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Managing the Growing Fallout from the Coronavirus—Contractual Non-Performance Defenses Around the World

By almost any measure, the novel coronavirus pandemic appears poised to eclipse anything the global markets have ever seen in terms of business disruption. Countries, states, localities, and entire industries have come to a standstill in an effort to prevent the spread of COVID-19. Stock markets have turned wildly volatile and have erased trillions of dollars in value. Even as China appears to have gained some control over the virus, reports indicate that its industries face severe challenges ahead. As of the time of this publication, the Chinese government already has issued thousands of force majeure certificates and high-profile businesses like CNOOC, Total, and Shell have declared force majeure events regarding receipt of natural gas shipments. Global production lines have been shut down or throttled and material and labor shortages are further disrupting contracts around the world. Law firms are inundated with questions from clients struggling with never-anticipated difficulties that may prevent them from fulfilling their contractual obligations.

Although the COVID-19 pandemic appears to be charting new ground, this article reviews the traditional approaches taken by courts when presented with unforeseen events that render contractual performance difficult or impossible. Despite differences across jurisdictions, courts facing these difficult circumstances typically evaluate whether contractual performance can be excused under three broad legal doctrines: (1) impossibility (common law force majeure); (2) hardship (impracticability); or (3) contractually defined supervening events (*i.e.*, "force

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INSIDE

Three Partners Named "Litigator of the Week" by *The American Lawyer Litigation Daily*

Jim Asperger, Kevin Johnson, and Bill Price were named "Litigators of the Week" in *The American Lawyer* for successfully representing the California Institute of Technology ("Caltech") in a patent infringement lawsuit against Apple and Broadcom that awarded Caltech $1.1 billion in damages. This is the sixth-largest patent verdict of all time. Q

Quinn Emanuel Is Ranked One of the Top-10 Firms for PTAB Litigation

A new report from *Lex Machina* ranked Quinn Emanuel one of the top-10 firms for Patent Trial and Appeal Board (PTAB) litigation. Quinn Emanuel represented clients in 362 cases before the PTAB between 2012 and 2019, including 144 cases in which the firm represented petitioners and 218 cases in which it represented patent owners. Q

Quinn Emanuel Awarded *Law360*'s "Practice Group of the Year" in Two Practice Areas

Law360 selected Quinn Emanuel as a winner of its "Practice Group of the Year" award for 2019 in two practice areas: Telecommunications and Trials. *Law360* highlighted the firm's work for Qualcomm in "in the trenches of the Apple-Qualcomm patent wars," Samsung in "a sprawling cross-licensing dispute with Chinese phone behemoth Huawei," and Olaplex in a patent infringement trial against L'Oreal. Q majeure" or "vis major" contractual clauses). This article explains how each of these doctrines has been applied under various civil law and common law regimes.

I. Impossibility Defenses

The term force majeure (force major, equivalent to *vis major* in Latin) is a French term that was incorporated into the original Napoleonic Civil Code. Today, in both civil law and common law systems, force majeure is a defense to a breach of contract action that excuses a party from its contractual obligations because performance has been rendered impossible. The following discussion addresses how various code-based and common law jurisdictions address and evaluate force majeure and similar impossibility defenses.

French Law. In the French civil code, force majeure is defined as a contractual excuse when unforeseen events prevent performance. Specifically, Article 1218 of the French Civil Code provides:

> In contractual matters, there is force majeure where an event beyond the control of the obligor, which could not reasonably have been foreseen at the time of the conclusion of the contract and whose effects could not be avoided by appropriate measures, prevents performance of his obligation by the obligor.
>
> If the prevention is temporary, performance of the obligation is suspended unless the delay which results justifies termination of the contract. If the prevention is permanent, the contract is terminated by operation of law and the parties are discharged from their obligations ...

When interpreting Article 1218, French courts have rarely found that an epidemic event is sufficient to invoke a force majeure defense. For example, in 1998, a French court held (CA Paris, Sept. 25, 1998, 1996/08159) that a minor plague epidemic did not constitute force majeure because a preventive treatment was available. The same court, however, held that the 2013 Ebola epidemic could constitute force majeure (CA Paris, Mar. 17, 2016, 15/04263), but only if non-performance was a direct result of the epidemic. And a separate French court held that a chikungunya virus epidemic in the French Caribbean did not constitute force majeure because the disease was widely known and non-lethal (CA Basse-Terre, Dec. 17, 2018, n°17/00739).

The current pandemic, however, appears to be readily distinguishable from the epidemics at issue in these cases. Unlike the plague or chikungunya, the coronavirus is new, fast spreading, potentially lethal, and has no known cure. For those reasons, the French government already has declared the coronavirus outbreak a force majeure event for government contracts.

German Law. Section 275 of the German Civil Code codifies force majeure principles and states: "A claim for performance is excluded to the extent that performance is impossible for the obligor or for any other person."

Under German law, a force majeure event only excuses performance of contractual obligations where circumstances beyond the parties' control have permanently rendered performance impossible. Temporary impediments to contractual performance, which could be removed prior to the deadline for performance, do not excuse a party from performing its obligations. German courts scrutinize the facts of each case to determine if an unexpected event has permanently rendered performance impossible.

Chinese Law. Under Chinese law, force majeure principles have been recognized and codified under the term *bu ke kangli* in the General Principles of Civil Law and Contract Law. The main Contract Law provisions are:

Article 117

> If a contract cannot be fulfilled due to force majeure, the obligations may be exempted in whole or in part depending on the impact of the force majeure, unless laws provide otherwise. If the force majeure occurs after a delayed fulfillment, the obligations of the party concerned may not be exempted.
>
> Force majeure as used herein means objective situations which cannot be foreseen, avoided or overcome.

Article 118

> Either party that is unable to fulfill the contract due to force majeure shall notify the other party in time in order to reduce losses possibly inflicted to the other party, and shall provide evidence thereof within a reasonable period of time.

The SARS epidemic that began in 2002 presented Chinese courts with myriad *bu ke kangli* claims. Courts in Beijing and Guangdong instructed trial courts to apply the *bu ke kangli* doctrine to epidemic-related disruptions when: (1) the parties entered the disputed contract before the epidemic arose (such that it was unforeseeable); and (2) the epidemic's supervening effects did not occur after an inexcusable delay in contractual performance. In 2003, the Chinese

Supreme Court instructed lower courts to apply the *bu ke kangli* doctrine any time a party is unable perform its contractual obligations due to measures adopted by the government to address an epidemic.

On February 7, 2020, the Fangshan District Court in Beijing issued a release recommending that courts follow the Chinese Supreme Court's 2003 guidance when evaluating contracts affected by the coronavirus pandemic. The District Court noted, however, that non-performance caused by negligence on the part of the non-performing party should not be excused.

UN Convention on Contracts. The United States, China, and 91 other countries have adopted the United Nation's Convention on Contracts for the International Sale of Goods (CISG). The CISG commonly is the default law governing contracts with Chinese parties concerning the international sale of goods, and it contains what is widely recognized as an impossibility defense. Specifically, Article 79 of the CISG states in relevant part:

> (1) A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.
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> * * *
>
> (3) The exemption provided by this article has effect for the period during which the impediment exists.
>
> (4) The party who fails to perform must give notice to the other party of the impediment and its effect on his ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, he is liable for damages resulting from such non-receipt.

The protections available under Article 79 of the CISG are generally considered to be equivalent to force majeure under French law. When litigating under a CISG provision, however, the forum in which a matter is tried will be a factor because a particular jurisdiction may be influenced by the peculiarities of its local law and norms.

U.S. Common Law. In U.S. courts, the term "force majeure" typically refers to an express contractual provision rather than a common law defense. The common law doctrine of impossibility, however, may excuse performance when performance has been rendered impossible by an unforeseeable event.

The impossibility doctrine under U.S. law traces its roots to the English case of *Taylor v. Caldwell*. In *Taylor*, a fire destroyed a music hall, which made it impossible for a musician to fulfill his contractual obligations to perform. The music hall likewise could not fulfill its obligation to supply a venue for the musician's performance. The Queen's Bench appellate court held that both parties were excused from performance because the fire rendered all future performance impossible.

U.S. courts have applied similar principles to excuse performance of contractual obligations when intervening, unexpected events make performance impossible. For example, in *Kel Kim Corp. v. Cent. Markets, Inc.*, 70 N.Y.2d 900 (1987), New York's Court of Appeals held:

> Impossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible. Moreover, the impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract.

Courts in the U.S. have taken a restrictive view on the impossibility defense. For instance, in *United States v. Gen. Douglas MacArthur Senior Vill.,* 508 F.2d 377 (2d Cir. 1974), the Second Circuit held that "[d]ischarge under this doctrine has been limited to instances where a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party." Courts also look at how the parties allocated risk in their contracts; if the risk of impossibility was allocated on the face of the contract, courts are unlikely to excuse performance based on the common law doctrine of impossibility.

English Common Law. In England, the impossibility defense falls squarely under the doctrine of frustration of purpose (which is discussed below). Like in the U.S., the doctrine is strictly construed by English courts, which tend to look closely at the issue of allocation of risk under the parties' contract and whether the entire value of the contract to the party seeking relief has been negated.

Other East Asian Law. Like French, German, and Chinese law, the civil law-based systems of Japan, South Korea, and Taiwan also provide for codified impossibility doctrines. The common law jurisdictions of Hong Kong and Singapore, however, follow the English lead excusing performance based on impossibility or frustration of purpose, but strictly applying those doctrines.

II. Hardship Defenses

Even where contract performance is not impossible, courts may excuse performance or alter a party's contractual obligations when extreme circumstances render performance unforeseeably difficult. The discussion below provides an overview of the circumstances in which courts in various jurisdictions might excuse performance or reform contractual obligations based on a claim of hardship.

French Law. In 2016, amendments to the French Civil Code codified a hardship defense under French Law. Article 1195 to the French Civil Code now states:

> If a change of circumstances that was unforeseeable at the time of the conclusion of the contract renders performance excessively onerous for a party who had not accepted the risk of such a change, that party may ask the other contracting party to renegotiate the contract. The first party must continue to perform his obligations during renegotiation.
>
> In the case of refusal or the failure of renegotiations, the parties may agree to terminate the contract from the date and on the conditions which they determine, or by a common agreement ask the court to set about its adaptation. In the absence of an agreement within a reasonable time, the court may, on the request of a party, revise the contract or put an end to it, from a date and subject to such conditions as it shall determine.

There is little case law interpreting this provision and it remains to be seen how French courts might apply it to a pandemic. Given the massive disruption caused by the COVID-19 pandemic, it would be reasonable for French courts to seriously consider whether Article 1195 excuses contractual performance where the coronavirus pandemic has made contractual performance particularly onerous. The hardship doctrine could be useful when the conditions for the force majeure doctrine under the French Civil code are not satisfied. For instance, a party that has the ability to perform its obligations despite the massive disruption caused by the pandemic (hence negating force majeure), may ask a court to reform the terms of an agreement if performance becomes "excessively" more expensive or difficult than anticipated at the time of contracting. Still, given the lack of precedent, how the French courts will rule in any particular case is difficult to predict.

German Law. Germany's hardship doctrine, which dates back to the period of hyperinflation between the two world wars, is codified in Section 313 of the German Civil Code. Section 313 states:

> (1) If circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration.
>
> (2) It is equivalent to a change of circumstances if material conceptions that have become the basis of the contract are found to be incorrect.
>
> (3) If adaptation of the contract is not possible or one party cannot reasonably be expected to accept it, the disadvantaged party may revoke the contract. In the case of continuing obligations, the right to terminate takes the place of the right to revoke.

Like the doctrine reflected in the French Civil Code, courts apply Germany's hardship doctrine to reform a contract to account for a newfound hardship that was not anticipated at the time of contracting.

Chinese Law. In 2009, the Chinese Supreme Court (acting in a quasi-legislative capacity) adopted a hardship doctrine under the term *qingshi biangeng*. The *qingshi biangeng* doctrine provides:

> After formation of a contract, if an objective situation occurs that the parties could not foresee at the time of contracting, and that is a major change which is not force majeure and does not qualify as a commercial risk, rendering continued performance of the contract manifestly unfair to one party or rendering its purpose unattainable, upon a request by a party to vary or terminate the contract, a court should confirm whether to vary or terminate the contract, in accordance with principles of fairness and taking into account the actual circumstances of the case.

Since the COVID-19 outbreak, lower courts in China, such as the Heilongjiang province court system, have issued guidance indicating that *qinshi biangeng*, like *bu ke kangli*, should be available for reformation or rescission of contracts affected by the pandemic. The court's guidance, however, also indicated that these doctrines should be applied only to unforeseeable events, which means, as a general matter, they will not be available for contracts executed after the current crisis became known.

CISG. Although practitioners generally agree that the CISG does not provide a contractual hardship defense, some courts and tribunals have applied Article 79 (related to impossibility) in hardship circumstances. Whether a particular tribunal will apply Article 79 to mere hardship depends on the tribunal that is presiding over the particular case.

U.S. Law. The U.S. common law doctrine related to hardship is often called impracticability or frustration of purpose, and it again traces its roots to an English case, *Krell v. Henry*, 2 KB 740 (1903). In *Krell*, a tenant rented a premises overlooking the route for the coronation procession of King Edward VII. King Edward VII became ill and the procession was cancelled. The court held that the tenant was excused from his duty to pay rent because he could no longer receive his bargained-for benefit (a view of the coronation procession).

The principles underlying that decision are now reflected in Section 261 of the Restatement (Second) of Contracts and Article 2 of the Uniform Commercial Code (UCC), which has been adopted in nearly identical form by all U.S. states to govern contracts relating to the sale of goods.

Section 615(b) of the UCC provides that delayed delivery is excused when "performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made. . . ." Section 615 does not, however, extend to conditions or events that reasonably should have been anticipated by the parties at the time of contracting. For example, Comment 4 to UCC § 615 references *Ford & Sons Ltd. v. Henry Leetham & Sons Ltd*, 21 Com. Cas. 55 (1915), another English case, which held that routine changes in market prices are not a cognizable contractual hardship. On the other hand, a severe shortage of necessary materials caused by an unforeseeable, extreme event may create a hardship excuse. The outcome of any hardship defense will depend on the specific language of the contract at issue. For instance, in *N. Indiana Pub. Serv. Co. v. Carbon Cty. Coal Co.*, 799 F.2d 265, 267 (7th Cir. 1986), the Seventh Circuit held that the presence of a price floor and absence of a price ceiling in the parties' contract meant that the risk of price escalation had been passed on to the buyer, regardless of potential hardship caused by changes in market conditions.

A similar doctrine, frustration of purpose, may excuse performance where an unforeseeable event renders the mutually understood purpose of the contract worthless to one contracting party. The doctrine of frustration of purpose is embodied in Section 265 of the Restatement (Second) of Contracts, which states:

> Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.

Courts applying Section 265 hold that when an unforeseeable event "makes one party's performance virtually worthless to the other, frustrating his purpose in making the contract," performance may be excused. *See, e.g., PPF Safeguard v. BCR Safeguard Holding*, 85 A.D.3d 506, 508 (N.Y. App. Div. 1st Dep't 2011 (citing Restatement (Second) of Contracts § 265 comment a)).

The Restatement further indicates that the frustrated purpose has to be the *sine qua non* of the contract, as understood by both parties at the time of contracting. For example, in *Rembrandt Enterprises, Inc. v. Dahmes Stainless, Inc.*, No. 5:15-CV-4248-LTS-KEM, 2017 WL 3929308 (N.D. Iowa Sept. 7, 2017), a large-scale farming enterprise sought to be excused from a contract to purchase a USD 9 million industrial egg dryer, which was part of its plans for an expansion of its operations. The farming enterprise canceled its expansion plans after the Avian flu forced it to cull half of its chickens and caused it to lose a lucrative contract to supply eggs to Kellogg. The purchaser sought to avoid its obligations, and the district court found that a force majeure clause in the parties' contract was not triggered because performance was not impossible. The court nonetheless allowed the case to proceed to trial on the issue of frustration of purpose, finding sufficient evidence to show that both parties might have understood the purpose of the contract was to support the purchaser's expansion of operations to meet demand from the anticipated Kellogg orders.

English Law. Under English law, hardship alone is not an excuse for performance, but frustration of purpose has been recognized as far back as *Krell v. Henry* (1903). The House of Lords Appellate Committee's decision in *National Carriers Ltd v. Panalpina (Northern) Ltd.*, 1 AC 675 (1981), formulated the doctrine as follows:

> Frustration of a contract takes place when there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances; in such case the law declares both parties to be discharged from further performance.

National Carriers involved a 10-year lease for a warehouse, which was interrupted by a government closure of the road leading to the warehouse that lasted for 20 months. Despite the severe interruption, the court held that the doctrine of frustration of purpose was not triggered because the road would be re-opened three years prior to expiration of the lease. And unlike the relief available under French and German law to address hardship claims, the frustration of purpose doctrine under English law is not available to rewrite a contract to account for a temporary change in circumstances. Indeed, the reluctance of English courts to excuse contractual duties was explained recently by the English High Court in *Canary Wharf (BP4) T1 Ltd. v. European Medicines Agency* (2019) EWHC 335 (Ch): "[S]ince the effect of frustration is to kill the contract and discharge the parties from further liability under it, …[it] must not be lightly invoked and must be kept within very narrow limits."

Other East Asian Law. Hardship doctrines similar to those in the German Civil Code are available in the civil law systems of Japan, South Korea, and Taiwan. Hong Kong and Singapore, however, follow English law that hardship alone is not sufficient to excuse nonperformance.

III. Supervening Event Clauses

It is commonplace for contracts to contain express "force majeure" or "vis major" clauses. These clauses typically list events including acts of God, terrorist attacks, inclement weather, union strikes, riots, and wars which can excuse or modify contractual obligations. Some contracts also contain a separate hardship clause, which is often called a "material adverse change" or "material adverse effect" clause, which likewise can change a party's obligations or release a party from obligations it has not yet performed.

Courts in different jurisdictions take different approaches to the interpretation of express force majeure clauses. U.S. and English courts, for example, are reluctant to offer broad interpretations of force majeure provisions. In England, under the leading case of *British Electrical and Associated Industries (Cardiff) Ltd v. Patley Pressings Ltd.* (1953) 1 WLR. 280, a generic force majeure clause—which referred only to a "force majeure event"—was held to be void for uncertainty. Another English court recently held in *Maritime Inc. v. Limbungan Makmur SDN BHD* (2019) EWCA Civ 1102 that a force majeure clause will apply only where a defined force majeure event was the sole cause of a party's non-performance. U.S. courts also are reluctant to extend a force majeure clause to situations not specifically identified in a contract. For example, the New York Court of Appeals held in *Kel Kim Corp.* that "[o]rdinarily, only if the force majeure clause specifically includes the event that actually prevents a party's performance will that party be excused."

Depending on the governing body of law, parties should also be aware that an express contract clause may supplant rights of recourse that otherwise would be available. For instance, in France, the force majeure regime in Article 1218 of the Civil Code can be contractually amended, and therefore restrictive lists of qualifying events in force majeure clauses might narrow the scope of relief available. The same result could occur under English law when the contract addresses the consequences of a supervening event through a force majeure clause. Under such circumstances, a party may not be able to pursue recourse to the doctrine of frustration.

IV. Conclusion

Given the widespread, unexpected, and still uncertain economic impact of the COVID-19 pandemic, commercial disputes are inevitable. Whether a business anticipates disruptions caused by the crisis or is already experiencing them, it should take stock of its potential legal options, both under governing law and the terms of the specific contracts that are affected. Specifically, businesses should consider taking the following actions:

- Examine each affected contract's governing law and forum selection clauses, or determine the body of law that might be applicable and where litigation can be filed. The controlling law and forum may shape whether and in what form a defense to non-performance is available, and also may shape how the express terms of a supervening event clause will be construed.
- Review the specifics of any supervening event clauses in the affected contract, especially to see if they include epidemic or pandemic events or, alternatively, a generic definition or some other term that could arguably cover the event. It also is advisable to review any contractual provisions with respect to notices that may be required to trigger such a clause.
- Review insurance contracts to determine whether there is coverage for force majeure events.

Going forward, businesses also should consider the following:

- When drafting new contracts where performance could be interrupted by the effects of an epidemic, consider specifying the contract's purpose in recitals or elsewhere. Express identification of the contract's purpose can later be used by a court or tribunal to determine whether the purpose of the contract has been frustrated.
- Tailor force majeure or material adverse change clauses to account for the COVID-19 pandemic and potential follow-on effects. For material adverse change clauses, consider whether price adjustment mechanisms or adjustment to performance deadlines are appropriate. Q

Cambridge Analytica Found Liable for Violating Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and the European Union-United States Privacy Shield Framework

Cambridge Analytica LLC was a U.S. consulting firm and marketing agency that became known for its involvement in the Facebook-Cambridge Analytica scandal relating to the 2016 U.S. elections. Although the company became insolvent and closed its U.S. operations in 2018, its impact on data collection and privacy issues continues. On December 6, 2019, the Federal Trade Commission (FTC), an independent U.S. agency whose role is to protect consumers and competition across broad sectors of the economy, issued an order finding Cambridge Analytica violated Section 5 of the FTC Act, 15 U.S.C. § 45 by making (a) false and deceptive representations to Facebook users to collect their personal data; and (b) false and deceptive statements regarding its participation in the European Union-United States Privacy Shield framework (Privacy Shield). The FTC Opinion is noteworthy because it applies Section 5 to harvesting personal information on social media and the Privacy Shield.

Background

In March 2019, the FTC launched an investigation concerning Cambridge Analytica's representations to tens of millions of Facebook users that their user names and other identifiable information were not being collected while, in reality, that information was being harvested for voter-profiling and targeted advertising. Cambridge Analytica harvested data without the users' consent through GSRApp, an application developed by Alekdandr Kogan, an America data scientist and research associate at the University of Cambridge. The FTC filed an administrative complaint against Cambridge Analytica on July 24, 2019. Facebook ultimately settled a related case, and agreed to pay a $5 billion penalty, which is the largest penalty ever imposed by the FTC for a violation of consumers' privacy.

The Cambridge Analytica saga started in late 2013 when researchers at the Psychometrics Center of the University of Cambridge developed an algorithm that could predict an individual's personality traits based on "likes" of public Facebook pages. For instance, when a person "liked" Facebook pages related to *How to Lose a Guy in 10 Days*, George W. Bush, and hip-hop, the algorithm used that specific combination of data points to predict certain personality traits, such as a conservative and conventional personality. The researchers asserted that their algorithm could predict an individual's personality traits better than the person's co-workers, friends, or family. Cambridge Analytica offered voter-profiling, micro-targeting, and other marketing services to U.S. political campaigns and other clients.

Cambridge Analytica collected (1) profile data from 250,000 to 270,000 Facebook users in the U.S.; and (2) "likes" and personal information from up to 65 million "friends" of those Facebook users (30 million of which were identifiable U.S. consumers). Cambridge Analytica ultimately used that data to perform targeted advertising related to the 2016 U.S. elections.

The FTC's Opinion and Order

Section 5 of the FTC Act gives the FTC the power to prohibit, *inter alia,* "unfair or deceptive acts or practices in or affecting commerce." While Section 5 does not *per se* provide the FTC authority to protect consumers' privacy, Section 5 has been construed to allow the FTC to safeguard consumers whose privacy has been invaded through deceptive acts.

The FTC's three-step inquiry to determine whether Cambridge Analytica's representations were deceptive and violated Section 5 consisted of assessing (1) what claims were conveyed; (2) whether those claims were false, misleading or unsubstantiated; and (3) whether the claims were material. The FTC looked into Cambridge Analytica's representations to Facebook users, such as "We want you to know that we will NOT download your name or any other identifiable information – we are interested in your demographics and likes," and found them to be false. The FTC then found that Cambridge Analytica's false representations to Facebook users that the company would *not* download names or other identifiable information were material because they "involve[d] information that is important to consumers and, hence, likely to affect their choice of, or conduct regarding, a product." The FTC thus found that Cambridge Analytica violated Section 5.

To remedy Cambridge Analytica's violation, the FTC (i) prohibited Cambridge Analytica from making misrepresentations regarding how it collects, uses, shares, or sells consumer information; (ii) ordered Cambridge Analytica to delete the Facebook data it obtained, along with all associated work product; and (iii) permanently enjoined Cambridge Analytica from disclosing, using, selling, or receiving any benefit from the information it collected.

The FTC also found Cambridge Analytica liable for deceptive acts and practices related to its participation in the Privacy Shield. The Privacy Shield is an agreement between the European Commission (EC) and the U.S. Department of Commerce that protects personal data transferred from the European Union to the United States and allows companies on both sides of the Atlantic to comply with the requirements of the 1995 European Union Directive on Data Protection. Every company participating in the Privacy Shield must self-certify to the Department of Commerce that it is in compliance with the Privacy Shield principles and requirements in line with the 1995 EU Directive standards, and companies must annually re-certify that they remain in compliance with those principles.

To date, the FTC has filed enforcement actions against 21 companies, including Cambridge Analytica, for failing to adhere to the requirements of the Privacy Shield. In the case of Cambridge Analytica, the FTC found that the company had represented to the public that it was participating in the Privacy Shield program and adhering to its principles, but it had failed to renew its certification after it had expired. As a result, the FTC prohibited the company from (i) making misrepresentations regarding the extent to which Cambridge Analytica participates in any privacy or security program sponsored by a government, self-regulatory, or standard-setting organization; and (ii) possessing or controlling personal information from European Union residents that Cambridge Analytica received while participating in the Privacy Shield. The FTC also ordered the company to comply with its continuing obligations under the Privacy Shield by, among other things, applying Privacy Shield protections to the personal information it received, protecting such information by means authorized under EU law, or returning or deleting such personal information.

Cambridge Analytica is just one of many companies targeted by the FTC for non-compliance with the Privacy Shield. The FTC recently reached settlements with companies such as Click Labs Inc. and Incentive Service Inc. which falsely claimed to participate in the Privacy Shield, and Global Data Vault LLC and TDARX, Inc. which failed to renew their certifications for the program.

Takeaway

Companies should carefully read and update their privacy policies to make sure they honor their representations to consumers about how they collect, use, share, and sell consumer data. Furthermore, with regard to the Privacy Shield or similar programs, companies representing that they participate in such programs must make sure that they are properly registered and follow all program requirements. In the event a company decides to withdraw from the Privacy Shield, it should contemporaneously remove references to the program from its website, and set up mechanisms to appropriately protect, securely return, or delete information collected while participating in the program. Q

PRACTICE AREA NOTES

Appellate Practice Update

One Quarter of All Federal Appellate Judges Appointed by Trump; Few Vacancies Remain

For nearly every litigant, the federal court of appeals represents the last opportunity for relief, rendering the composition of the federal appellate courts an important data point to consider in planning legal strategy. In his first three years in office, President Trump has moved swiftly in appointing—and the Senate has moved swiftly in confirming—appellate court judges. Currently, only one judgeship on a federal court of appeals is vacant. Judicial Vacancies, https://www.uscourts.gov/judges-judgeships/judicial-vacancies.

In the past three years, nearly 200 new judges have been appointed to the federal judiciary, including two Supreme Court justices and 51 judges on the courts of appeals. *Judgeship Appointments by President*, https://www.uscourts.gov/sites/default/files/apptsbypres.pdf. At the close of 2019, President Trump had appointed one-quarter of all judges on the federal appellate courts.

These appointments have flipped three courts of appeals from courts with a majority of Democratic-appointed active judges to a majority of Republican-appointed active judges. Prior to the start of the Trump Administration, a majority of active judges on the Second Circuit, the Third Circuit, and the Eleventh Circuit had been appointed by Democratic administrations. As the new decade begins, the Second Circuit now has seven active Republican-appointed judges, five of whom were appointed under the Trump Administration, compared to six active judges appointed during Democratic administrations. On the Third Circuit, President Trump has appointed four of the fourteen active judges, bringing the total number of Republican-appointed judges to eight. And five new judges have joined the Eleventh Circuit in the past three years, with one more recently confirmed by the Senate. That will bring the total number of Republican-appointed active judges to seven, compared to only five Democratic-appointed Eleventh Circuit judges. President Trump is expected to appoint one more judge to fill an anticipated vacancy on the Eleventh Circuit in 2020.

Several other circuit courts have seen an increase in the number of Republican-appointed judges. For instance, although the Ninth Circuit maintains a majority of active judges nominated by Democratic presidents, ten new judges have joined the Ninth Circuit in the past three years. Thus, thirteen of the twenty-nine active Ninth Circuit judges were appointed during a Republican administration. The Fifth Circuit now has five Trump-appointed judges, with one additional vacancy remaining. If the Senate confirms a Trump appointee for that vacancy, the Fifth Circuit will have twelve Republican-appointed judges out of seventeen active judges. President Trump also has appointed six judges to the Sixth Circuit, setting the total number of Republican-appointed active judges on the court at eleven, compared to five appointed by Democratic administrations.

The appointment of 51 courts of appeals judges in the past three years already exceeds the total number of federal appellate court judges appointed during the eight years of the Obama Administration. But, of course, these judges did not all replace judges appointed by Democratic administrations. In fact, the majority of the new federal appellate judges replaced judges who also had been appointed by Republican administrations.

The spate of appointments has changed the composition of the courts of appeals in another way—by lowering the average age of the active judges. Because every court of appeals judge who takes "senior status" creates a vacancy for a new "active status" judge, the new appointees are generally much younger than the judges they have replaced. Yet, although 51 circuit court judges have been confirmed in the past three years, that pace certainly will not continue because only one current vacancy remains.

Bankruptcy and Restructuring Litigation Update

Protecting Intellectual Property in Bankruptcy

In the modern economy, intellectual property is often a business's most valuable asset. The treatment of intellectual property under Title 11 of the United States Code (the "Bankruptcy Code"), therefore, has a significant impact on the value of a corporate debtor and the assets that are available to the company's creditors. The Bankruptcy Code balances the rights of debtors, license counterparties, and other creditors, to establish whether a debtor can monetize its intellectual property or retain its intellectual property rights.

Here are the general rules that govern the treatment of intellectual property rights held by a debtor:

- *Where the debtor is a licensee under an exclusive IP license*: The debtor holds freely alienable property rights in the IP.
- *Where the debtor is a licensee under a non-exclusive IP license*: The debtor ***may*** be able to retain the IP rights but almost certainly ***cannot*** sell those rights to others.
- *Where the debtor is a licensor under an exclusive IP license*: Absent an avoidable transfer, the debtor cannot rescind the license; therefore, the debtor cannot grant other parties licenses to use the same IP.
- *Where the debtor is a licensor under a non-exclusive IP license*: Absent an avoidable transfer, the debtor cannot rescind the license, but the non-exclusive license does not prohibit the debtor from granting other parties licenses to use the same IP.

The Debtor as Licensee: Selling Licenses

Federal copyright and patent laws prohibit a licensee from assigning non-exclusive intellectual property rights to a third party. Bankruptcy courts abide by this restriction. *See, e.g.*, *In re Golden Books Family Entertainment, Inc.*, 269 B.R. 300 (Bankr. D. Del. 2001) (non-exclusive licenses cannot be assigned under federal copyright law); *Perlman v. Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.)*, 165 F.3d 747 (9th Cir. 1999) (assignment of non-exclusive patent license is prohibited by federal patent law). Similarly, the court in *In re Trump Entm't Resorts, Inc.* held that "trademark licenses are not assignable in the absence of some express authorization from the licensor, such as a clause in the license agreement itself." 526 B.R. 116, 123 (Bankr. D. Del. 2015) (citing *In re XMH Corp.*, 647 F.3d 690, 695 (7th Cir. 2011) ("as far as we've been able to determine, the universal rule is that trademark licenses are not assignable in the absence of a clause expressly authorizing assignment"); *see also Miller v. Glenn Miller Prods., Inc.*, 454 F.3d 975, 988, 992-93 (9th Cir. 2006); 3 McCarthy on Trademarks § 18:43 (4th ed. 2010)). Given the alienability restrictions on non-exclusive intellectual property, a debtor seeking to sell such assets must generally obtain the consent of the licensor. In some instances, however, the license itself may permit a sale or assignment of the licensed rights. *See Murray v. Franke-Misal Technologies Group, LLC (In re Supernatural Foods, LLC)*, 268 B.R. 759 (Bankr. M.D. La. 2001) (license permitting assignment in connection with *sale of substantially all assets* amounted to requisite consent to transfer).

In contrast to non-exclusive licenses, federal law permits a licensee to freely transfer exclusive patent and copyright licenses. Bankruptcy courts follow this rule. *See In re Golden Books Family Entertainment, Inc.*, 269 B.R. 311 (Bankr. D. Del. 2001) (exclusive copyright license assignable under copyright law) (citing *In re Patient Educ. Media, Inc.*, 210 B.R. 237 (Bankr. S.D.N.Y. 1997)). Trademark licenses stand as the lone exception to the free alienability of an exclusive license. "The general prohibition against the assignment of trademark licenses absent the licensor's consent is equally applicable to both exclusive and non-exclusive trademark licenses." *Trump Entm't*, 526 B.R. at 127.

The Debtor as Licensee: Retaining Licenses

While a non-exclusive license cannot be assigned, it is an open question whether a reorganized debtor nevertheless retains its intellectual property. *See* 11 U.S.C. § 365(a) (permitting debtors to assume executory contracts). Some jurisdictions, such as the Third and Ninth Circuits, do not permit reorganized debtors to retain their licenses. Others, including the First, Fourth, and Fifth Circuits, permit debtors to assume their pre-petition intellectual property licenses.

The Third Circuit pioneered the "hypothetical" test under which the bankruptcy court must replace the debtor (whether or not reorganized) with a hypothetical third party to determine whether the third party would be able to acquire the license. If the hypothetical third party could not acquire the license, then the debtor cannot retain it. *See In re West Elecs., Inc.*, 852 F.2d 79, 83 (3d Cir. 1988). Unfortunately, the "hypothetical" test yields value-decimating results. *See, e.g.*, *In Re Access Beyond Technologies, Inc.*, 237 B.R. 32 (Bankr. D. Del. 1999) (on a motion to sell assets, the court determined that non-exclusive patent license was non-assumable and nonassignable); *see also In re Catapult Entertainment, Inc.*, 165 F.3d 747 (9th Cir. 1999) (the plain language of section 365(c)(1) precluded the debtor from assuming the intellectual property licenses because federal patent law renders patent licenses personal and nondelegable).

Under the "actual" test applied in other circuits, courts allow a debtor to retain a license, reasoning that the retention and use of the license is not an assignment of the license. As long as the debtor does not assign the license, courts applying the "actual" test hold that there is no reason to analyze whether the debtor can compel the licensor to accept performance from a third party. *See, e.g.*, *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489, 493 (1st Cir. 1997). The Fourth Circuit and Fifth Circuit have adopted the "actual" test. *See RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp)*. 361 F.3d 257 (4th Cir. 2004); *In re Mirant Corp.*, 230 B.R. 693, 705 (5th Cir. 1999). And although the Second Circuit has not ruled on this issue, bankruptcy courts within the Second Circuit have adopted the "actual" test. *See, e.g.*, *In re Adelphia Communications Corp.*, 359 B.R. 65 (Bankr. S.D.N.Y. 2007).

Consequences and Conclusions

Generally, the Bankruptcy Code's treatment of intellectual property follows applicable non-bankruptcy law. In a bankruptcy proceeding, a rejection of a license (equivalent to breach) has the same consequences as a breach outside the bankruptcy context. Similarly, the Bankruptcy Code neither expands nor contracts a debtor's ability to sell its intellectual property.

There are, however, some areas where the Bankruptcy Code departs from applicable non-bankruptcy law. In those areas, the determination of rights to intellectual property therefore depends on the debtor's jurisdiction and the non-bankruptcy law applicable to intellectual property. Careful planning can mitigate the effect of these exceptions. Using the "hypothetical" test as an example: Negotiating a plan of reorganization prior to filing a petition for bankruptcy relief may help a company obtain the consent of its intellectual property licensors, thereby permitting the company to retain its intellectual property during the company's bankruptcy proceeding. Alternatively, a company with substantial holdings of intellectual property may elect to file for bankruptcy in a jurisdiction that uses the "actual" test under which the debtor may be able to retain the license and reorganize under a bankruptcy plan.

Partner Luke Nikas Is Recognized by *Crain's* 40 Under 40 class of 2020

Crain's New York Business recognized partner Luke Nikas in the publication's 40 Under 40 annual listing. The award celebrates the most professionally accomplished rising stars under the age of forty. Nikas' experience representing clients in complex litigation and in the art world helped secure his place in the award class of 2020. In 2019, Nikas obtained a major copyright victory for the Andy Warhol Foundation that will have a lasting impact on the art world and the law of fair use. Among other victories that contributed to the award, Nikas secured the dismissal of a case against tennis star Naomi Osaka, the dismissal of a defamation claim against Alec Baldwin, and the dismissal of numerous claims against Morgan Art Foundation, a patron of the late artist Robert Indiana and the owner of the rights to his most famous works, including the iconic LOVE sculpture.

Quinn Emanuel Wins Asylum for Mother and Child

Quinn Emanuel represented, on a pro bono basis, a young Honduran mother (Y. U-R) and her son (D. M-U) in their quest for asylum in the United States. For their protection, we have not identified them by name.

Beginning when she was 10 years old, Y. U-R was groomed by D. M-U's father—a 25 year-old man. In a country where the age of consent is 18, Y. U-R had two children by the age of 16. D. M-U's father violently abused Y. U-R, and twice nearly killed her. As a baby, D. M-U was so afraid of his father that he would cry himself purple whenever his father came near.

To make matters worse, Y. U-R was also in the crosshairs of the local gang boss, who had killed her brother and driven her sister out of the country. The gang boss told Y. U-R that he had paid a hit man to kill her but, unlike her brother, her head would be cut off and sent to her mother. After a failed attempt to kidnap her, Y. U-R fled with D. M-U to the United States, where she sought asylum. Y. U-R's "sin" in all of this was to tell men to stop abusing women, that women are not property to be mistreated, and that women deserved respect like anybody else.

It is nearly impossible for anyone who is a victim of domestic violence or gang violence to get asylum. Also, because certain applicants—including Y. U-R and D. M-U—are forced to wait in Tijuana for their court dates, it can be dangerous for an applicant to pursue an asylum claim. That was the case for Y. U-R and D. M-U , because the gang boss's brother showed up in Tijuana shortly after they did.

After multiple hearings, the Court issued a lengthy decision granting asylum. We expect the Court's written decision will be frequently cited in the future to help others seeking asylum, particularly victims of gender-based violence in Central American countries.

Complete Defense Verdict in Section 10(b) Securities Fraud Trial

On January 29, 2020, in one of the rare Section 10(b) securities fraud cases to go to trial, Quinn Emanuel obtained a complete defense verdict for C3.ai, its CEO, Thomas Siebel, and former COO, David Schmaier. Plaintiffs—who were former shareholders of an energy efficiency start-up "E2.0"—asserted claims of federal securities fraud, Delaware common law fraud, and breach of contract arising from C3's acquisition of E2.0 in 2012. Plaintiffs alleged damages of $68.75 million, but instead walked away with nothing and were ordered to pay Defendants' attorney's fees and costs.

The litigation arose from a 2012 stock-for-stock merger through which C3, a leading AI software provider, acquired E2.0. C3 pursued the merger believing E2.0's software, which focused on the residential market, could complement its own software for large commercial and industrial companies. E2.0 believed the possibility of obtaining equity in an early-stage company founded by Siebel was a "once in a lifetime proposition."

Although C3 had hoped the E2.0 business would thrive post-merger, it did not. Within months, the E2.0 business unit was shut down and its residential software was abandoned. Plaintiffs brought suit, claiming Defendants (1) falsely represented that C3 was worth $500 million during merger negotiations; (2) made a number of other misrepresentations regarding C3's business and prospects; and (3) breached the merger agreement by interfering with E2.0's ability to meet its "earnout" and not issuing "holdback" shares due to indemnification breaches.

Following a 7-day bench trial, Judge Colm Connolly of the United States District Court for the District of Delaware rejected each of the Plaintiffs' claims. In his written opinion, Judge Connolly repeatedly wrote that C3's witnesses were "highly credible," while simultaneously finding that Quinn Emanuel had shown the Plaintiffs' witnesses were "not credible" based on their "demeanor" and the fact that their testimony contradicted the credible testimony of C3 witnesses and the documentary record. The Court also found there was no credible evidence that Defendants represented C3 was worth $500 million, or made any other misrepresentations, finding instead that we had "clearly established that Defendants were transparent with Plaintiffs throughout the merger negotiations." The Court concluded its opinion by awarding our clients their attorneys' fees and costs in defending the action, completing the across-the-board victory. Q quinn emanuel

865 South Figueroa Street, 10th Floor, Los Angeles, California 90017

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- We are a business litigation firm of more than 800 lawyers — the largest in the world devoted solely to business litigation and arbitration.
- As of March 2020, we have tried over 2,300 cases, winning 88% of them.
- When we represent defendants, our trial experience gets us better settlements or defense verdicts.
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- We have won five 9-figure jury verdicts and one 10-figure jury verdict.
- We have also obtained forty-three 9-figure settlements and nineteen 10-figure settlements.

Prior results do not guarantee a similar outcome.

LOS ANGELES
865 S. Figueroa St.,
10th Floor
Los Angeles, CA 90017
+1 213-443-3000

NEW YORK
51 Madison Ave.,
22nd Floor
New York, NY 10010
+1 212-849-7000

SAN FRANCISCO
50 California St.,
22nd Floor
San Francisco, CA 94111
+1 415-875-6600

SILICON VALLEY
555 Twin Dolphin Dr.,
5th Floor
Redwood Shores, CA 94065
+1 650-801-5000

CHICAGO
191 North Wacker Dr.,
Suite 2700
Chicago, IL 60606
+1 312-705-7400

WASHINGTON, D.C.
1300 I Street NW,
Suite 900
Washington, DC 20005
+1 202-538-8000

HOUSTON
Pennzoil Place
711 Louisiana St.,
Suite 500
Houston, TX 77002
+1 713-221-7000

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

BOSTON
111 Huntington Ave.,
Suite 520
Boston, MA 02199
+1 617-712-7100

SALT LAKE CITY
60 E. South Temple,
Suite 500
Salt Lake City, UT 84111
+1 801-515-7300

TOKYO
Hibiya U-1 Bldg., 25F
1-1-7, Uchisaiwai-cho,
Chiyoda-ku
Tokyo 100-0011
Japan
+81 3 5510 1711

LONDON
90 High Holborn
London WC1V 6LJ
United Kingdom
+44 20 7653 2000

MANNHEIM
Mollstraße 42
68165 Mannheim
Germany
+49 621 43298 6000

HAMBURG
An der Alster 3
20099 Hamburg
Germany
+49 40 89728 7000

MUNICH
Hermann-Sack-Straße 3
80331 Munich
Germany
+49 89 20608 3000

PARIS
6 rue Lamennais
75008 Paris
France
+33 1 73 44 60 00

HONG KONG
4501-03 Lippo Centre, Tower One
89 Queensway, Admiralty
Hong Kong
+852 3464 5600

SYDNEY
Level 15
111 Elizabeth Street
Sydney, NSW 2000
Australia
+61 2 9146 3500

BRUSSELS
Blue Tower
Avenue Louise 326
5th floor
1050 Brussels
Belgium
+32 2 416 50 00

ZURICH
Dufourstrasse 29
8008 Zürich
Switzerland
+41 44 253 80 00

SHANGHAI
Unit 502-503, 5th Floor, Nordic House
3 Fenyang Road, Xuhui District
Shanghai 200031
China
+86 21 3401 8600

PERTH
Level 41
108 St Georges Terrace
Perth, WA 6000
Australia
+61 8 6382 3000

STUTTGART
Büchsenstraße 10, 4th Floor
70173 Stuttgart
Germany
+49 711 1856 9000