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English Fraud Litigation: Weapons of Mass Destruction

Imagine if you could have your opponent's premises searched, his Gmail, Hotmail, and Yahoo accounts secretly monitored, his assets frozen, his passport seized, and even have him arrested and imprisoned – all before trial.

The English Courts have developed powerful and innovative remedies such as these to assist victims of fraud. And while they may be familiar to English civil fraud lawyers, they are likely less familiar to lawyers in other jurisdictions. In this article, we summarize some of the different kinds of aggressive measures that are available in English civil fraud litigation, which include substantial fines, asset seizures, orders to search premises, and even imprisonment. These are very effective deterrents and one of the reasons why victims of international fraud frequently turn to the English courts. Partly in recognition of these unique, wide ranging, and creative remedies, civil fraud litigation is treated as a separate, specialized practice area in England.

Worldwide Freezing Orders – "Nuclear Weapon" of English Litigation

"Worldwide Freezing Orders" (WWFOs for short) are referred to as the "nuclear weapons" of English litigation. They force potential fraudsters to disclose their assets wherever they may be based, freeze those assets, and ultimately prevent them from being dissipated. WWFOs can be made in support of English proceedings or in support of foreign proceedings. They can be made against parties domiciled outside England.

Compliance with WWFO's can be extremely time consuming and burdensome. Very frequently the respondent may attempt to breach a WWFO in an effort to conceal assets or in the mistaken belief that there will be no consequences. The Court, however, has developed numerous devices to police compliance. If fraudsters refuse or fail to comply with the orders of the Court, they can be imprisoned, fined and/or barred from defending the claims against them (see below). Border authorities keep records of parties in

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Top Litigator Joins the Firm's New York Office

Luke Nikas has joined the firm as a partner based in the New York office. Mr. Nikas was previously a partner at Boies Schiller Flexner LLP. He is a commercial litigator with extensive experience and success representing clients in complex disputes across leading industries, including banking, insurance, art, real estate, pharmaceuticals, and health care. He has represented clients including Fortune 100 companies; large private companies and executive-ranks; prominent art foundations, collectors and galleries; and Pulitzer Prize-winning journalists. Recently, Mr. Nikas was named to *Lawdragon*'s 2017 list of the "500 Leading Lawyers in America" and *Benchmark Litigation*'s "Under 40 Hot List." A prominent art publication called him one of the most "highly influential" art lawyers in the world after he led the defense in a forgery case dubbed by ArtNews as "The Art Trial of the Century." Q

Stephen Hauss Named to *Global Investigations Review's* 40 Under 40

Global Investigations Review named Stephen Hauss to its 40 Under 40 list of the world's leading investigations specialists who will help shape the future of this practice area. Stephen's and the firm's work on behalf of Virginia First Lady Maureen McDonnell and in the FIFA investigation were highlighted in the publication's profile. Q

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contempt of court, who are liable (if they are in transit through England) to be arrested and immediately taken to court for sentencing.

In view of its powerful effect, an application for a WWFO is almost always made without notice, so that the respondent does not dissipate its assets in the interim (*i.e.*, between the application and the hearing date). Where an application is made without notice, the applicant must disclose all matters that are material to the court in deciding whether to grant the order and, if so, on what terms. This includes disclosure of relevant facts and legal principles even if they are not in the applicant's favor. This is known as the duty of full and frank disclosure. Failure to give full and frank disclosure is something which the English Courts take very seriously given the draconian consequences of a WWFO.

The definition of assets for the purposes of the WWFO is broad. In addition to encompassing traditional assets (bank accounts, properties, investments, etc.), it can also extend to less obvious assets: for example, loan facilities, assets owned by wholly owned companies, interests in a trust fund, and assets owned by a trust. It includes assets in which the respondent has a legal or beneficial interest.

A WWFO does not give the innocent party any priority or security over the frozen assets in question. Rather, it seeks to preserve the assets so that any subsequent judgment in favor of the applicant can be enforced against the assets so preserved. In certain circumstances, a WWFO may also be made against other parties who appear to hold assets on behalf of the respondent. This is a very effective tool where a respondent controls (directly or indirectly) third parties and uses those third parties to create an artificial separation of ownership of assets.

In order to obtain a WWFO in England & Wales, the applicant must demonstrate to the Court that: (i) it has a cause of action, *i.e.*, an underlying legal or equitable right that has been breached; (ii) the English Court has jurisdiction (as to which see below); (iii) it has a good arguable case against the potential fraudster – *i.e.,* a case "*which is more than barely capable of serious argument and yet not necessarily one which the judge believes to have a better than 50 per cent chance of success*"; (iv) there is a real risk that, without the WWFO, the fraudster will seek to dissipate assets beyond the reach of the innocent party—the court may infer a risk of dissipation from the parties' previous conduct, particularly if there is evidence of fraud or if the assets could easily be transferred to third parties; and (v) under the circumstances, it is just and convenient for the order to be granted.

Out of all these conditions, risk of dissipation is often the most difficult to prove. The courts will consider, objectively, whether there is a risk of dissipation, taking into account all the circumstances. Relevant factors in demonstrating risk of dissipation include *inter alia*: (i) the ease with which the assets in question could be moved out of the applicant's reach; (ii) evidence of the respondent's dishonesty, particularly in relation to misuse of assets; (iii) potential adverse inferences to be drawn from the respondent's incorporation in a tax or finance haven (in the case of a company); (iv) the respondent's past and present credit record; and (iv) circumstances where the underlying claim involves allegations of criminal behavior by the respondent.

Burdensome Compliance

Once a WWFO is obtained and served, the respondent is required to give disclosure of his *worldwide* assets over a *de minimis* amount, for example USD 5,000. This disclosure must be given in an extremely limited timeframe—often a matter of days. This makes compliance both burdensome and time-consuming, particularly where the respondent holds assets around the world in a number of various forms.

The information provided must include (among other things) the value of the assets; their location; and whether or not the assets are individually or jointly owned. In addition, within a further few days, the information must be verified by a sworn affidavit from the respondent to the Court. The obligation to provide the information is on-going and newly acquired assets must also be disclosed on a rolling basis.

Non-Compliance with a WWFO

Failure to comply with a WWFO (including unnamed parties that are placed on notice of the terms of the WWFO) is a serious offense. It may result in imprisonment, fines or asset seizures (as to which, see below). There is therefore a strong incentive on the respondent to a WWFO with any interest in maintaining links with England & Wales to provide the required information on a timely and accurate basis, and not to attempt to dissipate its assets or otherwise try to conceal them further.

To the extent, however, that information comes to light and shows that the disclosure provided by the respondent is deficient, there are a number of steps that the applicant can take to further increase pressure on the respondent.

Third-Party Disclosure Orders

A claimant's priority is invariably to position itself so

that it can recover the assets that were taken from it as quickly as possible. If a respondent complies fully with a WWFO, the innocent party will learn not only the location of the respondent's assets but will also know that they are frozen by the WWFO. If, however, the respondent has been less than honest with its asset disclosures, the innocent party must locate the fraudulent proceeds as a priority. This can be far from straightforward, with potential fraudsters becoming increasingly sophisticated in hiding funds, often by means of complex corporate structures spread across numerous offshore jurisdictions.

In order to protect innocent parties as much as possible, and to enable them to trace the flow of funds from source to their current location, the English Court has developed a number of different forms of disclosure orders ("Disclosure Orders"), which can be used to obtain information from third parties as to the whereabouts of the stolen assets.

To obtain Disclosure Orders, the innocent party must typically demonstrate that a third party respondent against whom the order is sought is likely to have relevant documents or information available to it.

In many cases, Disclosure Orders are obtained against banks that the respondent is known to have accounts with. The banks can be required to provide the applicant with banking records held in relation to the respondent, including (but not limited to) client opening information, bank account statements and copies of checks. Critically, banks can be ordered to provide the information in a very short time frame (usually a matter of days) and to provide it not just in relation to the known bank accounts of the respondent but also in relation to any other account held by that individual. The innocent third party can therefore effectively "trace" the flow of funds through various accounts.

More recently, in addition to Disclosure Orders against banks, the Courts have been willing to grant Disclosure Orders against Internet and email providers, such as Yahoo. Such an order allows victims of fraud to access and review electronic communications in relation to a fraud that had been committed. This order was obtained in the *JSC BTA Bank v Ablyazov* litigation and had devastating consequences as it effectively granted the Court a private window into the fraudster's activities. The order is demonstrative of the extent to which Courts are increasingly prepared to help victims.

Of critical importance when seeking Disclosure Orders is the innocent party's ability to request a "gagging order" from the Court. The gagging order prevents the disclosing party from "tipping off" the fraudster to the fact of the application or resulting disclosure. It is extremely helpful at allowing victims to attempt to stay ahead of a fraudster seeking to dissipate assets or avoid orders of the English Court. This maximizes the innocent parties' prospects of locating both where funds have flowed since the fraudulent scheme took place and where they presently are.

Contempt of Court – Imprisonment

When a respondent has failed properly to comply with its obligations pursuant to a WWFO, it may be open to the applicant to issue contempt proceedings. These can be brought on an urgent basis soon after a respondent has breached its obligations, the purpose being to seek relief from the Court in an attempt to secure compliance with the order and to secure available assets.

If the Court is satisfied that the respondent has committed a serious breach of the Court's order, sanctions are extremely severe.

In recent years, for instance, there have been many instances of respondents being given prison sentences of up to two years for breaches of WWFOs. These include, amongst many others, *JSC BTA Bank v Ablyazov* (Mr Ablyazov was sentenced to 22 months in prison for disposal of assets, non-disclosure of assets and lying to the Court); *Thursfield v Thursfield* (a 24 month sentence was imposed for continued failure to provide documents under a WWFO); *JSC BTA Bank v Solodchenko and others* (a 21 month sentence was ordered on the basis that compliance with the Court's order was incomplete and had contained knowingly false information), and the very recent *Ji-Chuen Jason Tsai* case, where the respondent was sentenced to 18 months' imprisonment for multiple individual breaches of the WWFO.

Contempt proceedings are, however, usually expensive and time-consuming applications. In practice, parties therefore often strategically take the preliminary steps necessary for contempt proceedings without ultimately following through with the application. This is to place the defendant or those associated with the defendant under significant pressure during the preliminary stages in litigation, with the objective of securing an early settlement of the dispute.

Debarring Orders

The Court is also increasingly issuing so-called "Debarring Orders" if it is satisfied that the defendant has failed to comply with a WWFO. The claimant victim obtains an "unless order", which requires the

respondent to properly comply with the WWFO, failing which the respondent will be barred from defending the claim against it.

While this can be seen as a draconian measure, the English Courts have traditionally considered that the overriding interest of justice includes orders of the court being respected and obeyed.

The opportunity to effectively tie the respondent's hands from defending itself is a serious weapon in a litigant's arsenal. If obtained, it can help facilitate a swift dispute resolution at reduced costs (particularly given that debarring orders are likely to be less costly than an application for contempt of court or even an application for cross examination of assets). For this reason, a trend is emerging in London proceedings whereby applicants are opting to strategically bring contempt proceedings in the knowledge that if contempt of Court is established, this could lead to a debarring order. In what is known as "sanctions based litigation," parties are effectively seeking to obtain judgment by circumventing the trial procedure, thus saving significant time and costs. Sanctions based litigation can be a very effective means of obtaining swift justice.

Passport Seizure

If an individual respondent is considered a flight risk, the Court is sometimes prepared to order the respondent to hand over his/her passport to the applicant's solicitors preventing him/her from leaving the country. This is another effective means of facilitating early settlement.

Search and Seize Orders

Finally, parties are able to seek Search and Seize Orders from the English Court. Search orders are a form of mandatory injunction, which require a defendant to allow the applicant's representatives to enter the defendant's premises and to search for, copy, remove, and detain documents, information, or material. The purpose of a search order is to allow applicants to preserve evidence or property which is, or may be, the subject of an action.

Search orders are effective weapons in circumstances where there is a belief that the defendant will destroy documents in contravention of a Court order. By obtaining a search order on a without notice basis, an applicant may be able to gain a significant advantage in the litigation by obtaining information and documents that it would otherwise never be able to obtain.

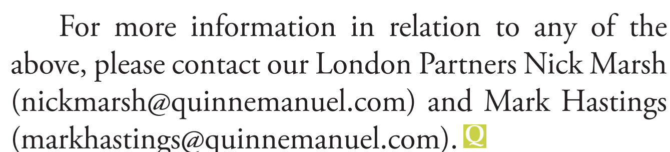
Due to their nature, search orders are considered one of the most draconian orders that the Court can make. If a defendant fails to comply with a search order, he may be held in contempt of court and similar sanctions to WWFOs (as set out above) may apply. Search orders should therefore always be considered when acting against fraudsters who are prepared to take steps to evade justice. They can be very effective tools in a English litigant's armory.

Quinn Emanuel's London Office

Quinn Emanuel's London office has vast experience of obtaining WWFOs, Disclosure Orders, and Search Orders in London in aid of both domestic and foreign proceedings. We forensically review the documents and disclosures made by fraudsters and, where the information is misleading or incomplete, we take strategically aggressive and robust steps to use the full gamut of remedies, including applications for contempt of court.

When obtaining Disclosure and Search Orders, we trace and recover undisclosed assets belonging to fraudsters. Our approach allows our clients to make maximum recoveries of the sums that are owed to them.

For more information in relation to any of the above, please contact our London Partners Nick Marsh (nickmarsh@quinnemanuel.com) and Mark Hastings (markhastings@quinnemanuel.com).



NOTED WITH INTEREST

Supreme Court Takes on Drugs, Data, and Extraterritoriality

On October 16, 2017, the Supreme Court made a surprising grant of review in a case which may have far reaching consequences for tech companies and litigants generally. The case, *United States v. Microsoft Corp.*, involves a subpoena issued in a domestic drug trafficking investigation, which the Second Circuit quashed on the ground that the Stored Communications Act, 18 U.S.C. 2703 ("SCA"), does not apply extraterritorially. Although the Second Circuit did not create any circuit split, the Supreme Court granted certiorari, possibly setting the stage for a decision with major implications for data storage practices, privacy, and the role played by tech companies in law enforcement and dealing with conflicting international rules on privacy.

Electronic communications providers such as Microsoft store vast amounts of data and information, which can be kept on servers anywhere in the world and often are stored far from where the stored communications originated or were sent. In December 2013, a magistrate judge in the S.D.N.Y. issued a warrant under the SCA for information concerning an individual who used an msn.com email account. The warrant was served on Microsoft in the United States. Microsoft handed over the information stored in the United States, but objected to providing communications stored in a data center in Ireland, even though the information was electronically available to Microsoft from the United States. When Microsoft moved to quash the latter aspect of the warrant, the magistrate judge denied the motion, and the district court affirmed. On appeal, however, the Second Circuit overturned the decision and ordered the warrant quashed.

In overturning the lower court, the Second Circuit relied not only on the SCA's text and the practice relating to it, but also on the presumption against applying American law extraterritorially. The court of appeals noted that the SCA uses the language of warrants, which have historically been territorially-limited, and that the boilerplate language on the SCA warrant in the case contemplated the searching of premises and the seizure of materials and things rather than production of materials under Microsoft's control, as a subpoena would. In addition, the Second Circuit invoked the presumption endorsed by the Supreme Court in *Morrison v. Nat'l. Australia Bank, N.A.,* 561 U.S. 2869 (2010), and recently reaffirmed in *RJR Nabisco, Inc. v. European Community,* 136 S. Ct 2090 (2016), that American laws apply only within United States territory unless explicit statutory language extends the law's reach extraterritorially.

As the Second Circuit acknowledged, refusal to apply the SCA extraterritorially will significantly impact law enforcement. The government's ability to timely investigate and prosecute cases as varied as drug trafficking, child sexual exploitation, and terrorism will be hampered if law enforcement officials are unable to obtain information from electronic communications providers using a valid warrant simply because the provider has elected, usually for economic reasons, to store the information in data centers outside the country. Indeed, when the United States government petitioned for review of the Second Circuit's decision in *Microsoft*, more than thirty states filed an amicus brief supporting the petition. This amicus brief described the challenges law enforcement would face under the Second Circuit's decision, including delays in accessing time-sensitive information and resource-intensive applications to foreign bodies for data, as well as avoidable tensions created by involving foreign governments in the seizure of data that may be protected in countries with more restrictive privacy laws when an engineer in the United States can access the data on a foreign server without complication.

In addition to these important law enforcement considerations, the *Microsoft* case also implicates broader issues of widespread importance. The SCA was enacted in 1986 before the Internet had assumed its current, ubiquitous role, before the advent of cloud computing technology, and before the rise of social media and other new means and forms of communication. As a result, the SCA is badly outdated and in need of modernization. However, despite bipartisan recognition of the need to reform the SCA, Congress has failed to act, leaving the courts to administer a law increasingly out of tune with contemporary circumstances. The Supreme Court's grant of review in the *Microsoft* case may indicate a willingness to intervene in adapting laws such as the SCA to changing technology. Or, alternatively, the Supreme Court may decide that courts should refrain from attempting to do so. Many foreign countries, particularly in Europe, have data privacy laws of their own, and many are more stringent than American laws. A broad interpretation of the SCA might bring American law enforcement efforts into conflict with those laws, creating international tensions. Especially in light of those potential problems, the Supreme Court may decide that it should leave the problem of adapting the SCA to modern circumstances to the political braches, which are better suited to deal with such considerations.

Whatever route the Supreme Court takes, its decision in the *Microsoft* case may have a profound impact. If the Court affirms the Second Circuit's decision and holds that the SCA does not apply extraterritorially, communications providers will be forced to formulate their practices at the intersection of public policy and technology without clear legal proscription or guidance. This will force them to become the gatekeepers of both the privacy of their customers' communications and the public safety interests raised by the government and their amici. Thus, in deciding where to store communications, communications providers will be forced to consider not only the economic advantages of storing communications in data centers outside the United States, but also their impact on law enforcement activities—a responsibility heightened by recent revelations about Russian use of social media in the last presidential election.

If the Supreme Court overturns the Second Circuit's decision, communications providers will be relieved of much of this responsibility. But if they are required to produce communications that are stored in foreign countries, they will face another problem: they will have to deal with foreign privacy laws, which may bar the production of such communications. As a consequence, communications providers will be forced to create policies and procedures for data storage allowing them to comply with their obligations under both the SCA and foreign privacy laws. In addition, many customers undoubtedly will take the different solutions reached by communications providers into account in choosing and utilizing communications providers.

And the *Microsoft* decision may have even greater impact if the Supreme Court overturns the Second Circuit's decision on broad grounds. While the Court might overturn on narrow grounds relating solely to law enforcement concerns, the Supreme Court's grant of cert in *Microsoft* may also indicate that the Court is rethinking the presumption against extraterritoriality in light of the increasing interconnectedness of global economies and global technologies. The Court may decide that presuming that law ends at territorial limits makes no sense in dealing with legal concerns raised by technologies that know no such limits. Such a ruling could impact many statutes as well as the requirements of and limits on document production from foreign jurisdictions in civil cases. For example, if communications stored in foreign countries are deemed to be under the control of communications providers because they can be accessed from the United States, litigants may be deemed to control any information that they access from United States and may be required to produce that information in discovery.

In short, no matter how it is decided, the *Microsoft* case may have far-reaching consequences and therefore should be followed carefully. Q

PRACTICE AREA NOTES

International Arbitration Update

Recent Developments in Third-Party Funding in International Arbitration. In recent years, reliance on third-party funding in arbitration has increased. Third-party funding raises two primary issues, which are intertwined: (1) should the existence of such funding be disclosed to the arbitrator(s) and the opposing party; and (2) should its existence require the funded party to provide security for costs? The rationale for disclosure is to allow arbitrators to check for conflicts of interest. However, an opposing party may use the disclosure to argue that security for costs is necessary because third-party funding could imply that a party lacks funds to pay for its own arbitration.

These issues were recently discussed in the international arbitration community through the Draft Report for Public Discussion of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration ("Draft Report"). The Draft Report was open to public comment between September 1 and October 31, 2017, and a final version incorporating public comments is forthcoming in April 2018.

The Draft Report notes that, on the issue of disclosure, no arbitral institutions have expressly required disclosure of third-party funding as a matter of course. Rather, arbitrators generally have discretion as to whether to require disclosure on a case-by-case basis. However, laws recently passed by Hong Kong and Singapore require such disclosure in locally seated arbitrations. In both jurisdictions, the laws require a party to disclose the existence of third-party funding and the name of the funder. Similarly, in arbitrations outside of Hong Kong and Singapore in which the arbitrators have required disclosure of third-party funding, parties generally have only had to disclose the identity of the third-party funder, not the terms of the funding arrangement or the reasons for the funding.

On the issue of security for costs, the general consensus in arbitral case law is that the use of third-party funding alone is not sufficient to grant security for costs. Rather, an opposing party would also have to establish bad faith or abuse. A recent decision supporting this trend is *Eskosol S.P.A. in Liquidazione v. Italian Republic*, ICSID Case No. ARB/15/50), Procedural Order No. 3 (June 12, 2017). In *Eskosol*, the arbitral panel denied security for costs against a party with a third-party funder, even though the party had been declared insolvent and placed under

receivership, noting: "The Tribunal is of the view that financial difficulties and third-party funding—which has become a common practice—do not necessarily constitute *per se* exceptional circumstances justifying that the Respondent be granted an order of security for costs."

Overall, third-party funding has gained acceptance in the international arbitration community; however, the community continues to discuss and work out how precisely to deal with it. At this time, international arbitration practitioners should be prepared that they may be required to disclose the existence of third-party funding and the name of the funder, given that arbitrators generally have discretion to require such disclosures. In addition, although the existence of third-party funding in and of itself likely will not cause a panel to require security for costs, practitioners representing parties that have third-party funders should be prepared to face requests by opposing parties for security for costs.

Energy Litigation Update

Recent Federal Decisions on the Constitutionality of State Power-Plant Subsidies. Given an absence of a federal scheme to subsidize power plants that may provide certain benefits (like low carbon emissions) that are not fully valued in the existing interstate wholesale markets, several states have enacted such schemes. Federal courts—so far, the Supreme Court of the United States, and two subsequent federal district courts—have evaluated challenges to such state programs. In *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288 (2016), the Supreme Court held that the Federal Power Act, 16 U.S.C. § 791a *et seq.*, preempted a Maryland regulation subsidizing new in-state electricity generation that effectively set the wholesale rate that a new generator would be paid. Although the Court held that the Maryland program impermissibly "disregard[ed] an interstate wholesale rate required by FERC [the Federal Energy Regulatory Commission]," it stressed that its "holding [was] limited." *Id.* at 1299. Two subsequent district court decisions, *Coalition for Competitive Electricity, Dynegy Inc. v. Zibelman*, -- F. Supp. 3d --, 2017 WL 3172866 (S.D.N.Y. July 25, 2017), and *Village of Old Mill Creek v. Star*, 2017 WL 3008289 (N.D. Ill. July 14, 2017), dismissed challenges to state programs that subsidize renewable energy production through so-called zero emission credits ("ZECs"). The decisions are summarized below.

In *Hughes*, Maryland electricity regulators sought to encourage the development of new in-state generation because the State's location in a particularly congested part of the regional grid makes importing enough electricity difficult. 136 S. Ct. at 1294. Concerned that the generally applicable wholesale rates were too low to incentivize adequate new development, regulators required utilities that deliver electricity to retail consumers in Maryland to enter into a "contract for differences" with a new power plant. *Id.* at 1294-95. The order required the plant to sell its power to PJM, the regional transmission organization that oversees the Pennsylvania-New Jersey-Maryland region's wholesale market, at a "clearing price" PJM set through an auction, and required the Maryland utilities to buy their power from PJM at the same price. *Id.* at 1293, 1297. The contract for differences, however, effectively replaced PJM's auction-based clearing price—so long as the plant sold its power through the auction, if the clearing price was lower than the rate set in the contract, the utilities paid the difference to the plant; and if the clearing price was higher, the plant paid the difference to the utilities. *Id.* at 1295 & n.5.

The Supreme Court, assuming without deciding that plaintiffs could seek declaratory relief under the Supremacy Clause, *Id.* at 1296 n.6, held that the Maryland program "invade[d] FERC's regulatory turf," *Id.* at 1297. By requiring the plant to participate in the auction but guaranteeing CPV a different rate than PJM's auction-based clearing price, Maryland had "adjust[ed] an interstate wholesale rate," a power exclusive to the federal government. *Id.* The Court rejected Maryland's argument that the regulation served the permitted goal of encouraging new power plant construction, holding that "States may not seek to achieve ends, however legitimate, through regulatory means that intrude on FERC's authority over interstate wholesale rates." *Id.* at 1298. The Court also rejected analogizing the scheme to a direct bilateral contract for the sale of power between the plant and the utilities, pointing out that "[t]he contract for differences does not transfer ownership" of energy capacity, but instead "operates within the auction." *Id.* at 1299.

Although the *Hughes* Court struck down Maryland's regulation, it limited the effect of its ruling. The Court's opinion expressly did not "address the permissibility of various other measures States might employ to encourage development of new or clean generation," so long as such measures were "untethered to a generator's wholesale market participation" and did not "condition payment of funds on capacity clearing the auction." *Id.* (internal quotation omitted).

This summer, the District Courts for the

Northern District of Illinois and Southern District of New York considered whether two similar state subsidy programs were among those allowed under *Hughes*. The Illinois program challenged in *Village of Old Mill Creek* creates zero emission credits, or ZECs, awards them to qualifying facilities (in effect, two Illinois nuclear power plants) for each megawatt hour of energy produced, and requires Illinois utilities to purchase all of the ZECs conferred each year. 2017 WL 300828 at *1, *3-4. The price of ZECs "decreases if wholesale market prices increase, up to a limit, and it increases if wholesale market prices decrease." *Id.* at *5. The New York program at issue in *Coalition for Competitive Electricity* similarly requires utilities to purchase ZECs from nuclear generators, although only to those plants that are deemed to be at risk of closure absent the ZECs. 2017 WL 317866 at *3. As in Illinois, the price of New York ZECs varies with "a forecast of wholesale electricity prices." *Id.* at *4.

In *Old Mill Creek*, the district court rejected the merits of a challenge to Illinois's subsidies (after ruling that plaintiffs largely lacked standing and could not seek to enjoin a state regulation on the basis of a preemption claim). *See* 2017 WL 3008289 at *5-10. Although the ZECs substantially affect the quantity and terms of wholesale electricity sales by subsidizing nuclear energy, the court held that they do so indirectly and thus, according to the court, without running afoul of *Hughes*' holding. *Id.* at *12. The court explained that, even if the plants receiving ZECs have to sell their power in the auction as a practical matter, Illinois's ZEC program itself neither required them to do so nor conditioned their receipt of ZECs on joining the auction. *Id.* at *13. Accordingly, the court ruled that the challenged scheme does "not impos[e] a condition directly on wholesale transactions," passing muster under *Hughes*, which preempts programs in which "a tether to wholesale rates is indistinguishable from a direct effect on wholesale rates." *Id.*

The *Coalition* district court, after similarly ruling that it lacked equity jurisdiction to hear preemption claims, 2017 WL 3172866 at *5-7, adopted similar reasoning in upholding New York's ZEC program on the merits. Because "nuclear generators receive ZECs for their zero-emissions *production* of energy, and not for the sale of that energy into the wholesale market," the court held the "direct and concrete tie (or tether)" between the challenged scheme and the generator's participation in the wholesale interstate market that was fatal in *Hughes* is absent. *Id.* at *10-11. Like the Illinois challengers, the New York plaintiffs were unable to explain why the ZEC program's substantial but indirect market distortions should be preempted while other state incentives, like tax exemptions, land grants, or direct subsidies are not. *Id.* at *12. As a result, the *Coalition* court ruled that by separating the ZEC subsidy from its recipients' participation in the auction, "New York has successfully threaded the needle left by *Hughes* that allows States to adopt innovative programs to encourage the production of clean energy." *Id.* at *14.

The plaintiffs in *Old Mill Creek* and *Coalition* have appealed the district courts' decisions to the Seventh and Second Circuits, respectively. *See Village of Old Mill Creek v. Star*, 7th Cir. Case No. 17-2433 (Consolidated with 17-2445); *Coalition for Competitive Elec. v. Zibelman*, 2d Cir. Case No. 17-2654. Briefing in both appeals is ongoing, and the anticipated decisions by the Courts of Appeals may shed further light on the line between permissible and impermissible state programs to subsidize particular power plants.

Antitrust & Competition Update

Intel *Judgment Hinting at EU Departure from* Per Se *Treatment for Loyalty Rebates Highlights Continued Difference in EU/US Approaches to Market Power.* On September 6, 2017 the Court of Justice of the European Union set aside a judgement by the General Court which had upheld a EUR 1.06 billion fine imposed by the European Commission on microchip manufacturer Intel for abusing its dominant position through the issuance of certain loyalty rebates. The Court of Justice ruled that the European Commission may not conclude that a rebate scheme operated by a dominant company is *per se* illegal if the company contends that its conduct is not capable of restricting competition. Instead, the Commission must assess a number of economic and legal factors to determine whether the dominant company's conduct amounts to a breach of EU competition law.

In adopting this nuanced approach to rebates, the Court of Justice displayed the continued differences between the EU approach and that of the United States, which views loyalty rebates as inherently procompetitive unless predatory under *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*

Case Background. In 2009 the European Commission imposed a then record EUR 1.06 billion fine on Intel after finding that the microchip manufacturer had abused its dominant position on the market for x86 central processing units (CPU) in breach of the prohibition under Article 102 of the Treaty for the Functioning of the European Union (TFEU).The Commission concluded that Intel had operated rebate schemes which foreclosed rival x86

CPU suppliers, preventing them from competing with Intel on the merits of their products alone. This foreclosure reduced competition and the incentive to innovate on the x86 CPU market.

Intel appealed the Commission's decision to the General Court of the European Union. After its appeal failed at first instance, Intel referred points of law to the Court of Justice of the European Union, which ruled in Intel's favor on a number of counts, which are discussed below. The Court of Justice has referred the case back to the General Court for consideration in light of its ruling.

Intel's First Appeal. In its judgment the General Court identified three types of rebate schemes:

- **Category 1:** Volume rebates, which are presumed to be lawful as they account for efficiency gains and/or economies of scale;
- **Category 2:** Exclusivity rebates, which are conditional on a customer buying all, or most, of its requirements from the dominant supplier; and
- **Category 3:** All other rebates, which may or may not be lawful, depending on the economic and legal context.

Intel had awarded two rebate schemes: one to major computer manufacturers on condition that they purchase all, or almost all (80-90%), of their x86 CPUs from Intel; and one to a reseller, on the basis that it exclusively supply computers containing Intel's x86 CPU. The General Court classified both schemes as exclusivity rebates.

Relying on its judgement in *Hoffmann-La Roche (Hoffmann-La Roche v Commission,* 85/76, EU:C:1979:36, paragraph 89) the General Court upheld the Commission's decision that exclusivity rebates offered by a dominant company are by their very nature capable of restricting competition and foreclosing competitors. The Court's reasoning in *Hoffmann* is based on the observation that exclusivity rebates are not linked to an economic burden or benefit for either party – they are designed to prevent a customer from choosing between suppliers (*Hoffmann,* paragraph 90). The Commission does not need to determine, by reference to the relevant facts and circumstances, that the rebates are actually capable of restricting competition to find that they are unlawful.

Strictly speaking, the General Court in *Intel* did not categorize exclusivity rebates as unlawful *per se*, only presumptively so– it acknowledged that it is open to the dominant company to prove that its use of exclusivity rebates is objectively justified, or outweighed by advantages that benefit consumers. However the General Court effectively ruled out this line of defense for dominant companies, noting that exclusivity rebates are only capable of having beneficial effects "*in a normal situation on a competitive market*", not in a market where "*precisely because of the dominant position of one of the economic operators, competition is already restricted*"(*Intel Corporation v Commission*, Case T-286/09 paragraph 94) .

Intel's Second Appeal. On appeal from the General Court, Intel submitted it was not possible for the Commission to conclude loyalty rebates were unlawful without taking into account the relevant legal and economic circumstances. The Court of Justice agreed with Intel.

The Court of Justice noted that it is not the purpose of Article 102 TFEU to prevent a company from acquiring a position of dominance, nor to assist a less efficient competitor in remaining on the market. Market exit is not detrimental to competition if the excluded player is not efficient or attractive to customers.

The Court of Justice initially quoted the General Court's reasoning under *Hoffmann* with approval, noting that loyalty rebates offered by a dominant company fall within the prohibition under Article 102 TFEU. However the Court of Justice went on to clarify that the Commission may not conclude that there has been an infringement of competition law if the dominant company submits "*on the basis of supporting evidence, that its conduct was not capable of restricting competition, and in particular, of producing the alleged foreclosure effects.*" If so, the Commission must then review the following evidence to determine whether the conduct is unlawful:

- The extent of the company's dominant position on the relevant market;
- The share of the market affected by the loyalty rebate;
- The conditions and arrangements for granting the rebate;
- The duration and amount of the rebate; and
- Whether a strategy possibly existed to exclude competitors at least as efficient as the dominant company.

The Court of Justice did not specify the threshold for determining whether conduct by a dominant company restricts competition. In his Opinion Advocate General Wahl suggests that a rebate scheme may be unlawful when "*in all likelihood"* it has anticompetitive, "foreclosure" effects—this is a higher threshold than "*more likely than not"* (Opinion of Advocate General Wahl, 20 October 2016, *Intel v European Commission*, paragraph 117). If a rebate

scheme does have foreclosure effects the Commission must then decide if these are outweighed by any advantages which benefit the consumer.

The Court of Justice's judgment forms a continuum with prior case law. Advocate General Wahl noted that the General Court's decision in *Intel* was one of the very few cases in which rebates were assessed in the abstract, without reference to their legal and economic context. In *Hoffmann* the Court had concluded that the rebates were unlawful after a careful review of: (i) the conditions in which the rebates were granted; and (ii) the share of the market affected. The General Court sought to distinguish the rebate schemes in *Intel* on the basis that they were conditioned on exclusivity. Although the Court of Justice did not rule on this issue, the Advocate General notes that EU case law only recognizes two types of rebates: Category 1 rebates which are presumed to be lawful; and all loyalty rebates, which are presumed to be unlawful whether conditional on exclusivity or not. Either way legality is determined by assessing the legal and economic context of the rebate scheme.

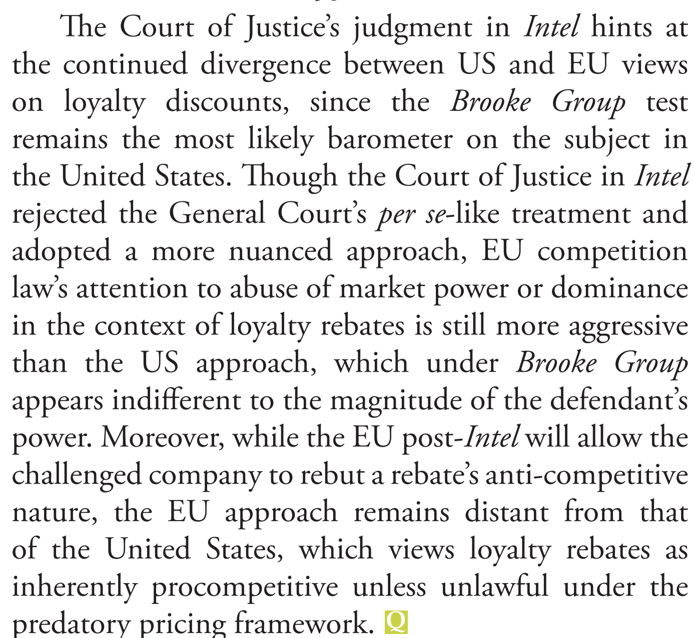
The Court of Justice's judgment also appears to endorse the use of the "as efficient competitor" (AEC) test, which assesses on economic terms whether a competitor as efficient as the dominant company would be able to continue to compete in light of the dominant company's rebates. In principle, if the AEC test is met, the dominant company's rebate scheme does not infringe competition law.

US Approach. The *Intel* judgment highlights the difference in approaches to loyalty rebates taken by the United States and the European Union. Historically, in the United States, loyalty rebates or discounts have been treated as procompetitive. Such discounts are recognized as netting benefits for consumers unless the discount renders prices so low that they run afoul of the test outlined for predatory pricing. Courts evaluating loyalty discounts therefore typically use the framework set forth in the guiding U.S. Supreme Court case on predatory pricing, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp,* 509 U.S. 209 (1993).

Under *Brooke Group*, a plaintiff must prove (1) "that the prices complained of are below an appropriate measure of its rival's costs[,]" and (2) "that the competitor had a reasonable prospect...or dangerous probability of recouping its investment in below-cost prices." *Id*. at 222, 224. Following the logic of *Brooke Group*, without this prospect of recoupment, loyalty discounts "produce[] lower aggregate prices in the market, and consumer welfare is enhanced." *Id*. at 224. The Court noted, "[t]hat below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: It is axiomatic that the antitrust laws were passed 'for the protection of *competition*, not *competitors*.'" *Id*. *(*quoting *Brown Shoe Co.* v. *United States,* 370 US 294, 320 (1962)), (emphasis in original). Ultimately, a defendant's degree of dominance is unlikely to be important in an evaluation of loyalty rebates under the *Brooke Group* test.

Some courts however have looked at loyalty discounts under an exclusive dealing analysis. When the discounts are explicitly contingent on exclusivity, they "are often treated as the legal equivalent of exclusive dealing contracts." 1 ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 253 (8th ed. 2017). In that situation the discounts are subject to a rule of reason analysis, which would "focus on a number of factors, including: the defendant's market power; the degree of foreclosure from the market; barriers to entry; the duration of the contracts; whether exclusivity has the potential to raise competitors' costs; the presence of actual or likely anticompetitive effects; and legitimate business justifications." Lauren N. Norris, *Exclusive Dealing: An Antitrust Analysis*, American Bar Association, https://www.americanbar.org/groups/young_lawyers/publications/the_101_201_practice_series/exclusive_dealing_an_antitrust_analysis.html (last visited Dec. 28, 2017). Here, a competitor's market power could be important, as "[c]ourts have held that a monopolist may be held to a different standard than a non-dominant firm in the context of exclusive dealing arrangements." Where the loyalty discounts "do not require exclusivity but only provide financial inducements to distributors to purchase most or all of their needs from the defendant" – sometimes referred to as "de facto exclusive dealing" – courts are split on what standard should apply. ANTITRUST LAW DEVELOPMENTS at 253.

The Court of Justice's judgment in *Intel* hints at the continued divergence between US and EU views on loyalty discounts, since the *Brooke Group* test remains the most likely barometer on the subject in the United States. Though the Court of Justice in *Intel* rejected the General Court's *per se*-like treatment and adopted a more nuanced approach, EU competition law's attention to abuse of market power or dominance in the context of loyalty rebates is still more aggressive than the US approach, which under *Brooke Group* appears indifferent to the magnitude of the defendant's power. Moreover, while the EU post-*Intel* will allow the challenged company to rebut a rebate's anti-competitive nature, the EU approach remains distant from that of the United States, which views loyalty rebates as inherently procompetitive unless unlawful under the predatory pricing framework.



Dismissal of Antitrust Claims Affirmed by 9th Circuit

Quinn Emanuel recently vindicated the rights of its clients to vigorously compete in a market in which they have earned a 75% share. J.G. Wentworth and Peachtree, faced claims for violation of Section 7 of the Clayton Act arising from J.G. Wentworth's acquisition of Peachtree in 2011 and the resulting high combined market share, and of Section 2 of the Sherman Act based on alleged exclusionary practices, including coordinating bidding for Google AdWords, and misleading consumers. The plaintiff, Novation Ventures, is in the same business: purchasing structured settlement receivables.

The firm moved to dismiss all claims based on failure properly to allege antitrust injury or exclusionary conduct. Prior to oral argument, the Court granted the motion in its entirety, but with leave to amend. Novation amended its complaint on June 8, 2015, adding additional claims for violation of Section 43(a) of the Lanham Act and California Business and Professions Code Section 17200. Quinn Emanuel filed another motion to dismiss, which also was granted. Novation filed a Second Amended Complaint on October 13, 2015. Quinn Emanuel moved again to dismiss, and the district court again granted the motion, this time without leave to amend. Final judgment was entered February 10, 2016, and Novation noticed an appeal before the Ninth Circuit Court of Appeals shortly thereafter.

On October 19, 2017, a unanimous three-judge panel upheld the dismissal. The panel agreed with the District Court that Novation cannot rely on harm to consumers, if there is any, to establish its own standing but must show that it was harmed itself. Because it did not do so, the panel ruled that the lower court correctly dismissed its claims. The panel further held that Novation had not identified a false or misleading statement by J.G. Wentworth or Peachtree that would support a false advertising claim under the Lanham Act. Finally, the panel ruled that since Novation could not plead a violation of federal law on which to predicate a claim for unfair or unlawful business practices under California Business and Professions Code Section 17200, the District Court had properly dismissed that cause of action, too.

Eve-of-Trial Summary Judgment Victory

Quinn Emanuel successfully defended Wellquest International Inc. ("Wellquest") and five related defendants in a breach of partnership agreement case in Los Angeles County Superior Court. Plaintiff was an elderly widow who sought tens of millions of dollars in compensatory damages plus punitive damages, interest and attorneys' fees.

Wellquest distributes numerous home electronics and beauty products in the US. Plaintiff claimed to have introduced the manufacturers of several extremely successful products to Wellquest and was therefore owed a royalty on all sales of the products derived from those manufacturers and distributed by Wellquest, for all time.

Plaintiff asserted 13 claims against six of our clients including breach of a partnership agreement, unjust enrichment, breach of contract, and breach of a joint venture, among others. After three years of litigation, we convinced the Court to dismiss 12 of these claims, and five of the defendants, with prejudice. The only claim that remained was breach of a written contract against Wellquest. Following an Interlocutory appeal, much of the rest of the case was ordered to binding arbitration and a jury trial set for the remainder of plaintiff's claim.

Just two days before the jury was to be empaneled the Court granted our summary judgment motion and entered judgment on behalf of Wellquest as to the entire claim (including the part previously ordered to be arbitrated).

Plaintiff is now facing motions for Wellquest's costs and attorneys' fees. Q

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- We are a business litigation firm of more than 720 lawyers — the largest in the world devoted solely to business litigation and arbitration.
- As of December 2017, we have tried over 2,645 cases, winning 88% of them.
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- We have won five 9-figure jury verdicts.
- We have also obtained thirty-four 9-figure settlements and fifteen 10-figure settlements.

Prior results do not guarantee a similar outcome.

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