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French Defenses Against Foreign Legal Proceedings May Be Getting a Boost

In the United States, all attorneys are entitled to the benefits of attorney-client privilege and work product doctrine whether they work for a private law firm, a corporation, or the government. But in France (and to an extent the rest of Europe, where legal privilege is generally less robust for in-house counsel than in the United States), in-house counsel has no such privilege. An in-house counsel’s correspondence with other company employees on legal matters, as well as that counsel’s memoranda and notes, are subject to discovery in foreign litigation. At the same time, U.S. courts have been largely hostile to claims by French companies (and indeed, all foreign litigants with similar claims) that producing relevant documents located in France will subject them to prosecution in France under the French “blocking statute”—a domestic law that imposes criminal penalties for

producing documents in a foreign country.

Perhaps because their internal legal correspondence and memoranda are not protected from discovery and the rarely-enforced blocking statute is a poor deterrent to cooperation with foreign regulators, French companies historically have been the subject of some of the largest criminal settlements by foreign companies with the U.S. Department of Justice (“DOJ”). Now, voicing concerns that the United States is using DOJ enforcement as a weapon in the international economy, a French politician has proposed that France fight back by: (1) strengthening its blocking statute to impose greater penalties on French companies that produce documents in foreign litigation absent a French court order; and (2) expanding the concept of legal privilege to include in-house counsel. The ultimate result of these recommendations is unclear,

(continued on page 2)

INSIDE

“Do’s” and “Do Not’s” for
Electronic Communications
and Litigation
Page 3

Bankruptcy Update
Page 4

Securities and Structured
Finance Update
Page 7

Life Sciences Update
Page 9

Precedential Victory for Oyster
Bay in the Second Circuit and
Other Victories
Page 10

International Arbitration Specialist Mark McNeill Joins QE in New York

Mark McNeill has joined the firm as a partner in the New York office. He previously headed Shearman & Sterling’s arbitration practice in London. He has represented companies and States in numerous commercial and investment treaty arbitrations, including in matters involving intellectual property, technology, nuclear construction, pharmaceuticals, business combinations, oil & gas, taxation, mining, insurance, and reinsurance. Mark was also an Attorney-Adviser in the Office of the Legal Adviser of the U.S. Department of State, where he represented the United States in investor-state arbitrations under the investment chapter of the North American Free Trade Agreement (NAFTA). [Q](#)

Susheel Kirpalani Receives St. Francis Award by Catholic Renewal

New York Partner Susheel Kirpalani has been honored by the Catholic Renewal with the St. Francis Service Award. This award is given to a member of the corporate restructuring community who, regardless of creed, has demonstrated a standard of selfless integrity, humility, and charity that warrants the recognition and acclaim of his or her peers. Catholic Renewal is a group of professionals in the corporate restructuring industry committed to providing charitable assistance to those in need through the spiritual growth of its members. Funds raised in connection with the Fall Reception during which the St. Francis Service Award is given assist Catholic Renewal, acting in association with Catholic Charities of the Archdiocese of New York, to combat poverty and provide millions of meals for hungry New Yorkers along with support to move those in need towards independence. [Q](#)

but French companies should probably not consider them a silver bullet to U.S.-based criminal investigations or civil litigation.

In the United States, courts generally extend the attorney-client privilege to attorneys that are working “in-house” at a business organization. The company is the “client,” and the in-house attorney’s communications with employees of the company can be protected from subsequent discovery, so long as certain conditions are met. *See, e.g., Upjohn Co. v. United States*, 449 U.S. 383, 395 (1981). This in-house attorney-client privilege can be especially important during a company’s internal investigation into potential wrongdoing, particularly where in-house attorneys lead a preliminary investigation before outside counsel is retained.

By contrast, though the French legal system does provide legal privilege to attorneys, the privilege does not extend to in-house counsel. That is, there is no legal privilege covering communications between the counsel and any other company employees, even if the employees have come to the in-house counsel specifically to discuss a legal issue. *See, e.g., C-550/07 P, Akzo Nobel Chemicals Ltd and Akros Chemicals Ltd v European Commission*, 2010 I-08301 (European Court of Justice case interpreting French law on legal privilege and holding that French in-house counsel’s work is not protected because: (1) in-house counsel in France are not formally *avocats*; and (2) in-house counsel lack sufficient independence from their employers). This creates a situation where in-house attorneys’ correspondence and work product can be used by a foreign authority during its investigation, or be the subject of a production order in foreign civil litigation.

The impact on French companies exposed to U.S. criminal investigations or civil discovery demands is exacerbated by the fact that U.S. courts tend to take a dim view of another potential protection: the so-called blocking statute. In France, the blocking statute prohibits any French company from producing documents in a foreign litigation, absent a French court order. *See* Article 1bis, French Penal Code Law No. 68-678 of July 26, 1968, amended by Law No. 80-538 of July 16, 1980 (the French “blocking statute”). Though violations of the blocking statute are a criminal offense and are punishable by fines and prison, there has been only one conviction in the 50-year history of the blocking statute.

Despite the potential criminal penalties that French companies face, U.S. courts tend to order French companies (and all foreign companies subject to a blocking statute in their domestic market) to produce documents, regardless of any penalties they may face in their home countries. *See, e.g., In re Vivendi Universal S.A. Secs. Litig.*, 2006 WL 3378115 (S.D.N.Y. Nov. 16,

2006) (ordering French company to produce documents after weighing four factors, including the hardship of compliance in light of the French blocking statute and the competing interests of the United States in enforcing its laws and France in regulating its domestic companies).

These two factors—the lack of legal privilege for in-house counsel and an under-enforced French blocking statute—may explain why French companies have been well represented on the list of foreign companies with large settlements with U.S. regulators. Consider, for instance, if the French blocking statute imposed more serious criminal penalties for non-compliance and was routinely enforced: French companies might then be much less likely to cooperate with a U.S. criminal investigation by turning over documents (including unprotected internal legal correspondence and memoranda) in response to a criminal subpoena, which would make it much more difficult for DOJ to ultimately prove its case. Such circumstances may lead to fewer or smaller settlements by French companies as they block U.S. investigations.


Instead, recent settlements by French companies with DOJ have been substantial, including:

- In **May 2013**, Total S.A., a French oil company, entered into a Deferred Prosecution Agreement with the DOJ in connection with allegations of foreign bribery and agreed to pay **\$398 million** in penalties and disgorgement;
- In **June 2014**, BNP Paribas S.A., a French financial institution, pleaded guilty to violating U.S. sanctions against conducting business with Cuban, Iranian and Sudanese entities and agreed to pay an **\$8.9 billion** penalty;
- In **December 2014**, Alstom S.A., a French power and transportation company, pleaded guilty to Foreign Corrupt Practices Act violations and agreed to pay a **\$772 million** fine; and
- In **June 2018**, Société Générale, a French financial institution, entered into a Deferred Prosecution Agreement with the DOJ in connection with its role in interest rate manipulation and agreed to pay **\$1.3 billion** in fines and penalties to U.S. and French authorities.

French MP Raphaël Gauvain certainly believes there is a connection between the weak French blocking statute and the lack of legal privilege for in-house counsel on the one hand, and the large penalties paid by French companies to U.S. regulators on the other. Further, he believes that U.S. authorities are intentionally targeting French companies as a form of economic sabotage, and have been more successful than they otherwise would have been due to these factors. Mr. Gauvain recently authored a report recommending that France protect French companies from foreign authorities by, among

other measures: (1) strengthening the existing French blocking statute by providing greater penalties for companies and individuals that do not comply with it; (2) providing additional resources for French companies that report to the authorities any request that would potentially place them in violation of the blocking statute (such as a foreign civil production order); and (3) expanding the scope of legal privilege to encompass communications with, and work product by, in-house counsel. See Raphaël Gauvain, Claire D’Urso & Alain Damais, *Rétablir la souveraineté de la France et de l’Europe et protéger nos entreprises des lois et mesures à portée extraterritoriale*, June 26, 2019.

The fate of these recommendations remains to be seen. The report has been transmitted to French Prime Minister Edouard Philippe for further study and potential action. However, it is unclear if the proposed changes would have any impact on French companies subject to U.S. criminal investigation or civil

litigation. While in-house counsel legal memoranda and correspondence may have aided DOJ investigations into French companies in the past, they are far from the only sources of information about potential criminal wrongdoing. And in civil litigation, the hardship to the company facing a discovery order from a U.S. court is only one factor to be considered in deciding whether to compel production in contravention of a foreign blocking statute; increasing the hardship by strengthening the French blocking statute may not meaningfully affect a U.S. court’s analysis, given that the statute appears to be rarely enforced and only a single individual (but no French company) has ever been convicted of violating the blocking statute. Ultimately, while the report may be a political boon to Mr. Gauvain and Mr. Philippe in criticizing U.S. enforcement actions, any changes in the French blocking statute or legal code may have minimal impact on French companies ensnared in U.S. criminal investigations or civil litigation. 

NOTED WITH INTEREST

“Do’s” and “Do Not’s” for Electronic Communications and Litigation

Litigators know that the best ammunition for their case usually comes from the opponent’s electronic communications. Why? Because all too often, management and employees simply cannot resist the urge to send their off-the-cuff reactions. And many write these messages under the entirely mistaken belief that all traces can be erased with a simple deletion. This creates a false sense of security for those communicating electronically, frequently leaving an easily discoverable paper trail of embarrassing or damaging statements as a result.

It is a given that you must always faithfully comply with your obligations to preserve and produce discoverable evidence. But you never have an obligation to unnecessarily or unwittingly create evidentiary bombshells in the first instance. Fortunately, it does not take much effort to drastically reduce the risk that your messages will come back to haunt you, your colleagues, or your clients. Simply stated, the key is to be proactive and to give some thought to what you are doing before writing a message or responding to one.

The following list is not exhaustive. But it identifies many important factors to keep in mind prior to hitting send. It may not always be easy to adhere to the below principles, and it may seem tedious and unnecessary to do so. But it can be the difference between having your message blend in with the other items produced

in discovery or having it marked “Exhibit A” at a deposition or trial, where you may be subjected to hours of embarrassing questions.

Do’s

- Assume your email or message **WILL BE** made public.
- Assume nothing is ever deleted forever.
- Say only what you mean, and mean exactly what you say; your written words may be read out of context in the future and will be taken at face value.
- Ask yourself if you would be embarrassed if your mother or the *New York Times* saw your message.
- Be thoughtful; think before you write, edit before you send.
- Think about who you want to be “cc’d”; be careful when copying new people on a chain.
- Keep your messages professional and respectful.
- When discussing personal matters, start a new message chain with a new subject.
- Check that your attachments are correct.

- Check that autocompleted email addresses are for the intended individuals.
- Use phone calls and in-person meetings instead of emails or other written messages to discuss sensitive matters.
- Treat voicemail just like email, because most voicemails are now sent as attachments to email.
- Forward messages to those you want to be aware of an email chain, but do not want to directly include in the chain.
- Understand that text messages, intra-office messaging apps, and social media messages can be used in litigation and made public just the same as emails.
- Develop and enforce message retention policies for non-email messaging programs, including text messaging, social media, and cloud-based applications.
- Label messages as subject to the attorney-client privilege if there is a reasonable basis for doing so.
- Where there is a potential dispute on the horizon, limit written messages to the greatest extent possible.
- Understand that your personal devices are subject to discovery in future litigation.
- Use offensive, inflammatory, profane, or unprofessional language.
- Write “delete this message after reading,” “it would be best to talk by phone,” or something similar.
- Make any reference to “killing the competition,” “dominating the market,” or similar concepts.
- “Reply all” unless you confirm that each addressee should receive your reply.
- Use messages to vent personal frustration or expose internal disagreement.
- Include personal matters in work-related message chains.
- Include attachments other than those strictly necessary for your purposes.
- Add new recipients to a message chain before confirming those recipients were not purposefully excluded and need to know all the subjects discussed in the chain.
- Use the “cc” function to add internal team members on outside distributions or use the “bcc” function to add others to an existing email thread; it heightens the risk of disclosure of sensitive information through an inadvertent “reply all.”
- Use messaging programs that automatically delete messages or intentionally fail to record them; it creates a perception you are trying to hide something.
- Share privileged messages with outside parties or with inside parties without a concrete need to know.
- Send non-privileged communications on the subject of the litigation after the litigation has started. [Q](#)

Do Not's

- Assume a message is unrecoverable simply because you have deleted it.
- Use sarcasm, hyperbole, speculation or make jokes; tone and context are often lost in written messages.
- Speculate about the cause of a potential problem or admit liability.

PRACTICE AREA NOTES

Bankruptcy Update

Rights Offerings, Backstop Commitments and Private Placements—Understanding Pacific Drilling and the Eighth Circuit’s Peabody Decision

Debtors are increasingly financing their emergence from bankruptcy through rights offerings subject to backstop commitments from a subset of their impaired

creditors. While bankruptcy courts regularly confirm reorganization plans that include this form of exit financing, two recent cases challenged its compatibility with the Bankruptcy Code. Although both cases ultimately approved the financings in question, the decisions provide guidance to debtors and creditors seeking court approval of backstop commitments and other exclusive financing opportunities going forward.

I. Background: Scrutiny for Backstop Commitments and Other Exclusive Financing Opportunities

Broadly speaking, a rights offering is a type of exit financing in which a debtor's existing creditors are offered the opportunity to invest new money in the reorganized debtor, often at a discount to the value attributed to the reorganized debtor in the plan of reorganization. Debtors sometimes favor rights offerings over alternative forms of financing because they provide valuable new equity financing, and a subset of participating creditors will often agree to guarantee that financing by making a "backstop" commitment—*i.e.*, the promise, in exchange for a fee, to purchase any remaining equity if the offering is undersubscribed. The agreement to enter into the backstop commitment is also often accompanied by the backstopping creditors' agreement to vote in favor of the plan of reorganization, which may ensure the favorable vote of the participating creditors' class. The opportunity to invest in the reorganized debtor at a discount may also be attractive to existing creditors, who are already familiar with the debtor's business (and who may have adopted a bullish view of the debtor's future prospects in the bankruptcy case). And backstopping opportunities may be attractive to creditors whose bankruptcy claims are impaired, because the fees they earn for their backstop commitments can help offset the impairment on their claims.

The demand for rights offerings as a means of raising valuable exit financing, and the concomitant practice of entering into backstop commitments to guarantee that financing, shows no signs of abating. Two recent cases, however, suggest that the fees and other benefits paid to backstopping creditors may be subject to heightened judicial scrutiny or challenge in the future. Backstopping creditors and debtors should thus take steps to demonstrate that the fees and other benefits paid to the backstopping creditors are provided on account of the creditors' new money commitment rather than their prepetition claims, and are generally consistent with the market for comparable financings.

II. Pacific Drilling: A Bridge Too Far?

On November 12, 2017, Pacific Drilling S.A. and its related debtors filed for bankruptcy in the Southern District of New York. *See* Case No. 17-13193 (MEW) (Bankr. S.D.N.Y.). On September 18, 2018, Judge Michael Wiles considered an uncontested motion seeking approval of an equity commitment relating to a \$500 million equity raise in which: (1) holders of unsecured claims would have the right to purchase \$350 million of equity in the reorganized company at a 46.9% discount to plan value through a rights offering;

and (2) an ad hoc group of lenders and noteholders, and existing majority shareholder Quantum Pacific Group, would have the right to purchase \$100 million and \$50 million of equity, respectively, at the same discount in a private placement. Under the proposed equity commitment, the ad hoc group of lenders and noteholders, which had also entered into a restructuring support agreement with the debtors, would backstop the rights offering in exchange for the \$100 million private placement and a fee of 8% of the full \$500 million equity raise, payable in equity of the reorganized debtor. *See id.* (Dkt. 535).

Notwithstanding the absence of any objections, Judge Wiles declined to approve the equity commitment at the September 18, 2018 hearing. Judge Wiles noted at the hearing that while "it is entirely reasonable and appropriate to raise financing on market terms and to pay reasonable commitment fees for that financing," "it's quite clear you're not supposed to give disproportionate treatment or different treatment to people just because they hold more claims than other people [do] ... [or] just to get their support for a plan." *Id.*, Sept. 18, 2018 Hrg. Tr. at 86 (Dkt. 622). Judge Wiles expressed concern that the 8% backstop fee "doesn't seem to bear any relationship to the actual risk" associated with it, and appeared to be "a plum opportunity that's been given to a special group of large creditors" supporting the plan "on a basis that's not equal to other similarly situated creditors." *Id.* at 87-88. Judge Wiles also took issue with the \$100 million private placement, questioning whether it was "really a disguised overallocation of rights in a rights offering," and stating that if it was directly related to the backstopping creditors' current bankruptcy claims, then the debtors would have "an equal treatment problem that's deadly to [the] plan." *Id.* at 26, 83. Judge Wiles expressed skepticism that the equity commitment was in fact a stand-alone financing unrelated to the ad hoc group's current claims, because it was not subject to market testing, and was "specifically designed to prohibit anybody else from even making another proposal." *Id.* at 27.

Judge Wiles deferred consideration of the equity commitment to September 25, 2018, when the debtors presented a revised equity commitment agreement. *Id.* (Dkt. 609). The revised agreement eliminated the \$100 million private placement, and revised the 8% backstop fee so that it would apply only to the uncommitted portion of the rights offering, with a 5% fee applying to the remainder. *Id.* (Dkt. 607 at 5). Noting once again the absence of objections, Judge Wiles approved the equity commitment at a September 25, 2018 hearing, but stated that he was doing so "not without a great deal of misgivings"—particularly with

respect to the backstop fee, which Judge Wiles found to be likely unwarranted, and to potentially constitute “just an extra payment and an extra recovery rather than a real standalone financing term.” *Id.*, Sept. 25, 2018 Hrg. Tr. at 17, 28 (Dkt. 634). Near the end of his remarks, Judge Wiles expressed “hope that in the future when these structures are presented, parties will explore in more detail the issues and concerns that I have raised.” *Id.* at 29.

III. The Peabody Case: The Eighth Circuit’s Decision

The Peabody Energy Corporation (“Peabody”) bankruptcy case raised issues similar to those addressed by Judge Wiles in *Pacific Drilling*. The Peabody plan of reorganization provided for exit financing commitments of \$1.5 billion in new money, consisting of \$750 million to be raised through a private placement of preferred equity sold at a 35% discount to the agreed-upon value in the plan (the “Private Placement”) and \$750 million to be raised through a rights offering of common stock sold at a 45% discount to the agreed-upon value in the plan (the “Rights Offering”). Initially, the Debtors limited participation in the Private Placement to a small group of Second Lien and Class 5B Noteholders (the “Consenting Noteholders”), who held approximately 40% of such claims and who had participated in the mediation that had resulted in the Plan. The Consenting Noteholders agreed: (1) to provide a full backstop of the Rights Offering and Private Placement (the “Backstop Commitment”) and; (2) to sign a Plan Support Agreement (“PSA”) agreeing to support the Plan subject to bankruptcy court approval (the “Support Commitment” and together with the Backstop Commitment, the “Commitments”).

Ultimately, the Plan was revised to grant the Consenting Noteholders the exclusive right to purchase the first 22.5% of preferred equity in the Private Placement. Next, other Second Lien and Class 5B Noteholders willing to sign onto the Commitments, together with the Consenting Noteholders, had the exclusive right and obligation to purchase their pro rata share of the next 5% of preferred equity. Then, a third group of noteholders that subsequently signed onto the Commitments were permitted to join the other participating noteholders to purchase their pro rata share of the remaining 72.5% of preferred equity. “The Plan provided that [f]or the avoidance of doubt, any Preferred Equity purchased ... in the Private Placement ... shall be solely on account of the new money provided in the Private Placement and not on account of any purchaser’s [bankruptcy claims].” *In re Peabody Energy Corp.*, 582 B.R. 771, 776-77 (E.D. Mo. 2017)

(quotation marks omitted).

Approximately 95% of Second Lien and Class 5B Noteholders signed onto the Commitments and participated in the Private Placement. A small group of noteholders who did not participate in the mediation (the “Ad Hoc Group”) objected to the Plan, arguing that the Private Placement: (1) violated Bankruptcy Code § 1123(a)(4) by treating claims in the same class unequally; (2) violated the good faith requirement in Bankruptcy Code § 1129(a)(3) by failing to maximize the value of the debtors’ estate; and (3) violated Bankruptcy Code § 1125(b) by improperly soliciting creditor votes in favor of the Plan. Case No. 16-42529-399 (Bankr. E.D. Mo) (Dkt. 2649). The Bankruptcy Court overruled these objections and confirmed the Plan on March 17, 2017, and the District Court affirmed that decision on December 29, 2017. *See id.* (Dkt. 2763); *In re Peabody Energy Corp.*, 582 B.R. at 783-84.

The Ad Hoc Group appealed the District Court’s decision to the Eighth Circuit, arguing again that the Private Placement resulted in unequal treatment of similarly situated non-participating creditors on account of their claims, and violated the Bankruptcy Code’s good faith requirement by offering a substantial portion of the reorganized debtors’ equity at an indisputably below-market price and conditioning the opportunity to receive that discount on an agreement to vote in favor of the Plan. (The Ad Hoc Group did not pursue its argument that the Plan violated § 1125(b) of the Bankruptcy Code at this phase of the case.) The debtors responded by arguing that: (1) the right to participate in the Private Placement was granted not on account of creditors’ prepetition claims, but rather in exchange for their Backstop Commitment; and (2) the good faith requirement is met when “there is a reasonable likelihood that the plan will achieve a result consistent with the standards prescribed under the Code,” and that the Plan satisfied this standard, given that the Rights Offering and Private Placement, together with the Plan’s other terms, allowed Peabody to succeed as a going concern while maximizing recoveries for creditors who otherwise might have received nothing. *Ad Hoc Comm. of Non-Consenting Creditors v. Peabody Energy Corp.*, No. 18-1302 (8th Cir. Apr. 16, 2019), *audio available at* <http://media-oa.ca8.uscourts.gov/OAaudio/2019/4/181302.MP3>.

Furthermore, during oral argument the Eighth Circuit panel raised potential concerns similar to those articulated by Judge Wiles in *Pacific Drilling*, including whether the additional value conferred on participating creditors was truly provided in exchange for new value and whether conditioning additional payments on

plan support constitutes bad faith or “vote buying.” *Id.* Notwithstanding these questions, however, on August 9, 2019, the Eighth Circuit affirmed the lower courts’ decisions, holding that the right to participate in the Private Placement did not constitute “unequal treatment” in violation of Bankruptcy Code § 1123(a)(4) because the opportunity “was not ‘treatment for’ the participating creditors’ claims,” but rather was “consideration for valuable new commitments made by the participating creditors,” including the promise to support the plan and to backstop the Private Placement and Rights Offering. *In re Peabody Energy Corp.*, No. 18-1302, 2019 WL 3756884, at *5 (8th Cir. Aug. 9, 2019). With respect to the question of good faith, although the court found it “troubling that creditors wishing to take part in the Private Placement had to elect to do so before approval of all the agreements and the disclosure statement,” it nevertheless concluded that it lacked “a definite and firm conviction that a mistake ha[d] been committed” by the Bankruptcy Court under a “clear error” standard of review, in light of countervailing factors that included: (1) broad acceptance of the Plan by all twenty classes; (2) participation in the Private Placement by 95% of unsecured creditors; (3) the high cost of delayed plan consummation; and (4) the potential for plan sabotage and market risk absent the Support Commitment. *Id.* at *6-7 (quotation marks omitted).

IV. Significance

The Eighth Circuit’s *Peabody* decision may largely put to rest speculation that Judge Wiles’s concerns in *Pacific Drilling* signaled the dawning of a new era in which proposed backstop commitments and exclusive financing opportunities would be subjected to more rigorous scrutiny. It is notable, however, that while the courts in both *Pacific Drilling* and *Peabody* ultimately approved the financings in question, they also involved instances where the financings were challenged by only a small group of creditors (*Peabody*), or not challenged at all (*Pacific Drilling*). This may indicate a recognition by the restructuring community that creditors who are willing to become restricted to negotiate a plan with the debtor may be entitled to some compensation for that work, and that the opportunity to participate in a backstop or private placement may be an appropriate way to provide such compensation. It remains to be seen, however, whether other courts in the Southern District of New York or elsewhere will heed Judge Wiles’s caution, especially in the event that a proposed financing is subject to objection from a material portion of the creditor body.

Securities and Structured Finance Update

CMBS Fair-Value Purchase Option Litigation: Current Issues and Trends

For several years, the commercial mortgage-backed security (“CMBS”) market has been plagued by an abusive scheme involving fair-value purchase options. The scheme is simple: a special servicer or controlling-class representative holds the right under the pooling and servicing agreement (“PSA”) to purchase loans owned by the CMBS trust. They work to acquire the loan at a depressed price through a low appraisal, and then flip it to a purchaser for its true value, reaping millions at the expense of the CMBS trust. Four recent cases addressing this scheme offer lessons for investors who may look to curb this abuse.

Last year, such investors were dealt an initial blow when New York’s intermediate appellate court dismissed two suits over the exercise of fair-value purchase options, concluding they were barred by the no-action clause in the CMBS PSA. See *Alden Global Value Recovery Master Fund, L.P. v. KeyBank N.A.*, 159 A.D.3d 618 (1st Dep’t 2018); *M.H. Davidson & Co. v. C-III Asset Mgmt., LLC*, 161 A.D.3d 710 (1st Dep’t 2018). Through a no-action clause, a typical CMBS PSA restricts investors from bringing suit. Often the no-action clause requires that, as a condition precedent to filing suit, a certain percentage (e.g., 25%) of investors give written notice of a default to the trustee. By requiring a meaningful group of investors to act, no-action clauses can curb strike suits that waste the trust’s assets. But they can also limit access to courts’ oversight of abusive trust parties when their actions harm a small number of investors—as is often the case when, as here, marginal losses are concentrated on a narrow strip of certificateholders.

In *Alden Global*, the First Department held that a no-action clause barred claims concerning the exercise of a \$59 million purchase option on the Bryant Park Hotel loan, which was refinanced for over \$100 million dollars just a few weeks later. 159 A.D.3d at 624-26. Two months later, in *M.H. Davidson & Co.*, the court again barred a challenge to the exercise of a purchase option on two loans totaling over \$350 million because of the no-action clause. 161 A.D.3d at 710. In both *Alden Global* and *M.H. Davidson & Co.*, the exercise of the fair-value purchase options had been completed before the suit was filed. As a result, the only relief available to harmed investors was damages. But because the investors could not satisfy the no-action clause, they were left without a remedy.

More recently, in response to these decisions, investors have sought to take proactive steps to combat abusive fair-value purchase options before they are

completed. By preventing the exercise of the fair-value purchase option at all, investors have successfully avoided harm without running afoul of the no-action clause. Two recent cases from New York's Commercial Division provide helpful guidance for navigating these early-action strategies.

In *Metacapital Mortgage Opportunities Master Fund, Ltd. v. Wells Fargo Bank, N.A.*, No. 656170/2018 (Sup. Ct. N.Y. Cty.), an incoming controlling-class representative (who also held 25% of the voting rights in the CMBS trust) sued the trustee and moved by order to show cause for a temporary restraining order and preliminary injunction to block the exercise of a purchase option. In suing the trustee, the *Metacapital* plaintiff avoided dismissal by relying on New York law that excuses compliance with the no-action clause for claims against a trustee "because it would be absurd to require [investors] to ask the Trustee to sue itself." *Quadrant Structured Prods. Co. v. Vertin*, 23 N.Y.3d 549, 556 (2014) (quoting *Cruden v. Bank of N.Y.*, 957 F.2d 961, 968 (2d Cir. 1992)).

In the CMBS PSA at issue in *Metacapital*, the special servicer's right to act was granted by the trustee through a power of attorney. The plaintiff thus asked the Court to direct the trustee to revoke the power of attorney to prevent the exercise of the fair-value purchase option. *Metacapital*, No. 656170/2018, Hrg. Tr. at 3 (Dec. 17, 2018), NYSCEF Doc. No. 26. The Court granted the requested relief to maintain the status quo pending a hearing on the preliminary injunction. *Id.* at 5. After obtaining the temporary restraining order, the new controlling-class representative replaced the special servicer. The case later settled. *Id.*, Stipulation (Feb. 12, 2019), NYSCEF Doc. No. 79.

In *TCA SPV IV LLC v. Wells Fargo Bank, N.A.*, Nos. 655359/2018 and 650385/2019 (Sup. Ct. N.Y. Cty.), the loan involved—the Fireman's Fund loan—was split into two notes held by different CMBS trusts (BACM 05-5 and GECMC 2005-C4) subject to a co-lender agreement. *Id.*, No. 650385/2019, Pet. ¶ 34 (Jan. 18, 2019), NYSCEF Doc. No. 1. Typically in this structure, the deal documents identify one trust's controlling-class representative as the party permitted to replace the special servicer for the loan. Counter to this convention, the *TCA SPA IV* deal documents identified the party to exercise these rights by a defined term (the "Fireman's Fund Controlling Holder"), but did not say who the Fireman's Fund Controlling Holder was. *Id.* ¶ 41. Notwithstanding this anomaly, the BACM 05-5 controlling-class representative previously had appointed a new special servicer for the Fireman's Fund loan.

Then, in the same month that the loan moved to

special servicing, another investor wrote the trustee to challenge that special servicer's appointment by the BACM 05-5 representative. In response to the investor's letter, the trustee rescinded the prior appointment of the special servicer for the Fireman's Fund loan and reappointed the first special servicer. *Id.* ¶ 52. After its reappointment, the first special servicer received an offer to purchase the Fireman's Fund loan at par value (which, if accepted, would thwart any attempt to exercise the fair-value purchase option at a lower price). *Id.* ¶ 61. The BACM 05-5 controlling-class representative sued the trustee and moved for a temporary restraining order and preliminary injunction seeking a declaration that it was the proper party to appoint the special servicer for the Fireman's Fund loan and to block the par sale of the Fireman's Fund loan. Based on its interpretation of the PSA, the Court first ruled that the controlling-class representative did not have the right to replace the special servicer of the Fireman's Fund loan. *Id.*, No. 655359/2018, Hrg. Tr. at 73-75 (Sup. Ct. N.Y. Cty.), NYSCEF Doc. No. 60. Two months later, the Court rejected the controlling-class representative's attempt to block the sale at par. *Id.*, No. 650385/2019, Decision & Order on Motion (Mar. 6, 2019), NYSCEF Doc. No. 75.

Considered together, these four cases offer helpful guidance for investors to consider when facing an abusive exercise of a fair-value purchase option. Some useful strategies include:

- ***Understanding what the PSA says about the fair-value purchase option and the rights of the controlling-class representative, special servicer, and other investors.*** The actual deal terms may deviate significantly from industry convention, as in *TCA SPA IV*, or may provide ways to avoid no-action clause issues, as in *Metacapital*. Also, certain PSAs grant broad information rights for certificateholders, which require disclosure of reports prepared by the special servicer on property value and disposition strategy (e.g., Asset Status Reports) and some correspondence between the special servicer and controlling-class representative.
- ***Partnering with aligned investors.*** Review the no-action clause and identify what the conditions precedent to suit are. Joining with aligned investors can provide leverage and, ideally, may satisfy the no-action clause's conditions, avoiding the results in *Alden Global* and *M.H. Davidson & Co.*
- ***Knowing the controlling-class representative and special servicer.*** Certain parties are repeat players in purchase-option controversies.

Familiarity with these parties and ability to remain in contact with them can facilitate rapid and impactful early intervention.

- **Identifying targeted loans early.** Know what loans may be subject to the exercise of a fair-value purchase option and actively engage with deal parties to deter misconduct, like the letter sent by investors in *TCA SPA IV*.
- **Carefully monitoring for notices of exercise of fair-value purchase options.** Certain PSAs may provide short timeframes to react to the exercise of fair-value purchase options, so careful monitoring for notices of such exercise can ensure maximum time to strategize.
- **Offering to “credit bid” properties subject to abusive purchase options.** By leveraging the expected return on an investment in the CMBS certificates to bid the property, victims of an abusive purchase option may be able to acquire the property themselves or, at least, deter the special servicer from exercising at a lower price for fear of violating the servicing standard.

Life Sciences Update

Federal Circuit Denies Rehearing En Banc in Contentious Case Involving Patentability of Diagnostic Testing

On July 3, 2019, in *Athena Diagnostics, Inc. v. Mayo Collaborative Services, LLC*, 927 F.3d 1333 (Fed. Cir.), the Court of Appeals for the Federal Circuit denied Plaintiff Athena’s petition for rehearing en banc.

The denial of the petition, however, led to eight separate concurring and dissenting opinions from active Federal Circuit judges, an unusually large number, demonstrating significant splits of opinion regarding the patentability of diagnostic test kits, as well as express requests for either Supreme Court or Congressional clarification regarding such patentability.

In the original panel decision, the Federal Circuit affirmed the dismissal of a patent infringement complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) on the ground of subject matter ineligibility. See *Athena Diagnostics, Inc. v. Mayo Collaborative Servs., LLC*, 915 F.3d 743, 753-54 (Fed. Cir. 2019). The patent at issue was directed to a diagnostic test for an autoimmune disease that involved testing for the presence of certain antibodies by contacting the sample with a radioactive labeled protein. In the panel decision, the Court affirmed the district court’s dismissal based on 35 U.S.C. § 101, following Supreme Court precedent in *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*, 566 U.S. 66, 77 (2012).

The patent holder moved for rehearing en banc,

which the Federal Circuit denied, accompanied by eight opinions. 927 F.3d 1333 (Fed. Cir. 2019).

- *Lourie* (joined by Judges Reyna and Chen) Judge Lourie concurred with the denial of rehearing because, according to Judge Lourie “we can accomplish little in doing so” as the court is bound by Supreme Court precedent in *Mayo*. *Id.* at 1335. Judge Lourie noted that concerns have been expressed about this precedent and wrote that if he were to “write on a clean slate” only claims directed to natural laws themselves would be outside of patent eligibility. *Id.*
- *Hughes* (joined by Judges Prost and Taranto): Judge Hughes concurred with the denial and echoed Judge Lourie that *Mayo* controls and forecloses a decision different than that of the panel. Judge Hughes, however, requested additional clarification about patent eligibility for diagnostic testing patents from either the Supreme Court or Congress. *Id.* at 1337.
- *Dyk* (joined by Judge Hughes, and joined by Judge Chen for portions): Judge Dyk concurred with the denial and provided an overview of the importance of Section 101 eligibility analysis. *Id.* at 1338–39. Additionally, Judge Dyk expressed concern for the natural law approach of the Supreme Court’s *Mayo* precedent. *Id.* at 1339. Judge Chen joined in the portion of Judge Dyk’s opinion in which Judge Dyk wrote that it would be desirable for the Supreme Court to revisit and refine the *Mayo* framework. *Id.* at 1340. Judge Dyk further stated that Athena’s case would be a good case to revisit the issue. *Id.* at 1343-44.
- *Chen*: Judge Chen concurred with the denial but wrote that further Supreme Court guidance would be helpful for diagnostic patents. Judge Chen provided an overview of Supreme Court 101 precedent, describing how recent cases such as *Mayo* deviate from the core rationale of earlier precedent as articulated in *Diamond v. Diehr*, 450 U.S. 175 (1981). *Id.* at 1344. Judge Chen argued that the analytical approach set forth in *Mayo* is “considerably harder to apply consistently than the *Diehr* framework, and more aggressive in its reach.” *Id.* at 1348.
- *Moore* (joined by Judges O’Malley, Wallach and Stoll): Judge Moore dissented from the denial and argued that the patent claims at issue are distinguishable from the Supreme Court’s *Mayo* precedent. Judge Moore argued that “[w]e have turned *Mayo* into a per se rule that diagnostic kits and techniques are ineligible.” *Id.* at 1354. Judge Moore further stated that there are strong

(continued on page 11)

VICTORIES

Precedential Victory for Oyster Bay in the Second Circuit

The firm achieved an important victory for municipalities struggling with civil litigation caused by the misconduct of their officials. In a recent decision, the U.S. Court of Appeals for the Second Circuit ruled that the Town of Oyster Bay, located in the greater New York metropolitan area, could not be liable on a contract that had been agreed to by Town officials without the approval of the Town's governing body, the Town Board. See *PHL Variable Ins. Co. v. Town of Oyster Bay*, 929 F.3d 79 (2d Cir. 2019).

The plaintiff, PHL Variable Insurance Company, lent millions of dollars to Harendra Singh, a restaurateur whose companies operated the concessions at the Town's parks and beaches. PHL claimed it made the loan because the Town guaranteed the loan's repayment. The guarantee, however, was fraudulent: it was agreed to by Town officials who have since admitted to accepting bribes from Singh in exchange for falsifying the Town's agreement to guarantee his debts, including the loan from PHL. Singh, as well, pleaded guilty to bribery and other public corruption charges after the scheme was uncovered. Against this backdrop, PHL sued the Town, seeking to enforce the guarantee and claiming that the Town also committed fraud through its corrupt officials.

The firm moved to dismiss PHL's claims, arguing that the guarantee was unenforceable because it was never authorized by the taxpayers' elected officials on the Town Board, as required by New York's Town Law. The firm also argued that PHL proceeded at its own risk when it dealt exclusively with the disloyal officials rather than obtain Town Board authorization.

The Second Circuit agreed, affirming the district court's dismissal of PHL's claims with prejudice in a comprehensive opinion that adopted virtually all of the arguments advanced by the firm on behalf of the Town. In doing so, the Second Circuit reasoned that the purpose of the rule requiring Town Board approval is "to guard against extravagance and collusion on the part of public officials." *Id.* at 90 (quotation marks omitted). This requirement is "stringently enforced," the Court ruled, and because there was no Town Board approval in this case, PHL had no valid contract with the Town. *Id.* at 89-94. Similarly, in affirming the dismissal of PHL's fraud claims, the Second Circuit held that PHL could not have been misled into believing it had a legal contract with the Town since it "is presumed to have known" municipal law, including that "it would need [Town Board] authorization." *Id.* at 94.

Most importantly for municipalities, the Second

Circuit affirmed the principle that statutes governing municipal contracts protect taxpayers above everyone else, even in cases of public corruption. *Id.* at 93. As a result of this principle, the "risk of loss" from an unauthorized contract was on PHL, not the Town's innocent residents. *Id.* at 92 (quotation marks omitted). If there is "occasional hardship" from this, the Court concluded, it should be borne by the person who failed to determine whether proper authorization existed. *Id.* at 93 (quotation marks omitted).

NAFTA Tribunal Upholds Jurisdiction Over All Claims and Awards Interim Legal Costs

Quinn Emanuel represents a group of 38 individuals and entities in an international arbitration under the North American Free Trade Agreement (NAFTA). The investors' claims arise from various measures taken by the Mexican government, including the cancellation of valid permits to operate casinos in Mexico, culminating in the closure of the U.S. investors' casino business in Mexico. The arbitration is administered by the International Center for the Settlement of Investment Disputes (ICSID), with a legal seat of arbitration in Toronto, Canada. Mexico raised a number of jurisdictional objections and requested that the Tribunal dismiss the entire case or, alternatively, substantially reduce the damages the Claimants were seeking.

On July 19, 2019, Quinn Emanuel achieved a complete jurisdictional victory against the government of Mexico. The Tribunal, consisting of Dr. Gaëtan Verhoosel (president), Prof. Gary Born (Claimants' nominee) and Prof. Raúl Emilio Vinuesa (Respondent's nominee) issued a partial award rejecting each of Mexico's jurisdictional objections under the Treaty and upheld the Tribunal's jurisdiction, allowing the Claimants to proceed with their claims and to potentially recover the full measure of the damages (over \$150 million) that Mexico caused the Claimants. In a nod to the full scope of the victory, the tribunal also took the highly unusual step of awarding Claimants over \$1.4 million in attorneys' fees and costs.

The Claimants owned and operated 5 successful casinos in Mexico until 2014, when Mexico unlawfully shut down their operations. At the time the casinos were shuttered, the Claimants were in the process of opening two additional casinos, one in Cabo and one in Cancun. In 2014, shortly after Mexico shut down the casinos, the Claimants retained another law firm to pursue an international arbitration. That law firm filed a Notice of Intent on the Claimants' behalf and tried to broker negotiations with the government of Mexico, to no avail.

In 2016, the Claimants chose to retain Quinn Emanuel. The Quinn Emanuel team worked carefully and closely to counter Mexico's jurisdictional arguments, which included: (1) that the Claimants had not properly engaged Mexico's consent under Article 1121 of the NAFTA; (2) that the Claimants' Notice of Intent did not comply with Article 1119 of the Treaty; and (3) that the Claimants could not prove that they had the requisite ownership and control over the local Mexican companies to pursue a claim on their behalf. On the Article 1121 consent issue, the Tribunal found that the Request for Arbitration's clear language whereby the Claimants "accepted Mexico's offer to arbitrate" showed that the Claimants did in fact consent to arbitration. On the Article 1119 Notice of Intent issue, a majority of the Tribunal held that the Notice of Intent's omission of some of the Claimants was not a jurisdictional matter, but an admissibility matter which afforded the Tribunal discretion to decide whether to admit the Additional Claimants' claims. In reaching this conclusion, the Tribunal squarely rejected the proposition that Mexico's consent to NAFTA arbitration under Article 1122 was conditional on satisfaction of Article 1119's Notice of

Intent requirement. On the standing issue, a majority of the Tribunal found that the Claimants owned and/or controlled all of the Mexican entities (with the exception of one minor company) and that they had standing to bring claims on behalf of all of the companies.

This is a significant victory for Quinn Emanuel and will allow the Claimants to proceed with their substantive claims against Mexico and to potentially recover the full measure of the damages. The case is *B-Mex, LLC et al. v. United Mexican States*, ICSID Case No. ARB(AF)/16/3. Quinn Emanuel works with Julio Gutiérrez of Rios Ferrer, Guillen-Llarena, Treviño y Rivera, SC as co-counsel in Mexico. [Q](#)

PRACTICE AREA NOTES (cont.)

(continued from page 9)

- economic incentives for patent protection for diagnostic inventions. *See id.* at 1357 ("Unless one opposes the notion of patent protection entirely, it cannot be reasonably disputed that claims to diagnostic kits and techniques, like pharmaceuticals, which require enormous initial investments in terms of both time and money, are the reason we suffer the promise of a monopoly.").
 - *Newman* (joined by Judge Wallach): Judge Newman dissented from the denial and highlighted the importance of diagnostic testing patents, arguing that Supreme Court precedent is being applied too broadly. *Id.* at 1364.
 - *Stoll* (joined by Judge Wallach): Judge Stoll dissented from the denial and argued that the Federal Circuit has "established a bright-line rule of ineligibility for all diagnostic claims" that is based on an overly-broad and flawed test for eligibility. *Id.* at 1370. Judge Stoll further argued that the Federal Circuit has applied *Mayo* too rigidly and should instead "create judicial doctrine geared toward the practical application of *Mayo*'s principles." *Id.* at 1371.
 - *O'Malley*: Judge O'Malley dissented from the denial and argued that the Supreme Court has ignored Congress's direction to the courts to apply Section 101 as written. Judge O'Malley further called for Congress to intervene. *Id.* at 1373.
- Given the express requests for Supreme Court and/or Congressional clarification or intervention by Federal Circuit judges, it appears that the issue of patent eligibility for diagnostic testing will remain hotly contested. [Q](#)

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business litigation report

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