. Mr. Faulkner's practice focuses on intellectual property litigation across many industries with a focus on representing brand companies in Hatch-Waxman Act pharmaceutical patent infringement cases. Mr. Faulkner has more than 25 years of experience litigating high-stakes matters, including trying cases to verdict in numerous jury and bench trials. Mr. Faulkner began his career as a trial attorney in the U.S. Department of Justice, Tax Division. Mr. Faulkner received a J.D. from J. Reuben Clark School of Law at Brigham Young University, magna cum laude, and earned a B.S. in Economics from Brigham Young University, cum laude.

billion, and have Gazprom, the Russian gas company, sell natural gas to Naftogaz, Ukraine's national gas company, at a discount.

On December 24, 2013, Ukraine purportedly issued US $3 billion Eurobonds, at 5% interest payable bi-annually, which was taken up as to 100% by Russia (the "Russian Bonds"). The Russian Bonds, although dressed up as a standard capital markets issuance, in reality represented a bilateral loan made by Russia to Ukraine and constituted the first tranche of the promised lending of US $15 billion under the Presidents' deal.

President Yanukovych's decision proved to be a watershed moment in Ukrainian history. Public protests had already begun in late November 2013 at Independence Square in Kyiv, when President Yanukovych's decision not to proceed with the EU agreement was first announced. As the days passed, the protests – which became known as the 'Revolution of Dignity' – spread across Ukraine. By early 2014, the protests had turned violent, with Ukraine's security services using force against civilian demonstrators. This came to a terrible head when, in mid-February 2014, scores of civilians were shot dead on the streets of Kyiv, killed by what are widely believed to have been Russian commandos in disguise and operating among the Ukrainian security services. An agreement to try to settle the political crisis was signed by the Ukrainian President and prominent opposition figures on February 21, 2014, but as the protests continued, President Yanukovych abandoned his post and was exfiltrated to Russia by Russian special forces.

With Yanukovych gone, and a more pro-EU (and anti-Russia) administration certain to follow in Kyiv, Russia reversed its position towards Ukraine and effectively cancelled the agreement reached in November 2013. It cancelled its future commitment to lend up to a further US $12 billion to Ukraine, procured Gazprom to cease to continue its discounted pricing of natural gas, and took other steps to punish Ukraine economically. Even more seriously, Russia launched a full scale military operation against Ukraine, illegally invading and purportedly annexing Crimea, and fueling and supporting separatist elements in eastern Ukraine, the country's industrial heartland. These actions ignited a civil war in eastern Ukraine that to date has resulted in the killing of more than 10,000 Ukrainian people and displaced millions more. The civil war continues despite a peace deal brokered by Western economies.

Economically, Ukraine was brought to its knees. Trade with Russia – which was Ukraine's largest trading partner – dwindled almost to nothing. The currency went into freefall and the economy collapsed. Ukraine had to seek tens of billions of dollars of emergency assistance from the International Monetary Fund to survive the crisis.

The Fate of the Russian Bonds

December 21, 2015 marked the purported maturity date of the Russian Bonds. However, on 18 December 2015, Ukraine's parliament passed a law imposing a moratorium on repayment and the Russian Bonds went into "default." The Government of Ukraine engaged Quinn Emanuel to marshal its defense of Russia's inevitable legal claim.

Russia's "Simple" Debt Claim

On February 16, 2016, the Russian Ministry of Finance directed the Trustee of the Russian Bonds, the Law Debenture Trust ("Law Debenture"), to initiate enforcement proceedings against Ukraine. A day later, Law Debenture commenced proceedings against Ukraine in the High Court of England & Wales seeking US $3.075 billion as principal and interest for the second half of 2015, together with legal costs. The bonds contracts were governed by English law and subject to English court jurisdiction.

Law Debenture characterized Russia's claim as a "simple debt claim," reflecting the clear terms of the bonds documentation that (as is customary in such capital markets instruments) prohibited any counterclaims, set-offs or other defenses to repayment. Law Debenture maintained that the factual backdrop to the Russian Bonds was irrelevant to the legal position, and it filed an application for judgment to be entered against Ukraine in the full amount on a summary basis, without the necessity of a public trial.

Ukraine's Defenses

The Quinn Emanuel team, ably assisted by leading English barristers Bankim Thanki QC, Ben Jaffey QC and Simon Atrill, advanced four principal defenses for Ukraine, emphasizing that Russia's claim formed part of a broader strategy of illegitimate economic, political, and military aggression by Russia against Ukraine and its people.

Defense 1 – Lack of Capacity / Authority

First, Ukraine argued it lacked capacity, alternatively authority, to enter into the contracts for the Russian Bonds, thus rendering those contracts void. This defense relied on matters of Ukrainian law, which Ukraine argued should be taken into account when determining the issues under English conflict of laws rules.

Specifically, Ukraine argued that the Russian

Bonds breached the borrowing limits in its Budget Law of 2013 and that, as a consequence, the Cabinet of Ministers of Ukraine ("CMU") lacked capacity to approve the borrowing, in addition to which Ukraine's Minister of Finance had no authority to enter into the contracts. Moreover, the process for approval of the borrowing by the CMU failed to satisfy various formal requirements under the applicable Ukrainian rules, rendering it ineffective as a matter of Ukrainian law. Law Debenture argued in response that Ukraine, as a nation-State, had unlimited capacity to contract, that the Minister of Finance had authority by virtue of his position (as well as on other grounds) and in any event that Ukraine had ratified and affirmed the Russian Bonds through its subsequent acts – which included paying interest throughout 2014 and again in June 2015.

Defense 2 - Duress

Secondly, Ukraine contended that its entry into the contracts for the Russian Bonds was procured by duress. Under English law, duress renders a contract voidable and Ukraine asserted that it had avoided the contract. Ukraine's position was that its purported consent to the debt was vitiated by the unlawful and illegitimate threats and pressure exerted by Russia during 2013 which resulted in Ukraine having no alternative other than to accept Russia's money. Ukraine further argued that it was the subject of Russia's continuing duress in the period after the Russian Bonds were purportedly issued.

Law Debenture, on the other hand, argued that the English Court was precluded by the doctrine of Foreign Act of State (non-justiciability) from adjudicating on Ukraine's duress defense as, in order to do so, the court would be required to consider and make rulings on the legality or otherwise under international law of the acts of one foreign sovereign state (Russia) towards another (Ukraine) on the international plane. Having regard to the decision of the UK Supreme Court in *Belhaj v. Straw* (*[2017] UKSC 3*), Law Debenture argued that Ukraine's defense lacked a "domestic foothold" as it was not based on English law rights and duties, but matters between States under international law.

Ukraine, in return, advanced reasons as to why, under applicable principles, its duress defense ought to be held justiciable. Additionally, Ukraine argued that, even if held non-justiciable as Law Debenture claimed, the consequence of such a ruling should be a "stay" (i.e. suspension) of the proceedings, and not the entry of a summary judgment against Ukraine. Otherwise, Ukraine would be denied its right to a fair trial and suffer an adverse judgment without being allowed to plead a defense.

Defense 3 – Implied Terms

Ukraine also argued that, under English law principles, terms fell to be implied into the contracts for the Russian Bonds to the effect that Russia would not deliberately interfere with or hinder Ukraine's ability to repay, or demand repayment if in breach of its obligations towards Ukraine under public international law. Ukraine said that Russia was clearly in breach of such terms by virtue of its aggressive acts towards Ukraine. Law Debenture advanced various arguments against the implication of such terms, including that the contracts for the Bonds are tradeable instruments which could be purchased by third parties and which must therefore be certain on the face of the documents as to their terms.

Defense 4 - Countermeasures

Fourthly, Ukraine argued that its non-payment was a valid countermeasure under public international law in response to Russia's own violations of its international law obligations towards Ukraine, which English law ought to recognize. Countermeasures are unilateral reprisals by a State as justified responses against unlawful acts committed against it by the other State that is the target of the countermeasure. In response, Law Debenture argued that English law does not and ought not to recognize any such a defense.

"Other Compelling Reasons"

In addition to these defenses, Ukraine contested Law Debenture's entitlement to summary judgment, citing that Law Debenture's claim was in reality another tool of Russian oppression against Ukraine and that, in light of the underlying circumstances, there were "other compelling reasons" why the matter should be subject to a full public trial and Russia denied the benefit of the summary judgment in the face of its egregious conduct.

The High Court Sides With Russia

Mr. Justice Blair, sitting in the specialist Financial List division of the High Court of Justice, delivered his decision on Russia's summary judgment application in March 2017. Whilst the judgment recognized the "deeply troubling circumstances" surrounding the Russian Bonds, the Court held in short that it was constrained by the applicable principles of English law to hold that none of Ukraine's defenses stood a realistic prospect of success at trial.

On the particular defenses raised by Ukraine, the Court held that:

i. The capacity of a sovereign nation-State is unlimited as a matter of English law – a point not previously considered in any English court judgment – and the Ukrainian Minister of

Finance had authority to transact the Russian Bonds;

ii. Although Ukraine has "a strong case" on duress, English law prohibits the Court from adjudicating on allegations which concern the acts of one sovereign state towards another on the international plane; and the consequence of such a finding of "non-justiciability" is that Law Debenture should be entitled to judgment (and Ukraine should be refused its request for a stay of the claim);

iii. The terms contended for by Ukraine do not fall to be implied into the contracts for the Russian Bonds as those terms contradict express terms of the contracts and would render the agreements unworkable;

iv. The defense of countermeasures failed for the same reason as the failure of the duress defense, namely that it would require the English Court to adjudicate on matters between foreign sovereign states which are non-justiciable; and

v. There were no "other compelling reasons" to justify permitting the case to proceed to a full trial.

In Ukraine's favor, the Court also held that Law Debenture's argument that Ukraine had ratified and affirmed the bonds contracts by its subsequent acts was not suitable for summary determination, as it required a detailed examination of the evidence which could only properly be undertaken at a full trial. However, in light of the Court's primary findings, this had no impact on the Court's decision to enter summary judgment against Ukraine.

But High Court Also Grants Permission to Appeal and Stay of Execution of the Judgment

Despite that adverse decision, because of the novelty and complexity of the legal and factual issues at play, as well as the importance of the case, the Court granted Ukraine's request for general and unconditional permission to appeal the Judgment to the Court of Appeal. The Court also imposed a stay of execution of the summary judgment pending the outcome of that appeal.

The case therefore took a step up to the Court of Appeal.

The Court of Appeal Vindicates Ukraine's Position

Ukraine's appeal was heard by the Court of Appeal at the end of January 2018 before a senior panel of appeal justices (Lady Justice Gloster, Lord Justice Sales and Lord Justice Richards). On September 14, 2018, the Court delivered a landmark judgment breaking new legal ground and vindicating Ukraine's position.

The Court reversed the High Court's decision on Ukraine's duress defense, finding that there is a clear "domestic foothold" for the English Court to adjudicate the defense. The Court of Appeal ruled that English courts are "well capable of construing treaty obligations…and assessing their application," particularly so given the choice of English court jurisdiction in the Russian Bonds contracts, the clear condemnation of Russia's acts by the UK government (as well as the EU) and significantly, Russia's refusal to take up Ukraine's offer of having the dispute determined before the International Court of Justice. The Court of Appeal judges said "It would be unjust to permit... Russia to proceed to seek to make good the contract claim without Ukraine being able to defend itself by raising its defense of duress at trial," and that it was desirable for the case to go to trial "to allow the whole pattern of alleged threatening behavior by Russia to be assessed in its full context." Thus, the Court concluded that a full trial of Ukraine's duress defense was required.

Additionally, the Court held that, even had it agreed with the judge below that the duress defense was non-justiciable, it would as a consequence have ordered a permanent stay of the proceedings since it would be contrary to the requirement of natural justice and fairness for Ukraine to be denied the opportunity to defend itself before the Court and yet face an adverse judgment.

Although the Court of Appeal upheld the High Court on the remaining grounds of Ukraine's appeal, the reversal of the High Court on the duress defense was sufficient to overturn the summary judgment and require the case on that defense to be sent to a full public trial. Unusually, as such matters are almost always left for the Supreme Court to determine, the Court of Appeal also granted both parties permission to appeal to the Supreme Court. This again reflects both the importance of the case and the novelty and complexity of the issues.

The decision of the Court of Appeal sets down new law on a case without precedent in the English courts. It posits the principles that the English court will apply when dealing with sovereign-sovereign disputes that have a commercial context and are subject to English law and court jurisdiction by the parties' agreement. Amongst other new points of law, it clarifies the application of the Supreme Court's ruling in the *Belhaj* case and makes clear that, if an otherwise viable defense is non-justiciable, a permanent stay of proceedings will be warranted to ensure that the defendant is not condemned unheard.

It can be expected that the case will now move to

the Supreme Court for the next round in this fierce dispute which will likely run through 2019. The Supreme Court will have the opportunity further to develop the common law in the novel areas touched by this case, and in the process reinforce the distinction of English law and the pre-eminence of the English courts in adjudicating complex and sensitive disputes of an internationalist nature. In the meantime, this decision represents a huge victory for Ukraine in this bitter fight in which it seeks to cast a public spotlight on Russia's acts of aggression and to have those adjudicated on by a transparent and impartial tribunal, something which Russia has strained every muscle to resist.

NOTED WITH INTEREST

SFO v. ENRC: Privilege Restored for Internal Investigation Documents

The English Court of Appeal has handed down its much-anticipated judgment in *The Director of the Serious Fraud Office v. Eurasian Natural Resources Corporation Limited* [2018] EWCA Civ 2006. At first instance, the High Court took a restrictive approach to both litigation privilege and legal advice privilege. The Court of Appeal has allowed the appeal, finding that the London-headquartered mining company Eurasian National Resources Corporation (**ENRC**) was entitled to claim litigation privilege over documents generated during an internal investigation following a whistleblower report because they had been created once criminal legal proceedings were sufficiently contemplated.

The Court has restored the orthodox position that subject to the particular facts at hand, documents created in the course of an internal investigation (including interview notes prepared by lawyers) are capable of being protected from disclosure to UK authorities by virtue of litigation privilege where their dominant purpose is to advise on, or obtain evidence in relation to, actual or contemplated litigation (including avoiding or settling such litigation).

The Court of Appeal dismissed the appeal on legal advice privilege, considering itself bound by the House of Lords decision in *Three Rivers No 5* to find that legal advice privilege is limited to communications between a lawyer and those specifically tasked with seeking and receiving justice on behalf of the client company. However, the Court observed that the decision places large corporations at a disadvantage compared to small or medium sized enterprises, since for large corporations the information on which legal advice is sought will rarely be in the hands of the main board or those it appoints to seek and obtain the legal advice. According to the Court, the narrow definition of the "client" as established in *Three Rivers No 5* is outdated, and it would have departed from the decision had the opportunity been available.

Background to the Case

In early 2011, ENRC instructed lawyers to conduct a fact-finding investigation into a whistleblower's allegation of corruption and wrongdoing in relation to its Kazakh subsidiary. There followed a lengthy period of dialogue between ENRC and the UK Serious Fraud Office (**SFO**), including a series of meetings in which ENRC updated the SFO on the progress of its internal investigation. The SFO formally announced that it was commencing a criminal investigation in April 2013.

As part of its investigation, the SFO sought to compel ENRC to produce a range of documents, including interview notes taken by external lawyers, material associated with a review by forensic accountants, and presentations by external lawyers for the purpose of advising and receiving instructions from the ENRC internal team. When ENRC claimed legal professional privilege in respect of these documents, the SFO commenced proceedings in the High Court, seeking production on the basis that they were not privileged.

Litigation Privilege

The first instance decision – no litigation privilege

The test for when litigation privilege applies was set out by Lord Carswell in *Three Rivers District Council v. Bank of England (No. 6)* [2004] UKHL 48:

> Communications between parties or their solicitors and third parties for the purpose of obtaining information or advice in connection with existing or contemplated litigation attracts litigation privilege when, at the time of the communication in question, the following conditions are satisfied:
> (a) litigation is in progress or reasonably in contemplation;
> (b) the communications are made with the sole or dominant purpose of conducting that anticipated litigation;
> (c) the litigation must be adversarial, not

investigative or inquisitorial.

ENRC's claim for litigation privilege fell at the first hurdle in the High Court before Mrs Justice Andrews.

The judge ruled that a criminal investigation by the SFO is not adversarial litigation for privilege purposes. According to the judge, an SFO investigation is a preliminary step taken before any decision to prosecute is made. In practice this means that a claim to privilege can only be made out where a prosecution is in "reasonable contemplation." The judge took the view that ENRC did not contemplate a prosecution when the documents in question were produced, such that those documents were not protected by litigation privilege.

The judge also ruled that, even if a prosecution had been reasonably in contemplation, none of the documents in question were created with the "dominant purpose" of being used in the conduct of such litigation. In the judge's view, the main purpose of the internal investigation was to establish whether there was any truth to the whistleblower allegations, and to prepare for any future SFO investigation. Against a background of cooperation and openness, fact-finding aimed at obtaining legal advice on how to avoid an investigation is not covered by litigation privilege.

The Court of Appeal decision – orthodoxy restored

On September 5, 2018, the Court of Appeal upheld ENRC's claim to litigation privilege over the categories of documents described above. The Court considered two main issues:

- Issue 1: Was the judge right to determine that, at no stage before all of the documents had been created, criminal legal proceedings against ENRC or its subsidiaries or their employees were reasonably in contemplation?
- Issue 2: Was the judge right to determine that none of the documents were brought into existence for the dominant purpose of resisting contemplated criminal proceedings against ENRC or its subsidiaries or their employees?

As regards Issue 1, the Court of Appeal found that a criminal prosecution was reasonably in contemplation when the documents at the center of the SFO's application were created. In the Court's view, the whole sub-text of the relationship between ENRC and the SFO was the possibility, if not the likelihood, of prosecution if the self-reporting process did not result in a settlement.

The Court of Appeal held that while not "every SFO manifestation of concern would properly be regarded as adversarial litigation," when the SFO specifically notifies a company of the prospect of prosecution and legal advisers are engaged to deal with that situation, "there is a clear ground for contending that criminal prosecution is in reasonable contemplation."

Moreover, the Court of Appeal held that although a party anticipating a possible prosecution will often need to investigate before it can be certain that a prosecution is likely, uncertainty does not prevent proceedings from being in reasonable contemplation.

As regards Issue 2, the Court of Appeal disagreed with the judge that ENRC's dominant purpose in launching the investigation was compliance and governance, finding that the need to investigate corruption allegations was just a "subset" of the dominant purpose of defending contemplated proceedings. According to the Court:

> Legal advice given to head off, avoid, or even settle reasonably contemplated proceedings is as much protected by litigation privilege as advice given for the purpose of resisting or defending such contemplated proceedings.

In reaching this conclusion, the Court remarked that if corporates were not to benefit from legal privilege in these circumstances, "the temptation might well be not to investigate at all," which would clearly work against good governance and best practice compliance considerations.

The SFO is understood to be considering an appeal to the Supreme Court.

Legal Advice Privilege

The judge at first instance rejected ENRC's claims that interview notes taken by solicitors in the course of the investigation were subject to legal advice privilege, finding that there was no evidence that any of the persons interviewed were authorized to seek and receive legal advice on behalf of ENRC.

In reaching this decision, the judge endorsed the decision of Hildyard J in *The RBS Rights Issue Litigation* [2016] EWHC 3161 (Ch), which she said supports the proposition that:

> legal advice privilege attaches only to communications between a lawyer and those individuals who are authorized to obtain legal advice on that entity's behalf. Communications between the solicitors and employees or officers of the client, however senior in the corporate hierarchy, who do not fall within that description will not be subject to legal advice privilege.

The judge found that Hildyard J's reasoning in *RBS* was consistent with *Three Rivers No 5*, and was also correct as a matter of principle.

ENRC and the Law Society of England and Wales, which intervened in the appeal, submitted that *Three*

Rivers No 5 was wrong. To attract legal advice privilege, all that should be necessary is that the employee in question is authorized by the client to provide the information to the company's lawyer.

The Court of Appeal saw "much force" in ENRC's submission. It observed that confining legal advice privilege to communications between lawyer and "client," in the narrow sense of those authorized to seek and receive legal advice on a corporation's behalf, places large corporations at a disadvantage. For such organisations, it is unlikely that the information on which legal advice is sought will be in the hands of the main board or those it appoints to seek and obtain the legal advice. The Court also noted that English law is out of step with the international common law on this issue.

However, the Court of Appeal declined the appeal on grounds it was bound to follow the decision in *Three Rivers No 5*, which remains good law in England and Wales. The Court noted that if it had been open to it to depart from *Three Rivers No 5*, it would have been in favor of doing so, but that as things stand the matter will have to be considered by the Supreme Court in this or an appropriate future case.

Implications for Companies

The Court of Appeal's ruling is significant for any company faced with undertaking an internal investigation in response to allegations of wrongdoing. The decision does away with a number of illogical distinctions, such as the judge's conclusion that documents prepared with the purpose of warding off litigation in the first place, rather than defending it, are not covered by litigation privilege. The decision will mean that businesses can be more confident again about thoroughly investigating allegations of wrongdoing.

However, while the decision is being characterized in the legal press as a "resounding defeat" for the SFO, the Court of Appeal emphasized that whether litigation privilege applies is a question of fact and ENRC's words and actions were scrutinized before the claim to privilege was upheld. Businesses and their legal advisers must therefore remain vigilant and expect assertions of privilege to be examined closely by third parties, regulators and law enforcement. It remains key to any claim for litigation privilege that litigation can be shown to have been both reasonably contemplated at the time of any investigation and to have been the sole or dominant purpose of any documents in question.

ENRC's appeal succeeded on litigation privilege alone. The decision on legal advice privilege in *Three Rivers No 5* continues to apply. It therefore remains the case that communications between an employee of a corporation and the corporation's lawyers will not attract legal advice privilege unless that employee has been tasked with seeking and receiving such advice on behalf of the client. Q

PRACTICE AREA NOTES

Product Liability Update

Innovator Liability and New Considerations for Brand-Name Manufacturers. It has long been a well-settled principle of tort law that a manufacturer can only be responsible for tort claims arising from its own product. However, a recent decision of a Massachusetts state court permitting generic drug users to sue brand-name pharmaceutical companies pursuant to an "innovator liability" tort theory suggests a potential shift away from this long-standing principle. Any expansion of tort liability for branded companies may have broader implications, with claimants seeking to disturb the scope of tort liability more generally and in other contexts.

By way of background, claimants have long sought to hold brand-name drug manufacturers liable for injuries allegedly sustained as a result of their ingestion of generic bioequivalents. The overwhelming majority of courts have rejected attempts to impose such "innovator liability," finding it contrary to well-established tenets of product liability law and principles of fundamental fairness to deem an innovator pharmaceutical company responsible for injuries associated with a product it did not manufacture. The seminal case in this area, *Foster v. American Home Products Corp.*, reasoned that imposing liability on the branded manufacturer where the product ingested by the plaintiff was actually manufactured and sold by a generic competitor would be unfair and would "stretch the concept of foreseeability too far." 29 F.3d 165, 171 (4th Cir. 1994). In so doing, it noted that "[t]here is no legal precedent for using a name brand manufacturer's statements about its own product as a basis for liability for injuries caused by other manufacturers' products,

over whose production the name brand manufacturer had no control" and that doing so "would be especially unfair when, as here, the generic manufacturer reaps the benefits of the name brand manufacturer's statements by copying its labels and riding on the coattails of its advertising." *Id.* at 170. *Foster* also reasoned that it would not be foreseeable to branded manufacturers that generic users would rely on their labeling, as generic manufacturers are responsible for their own labels and "are also permitted to add or strengthen warnings and delete misleading statements on labels, even without prior FDA approval." *Id.*

The Supreme Court's decision in *PLIVA, Inc. v. Mensing*—which found that state law tort claims against generic drug manufacturers are preempted by federal drug regulations—has since altered the landscape. 564 U.S. 604 (2011). In *Mensing*, the Supreme Court found that generic manufacturers could not possibly create "safer" labeling (as Plaintiffs alleged should have been done in pursuing their state law tort claims) and simultaneously comply with the federal requirement to keep their labeling the same as the branded counterpart's. *Id.* at 624. Indeed, the Hatch-Waxman Act—which sought to simultaneously make pharmaceutical drugs more accessible (by lessening the testing and approval burdens on generic manufacturers) and incentivize innovation (by extending patent terms for branded companies)—generally requires generic manufacturers to maintain the same label and warnings as its brand-name competitor once FDA approval is received. Of course, multiple abbreviated approval pathways exist for generic manufacturers under the Hatch-Waxman Act, and label differences are permissible in certain identified instances, such as with a 505(b)(2) application, if there are differences in the products' expiration dates, formulation, bioavailability, or pharmacokinetics, or if an indication or other aspect of labeling protected by patent or exclusivity is omitted. But *Mensing* necessarily halted claims against generic manufacturers in their tracks, with generic users resorting to filing suit against the branded manufacturer who initially developed the branded equivalent drug (but did not manufacture the product actually ingested).

The majority of courts considering such claims in the wake of *Mensing* have followed the reasoning in *Foster* and declined to expand the scope of tort liability as to branded manufacturers. For example, a 2017 decision in the Zofran Multi-District Litigation granted a motion to dismiss on that basis, noting that while "[i]t is true that dismissal would appear to leave consumers injured by generic drugs without any form of remedy, . . . it may [also] be unfair or unwise to require brand-name manufacturers to bear 100% of the liability, when they may have only 10%, or less, of the relevant market." *In re Zofran (Ondansetron) Prods. Liab. Litig.*, 261 F. Supp. 3d 62, 80 (D. Mass 2017). The court also noted that while *Mensing* exempted generic entities from state law claims, "[i]t does not clearly follow that brand-name manufacturers should bear all of the potential liability, particularly where it is unclear what the impact of such a potentially enormous shift in liability may have on the development of new drugs." *Id.*

The Massachusetts Supreme Judicial Court, on the other hand, has gone in the opposite direction. In *Rafferty v. Merck & Co., Inc.*, the plaintiff asserted state law tort claims against Merck in connection with his purported injuries after taking generic finasteride to treat an enlarged prostate. 92 N.E. 3d 1205 (Mass. 2018). Specifically, he alleged that the product label for finasteride did not adequately warn that sexual dysfunction side effects could continue after taking the drug, and that because the label conformed to Merck's American label for Proscar, Merck's duty to warn extended not only to users of Proscar but also to users of finasteride. *Id.* at 1211-12. He also alleged that international labeling for Proscar included a warning about persistent erectile dysfunction, which did not appear on the label when he ingested finasteride. *Id.* at 1212. Merck moved to dismiss, arguing that it did not manufacture the product the plaintiff ingested and so could not possibly be liable for his injuries, and its motion was granted, relying on a recent (and post-*Mensing*) Iowa Supreme Court case. *Id.* at 1212 (referencing the lower court's reliance on *Huck v. Wyeth, Inc.*, 850 N.W. 2d 353, 376-77 (Iowa 2014), *cert. denied*, 135 S.Ct. 1699 (2015)). The plaintiff appealed and the Supreme Judicial Court elected to review the decision. *Id.* at 1212. That move attracted significant *amici curiae* briefing in support of Merck, with a variety of entities arguing, among other things, that accepting an innovator liability theory would radically expand the scope of tort liability, unfairly subject innovators to limitless liability, significantly impact the ability to invest in (and thus chill) innovation, and would fundamentally change the pharmaceutical landscape and the intent of the Hatch-Waxman Act.

The *Rafferty* Court ultimately found that although a manufacturer's duty of care usually runs only to

the users of its product—because the risk of harm would only be foreseeable as to them—the *Rafferty* case "presents an exception to the usual pattern." *Id.* at 1215. It noted that "[w]ith generic drugs, it is not merely foreseeable but *certain* that the warning label provided by the brand-name manufacturer will be identical to the warning label provided by the generic manufacturer, and moreover that it will be relied on, not only by users of its own product, but also by users of the generic product." *Id.* After weighing public policy considerations—including plaintiff's inability to pursue the generic manufacturer post-*Mensing* on the one hand, and the potential impacts of permitting tort claims to proceed vis-à-vis the branded manufacturer on the other, including the significant increase in costs stemming from more litigation and the potential chilling of innovation—the Supreme Judicial Court imposed a duty on branded manufacturers to consumers of generic drugs "not to act in reckless disregard of an unreasonable risk of death or grave bodily injury." *Id.* at 1219. In so doing, it acknowledged that imposing *any* duty on branded companies to warn generic consumers placed Massachusetts in the minority of courts. *Id.* at 1220. Commentators have since noted that they expect that plaintiffs in Massachusetts will allege recklessness in all failure to warn cases moving forward.

Relatedly, the U.S. Court of Appeals for the Seventh Circuit's recent opinion in *Dolin v. GlaxoSmithKline LLC* declined to address the question of innovator liability at all, even though the trial court's rejection of GSK's "this was not our product" argument encouraged significant *amici curiae* submissions similar to those made in support of Merck in *Rafferty*. -- F.3d --, 2018 WL 4001208 at *11 (7th Cir. Aug. 22, 2018) (reversing the judgment and dismissing on preemption grounds, but declining to rule on "the new theory of liability that plaintiff advances"). Interestingly, this follows the Sixth Circuit's rejection of innovator liability. *See In re Darvocet, Darvon, and Propoxyphene Products Liability Litig.*, 756 F.3d 917 (6th Cir. 2014).

Rafferty and other similar outlier cases raise new considerations for branded companies as well as other product manufacturers, including those whose designs may be copied by competitors. Specifically, innovator companies should consider that plaintiffs will be seeking to expand tort liability in certain jurisdictions, and in turn, develop risk mitigation and preparedness strategies in order to be best-positioned to defend against these claims.

Securities & Structured Finance Litigation Update

U.S. Supreme Court Allows 1933 Act Securities Class Actions to Proceed in State Court, Continuing Trend of Strict Statutory Construction. Plaintiffs seeking to pursue securities misrepresentation claims under federal law can do so under either the Securities Act of 1933 (the "1933 Act") or the Securities Exchange Act of 1934 (the "1934 Act"). Although 1933 Act claims can be brought only by purchasers of publicly-traded securities pursuant to a registration statement (which excludes secondary market purchasers) or those suing the direct seller, and have a short statute of limitations (one year after discovery of the misrepresentation or three years after the sale), they are more powerful than 1934 Act claims for plaintiffs who can assert them. Unlike misrepresentation claims under the 1934 Act, misrepresentation claims under the 1933 Act do not require proof of scienter or reliance and treat loss causation only as an affirmative defense (rather than requiring it as an element of the claim). In addition, claims under the 1933 Act can be brought in either state or federal court, whereas claims under the 1934 Act must be brought exclusively in federal court, where motions to dismiss are granted more frequently.

In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), the U.S. Supreme Court analyzed whether *class actions* asserting misrepresentation claims under the 1933 Act could proceed in either state or federal court in light of the Securities Litigation Uniform Standards Act ("SLUSA") passed in 1988. SLUSA was intended to address plaintiffs' attempts to circumvent the Private Securities Litigation Reform Act, passed three years earlier to prohibit "perceived abuses" in federal securities cases, by filing securities class actions in state court. SLUSA amended the 1933 Act and the 1934 Act to prohibit altogether any class action brought on behalf of more than 50 persons, referred to as "covered class actions," asserting misrepresentation claims under state law in connection with a security listed on a national exchange. 15 U.S.C. § 77p. It also provided for the removal to federal court of any covered class actions brought in state court. *Id.* § 77p(c). Finally, SLUSA specifically made conforming amendments to the jurisdictional provisions of the 1933 Act allowing removal of certain covered class actions. The question posed in *Cyan* was whether this amendment divested state courts of their jurisdiction over covered class actions asserting misrepresentation claims under the 1933 Act, allowing removal to federal court.

(continued on page 11)

VICTORIES

Major Appellate Victory on Patent Infringement Claims on Wireless Hotspots

The firm won a major appellate victory in the Federal Circuit on behalf of clients Novatel Wireless and Verizon Wireless, affirming a complete defense jury verdict obtained by the firm in 2017. The firm prevailed in a one-week jury trial before the Honorable Marilyn Huff in the Southern District of California in April 2017, where the San Diego jury took just over two hours to return its verdict that there was no infringement of any of the seven asserted claims, a decisive win in favor of Quinn Emanuel's clients.

The plaintiff (Carucel) sought to overturn the jury's verdict in an appeal to the United States Court of Appeals for the Federal Circuit, requesting that the Court of Appeals reverse the jury verdict and enter a judgment of infringement or, in the alternative, order a new trial, arguing that the jury should not have been permitted to consider certain evidence about the functionality of the accused device when applying the district court's claim construction. The Court of Appeals rejected the plaintiff's arguments on appeal in their entirety and affirmed the jury's finding of no infringement on all asserted claims.

Not only does this appellate victory eliminate all of Carucel's claims against our clients' products, it also helps other smartphone manufacturers using hotspot technology because Carucel will have little incentive to pursue other smartphone manufacturers for infringement of these patents.

Appellate Victory For Samsung Reversing $115 Million Judgment and Ending Case

Quinn Emanuel recently achieved a complete victory for Samsung Electronics Co. in the New York Appellate Division, First Department, which reversed a $115 million judgment that had been entered against Samsung before we were retained for the appeal. In 2007, Samsung had entered into a series of contracts creating a patent pool for licensing patented digital television transmission technologies. While the pool had a ten-year term, the licensors expressly bargained for the right to leave the pool any time after five years, an option that made business sense given how rapidly television technology changes. Samsung exercised that early termination right in 2015, but MPEG LA, the pool administrator, refused to accept it and sued Samsung for breach of contract and more than $100 million in damages for failure to pay royalties from 2015 to 2017.

The case turned on the interplay of termination provisions in two related contracts, each of which gave Samsung "the right … to terminate with respect to itself all but not less than all" of the relevant contracts. One of the provisions, governing the agreement among the companies in the pool, expressly allowed unilateral voluntary termination after five years, subject to a sliding scale of financial penalties for doing so. The other provision allowed the pool members to fire the MPEG administrator collectively for various reasons, but had no early voluntary unilateral termination provision. The trial court accepted MPEG's argument that the agreements unambiguously prohibited Samsung's termination and entered a $115 million judgment against Samsung.

On appeal, the Appellate Division reversed, agreeing with Quinn Emanuel that the contracts unambiguously authorized Samsung to make a voluntary early exit from the pool in any of years 2012 to 2017. In a careful decision that tracked Quinn Emanuel's arguments, the court held that the two termination provisions are not inconsistent but instead "simply apply to different situations," and rejected MPEG's interpretation because it provided no opportunity for a pre-2017 unilateral termination and thus rendered superfluous the early termination provision, and the financial penalties associated with it. The court therefore held Samsung's 2015 early termination entirely proper and ordered that MPEG's claims be dismissed in their entirety.

The decision is not only a significant win for Samsung in its long-running battle with MPEG LA, but also reaffirms the power of de novo review of contract interpretation by an appellate court. We aimed in this case for a full reversal, and not merely a remand to the trial court to consider extrinsic evidence about the parties' expectations. In so doing, we made the contracts speak as simply as possible for themselves, and the result was a stunning reversal in Samsung's favor. Q

In a unanimous opinion, the Supreme Court in *Cyan* strictly interpreted SLUSA to hold that state courts still have jurisdiction over covered class actions asserting 1933 Act misrepresentation claims exclusively and that defendants cannot remove such class actions to federal court. By its terms, SLUSA kept the 1933 Act's existing jurisdictional framework "except as provided in section 77p of this title with respect to covered class actions." The Supreme Court ruled that this text, "read most straightforwardly," refers to Section 77p as a whole, rather than to the "covered class actions" definition of Section 77p, and therefore modified the 1933 Act's jurisdictional provisions only with respect to covered class actions involving securities listed on a national exchange and asserting misrepresentation claims under state law.

The Supreme Court rejected legislative purpose and policy arguments that SLUSA must be interpreted to require covered class actions asserting 1933 Act misrepresentation claims to proceed in federal court because otherwise securities plaintiffs could still circumvent protections provided in federal court, and defendants would be faced with having to defend class actions arising from the same misrepresentations in both state and federal court. For example, if a publicly-traded company issued shares to an acquisition target's shareholders in a merger pursuant to a registration statement with misleading financial statements, the target's shareholders could pursue 1933 Act claims in state court, while the other shareholders in the secondary market would be required to pursue 1934 Act claims in federal court. This could result in two different courts deciding claims based on the same misrepresentations and reaching conflicting conclusions about the material misrepresentation. Faced with these types of arguments, the Supreme Court acknowledged that it did "not know why Congress declined to require that 1933 Act class actions be brought in federal court," but stated that it "will not revise that legislative choice, by reading a conforming amendment and a definition in a most improbable way, in an effort to make the world of securities litigation more consistent or pure." *Cyan*, 138 S. Ct. at 1073.

The Supreme Court's decision in *Cyan* continues the Court's application of strict statutory construction in securities cases, regardless of whether it benefits plaintiffs or defendants. For example, commentators view *Cyan* as a plaintiff-friendly decision, yet in *California Public Employees' Retirement System v. ANZ Securities, Inc.*, 137 S. Ct. 2042 (2017), decided the prior term, the Supreme Court issued a decision that was considered defense-friendly based on strict statutory construction. In *ANZ*, the Supreme Court followed the plain language of the 1933 Act, providing that "[i]n no event shall any such action be brought to enforce a liability created under [Section 11] more than three years after the security was bona fide offered to the public," to hold that the statutory three-year time limit for filing lawsuits is a statute of repose, and therefore is not subject to the equitable tolling principles for statutes of limitations. Here again, the Court was unmoved by legislative purpose or policy arguments regarding the effects of its decision. For example, it held that even if its decision resulted in district courts being inundated with protective filings to preserve the statute of limitations for unnamed class members pending a class action, the Court "'lack[s] the authority to rewrite' the statute of repose or to ignore its plain import." *Id.*, 137 S. Ct. at 2053-54. Going forward, securities litigants can expect the Supreme Court to enforce securities laws as written and must rely on Congress for changes and reforms.

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business litigation report

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