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Cloud Computing: Legal Issues on the Horizon

In the May 2014 issue of the *Business Litigation Report*, we discussed a hot topic in law and technology: cloud computing. That topic did not cool down over the summer. Businesses and courts—including the Supreme Court—have continued to grapple with issues presented by computing in the cloud, including who owns the rights to key cloud computing technologies. Given the increased competition and growth in the cloud computing market, such litigation is likely to continue in the future, and will need to take changing legal rules into account.

The Cloud Computing Market

Broadly defined, "cloud computing" refers to the shared use of computing resources over a distributed computer network. Those resources may include storage, processing, communication, or other computer tasks. The network over which such resources are accessed may be public like the Internet, private like many enterprise IT environments, or a hybrid network combining public and private elements. The business case for shifting computing resources to the cloud is based on the flexibility that cloud computing provides. Instead of needing to buy racks of expensive servers and other equipment as a necessary first step to launching a business, today's startups can order "virtual" IT centers consisting of only the resources they actually need. Servers and other necessary technologies can be provisioned from a shared pool of computing resources almost as quickly as the company needs. The high fixed startup costs faced by many early IT departments, which posed significant barriers to entry in high-tech industries become, instead, "by-the-drink" operational expenses. As the business

(continued on page 2)

INSIDE

Quinn Emanuel Named One of the "Fearsome Foursome" for the Third Time Since 2010

Law360 has once again named Quinn Emanuel as one of the "four firms in-house counsel fear the most." The 2014 "Fearsome Foursome" were selected based on BTI Consulting Group's recent survey of 300 General Counsel and Chief Legal Officers at major corporations. According to the report, the Fearsome Foursome "have a history and a reputation of bringing every single resource to bear for their clients" and "enjoy a decided advantage when the opposing counsel is not part of their cohort." This is the third time Quinn Emanuel has been named to the Fearsome Foursome since 2010. Q

Lori Alvino McGill Honored by the *Washington Business Journal* as a "Legal Champion" and by *The National Law Journal* as One of D.C.'s Top "40 Under 40"

Washington, D.C. partner Lori Alvino McGill was recently recognized by the *Washington Business Journal* as a "Legal Champion" and by *The National Law Journal*'s *Legal Times*, as one of Washington D.C.'s top "40 Under 40." Ms. Alvino McGill was selected based on her professional accomplishments, including her prominent roles in several recent U.S. Supreme Court cases. Last year, she represented the birth mother and adoptive parents of "Baby Veronica," in *Adoptive Couple v. Baby Girl* (2013), both at the U.S. Supreme Court and on remand; and she represented the University of Texas at Austin in a challenge to the University's consideration of race as a factor in undergraduate admissions decisions in *Fisher v. University of Texas at Austin*. Q

Victoria Maroulis Named One of *Law360*'s "Influential Women in IP Law"

See page 11

grows, these "virtual" computing resources can scale accordingly, often rolling out updated or new services with little to no downtime.

Estimating the size of the cloud computing market is complicated by debates over its definition. However the market is defined, it is enormous. For example, Cisco Systems Inc.'s 2014 Global Cloud Index predicts a 23 percent compound annual growth rate in global data center IP traffic from 2013 to 2018, with more than seventy-five percent of that workload being processed in the cloud by the end of that period. One organization reported that resulting global cloud computing service revenue in 2014 could be as high as $209.9 billion, growing to $555 billion by 2020. *See* http://www.investorideas.com/news/2014/technology/08291.asp.

Cloud Computing Players

Historically, cloud computing has been broken into three main segments: Infrastructure as a Service ("IaaS"), Platform as a Service ("PaaS"), and Software as a Service ("SaaS"). These segments are differentiated based on the types of services they provide. IaaS consists of raw computing resources that can be shared among customers. IaaS offerings are highly customizable, but require significant customer involvement to develop and launch. At the other end of the spectrum, SaaS providers offer largely pre-configured applications that can be quickly deployed, but are often significantly limited in the degree to which they can be customized. PaaS lies somewhere in between the radical flexibility of IaaS and the pre-configured offerings from SaaS providers. Some prominent participants and product offerings in each segment are identified below.

IaaS

- Amazon Web Services Elastic Compute Cloud
- CenturyLink
- Google Compute Engine
- Microsoft Windows Azure
- OpenStack
- Rackspace
- Verizon Terremark
- VMWare

PaaS

- Amazon Web Services Elastic Beanstalk
- Cloud Bees
- Engine Yard
- Force.com
- Google App Engine
- Heroku
- IBM SmartCloud
- Microsoft Windows Azure
- OpenShift Online
- Red Hat OpenShift

SaaS

- Dropbox
- Google Apps for Business
- Microsoft Office 365
- Oracle
- Salesforce.com
- Zendesk
- Zoho

As is evident from even a cursory review of these lists, the lines between these categories are blurred, with companies often participating in multiple market segments. Moreover, new forms of cloud computing are emerging to supplement the three basic segments, including Unified Communications as a Service ("UCaaS"), which seeks to offload a firm's various telecommunications functions to cloud resources, and Anything as a Service ("XaaS"), which offers highly customized offerings to suit any customer need. Prominent players in these emerging market segments are listed below.

UCaaS

- Alcatel-Lucent
- Cisco Systems
- CSC
- Hewlett Packard
- IBM
- Microsoft
- Mitel
- Polycom
- RingCentral
- ShoreTel
- Verizon
- Vonage
- Voss
- 8x8

XaaS

- Amazon Web Services
- Hewlett Packard
- IBM
- Microsoft
- Oracle
- SAP AG
- VMWare

The applications for which cloud computing is being utilized are at least as diverse as the participants in the cloud computing market. Cloud technologies can be used for computing functions from basic data storage to complicated analysis of so-called Big Data. Many business functions also have been moved to the cloud, including sales force and inventory management. Cloud computing has engendered a variety of new industry-specific applications, from virtual doctor's appointments and health monitoring to precision agriculture. New cloud-based applications are being developed constantly.

Cloud Computing Standards

The variety of cloud network deployments produced substantial debate among commentators and IT professionals about how to properly define and implement "cloud computing." Recently, national and international standard-setting organizations have also entered the fray, adopting shared definitions and specifications for cloud computing.

For example, in October 2014 the U.S. National Institute of Standards and Technology ("NIST") released the final version of the "US Government Cloud Computing Technology Roadmap." That multi-volume document outlines a plan for implementing the U.S. government's 2011 Cloud Computing Strategy. Many of the NIST recommendations concern the development of consistent standards for cloud computing terminology and practices. In fact, the first NIST requirement is the development of "international voluntary consensus-based interoperability, portability, security, performance, and related standards" for implementing cloud computing technologies. (U.S. Government Cloud Computing Technology Roadmap, Vol. I, p. 5.)

International organizations are heeding the calls of NIST and others to develop shared standards for cloud computing. On October 15, 2014, The International Organization for Standardization and the International Electrotechnical Commission released the first editions of two different cloud computing standards. The first, ISO/IEC 17788, contains an "[o]verview and vocabulary" for cloud computing. The second, ISO/IEC 17789, describes a cloud computing "[r]eference architecture."

As recognized by the NIST requirements, the spread of shared vocabularies and architectures for cloud computing promises to simplify the adoption of cloud computing technologies among public and private organizations. Such standards are likely to continue evolving as cloud technologies are adopted more broadly.

Patenting the Cloud

In order to protect this rapidly expanding list of new technologies, cloud computing companies have actively sought patent protection for their inventions. A November 2013 review of U.S. patents containing the phrase "cloud computing" in their title, abstract, or claims—a methodology likely to underestimate the number of cloud-related patents—revealed nearly 200 patents, held by prominent cloud participants like IBM, Microsoft, Google, SAP, Amazon, and Verizon. *See* http://thoughtsoncloud.com/2014/03/analysis-of-cloud-computing-patent-holders/. Litigation between large market participants has already occurred. For example, Microsoft sued Salesforce.com for patent infringement in 2011; the case has settled.

Large market participants are not the only entities with patents covering cloud technologies. Non-practicing entities ("NPEs") are actively involved in cloud computing patent litigation. For example, SimpleAir, an NPE based in Texas, won an $85 million jury verdict based on cloud messaging patents in 2014. SimpleAir also reportedly settled disputes with other large corporations in the cloud computing space for unspecified sums. NPEs likely will play an increasing role in such litigation in the future. Many cloud computing startups have failed, often selling their patents to NPEs in a last-ditch attempt to monetize their technology.

As a result, a number of cloud computing companies have engaged in defensive maneuvers designed to mitigate the potential for litigation over cloud technologies. This includes both acquiring patents to use in counterclaims as leverage to settle any suits that arise and aggressively challenging the patents of NPEs in courts and at the Patent Office.

One company, Unified Patents, has made organizing such defensive efforts the central focus of its business model. Unified Patents offers a service whereby companies in different technology "Zones" can join together to defend their Zones against NPE litigation. Cloud storage technology is one of the Zones that Unified Patents intends to protect. To do so, Unified Patents pursues a multi-faceted strategy, buying patents related to Zones so that those patents cannot be obtained by NPEs and initiating *inter partes* review proceedings against patents that NPEs have asserted within the Zones. Whether such strategies will effectively deter NPE litigation against cloud computing technologies remains to be seen.

Cloud Computing and the Supreme Court

Three recent decisions by the U.S. Supreme Court are likely to significantly affect the outcome of future patent cases involving cloud computing. Each of these cases was previewed in the May 2014 Business Litigation Report article, but none had yet been decided. This summer, however, the Supreme Court issued its rulings in *Limelight Networks, Inc. v. Akamai Technologies, Inc.*; *Nautilus, Inc. v. Biosig Instruments, Inc.*; and *Alice Corp. v. CLS Bank*. Each of these rulings is likely to benefit defendants facing infringement allegations based on cloud computing patents.

Limelight Networks, Inc. v. Akamai Technologies, Inc., No. 12-786 (June 2, 2014). In this case, Limelight was accused of infringing a patent that claimed a computer-implemented method of delivering data across a content delivery network. One of the steps of the method was performed by Limelight's customers, rather than by Limelight itself, which Limelight contended would preclude its liability for infringement. Quinn Emanuel submitted an *amicus curiae* brief in support of Limelight on behalf of multiple clients. A unanimous Supreme Court found in Limelight's favor, holding that a single actor must perform all the steps of a claimed method for a claim to be infringed directly or indirectly. Given the inherently distributed nature of cloud computing, in which each layer of the service may be provided by a different entity, this ruling is likely to make it more difficult for patent plaintiffs to prevail against cloud computing providers when asserting method patents.

Nautilus, Inc. v. Biosig Instruments, Inc., No. 13-369 (June 2, 2014). This case addressed the validity of a patent covering a heart-rate monitor for use with exercise equipment. Although not concerning a cloud computing technology, the case addressed an issue that has been problematic for computing patents more generally: how to determine whether a patent claim is sufficiently definite under 35 U.S.C. § 112, ¶ 2. The Supreme Court, again unanimously, ruled that "a patent's claims, viewed in light of the specification and prosecution history, [must] inform those skilled in the art about the scope of the invention with reasonable certainty." Defendants will likely use the risk of invalidity under the Supreme Court's new test as leverage in patent suits.

Alice Corp. v. CLS Bank, No. 13-298 (June 19, 2014). This case also involved invalidity issues, although it was squarely focused on computing technology. Specifically, Alice Corporation asserted a patent that claimed a computer-implemented method for mitigating settlement risk by establishing a third-party intermediary to ensure the completion of financial transactions. CLS Bank argued that the patent was invalid because it claimed merely an "abstract idea," which is not eligible for patent protection under 35 U.S.C. § 101. The Supreme Court, again unanimously, applied a two-step inquiry for determining whether a patent claims patent-eligible subject matter. Step one asks whether the claims are drawn to ineligible matter, such as a law of nature, natural phenomenon, or abstract idea. If so, the second step considers each claim element as well as the claim as a whole to determine if something in the claim somehow transforms the claim into patent-eligible matter. The Supreme Court found that the claim at issue in *Alice* merely related to the abstract idea of "intermediated settlement," and the use of a generic computer to implement that idea did not transform it into patent-eligible subject matter. Defendants will no doubt rely on *Alice* and its progeny to attack patents that claim computer-implemented cloud computing technologies. Indeed, the Federal Circuit has already relied upon *Alice* to affirm invalidating a computer-implemented technology patent as a matter of law. *See BuySafe, Inc. v. Google, Inc.*, No. 2013-1575 (Fed. Cir. Sep. 3, 2014) (affirming dismissal of case alleging infringement of patent directed to forming a "transaction performance guaranty" contract using a computer).

Other Cloud Computing Legal Issues

Patent litigation is not the only legal issue faced by cloud computing firms. Several other issues are likely to spawn future litigation as cloud computing becomes increasingly popular and profitable.

Security and Privacy. A chief concern for businesses seeking to migrate some or all their options to the cloud is the security of the data that resides there. Experts continue to debate the relative security of data in the cloud, and firms such as Symantec and Fortinet are actively developing new technologies to safeguard data. As cloud applications extend into areas such as health care, in which the storage and protection of patient data is highly regulated, these security concerns are likely to grow increasingly prominent. Should the security of data stored in the cloud be compromised, affected parties may resort to the courts for redress.

SLA Enforcement. Most cloud computing services are governed by Service Level Agreements ("SLAs"). SLAs tend to include minimum guarantees by the cloud services provider relating to resource availability and operations. Breaches of these agreements can trigger contractual liability. Proposed EU regulations governing SLAs and net neutrality rules in the United States may further complicate service guarantees in the cloud and/or spawn additional litigation concerning their enforcement.

Conclusion

This article has touched on only a few of the legal issues relevant to the continuously evolving cloud computing industry. With the increased adoption of mobile network computing, smartphones, tablets and even wearable technology, cloud computing is certain to remain a prominent issue for both technologists and lawyers.

Stays Pending Covered Business Method Patent Review: *VirtualAgility v. Salesforce.com*

The Federal Circuit's divided decision in *VirtualAgility Inc. v. Salesforce.com, Inc.* is the first major decision from the Federal Circuit interpreting the discretionary stay provision of § 18(b)(1) of the America Invents Act ("AIA") for post-grant review of covered business method ("CBM") patents. 759 F.3d 1307 (Fed. Cir. July 10, 2014). In *VirtualAgility*, a majority of a Federal Circuit panel consisting of Judges Moore and Chen liberally interpreted the AIA's guidance for reviewing a district court's decision on a stay pending CBM review, easing the path to a stay at the district court level. *See generally id.*

In *VirtualAgility*, defendant Salesforce.com ("Salesforce") moved to stay litigation in the Eastern District of Texas pending a CBM review. CBM review is available only for patents that "claim[] a method or corresponding apparatus for performing data processing or other operations used in the practice, administration, or management of a financial product or service." 37 C.F.R. 42.301(a). VirtualAgility ("VA") filed suit in January 2013, alleging infringement of U.S. Patent No. 8,095,413 (the "'413 patent"). *VirtualAgility*, 759 F.3d at 1308. In May 2013, Salesforce petitioned for CBM review, and less than a week later, Salesforce moved to stay pursuant to AIA § 18(b)(1). *Id.* at 1308-09. In November 2013, Salesforce's petition was granted. *Id.*

In January 2014, shortly after the Patent Trial and Appeal Board granted Salesforce's petition for CBM review of the '413 patent, Judge Gilstrap of the Eastern District of Texas denied Salesforce's motion to stay. *Id.* at 1309. On appeal, the Federal Circuit reversed, finding that the factors enumerated in AIA § 18(b)(1) favored granting a stay. AIA § 18(b)(1) provides four factors on which the district court "shall" base a decision to stay pending CBM review:

(A) whether a stay, or the denial thereof, will simplify the issues in question and streamline the trial;

(B) whether discovery is complete and whether a trial date has been set;

(C) whether a stay, or the denial thereof, would unduly prejudice the nonmoving party or present a clear tactical advantage for the moving party; and

(D) whether a stay, or the denial thereof, will reduce the burden of litigation on the parties and on the court.

The Federal Circuit addressed each of the four AIA § 18(b)(1) factors in *VirtualAgility*, in each case considering the district court's methodology and conclusions. The district court concluded that the first § 18(b)(1) factor was neutral or weighed slightly against granting a stay. *VirtualAgility*, 759 F.3d at 1310. The district court reviewed the '413 patent's prosecution history as well as Salesforce's petition for CBM review, and was not convinced that all of the '413 patent's claims would be canceled. *Id.* But the Federal Circuit found that the district court's review of the PTAB's decision was error as a matter of law, holding that any challenge to the PTAB's determination that a patent's claims are "more likely than not" invalid amounts to an improper collateral attack on the PTAB's decision. *Id.* The stay determination is not the proper time or place for such a challenge. *Id.* Once removed from the calculus, the Federal Circuit reviewed the evidence of record and found that the first factor weighed heavily in favor of a stay. *Id.* at 1314. Because the PTAB determined that all claims of the lone asserted patent were more likely than not unpatentable on two independent grounds, the CBM review had the potential to dispose of the entire litigation—the "ultimate simplification of issues"—and the first factor weighed heavily in favor of a stay. *Id.*

The Federal Circuit also found that the second § 18(b)(1) factor heavily favored a stay. *Id.* at 1315-1317. The Federal Circuit determined that it was not clear error for the district court to wait until after the PTAB decided to institute the CBM review before it ruled on the motion to stay. *Id.* at 1315-16. While there is no consistent practice among the various district courts about when a district court must rule on motion to stay pending CBM review, "the case for a stay is stronger after post-grant review has been instituted." *Id.* at 1316. In this case, Salesforce filed its motion to stay mere days after filing its petition for CBM review, less than four months into the litigation as a whole, and the district court waited until after Salesforce's petition was granted before ruling on the motion to stay. *Id.* at 1308-09, 1317. Because "the time of the *motion* is the relevant time to measure the stage of the litigation," the Federal Circuit held that the second factor also heavily favored a stay. *Id.* at 1317 (emphasis added).

The Court then moved on to the third § 18(b)(1) factor. *Id.* Focusing on the direct competition between VA and Salesforce, the district court concluded that

VA, a small company with limited resources, would suffer irreparable harm due to lost market share and consumer goodwill. *Id.* The district court therefore found that the third factor weighed heavily against granting a stay. *Id.* The Federal Circuit disagreed and held that this factor at best weighed *slightly* against a stay. *Id.* at 1318. The Federal Circuit focused on VA's failure to move for a preliminary injunction. *Id.* at 1318-19. The Court acknowledged that there are a number of reasons a party may choose not to move for a preliminary injunction, but concluded that the fact that it was not worth VA's expense contradicted VA's assertion that it needed immediate injunctive relief and would be unduly prejudiced by a stay. *Id.* at 1319. The Court also found that although Salesforce did not include certain prior art in its petition for CBM review, the withholding of prior art was not indicative of any "dilatory motive" which would have counseled against a stay. *Id.* at 1319-20. Although the Court agreed that in some circumstances saving prior art for the district court would counsel against a stay, the facts surrounding the prior art in this case resulted in no clear tactical advantage if the case was stayed. *Id.* Therefore, under the clear error standard, the third factor at best weighed *slightly* against a stay. *Id.*

Lastly, addressing the fourth factor, the district court noted that the parties' arguments substantially overlap with those presented under the first factor, reaching similar conclusions for the fourth factor. *Id.* at 1311. Despite this overlap, the Federal Circuit was clear: the four-factor test expressly adopted by Congress cannot be collapsed into a three-factor test. *Id.* at 1313. Addressing the same facts it did when analyzing the first factor, the *VirtualAgility* Court found that the fourth factor heavily favored a stay as well. *Id.*

The Federal Circuit's decision in *VirtualAgility* was not unanimous. Judge Newman, the third panel member, authored a lengthy dissent criticizing the majority for not fully considering the effects of their broad decision. Judge Newman's dissent in *VirtualAgility* is a reflection of her concern that the majority opinion circumvented the district court's discretionary authority to manage its cases without making a single finding of an abuse of discretion, at least in part because it did not confront the issue of the proper standard of review of a motion for stay pending a CBM review. *Id.* at 1321-22 (Newman, J., dissenting). Judge Newman concluded that the majority's decision "effectively creates a rule that stays of district court litigation pending CBM review must always be granted." *Id.* at 1322. She noted that this "near automatic grant of litigation stays . . . tilts the legislative balance" and leads "to inequity and tactical abuse." *Id.*

The panel majority, however, addressed all four § 18(b)(1) factors at length, performing the fact-specific inquiry into each factor and concluding that when properly weighed a reversal of the district court's denial of a stay was necessary. *Id.* at 1310-20. The majority decision also addressed whether the proper standard was *de novo* review, as suggested by AIA § 18(b)(2) ("such review may be *de novo*"), or abuse of discretion, but declined to rule on the proper standard of review because even under the stricter abuse of discretion standard the district court's decision not to grant a stay must be reversed. *Id.* at 1309-10.

The Federal Circuit's opinion in *VirtualAgility* provides valuable guidance for the approach a party seeking CBM review should take if also seeking a stay. While a stay pending CBM review is not mandatory under AIA § 18, *VirtualAgility* paves the way for an easier road to stays in district court litigations pending CBM review. The Court's nuanced, fact-specific analysis of each of the four § 18(b)(1) factors provides a roadmap by which future parties considering CBM review can increase the likelihood of a district court granting a stay request.

Bankruptcy and Restructuring Update

Bankruptcy Code Section 502(d): Getting Back to Basics. Traders in distressed debt face a myriad of questions and issues when acquiring claims against a company in distress. One common issue that traders should always ensure that they have checked off before proceeding with the consummation of a trade is the risk of disallowance of the claim under Bankruptcy Code section 502(d). 11 U.S.C. § 502(d)

Only "allowed" claims may share in distributions from a debtor's estate. Section 502(d) provides for disallowance of claims where the creditor is in possession of property of the debtor's estate or received transfers that are avoidable as preferences or fraudulent transfers. The section states that, unless the creditor returns the property of the debtor's estate or otherwise pays the amount it is liable for, "the court shall disallow any claim of that entity."

The issue for claims traders is this—if I buy a claim from an entity that has possession of a debtor's property or is the recipient of an avoidable transfer, is my claim subject to disallowance under section 502(d) even if I have done nothing to trigger section 502(d)? A recent Third Circuit case, *In re KB Toys, Inc.*, 736 F.3d 247 (3d Cir. 2013), suggests yes. In *KB Toys*, after the debtor filed for bankruptcy, a claims trader purchased several claims. Each claims trading document provided that if the claim was disallowed, the original claimant was obligated to pay restitution to the trader. As it turns out, each original claimant had received a payment within 90 days of the bankruptcy filing, and the debtor's estate sued each original claimant to recover the preferential payment. Because each original claimant had gone out of business, the debtor's estate obtained default judgments. The estate then objected to the trader's claims under section 502(d), even though the trader itself had not received any avoidable transfers. The bankruptcy court sustained the objection, which the Third Circuit affirmed. The court interpreted the phrase "any claim of any entity" in a manner that focused on the claims, not the identity of the holder of the claim. "Because the statute focuses on claims—and not claimants—claims that are disallowable under § 502(d) must be disallowed no matter who holds them." *Id.* at 252. The court also noted policy concerns—if the claim was not disallowed, the original claimant would profit by selling the claim and the estate would have less money available to distribute to holders of allowed claims (or a bigger claim pool that would dilute recoveries). And the court noted that the trader had accounted for the risks of disallowance in its trading documents. The final nail in the coffin for the claims trader was a definitive statement that claims transferees have no defense to a section 502(d) claim objection even if they took for value and in good faith. *Id.* at 255.

KB Toys is not surprising—over the last ten years bankruptcy courts have increasingly disallowed claims under section 502(d) where the claim had been in the hands of a party that had received an avoidable transfer. But *KB Toys* appears to be the first circuit-level case on the subject, and it leaves no wiggle room for claims traders. Indeed, the Third Circuit rejected the approach adopted by one judge in the Southern District of New York to distinguish between "assignments" of claims and "sales" of claims, *Enron Corp. v. Avenue Special Situations Fund II, LP (In re Enron Corp.)*, 379 B.R. 425, 435-36 (S.D.N.Y. 2007). The *Enron* court had held that an "assignment" of a claim meant the claim could be disallowed under section 502(d), but that a "sale" of a claim may dictate a different result if the seller acquired the claim in good faith.

In light of *KB Toys*, claims traders will likely need to conduct more due diligence (thus increasing their costs and lowering purchase prices) to account for the risks of the claim sellers' possible liability for avoidable transfers and the credit risk of the sellers to either satisfy an avoidable transfer judgment or provide compensation to the claims trader. When acquiring a claim that has not yet been allowed, a claims trader at least should consider:

- Has the seller been listed on the debtor's schedules and statement of affairs as having received payments from the debtor within 90 days before bankruptcy, or otherwise identified as a potential litigation target?
- Is the trade a recourse/put-back trade or a non-recourse trade?
- What remedies are there for breaches of representations and warranties regarding claim allowance or non-receipt of avoidable transfers?
- Should a portion of the purchase price be escrowed pending claim allowance?
- Who defends (and has settlement authority over) an avoidance action brought by the estate?

Securities and Structured Finance Litigation Update

Recent Cases Signal That Victims of Terrorist Attacks May Be Able to Collect Damages from Financial Institutions. A pair of decisions from the United States Court of Appeals for the Second Circuit and United States District Court for the Eastern District of New York recently signaled that victims of international terrorism may be able to seek compensation for their losses from financial institutions that knowingly or willfully funded terrorist organizations. These decisions are the first of their kind and, given the potential implications they hold for institutions that provide financing in regions known for terrorist activities, have generated a substantial amount of interest from (among others) the U.S. government and international financial industry.

In the first case, *Linde, et al. v. Arab Bank, PLC*, 04-cv-2799 (E.D.N.Y.), a jury returned a verdict on September 22, 2014, finding that Arab Bank violated the 1990 Anti-Terrorism Act ("ATA") for funding Hamas and specific Hamas operatives who later injured and killed numerous plaintiffs in suicide bomb attacks. According to the *Linde* plaintiffs, Arab Bank violated the ATA because it failed to abide by the Patriot Act's Know Your Customer provision, which requires a financial institution to run individuals' names by the U.S. Treasury's Office of Foreign Assets Control and other U.S. government blacklists before providing them with financial services. In *Linde*, the individuals to whom Arab Bank provided services were known terrorists on those blacklists, but the English transliterations of their names were misspelled. Arab Bank claimed that this fact and others absolved it of liability; the plaintiffs claimed that Arab Bank either knew of the misspellings or willfully blinded itself to the differences and the individuals' true identities. After receiving jury instructions (among others) that the ATA renders banks liable if their services are a "substantial contributor" to plaintiffs' "reasonably foreseeable injuries," the jury agreed with the plaintiffs and found Arab Bank liable on all counts.

In a similar case, *Weiss, et al. v. National Westminster Bank PLC*, 13-cv-1618 (2d Cir.), the Second Circuit recently reinstated a series of ATA causes of action on behalf of 200 United States nationals who were victims of Hamas terrorist attacks in Israel. The plaintiffs alleged that National Westminster Bank ("NatWest") provided material support and resources to the Palestinian Relief & Development Fund (aka "Interpal"), which allegedly engaged in terrorist activity by soliciting funds and providing support for Hamas. The district court dismissed the plaintiffs' complaint on summary judgment because they did not identify any evidence that NatWest knew or exhibited deliberate indifference to whether Interpal funded "terrorist activities." In reversing the grant of summary judgment, the Second Circuit noted that the ATA only requires a plaintiff to show that NatWest knew or exhibited deliberate indifference to whether Interpal provided material support to a "terrorist organization," irrespective of whether Interpal's support aided terrorist activities of the terrorist organization. Accordingly, based on the plaintiffs' submitted evidence, the Second Circuit held there was a triable issue regarding whether NatWest possessed the necessary scienter with respect to Interpal and Hamas.

Although both of these cases provide never-before-seen precedent regarding financial institutions' liability under the ATA, much remains to be seen about what effect they will have going forward. With respect to *NatWest*, the case is only at the summary judgment phase and has yet to go to trial. Given that the summary judgment standard favors the non-movant—here, the plaintiffs—it may well be that NatWest is able to demonstrate at trial that it did not know, and was not deliberately indifferent to, the fact that Interpal provided material support to Hamas. There may also be other issues NatWest is able to demonstrate at trial that negate the ATA claims.

For its part, Arab Bank is likely to raise several issues on appeal of the *Linde* decision. In a post-trial statement, Arab Bank noted that it believes the *Linde* Court committed several errors, all of which it apparently intends to appeal. The first such alleged error stemmed from Arab Bank's claimed inability to produce documents from certain foreign jurisdictions during discovery. As a sanction for failing to produce the documents, the Court prohibited Arab Bank from introducing evidence at trial regarding its alleged efforts to combat terrorism and/or its efforts to comply with foreign anti-terrorism and money laundering laws. The second error Arab Bank claims is the Court's decision to exclude its expert from testifying on the nature of the "Saudi Committee," from which Arab Bank processed payments to the families of Hamas suicide bombers. (Arab Bank intended to provide testimony that the Saudi Committee is a humanitarian aid program that has never been designated by the U.S. as a terrorist organization.) Third, Arab Bank claims the *Linde* Court applied an improper causation standard under the ATA when it instructed the jury that the plaintiffs needed only to prove that Arab Bank's services were a substantial contributor to plaintiffs' reasonably foreseeable injuries.

As of now, the *Linde* and *NatWest* decisions provide important new precedent for victims of terrorist attacks who seek compensation for their and their loved ones' injuries. Depending on how the cases progress, they may herald a powerful new tool for such victims for years to come.

Life Sciences Litigation Update

MDL Court Strikes Plaintiffs' Experts' Testimony on Human Causation in Zoloft® Products Liability Litigation. This summer, the U.S. District Court presiding over a multi-district products liability litigation issued a pair of *Daubert* rulings striking all of plaintiffs' experts' testimony on human causation. The plaintiffs allege that Zoloft® (sertraline), a prescription medication sold by Pfizer, when taken during pregnancy, caused a wide variety of birth defects in the children born to the exposed mothers. Zoloft is commonly used to treat depression, anxiety, and other mental health conditions. Defendant Pfizer is represented by Quinn Emanuel.

The rulings are significant not only to the Zoloft MDL and other birth defects litigations nationwide, but they emphasize the strategic importance of identifying early in a litigation the procedural mechanisms necessary for the orderly resolution of key disputed issues, and demonstrating to the judge how those procedures will streamline litigation so that the court institutes them.

The mechanism identified in the Zoloft MDL was a two-phased *Daubert* proceeding in which general causation issues—applying across the board to the entire MDL docket—would proceed first, from discovery through *Daubert* rulings, and then be followed by specific-causation expert discovery in trial pick cases and *Daubert* motions, if necessary.

Following this sequence, including the exchange of expert reports on general causation, expert depositions, and briefing on Pfizer's *Daubert* motions (plaintiffs did not file any *Daubert* motions of their own), the court convened a seven-day hearing in April 2014 to hear first-hand from the four well-credentialed experts that Pfizer had challenged in their *Daubert* motions.

Plaintiffs' chief expert on general human causation was Anick Bérard, Ph.D., a perinatal pharmacoepidemiologist from the University of Montreal. She opined that the epidemiological literature supported that Zoloft, a selective-serotonin reuptake inhibitor ("SSRI"), is capable of causing a wide variety of birth defects impacting nearly every organ system in the human body. Plaintiffs also presented three other well-credentialed experts to testify regarding a supposed biological mechanism by which Zoloft could cause the myriad injuries at issue in the litigations.

In a *Daubert* ruling issued June 27, 2014, the district court held that Dr. Bérard's conclusions were only possible because she deviated from established epidemiological methods. The court also held Dr. Bérard failed to acknowledge and distinguish, or otherwise address, research findings contrary to her litigation opinion, including her own peer-reviewed, published research: "Dr. Bérard takes a position in this litigation which is contrary to the opinion she has expressed to her peers in the past, relies upon research which her peers do not recognize as supportive of her litigation opinion, and uses principles and methods which are not recognized by the relevant scientific community and are not subject to scientific verification." And, to find her "associations," Dr. Bérard improperly "cherry-picked" the studies, and findings within the studies, that she said supported her opinions, while ignoring other data that do not show that Zoloft causes such defects. *In re Zoloft (Sertraline Hydrochloride) Products Liab. Litig.*, __ F. Supp. 2d __, 2014 WL 2921648, MDL No. 2342 (E.D. Pa. June 27, 2014).

In a second *Daubert* ruling, issued August 12, 2014, the court addressed the three experts plaintiffs proffered on biological mechanism. The court noted that while these experts cited animal studies supporting their opinions, they did not address the absence of similar findings in humans or consider possible alternative explanations: "The court cannot allow unscientific speculation to be offered, even by genuinely talented scientists," the opinion said. "The court holds that the evidence upon which the experts rely in their reports is not sufficient to support a non-speculative opinion that Zoloft can cause birth defects in humans when used at conventionally prescribed doses."

The court further noted that the three 'mechanism' experts had never published their litigation opinion in peer-reviewed journals and that their theories were not generally accepted in their fields. The court also noted that the experts had failed to explain why the epidemiological data involving pregnant women who took Zoloft failed to show a link between Zoloft and defects in humans. In striking all testimony on human causation, the court held: "Here, the experts have given scant attention to the epidemiology research in their reports, and have failed to reconcile inconsistent epidemiological evidence with their opinions on human causation." *In re Zoloft (Sertraline Hydrochloride) Products Liability Litig.*, __ F. Supp. 2d __, MDL No. 2342, 2014 WL 3943916 (E.D. Pa. Aug. 12, 2014).

While striking all of plaintiffs' experts' testimony on human causation, the court held that certain opinions of the three mechanisms experts about biological plausibility based on the experimental animal studies otherwise met the *Daubert* test and were "generally reliable," and would not exclude them "*if they are otherwise admissible...*" (emphasis added). In fact, the court's June 2014 opinion noted that biological plausibility is irrelevant absent predicate epidemiological evidence, which plaintiffs lack: "the Court notes that the biological mechanism research does not, at this time, establish: 1) that each of the three developmental pathways hypothesized to be impacted by serotonin exist in humans; 2) the ideal range of serotonin in the developing organism (of any species); or 3) the range of serotonin present in the developing embryo when a pregnant woman is exposed (or unexposed) to Zoloft in pregnancy. In addition to the many unanswered questions about the proposed mechanism, *in vitro* and *in vivo* animal studies are 'unreliable predictors of causation in humans,' in the absence of consistent data from human epidemiologic studies." *In re Zoloft* , __ F. Supp. 2d. at ___, 2014 WL 2921648, at *11.

Following the Zoloft rulings, the plaintiffs have sought to name a new expert on general causation, Pfizer objected, and the parties are continuing to brief this issue. It remains to be seen whether the district court will reject plaintiffs' "*Daubert* 'do-over'" request and allow Pfizer to seek summary judgment dismissing plaintiffs' cases for lack of general causation—an essential element of each of their claims. In any event, the careful analyses undertaken by the court in its two Zoloft rulings will certainly be useful for other *Daubert* challenges on general causation opinions.

VICTORIES

Class Action Victory at Pleading Stage

The firm won a complete victory for ADT Security Services at the pleading stage of a putative California-wide class action. Plaintiff alleged that ADT violated California's Alarm Company Act by not informing customers of alarm system permits required by many local jurisdictions. Plaintiff also alleged that ADT violated local ordinances in many California jurisdictions by not obtaining permits for customers who failed to do so themselves. As a result, plaintiff asserted claims under consumer protection statutes and related common law doctrines.

The firm defeated all plaintiff's claims on demurrer. First, Quinn Emanuel obtained a ruling construing the Alarm Company Act, as a matter of first impression, such that ADT's disclosures of alarm permit requirements satisfy the statute. Plaintiff argued ADT was obligated to disclose the exact amount of the permit fee in each of the over 120 California jurisdictions that have alarm permit requirements. Based on the statutory text, the Los Angeles Superior Court disagreed and held ADT's disclosure of the potential for local permit requirements sufficient.

Second, in the same order, the firm obtained a ruling that plaintiff could not assert claims against ADT under the Los Angeles Municipal Code. Plaintiff, having signed a contract with ADT making it his responsibility to obtain any necessary alarm permits, sought to impose liability on ADT because it did not obtain a permit for him when he failed to do so. The Court held plaintiff authored his own harm by failing to obtain a permit and thus could not assert claims against ADT.

In the absence of a proposed amendment to cure the defects in plaintiff's complaint, the Court further denied plaintiff leave to amend, resolving all claims in ADT's favor.

Victory for Pinterest on Idea Theft Claim

The firm recently obtained dismissal with prejudice of a "Winklevoss-type" claim for Pinterest. In late 2012, plaintiff Theodore F. Schroeder, the owner of a now defunct website called Rendezvoo.com, filed a complaint in federal court, alleging that he and his fellow Rendezvoo.com co-founders originally developed the idea for a website very similar to the Pinterest.com website. The complaint went on to allege that the idea for their site was stolen from plaintiffs by one of their former partners who, they contended, then gave the idea to Pinterest's founders. The complaint brought claims for trade secret misappropriation and other related claims.

After the complaint was dismissed for lack of subject matter jurisdiction, plaintiffs subsequently re-filed the action in state court. The firm then moved to dismiss plaintiffs' complaint, and after briefing by the parties, Justice Melvin Schweitzer of the New York Supreme Court—Commercial Division granted Pinterest's motion to dismiss in its entirety, and dismissed Pinterest from the case with prejudice. In granting the motion to dismiss, Justice Schweitzer credited Quinn Emanuel's argument that plaintiffs' purported trade secrets were not protectable in the first instance, as plaintiffs had previously made them public through their Rendezvoo.com website. The Court also sided with Quinn Emanuel in finding that plaintiffs did not sufficiently allege any relationship between plaintiffs and Pinterest as was required to sustain plaintiffs' other claims for unjust enrichment and misappropriation of skills and expenditures. And finally, the Court found that plaintiffs had demonstrated no bad faith, corporate espionage or other misconduct by Pinterest, as was needed to support plaintiffs' claims.

International Arbitration Victory

On October 10, 2014, the firm's client, Core Carbon Group of Copenhagen, Denmark, received the Final Award of the Tribunal in the Stockholm Chamber of Commerce (SCC) arbitration it has pursued against Russian entities Rosgazifikatsiya (Rosgaz) and Centregasservice since early 2013. A distinguished international arbitral Tribunal made up of Peter Leaver QC (chair), Prof. Michael Reisman and Adv. Per Runeland found in favor of Core Carbon on all substantive issues and awarded the client in excess of $150 million in damages, together with the full amount of its legal costs and all of the costs of the arbitration.

This dispute arose out of projects into which Core Carbon had entered with the Russian parties in 2005 for the financing and implementation in Russia of carbon emission reduction projects under the Kyoto Protocol to the United Nations Framework Convention on Climate Change. Under the project contracts, Core Carbon agreed to provide many tens of millions of dollars of project financing, as well as expertise and equipment, in order to identify, measure and repair leaks in the ageing gas pipeline network that snakes across vast tracts of Russia. Those leaks were allowing harmful methane gasses to escape into the atmosphere, and the Kyoto Protocol introduced a mechanism whereby foreign investors were encouraged to invest in projects aimed at reducing such harmful emissions in exchange for the ability to generate carbon credits—so called "ERUs"—according to the volume of emission reductions achieved. Those carbon credits could then be traded in the international markets, allowing such investors to generate a return on their investments.

Core Carbon complied fully with its obligations under the project contracts and, in the period from 2005 to 2008, very substantial work was carried out, all financed by Core Carbon, as a result of which more than 150,000 individual pipeline components were repaired, and gas emissions were reduced by around 8 million tons per year. The emission reductions were carefully recorded and subjected to close scrutiny by independent expert agencies approved by the United Nations. The work was a resounding success. All that was needed in order for ERUs to be earned, and for Core Carbon to generate the profits from the projects to which it was entitled, was for those projects to be registered with the appropriate Russian authorities.

But that was not to be. At this critical point, the Russian parties withdrew their support for the projects, as well as their cooperation with the client, refusing to pursue the projects' registration with the Russian authorities, which only they could effect. Core Carbon tried for years to break the deadlock and to get the projects back on track for registration, but to no avail. Finally accepting that it had to give up on the projects ever being registered and on earning ERUs, in late 2012, Core Carbon terminated the project contracts and instead sought payment from the Russian parties of the termination costs to which it was entitled in such a scenario. But its requests for payment went unfulfilled. Quinn Emanuel was retained and the arbitration proceedings before the SCC swiftly followed.

In those proceedings, in a desperate attempt to avoid its obligations to Core Carbon, Rosgaz constructed its defense around sweeping allegations of fraud and corruption in the underlying projects, in which it accused Core Carbon of being complicit. Amongst its tactics, Rosgaz produced documents of questionable authenticity, argued that signatures on project contracts had been forged, and instigated criminal proceedings into the alleged fraud in Russia. Core Carbon and its legal team had to painstakingly deconstruct each of those allegations, and dismantle Rosgaz' evidence, in order to show the fallacy in the defense and establish the credibility and bona fides of Core Carbon's claims before the Tribunal.

In October 2014, little more than two months after the final hearing in late July, the Tribunal issued its Award, handing overwhelming victory to Core Carbon and vindicating the good work it had done on these very challenging projects in Russia. Q

Victoria Maroulis Named One of *Law360*'s "Influential Women in IP Law"

Quinn Emanuel partner Victoria Maroulis has been named one of the 20 most influential women in IP law by *Law360*—"a select group of female attorneys who are leading the charge in waging high-stakes patent battles, managing billion-dollar portfolios and closing mega IP deals." *Law360* recognized Ms. Maroulis for her key role in the smartphone patent wars between Samsung and Apple and her accomplishments on behalf of Genentech Inc., for which she has won two noteworthy Federal Circuit rulings. *Law360* noted Ms. Maroulis' ability to balance a successful career while raising a family of three children. "[Ms. Maroulis] credits the 'meritocracy' at Quinn Emanuel for allowing her to rise to the top based on talent." The firm has always championed female leaders and currently has 15 female practice area heads and office heads, including Ms. Maroulis who serves as both Co-Chair of the firm's National Life Sciences Practice and Co-Managing Partner of its Silicon Valley office. Q

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