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# Supreme Court to Address Under What Circumstances A Later Congress May Revoke Governmental Obligations To Pay

At the end of its most recent term, the U.S. Supreme Court granted certiorari in *Moda Health Plan, Inc. v. United States*, and two similar cases asserting virtually identical claims. These disputes present issues of critical importance regarding public-private enterprise and private entities' options to seek money damages if the federal government reneges on a promise to pay.

*Moda* and its companion cases present the question of under what circumstances, if any, a later Congress may obviate a statutory obligation to pay through the use of appropriations bills (as opposed to an explicit Act revoking the previously-enacted obligation to pay). In *Moda*, this question arose in connection with certain payment obligations included in the Patient Protection and Affordable Care Act ("ACA"). However, the decision has potentially broader implications because an essential tool for the government to achieve policy goals is influencing private action through financial incentives, such as tax credits or subsidies for behavior the government wants to encourage. If the government can renege on its promises through less-than-obvious, after-the-fact means (such as an appropriations bill), *and* private parties are unable to compel the payment of those owed amounts in court, then that arguably decreases the private sector's confidence in the government as a reliable business partner, and, along with it, the government's power to drive conduct using financial incentives.

In civil litigation involving situations such as these, the Tucker Act provides an avenue to pursue money damages against the United States based on, among other things, "money-mandating" statutes, *i.e.*, statutes promising to pay specific amounts in specific circumstances.

*(continued on page 2)*

## INSIDE



## *Chambers USA* Names William Burck "DC White Collar Crime & Government Investigations Lawyer of the Year"

William Burck has been named the "D.C. White Collar Crime & Government Investigations Lawyer of the Year" by *Chambers*, the preeminent legal ranking publisher. The selection was based on Burck's achievements in 2018 including his representations of high-level White House officials in the Mueller investigation, FIFA in a federal criminal investigation, former President George W. Bush in connection with the Senate confirmation of Justice Brett M. Kavanaugh, and a number of multinational companies in a wide array of cross-border investigations by US and foreign government law enforcement agencies. Q

## *The American Lawyer* Names Maaren Shah and Luke Nikas "Litigators of the Week"

Maaren Shah and Luke Nikas were named "Litigators of the Week" by *The American Lawyer* for two important back-to-back wins in the art world. In one case in which they represented The Andy Warhol Foundation For The Visual Arts, Inc., which resulted in a victory that established a standard for the fair use of existing images in new artistic creations that will protect Warhol's entire body of work as well as other works in the canon of modern and contemporary art from claims of copyright infringement. Nikas and Shah were also recognized for winning dismissal of claims against Morgan Art Foundation in a heated battle with the estate of Robert Indiana—famous for his "LOVE" sculpture and image that once adorned a postage stamp — concerning rights to Indiana's works and legacy. Q

Assuming a litigant is able to establish that it falls under a money-mandating statute's or a government contract's requirements for payment, then the government is left with few options. One of those options—if the facts support it—is to argue that the obligation to pay no longer exists because the government amended or revoked that obligation. Congress, however, may only revoke such an obligation with words that either expressly modify or repeal the law that created that obligation, or words that clearly imply Congress's intention to amend or repeal that law. *United States v. Langston*, 118 U.S. 389, 393 (1886). Repeals by implication are disfavored, and are "particularly disfavored" when contained in Congress's annual appropriations bills to fund the federal government. The general rule is that Congress's failure to make funds available to satisfy a payment obligation does not itself eliminate a monetary payment obligation. *See, e.g.*, *N.Y. Airways, Inc. v. United States*, 369 F.2d 743, 748 (Ct. Cl. 1966).

Despite this rule, a majority of a panel of the United States Court of Appeals for the Federal Circuit held in *Moda* that Congress had, through appropriations riders, suspended its obligation to pay ACA qualified health plan issuers certain amounts otherwise owed under the ACA's "risk corridors" program. The Supreme Court is now slated to examine that ruling.

**"Risk Corridors" – An Incentive Program That Became A Political Football**

Passed in 2010, the ACA implemented a wide range of reforms in the health insurance industry, including creating health benefit exchanges where issuers offer health plans on a virtual platform. These exchanges presented a great deal of risk, because two of the ACA's other major reforms were to require U.S. residents to obtain health insurance (*i.e.*, the "individual mandate") and to prevent health plan issuers from refusing health care coverage based on potential insureds' preexisting conditions. These reforms greatly expanded insured demographics in the nation, and health plan issuers lacked the data necessary to accurately assess the risk posed by this new, larger insurance pool.

To encourage providers to participate in the newly-created health exchanges, and to keep premiums low despite the risk of the unknown demographics, Congress established several risk-mitigating programs, including "risk corridors." Risk corridors was a three-year program, from 2014 through 2016. If an issuer's income exceeded costs by a certain amount, then it was required to pay a portion of that excess to the government. Likewise, if an issuer's costs exceeded its income by a certain amount, the ACA stated the government "shall pay" the insurer a specified portion of those losses. This three-year program was meant to cabin competition in the exchanges' early years so issuers throughout the nation could learn how to price health plans for the new insurance pool. It was heavily supported throughout the industry.

Nevertheless, at the end of 2014, nearly a year after the ACA went into effect, Congress included a rider in the annual appropriations bill that identified a particular fund, the Centers for Medicare and Medicaid Services ("CMS") Program Management account, and stated that the funds appropriated that year to that account could not be used to make risk corridors payments. Congress inserted similar riders in the appropriations bills for the following two years—restricting funding for the program's three-year life. These appropriations riders came after Congress had already tried and failed to amend the ACA to require a "budget neutral" program.

For a variety of reasons, issuers suffered unexpectedly large losses during the ACA's first three years. Accordingly, in each year of the risk corridors program, payments in were dwarfed by the payments out due to insurers. Due to this limited funding, the Department of Health and Human Services ("HHS") implemented a policy of paying out to insurers on a prorated basis. In total, risk corridors payments to insurers fell short by about $12 billion dollars over the three years of the program.

**Health Plan Issuers File Suit To Seek Unpaid Risk Corridor Amounts**

In 2015, Quinn Emanuel filed the first risk corridors suit in the nation. That case, *Health Republic Insurance Company v. United States*, is a class action on behalf of a nationwide group of qualified health plan issuers. We prevailed in opposing the government's motion to dismiss that case and, in doing so, obtained the first order in the country on the risk corridors payments issue—and the government's first defeat on that issue. After the court denied the government's motion, the case was slowed down by the class certification and opt-in process. Meanwhile, *Moda* and other cases proceeded to summary judgment, in which Moda obtained a full win based heavily on the reasoning from the *Health Republic* motion to dismiss decision. *Health Republic* is now stayed pending resolution of the *Moda* appeal, and Quinn Emanuel has submitted several amicus briefs supporting Moda's arguments, including at the Federal Circuit and in the certiorari petition process.

After Moda won at the trial court level, the government's appeal raised two key questions: (1) did the risk corridors statute require the government to pay providers who suffered losses according to the statutory formula; and (2) if so, did Congress suspend or repeal that obligation via subsequent appropriations riders? The Supreme Court is expected to address those same questions.

As to the first question, the government had argued that, despite the plain language of the ACA, which states that the HHS Secretary "shall pay" the statutory amount to insurers, there was no money-mandating obligation. Instead, the government argued that Congress had intended for risk corridors to be "budget neutral"—*i.e.*, only pay out what was paid in by "successful" issuer.

In response, *Moda* cited the ACA, as well as statements from HHS, that the program was *not* budget neutral. The Federal Circuit agreed. In its opinion, the *Moda* majority (supported by the dissent) held the risk corridors portion of the ACA was "unambiguously money-mandating." Furthermore, both the majority and dissent recognized longstanding precedent holding the government's failure to fund an obligation does not itself eliminate the obligation itself. Based on this, the Federal Circuit held that the ACA, as originally enacted, obligated the government to pay issuers the full risk corridors amount provided by the statutory formula.

The second question, however, proved decisive in the majority's decision that the government did not owe additional amounts at this time. That question focused on whether Congress suspended or repealed the money-mandating obligation embodied in the ACA, and it turned on whether the language in the appropriations riders was sufficiently clear to amend or repeal the risk corridors statute.

In deciding this question, the Federal Circuit acknowledged Supreme Court precedent holding Congress cannot suspend a money payment obligation absent "words that expressly, or by clear implication, modified or repealed the previous law." *United States v. Langston*, 118 U.S. 389 (1886). Typically, this is a very high hurdle, as best exemplified by two cases discussed extensively by both the *Moda* majority and dissent. These include *Gibney v. United States*, 114 Ct. Cl. 38 (1949), in which the Federal Circuit's predecessor found no obviation of an obligation to pay where Congress simply passed an appropriations bill limiting expenditures for that obligation; and *New York Airways, Inc. v. United States*, 369 F.2d 743 (Ct. Cl. 1966), in which the same predecessor court found that a mere failure to appropriate funds does not modify an obligation laid out in substantive law.

Over the years, however, there have been counter examples; *i.e.*, instances where courts found that appropriations legislation included sufficiently express and clear wording, such that it obviated a statutory obligation to pay. But, in those cases, the appropriations bills in question clearly indicated—by language, legislative history or both—Congress's intent to eliminate or modify the obligation. *See, e.g.*, *United States v. Vulte*, 233 U.S. 509 (1914) (military bonus suspended by appropriations bills, but only for the two years where the bills specifically eliminated the bonus); *United States v. Dickerson*, 310 U.S. 554 (1940) (obligation suspended for four years where appropriations language was express for two years, and legislative history made it clear that Congress also intended the suspension to apply to the following two years); *United States v. Will*, 449 U.S. 200 (1980) (four appropriations statutes amended a previous statute increasing certain rates for payment where one of the appropriations bills contained clear and express revocation language, and the legislative history for the other three bills plainly indicated that they, too, were intended to rescind the rate increase).

In *Moda*, both the trial court and the appellate court considered the above precedent, and the plaintiffs contended throughout that the precedent requires enforcement of the government's statutory obligation to pay risk corridor amounts. However, the *Moda* majority found that the three appropriations riders had "temporarily suspended" the government's obligation to pay the full statutory risk corridors amounts, therefore rendering the statute budget neutral for the years of the program. The majority held that Congress's intent in this regard was clear from (1) the fact that it had asked the GAO about possible funding sources for risk corridors, then cut off access to the only identified source for payment other than budget neutral payments, and (2) one of the riders' proponents made a reference to budget neutrality when discussing the appropriations bill in 2014.

The *Moda* dissent (by Judge Newman) strongly disagreed with this holding on the grounds that it deviates from the authorities mentioned. The dissent noted that, although the majority claimed this was only a permissible "temporary suspension," the case on which the majority relied for this proposition, *Vulte*, involved the suspension of a bonus payment for just two years of an ongoing annual bonus program that ran for multiple years. By contrast, the risk corridors program is a limited program that lasted only three years, so a "temporary" suspension of payments for each of those three years equaled a full obviation of the obligation to pay, via (the dissent argued) language that was not clear and unambiguous, as required by law.

Further, the dissent noted *Vulte* did not retroactively strip the plaintiffs of payment for actions they had already taken. In *Moda*, by contrast, issuers incurred losses and were only informed after the fact that they would not be paid the full amounts technically required by the statute. The dissent contended this sort of "bait and switch," if allowed to stand via a denial of the money damages claims, would seriously undermine the government's ability to incentivize private action in the future. (This argument was presented in an *amicus curiae* brief Quinn Emanuel submitted on behalf of a group of economists as part of the appeal.)

**_Moda_ Before the Supreme Court – Implications For Future Public-Private Enterprise**

As noted, the Supreme Court granted *certiorari* in *Moda* and two other risk corridors cases on June 24, 2019. It is expected that the Court will decide by June 2020 when, if ever, Congress may use appropriations riders to limit or eliminate an obligation to pay. If the Supreme Court sides with the *Moda* trial court, that will limit future Congresses' ability to obviate payment obligations, which should, in turn, create more certainty for private actors about when they can seek money damages if the government fails to pay. If the Supreme Court instead sides with the Federal Circuit *Moda* majority, that arguably provides future Congresses more power to limit the payment obligations imposed by a previous Congress with different policy goals. Either way, the implications for future private litigants in government-related litigation are significant.

**The Path Forward**

Although the risk corridors cases will provide important insight into the effects of future congressional action on government obligations to pay, all is not lost now for private litigants that believe the government owes them money. One notable example can be found in the context of a different ACA program that Congress also failed to fund. Cases involving that program—the largest of which is a class action helmed by Quinn Emanuel, *Common Ground Healthcare Cooperative v. United States*—address the government's failure to reimburse issuers' "cost-sharing reduction" payments. Cost-sharing reduction payments are payments issuers must make by law to reduce out-of-pocket expenses (like copayments) for certain low-income individuals. Congress never funded the cost-sharing reduction program, but, importantly, did not include any appropriations riders or similar language stating that appropriations were not be used for the program. The Obama administration nevertheless made those reimbursements for years, a policy that the Trump administration reversed in October 2017.

Quinn Emanuel recently secured summary judgment on behalf of the opt-in class in *Common Ground*, including based on *Moda*'s holding that virtually identical payment language in the risk corridors statute was "unambiguously money-mandating." As that decision shows, private parties are still able to collect on governmental payment obligations. *Moda*, however, will help clarify the limits on Congress's ability to circumvent those options through less-than-obvious means. Q

# NOTED WITH INTEREST

## QE Class Action Win Celebrated By Both Plaintiffs And Defendants

The firm achieved a groundbreaking victory on June 6, 2019 in *In re Hyundai & Kia Fuel Econ. Litigation*, when the Ninth Circuit, sitting *en banc*, reversed a controversial 2018 panel opinion that had decertified a nationwide class action and overturned the district court's approval of a class settlement based on potential variations in state law. The *en banc* opinion, which has been lauded in the press as "saving" the ability of parties to settle nationwide class actions, affirms that class manageability concerns need not be considered in the settlement context and courts are free to apply the laws of one state to a settlement. This ensures parties have the freedom to achieve nationwide resolution of class actions that could not have been certified for litigation purposes.

The case began in November 2011 when the U.S. Environmental Protection Agency began to receive complaints that Hyundai and Kia overstated the fuel efficiency of some of their model vehicles. In early 2012, a group of plaintiffs filed suit in the Central District of California seeking to represent a nationwide class of consumers. After approximately one year of litigation, the plaintiffs moved for class certification.

Shortly after the Court's tentative order on that motion (which would have denied certification of the proposed nationwide class) but prior to the final ruling, Hyundai and Kia announced the creation of a voluntary reimbursement program that would compensate owners and lessees of the affected vehicles for the higher fuel costs. This announcement triggered a torrent of class actions filed across the country. The federal cases were subsequently transferred to the Judicial Panel on Multidistrict Litigation and consolidated in the Central District of California.

The parties eventually reached a settlement valued at more than $210 million—one of the largest auto industry settlements in history. Despite its prior tentative ruling, the district court certified a nationwide settlement class and granted final approval of the settlement.

A group of objectors appealed the decision to the Ninth Circuit, arguing, among other things, that variations in state law defeated predominance. The Ninth Circuit panel credited this argument and, in a 2-1 decision, reversed the district court's approval of the settlement. The majority said the district court erred by failing to consider whether variations in state law preclude predominance, citing to the court's pre-MDL tentative ruling that acknowledged "material differences" among state laws.

The panel's decision was considered a "major blow" to nationwide class settlements. The ruling effectively mandated district courts to survey the laws of all 50 states before certifying a nationwide settlement class, a herculean test that many considered unworkable. It also put defendants in a particularly difficult position in terms of litigation strategy—a defendant could successfully defend a case in the early stages by showing it was not likely to be certified, thus positioning for a more favorable settlement, but it could not resolve the case through settlement if the same certification standard applied.

Parties on both sides of the case petitioned for an *en banc* review of the panel's decision, which the Ninth Circuit granted. Hyundai, represented by Quinn Emanuel, acknowledged that the Supreme Court's holding in *Amchem Products v. Windsor*, 521 U.S. 529 (1997) requires courts to give "undiluted, even heightened attention" to Rule 23's standards in the settlement context, but it argued that *application* of those standards should differ. The Ninth Circuit agreed that "settlement plays [a] role in the predominance inquiry." In particular, the court observed that "manageability is not a concern in certifying a settlement class where, by definition, there will be no trial." The majority held that the district court was not required to conduct an extensive choice of law analysis prior to certifying the class because application of various state laws is fundamentally a manageability problem. Moreover, the Ninth Circuit said the burden was on the objectors—not the proponents—to establish that some other state's law should have been applied, and the objectors in the case failed to meet that burden.

The majority decision affirming the nationwide settlement was a major win for both plaintiffs and class action defendants. Most importantly, the decision permits nationwide settlement classes to be certified on a less stringent basis while also reaffirming the heightened standards and rigorous analysis that must apply to litigated classes. This provides a defendant the ability to vigorously oppose nationwide class actions that it intends to litigate, while also providing reasonable standards to achieve nationwide resolution through settlement when desirable. Q

# PRACTICE AREA NOTES

## Product Liability Litigation Update

***Merck v. Albrecht*: Impossibility Preemption Defense as a Question of Law and Guidance on the "Clear Evidence" Standard**.

A decade ago in *Wyeth v. Levine*, the Supreme Court held that drug manufacturers, when faced with state tort suits alleging failure to warn, had to produce "clear evidence" that the FDA would have rejected any additional warning required by state law to succeed on the affirmative defense of impossibility preemption. 555 U.S. 555 (2009). Responding to a call for guidance on the "clear evidence" standard by the Third Circuit, the Supreme Court granted *certiorari* in *Merck v. Albrecht*. 587 U.S. ___, 139 S.Ct. 1668, 1676 (2019).

In *Albrecht*, the Court held that "clear evidence" is "evidence that shows the court that the drug manufacturer fully informed the FDA of the justifications for the warning required by state law and that the FDA, in turn, informed the drug manufacturer that the FDA would not approve a change to the drug's label to include that warning." *Id*. at 1672. The Supreme Court held that this inquiry requires a judge to "simply ask himself or herself whether the relevant federal and state laws 'irreconcilably conflict.'" *Albrecht*, 139 S.Ct. at 1679. The Court also clarified that preemption is solely "a question for the judge to decide, not a jury." *Id*. at 1672.

The impossibility preemption defense arose in *Albrecht* in the context of the FDA-approved pharmaceutical, Fosamax, a prescription drug meant to prevent and to treat osteoporosis in postmenopausal women. Fosamax nevertheless *increased* the risk of certain types of bone fractures. *Id.* at 1673. The FDA, however, did not require the original Fosamax label (approved in 1995) to include a warning of that theoretical risk, even though Merck brought those considerations to the FDA's attention, pre- and post-approval. As the science developed, in 2011, the FDA required the Fosamax label to warn about atypical femoral fractures. The respondents in *Albrecht* were individuals who took Fosamax and developed such a fracture in the interim and sued Merck for failing to warn them of the risk.

In the lower court, Merck moved for summary judgment on federal preemption grounds, which the court granted. The court concluded that the FDA's rejection of Merck's 2008 Prior Approval Supplement (PAS), regarding a warning about the risk of "stress fractures," constituted "clear evidence" federal law prevented Merck from complying with a state-law duty to warn of the atypical femoral fracture. *See id.* at 1675. The Third Circuit declined to follow the trial court's "clear evidence" conclusion and ruled that whether the FDA would have rejected an additional warning was a question of fact for the jury. *Id.* at 1676.

The Supreme Court granted Merck's *cert* petition in view of a Circuit split "concerning the application of *Wyeth*." *Id.* The majority, led by Justice Breyer, stated that even though the FDA has the authority to order manufacturers to amend product labels, the manufacturers bear the ultimate responsibility to provide a warning that adequately describes a known risk connected with a particular drug. *Id.* at 1677. Justice Breyer also found that judges are better positioned than juries to apply legal skills to undisputed facts, to make rulings on the nature and scope of an agency's determination, and to understand and interpret agency decisions in the context of complicated statutory and regulatory law. *Id.* at 1679-80. Moreover, Breyer concluded that some relevant "contested brute facts" would be properly "subsumed within an already tightly circumscribed legal analysis" that would not warrant submission to a jury for fact-finding. *Id.* Notably, the Court refused to address what disapproval methods by the FDA constitute a final agency action carrying preemptive effect—a determination left to the lower courts on remand. *Id.* at 1679.

In a concurring opinion, Justice Alito (joined by Justices Roberts and Kavanaugh) criticized the majority opinion as "misleading," noting that the FDA does not only have the authority to order manufacturers to amend labels, but, pursuant to 21 USC Section 355(o)(4)(A), it has the *duty* to do so when "the Secretary becomes aware of new [material] information." *Id.* at 1684 (Alito, J., concurring); *see also* 21 U.S.C. § 355. Although generally agreeing with the Court's new definition of "clear evidence," the FDA's duty, Justice Alito wrote, would alter the "clear evidence" analysis because any decision by the FDA declining an additional warning could logically be seen as a final determination that the label change was unjustified. *Albrecht*, 139 S.Ct. at 1684-85. According to Justice Alito, the FDA's duty applies regardless of whether the particular manufacturer informs the FDA of the justifications for a warning mandated by state law or whether the FDA communicates to the drug manufacturer that the label change would not be approved. *Id.*

In another concurring opinion, Justice Thomas concluded that the FDA's letter responding to Merck's 2008 PAS did not constitute a final agency action with preemptive effect. *Id.* at 1683. Although Justice Thomas gave a narrower definition to finality in agency actions, he would expand the scope of preemption to any state law that logically contradicts federal law, even if it is theoretically possible to comply with both. *Id.* at 1681.

Irrespective of the final arbiter of a label's propriety, the Court's new guidance on what constitutes "clear evidence" does not appear to lower the bar for establishing the defense. The Court's decision in *Albrecht* re-affirms its view set forth a decade ago in *Wyeth* that "[i]mpossibility preemption is a demanding defense." *Id.* at 1678.

## Bankruptcy Update

### ***Mission Product Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652 (2019): The Supreme Court Protects Trademark Licensees, But Raises New Questions About The Effect Of Rejecting Executory Contracts***

The Supreme Court has resolved a significant Circuit split concerning whether a trademark licensee can continue to use a mark notwithstanding rejection of the license agreement in bankruptcy. In an 8-1 decision, the Court found in favor of the trademark licensee, holding that the debtor's rejection of the license merely constitutes a breach , rather than a termination, and thus the non-debtor licensee may continue to exploit the debtor's trademark notwithstanding rejection. *See Mission Product Holdings, Inc. v. Tempnology, LLC,* 139 S. Ct. 1652 (2019). While this may be a good outcome for trademark licensees, the decision may have implications for bankruptcy practice far beyond the world of trademark licenses.

Bankruptcy Code Section 365(a) (11 U.S.C. § 365(a)) provides that a Chapter 11 debtor may assume or reject any executory contract, subject to bankruptcy court approval. A contract is "executory" when some performance remains due on both sides, such that the non-performance of one party will result in a breach of that agreement. Section 365(g) states that "the rejection of an executory contract [ ] constitutes a breach of such contract" immediately before the filing date of the bankruptcy. The practical consequences of this are (1) the debtor is no longer required to perform, and (2) the non-bankrupt counterparty is entitled to a claim for damages, but that claim can be discharged in bankruptcy, and the counterparty may only receive cents-on-the dollar for its damage claim (or in some cases nothing at all).

But what if the non-bankrupt counterparty still wants to receive the benefits of the rejected contract? In most cases the non-bankrupt party is out of luck – the debtor cannot be compelled to perform following rejection. There are, however, limited statutory exceptions. For example, Section 365(n) provides that a licensee of certain intellectual property (principally copyrights and patents) can continue to use such intellectual property as long as it continues to fulfil its obligations under the license, including the payment of royalties. Trademarks, however, are excluded from the Bankruptcy Code's definition of "intellectual property" and therein lied the problem for the non-bankrupt trademark licensee in *Mission Product*. Can the licensee continue to use the debtor's trademark notwithstanding the debtor's rejection of the license?

**Factual Background and Procedural History**

Mission held licenses from Tempnology to distribute activewear products. Tempnology, however, filed for Chapter 11 and sought to reject the licenses. Tempnology also sought a declaration from the bankruptcy court that rejection of the licenses not only allowed it to stop performing but also terminated Mission's rights to use the trademarks. The bankruptcy court agreed.

The Bankruptcy Appellate Panel ("BAP") for the First Circuit reversed, relying on *Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC* 686 F.3d 372, 376-77 (7th Cir. 2012). The *Sunbeam* court focused on Section 365(g)'s direction that rejection of a contract constitutes a breach not a rescission. While rejection converts a debtor's breach of the contract to a prepetition damages claim, it does not "vaporize" the counterparty's rights.

The First Circuit Court of Appeals reversed. Relying on unique features of trademark law, the Court held that allowing a licensee to retain its rights after rejection could jeopardize the continued validity of the trademark because the debtor would no longer be monitoring and exercising quality control over goods associated with the marks. Requiring the debtor to do so would frustrate "Congress's principal aim in providing rejection" to "release the debtor's estate from burdensome obligations." The Supreme Court granted *certiorari* to resolve this conflict between the Seventh and First Circuits.

**The Supreme Court Resolves the Circuit Split**

Justice Kagan authored the Court's opinion holding that rejection of an executory contract operates as a breach giving rise to a prepetition damages claim, but it does not rescind the agreement. The Court adopted the Seventh Circuit's reasoning in *Sunbeam* and looked to non-bankruptcy contract law to determine whether a breach should be treated as a termination. As Justice Kagan noted, outside of bankruptcy, the non-breaching party gets to decide whether to continue performing its own obligations under the agreement. The breaching party, here the debtor, has no ability to terminate the agreement.

In preserving the rights of the non-debtor party to a rejected contract, Section 365 reflects the general bankruptcy rule that the estate cannot possess anything more than the debtor itself had outside of bankruptcy. In other words, the same counterparty rights that survive a breach outside of bankruptcy survive a rejection inside of bankruptcy.

The Court rejected Tempnology's "negative inference" argument that a debtor's rejection of a contract terminates a counterparty's rights unless the contract falls within the express statutory exceptions of Section(n) which as noted only protects certain types of intellectual property licenses (principally copyrights and patents).. While Section 365(n) certainly addresses specific post-rejection rights, and may indeed limit, ever so slightly, the applicability of Section 365(g), the Court found that just because trademark licenses are not covered by Section 365(n), that does not abrogate Section 365(g)'s application to all executory contracts, including trademark licenses.

The Court also rejected Tempnology's remaining arguments, including that the value of a debtor's trademarks will be significantly denigrated if the debtor is unable to monitor the use of those marks. The Court reasoned that, by allowing a debtor to reject all future contractual obligations, Section 365 "does not grant the debtor an exemption from all the burdens of generally applicable law-whether involving contracts or trademarks," nor does it relieve the debtor of the need to make economic decisions about preserving the estate's value, even if it means investing resources to preserve the marks (and potentially significantly increasing the cost of Chapter 11).

**Practical Implications**

Trademark licensees can now take comfort in knowing that they retain the same post-rejection rights to exploit the marks that they would have had if the breach had occurred outside of bankruptcy. Licensees cannot demand future affirmative performance from the debtor (such as the debtor's protection of the mark), but they otherwise can elect to continue utilizing onthe mark on the same terms they did pre-rejection. Indeed, trademark licensees may have somewhat broader post-rejection rights than patent and copyright licensees, who are restricted to the post-rejection rights delineated in Section 365(n).

The *Mission* decision arguably is not limited to trademark licenses. The Court discussed general contract principles and the applicability of Section 365(g) to all executory contracts. The decision thus raises the question of whether (and to what extent) it has diminished the power of rejection in bankruptcy and made it more difficult for a debtor to shed burdensome obligations. As Justice Kagan noted, "[t]he Code of course aims to make reorganizations possible. But it does not permit anything and everything that may advance that goal." *Mission* thus may create more obstacles to achieving a successful reorganization.. Although the general principle that "rejection is a breach and not a termination" is a long-standing one, *Mission* may encourage parties to rejected contracts to assert their rights to continue to use the debtor's tangible or intangible personal property post-rejection.

Take, for example, parties who lease equipment from a debtor. *Mission* suggests that those parties may be allowed to retain possession of the leased property, notwithstanding the debtor's rejection of the lease. Indeed, the Court used a hypothetical involving a copy machine leased by a debtor to a law firm, and the ensuing breach when the debtor fails to service the copier. The Court noted that outside of bankruptcy, the lessee can excuse the breach and still keep possession of the copier through the term of the lease. According to *Mission*, that result should be the same both inside and outside of bankruptcy. If the copier lessor files for Chapter 11 and decides to reject its agreement with the law firm, the rejection is merely a breach, not a termination. The debtor can stop servicing the copier, but it cannot regain possession of the copier if the law firm wants to keep using it during the lease term. In other words, the law firm has an option about how to respond—continue the contract, or walk away and file a claim in the bankruptcy for damages.

*Mission* thus may hinder the ability of some debtors and their creditors to maximize the value of a bankruptcy estate.

Although *Mission* has clarified the rights of trademark licensees in bankruptcy, it also has potentially raised new questions about the effect of rejection in other contexts.

## Securities & Structured Finance Litigation Update

***Securities Regulatory Framework For Cryptocurrencies Put To The Test***

The Securities and Exchange Commission (SEC) will have to defend its evolving framework for regulating a cryptocurrency as a security in a recently-filed court case where settlement is unlikely. In early June, the SEC filed a complaint in the Southern District of New York (Case No. 19-cv-5244) against Kik Interactive Inc. ("Kik"), a private Canadian company formed in 2009 that owns and operates a mobile messaging application. The complaint alleges that Kik's offering of one trillion digital tokens called "Kin" to more than 10,000 investors worldwide for approximately $100 million was an illegal sale of an unregistered security. Kik has announced it will fight the lawsuit, which means the SEC will face its first judicial test of its evolving regulatory framework for digital assets.

Section 5 of the 1933 Securities Act prohibits the unregistered offer or sale of a "security" absent an exemption from registration. There is no special exemption for cryptocurrency offerings; if they have not been registered, the argument is that they are not securities. The Securities Act defines a security to include a variety of instruments, such as stocks, bonds, and "investment contracts." Over 70 years ago, in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), the U.S. Supreme Court defined what constitutes an investment contract. Specifically, "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *Id.* at 298-99.

*Howey* does not apply cleanly to cryptocurrencies, which may have traits both of currencies (operating as a unit of value that can be exchanged for goods and services) and securities (operating as an investment that may increase in value due to the efforts of others). The SEC has struggled to apply this seventy-year-old case to the digital asset space. To date, although the SEC has brought Section 5 cases, many have been directed at companies running clearly fraudulent operations. In addition, because the vast majority of those cases have settled, they have not produced published opinions setting forth an analytical framework.

In June 2018, SEC Director of Corporate Finance William Hinman attempted to articulate a framework in his "When *Howey* Met Gary (Plastic)" speech, which analyzed when a digital asset would be considered a security. The speech repeated basic principles, such as the importance of the economic substance of a transaction over labels, analyzed the investment contract concept from *Howey*, and listed 13 "illustrative" factors relevant to the investment contract analysis for digital assets. The speech left many industry participants seeking more clarity.

Accordingly, in April 2019, the SEC staff provided a more formal framework for evaluating whether a cryptocurrency qualifies as an "investment contract" and therefore a security. The April 2019 statement, by Director Hinman and Valerie Szczepanik (the SEC's "crypto Czar") stated that because cryptocurrency offerings typically involve an investment of money in a common enterprise, the real question is whether a purchaser has a reasonable expectation of profits derived from the efforts of others. The April 2019 statement identified three categories of characteristics relevant to this factor. The first category is reliance on the efforts of others, including an analysis into whether important tasks will be performed by a few third parties, rather than an unaffiliated, dispersed community of network users. The second category is reasonable expectation of profits from the work of others rather than price appreciation resulting solely from external market forces. The third category is "other relevant considerations," such as whether the digital asset is marketed in a way that emphasizes its potential for an increase in value rather than its functionality.

The SEC's efforts to provide more clarity have come at a cost, requiring it to reach farther from guidance provided by case law. The Kik lawsuit will force the SEC to defend its framework before a court. Unlike prior digital asset firms targeted by the SEC, Kik has announced it has no intentions of settling the case. Kik took the extraordinary step of publicizing its response to the SEC's Wells Notice by warning of a possible enforcement action before it was sued and has launched a crowdfunding campaign seeking to raise $5 million for its defense (the fund has raised about $1.75 million as of July 2019).

In the Kik lawsuit, the SEC alleges that Kik's offering of Kin tokens was an unregistered securities offering in violation of Sections 5(a) and (c) of the 1933 Securities Act because the Kin tokens are investment contracts, and thus securities. The SEC alleges that the tokens are investment contracts because purchasers of Kin tokens invested money in a common enterprise with Kik and each other with the reasonable expectation of profits derived from the entrepreneurial and managerial efforts of Kik and its agents. Among other facts that the SEC considered important were that Kik repeatedly promised potential buyers that they stood to profit from investing in Kin allegedly as a result of Kik's efforts, including the development of a Kin Ecosystem and the creation of a "rewards engine," and that Kik allegedly assured potential buyers that they would be able to trade Kin on secondary trading platforms, often described as "exchanges," to convert Kin to dollars or another digital currency (*e.g.*, Bitcoin or Ether). Overall, the complaint repeatedly highlights the ways that Kik described Kin as an investment opportunity.

The Kik case almost certainly will generate case law interpreting when a digital asset qualifies as a security, and may provide the first in-depth judicial analysis of whether and how *Howey* applies to digital assets. Only time will tell if the case gives the market the certainty and clarity it has been clamoring for.

## Life Sciences Litigation Update

**Federal Circuit Holds Diagnostic Method Claims Patent Ineligible While Acknowledging Public Policy Implications.** Patents claiming diagnostic methods continue to face patent ineligibility challenges under 35 U.S.C. § 101. Earlier this year, in *Athena Diagnostics, Inc. v. Mayo Collaborative Services, LLC*, 915 F.3d 743 (Fed. Cir. 2019), the Court of Appeals for the Federal Circuit affirmed the dismissal of a patent infringement complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) on the ground of subject matter ineligibility. *Athena* is one of several decisions by the Federal Circuit concerning the patentability of diagnostic method claims following *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*, in which the Supreme Court held that claims to a diagnostic method based on a "law of nature," *i.e.*, correlations between thiopurine metabolite levels in the blood and the toxicity and efficacy of thiopurine drugs, were invalid under Section 101. 566 U.S. 66, 77 (2012).

The patent in *Athena* claimed methods for diagnosing neurological disorders such as *myasthenia gravis* ("MG"), an autoimmune disease characterized by muscle weakness, drooping eyelids, double vision, and slurred speech. 915 F.3d at 747. The inventors discovered the association between MG and certain antibodies in the human body that bind to a protein called muscle-specific tyrosine kinase ("MuSK"). *Id.* The claims at issue recited methods for diagnosing a MuSK-related disorder such as MG comprising three steps: (1) "contacting" a radioactively-labeled MuSK protein with bodily fluid (if MuSK antibodies are present in the fluid, they will bind to the labeled MuSK); (2) "immunoprecipitating" any antibody/MuSK complex from the bodily fluid, *i.e.*, isolating the complex by adding a secondary antibody that specifically binds to MuSK antibodies; and (3) "monitoring" for the radioactive label, wherein the label's presence indicates that a person has the disorder. *Id.* According to the patent specification, the immunoassay techniques of adding a radioactive label to a protein and immunoprecipitation were known at the time of invention. *Id.* at 748.

Athena, the exclusive licensee of the patent-in-suit, marketed a diagnostic test that evaluated the presence of MuSK antibodies and accused Mayo's competing diagnostic tests of infringement. *Id.* at 746. Mayo moved to dismiss Athena's complaint under Rule 12(b)(6) on the ground that the patent claims were invalid under Section 101. *Id.* The District Court granted the

## Successful Settlement Achieved for ASM International

The firm represented ASM International and affiliates against Kokusai Electric (previously Hitachi Kokusai Electric) and affiliates in patent infringement actions in the U.S. and Japan, as well as multiple IPR proceedings, recently obtaining a valuable settlement in an international series of disputes. These cases were brought after a ten year licensing history where Kokusai Electric received licenses from ASM to ASM's significant batch atomic layer deposition ("ALD") technology. After Kokusai Electric refused to take another follow-on license to ASM's ALD technology, the parties initiated three separate patent infringement actions against each other in the United States: *ASM IP Holding v. Hitachi Kokusai Electric, et al.*, No. 3:17- cv-06879 (N.D. Cal.), filed December 1, 2017; *Hitachi Kokusai Electric v. ASM International, et al.*, No. 3:17- cv-06880 (N.D. Cal.), filed December 1, 2017; *Hitachi Kokusai Electric, et al. v. ASM International, et al.*, No. 3:18-cv-00323 (D. Or.), filed February 20, 2018. Across the three cases, ASM and Kokusai Electric each asserted eleven patents. In conjunction with the District Court litigations, ASM sought *inter partes* review of all eleven asserted Kokusai Electric patents, and Kokusai Electric sought *inter partes* review of three ASM asserted patents. In addition to the U.S. ligations, in 2018, ASM filed lawsuits in Japan against Kokusai Electric seeking injunctions for patent infringement of two separate patents, and, in 2019, Kokusai Electric filed its own lawsuits in Japan against ASM seeking injunctions for patent infringement of seven separate patents.

Under the terms of the settlement and license, our client, ASM, will receive $115 million in exchange for a portfolio-wide cross licenses through July 1, 2021, and an ongoing license for any litigated patents. This settlement is unrelated to a previous arbitration proceeding that ASM initiated in August 2017 with the American Arbitration Association against Kokusai Electric for breach of a license agreement that expired in November 2017. A final award in the arbitration is due by September 25, 2019, following a five-day hearing that was concluded in March 2019.

## QE Scores Another Defamation Win; Decision Clarifies Scope of Damages Discovery

The firm recently secured a victory in New York state appellate court, creating new precedent regarding the scope of discovery a defendant may seek regarding a plaintiff's damages claim in a defamation action. The decision affirmed the trial court's 45-page decision, which was based on voluminous cross-motions to compel complete document productions. *See Gottwald v. Geragos*, 61 Misc.3d 1214(A) (N.Y. Sup. Ct. 2018); *id.*, 172 A.D.3d 445 (1st Dep't 2019). Under this precedent, a defendant accused of defamation may seek discovery concerning the plaintiff's past reputation, including any previous claims made against the plaintiff or evidence of "prior bad acts" that are similar in nature to the subject matter of the alleged defamatory statements. Additionally, the decision clarifies that defamation defendants may seek discovery regarding the plaintiff's financial history, even where the plaintiff purports to disclaim any economic damages.

The firm persuaded the trial court that a libel plaintiff may not assert reputational damage while withholding discovery that bears on whether the reputation was good or bad prior to the alleged defamation. The Court noted the absence of "factually on-point precedent holding that [the C.P.L.R.] invariably permits the liberal discovery of 'prior acts' evidence of a defamation plaintiff's reputation." *Gottwald*, 61 Misc.3d 1214(A) at *14. But the Court was persuaded that even if a plaintiff's prior bad acts may not be admissible at trial, they are "nevertheless subject to discovery *before* trial." *Id.* Accordingly, the Court upheld requests for documents that concerned claims by any individual against the plaintiff of the nature at issue in the alleged defamatory statements. On appeal, the firm prevailed again over the plaintiff's objection that such evidence may not be discovered because it is not admissible. The First Department found plaintiff's arguments "unavailing." *Gottwald*, 172 A.D.3d 445.

The trial court also held that a defamation plaintiff's financial history is relevant and discoverable, even where the plaintiff purports to disclaim so-called "special damages." *Gottwald*, 61 Misc.3d 1214(A) at *15-16. In defamation, a statement is defamation *per se* where it "charge[s] plaintiff with a serious crime," and in such cases, the "plaintiff need not allege or prove 'special damages,'" which consist of, for example, lost profits or direct economic loss. *Id.* at *15. Rather, a plaintiff in such a case may recover general damages (*e.g.*, for embarrassment), which are presumed. *Id.* The plaintiff argued that because he did not seek damages for "lost profits," his financial history was irrelevant. The trial court, however, disagreed, and found even though "the existence of compensatory damages is presumed, the quantum of such damages is not, and the party who made the defamatory statement … must be permitted to rebut the presumption and disprove the amount of damages sought to be recovered." *Id.* at *1. In other words, a defamation defendant may seek to show that the plaintiff suffered no economic harm in mounting a case that the plaintiff suffered no damages, even where the plaintiff does not seek to recover for specific economic harm. The appellate court again affirmed this holding, finding the plaintiff's arguments on this score "unavailing" as well. *Gottwald*, 172 A.D.3d 445.

This precedent – which is the latest in a recent string of wins for the firm's plaintiff- and defense-side defamation practice -- provides new tools to a defendant accused of defamation to obtain discovery in order to disprove the plaintiff's damages claim.

# PRACTICE AREA NOTES (cont.)

motion, concluding that the claims were directed to a law of nature and lacked an inventive concept because the recited steps involved only standard techniques in the art. *Id.* at 748.

The Federal Circuit agreed. In its decision, the majority reiterated the two-part test for subject matter eligibility established by the Supreme Court in *Mayo* and *Alice Corp. v. CLS Bank International*, 573 U.S. 208 (2014). First, a court must determine whether a claim, when viewed as a whole, is "directed to" an "implicit exception" to eligibility under Section 101, such as "laws of nature, natural phenomena, and abstract ideas." *Athena*, 915 F.3d at 749. If the claim is directed to a law of nature, for example, then under step two, the court determines "whether the limitations of the claim apart from the law of nature, considered individually and as an ordered combination, 'transform the nature of the claim into a patent-eligible application.'" *Id.* (quoting *Alice*, 573 U.S. at 217).

Applying the *Mayo/Alice* test, the *Athena* majority determined that under step one, the diagnostic method claims were directed to a law of nature – namely, the correlation between the presence of naturally-occurring MuSK antibodies and MuSK-related diseases. *Id.* at 750. The majority concluded that the claims, similar to other diagnostic method claims it held ineligible under Section 101 in other decisions since *Mayo*, were "directed to a natural law because the claimed advance was only in the discovery of a natural law, and that the additional recited steps only apply conventional techniques to detect that natural law." *Id.* at 751. The majority also noted that the specification described the invention "principally as a discovery of a natural law" and "not as an improvement in the underlying immunoassay technology." *Id.*

In addition, the majority made several key observations relevant to analyzing diagnostic method claims under step one of the *Mayo/Alice* test. First, the fact that the claims did not preempt other ways of examining the correlation between MuSK antibodies and MuSK-related disorders was insufficient to render the claims patent eligible. *Id.* at 752. Second, the use of a man-made molecule (*i.e.*, a radioactive label) in claimed methods "employing standard techniques to detect or observe a natural law" was also insufficient to render the claims patent eligible. *Id.* Lastly, the majority distinguished claiming a "natural cause of an ailment and well-known means of observing it" from claiming "applications of natural laws" or "new treatment[s] for an ailment, albeit using a natural law." *Id.* at 752-53. The former claim is ineligible as it "in effect only encompasses the natural law itself," whereas the latter claim is patent eligible as it "is not claiming the natural law." *Id.*

With respect to step two of the *Mayo/Alice* test, the majority concluded that the claims lacked an inventive concept. The specification described the processes of immunoprecipitation and labeling proteins with a radioactive label, and the overall immunoassay, as conventional techniques. *Id.* at 753-54. Thus, the recited steps not drawn to ineligible subject matter "only require[d] standard techniques to be applied in a standard way." *Id.* at 753.

Notably, the majority and dissenting opinions both recognized that public policy favors patentability of diagnostic methods. In a dissenting opinion, Judge Newman argued that the majority was "enlarg[ing] the inconsistencies" in the Federal Circuit's decisions on the eligibility of diagnostic methods, and "exacerbat[ing] the judge-made disincentives to development of new diagnostic methods, with no public benefit." *Id.* at 757. The dissent highlighted the concerns raised in various *amici curiae* briefs that the unpredictability of patent protection caused by the Court's decisions inhibit innovation and disincentive the development of new diagnostic procedures. *See id.* at 762-64. In response, the majority agreed that "providing patent protection to novel and non-obvious diagnostic methods would promote the progress of science and useful arts." *Id.* at 753 n.4. Nevertheless, the majority held the claims at issue were patent ineligible because application of the *Mayo/Alice* test left "no room for a different outcome."

Following the panel's decision, Athena filed a petition for rehearing *en banc* on April 8, 2019, which is currently pending before the Federal Circuit.

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# business litigation report

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