June 2018

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# New Questions on Patent Venue Arise in the Wake of *TC Heartland*

Last year in *TC Heartland LLC v. Kraft Foods Group Brands LLC*, 137 S. Ct. 1514 (May 22, 2017), the Supreme Court dramatically changed the venue landscape for patent cases. Prior to *TC Heartland*, venue in patent cases was proper in any federal court with personal jurisdiction over the defendant. After *TC Heartland,* however, venue for cases against domestic parties is proper only in: (1) the district "where the defendant resides" which, in the case of corporate defendants, was held to be the corporation's state of incorporation; or (2) a district where the defendant "has committed acts of infringement and has a regular and established place of business." As a result of this change, which significantly limited the number of districts where a corporation "resides," focus has moved to interpreting the remainder of the patent venue statute (28 U.S.C. §1400(b)). This article attempts to identify some of the issues that have arisen since and as a result of the *TC Heartland* decision.

***Background***

Venue for patent cases is governed by 28 U.S.C. § 1400(b), which provides that a patent infringement action may brought either "in the judicial district where the defendant resides, or where the defendant has committed acts of infringement and has a regular and established place of business." Prior to *TC*

*(continued on page 2)*

## INSIDE



## Qualcomm/NXP Wins 2018 Merger Control Matter of the Year at the Global Competition Review Awards

The firm was awarded 2018 Merger Control Matter of the Year at the 8th annual GCR Awards for its work on the *Qualcomm/NXP* matter. The team was led by Brussels partners Stephen Mavroghenis and Miguel Rato, and associates Mark English, Pedro Fajardo, Laura Abram, Maria Belen Gravano, Zena Prodromou, Susanna Kärkelä, and Layla Bakker. The firm's work on the *TruEx v. MarkitSERV* matter was shortlisted for Litigation of the Year – Non-Cartel Prosecution, and Dan Brockett was shortlisted for Litigator of the Year. Q

## Quinn Emanuel Named World Leader in International Arbitration by the *Global Arbitration Review*

The firm and its partners were once again highly ranked by the *Global Arbitration Review*, ranking 4th on the 11th annual *GAR*30 list. The publication specifically highlights the firm's success, mentioning our steep climb from 11th place in 2017 to fourth in 2018. *GAR* specifically notes the rapid development of our practice, including recognizing the firm's hiring of Michael Young QC. *GAR*'s researchers predict the firm will soon rank first on the highly competitive list if the volume of our caseload continues to increase. Q

## Richard East and Sue Prevezer QC "Highly Recommended" by *Legal Business* at U.S. Law Firm of the Year Awards Dinner

Richard East and Sue Prevezer were "Highly Recommended" by the London publication *Legal Business* at the 15th annual U.S. Law Firm of the Year awards ceremony which recognizes U.S. law firms and partners that have made outstanding economic progress while achieving the best results for clients in London. The publication refers to the firm as a "disputes powerhouse," highlighting our London office's exceptional financial growth. The firm was shortlisted once again for the U.S. Law Firm of the Year award. Q

*Heartland*, a defendant was said to "reside" in any district with personal jurisdiction over the defendant. Following *TC Heartland,* however, a domestic corporate defendant is now said to "reside" only in its state of incorporation, thus significantly narrowing the number of jurisdictions where a domestic corporation can be sued for patent infringement. With this narrowing of the interpretation of "resides," renewed attention has been placed on the alternative criteria for venue under Section 1400(b)—those districts where a defendant has both a "regular and established place of business" and "has committed acts of infringement." Against this backdrop, the courts have been required to address a number of long dormant questions surrounding patent venue determinations.

***The Question of Waiver***

One of the first questions to arise in the wake of *TC Heartland* was what to do about the cases that had been filed in (now improper) venues pre-*TC Heartland*. Had defendants in those cases waived their right to challenge venue by failing to move to dismiss under Rule 12(b)(3) months or even years before the Supreme Court decided *TC Heartland*? The majority of district courts initially concluded that no waiver had taken place because of Fed. R. Civ. P. 12(g)(2), which provides that a defendant must raise all "defense[s] or objection[s] that w[ere] available to the party" at the time it makes its first defensive move (*i.e.,* an Answer or Rule 12 motion). In the view of those courts, the improper venue defense was not "available" prior to *TC Heartland* because the Supreme Court announced new venue law, thus making the waiver under Rule 12(g)(2) inapplicable. But several district courts, including both the Eastern District of Texas and the District of Delaware, reached the opposite conclusion and held that, as *TC Heartland* merely reaffirmed pre-existing venue law (including the Supreme Court's 1957 decision in *Fourco Glass Co. v. Transmirra Products*), the improper venue defense always had been "available," even prior to *TC Heartland*.

The waiver question ultimately reached the Federal Circuit in *In re Micron Technology, Inc.*, 875 F.3d 1091 (Fed. Cir. Nov. 15, 2017). In that case, the defendant Micron had been sued in the District of Massachusetts and begun litigating the merits of its case prior to *TC Heartland*'s issuance. When Micron later moved to dismiss for improper venue in the wake of *TC Heartland*, the district court found that Micron had waived the defense by failing to make it in an initial Rule 12 motion and that, because *TC Heartland* merely reaffirmed the Supreme Court's prior ruling in *Fourco*, the defense had been "available" to Micron under Rule 12(g)(2) all along. Micron subsequently petitioned the Federal Circuit for a writ of mandamus.

On November 15, 2017 the Federal Circuit granted Micron's petition, holding that "*TC Heartland* changed the controlling law in the relevant sense . . . the venue defense now raised by Micron (and others) based on *TC Heartland*'s interpretation of the venue statute was not 'available,' thus making the waiver rule of Rule 12(g)(2) and (h)(1)(A) inapplicable." Although the Federal Circuit thus resolved the issue of Rule 12 waiver, it left the door open to two additional types of waiver deriving from district courts' "inherent power" to manage their dockets. The first would turn on a case's proximity to trial, allowing a district court to continue to find waiver where a case had progressed to the eve of trial. The second would look to whether the defendant had engaged in a "tactical wait-and-see bypassing of an opportunity to declare a desire for a different forum, where the course of proceedings might well have been altered by such a declaration." But beyond these broad pronouncements, the Federal Circuit declined to explain further how and when these categories of waiver might apply. On remand from the Federal Circuit, Micron's case was transferred to Delaware and later settled without further analysis of the venue issues.

***The Meaning of Section 1400(b)'s "Regular and Established Place of Business" Standard***

Unsurprisingly, another question that arose immediately after *TC Heartland* issued was how to define 28 U.S.C. § 1400(b)'s requirement of a "regular and established place of business." Because the definition of "resides" was previously construed broadly, courts had little reason to construe the "regular and established place of business" clause prior to *TC Heartland*. The last appellate decision to discuss the "regular and established place of business" standard was the Federal Circuit's 1985 decision in *In re Cordis Corp.*, 769 F.2d 733 (Fed. Cir. 1985). In *Cordis*, the defendant had two employees in the district. These employees worked out of offices within their homes and stored company literature, documents, and products there. Cordis, for its part, hired a local secretarial service to support both employees and listed the employees' homes in the public telephone directory under Cordis's name. Under these facts, the district court had found that these home offices constituted a "regular and established place of business" for purposes of Section 1400(b) despite the fact that they were not traditional storefronts. When Cordis sought mandamus review from the Federal Circuit, the Court declined to provide an exact test for determining whether a "regular and established place of business" existed but simply held that the facts of *Cordis* did not meet the standard for mandamus relief. The Federal Circuit did note, however, that "the appropriate inquiry is whether the corporate defendant does its business in that district through a permanent and continuous presence there and not as Cordis argues, whether it has a fixed physical presence in the sense of a formal office or store."

In the wake of *TC Heartland*, district courts initially looked to *Cordis* when assessing whether a "regular and established place of business" existed for the purposes of patent venue. Some courts took an expansive view of the "regular and established place of business" standard. For example, Judge Gilstrap of the Eastern District of Texas found that the standard was met simply because the defendant had employees who lived in the District. *Kranos IP v. Ridell, Inc.*, No. 17-cv-443, 2017 WL 3704762, at *9 (E.D. Tex. Aug. 28, 2017). At the other end of the spectrum, a court in the Western District of Wisconsin found that the standard expressly required "some sort of office or location from which employees work on a regular basis." *Cellular Dynamics International, Inc. v. Lonza Walkersville, Inc.*, No. 17-cv-27, 2017 WL 4046348, at *6 (W.D. Wisc. Sept. 12, 2017). In September 2017 however, the Federal Circuit handed down its decision in *In re Cray Inc.*, 871 F.3d 1355 (Fed. Cir. Sept. 21, 2017) and offered guidance on this issue. The Federal Circuit broke the "regular and established place of business" standard into three components.

First, the Federal Circuit noted that to meet the "regular and established place of business" requirement there must be a "physical place in the district." The court defined "place" as "a building or a part of a building set apart for any purpose or quarters of any kind from which business is conducted" and expressly excluded any "virtual space or [] electronic communications from one person to another." Second, the Federal Circuit held that there must be a "regular and established" place of business, meaning that the business must "operate in a steady, uniform, orderly, and methodical manner" and must be "settled certainly, or fixed permanently." Finally, the Federal Circuit explained that the place at issue "must be the place of the defendant." The Federal Circuit identified relevant considerations as including "whether the defendant owns or leases the place, or exercises other attributes of possession or control over the place," whether the company products or marketing materials were stored there, and whether a defendant listed the alleged place of business on a website, or in a telephone or other directory.

Although *Cray* provided significant direction on the "regular and established place of business" standard, courts continue to forge new ground in this area. For example, in *Peerless Network, Inc. v. Blitz Telecomm Consulting, LLC*, Judge Oetken of the Southern District of New York rejected the argument that "networking equipment" could constitute a "regular and established place of business" for a telecommunications company. No. 17-cv-1725, 2018 WL 1478047, at *4 (S.D.N.Y. Mar. 26, 2018). Although the defendant's business in the district may have been conducted *through* the networking equipment, no business was conducted *from the site* where the equipment was located (*i.e.,* the telecommunications center where it was hosted). The Court acknowledged that *Cray*'s limitations on venue could lead to an "unsatisfying" outcome in the age of widespread digital commerce, but found that *Cray* and its interpretation of Section 1400(b) foreclose basing venue on a mere digital presence in the district.

Post-*Cray* courts have also struggled to determine the extent to which a third party's facility in the District can constitute a "regular and established place of business" for the defendant. For example, in *Reflection, LLC v. Spire Collective LLC*, a court in the Southern District of California considered whether Amazon's fulfillment centers in the district could satisfy the requirement for a defendant that distributed products from those facilities. The court found that this argument failed all three prongs of *Cray* because the defendant exercised no control over Amazon's facilities and the parties had only a contractual relationship. No. 17-cv-1603, 2018 WL 310184, at *3 (S.D. Cal. Jan. 5, 2018).

### *Who Bears the Burden of Proving (Improper) Venue?*

Another question that arose in the wake of *TC Heartland* is which party bears the burden of proof on the venue question. Many of the regional circuit courts of appeal have addressed this issue in the context of non-patent cases, with the First, Second, Fourth, Seventh, and Ninth Circuits all holding that the plaintiff bears the burden while the Third and Eighth Circuits have reached the opposite conclusion. While district courts initially reached differing conclusions regarding the question of burden, the Federal Circuit has just recently weighed in to settle the question. On May 14, 2018, the Federal Circuit issued an opinion in *In re ZTE Corp.*, No. 2018-113, which held that "upon motion by the Defendant challenging venue in a patent case, the Plaintiff bears the burden of establishing proper venue" and noting that "[s]uch a holding best aligns with the weight of historical authority among the circuits and best furthers public policy." As a practical matter, it remains to be seen how this shift in burden will affect Rule 12(b)(3) motions going forward.

***Where Does "An Act of Infringement" Occur for Purposes of 28 U.S.C. § 271(E)(2)?***

Courts have also begun to confront the question of where an "act of infringement" occurs for the purposes of infringement under 28 U.S.C. § 271(e)(2). Section 271(e)(2) allows a plaintiff to allege infringement based on the filing of an Abbreviated New Drug Application (ANDA) with the FDA. As the name suggests, a defendant in an ANDA case has merely *applied* to use, make, sell, or offer for sale an infringing product, pending FDA approval.

For venue purposes, this creates an interesting question. Where do the "acts of infringement" occur for the purposes of Section 271(e)(2)? One answer could be that the filing of the ANDA with the U.S. Food and Drug Administration (FDA) in Maryland would supply the "act of infringement," possibly creating venue in Maryland if the defendant also had a regular and established place of business there. A different approach suggested by the plaintiff in *Bristol-Myers Squibb Co. v. Mylan Pharmaceuticals Inc.*, No. 1:17-cv-379 (D. Del.), is that an "act of infringement" could be said to occur wherever the defendant *intends* to sell the potentially infringing product, should it succeed in the litigation. In that case, the plaintiff analogized the question of venue to that of personal jurisdiction, pointing to a recent Federal Circuit decision (*Acorda Therapeutics v. Mylan Pharmaceuticals Inc.*, 817 F.3d 755 (Fed. Cir. 2016)) holding that *intent* to sell the allegedly infringing product in the jurisdiction is sufficient to establish personal jurisdiction. Chief Judge Stark accepted Bristol-Myers' argument regarding the acts of infringement clause of the statute and ordered further venue discovery relating to the issue of whether Mylan had a regular and established place of business in the District of Delaware. Likewise, the District of New Jersey recently adopted the *Bristol-Myers Squibb* rationale in finding that the "acts of infringement" take place anywhere the accused product is intended to be sold. *Celgene Corp. v. Hetero Labs Ltd.*, No. 17-cv-3387, 2018 WL 1135334, at *3 (D.N.J. Mar. 2, 2018).

However this prospective view of where infringement has occurred has not been universally accepted. For example, the Northern District of Texas recently criticized the holding in *Bristol-Myers Squibb*, commenting that "the Delaware court's approach to venue in ANDA cases is a liberal interpretation of the venue statute and, thus, inconsistent with the Federal Circuit's guidance" in *Cray*. *Galderma Labs, L.P. v. Teva Pharmaceuticals USA, Inc.*, No. 3:17-cv-1076, 2017 WL 6505793, at *6 (N.D. Tex. Nov. 17, 2017). This split in opinion regarding this clause of the patent venue statute will likely be resolved by the Federal Circuit as a result of an appeal from one of these early cases.

***Conclusion***

*TC Heartland*'s change to the law of patent venue has given rise to a host of related questions that courts at both the district and appellate levels continue to grapple with. While the Federal Circuit's decisions in *Cray* and *Micron* have resolved certain threshold issues, many more remain and it may be some time before litigants know with certainty where they can and cannot be sued for patent infringement. Q

# NOTED WITH INTEREST

## United States Supreme Court Holds That Litigant May Appeal Final Judgment in Individual Action That Is Part of Ongoing Consolidated Proceeding

In *Gelboim v. Bank of America Corp.*, 135 S. Ct. 897 (2015), the Supreme Court held that one of multiple cases consolidated for multidistrict litigation under 28 U.S.C. § 1407 is immediately appealable upon an order disposing of that case, regardless of whether any of the other cases remain pending. But the Court declined to answer whether the same rule applies to cases consolidated under Rule 42(a) of the Federal Rules of Civil Procedure. *Hall v. Hall* answers that question. 138 S. Ct. 1118 (2018). In a unanimous decision authored by Chief Justice Roberts, the Supreme Court held that civil cases consolidated under Federal Rule of Civil Procedure 42(a) retain their separate identities, so that a final decision in one case is immediately appealable by the losing party, even if other cases in the consolidated proceeding remain pending. The holding resolves a four-way split among the courts of appeals and provides clear guidance to civil litigants about when they must appeal.

***Background***

The case arises from a long-running family dispute. Samuel Hall, a lawyer in the Virgin Islands, served as the caretaker for his mother Ethlyn Hall and provided her with legal assistance. The two had a falling out over Samuel's handling of Ethlyn's real estate holdings. During a visit from her daughter Elsa, Ethlyn established an *inter vivos* trust, transferred all of her property into the trust, and designated Elsa as her successor trustee.

Ethlyn then sued Samuel and his law firm in the district court of the Virgin Islands both in her individual capacity and as trustee of the trust (the "trust case"). While the case was pending, Ethlyn died and Elsa became the successor trustee and accordingly the plaintiff in the trust case. In response, Samuel filed various counterclaims against Elsa—in both her individual and representative capacities—alleging that Elsa had interfered in Ethlyn's relationship with Samuel. Elsa, however, was not a party to the trust case in her individual capacity. As a result, Samuel filed a new complaint against Elsa in her individual capacity in the same district court (the "individual case"), raising the same claims that he had asserted as counterclaims in the trust case. On Samuel's motion, the district court consolidated the actions under Rule 42(a)(2), which allows courts to consolidate actions involving "common questions of law or fact."

In both cases, the jury found against Elsa, and in both cases, the clerk entered judgment. But in the individual case, the district court granted Elsa a new trial, which had the effect of reopening the judgment. Elsa then filed a notice of appeal from the district court's judgment in the trust case. Samuel moved to dismiss the appeal on jurisdictional grounds, arguing that the judgment was not final and appealable because the individual case was pending. The Court of Appeals for the Third Circuit agreed with Samuel and dismissed the appeal for lack of jurisdiction, concluding that because the actions had been consolidated for all purposes, a judgment on one set of claims was not final while another set of claims remained in the district court.

***The Decision***

The Supreme Court reversed. The Court started its analysis by explaining that had the district court not consolidated the trust and individual cases, there would be no question that Elsa could immediately appeal from the judgment in the trust case because 28 U.S.C. § 1291 vests the courts of appeals with jurisdiction over "appeals from all final decisions of the district courts," except those directly appealable to the Supreme Court. Thus, the Court viewed the question confronting it as whether the consolidation had merged the cases into one, so that judgment in the trust case was interlocutory because work remained to be done in the individual case.

After reviewing various dictionary definitions of "consolidate," the Court concluded that the case "was not a plain meaning case." It thus turned to the legal lineage of the word, which it explained stretches back at least to the first federal consolidation statute, enacted by Congress in 1813. The Court canvassed Supreme Court and courts of appeals decisions interpreting that statute and in which consolidation was held not to affect the amount in controversy of cases, the number of peremptory challenges available to parties, and the issues that parties could raise or appeal. The Court explained that these cases demonstrate that, from the outset, courts understood "consolidation not as completely merging the constituent cases into one, but instead as enabling more efficient case management while preserving the distinct identities of the cases and the rights of the separate parties in them."

The Court noted that it was against this backdrop that Rule 42(a) was enacted in 1938. Because Rule 42(a) was modeled on the 1813 statute and did not define "consolidate," the Court concluded that "the term presumably carried forward the same meaning we had ascribed to it under the consolidation statute for 125 years." The Court explained that Samuel's argument that there was a significant distinction between the original consolidation statute and Rule 42(a)(2) was based on a strained reading of the Rule. And the Court added that if Rule 42(a) were meant to transform consolidation into something different than what it had been, the Court "would have heard about it" from Congress or the Rules Advisory Committee. The Court observed that nothing in the drafting or committee proceedings leading to Rule 42 revealed such an expectation or intent.

The Court concluded by explaining that its opinion did not mean that district courts cannot consolidate cases for "all purposes" in appropriate it circumstances. Rather, its holding should be read to mean that constituent cases retain their distinct identities at least to the extent that a losing party in one action is able to immediately appeal a final judgment. Q

## Energy Litigation Update

***The EU's Bid to Regulate Russia's Nord Stream 2.*** The EU has for some time sought to impose its rules in the Third Energy Package (the "TEP") on third country pipelines entering the EU. These rules cover such matters as unbundling (which requires the separation of network ownership from production and transportation of gas), transparency of network capacity, non-discriminatory third party access, and transparent, regulated tariffs. The driver for the EU's desire to extend the TEP is the Nord Stream 2 pipeline ("Nord Stream 2"). Nord Stream 2 is a twin pipeline comprising more than 200,000 pipe segments running from Vyborg in Russia, along an offshore route of some 1,200 kilometers under the Baltic Sea to an area near the German port of Greifswald. Once completed, the total capacity of each of the two strings will be 55 billion cubic meters of gas per year, making an aggregate annual capacity of 110 billion cubic meters of gas per year for Nord Stream 1 and Nord Stream 2 combined. The estimated doubling of volumes of gas imported from Russia to the EU once Nord Stream 2 comes on-stream causes concern in Brussels, as it runs somewhat contrary to the EU's current energy strategy both to secure and diversify its energy supplies and to reduce EU dependence on Russian gas supplies.

The EU's primary concern is that when Nord Stream 2 comes on-stream (currently estimated to occur by the end of 2019) Gazprom – the sole shareholder in Nord Stream AG, which owns the pipeline - will have the ability to significantly increase the volumes of natural gas that it transports into the EU without the application of the rules in the TEP. Moreover, Russia is currently challenging these rules before the World Trade Organization, claiming that they are inconsistent with the EU's obligations under a number of international agreements, including the General Agreement on Trade in Services, the General Agreement on Tariffs and Trade and the World Trade Organization Agreement.

Whether and to what extent EU law applies to Nord Stream 2 has therefore been in the spotlight, with the EU Council Legal Service and other expert commentators issuing contradictory views. Even the Council Legal Service has issued incongruent opinions. The outcome of this issue is important, not only because clarity is needed in relation to Nord Stream 2 but also because it will set a precedent for other pipelines, both existing and future, that import natural gas from third countries into the EU.

Aside from the EU's bid to regulate Nord Stream 2, there are more problems on the horizon for this controversial project: as recently as May 18, 2018, a senior US State Department official has reiterated a US threat to impose sanctions over Nord Stream 2 (*see* Oilprice.com, May 20, 2018), a move that is opposed by Germany. Also, on May 9, 2018, Poland's competition authority announced that it had initiated proceedings against Gazprom and the five other European companies financing Nord Stream 2, ENGIE, OMV, Shell, Uniper and Wintershall, over a potential breach of anti-monopoly law. *See* Financial Times, May 9, 2018.

***Background***

The EU is a party to the United National Convention on the Law of the Sea, 1982 ("UNCLOS"), which is therefore binding the EU member states as well as the EU itself. The EU has sovereignty in its own territory and, under UNCLOS, EU territory extends beyond its land territory and internal waters to its territorial sea (Article 2). Accordingly, EU energy law is applicable to pipelines in the territorial sea and onshore. From a sovereignty perspective, therefore, the Gas Market Directive (Directive 2009/73/EC, referred to here as the "Gas Directive") is capable of applying to the parts of Nord Stream 2 that pass through its territorial waters and onshore to the receiving terminal, just as Russian law will apply to that part of the pipeline which passes through Russian territory, except that at present, it is framed as applying to the EU's internal natural gas market only. As such, the law would need to be amended for it to apply.

Beyond the territorial sea, the position is different. Pursuant to Articles 56 and 58 of UNCLOS, no member state has full sovereign rights in the area of sea immediately beyond its territorial sea, known as the Exclusive Economic Zone ("EEZ"). The EEZ is subject to the specific legal regime established in Part V of UNCLOS. Although coastal states have certain rights in relation to their EEZ, these are limited to *"the purpose of exploring and exploiting, conserving and managing the natural resources… and with regard to other activities for the economic exploitation and exploration of the zone"* (Article 56). To the extent that EU law may seek to impose rules beyond the EU's territory, in the EEZ (and continental shelf) of member states, this would be restricted to rules of this nature. Given that sovereignty is significantly more limited in relation to the EEZ, the remaining offshore pipeline of Nord Stream 2 comprising around 950 km of pipeline in the EEZ of each of Germany, Denmark, Sweden and Finland, would therefore not be subject to EU energy law.

As mentioned above, at present, the Gas Directive, and other EU legislation applicable to pipelines, is not framed to apply to external pipelines from third countries. It is concerned solely with the rules for the EU's internal natural gas market. Indeed, the TEP and the Gas Directive have not been applied to any other pipelines from third countries, such as the Transmed, Medgas and Greenstream pipelines. The EU has taken a number of steps recently to change the situation.

***Steps Taken by the EU***

On November 13, 2017, in order to address concerns about Nord Stream 2, the European Commission issued a proposal to amend the Gas Directive to extend its application to natural gas pipelines running between the EU and third countries. This proposal includes broadening the definition of "interconnector" which currently applies only to internal pipeline systems, to *"a transmission line which crosses or spans a border between Member States or between member States and third countries up to the border of Union jurisdiction."* Such an amendment would enable the EU's rules on unbundling, transparency, third party access and regulated tariffs to apply in the territorial sea and to the sections of Nord Stream 2 prior to it connecting with the EU's internal transmission systems.

At a meeting of the Working Party on Energy on January 11, 2018, the Council Legal Service was asked to issue an opinion on whether application of its proposal to the EEZ of EU member states was compatible with UNCLOS. On 1 March 2018, the Council Legal Service issued its opinion which, in a set-back for the EU, said that internal energy market rules could not legally extend to the EEZ (see Opinion of the Legal Service 6738/18) on the basis of UNCLOS, Articles 56 and 58, by which the coastal state does not have full sovereign powers in the EEZ. Accordingly, EU energy regulations cannot apply there.

Against this view, the EU Commission has argued that Article 79(4) of UNCLOS providies support for the its position that the Gas Directive can be extended the EEZ (*see* Euractiv.com). However, this is a misapplication of the provision. Article 79(4) does not confer any additional rights or powers on a coastal state but, rather, refers to its existing rights under the convention. It does not explicitly permit the EU to extend the rules of the Gas Directive to the EEZ.

Finally, a subsequent opinion issued by the Council Legal Service on March 26, 2018 finds that the EU regulatory framework may be extended to apply to parts of a pipeline up to the border of "Union jurisdiction" provided that, in the legislator's assessment, the security of energy supply is enhanced by a regulated framework for third country interconnectors. If the legislator is satisfied that this is the case, then the there is an additional requirement to apply the principle of proportionality to achieve the intended purpose (an issue which will be determined by the EU Council) (see Opinion of the Legal Service 7502/18). This view is on an assumption that the EU Commission's proposal to extend the Gas Directive and related legislation to third country interconnectors *"falls within the scope of the establishment and functioning of the internal market in gas."* In such circumstances, the EU's rules on unbundling, transparency, third party access and regulated tariffs would apply.

***Inter-Governmental Agreement Between the EU and Russia***

As noted above, different legal regimes apply to Nord Stream 2, depending upon the area through which the pipeline is passing, namely EU law, Russian law, and international law in the areas in which no single state has full sovereign rights. However, the pipeline as a whole is connected and regulations on the operation of one part of the pipeline necessarily affect operations on the rest of the pipeline. Once the Gas Directive and related legislation is extended to apply to pipelines carrying natural gas from third countries into the EU, any applicable EU rules would need to be applied to the rest of Nord Stream 2 outside the EU's jurisdiction, resulting in a territorial extension of EU law. However, Russia is unlikely to consent to such an extension and a conflict would arise between the rules applicable to the pipeline.

In addressing this issue in its latest opinion of March 28, 2018, the Council Legal Service states that the EU and the third country would have to conclude an inter-governmental agreement for the operation of the pipeline to resolve any contradiction in their respective rules. This is what the EU Commission previously proposed in relation to Nord Stream 2. In particular, on June 12, 2017, the Directorate General for Energy of the European Commission submitted a draft recommendation to the EU Council for a decision authorizing the negotiation of an agreement between the EU and Russia *"on the operation of Nord Stream 2 to ensure a coherent regulatory framework contributing to market functioning and security of supply in the Union."* However, this request was rejected when the Council's Legal Service issued an opinion that the Gas Directive did not apply to Nord Stream 2.

The latest opinion nonetheless holds that, upon the adoption of the Commission's proposals (which the Council Legal Service supports), an inter-governmental agreement will be needed. The irony is that such a conflict arises as a result of the EU's proposals to extend the application of EU energy law, and not on the basis of the law as it currently stands. Any international agreement necessitated by a conflict would fall within the exclusive competence of the EU. As a consequence, member states would not be entitled to enter into international commitments which would affect the EU's common rules on unbundling, third party access, regulated tariffs and transparency and would be obliged to take appropriate steps to terminate such existing agreements with third countries.

The opinion provides sufficient support for the Commission's proposals for the EU to move forward with its agenda concerning Nord Stream 2, although the opinion has a narrow scope and does not address all the relevant legal issues.

## International Arbitration Update

***Where Next for Bilateral Investment Treaty Claims Within the EU? The Impact of the* Achaea v. Slovakia *Decision.*** On March 6, 2018, the European Union's Court of Justice ("EUCJ") handed down a decision that has provoked considerable excitement in the arbitration community. Indeed, few decisions of the EUCJ have attracted such attention recently. Some have argued that it heralds the death of investment treaty claims within the EU. While any decision of the EUCJ affecting arbitration creates excitement within the arbitral world, should users of treaty claims be unduly concerned? We think not.

The EUCJ's decision concerned an award rendered in arbitration proceedings between Achmea BV and the Slovak Republic (Case C-284/16). Achmea BV (a Dutch entity) had, through a local subsidiary, invested in Slovakia's medical insurance sector following the liberalization of its private healthcare market in 2004. Two years later, the Slovak Republic partially reversed its policy, restricting the rights of a party to distribute profits generated in that area. Arguing that those measures had caused it loss, Achmea BV commenced proceedings under a 1991 Bilateral Investment Treaty between the Netherlands and the (then) Czech and Slovak Federative Republic ("the BIT").

During the course of the arbitration proceedings, the Slovak Republic had argued that the Arbitral Tribunal lacked jurisdiction. It did so on the basis that the provision in the BIT allowing recourse to an arbitral tribunal was incompatible with EU law, following Slovakia's accession to the European Union. That only occurred in 2004, more than a decade after the execution of the BIT.

The jurisdictional argument was rejected by the Tribunal, which went on to find in favor of Achmea on the substantive claims. In December 2012, the Slovak Republic were ordered to pay Achmea damages totaling Euro 22.1 million.

The Slovak Republic brought an action to set aside the award before the Courts of Germany. From there, the dispute worked its way to the EUCJ, which went on to address (at least in part) the compatibility of so-called "intra-EU BIT claims" with EU law. In other words, where a dispute arises between one investor from an EU Member State with another Member State, are the BIT provisions referring the matter to arbitration compatible with EU law?

In broad overview, the EUCJ confirmed Slovakia's submissions on two specific points. First, it agreed that the arbitration provision in the BIT (i.e. the 1991 BIT between Holland and the (then) Czechoslovakia) was contrary to Article 344 of the Treaty on the Functioning of the EU ("TFEU"; better known as the Treaty of Rome). That Article underscores the exclusive jurisdiction of the EUCJ on the interpretation or application of EU Treaties ("Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein").

Secondly, the EUCJ agreed with Slovakia's argument that the BIT's arbitration clause was contrary to Article 267 of the TFEU. That Article regulates "preliminary rulings" from the EUCJ, providing a mechanism for a court or tribunal of an EU Member State to request a decision from the EUCJ on the interpretation of EU law. The aim of that procedure is said to ensure "the full effectiveness of the rules of the EU" (paragraph 43 of the EUCJ ruling).

In this way, the EUCJ interpreted Articles 267 and 344 of the TFEU as precluding intra-EU BIT claims under the Dutch/Slovakian BIT, preventing (in this case) Achmea BV from bringing an arbitration claim under that instrument against the Slovak Republic.

Does this mark the death of all intra-EU arbitration claims? Should users (or potential users) be unduly concerned? In short, no. To begin with, the decision is wrong, and palpably so. It also has no binding force on international arbitration tribunals. But putting those points to one side, even on its face it is unlikely to have broad reach, as Quinn Emanuel partners Philippe Pinsolle and Isabelle Michou discussed at length recently in a paper for Dalloz Actualités©.

Why? At most, the decision applies only to intra-EU arbitrations under intra-EU BITs. In particular, it has no application to ICSID arbitration (which is governed instead by the 1965 Washington Convention). It also has no application to commercial arbitration, with paragraph 55 of the EUCJ decision drawing an explicit distinction with those types of claims: "While [commercial arbitrations] originate in the freely expressed wishes of the parties, [BIT arbitrations] derive from a treaty by which Member States agree to remove from the jurisdiction of their own courts, and hence from the system of judicial remedies which... [EU law] requires them to establish in the fields covered by EU law."

The exclusion of commercial claims and ICSID disputes from the ruling has a significant impact on the effect of the EUCJ ruling. But does it even apply to all intra-EU BIT claims? Once again, no. There is a strong argument that it is limited to the BIT under review - i.e., that between Holland and Slovakia in 1991. On its face, the EUCJ's analysis is limited to the BIT in question.

In short, the *Achmea* decision is a bad decision which is almost certainly wrong. Thankfully, though, the impact of that decision is likely to be limited. Commercial and ICSID arbitrations are excluded, and there is a good argument that its ambit goes no further than the BIT in question.

It is only if the EUCJ's decision is found to have general effect that real problems might arise. At the very least, it would call into question the sense of having an EU-seat for intra-EU BIT arbitrations. The risk of annulment proceedings at the seat, were *Achmea* to be held to have general application, would be real. Whilst problems would still arise should any award be enforced within the EU, the annulment risk would play to the advantage of major non-EU arbitral seats. That might even including the United Kingdom once Brexit terms are finalized next year.

## Appellate Practice Update

***New Supreme Court Precedent on Clear Error Versus* de Novo *Review.*** On March 5, 2018, the Supreme Court decided a case nominally about bankruptcy, but which may have broader implications regarding the standard of review in a wide variety of contexts. In *U.S. Bank National Association v. Village at Lakeridge*, 584 U.S. ___ (2018), the Supreme Court addressed whether an appellate court should apply *de novo* or clear-error review to a bankruptcy court's determination that a person is a "non-statutory insider" of a debtor, which often turns on whether the person's transactions with the debtor (or another of its insiders) were at arm's length. In a unanimous opinion by Justice Kagan, the Court held that this is a mixed question of fact and law, and that the clear-error standard of review applies.

In reaching this conclusion, the Court carefully examined the dividing line between *de novo* and clear-error review. The Court first explained that the legal test for non-insider status, which the Ninth Circuit held to incorporate a requirement that the transaction not be conducted at arm's length, is clearly subject to *de novo* review. Slip op. at 5-6. The Court then recognized that the historical facts relevant to the legal test—"addressing questions of who did what, when or where, how or why"—were unquestionably subject to clear-error review. *Id.* at 6. The remaining issue was a mixed question of law and fact regarding "whether the historical facts found satisfy the legal test chosen for conferring non-statutory insider status." *Id.* at 7. And the standard of review for that question rests on "the nature of the mixed question here and which kind of court (bankruptcy or appellate) is better suited to resolve it." *Id.* at 8. In particular, "the standard of review for a mixed question all depends—on whether answering it entails primarily legal or factual work." *Id.* at 9. Thus, when a mixed question "require[s] courts to expound on the law, particularly by amplifying or elaborating on a broad legal standard," then "appellate courts should typically review a decision *de novo*." *Id.* at 8. And in contrast, when a mixed question requires courts "to marshal and weigh evidence, make credibility judgments, and otherwise address" factual issues, then "appellate courts should usually review a decision with deference" (though this deference may not apply in the "constitutional realm"). *Id.* at 7-8 & n.4.

Applying this approach, the Court held that the clear-error standard governed review of whether the facts showed an arm's-length transaction. The Court reasoned that an arm's-length transaction can be defined as "a transaction conducted as though the two parties were strangers," and applying this definition to the facts "is about as factual sounding as any mixed question gets." *Id.* at 10. In addition, the Court noted that *de novo* review is unnecessary because courts "have never tried to elaborate on the established idea of a transaction conducted as between strangers," and "there is no apparent need to further develop 'norms and criteria,' or to devise a supplemental multi-part test, in order to apply the familiar term." *Id.* at 10-11. Nonetheless, the Court held that "if an appellate court someday finds that further refinement of the arm's-length standard is necessary to maintain uniformity

*(continued on page 11)*

## Complete Victory for Swiss Client in Contract Dispute

On March 6, 2018, the firm won a complete victory from Judge Rakoff dismissing all claims against our client, Mercuria Energy Trading, and several affiliated entities. This was a highly contentious contract dispute in which Mercuria's former employee claimed that Mercuria owed him more than $32 million in carried interest payments. The plaintiff, Jeff Miller, had worked as a senior oil-and-gas trader at Mercuria between 2008-2012. During that time, Miller helped source and complete Mercuria's acquisition of an Argentine oil company named Glacco, and in exchange for this work had received all of the Class A preferred shares in Glacco's parent company. Those shares, which were governed by the parent company's by-laws, carried certain redemption and payout rights upon the occurrence of a dissolution or restructuring of the company. In 2012, Miller resigned from Mercuria. Before he resigned, Miller had been working on a deal that would merge Glacco and other Mercuria oil/gas assets in Argentina with another Argentine company: Roch S.A. It was anticipated that following the merger, Mercuria and Roch would take the combined company public on the Toronto Stock Exchange. So Miller negotiated—as part of his departure from Mercuria—an agreement that if the Mercuria/Roch merger were consummated and otherwise triggered a redemption payment on his Glacco shares, and if that merged company went on to undergo an IPO or a sale of its equity to a third party, then instead of his ordinary redemption payment Miller would be entitled to exchange his Glacco shares for (far more valuable) shares in the pre-IPO Mercuria/Roch company. This agreement was memorialized in a Separation Agreement between him and Mercuria signed at his departure.

Unfortunately for Miller, the Mercuria/Roch merger deal was never completed, leaving Miller with only his existing Glacco shares. Then, last year, Mercuria entered into an entirely different and unrelated transaction to form a company called Phoenix Global Resources. Miller, seeing public reports of the Phoenix Global transaction, claimed that Mercuria owed him a redemption payment on his Glacco shares using the valuation formula set forth in his Separation Agreement—which was specific to the Mercuria/Roch merger and share exchange for Mercuria/Roch shares—but this time using the value of the Phoenix Global transaction as a proxy for the Mercuria/Roch merger value. When Mercuria refused to pay, Miller filed suit in the Southern District of New York, claiming that Mercuria acted in bad faith and breached the Separation Agreement. Miller sought more than $32 million in damages.

The firm moved to dismiss the claims based on the plain language of the contract. Judge Rakoff issued a 32-page opinion agreeing with our position across the board and dismissing the complaint in its entirety, with no opportunity to replead. The Court concluded that the plain language of the Separation Agreement provided for a redemption payment (in the form of an exchange of shares) only upon the occurrence of the Mercuria/Roch merger, which had never occurred. Therefore, the Court held, Miller was not entitled to any payment as a result of the Phoenix Global transaction, and Mercuria breached no contractual or other duties by refusing to pay him.

## Dismissal of Claims in London to Set Aside USD 820 Million Arbitration Award and Freezing Orders

The firm has recently achieved a series of victories in London for our client, Raga Establishment Limited against the SCM Group, owned and controlled by the Ukrainian oligarch, Rinat Akhmetov.

Mr. Akhmetov is the richest man in Ukraine, with a net worth of over USD 4 billion. In 2013, he agreed to purchase our client's 97% stake in "Ukrtelecom", Ukraine's national telecoms operator. The deal was concluded in June 2013, with the purchase to be carried out through one of Akhmetov's holding vehicles, SCM Financial Overseas Ltd, for a price of USD 860 million, to be paid in three instalments. SCM paid the first instalment but nothing else.

By the time the firm was brought on board in the summer of 2016, the unpaid instalments had been outstanding for over a year. In addition, the purchasing SCM entity had been stripped of virtually all of its assets except for Ukrtelecom itself (which was by then in dire financial straits and would soon be subject to confiscation proceedings by the Ukrainian State). Despite the delay in bringing proceedings, we managed to secure freezing injunctions in both England and Cyprus.

In less than a year we secured an award dismissing SCM's defenses in their entirety and awarding Raga over USD 760.6 million (the full amount owed).

Before the arbitration had even commenced, SCM was stripped bare; transferring its assets to other SCM Group companies at an undervalue and leaving the company insolvent. We brought proceedings in Cyprus against five different SCM Group companies, their directors and Mr. Akhmetov personally for conspiring to defraud Raga, and immediately obtained worldwide freezing injunctions against all of them. We also obtained attachment orders in the Netherlands preventing Mr. Akhmetov and the SCM defendants from disposing of their interest in a number of key Dutch subsidiaries, which hold the bulk of the Group's industrial assets.

Mr. Akhmetov and SCM applied to set aside the Dutch attachments and brought proceedings in England to set aside the arbitral award. In April, the Amsterdam court dismissed SCM's application to set aside the Dutch attachments. In the process, it noted that SCM had failed to provide any adequate explanation for what clearly appeared to be a series of non-arm's length transactions. Then, in May, the English court rejected SCM's application to set aside the arbitral award. The next step is to continue the pursuit of our claims in Cyprus against the SCM Group and Mr. Akhmetov personally. Q

*(Appellate Practice Update continued from page 9)*

among bankruptcy courts, it may step in to perform that legal function." *Id.* at 11 n.7. But "what it may *not* do is review independently a garden-variety decision, as here, that the various facts found amount to an arm's-length (or a non-arm's-length) transaction and so do not (or do) confer insider status." *Id.*
Because the Court relied on numerous precedents outside the bankruptcy context and its reasoning does not limit itself to that context, lower courts are likely to find it applicable in any case concerning a mixed question of law and fact. And while *U.S. Bank*'s analysis did not purport to break new ground, its synthesis of the precedents in this area of law is instructive. Indeed, it is rare for courts to engage in the kind of detailed, principled analysis of which standard of review to apply to a mixed question based on how factual the inquiry really is and whether there is a need for guidance in the application of the standard at issue. Accordingly, *U.S. Bank* may lead some courts to reconsider their views on whether particular issues are subject to *de novo* or clear-error review. One commentator has noted that negligence, which is arguably as fact-dependent and resistant to multi-part tests as the standard for arm's-length transactions, is one area where courts may see *U.S. Bank* as suggesting that clear-error review is required. *See* Alan B. Morrison, *U.S. Bank National Ass'n v. Village at Lakeridge*: Reviewing Mixed Questions of Fact & Law, Geo. Wash. L. Rev. On the Docket (Oct. Term 2017), *see* https://www.gwlr.org/u-s-bank-national-assn-v-village-at-lakeridge.

*U.S. Bank* also shows the need for litigants to keep in mind the connection between the nature of the argument on the merits and the argument on the standard of review. For instance, if a litigant wants *de novo* review, then it may need to explain how the issue at hand is susceptible to some specific sub-tests, and how it would benefit from appellate-court guidance for consistent application. In contrast, if a litigant seeks clear-error review, then the merits argument may benefit from focusing on an overall application of the facts to the standard being applied without delving into possible criteria or multi-part tests for application of the standard. In any event, *U.S. Bank* suggests that simply noting that a question is a mixed one is not enough to decide the standard of review, and that a careful, issue-specific analysis is now required. Q

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# business litigation report

## quinn emanuel urquhart & sullivan, llp

Published by Quinn Emanuel Urquhart & Sullivan, LLP as a service to clients and friends of the firm. It is written by the firm's attorneys. The Noted with Interest section is a digest of articles and other published material. If you would like a copy of anything summarized here, please contact Elizabeth Urquhart at +44 20 7653 2311.

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