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Ninth Circuit Shifts "Significant Expense" of Compliance with Third Party Subpoenas to Party Seeking Discovery

The escalating cost of discovery compliance is especially frustrating for non-parties who are subpoenaed for evidence allegedly relevant to litigation in which they have no stake. Responding to a broad subpoena may require retaining vendors to collect and process potentially responsive electronically-stored information ("ESI"), interviewing employees to determine relevant custodians, and hiring outside counsel to review documents for responsiveness and privilege. The costs in time, effort, and dollars can be considerable. *See, e.g.*, *Linder v. Calero-Portocarrero*, 251 F.3d 178, 182 (D.C. Cir. 2001) (estimated costs of compliance with third party subpoenas to federal agencies in wrongful death action totaled $199,537.08).

Rule 45 of the Federal Rules of Civil Procedure provides for cost-shifting to protect non-parties from these costs. Yet, although subpoenas are a staple of federal litigation, there is a relative dearth of case law regarding cost-shifting for third party discovery. Recently, however, the United States Court of Appeals for the Ninth Circuit clarified that cost-shifting is mandatory if a non-party has incurred "significant expense" in responding to a subpoena. *Legal Voice v. Stormans Inc.*, 738 F.3d 178, 182 (9th Cir. 2013) This holding should encourage more non-parties to pursue cost-shifting aggressively and, at the same time, encourage federal litigants to be more conservative in their discovery requests to non-parties and more amenable to negotiated limitations on non-parties' discovery responses.

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INSIDE

Quinn Emanuel Wins 2014 *Chambers USA* Product Liability Practice Group of the Year

The firm was honored at the 2014 *Chambers and Partners* Practice Group of the Year Awards in New York City as the Product Liability Practice Group of the Year. The firm's stellar group of product liability lawyers includes Sheila Birnbaum, Mark Cheffo, and Faith Gay in the New York office, Mike Lyle and Eric Lyttle in the Washington, D.C. office, and many other well known practitioners in other offices around the globe. Q

Quinn Emanuel Receives Top Dispute Resolution Rankings in *The Legal 500 EMEA 2014*

Quinn Emanuel Moscow has been recognized by *The Legal 500 Europe, Middle East & Africa 2014* as a top-tier firm for dispute resolution in Russia. The firm received the following rankings:

- Dispute Resolution: Litigation (Tier 1) – the only international law firm included in Tier 1
- Dispute Resolution: Arbitration and Mediation (Tier 2)

The firm's Moscow office was recognized for its representation of Russian businesspeople and companies in several multi-billion dollar arbitrations across various jurisdictions arising out of a major construction project in the CIS. The Moscow team also won a series of victories in the Russian courts in cases concerning the control of Hungarian gas trader EMFESZ. Moscow Managing Partner Ivan Marisin was recognized as a Leading Individual in both Dispute Resolution: Litigation and Dispute Resolution: Arbitration and Mediation. Q

Fourteen Partners Ranked by *Managing Intellectual Property* Magazine

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Rule 45(d)

Rule 45(d)(1) states that "[a] party or attorney responsible for issuing and serving a subpoena must take reasonable steps to avoid imposing undue burden or expense on a person subject to the subpoena." Fed. R. Civ. P. 45(d)(1). Where a non-party objects to some or all of a subpoena's requests, the requesting party must seek a court order compelling compliance with the subpoena. Fed. R. Civ. P. 45(d)(2)(B). Compliance "may be required only as directed in the order, and the order must protect a person who is neither a party nor a party's officer from significant expense resulting from compliance." Fed. R. Civ. P. 45(d)(2)(B)(ii).

A non-party seeking to shift the cost of subpoena compliance by applying Rule 45(d)'s protection from "significant expense" must object to the subpoena's requests and refuse to comply in the first instance. Rule 45(d)(2)(B)(ii) is triggered only where the court orders compliance with a subpoena and courts will not shift costs to the requesting party where the non-party voluntarily complies with a subpoena. *See, e.g.*, *DNT, LLC v. Sprint Spectrum, LP,* 750 F. Supp. 2d 616, 626 (E.D. Va. 2010) (where non-party produced documents before court ordered compliance, it could not seek reimbursement of costs under Rule 45); *Angell v. Kelly*, 234 F.R.D. 135, 139 (M.D.N.C. 2006) (same).

***The Ninth Circuit's Holding in* Legal Voice**

In *Legal Voice v. Stormans Inc.*, 738 F.3d 1178 (9th Cir. 2013), a unanimous panel of the Ninth Circuit held that, where a court compels complete or partial compliance with a subpoena, cost-shifting under Rule 45(d) is mandatory whenever a non-party incurs "significant expense" in responding.

Legal Voice was an advocacy group that prompted the Washington State Board of Pharmacy to promulgate new regulations in response to reports that certain pharmacists were obstructing patients' access to emergency contraceptives. *Legal Voice*, 738 F.3d at 1181. Legal Voice also participated in the rulemaking process. *Id.* Stormans, a pharmacy, and certain pharmacists filed suit to challenge the new rules and served a subpoena on Legal Voice seeking production of fourteen categories of documents. *Id.* Two motions to compel and a motion for reconsideration later, Legal Voice had spent $20,000 complying with the subpoena as narrowed by the district court. *Id.* at 1181-82. The district court denied Legal Voice's repeated requests for cost-shifting or sanctions. *Id.* After the district court entered final judgment, Legal Voice appealed the district court's denial of its requests. *Id.* at 1182.

After rejecting the plaintiffs' argument that Legal Voice's appeal was untimely, *id.* at 1182-83, the Court of Appeals held that Rule 45(d)(2)(B)(ii) "requires the district court to shift a non-party's cost of compliance with a subpoena, if those costs are significant." *Id.* at 1184. The Ninth Circuit found that "[t]he plain language of the rule" states that a "district court's order compelling compliance with a subpoena '*must* protect a person who is neither a party nor a party's officer from significant expense resulting from compliance,' and provides no exceptions." *Id.* (emphasis in original) (internal citations omitted) (quoting Fed. R. Civ. P. 45(d)(2)(B)(ii)). "This language," the Court stated, "leaves no room for doubt that the rule is mandatory." *Id.* The Court of Appeals provided clear direction to district courts: "[W]hen discovery is ordered against a non-party, the only question before the court in considering whether to shift costs is whether the subpoena imposes significant expense on the non-party. If so, the district court must order the party seeking discovery to bear at least enough of the cost of compliance to render the remainder 'non-significant.'" *Id.*

Thus, the Court of Appeals reversed the district court's denial of Legal Voice's requests for cost-shifting, finding that "the district court erred . . . by framing the issue in terms of undue burden, rather than significant expense. . . Rather than considering whether compliance was unduly burdensome, the district court should have considered only whether that cost was significant." *Id.* at 1184-85. The Court of Appeals "ha[d] no trouble concluding that $20,000 is 'significant.'" *Id.* at 1185. However, the Court affirmed the district court's decision not to award discretionary sanctions under Rule 45(d)(1). *Id.*

Cost-Shifting Outside the Ninth Circuit

Other courts have considered Rule 45(d)(2)(B)(ii)'s cost-shifting provision and reached similar conclusions. *See, e.g.*, *Linder*, 251 F.3d at 182 ("Under the revised Rule 45, the questions before the district court are whether the subpoena imposes expenses on the non-party, and whether those expenses are 'significant.' If they are, the court must protect the non-party by requiring the party seeking discovery to bear at least enough of the expense to render the remainder 'non-significant.' The rule is susceptible of no other interpretation."); *R.J. Reynolds Tobacco v. Philip Morris, Inc.*, 29 F. App'x 880, 883 (3d Cir. 2002) ("[D]istrict courts must determine whether the subpoena imposes expenses on a non-party and whether those expenses are significant. Significant expenses must be borne by the party seeking discovery.") (internal citations omitted); *Crandall v. City & Cnty. of Denver, Colorado*, No. 05-C-00242-

MSK-MEH, 2007 WL 162743, at *1 (D. Colo. Jan. 17, 2007) ("It is the Court's obligation to protect any person who is not a party to the underlying lawsuit from significant expense resulting from the inspection and copying which was commanded pursuant to Rule 45. The rule is mandatory. The court must protect the nonparty by requiring the party seeking discovery to bear at least enough of the expense to render the remainder nonsignificant. . . . The cost shifting is not limited to costs of inspection and production, but those significant expenses resulting from the inspection and copying.") (internal citations and quotations omitted).

In some jurisdictions, additional considerations are factored into the analysis to determine how much of the "significant expense" should be shifted to the requesting party. *See, e g.*, *United States v. Blue Cross Blue Shield of Michigan*, 10-CV-14155, 2012 WL 4838987, at *2 (E.D. Mich. Oct. 11, 2012) ("To determine how much cost to shift from the nonparty, the court must balance the equities of the particular case, including '(1) whether the putative nonparty actually has an interest in the outcome of the case, (2) whether it can more readily bear its cost than the requesting party; and (3) whether the litigation is of public importance.'") (quoting *In re Exxon Valdez,* 142 F.R.D. 380, 383 (D.D.C. 1992)); *accord Crandall*, 2007 WL 162743, at *1.

Lessons for Subpoena Targets and Requesting Parties

Legal Voice and other cases are instructive for both the targets of subpoenas and the parties that issue them.

Be careful what you ask for. The Ninth Circuit's instruction that cost-shifting of "significant" expense is mandatory should encourage many litigants to tailor subpoenas as narrowly as possible to avoid unanticipated litigation costs. Although courts often narrow the scope of the requesting party's initial requests in ordering compliance, there are no guarantees a court will do so in any given case. Under *Legal Voice*, it is possible that the requesting party will bear the risk that the costs of compliance with a broad non-party subpoena turn out to be significant.

Always object. A non-party must object to the subpoena's requests and refuse to comply in the first instance in order to ensure it can avail itself of the cost shifting protections under Rule 45(d)(2)(B)(ii). *See, e.g.*, *McCabe v. Ernst & Young, LLP*, 221 F.R.D. 423, 426 (D.N.J. 2004) ("Rule 45 is intended to 'clarify and enlarge the protections afforded persons who are *required* to assist the court by giving information and evidence[.]'") (emphasis in original). Otherwise, requesting parties could find themselves required to reimburse significant compliance expenses without any warning. *See id.* at 427. ("[E]xpedient compliance does not outweigh the prejudice that would ensue to Plaintiffs if required to pay exorbitant counsel fees absent an opportunity to address their subpoenas and mitigate counsel fees."). Where significant expense will be involved in responding to a subpoena, non-parties will likely have colorable objections based on burden, scope, and relevance they should be sure to assert in an initial round of objections.

Alert the court and litigants to the expense of compliance. In opposing a motion to compel, or moving to quash or for a protective order, subpoena targets should provide as much detail as possible regarding the burden and expense that compliance would entail. Specific details about time and expense are likely to be more persuasive to the court than abstract objections based on burden or scope, and a failure to include specific evidence regarding the costs of compliance can defeat a subpoena target's request for cost-shifting. *See, e.g.*, *Callwave Commc'ns, LLC v. Wavemarket, Inc.*, C 14-80112 JSW (LB), 2014 WL 2918218, at *6 (N.D. Cal. June 26, 2014) ("[T]o determine whether the costs even can be shifted (let alone to determine how much they should be shifted), the court must first determine whether the costs are 'significant.' The problem here is that [the subpoena target] did not even tell the court how much it estimates it will spend to comply with the subpoena, let alone provide any evidence to support that amount. Without a specific dollar amount, the court cannot say whether [the target's] costs are significant."). Putting the court and the requesting party on notice of the expense can also serve to undermine any objections by the requesting party at the cost-shifting stage.

Be proactive. Similarly, requesting parties should consider taking steps to monitor the costs of compliance with a subpoena. *See, e.g.*, *In re Subpoena of Am. Nurses Ass'n*, 290 F.R.D. 60, 75 (D. Md. 2013) (rejecting argument that requesting party should not be required to pay certain costs of compliance, noting that "[i]f Plaintiffs were so concerned about controlling costs, if Plaintiffs were so concerned about selecting the e-discovery vendor to conduct searches they endorsed, the Court is perplexed by the abdication by Plaintiffs' counsel for the first three weeks after the Court's [ruling compelling production]"), *objections overruled*, 11-CV-02836-AW, 2013 WL 5741242 (D. Md. Aug. 8, 2013). At least one court has opined that requiring the requesting party to pre-pay production costs is the best course of action, because it allows the requesting party more control over the expense it will ultimately absorb and helps to avoid surprise. *See, e.g.*, *Goldstein v. State Farm Fire & Cas. Co.*, No. 06-4565-HGB-

SS, 2008 WL 4373032, at *3 (E.D. La. Sept. 23, 2008) ("[W]hile a nonparty ordered to comply with a subpoena must be protected from significant expenses, this must be accomplished in such a manner that the party seeking discovery is protected from excessive costs. The resolution of these conflicting goals is best accomplished by fixing the costs of compliance in advance of production. When this is not possible, the risk of uncertain costs must be fully disclosed to the party seeking discovery.").

Don't expect to avoid the bill entirely. The law does not require courts to shift *all* of the costs of compliance with a subpoena to the requesting party. For example, in *Legal Voice*, the Ninth Circuit observed that the district court need only shift enough of the cost of compliance to make the expense shouldered by the non-party "non-significant." Where to draw the line in any particular case will depend on a variety of circumstances, including whether the responding party is a regular part of third party discovery. Indeed, courts have declined to shift expenses that they find routine to the non-party's business. *See, e.g.*, *In re Subpoena of Am. Nurses Ass'n*, 290 F.R.D. at 77 (attorneys' fees would not be shifted completely to requesting party because non-party "has undoubtedly received third-party subpoenas in the past" and "[s]uch subpoenas are a cost of doing business in today's society"); *see also E.E.O.C. v. Kronos Inc.*, 694 F.3d 351, 371-72 (3d Cir. 2012), *as amended* (Nov. 15, 2012) (allocating costs of compliance with administrative subpoena with reference to Rule 45) ("[T]he primary consideration in fairly allocating the cost of compliance with an administrative subpoena is whether the cost of compliance with the subpoena 'exceed[ed] that which the respondent may reasonably be expected to bear as a cost of doing business.'") (citations omitted).

Another court, in applying *Legal Voice*, recited two lists of factors a court should consider when deciding how much of the expense to shift: first, "(1) whether the nonparty has an interest in the outcome of the case; (2) whether the nonparty can more readily bear its costs than the requesting party; and (3) whether the litigation is of public importance," and second, "(1) the scope of the discovery; (2) the invasiveness of the request; (3) the extent to which the producing party must separate responsive information from privileged or irrelevant material; and (4) the reasonableness of the costs of production." *See Callwave Commc'ns*, 2014 WL 2918218, at *3 (internal citations and quotations omitted). Consideration of such diverse factors may still give district courts considerable discretion when apportioning "significant expense" between the requesting party and the responding non-party, notwithstanding *Legal Voice*'s clear instruction that courts must shift enough of the expense of compliance with third party subpoenas to the requesting parties to render it not "significant."

Finally, although *Legal Voice* made clear that an "undue burden" analysis is improper under Rule 45(d)(2)(B)(ii), at least one district court bound by, and purporting to apply, that decision noted that "[w]hether a cost is 'significant' necessarily relates to the nature of the case and the parties' respective financial situations." *Siltronic Corp. v. Employers Ins. Co. of Wausau*, 3:11-CV-1493-ST, 2014 WL 991822, at *1 (D. Or. Mar. 13, 2014). Thus, district courts may still be inclined to consider the financial wherewithal of the subpoena target in determining whether expenses are significant. The $20,000 of expenses that was "significant" to the advocacy group in *Legal Voice* might not be deemed "significant" if incurred by a multi-billion dollar company. Q

NOTED WITH INTEREST

Delaware Court Finds Password Protection for Electronic Documents Insufficient to Preserve Trade Secrets

Key questions in most trade secret cases are whether information was misappropriated and whether that information qualified as a trade secret in the first place. Under the Uniform Trade Secrets Act's definition of a trade secret, whether information is a qualified trade secret depends on whether the efforts taken to maintain the information's secrecy are "reasonable under the circumstances." *See, e.g.*, Del. Code Ann. tit. 6, § 2001(4) (West) (adopting, like the majority of states, the Uniform Trade Secrets Act's definition of a trade secret). For example, strict password policies are a common business practice when it comes to protecting digital files, and one might assume they are a "reasonable" method of protecting digitally stored trade secrets. Not so, according to the Delaware Court of Chancery, which ruled that in the circumstances of a recent case, password protection alone was not sufficient to maintain trade secret status. *Wayman Fire Prot., Inc. v. Premium Fire & Sec., LLC*, No. 7866-VCP, 2014 WL 897223 (Del. Ch. Mar. 5, 2014).

At issue in *Wayman Fire Protection* were two reports taken from the plaintiff's Salesforce.com account. The first, an "opportunities report," identified Wayman's prior bids, prospective business opportunities, and Wayman's internal assessments of those opportunities. *Id.* at *13. The second, a "contacts report," simply listed the names and contact information of Wayman's current clients. *Id.* Both reports wound up in the hands of a competitor, Premium Fire & Security, when a Wayman employee departed for Premium Fire and took his backup of the electronic files he used at Wayman with him. *Id.* at *7. The employee then copied this entire backup drive, including the Salesforce reports from Wayman, onto his Premium Fire computer. *Id.* After losing a bid to Premium Fire, Wayman began to suspect that the employee had taken Wayman's files with him to his new employer, and ultimately it sued Premium Fire and Wayman's former employees for tortious interference with prospective contractual relations, misappropriation of trade secrets, misuse of computer system information, breach of the duty of loyalty, conversion, and civil conspiracy. *Id.* at *8. After a bench trial, the court found no liability for misappropriation of trade secrets, in part because Wayman failed to show its password policies met the standard for reasonable efforts to protect the secrecy of the information. *Id.* at *15-16 (addressing faults in plaintiff's proof of misappropriation). Although the defendants conceded that the former employee had copied the files to Premium Fire's computer and used them without Wayman's permission, the court ruled that the Salesforce reports did not qualify for trade secret protection. *Id.*

In Delaware, as in other states, customer lists are recognized as potentially eligible for trade secret protection. *See, e.g., Am. Family Mut. Ins. Co. v. Roth*, 485 F.3d 930, 933 (7th Cir. 2007) (under Wisconsin's implementation of the Uniform Trade Secrets Act, customer lists are eligible for protection as trade secrets); *N. Atl. Instruments, Inc. v. Haber*, 188 F.3d 38, 44 (2d Cir. 1999) (under New York law customer lists are protectable as trade secrets); *cf. Nationwide Mut. Ins. Co. v. Mortensen*, 606 F.3d 22, 28 (2d Cir. 2010) (under Connecticut law, customer lists are within the scope of trade secret protection, but a number of the state's courts have noted that they often lie on the periphery of the law of trade secrets) (quotation omitted). In *Wayman Fire Protection*, however, the court was "not persuaded that merely password protecting the Salesforce information at issue here constitute[d] reasonable efforts to protect the confidentiality of that information." 2014 WL 897223, at *16. Wayman protected the Salesforce documents by limiting access to only a handful of employees, each of whom had a Salesforce password that had to be changed every 30-60 days. *Id.* at *8. But limiting access to the documents was not enough: What mattered to the court was whether Wayman's efforts sufficiently conveyed "that the Salesforce information was highly confidential or secret." *Id.* at *16. The Delaware Court of Chancery found that because it was not "inherently obvious" that client names and phone numbers—most of which competitors could easily have found on their own simply by determining which businesses were subject to fire alarm and protection regulations—were confidential, proprietary information, Wayman "should have done something more to impress that fact upon those with access to Salesforce." *See id.* For example, Wayman could have "monitor[ed] its authorized employees' use of Salesforce or restrict[ed] those employees' abilities to download, export, or otherwise transmit Wayman's Salesforce data." *Id.* at *8.

The finding that the password protected files did not qualify for trade secret protection stands out in contrast with the court's other findings on related issues where Wayman established liability. Notably, the defendants conceded liability under Delaware's Misuse of Computer System Information Act. *See id.* at *17 (citing 11 Del. C. § 935). The court specifically found that Premium Fire knowingly retained and improperly used computer data, in violation of the statute. *Id.* at *19. As a consequence, the court awarded Wayman unjust enrichment damages. *Id.* at *29-30. However, the court held that Wayman had not shown any of the defendants acted "wilfully and maliciously" in misusing the computer files, a prerequisite for treble damages under the statute. *Id.* at *19. Furthermore, the court found the computer files which the former employee copied from Wayman and used during the course of his job at Premium Fire were sufficiently "confidential" to trigger a duty of loyalty on the part of the employee. *Id.* at *22; *see also id.* at *20 (noting that under Delaware law, "if an employee in the course of his employment acquires secret information relating to his employer's business, he occupies a position of trust and confidence toward it and must govern his actions accordingly"). Based on that finding, the court concluded that the former employee's misuse of Wayman's confidential information breached his duty of loyalty by benefiting Premium Fire, a direct competitor of Wayman. *Id.* at *22. Thus, the court distinguished both the defendants' unauthorized use of Wayman's information—required to support Wayman's Misuse of Computer System Information Act claim—and the mere confidentiality of the information—required to support Wayman's breach of duty of loyalty claim—from the more restrictive requirement that efforts to maintain secrecy be "reasonable under the circumstances" as required to

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Insurance Litigation Update

No Longer on the Hook for Indemnity: NY Court of Appeals Reverses Decision That Held Insurers Liable to Indemnify Where They Wrongly Refused to Defend a Claim. In a decision last year in *K2 Investment Group, LLC v. American Guarantee & Liability Insurance Co.*, the New York Court of Appeals held that a wrongful failure to defend would result in the insurer being on the hook for indemnity, even if there was no coverage because of an applicable exclusion. The decision sent shockwaves through the insurance industry. Earlier this year, the court granted reconsideration on the ground that even a wrongful failure to defend does not create indemnity where there is none. This reversal brings New York back in line with the predominant rule nationally.

The Original Decision. The New York Court of Appeals handed down its first decision in *K2 Investment Group, LLC v American Guarantee & Liability Insurance Co.,* 993 N.E.2d 1249 (N.Y. 2013), on June 11, 2013. The underlying case concerned a legal malpractice claim brought against a NY attorney. The plaintiff, K2, loaned money to a company which subsequently defaulted on the loan. The NY attorney partly owned that company, and had failed to register K2's mortgages. As a result, K2 faced difficulties in recovering against the assets securing the loan. K2 alleged that the NY attorney had represented it in the transaction and had committed malpractice in failing to register the mortgages.

The NY attorney was insured for malpractice by American Guarantee. American Guarantee refused to defend him, and he suffered a default judgment. American Guarantee later conceded that it was, indeed, required to defend the attorney. The attorney assigned his rights against the insurer to K2, which brought suit against American Guarantee seeking indemnification for the judgment against the attorney.

American Guarantee sought to rely on two exclusions in the policy (the "business enterprise" and the "insured's status" exclusions) to establish that the loss suffered by the attorney was not covered. In its June 2013 decision, the New York Court of Appeals held that the failure of American Guarantee to fulfill its duty to defend the attorney disentitled it from relying on the exclusions in the policy.

The Reversal. The Court was asked to reconsider its earlier decision, and reversed it in an opinion handed down on February 18, 2014: *K2 Investment Group, LLC v. American Guarantee & Liability Insurance Co.*, 983 N.Y.S.2d 761 (N.Y. 2014).

The New York Court of Appeals held that its earlier decision was in error for failing to give regard to a controlling precedent, *Servidone Const. Corp. v. Security Ins. Co. of Hartford*, 477 N.E.2d 441 (N.Y. 1985). In *Servidone*, the Court held that when an insurer wrongfully refuses to defend an insured, that insurer is not precluded from asserting its defences to coverage for indemnity. *Servidone* concerned an insured who had entered into a settlement. The New York Court of Appeals' judgment in *K2* has now confirmed that the same principle applies equally where judgment has been entered against the insured.

Consequences. The June 2013 decision had elicited widespread concern from the NY insurance industry, prompting many insurance associations to file *amicus* briefs. The Court of Appeals' reversal not only brings New York back in line with the predominant national rule, but also removes a precedent that may have proved tempting for courts in other states faced with sympathetic insureds.

Defense Costs at Risk in Australia and New Zealand. Recent developments in Australia and New Zealand have called into question whether insureds can access defense costs to defend a claim against them.

New Zealand and many states in Australia, including New South Wales, have statutes which create charges, in favor of claimants, over insurance funds potentially payable to insured defendants. The provisions were designed decades ago, to address a perceived risk of an insured obtaining a sum from an insurer, and then either disappearing or becoming insolvent. In both situations, even if the claimant obtained a verdict against the insured, the claimant may not recover, or may not recover in full. Until recently, these (somewhat obscure) provisions were rarely considered or invoked.

Liability insurance policies typically provide coverage for the costs incurred by an insured in defending a claim, which are to be paid prior to the resolution of the claim. It is also usual for the limits of the policies to be inclusive of defense costs, meaning that payment of defense costs erodes the limit available to meet any eventual liability. Recent decisions in New Zealand and Australia have considered whether, because the payments erode the limit, they are subject to the statutory charge. If defense costs are subject to the charge, then insurers cannot pay defense costs without subjecting themselves to liability for the payments made. More specifically, if an insurer pays defense costs, and a claimant subsequently establishes liability which exceeds the remaining limit on the policy, then the claimant may enforce the charge against the insurer, thereby requiring the insurer to pay the value of the payments already made. To avoid this issue, an insurer may refuse to pay defense costs.

While the insured could sue on the contractual right to defense costs in response, the existence of the statutory charge may be a valid defense. These issues are now the subject of competing jurisprudence in Australia and New Zealand.

In *Steigrad & Ors v. BFSL 2007 Ltd. & Ors*, [2011] NZHC 1037, the New Zealand High Court held that defense costs could be subject to the statutory charge. The New Zealand Court of Appeal overturned that decision. Subsequently, in *Chubb Insurance Company v. Moore* [2013] NSWCA 212, the New South Wales Court of Appeal considered an effectively identical New South Wales statute. The case was decided on a preliminary issue, such that it was not necessary to consider whether the statutory charge applied to defense costs. That said, the unanimous *obiter dicta* of the Justices was that the statutory charge could not attach to defense costs. Following the New South Wales decision, by a 3:2 majority, the Supreme Court of New Zealand overturned the New Zealand Court of Appeal, holding that the statutory charge could attach to defense costs. In doing so, the Supreme Court of New Zealand commented negatively upon the New South Wales Court of Appeal decision. An appeal from the New South Wales decision was pending before the High Court of Australia, but in March a conditional settlement was announced such that it is unlikely the appeal will proceed.

The clear result, in New Zealand at least, is that the statutory charge can apply to defense costs. The position in Australia is more uncertain: the industry is guided only by the *obiter dicta* of an intermediate appellate court, which has been directly engaged with and rejected by the New Zealand Supreme Court.

The Australian insurance industry has responded by offering separate defense costs only coverage. This approach was endorsed by the New Zealand Supreme Court. The New South Wales Court of Appeal acknowledged that, if the charge did apply to defense costs, splitting the coverage would overcome the problem. However, the Court observed that that "supposed solution" is contrary to "commercial logic." Split coverage encourages insureds to take out more coverage than they may need (for more premium). It also creates a risk that policy funds will be inaccessible to insureds and claimants, because they are available only for defense costs or only to meet liability.

The statutory charge issue continues to be raised in Australia. Insureds would welcome binding precedent or legislative intervention to resolve the current uncertainty. In New Zealand, some commentators are calling for the Supreme Court's decision to be reversed by legislation.

EU Litigation Update

English Court of Appeal Confirms Extra-Territorial Reach of Contempt Proceedings Against Foreign Company Directors:* <u>Dar Al Arkan Real Estate Development Co. and Another v. Al Refai and Others</u> *[2014] EWCA (Civ.) 715, [2014] WLR (D) 239. In a recent decision, the English Court of Appeal has confirmed that the principle against extra-territorial application of legislation does not prevent a committal order being made against a foreign director of a foreign company which has not complied with an order of an English court, and that the English courts have jurisdiction to give permission for service of contempt proceedings out of the jurisdiction. The decision demonstrates that where a company is required by a judgment or order of the English court to take certain action but fails to do so within the time fixed by the judgment or order, or disobeys a judgment or order to refrain from certain action, a committal order may be made against any director or officer of that company even if they are domiciled outside of the jurisdiction.

In this case the Claimants—a Saudi company and a Bahraini bank—brought proceedings for breach of confidence and other torts against the Defendants in England, alleging that the Defendants were pursuing a campaign of blackmail against them. Before commencing proceedings, the Claimants applied *ex parte* for interim injunctive relief. At the injunction hearings, the Claimants gave undertakings, and were subject to a court order, for the preservation of certain computer hard drives and data. The Claimants were subsequently found to be in breach of those undertakings and the court order. In response, the Second Defendant, Kroll Associates UK Ltd, brought contempt proceedings against the Claimants and sought a committal order (under CPR Rule 81.4(3)) against Sheikh Abdullatif as director of both Claimants. Sheikh Abdullatif was not domiciled in an EU Member State, as he was resident in Saudi Arabia. He argued that (i) a committal application could not be made outside the jurisdiction; that (ii) the English courts had no jurisdiction to give permission for service of contempt proceedings out of the jurisdiction; and that (iii) Article 22(5) of the Brussels I Regulation, which confers exclusive jurisdiction on the courts of an EU Member State regardless of domicile in proceedings concerned with the enforcement of judgments, had no application in the present case.

On the first issue, the English Court of Appeal acknowledged the presumption against extra-territoriality, but also noted that the Civil Procedure Rule Committee had the power to make rules with extra-territorial reach. The key issue was therefore the legislative intention behind CPR 81.4(3). The English Court of Appeal held that the intention to give CPR 81.4(3) extra-territorial effect could be inferred from the need to control proceedings brought in England, the need to control participants in such proceedings, and the need to have a means of recourse to discipline companies in contempt of court because of the actions of their directors. The practicability of the enforcement of an order outside the jurisdiction was considered by the English Court of Appeal to be a factor which must be weighed when interpreting a civil procedure rule; however, in the circumstances of this case, it did not outweigh the overriding public interest in the enforcement of judgments, orders, and undertakings in private civil litigation.

With regard to the second issue, the judge at first instance took a pragmatic approach to service of the committal application outside the jurisdiction by other means, namely by granting permission for service in Saudi Arabia with retrospective effect and indicating that, had it been necessary, he would have dispensed with service. The Court of Appeal confirmed that an application for committal was proceeding within the meaning of CPR 6.2 and the application notice in respect of Sheikh Abdullatif qualified as a claim form under CPR 6.36, and therefore gateway (3) of paragraph 3.1(3) of Practice Direction 6B applied, because there was a "real issue" for the court to try and the director was "a necessary or proper party" to the committal application.

Given that the English Court of Appeal allowed the service of contempt proceedings out of the jurisdiction on the basis of CPR 81.4(3) and CPR 6, it did not need to decide the third issue with regard to the correct application of Article 22(5) of the Brussels I Regulation. The first instance judge held on this point that he was bound by the previous English Court of Appeal decision in *Choudhary and Others v Bhattar and Others* [2009] EWCA (Civ) 1176, [2009] WLR (D) 326, even though he concluded that decision was reached *per incuriam* (that is, mistaken). In *Choudhary*, the English Court of Appeal held that Article 22(5) had no application to a defendant not domiciled in an EU Member State. The judge therefore stated that it was not open to him to hold that notice of the committal application could be served on Sheikh Abdullatif under Article 22(5) of the Brussels I Regulation. While it was not necessary for the English Court of Appeal to decide the applicability of Article 22(5), it nonetheless considered it appropriate to express its view, having regard to the judge's decision below and having heard full submissions on the point. The present English Court of Appeal found the reasoning of the judge at first instance compelling, in view of the jurisprudence of the European Court of Justice. Although this part of the judgment is expressed *obiter* and therefore does not resolve the *Choudhary* issue, it must now be doubted that the case is good law.

ITC Litigation Update

ITC Tightens Domestic Industry Requirement for Licensors After Recent Federal Circuit Decisions:* Certain Computers and Computer Peripheral Devices, and Components Thereof, and Products Containing Same, *Inv. No. 337-TA-841 (Jan. 2014). The Commission recently modified its longstanding practice by holding that licensing investments must be tied to articles that practice the patent in order to satisfy the domestic industry requirement. Comm'n Op. at 32 ("*Certain Computers*"). The Commission imposed this "articles" requirement based on recent Federal Circuit decisions. *Id.* at 44.

First, in *InterDigital Communications, LLC v. International Trade Commission*, the Federal Circuit confirmed that the domestic industry requirement may be satisfied by licenses. 707 F.3d 1295 (Fed. Cir. 2013) (denial of rehearing en banc). In doing so, the Federal Circuit stated that a domestic industry under subparagraph (C) of 19 U.S.C. § 1337(a)(3)—which requires a "substantial investment in [the patent's] exploitation, including engineering, research and development, or licensing"—must "pertain to products that are covered by the patent that is being asserted." *Id.* at 1297-98. The Federal Circuit noted that the requirements under subparagraph (C) parallel the requirements under subparagraphs (A) and (B), which have long been understood to require a showing that the investments relate to products that practice the asserted patent. Thus, in order to satisfy subparagraph (C), the domestic industry investments must likewise "exist with respect to articles protected by the patent." *Id.* at 1298. In *Certain Computers*, the Commission found that "the only plausible interpretation of [this] opinion is to impose an 'articles' requirement for subparagraph (C) domestic industries, including licensing-based domestic industries." Comm'n Op. at 32.

Second, in *Microsoft Corporation v. International Trade Commission* (decided after *InterDigital*), the Federal Circuit held that a complainant at the ITC must "provide evidence that its substantial domestic investment—*e.g.*, in research and development—relates to an actual article that practices the patent, regardless of whether or not that article is manufactured domestically or abroad." 731 F.3d 1354, 1362 (Fed. Cir.

2013) (citing *InterDigital*, 707 F.3d at 1299, 1304). Notably, the Federal Circuit decided this case in the context of a domestic industry based on the research and development portion of 19 U.S.C. § 1337(a)(3)(C), but the Commission held that the articles requirement also extends to other types of investments under subparagraph (C), including licensing. *Certain Computers*, Comm'n Op. at 35.

The Commission's decision in *Certain Computers* potentially limits access to the ITC for complainants that would rely on licensing to prove the existence of a domestic industry. These potential complainants include patent assertion entities and other non-practicing entities such as universities, startups, and inventors. The Commission's decision will deny access to the ITC to parties whose licensed patents are not practiced. Thus, potential complainants must: (a) determine if any of their licensees' products actually practice a claim of the asserted patent, and (b) if so, ensure that they can marshal sufficient evidence to make this showing during the investigation. And for those parties whose licensed patents are practiced, the Commission has likely increased the burden and cost of bringing an ITC complaint.

(Noted with Interest continued from page 5)

support a trade secret misappropriation claim.

The court also distinguished the facts of *Wayman Fire Protection* from a strikingly similar earlier case finding that electronic customer lists did qualify for trade secret protection. *Id.* at *14 n.108 (citing *Great Am. Opportunities, Inc. v. Cherrydale Fundraising, LLC*, 2010 WL 338219, at *19 (Del. Ch. Jan. 29, 2010). In *Great American Opportunities*, the electronic customer lists were password protected, but were further addressed in provisions in an employment contract and handbook, and in letters the company sent its employees following termination notifying them of the sensitive and proprietary nature of that information and prohibiting them from disclosing such information both during and after their employment. 2010 WL 338219, at *19. On these facts, the court held that the electronic customer lists qualified for trade secret protection. *Id.* at *20.

The court's opinion in *Wayman Fire Protection*, reaching the opposite conclusion, can be seen as suggesting that passwords have proliferated to the point where typing in a password is no longer adequate to put employees on sufficient notice that the information protected by that password is to be kept secret. This is consistent with the reality that today passwords are no longer reserved only for the most important or confidential information, but are becoming ubiquitous.

Wayman Fire Protection signals that the Delaware court is likely to enforce the burden on trade secret plaintiffs to show that alleged trade secrets are confidential and proprietary—that they are, in fact, secrets. There is no exhaustive list of acceptable methods, but in light of *Great American Opportunities* and *Wayman Fire Protection*, the more traditional instruments such as contracts, handbooks, and post-employment letters are likely to remain important tools in securing protection for trade secrets. At the same time, the *Wayman Fire Protection* opinion confirms that improper use of confidential information by former employees and competitors, even if it does not rise to the level of misappropriation of trade secrets, may establish significant liability for other torts under both statutory and common law claims.

Fourteen Partners Ranked by *Managing Intellectual Property* Magazine

The Quinn Emanuel partners listed below were named "IP Stars" by *Managing Intellectual Property* magazine in its second edition of "IP Stars." These talented individuals were recognized for their "unparalleled examination of the U.S. IP market." The firm itself was also highly ranked for its work in the Bio/Life Sciences, Copyright, ITC, Patent Contentious, and Trademark Contentious areas.

- Peter Armenio (New York, NY)
- Edward DeFranco (New York, NY)
- Jennifer Kash (San Francisco, CA)
- Fred Lorig (Los Angeles, CA)
- Victoria Maroulis (Silicon Valley, CA)
- Dave Nelson (Chicago, IL)
- Raymond Nimrod (New York, NY)
- William Price (Los Angeles, CA)
- Robert Raskopf (New York, NY)
- Andrew Schapiro (New York, NY)
- Claude Stern (Silicon Valley, CA)
- Robert Stone (Silicon Valley, CA)
- Bruce Van Dalsem (Los Angeles, CA)
- Charles Verhoeven (San Francisco, CA)

Quinn Emanuel Helps the Immigrant Defense Project Protect Important Third Circuit Precedent on the "Finality Rule"

The firm helped its pro bono client the Immigrant Defense Project ("IDP") obtain an important tactical victory before the United States Court of Appeals for the Third Circuit on an issue of exceptional importance to the client: preserving the "finality rule" for immigration purposes.

In January 2014, the Third Circuit published *Orabi v. Attorney General* recognizing that the "finality rule" is "alive and well" in the Third Circuit. 738 F.3d 535 (3d Cir. 2014). The finality rule provides that a criminal conviction does not attain a sufficient degree of finality for immigration purposes (and therefore cannot serve as a basis for deportation proceedings) until direct appellate review of the conviction has been exhausted or waived. In reaching its decision, the Third Circuit became the first circuit court to clearly recognize the continued viability of the finality rule since Congress' 1996 overhaul of the immigration laws. *Orabi* positioned the Third Circuit as an important counterweight to several other circuit courts which have held directly, or in *dicta*, that the finality rule did not survive the 1996 amendments. For years, IDP has been working to obtain a precedential opinion of this sort from the circuit courts and considered the *Orabi* opinion vital to the organization's interest in helping to ensure that the harsh consequences of deportation are not visited on immigrants (many of whom are lawful permanent residents with long and established roots in this country) on the basis of criminal convictions that may not withstand appellate review.

Several weeks after the Third Circuit entered its decision in *Orabi*, but before mandate had issued, Petitioner's underlying criminal conviction was affirmed by the Second Circuit. As a result, the Attorney General sought rehearing, asking the Court to vacate altogether its precedential ruling for alleged lack of jurisdiction. Petitioner, whom the government had previously deported to Egypt, could not be located for service. IDP thus asked us to represent them in developing a strategy to oppose the government's efforts to have this important decision vacated. Although the appellate rules do not permit answers to rehearing applications without the Court's permission, we submitted an application seeking leave as *amicus curiae* to formally oppose the government's rehearing request. In that application, we discussed the important policy interests that favor continued recognition of the finality rule and previewed our arguments that the government's contention that events post-dating the Court's opinion stripped the Court of jurisdiction was based on a fundamental misapprehension of Third Circuit law.

On March 27, 2014, relying on the case law we introduced on behalf of IDP, the Third Circuit denied the government's rehearing application, leaving the Court's precedential ruling on finality intact. This decision not only provides a direct benefit to many immigrants who may be threatened with deportation on the basis of wrongful criminal convictions, but stands as an important guidepost in IDP's efforts to have the finality rule recognized in other courts across the nation.

Victory for Entergy Corporation

In the spring of 2014, Quinn Emanuel won a hard-fought victory for Entergy Corporation regarding the Vermont Yankee Nuclear Power Station ("VY Station") in Vernon, Vermont, securing a certificate of public good from the Vermont Public Service Board that grants the VY Station authority to operate through the end of December 2014, and validates the VY Station's operation since the March 21, 2012 expiration date of its previous certificate of public good. This victory brings to a close more than three years of litigation concerning the future of the VY Station.

Pursuant to the Atomic Energy Act, the U.S. Nuclear Regulatory Commission ("NRC") regulates the radiological safety of nuclear power plants and licenses their operation. The VY Station's original 40-year federal license was set to expire in March 2012, but the NRC renewed it for another 20 years, through March 2032.

When Entergy acquired the VY Station in 2002, it agreed to obtain a certificate of public good (in effect, a state license) from the Vermont Public Service Board for any post-March 2012 operation. As relations between Entergy and the State deteriorated over the years, the State Legislature attempted to usurp the Board's authority to issue a certificate of public good for any nuclear power plant in the State by enacting statutes requiring legislative (as opposed to Board) approval for continued operation. Quinn Emanuel first represented Entergy in challenging these State statutes, which the Vermont district court invalidated in a January 2012 judgment that was subsequently affirmed by the Second Circuit in August 2013.

With the statutes invalidated, Quinn Emanuel still had to persuade the Board to issue a new certificate of public good allowing the plant to continue operating. The Board was required under state law to consider whether continued operation of the VY Station would promote the general good of the State of Vermont, giving due consideration to economic benefit from such operation along with, for example, the impact of continued operation on the power grid and the environment. The proceedings included five weeks of evidentiary hearings with dozens of witnesses and hundreds of pages of briefing over more than two years.

In August 2013, during the post-hearing briefing stage of the Board proceedings, Entergy determined that economic conditions (including low power prices as a result of ample natural gas-fueled power) warranted shutting down the plant voluntarily at the end of 2014. Entergy reached a settlement with the State of Vermont that would allow such operation in exchange for certain payments by Entergy, but the settlement still had to be approved by the Board under the "general good of the state" standard. After a final round of evidentiary hearings and briefing, the Board approved the settlement and issued a certificate of public good allowing the plant to continue operating through December 2014 and validating the plant's operation since the March 21, 2012 expiration date of its original certificate of public good.

IPR Victory for Major GPS Navigation Device Manufacturer

The firm recently won a complete victory for its client, a major manufacturer of GPS navigation devices, in one of the first-ever filed and argued *inter partes* review (IPR) proceedings. An IPR is a relatively new, trial-like proceeding which takes place before the Patent Trial and Appeal Board (PTAB) of the U.S. Patent and Trademark Office, and involves taking depositions and presenting evidence to a panel of three administrative patent judges at a hearing. It replaces the *inter partes* reexamination process that was used for many years as a means of invalidating a patent outside of actual litigation.

Quinn Emanuel coordinated across its Tokyo and Los Angeles offices to identify the strongest Japanese and English language prior art references. Working with a technical expert, we presented a report and extensive briefing to explain the complex references that were found. Because depositions are allowed in IPRs, as opposed to the prior *inter partes* reexamination system, we were able to establish a number of key admissions from the opposition's expert that were then used in the invalidation procedure. The IPR culminated in our successful oral argument at the PTAB before a gallery well-attended with legal and automotive industry observers. The IPR concluded when the PTAB issued its final written decision, finding every challenged claim unpatentable and giving our client a total victory.

Precedent-Setting Pro Bono Victory

In a precedent-setting pro bono victory, the firm was able to reduce Damon Penn's prison sentence by over ten years and secure a result of time-served on resentencing. The Supreme Court's decision in *Descamps v. United States*, 133 S. Ct. 2276 (2013), narrowed the class of convictions that served as qualifying predicates for the punitive Armed Career Criminal sentencing enhancement, which meant that many prisoners had erroneously been sentenced to a mandatory minimum prison term of fifteen years.

Damon Penn was one of these prisoners. While trying to earn money to buy his daughter a birthday present, he was pulled over for having a broken taillight. A search of his car revealed a handgun and he was subsequently convicted of illegal possession of a firearm. Based in part on a decade-old misdemeanor assault conviction, he was sentenced in 2010 to fifteen years in prison.

When the Supreme Court in *Descamps* held that convictions such as Mr. Penn's assault conviction could not serve as a predicate for the Armed Career Criminal enhancement, he wrote his own *pro se* habeas petition, but Quinn Emanuel attorneys soon asked to intervene on his behalf, and he obliged. Working in conjunction with the Federal Public Defenders Office for the District of Maryland, Quinn Emanuel submitted a supplemental habeas petition on his behalf. The supplemental petition allowed Mr. Penn to clear the significant hurdles required to obtain habeas relief: (1) the establishment of a new rule of law by the Supreme Court, (2) the retroactive application of that new rule of law, and (3) the entitlement to relief despite having failed to preserve the sentencing error in 2010. Despite maintaining for months that it intended to contest Mr. Penn's habeas petition, the Government soon conceded that Mr. Penn should be resentenced without the Armed Career Criminal enhancement.

At the resentencing, Quinn Emanuel argued for a time-served sentence for three reasons: that *Descamps* forbade the Court from considering the unproven and unadmitted allegations that Mr. Penn had brandished a handgun in connection with the simple assault conviction; Mr. Penn had been a model prisoner; and that even the Government's recommended sentence was equivalent to the time Mr. Penn had already served. The judge ultimately agreed with Quinn Emanuel's arguments that *Descamps* should be extended to prevent the court from using unproven circumstances of prior convictions to enhance sentences outside of the context of mandatory minimums. The judge specifically thanked the Quinn Emanuel attorneys for their thoughtful arguments. Mr. Penn received a sentence of time served, a reduction of over ten years, and walked free the next day to return home to his wife, five children, and ailing mother.

Quinn Emanuel's work product was disseminated to Federal Public Defenders offices across the country, enabling them to seek the same relief for others that we achieved for Mr. Penn. In addition, Mr. Penn's case was one of the first *Descamps*-related habeas cases to proceed to resentencing, so Quinn Emanuel's efforts set favorable precedent for the multitude of cases that will follow. Q

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business litigation report
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