Bloomberg Law Reports® Litigation

Vol. 2, No. 25 June 23, 2008

## In This Issue...



# Featured Article

## The Realities and Economics of Civil Litigation in Federal Court and Its Impact on Litigation Management

*Article contributed by:*
Stewart D. Aaron and Laura Weiss Tejeda

*Introduction*

There are certain realities that exist in litigating civil cases in the federal courts, particularly in New York and other metropolitan areas. There are inherent delays associated with civil cases, they can be very expensive to litigate and often never reach trial. Thus, it is incumbent upon legal advisors to fully understand the process, and to offer to their clients efficient means of managing federal civil litigation, as well as available alternatives. This article will address the federal civil litigation process and some of the alternatives to it.

*Delays Attendant to Federal Civil Litigation Process*

As any experienced practitioner well knows, there often can be long delays associated with civil litigation in the federal courts. This can be due to a number of factors, including a particular judge's caseload. Oftentimes, however, the main culprit is the Speedy Trial Act of 1974[1], which applies to criminal actions in federal court. The Act establishes time limits for completing the various stages of a federal criminal prosecution. For example, the information or indictment must be filed within 30 days from the date of arrest or service of the summons[2], and trial must commence within 70 days from the date the information or indictment was filed, or from the date the defendant appears before an officer of the court in which the charge is pending, whichever is later.[3] If a district judge has a particularly heavy criminal docket, he or she simply will not have sufficient time to adequately handle a "run of the mill" civil case, but will be preoccupied with criminal matters and civil cases in which emergency relief is needed. As aptly put by a practicing trial attorney in a 1991 article in *Fortune* magazine: "Civil cases must wait while these [criminal] trials cut in line before them, even though a civil case might involve huge stakes and have been years in preparation."[4]

The statistics bear out the delays that currently exist for civil cases in the federal court system. For example, for the 12-month period ending September 30, 2007, the median time interval from filing to disposition of civil cases filed in the U.S. District Court for the Southern District of New York was 9.8 months, and of those cases that went to trial, it was 12.3 months.[5] As

© 2008 Bloomberg Finance L.P. All rights reserved. BLOOMBERG LAW REPORTS is a registered trademark and service mark of Bloomberg Finance L.P.

of September 30, 2007, 18.3 % of the pending cases in the Southern District of New York had been pending for one to two years, 13% had been pending for two to three years, and 11.3% had been pending three years or more.[6]

*Costs of Federal Court Litigation*

Like the price of gasoline, the cost of litigating in federal court is ever-rising. The rising cost is partly attributable to electronic discovery. It is not uncommon in a commercial case for a law firm to need to review tens or hundreds of thousands of e-mail messages for responsiveness and/or privilege, with all the legal fees and expenses attendant thereto. In addition, motion practice is prevalent in federal court. Motions to dismiss and for summary judgment are routinely made, as well as discovery motions and motions *in limine*. All of these motions can be expensive to make and to respond to, requiring innumerable attorney hours in the legal research for, and preparation of, legal memoranda and accompanying documents.

*The "Vanishing" Federal Civil Trial*

After all the delays and the costs involved in litigating a civil case in federal court, one might think that a litigant could at least look forward to its day in court. However, it seems that the federal civil trial is going the way of the dinosaur.

Much has been written about the "vanishing" trial phenomenon; namely, that the number of trials in federal court is declining. The number of actual civil trials in federal district courts fell by almost 2,000 between 1962 and 2004, despite the fact that there were five times as many cases filed in 2004 as in 1962.[7] There has also been an increase in pretrial engagement of courts in cases filed between 1962 and 2002.[8] By 2002, 83.9% of cases terminated with some court action, including 74.1% terminating with some court action before pretrial, 8% with court action during or after pretrial, and 1.8% during or after trial. It has been suggested that some litigants do not even view going to trial as a positive outcome to filing a complaint. These commentators seem to imply that litigants who file in federal court view a trial as a tool to pressure their opponents into a settlement.[9]

Cases do not reach trial either because they are dismissed prior to trial, or because the parties consensually resolve the matter prior to trial. When faced with the risks of a jury trial in federal court, even the most strident defendant will seek the comfort and certainty of a settlement.

In addition, as noted by U.S. District Judge William G. Young of the District of Massachusetts in a 2007 *Business Week* article, some judges see their jobs as "managing" disputes and avoiding trial. These judges would seem most likely to encourage settlement so as to obviate the need for a trial.[10] Of course, not all federal judges are like-minded in this regard. Indeed, Judge Young believes that the jury trial plays an important part in our judicial system. In a July 2003 letter to his fellow federal district judges, Judge Young "invoked Alexis de Tocqueville to lament that 'the American jury system is withering away,' and that without jury trials, the courts' 'status as the grassroots guardians of constitutional values is threatened as never before.'"[11]

There are many federal judges who are very effective at managing their dockets and giving litigants opportunities to hold trials in their civil cases. Some of these judges lament that litigants often eschew trials and merely wish to conduct endless discovery. These types of litigants thus would seem less concerned with the "vanishing" trial phenomenon.

*Arbitration and Other Alternatives to Federal Civil Litigation*

Given the realities of federal civil litigation, including the economics of handling such litigation, it would be prudent for a corporation to consider available alternatives. It is not all that attractive to many a General Counsel to spend substantial legal dollars on motion practice and e-discovery, only to later capitulate prior to trial.[12]

What alternatives are available? As a defendant, a corporation often cannot choose the forum in which it will be sued. However, either before or after a dispute has arisen, parties to a contract or other relationship may be faced with a choice of having any disputes resolved in court (state or federal) or in some arbitral forum. For example, an increasing number of companies have been including arbitration clauses in their contracts – both with employees and other companies. The choice is not an easy one to make and can be influenced by a number of factors, including the court or courts that have jurisdiction over the parties and/or subject matter and the arbitral forums that may be available. Different courts and different judges in those courts may have varying styles in how they manage their civil dockets.

Arbitration can be more efficient and less expensive than federal (or state) court litigation, but this is not always the case As indicated earlier, in a case brought in federal court, motions to dismiss and for summary judgment are common, and will be given due consideration by a federal judge. For example, in a recent study on employment litigation, the data revealed that 60% of civil rights claims brought in federal court were dismissed on summary judgment. The same rate existed for contract cases, and the mix of cases was 15% and 25%, respectively. By contrast, none of the arbitration cases studied was resolved by summary judgment.[13] This may be because arbitrators feel more inclined to give the claimant his or her day in court, thereby denying motions to dismiss and for summary judgment that a federal judge would grant. Or, perhaps it is because the Federal Rules of Civil Procedure do not apply in arbitration and the decision-maker has more freedom to rule on equity rather than being strictly bound by legal principles. Regardless of the reason, a party deciding whether to choose arbitration should understand that an arbitrated controversy is unlikely to be resolved by the arbitrators short of a formal hearing. Thus, the ability to terminate a case in the motion stage, before hearing or trial, and perhaps before any discovery commences, can make federal litigation a cheaper alternative.

Another consideration in deciding whether to opt for arbitration is the cost associated with compensating the arbitrators. Private arbitrators are paid by the hour. Although the fees of the arbitrators often are split between the parties, the combined hourly rates of a three-arbitrator panel can be substantial.

One aspect of arbitration that may be deemed an advantage from a cost perspective is that the rules of arbitration generally do not permit discovery to the extent that the federal rules allow. For example, Rule 26 of the Federal Rules of Civil Procedure provides, "[p]arties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action."[14] As noted earlier, electronic discovery can cost hundreds of thousands of dollars for just collection and review alone. In addition, there will be the substantial legal fees and associated costs incurred in preparing for and participating in depositions of parties, third-party witnesses and expert witnesses.

However, the costs of discovery do not disappear in arbitration. In 2000, the Uniform Arbitration Act (Revised UAA) was amended to include, among other things, a section on pre-hearing discovery.[15] Under the Revised UAA, "[i]n order to make the proceedings fair, expeditious and cost effective," an arbitrator may now "permit a deposition of *any witness* to be taken for use as evidence at the hearing, including a witness who cannot be subpoenaed for or is unable to attend a hearing."[16] In addition, the Revised UAA allows an arbitrator to "permit such discovery as the arbitrator decides is appropriate in the circumstances."[17] Similarly, in 2007, the NASD[18] amended its arbitration code with respect to both customer disputes and industry disputes. The amended NASD Arbitration Code now contains a Discovery Guide and Document Production List[19] for customer disputes, which although aimed at streamlining document requests, appears to accept document production as a fact of dispute-resolution life. It should be noted, however, that the NASD Code of Arbitration "strongly discourages" depositions, which should cut down on the time and money spent in preparing for the arbitration hearing.[20]

Similar to the Revised UAA, Rule L-3(c) of Commercial Arbitration Rules of the American Arbitration Association permits arbitrators to hold a pre-arbitration hearing to consider "the extent to which discovery shall be conducted."[21] The scope of document discovery is likely to be similar in arbitration as it is in litigation. However, an AAA arbitrator is less likely to order full-scale depositions to be held prior to hearing, except perhaps to preserve testimony.

There are other advantages to arbitrating. For example, arbitration is usually private whereas federal litigation is public – barring some gag order or other confidentiality order. Another advantage is the finality of an arbitration decision. Dismissals and summary judgment decisions are almost always subject to appeal, thereby delaying final resolution. Also, even jury verdicts or judgments after a bench trial are readily appealed. By contrast, the burden is quite high for an arbitration award to be overturned.[22]

There are many other alternative methods of dispute resolution, including mediation, early neutral evaluation and the like. Regardless of the method used, the key is to recognize that certain disputes can and should be resolved in advance of litigation because of the time, burden and expense that is associated with litigation.

### *Managing Federal Civil Litigation after It Has Been Commenced*

Even after federal civil litigation has been commenced, a prudent corporate counsel will consider alternative dispute resolution in an appropriate case. Not only are there private ADR firms, but there also are court-annexed programs. For example, the Southern District of New York has a very successful mediation program, in which the mediators are experienced litigators who volunteer their time to the Court.

Once litigation has started, a litigation strategy must be developed in the context of the federal civil litigation realities discussed above (*i.e.*, the delays, costs and unlikelihood of a trial). To that end, it is important to assess the merits and value of the case both at the initial stages and as the discovery record develops. It is wise to make a conservative estimate of what the client stands to win or lose in the lawsuit. Thereafter, corporate counsel can use that estimate in deciding how much to invest in legal expenses.

Because the vast majority of cases settle before trial, by settling at the early stages of a case, rather than on the eve of trial, clients save on legal expenses. Corporate counsel effectively can devise legal strategies on a motion to dismiss or in discovery to challenge the other side's weakest claims and defenses. This will put the client in the best possible position for negotiating a favorable resolution.

Even if yours is the extraordinary case that will be handled through trial and any appeals, corporate counsel has an important role to play in managing the litigation. Consulting on legal strategy, of course, is important. However, corporate counsel also can manage costs by understanding the timing of the work that the litigators will be called upon to perform. Regular communication between corporate counsel and litigation counsel will go a long way towards controlling the amount spent on legal fees in a lengthy federal civil litigation.

*Mr. Aaron is a partner and Ms. Tejeda is an associate in the New York office of Arnold & Porter LLP.*

---

[1] 18 U.S.C. §§ 3161-74 (2008).
[2] 18 U.S.C. § 3161(b) (2008).
[3] 18 U.S.C. § 3161(c)(1) (2008).
[4] Sheldon H. Elsen, *Why Business Can't Get its Day in Court*, Fortune, Apr. 22, 1991.
[5] Judicial Business of the United States Courts, 2007, http://www.uscourts.gov/judbus2007/contents.html (last visited June 13, 2008).
[6] *Id.*

[7] John Lande, *How Much Justice Can We Afford: Defining the Courts' Roles and Deciding the Appropriate Number of Trials, Settlement Signals, and Other Elements Needed to Administer Justice*, 2006 J. Disp. Resol. 213, 216–17 (2006).
[8] Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts*, 1 J. Empirical Legal Stud. 459, 533–34 (2004).
[9] *Id.*
[10] Michael Orey, *The Vanishing Trial*, Business Week (Apr. 30, 2007).
[11] *Id.*
[12] Of course, the calculus in a frivolous or near frivolous case is different. As a defendant, you may want such cases to be brought in federal court where pleading and evidentiary standards generally are strictly enforced. Also, there may be cases where as a matter of principle, a corporation wants to "send a message" by vigorously defending itself through trial and all appeals.
[13] T. Eisenberg & E. Hill, *Employment Arbitration and Litigation: An Empirical Comparison*, 2003 Pub. L. & Legal Theory Res. Paper Series 1, 14, *available at* http://papers.ssrn.com/sol3/papers.crm?abstract_id=389780 (last visited June 3, 2008).
[14] Fed. R. Civ. P. 26(b)(1) (2008).
[15] 7 U.A.A. § 17(b) (2008). To date, the Revised UAA has been adopted by 12 states and the District of Columbia.
[16] *Id.* (emphasis supplied).
[17] *Id.* at § 17(c).
[18] The National Association of Securities Dealers, Inc. (NASD) is now the Financial Industry Regulatory Authority (FINRA).
[19] The Amended Discovery Guide and Document Production List can be found at: http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p018922.pdf (last visited June 12, 2008).
[20] NASD Code of Arbitration Procedure Rule 12510 (2008).
[21] Rule L-3 governs "Large Complex Cases," which are defined as civil cases involving a claim or counterclaim for at least $500,000. Available at http://www.adr.org (last visited June 3, 2008).
[22] *United Paperworkers Intern. Union, AFL-CIO v. Misco, Inc.* 484 U.S. 29, 38 (1987) ("[A]s long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious error does not suffice to overturn his decision."). New York state laws also require a heavy burden to overturn an arbitration award or decision. N.Y. CPLR § 7511 (2008); *see also Local 295–295C, IUOE v. Phoenix Envtl. Servs. Cor*, 21 A.D.3d 901, 800 N.Y.S.2d 516, 517 (N.Y. App. Div. 2d Dep't 2005) (recognizing "heavy burden" to overturn arbitration award or decision).

# Alternative Dispute Resolution

## Award

### Ninth Circuit Holds Public Policy Against Immigration Violations Does Not Justify Vacatur of Arbitration Award

*Aramark Facility Servs. v. Serv. Employees Int'l Union, Local 1877, No. 06-56662, 2008 BL 126964 (9th Cir. June 16, 2008)*

On June 16, 2008, the U.S. Court of Appeals for the Ninth Circuit reversed the district court's vacatur of an arbitration award on the ground that it violated public policy and remanded the matter with instructions to confirm the award.

*Factual Background*

Appellee Aramark Facility Services (Aramark) provides labor for the Staples Center, a sports and entertainment venue in Los Angeles. In early 2003, Aramark received letters from the Social Security Administration (SSA) notifying it that the social security numbers of about 3,300 of its employees nationwide did not match the SSA's database. In response to these "no-match" letters, Aramark asked its regional managers to confirm that the information it provided SSA matched the information provided by employees and, if so, to require corrective steps from the employees they supervised to rectify the discrepancies. Shortly thereafter, instructions were sent to 48 Aramark employees at the Staples Center who were represented by the Service Employees International Union (SEIU) and employed pursuant to a collective bargaining agreement between SEIU and Aramark. The instructions directed the employees to correct the social security number discrepancies and gave them three working days from the post marked date of the letter containing the instructions to show Aramark that a correction had been made. If the employees obtained a new social security card, they had 90 days from the date of re-application to bring the new card to Aramark. If the employees failed to bring in the proper documentation, then their employment would be terminated.

Believing the three-day turnaround time was too onerous, SEIU requested an extension but Aramark refused the request. Thirty-three employees did not timely comply with Aramark's request and were fired. The fired workers were told that they would be rehired if they supplied the required documentation, although it was unclear when they received that information. Although it suspected immigration violations, Aramark did not know for sure why the fired employees did not provide the additional documents. Each of those employees had, at the time they were hired, properly completed the required documents and provided proof of identity and eligibility to work in the United States. In addition, Aramark was never notified by any federal agency that its workers were suspected of being undocumented.

After the firings, SEIU filed a grievance on behalf of the Staples Center employees, and the matter was submitted to arbitration. The arbitrator concluded that there was no "convincing information" that any of the terminated workers were undocumented and, therefore, he found that the firings were without cause and awarded the workers back-pay and reinstatement. Aramark moved to vacate the award and the district court ruled in its favor, holding that because the fired employees failed to indicate that they were beginning the process of correcting the social security numbers discrepancies, Aramark had constructive notice that they were ineligible to work in the United States. Therefore, the district court determined that the arbitrator's award violated public policy because it required Aramark to violate the immigration laws. SEIU appealed this decision to the Ninth Circuit.

*Public Policy Grounds for Vacatur*

To vacate an arbitration award on public policy grounds, the court must find (1) that an explicit, well defined and dominant policy exists and (2) that the policy is one that specifically militates against the relief ordered by the arbitrator. In evaluating whether the arbitrator's award violated public policy, the Court stated that it would not "revisit" the arbitrator's factual findings, in particular the finding that there was no "convincing information" that any of the terminated workers were undocumented.

The public policy that Aramark referenced was embodied in laws that subjected employers to civil and criminal liability for employed undocumented workers "knowing" of their undocumented status. The term "knowing" includes constructive knowledge. Such policies, the Court agreed, would be violated if Aramark knowingly reinstated undocumented workers or provided back-pay to them. However, the Ninth Circuit stated that the harder question was whether these policies "specifically militate[d]" against the arbitrator's award. The Court noted that the cases upon which Aramark relied for support of its argument that public policy militated against the award were distinguishable because in those cases the Immigration and Naturalization Service (INS) had specifically visited the employers and notified them that their employees were suspected unlawful aliens and should be terminated if inspection of their documents did not allay the concerns.

The Ninth Circuit rejected Aramark's contention that two facts – the no-match letters and the employees' responses (or lack thereof) to those letters and Aramark's instructions – gave it constructive notice of immigration violations. The Court held that the no-match letters themselves could not have put Aramark on constructive notice that any particular employee was undocumented since the main purpose of the letters is not immigration-related, but rather is simply to let workers know that their earnings are not being properly credited. Mismatches could mean misuse by undocumented workers, but they could also indicate typographical errors, name changes, compound last names or inaccurate employer records. Furthermore, employers do not face penalties from the SSA for ignoring no-match letters and the Internal Revenue Service (IRS) does not impose sanctions based on no-match letters. Based on these facts, the Court concluded that the no-match letters fell short of the "positive information" from the government that the courts have held provide constructive notice of immigration violations.

The Ninth Circuit also rejected the argument that the employees' reactions to Aramark's instructions to procure proper documentation from SSA provided Aramark with constructive notice that the employees were undocumented. First, the Court noted that the arbitrator had found no "convincing information" that any of the fired workers were undocumented, and the arbitrator's factual findings were "not up for discussion" and weighed strongly against Aramark's argument. Second, the Court emphasized the "extremely short" time period in which the workers were told they should respond before they would be fired, and stated that it seemed likely that many of the workers concluded that they could not meet the initial deadline and stopped trying. The Ninth Circuit pointed out that under *Paperworks v. Misco, Inc.*, 484 U.S. 29 (U.S. 1987), the courts cannot second-guess the arbitrator's findings, even while conducting a public policy inquiry. Therefore, it was impermissible for the district court to consider the employees' post-termination conduct when the arbitrator had declined to credit that conduct as evidence of immigration violations.

*Conclusion*

The Ninth Circuit concluded that the public policy against knowing employment of undocumented workers did not specifically militate against the arbitrator's award. The district court's decision was reversed and the matter remanded with instructions to confirm the arbitration award.

# Motion to Compel

## California District Court Stays Third Party Action and Compels Arbitration of Dispute Between Casino and Interior Design Service

*Jonathan Browning, Inc. v. Venetian Casino Resort LLC*, No. 07-03983, 2008 BL 125386 (N.D. Cal. June 11, 2008)

On June 11, 2008, the U.S. District Court for the Northern District of California granted third party defendant Kirk Nix Associates Inc. d/b/a KNA Interior Designs' (KNA) motion to stay a third party action and to compel arbitration.

*Factual Background*

KNA offers interior design consulting services. Defendant Venetian Casino Resort, LLC (Venetian LLC) operates the Venetian Resort Hotel Casino (Venetian Casino Resort) in Las Vegas. Las Vegas Sands, LLC (Sands LLC), a managing member of the Venetian LLC, is wholly owned by Las Vegas Sands Corporation (Sands Corp.). Jonathan Browning, Inc. (Browning), the plaintiff in the underlying action, is a designer and seller of light fixtures. Browning's claims arose out of the alleged copying or inducement to copy and display of Browning's light fixtures in the remodeling of guest rooms in Venetian Casino Resort.

On February 1, 2006, KNA and the Venetian LLC executed an agreement (Agreement) regarding the remodeling of the guest rooms in the Venetian Casino Resort. KNA agreed to indemnify the Venetian LLC and its affiliates from and against all damages, loss, expenses, liabilities or costs to the extent such damages were caused by acts of KNA or by its negligent or wrongful performance of service under the

Agreement. The parties agreed that any disputes that arose out of the Agreement were subject to arbitration.

Browning filed a complaint against the Venetian LLC, the Sands LLC and the Sands Corp. (collectively, Venetian defendants) on August 2, 2007 seeking damages for copyright infringement and unfair competition based on the production and public display of Browning's light fixtures in the Venetian Casino Resort. On January 20, 2008, the Venetian defendants filed a third party complaint seeking contractual and declaratory relief against KNA. KNA moved the district court to enforce the arbitration provision in the Agreement.

*Motion to Compel Arbitration*

Under Section 4 of the Federal Arbitration Act, a district court must issue an order compelling arbitration if (1) a valid agreement to arbitrate exists and (2) that agreement encompasses the dispute at issue. As with any contract, an arbitration agreement is subject to all defenses to enforcement that apply to contracts generally. Although the court can determine whether a valid agreement to arbitrate exists, disputes over the meaning of specific terms are left to the arbitrator.

The district court noted that the Agreement was between KNA and Venetian LLC and that, in general, a court may only compel arbitration between parties who have entered into a written agreement to arbitrate. However, nonsignatories may be required to arbitrate claims "under ordinary contract and agency principles," such as equitable estoppel, which "precludes a party from claiming the benefits of a contract while simultaneously attempting to avoid the burdens that contract imposes." Here, because the nonsignatory Venetian defendants – Sands LLC and Sands Corp. – had initiated litigation to enforce their contractual rights, they were bound by the limitations of that same contract. "Knowing exploitation of the Agreement and assertion of their rights and benefits granted by virtue of a contractual relationship compel[led] enforcement of all provisions of the Agreement, including the agreement to arbitrate against all Venetian defendants."

The Venetian defendants argued that their equitable indemnity claims could not arise out of or relate to the Agreement between KNA and the Venetian LLC because the scope of the arbitration provision was limited to controversies or claims that arose out of or related to the Agreement or breach of the Agreement. The district court rejected this argument, noting that the equitable indemnity claims presupposed that there was some legal duty between KNA and the Venetian defendants that was distinct from the duties imposed by the Agreement. However, it was clear from the terms of the Agreement and the factual allegations that the alleged actions by KNA were performed under the duty imposed by the Agreement. Therefore, the equitable indemnity claims fell within the scope of the arbitration provisions.

The Venetian defendants also maintained that because KNA initially breached the Agreement, it could not enforce any of its provisions, including the arbitration provision. The district court was unpersuaded by this argument because there was no allegation that KNA had violated the arbitration provision it sought to enforce. Rather, KNA simply sought to enforce the provision that any and all disputes between the parties be resolved in the manner agreed upon in the Agreement. The district court held that there was no authority for the position that simply by alleging that KNA materially breached some provision of the Agreement, the district court was compelled to find that it could not seek to enforce the terms of the arbitration provision. Whether KNA breached another provision of the contract was for the arbitrator to decide.

*Conclusion*

The district court concluded that the arbitration agreement was enforceable and Browning was compelled to arbitrate his claims. The district court went on to grant the motion to stay the third party portion of the action pending arbitration but did not issue a stay as to the original claims by Browning against the Venetian defendants.

# Attorneys & Legal Practice

## Attorneys' Fees

### Federal Circuit Holds District Court Did Not Perform Adequate Analysis to Support "Exceptional Case" Ruling and Attorney's Fees Award

*Innovation Tech., Inc. v. Splash! Medical Devices, LLC*, No. 07-01424, 2008 BL 126955 (Fed. Cir. June 16, 2008)

On June 16, 2008, the U.S. Court of Appeals for the Federal Circuit determined that the district court failed to make adequate findings that the patent infringement action at issue was an "exceptional case" to warrant an award of attorney's fees pursuant to 35 U.S.C. § 285.

*Background & Procedural History*

Appellant Innovation Technologies, Inc. (Innovation) sued Splash! Medical Devices LLC (Splash) for infringement of its patent covering a method for irrigating wounds. More than a year after the commencement of the suit, but before the district court held a *Markman* hearing or construed Innovation's claims, Innovation executed a covenant not to sue Splash for infringement of the patent at issue and moved to dismiss the action. The district court granted the motion to dismiss and Splash moved for attorney's fees pursuant to Section 285. The district court granted the motion and awarded Splash attorney's fees and expenses totaling over

$140,000. The court's order was a single paragraph in length and consisted of the following three substantive sentences:

> This case qualifies as an "exceptional" case under 35 U.S.C. § 285 justifying an award of attorney's fees to Splash as the prevailing party. Splash has shown by clear and convincing evidence that Innovation knew or, on reasonable investigation, should have known, that its claims of infringement were baseless. It appears to me that the lawsuit was filed solely for the purpose of harassing a small competitor.

*District Court Failed to Conduct "Exceptional Case" Analysis*

Section 285 allows courts to award reasonable attorney's fees to the prevailing party in "exceptional cases." Section 285 requires courts to conduct a two-part inquiry: (1) is the case exceptional? If so, (2) should attorney's fees be awarded?

In the instant case, the Federal Circuit noted that the only reasoning provided by the district court to explain its holding that this was an exceptional case was that Splash demonstrated that "Innovation knew or, on reasonable investigation, should have known, that its claims of infringement were baseless." According to the Court, the district court provided "no explanation of, or factual basis for, that conclusion." As explained by the Federal Circuit, "[a] district court must provide reasoning for its determination that a case is exceptional for us to provide meaningful review. Further, an exceptional case finding is not to be based on speculation or conjecture but upon clear and convincing evidence." *Stephens v. Tech Int'l, Inc.*, 393 F.3d 1269 (Fed. Cir. 2004).

Although the district court was not required to determine the meaning of the claims in this action to ascertain whether the case was "exceptional," the district court should have conducted an analysis to determine "whether Innovation's proposed construction of the disputed language was sufficiently plausible to justify filing suit based upon that construction." Additionally, the district court should have considered why Innovation chose to execute a covenant not to sue and to dismiss the action against Splash. As explained by the Federal Circuit, the district court should have considered "[w]hat significance, if any, did such action have with respect to the merits of Innovation's case – did it indicate that the claims of infringement were 'baseless'?"

Because the district court did not make any of these necessary findings, the Federal Circuit was unable to ascertain what the court relied upon to make its finding that the case was "exceptional." The district court's conclusory statements that Innovation "knew or, on reasonable investigation, should have known, that its claims of infringement were baseless . . . [and] that the lawsuit was filed solely for the purpose of harassing a small competitor" were not sufficient to explain the district court's basis for its ruling. Accordingly, the Federal Circuit vacated the district court's holding that the case was "exceptional" and remanded the case to the district court to make further findings.

# Civil Practice & Procedure

## Claim and Issue Preclusion

### Supreme Court Rejects Theory of Claim Preclusion by Virtual Representation

*Taylor v. Sturgell*, No. 07-00371, 2008 BL 124955 (U.S. June 12, 2008)

On June 12, 2008, the U.S. Supreme Court overturned the decision of the U.S. Court of Appeals for the D.C. Circuit and disapproved the concept of claim preclusion by virtue of "virtual representation" by a third party. In doing so, the Court rejected a doctrine that had been adopted in varying degrees by six of the U.S. Courts of Appeal.

*Factual Background*

The instant case stemmed from two separate Freedom of Information Act (FOIA), 5 U.S.C. § 552, requests submitted to the U.S. Federal Aviation Administration (FAA) for documents pertaining to the design of a vintage airplane. The first request, submitted by Greg Herrick, was denied by the FAA under FOIA's trade secret exception. Herrick then filed a federal suit against the FAA in the U.S. District Court for the District of Wyoming, arguing that Fairchild Engine and Airplane Corp. (Fairchild), the company that originally submitted the documents to the FAA, waived any trade secret protection by a letter authorizing the FAA to release the documents to the public if they were needed to make repairs to an aircraft manufactured by Fairchild.

The district court held that since the documents had never actually been released pursuant to the letter, trade secret protection still attached to the documents. In the alternative, the court held that even if the confidential status had been waived by the letter, it was restored when Fairchild objected to Herrick's FOIA request. Herrick appealed to the U.S. Court of Appeals for the Tenth Circuit. The Court found that Fairchild waived trade secret protection for the documents by virtue of the letter but upheld the district court's decision on its alternative theory. It noted, however, that Herrick failed to challenge the district court's assumption that trade secret status could be resurrected by subsequent action and expressly disclaimed any endorsement of that assumption.

Less than a month after the Tenth Circuit issued its opinion, Brent Taylor submitted a FOIA request to the FAA for the same documents. Taylor and Herrick were friends and also members of the same antique aircraft organization. After the FAA failed to respond to Taylor's request, he filed an action against the FAA in the U.S. District Court for the District of Columbia in which Fairchild intervened as a defendant. Although Taylor was not a party to Herrick's Wyoming action and did not participate in the suit, the district court held that the D.C. action was barred by the doctrine of claim preclusion under the theory of virtual representation. The district court adopted a test for virtual representation established by the U.S. Court of Appeals for the Eight Circuit that required "an 'identity of interests' between the person to be bound and a party to the judgment." On appeal, the D.C. Circuit affirmed, however, it rejected the Eighth Circuit test adopted by the district court and established its own five-factor test to determine when the parties have an identity of interests sufficient for the application of the virtual representation doctrine.

The U.S. Supreme Court granted certiorari "to resolve the disagreement among the Circuits over the permissibility and scope of preclusion based on 'virtual representation.'"

*Virtual Representation Doctrine Impermissibly Expands Non-Party Preclusion*

As the Court explained, the doctrine of claim preclusion prevents needlessly repetitive litigation of claims that parties have had a full and fair opportunity to pursue, preserves judicial resources and reduces the possibility of inconsistent judgments. However, "[a] person who was not a party to a suit generally has not had a 'full and fair opportunity to litigate' the claims and issues settled in the suit." Therefore, the Court explained, the application of claim preclusion against non-parties is tempered by the "deep-rooted historic tradition that everyone should have his own day in court" and only applies in certain limited circumstances. (Internal quotation omitted.)

The Court found that the doctrine of virtual representation as applied by the circuit courts impermissibly expanded the application of non-party preclusion by inappropriately relaxing the requirement that the non-party was "adequately represented" by the party to the suit in which the judgment was entered. As the Supreme Court established in *Richards v. Jefferson County*, 517 U.S. 793 (1996), representation is only adequate if, at the very least, special procedures were in place to protect the non-parties' interests or there was a clear understanding between all of the parties that the litigating party brought the suit in a representative capacity. Because the definition of "adequate representation" in the cases establishing the virtual representation doctrine did not comport with the minimum requirements set out in *Richards*, those cases were disapproved by the Court.

*Supreme Court Refused to Adopt Case-by-Case Analysis For Non-Party Preclusion*

Fairchild and the FAA next argued that the Supreme Court should abandon the concrete and distinct grounds for the application of non-party preclusion and replace them with a fact-specific, case-by-case analysis to determine if "the relationship between a party and a non-party is 'close enough' to bring the second litigant within the judgment."

The Court rejected their proposal. First, the Court reasoned that the proposal runs counter to the general principle that parties should be able to have their own day in court and that non-party preclusion should only apply in limited circumstances. Second, taking such a potentially expansive approach would undermine the procedural safeguards established in the recognized grounds for non-party preclusion currently in place. For example, non-parties can be bound by judgments in the class action context. However, Rule 23 of the Federal Rules of Civil Procedure sets forth particular rules that have to be followed in order for those non-parties to be bound by the judgment in the class action. Under the respondents' approach, the courts would be free to circumvent the procedures set out in Rule 23 and create "de facto class actions at will." Lastly, the Court held that removing the clear requirements for non-party preclusion currently in place and replacing them with an amorphous, undefined test would make the district court's determination more difficult and unpredictable. As the Court explained, "[a]n all-things-considered balancing approach might spark wide-ranging, time-consuming, and expensive discovery tracking factors. . . . And after the relevant facts are established, district judges would be called upon to evaluate them under a standard that provided no firm guidance."

*Non-Party Preclusion Applies Equally to Public and Private Litigation*

Respondents' last argument was that non-party preclusion should be more broadly applied in public-law litigation than in suits between private litigants because: (1) public suits are for the benefit of the public at large and the government has the latitude to limit the number of such suits that can be filed; and (2) there is a higher probability of repetitive, vexatious litigation in public-law actions because of the large number of potential plaintiffs with standing to bring suit.

Neither argument was accepted by the Court. First, it noted that FOIA actions more closely resemble private-law actions than public-law cases because the relief granted is for the benefit of the individual litigant and not the public at large. Regardless, even assuming that the FAA and Fairchild were correct, their argument would merely support the contention that Congress could limit successive suits by additional parties through legislation, but would not support the idea that the courts could do so by judicially expanding the application of claim preclusion. Next, the Court dismissed respondents' concerns regarding a flood of vexatious public-law actions absent an expanded application of non-party preclusion. The well-established doctrine of *stare decisis* would make dealing with purely repetitive cases relatively easy. In addition, the Court noted that "the human tendency not to waste money will deter the bringing of suits based on claims or issues that have already been adversely determined against others." (Internal quotations omitted.)

Accordingly, the Supreme Court rejected the theory of virtual representation and remanded the case for a determination of whether Taylor's case was barred by one of the established grounds for non-party preclusion.

# Foreign Sovereign Immunities Act

## D.C. Appeals Court Rejects Russian Government's Immunity Defense in Litigation over War-time Seizure of Religious Manuscripts

*Agudas Chasidei Chabad v. Russian Federation*, No. 07-7002, 2008 BL 127857 (D.C. Cir. June 13, 2008)

On June 13, 2008, the U.S. Court of Appeals for the D.C. Circuit held that the "expropriation exception" to the Foreign Sovereign Immunities Act (FSIA), 28 U.S.C. § 1605(a)(3), applied to a non-profit Jewish organization's claim that the Russian Federation, as successor to the Soviet Union, seized thousands of the organization's religious books, manuscripts and documents during the Russian Revolution and in the aftermath of World War II in violation of international law. In addition, the D.C Circuit found "no abuse of discretion" in the district court's decision that Russia was not an adequate alternative forum for the plaintiff's lawsuit. Finally, the Court held that defendants failed to show that they were entitled to invoke the act of state doctrine for seizures occurring within Russia's jurisdiction.

*Chabad-Lubavitch Collection*

Agudas Chasidei Chabad of United States (Chabad), a New York-based non-profit, is the "policy-making and umbrella organization" for the Chabad-Lubavitch spiritual movement founded in 18th century Russia. According to Chabad, Chabad-Lubavitch collected thousands of religious books, manuscripts and documents (Collection) over the years. During the Russian Revolution, the Russian government allegedly seized a portion of the Collection known as the Library from a private Moscow warehouse and rejected the group's attempt to recover the materials, which are presently held by the Russian State Library (RSL). Nazi forces allegedly seized another portion of the Collection known as the Archive in Poland, where the group's Rebbe leader lived for several years after he was expelled from Russia. In September of 1945, the Soviet military took the Archive to Moscow, where it is presently held by the Russian State Military Archive (RSMA).

After failing to recover the Library and Archive collections in the years since World War II, Chabad filed the instant action against the Russian Federation, the Russian Ministry of Culture and Mass Communication, the RSL and the RSMA (collectively, Russia). Russia moved to dismiss the lawsuit as barred by the FSIA, *forum non conveniens* and the act of state doctrine. The U.S. District Court for the District of Columbia held that Chabad's claims relating to the Library were barred by the FSIA and denied Russia's motion to dismiss Chabad's claims relating to the Archive. Chabad and Russia appealed.

*FSIA Does Not Bar Plaintiff's Claims*

Under 28 U.S.C. § 1330(a), federal courts have jurisdiction over lawsuits against foreign states "as to any claim for relief in personam with respect to which the foreign state is not entitled to immunity either under sections 1605–1607" of the FSIA. Under Section 1605(a)(3) of the FSIA, federal courts can assert jurisdiction over foreign states for claims "in which rights in property taken in violation of international law are in issue" and the property "is owned or operated by an agency or instrumentality of the foreign state" that "is engaged in a commercial activity in the United States."

To assess whether this "expropriation exception" to the FSIA applied to Chabad's claims against Russia, the D.C. Circuit first examined whether by claiming that Russia took the Library and Archive in violation of international law, Chabad "put its rights in property in issue in a non-frivolous way." The Court viewed plaintiff's assertion that upon its incorporation, Chabad became vested with the property rights of Chabad-Lubavitch as substantial and non-frivolous. Further, the Court found that Chabad asserted substantial and non-frivolous claims that both the Library and Archive were taken in violation of international law. In doing so, the Court reversed the district court's decision that (1) seizure of the Library from Chabad-Lubavitch's Rebbe, a Soviet citizen, did not violate international law and (2) the Russian government actions that prevented Chabad from recovering the Library after Russia promised to return it in 1991 did not constitute a taking.

The Court next examined whether Chabad presented "adequate supporting evidence" that the RSL and RSMA were engaged in commercial activity in the United States and whether Russia "establish[ed] the absence of [this] factual basis by a preponderance of the evidence." The Court found that "both the RSMA and the RSL engaged in sufficient commercial activity in the United Statesto satisfy that element of 28 U.S.C. § 1605(a)(3)" because these entities had entered into contracts with U.S. corporations for the publishing and sale of their materials. In so finding, the Court rejected Russia's argument that either the property at issue must be physically present in the U.S. or defendants' commercial activity must have "substantial contact" with the U.S.

Finally, the Court rejected Russia's argument that Chabad "failed to pursue and exhaust remedies it has in the Russian Federation to recover the Archive." The Court noted that "nothing in § 1605(a)(3) suggests that plaintiff must exhaust foreign remedies before bringing suit in the United States." In addition, the Court found that even if Section 1605(a)(3) required plaintiff to exhaust foreign remedies, the remedy available under Russian law was inadequate.

*Forum Non Conveniens*

The district court rejected Russia's argument for dismissal of Chabad's claims on *forum non conveniens* grounds based on Russia's failure to show that (1) Russia was an adequate alternative forum for the plaintiff's lawsuit and (2) "a balancing of private and public interest factors strongly favor[ed] dismissal." Having already found that the remedy available to Chabad under Russian law was inadequate, the Court noted that "a foreign forum is not inadequate merely because it has less favorable substantive law." (Internal quotation omitted.) However, the Court concluded that the district court did not abuse its discretion in finding that the "balance of conveniences" weighed against dismissal in light of Chabad's apparent willingness to pay the travel expenses of Russian deposition witnesses and despite defendants' suggestion that a Russian court might not enforce a U.S. court's judgment.

*Act of State Doctrine*

The act of state doctrine limits a court's ability to examine a foreign sovereign's taking of property within its own jurisdiction. As the U.S. Supreme Court ruled in *Banco Nacional de Cuba v. Sabbatino*, courts will not examine a foreign government's "taking of property within its own territory . . . in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, even if the complaint alleges that the taking violates customary international law." 376 U.S. 398, 428 (1964).

In the instant case, the Court held that Russia failed to show that the act of state doctrine applied to its seizure of the Archive because Russia did not establish conclusively that the seizure occurred in German territory occupied by Russia after World War II rather than in post-war Poland, outside Russia's jurisdiction. Regarding Russia's taking of the Library, the Court noted that 22 U.S.C. § 2370(e)(2) "normally bars application of the act of state doctrine to seizures occurring after January 1, 1959." Because Chabad alleged that Russia re-took the Library in 1991–1992, the Court ruled that the act of state doctrine "poses no apparent barrier to the plaintiff's claim."

*Conclusion*

Accordingly, the D.C. Circuit held that the district court could exercise subject matter jurisdiction over Chabad's claims against the Russian government.

# Class Actions

## Removal

### Seventh Circuit Clarifies Deadline to File Petition for Leave to Appeal Remand Order

*Spivey v. Vertrue, Inc.*, No. 08-08009, 2008 BL 124483 (7th Cir. June 11, 2008)

On June 11, 2008, the U.S. Court of Appeals for the Seventh Circuit granted defendant's petition for leave to appeal the lower court's remand order in this putative class action. In so ruling, the Court clarified the time limit in which such petitions must be filed.

*Factual background*

On November 2, 2007, Quinten Spivey initiated this suit against Vertrue, Inc., a marketing services company. Spivey alleged that Vertrue's billing system had submitted unauthorized charges on his and other of its customers' credit cards. Vertrue removed the action to federal court under the Class Actions Fairness Act, which allows removal of class actions in certain circumstances. 28 U.S.C. § 1453. Spivey moved to remand on the grounds that the amount of controversy did not exceed the requisite $5 million, and the district court granted the motion.

Subsequently, Vertrue filed a petition for leave to appeal the remand order. Vertrue's counsel mailed the petition seven days after the district court's entry of the order, and the Seventh Circuit received the petition three days later. Thus, the petition was "filed" ten days after the remand order issued. Spivey argued that the petition was untimely and therefore the appellate court lacked jurisdiction.

*Appeal of Removal Pursuant to CAFA*

Section 1453(c)(1) provides that:

> a court of appeals may accept an appeal from an order of a district court granting or denying a motion to remand a class action to the State court from which it was removed if application is made to the court of appeals not less than 7 days after entry of the order.

28 U.S.C. 1453(c)(1). Reading the language of this section literally, Vertrue's petition was timely, as it was filed ten (and "not less than 7") days after entry of the remand order.

Spivey argued, however, that the petition was untimely because "the law cannot mean what it says," as "time limits for appeals always set the last date allowed for action, rather than the earliest time to file something." Instead of requiring that petitions for leave to appeal be filed "not less than 7 days after entry of the order," Spivey contended that the statute should have required that such petitions be filed "within 7 days" or "not more than 7 days" after the remand order.

The Seventh Circuit noted that while Congress has not yet enacted a technical-corrections bill to remedy this "gaffe," other circuits have held that "a petition filed within seven days of the district court's order should be accepted, rather than thrown out with instructions to submit another once a week has passed." Noting that this interpretation mirrored Rule 4(a)(2) of the Federal Rules of Appellate Procedure, which provides that a premature notice of appeal remains on file and becomes effective when the decision is entered, the Seventh Circuit concurred with its sister circuits, finding that "it makes sense to use the same approach for a premature permission for leave to appeal." The Court, however, declined to follow those circuits in disallowing petitions that were not filed within the seven days following entry of the remand order. Rather, the Seventh Circuit found that those who relied on the text of the statute and waited for seven days before filing should not be punished for doing so.

Additionally, to preclude the possibility of litigants having an unlimited time to file an appeal, the Court noted that Rule 5(a)(2) of the Federal Rules of Appellate Procedure provides that when there is no other limit, a petition for permission to appeal must be filed within thirty days. Thus, in the Seventh Circuit, a petition for leave to appeal a CAFA remand order may be filed within seven days and must be filed within 30 days of entry of the order. Consequently, the Court concluded that Vertrue's petition for leave to appeal was timely.

*Amount in Controversy*

Turning to the substance of the appeal, the Court found that Vertrue had fulfilled its burden of demonstrating that the amount in controversy exceeded $5 million and that diversity jurisdiction was proper. Accordingly, the Seventh Circuit reversed and remanded the case to the district court for adjudication on the merits

# Criminal Practice & Procedure

## Habeas Corpus

### U.S. Supreme Court Holds Guantanamo Detainees Have Constitutional Right to Habeas Corpus

*Boumediene v. Bush*, Nos. 06-01195, 06-01196, 2008 BL 126557 (U.S. June 12, 2008)

On June 12, 2008, the U.S. Supreme Court, in a 5-4 decision, held that petitioners, foreign nationals detained at the U.S. Naval Station at Guantanamo Bay, Cuba (Guantanamo), have a constitutional right to habeas corpus.

*Background*

President Bush is authorized "'to use all necessary and appropriate force against'" persons determined to have aided the September 11, 2001 terrorist attacks. (Quoting Authorization for Use of Military Force (AUMF), § 2(a), 115 Stat. 224, note following 50 U.S.C. § 1541). The Supreme Court, in *Hamdi v. Rumsfeld*, 542 U.S. 507, 518 (2004), held that the detention of "enemy combatants" fighting against the United States in Afghanistan fell within the purview of the President's power. Subsequent to *Hamdi*, the Defense Department established Combatant Status Review Tribunals (CSRTs) to determine whether the Guantanamo detainees were "enemy combatants."

Petitioners, some of whom were apprehended on the battlefield in Afghanistan, were detained by the Defense Department and transferred to Guantanamo. Petitioners appeared before separate CSRTs, whereby each was deemed an "enemy combatant." In response to the CSRT determinations, petitioners sought writs of habeas corpus in the U.S. District Court for the District of Columbia. The district court rejected the petitions and petitioners appealed. While the appeals were pending, Congress passed the Detainee Treatment Act of 2005, 119 Stat. 2739 (DTA), which amended 28 U.S.C. § 2241 to provide that "no court, justice, or judge shall have jurisdiction to hear or consider . . . an application for a writ of habeas corpus filed by or on behalf of an alien detained by the Department of Defense at Guantanamo Bay, Cuba." 119 Stat. 2742. In *Hamdan v. Rumsfeld*, 126 S.Ct. 2749 (2006), the Supreme Court held that this provision did not apply to cases pending at the time of the DTA's enactment. Congress responded to *Hamdan* by passing the Military Commissions Act of 2006 (MCA), § 7(a), which unequivocally stated that the amendments to Section 2241 were to "apply to all cases, without exception," including those pending when the DTA was enacted.

On February 20, 2007, the Court of Appeals for the District of Columbia affirmed the district court's rejection of petitioners' writs, holding that MCA § 7 stripped the court of jurisdiction to consider petitioners' habeas corpus applications. See *Boumediene v. Bush*, 476 F.3d 981 (D.C. Cir. 2007). The Court of Appeals further held that because petitioners did not have the right to habeas corpus review, they were not entitled to the protection of the Suspension Clause of the Constitution, Art. 1, § 9, cl. 2, which states that "[t]he privilege of the writ of habeas corpus shall not be suspended, unless, when in cases of rebellion or invasion the public safety may require it."

The Supreme Court granted *certiorari* to determine "whether [petitioners] have the constitutional privilege of habeas corpus, a privilege not to be withdrawn except in conformance with the Suspension Clause," and, if so, whether the DTA, which provided certain procedures for review of detainees' status, was "an adequate and effective substitute for habeas corpus."

*Guantanamo Detainees Have a Constitutional Right to Habeas Corpus Review*

In order to decide the constitutional question, Justice Kennedy, delivering the majority decision, stated that the Court was required to determine "whether petitioners [were] barred from seeking [a] writ or invoking the protections of the Suspension Clause either because of their status, *i.e.*, petitioners' designation by the Executive Branch as enemy combatants, or their physical location, *i.e.*, their presence at Guantanamo Bay." The Government argued that "non-citizens designated as enemy combatants and detained in territory located outside our Nation's borders" do not have the "privilege of habeas corpus." Petitioners contended that they had "cognizable constitutional rights and that Congress, in seeking to eliminate recourse to habeas corpus as a means to assert those rights, acted in violation of the Suspension Clause."

To inform its decision, the Court sought guidance from the history and purpose of habeas corpus, "founding-era authorities" that addressed the issue of whether foreign nationals detained in distant countries "may assert the privilege of the writ and seek its protection," and Supreme Court precedent discussing the Constitution's extraterritorial application. After reviewing the relevant authorities, the Court concluded that petitioners were entitled to the constitutional privilege of habeas corpus:

> It is true that before today the Court has never held that non-citizens detained by our Government in territory over which another country maintains *de jure* sovereignty have any rights under our Constitution. But the cases before us lack any precise historical parallel. They involve individuals detained by executive order for the duration of a conflict that, if measured from September 11, 2001, to the present, is already among the longest wars in American history. The detainees, moreover, are held in a territory that, while technically not part of the United States, is under the complete and total control of our Government. Under these circumstances the lack of a precedent on point is no barrier to our holding.
>
> We hold that Art. I, § 9, cl. 2, of the Constitution has full effect at Guantanamo Bay.

In reaching this conclusion, the Court distinguished – and relied on – its decision in *Johnson v. Eisenstrager*, 339 U.S. 763 (1950). In *Eisenstrager*, the Court addressed whether habeas corpus jurisdiction extended to enemy aliens convicted of violating the laws of war. There, the prisoners were detained at Landsberg Prison in Germany after World War II, and were denied the privilege of habeas corpus. In denying the prisoners right to habeas corpus, the Court emphasized that the prisoners "at no relevant time were within any territory over which the United States is sovereign, and [that] scenes of their offense, their capture, their trial and their punishment were all beyond the territorial jurisdiction of any court of the United States." 339 U.S. at 778.

The Court distinguished *Eisenstrager* noting that, unlike the control exercised over Guantanamo, the United States Government lacked plenary control over the Landsberg Prison. According to the Court, "[n]othing in *Eisenstrager* [stated] that *du jure* sovereignty is or has ever been the only relevant consideration in determining the geographic reach of the Constitution or of habeas corpus." Instead, the Court determined "questions of extraterritoriality turn on objective factors and practical concerns, not formalism."

Focusing on certain language of the *Eisenstrager* decision, the Court set forth three factors relevant to determining the reach of the Suspension Clause:

> (1) the citizenship and status of the detainee and the adequacy of the process through which that status determination was made; (2) the nature of the sites where apprehension and then detention took place; and (3) the practical obstacles inherent in resolving the prisoner's entitlement to the writ.

The Court found that application of these factors favored extending the privilege of habeas corpus to detainees at Guantanamo. With respect to the first factor, the Court noted that the procedures afforded in the CSRT proceedings fell "well short of the procedures and adversarial mechanisms that would eliminate the need for habeas corpus review." As to the second factor, the Court found that, unlike the Landsberg Prison, Guantanamo was "within the constant jurisdiction of the United States," and "[i]n every practical sense" Guantanamo could not be characterized as "abroad." With respect to the third factor, the court stated that although it was sensitive to the fact that "[h]abeas corpus proceedings may require expenditure of funds" and "may divert the attention of military personnel from other pressing tasks," such concerns did not warrant denying petitioners their right to habeas corpus review.

*Congress Has Not Provided an Adequate Substitute for Habeas Corpus Review*

Finding that petitioners were entitled to the privilege of habeas corpus, the next question the Court was required to address was whether the MCA – the statute stripping the courts of jurisdiction to issue writs – "avoids the Suspension Clause mandate because Congress has provided adequate substitute procedures for habeas corpus." The Court held that Congress' review procedure, Section 1005(e) of the DTA, was an inadequate substitute for habeas corpus. In so concluding, the Court noted that both statutes at issue – the DTA and the MCA – were purposefully "intended to circumscribe habeas review." The Court also noted that by granting the Court of Appeals "exclusive" jurisdiction over petitioners' cases, Congress intended to limit the scope of review.

Although the Court did not endeavor to define with any specificity the type of review procedure that would constitute an effective substitute proceeding, it stated the following:

> For the writ of habeas corpus, or its substitute, to function as an effective and proper remedy in this context, the court that conducts the habeas proceeding must have the means to correct errors that occurred during the CSRT proceedings. This includes some authority to assess the sufficiency of the Government's evidence against the detainee. It also must have the authority to admit and consider relevant exculpatory evidence that was not introduced during the earlier proceeding. Federal habeas petitioners long have had the means to supplement the record on review, even in the postconviction habeas setting . . . . Here that opportunity is constitutionally required.

Upon analysis, the Court held that the DTA review proceeding fell "short of being a constitutionally adequate substitute [for habeas review]," emphasizing that the detainees had "no opportunity to present evidence discovered after the CSRT proceedings concluded." The DTA process was, "on its face, an inadequate substitute for habeas corpus."

*No Prudential Barriers to Habeas Review*

Finally, the Court held that there were no prudential barriers to habeas review. According to the Court, certain "accommodations [could] be made to reduce the burden habeas corpus proceedings will place on the military without impermissibly diluting the protections of the writ." Specifically, the Court suggested that "[c]hanneling future cases to one district court would no doubt reduce administrative burdens on the Government."

*Dissenting Opinions*

Chief Justice Roberts authored a dissent, emphasizing his belief that the majority "struck down as inadequate the most generous set of procedural protection ever afforded aliens detained by this country as enemy combatants." According to the Chief Justice, the DTA review procedures were more than "adequate to vindicate whatever due process rights petitioners may have."

In a separate dissent, Justice Scalia concluded that the "writ of habeas corpus does not, and never has, run in favor of aliens abroad." Justice Scalia further stated that the Court's decision in *Eisenstrager* unequivocally confirmed that principle, and characterized the majority's attempt to distinguish *Eisenstrager* as a "sheer rewriting of the case." In highly-critical fashion, Justice Scalia further described the "disastrous consequences" of the majority opinion, including his belief that the majority decision "will almost certainly cause more Americans to be killed." According to Justice Scalia, the "Nation will live to regret" the Court's decision.

*Conclusion*

By a 5-4 majority, the Supreme Court held that petitioners, detainees at Guantanamo Bay, were entitled to "invoke the fundamental procedural protections of habeas corpus." Accordingly, the Supreme Court reversed the Court of Appeals' decision, and directed that petitioners' cases be remanded to the district court for proceedings consistent with the Court's opinion.

# Environmental Litigation

## Clean Air Act

### D.C. Circuit Denies Petition to Review EPA's Residual Risk Rulemaking under Clean Air Act

*Natural Resources Defense Council and Louisiana Environmental Action Network v. Environmental Protection Agency, No. 07-01053, 2008 BL 120815 (D.C. Cir. June 6, 2008)*

On June 6, 2008, the U.S. Court of Appeals for the District of Columbia denied the Natural Resources Defense Council and the Louisiana Environmental Action Network's (petitioners) challenge to the Environmental Protection Agency's (EPA) decision not to modify a previously-implemented rule governing technology-based emission standards.

*Background*

Section 112 of the Clean Air Act (CAA) regulates hazardous air pollutants (HAPs). The 1990 amendments to the CAA required the EPA to adopt technology-based standards (*e.g.*, best available control technology) to control emissions for major sources that emit HAPs. Pursuant to CAA § 112, the EPA was obligated to review any residual health risks that had not been eliminated by the adopted technology-based standards.

In 1994, the EPA promulgated technology-based emission standards. Five years later, the EPA, interpreting the CAA as requiring it to consider whether to revise the adopted technology-based standards, commenced residual risk rulemaking proceedings. In its notice of proposed rulemaking, the EPA proposed two options for the residual risk rulemaking, one of which would have imposed stricter standards on the industry. The option which the EPA adopted as its final rule, however, was merely a reaffirmation of the existing rule. The EPA determined that under the existing standard, no individual would face an excess lifetime cancer risk of greater than the presumptively acceptable level (*e.g.*, one-in-one million).

During the same rulemaking, the EPA also sought to satisfy the requirement of CAA § 112(d)(6), which, required the EPA to "review, and revise as necessary" the technology-based standards at least once every eight years. After the EPA reviewed the technology-based standards that had been adopted, however, it concluded that there were no such technological developments.

Petitioners challenged the EPA's actions on several grounds, primarily contending that, under its interpretation of CAA § 112(d)(6), the EPA was obligated to implement stricter emissions standards. Petitioners also argued that, in reviewing technology-based standards, the EPA violated the CAA by taking cost into account. Alternatively, petitioners claimed that the rulemaking violated the Administrative Procedures Act (APA), since it relied on "unreliable" data supplied by the industry.

*Discussion*

First, petitioners contended that CAA § 112(f)(2)(A) obligated the EPA to revise the industry standards so that the lifetime excess cancer risk to exposed persons would be no greater than one-in-one million. The Court, however, found that although the statute instructed the EPA to "promulgate standards," it said nothing about the specific content of those standards. The Court reasoned that, if Congress had wished to set a "bright-line standard," it would have explicitly stated such in the statute. Accordingly, the D.C. Circuit concluded that CAA

§ 112(f)(2)(A) simply called for standards that "provide[d] an ample margin of safety to protect public health."

The Court also noted that the emission standard for Benzene defined an "ample margin of safety" as being achieved when people faced lifetime cancer risks of no greater than one-in-one million, and that no person faced a risk greater than one-in-ten thousand. The D.C. Circuit stated, however, that the one-in-one million standard was merely an aspirational goal, which, according to the Court, undermined petitioners' argument that EPA was required to reduce residual risks to one-in-one million for all sources emitting carcinogenic HAPs. Thus, the Court, concluded that the EPA's interpretation of CAA § 112(f)(2) was a reasonable construction of the statute.

Second, petitioners contended that the EPA, pursuant to CAA § 112(d)(6), was obligated to completely recalculate the maximum achievable control technology (*e.g.*, start from scratch) every eight years. The D.C. Circuit disagreed, finding that the "review, and revise as necessary" language found in CAA § 112(d)(6) could not reasonably be construed as imposing such an obligation.

Petitioners also argued that the EPA's rulemaking should be set aside because the EPA improperly considered costs in deciding whether to revise the industry standards. Although it was undisputed that EPA stated in its notice of proposed rulemaking that certain technological components should not be considered due to cost, the Court concluded that it was irrelevant that EPA had done so since EPA had satisfied the core requirement of CAA § 112(d)(6) – namely, that there were no "significant [industry] developments in practices, processes and control technologies." As a result, the D.C. Circuit concluded that it could not set aside the EPA's finding on this ground.

Lastly, petitioners claimed that the EPA's analysis of residual health risks from industry facilities was arbitrary and capricious. Petitioners emphasized that, in making its assessment, the EPA relied on industry-supplied data that was submitted to the agency on request. Based on this industry-supplied data, the EPA determined that no source presented a lifetime risk of greater than one-in-one million. Petitioners argued that the EPA should have handled the data collection itself, and that the industry-supplied data was unreliable. Again, the Court disagreed with petitioners, finding that the industry-supplied data was not unreliable, and that it was not unreasonable for EPA to request data from the industry since it would have been costly and time-consuming for EPA to have acquired the information any other way.

*Conclusion*

Accordingly, the D.C. Circuit denied the petition for review, concluding that the EPA's interpretation of the CAA was neither arbitrary nor capricious.

# General Liability Insurance; Pollution Exclusions

## Fifth Circuit Holds Pollution Exclusion Applies to Oil Waste Vapors

*Noble Energy Inc. v. Bituminous Casualty Co.*, No. 07-20354, 2008 BL 114875 (5th Cir. June 2, 2008)

On June 2, 2008, the U.S. Court of Appeals for the Fifth Circuit affirmed the district court's ruling that Bituminous Casualty Company (Bituminous) did not have a duty to defend or indemnify Noble Energy Inc. (Noble), holding that a pollution exclusion applied to the claims asserted against Noble.

*Background*

Noble is engaged in the exploration and production of petroleum. In August 2000, Noble and T&L Lease Services, Inc. (T&L) entered into an agreement (Noble/T&L Agreement), pursuant to which T&L was retained to dispose of sediment from Noble's storage tanks. The Noble/T&L Agreement required T&L to provide additional insurance coverage to Noble under T&L's general liability and auto policies. Toward that end, T&L purchased a commercial auto policy and a commercial umbrella policy from Bituminous.

On January 12, 2003, T&L dispatched two trucks to pick up sediment from Noble's storage tanks and to haul it to a disposal facility owned and operated by BLSR Operating, Ltd. (BLSR). While BLSR employees were unloading the sediment from the T&L trucks, one of truck's engines exploded, causing a fire that engulfed both trucks. One T&L employee and two BLSR employees were killed, and several other workers were injured. It was later determined that combustible vapors emanating from the sediment, which contained gas condensate, caused the explosion and fire.

Plaintiffs, surviving employees and the estates of the deceased, filed suit against T&L, Noble and several other companies (underlying lawsuit). Soon thereafter, Noble's insurance broker, Marsh USA, Inc. (Marsh), sent a demand letter to Bituminous, asserting that Bituminous was obligated to defend and indemnify Noble in the underlying lawsuit since Noble was an additional insured under T&L's policy. Bituminous rejected Noble's demand.

In April 2004, Noble entered into a settlement agreement with plaintiffs in the underlying lawsuit. Several months later, Noble filed this breach-of-contract and declaratory-judgment action against Bituminous. Bituminous removed the suit to federal court, and both sides filed motions for summary judgment. Noble argued that Bituminous had a duty to indemnify it for monies paid pursuant to the settlement agreement in the underlying lawsuit, up to Bituminous' policy limit of one million dollars. Bituminous filed a cross-motion for summary judgment, contending that it did not have a duty to defend and did not owe indemnification to Noble.

The district court granted Bituminous's motion for summary judgment, holding, in part, that Bituminous did not have a duty to defend Noble because the policy's pollution exclusion barred coverage for plaintiffs' claims. This appeal followed.

*Controlling Law*

The Fifth Circuit noted that Texas law – which governed the claims at issue – followed the "eight corners" rule of insurance contract interpretation. Under the "eight corners" rule, an insurer's duty to defend is determined by the underlying complaint without regard for the truth the allegations. If the complaint alleges facts stating a cause of action potentially falling within the insurance policy's scope of coverage, the insurer has a duty to defend the insured. The Court also noted that under Texas law, insurance policies are controlled by rules of construction applicable to contracts. If the plain language of the insurance policy can be given a definite or certain legal meaning, it is considered unambiguous. Conversely, if the policy language is subject to two or more reasonable interpretations, it is considered ambiguous. Whether the language of a policy is ambiguous is a question of law for the court to determine by looking at the contract in light of the circumstances present at the time the policy was entered.

*Analysis*

At the outset of its analysis, the Fifth Circuit noted that Texas courts have consistently held similar pollution exclusions to be unambiguous. Thus, the question to be decided was whether the accident that allegedly caused plaintiffs' injuries fell within the scope of the pollution exclusion – *i.e.*, whether it arose out of a "discharge, dispersal, release or escape of pollutants."

Noble argued that the pollution exclusion was not implicated because the explosion was not caused by the sediment's alleged "pollutant" quality – *i.e.*, its quality as a flammable accelerant. The Fifth Circuit disagreed, noting that Noble plainly ignored the fact that the combustible vapors from the gas condensate component of sediment – the cause of the explosion – fell squarely within the pollution exclusion's unambiguous definition of "pollutant." Accordingly, Noble's alleged liability unquestionably arose out of the discharge, dispersal, release, or escape of the sediment and its vapors.

*Conclusion*

Finding that the policy's pollution exclusion applied to the claims asserted against Noble in the underlying lawsuit, the Fifth Circuit affirmed the district court's ruling that Bituminous was not obligated to defend or indemnify Noble.

# Evidence

## Witnesses

### New York High Court Holds Dead Man's Statute Does Not Apply in Attorney Disciplinary Proceeding

*In re Zalk*, No. 98, 2008 BL 127419 (N.Y. June 12, 2008)

On June 12, 2008, the New York Court of Appeals held that the Dead Man's Statute, N.Y. C.P.L.R. § 4519, did not apply in a disciplinary proceeding against an attorney who was accused of mishandling a client's funds after the death of the client.

*Background*

Richard Zalk was a New York attorney who represented Ruth Gellman prior to her death in September 2000. Zalk and Ruth met in 1970 when Zalk represented her father's estate, and over the next several decades, Zalk performed occasional legal work for Ruth and her husband Arthur. Zalk claimed that he never sent regular billing statements to the Gellmans; rather, he would agree with them as to an appropriate charge at the end of each matter.

After Zalk represented Arthur's estate in 1990, he charged $5,000. Ruth suffered a massive heart attack in 1992, which caused her to be hospitalized for three months and caused her health to deteriorate severely. She was eventually bed-ridden and confined to her home. Zalk continued to perform legal work for her after Arthur's death, mostly related to Hamilton Gardens, an apartment complex that Ruth's father had willed to her. However, in light of Ruth's limited financial resources, Zalk never billed nor received payment for his legal services. Instead, Zalk testified that he and Ruth agreed that once Hamilton Gardens was sold, he would receive payment for his legal work from 1990 to 2000. Zalk did not keep any detailed time records for the legal work he performed during this ten-year stretch.

In 1998, Zalk represented Ruth in the $2 million sale of Hamilton Gardens. A $200,000 down payment was placed in his attorney escrow account. After the closing on April 5, 2000, Zalk went to Ruth's home with her daughter Michelle Gellman, where Zalk explained the closing details and calculation of the escrow account expenses. According to Zalk, Ruth told him:

> We both know that I owe you that and a hell of a lot more for everything you've done for me, not just in connection with Hamilton Gardens but for everything you've done for me since Arthur's death for which you've never billed me . . . [W]hat you're going to do is you're going to pay off whatever has to be paid off . . . and whatever remains of the downpayment [sic] is going to be your fee for everything you have done for me over the past ten years.

Michelle Gellman testified that she did not overhear what Zalk and her mother discussed.

Zalk claimed that he was hesitant to accept this offer but Ruth insisted that the funds were his. He encouraged her to keep some of the escrow money to pay capital gains taxes, both at her home on April 5, 2000 and then in a letter he sent to her later that month. In that letter, he stated "'[w]hile I am enormously touched by your extremely generous offer I cannot accept it.'" He testified that Ruth called him on the telephone and said that she insisted on Zalk taking the funds from the escrow account as his fee.

Not long after Ruth and Zalk reached the alleged oral agreement, Ruth was hospitalized. Zalk testified that in July 2000, when Zalk visited Ruth in the hospital, Ruth affirmed that Zalk should keep the balance of the escrow account. Ruth died in September 2000, and Zalk represented Ruth's estate. During this representation, he corresponded with Ruth's two daughters, who were appointed co-administrators of the estate.

Closing expenses for the Hamilton Gardens sale amounted to $10,079. In the 13 months after Ruth's death, Zalk removed $100,000 from the escrow account for his own use, leaving $62,000 in the account. In October 2001, the Gellman daughters demanded "an accounting for the Hamilton Gardens sale and a check for the balance of monies remaining." In February 2003, the daughters filed a complaint with the Departmental Disciplinary Committee (Committee), "asking for a determination as to whether Zalk's retention of $162,000 from their mother's estate was appropriate."

The Committee served Zalk with formal charges in September 2004, claiming that he misappropriated the funds in the escrow account, engaged in a "conflict of interest by representing Ruth Gellman's estate once his claim to the escrow account was disputed" and engaged in "conduct adversely reflecting on his fitness as a lawyer."

A disciplinary hearing before a referee was held, and the Committee argued that the Dead Man's Statute did not apply and should preclude Zalk's testimony about his alleged fee agreement with Ruth.

*Dead Man's Statute*

The Dead Man's Statute provides:

> Upon the trial of an action or the hearing upon the merits of a special proceeding, a party or person interested in the event . . . shall not be examined as a witness in his own behalf or interest . . . against the executor, administrator or survivor of a deceased person . . . concerning a personal transaction or communication between the witness and the deceased person . . . except where the executor, administrator, survivor . . . or person so deriving title or interest is examined in his own behalf . . . concerning the same transaction or communication.

N.Y. C.P.L.R. § 4519. The Court of Appeals noted that the Dead Man's Statute was "'widely considered to be the last vestige of the common-law rule which made all interested person and parties incompetent to testify.'" *Matter of Wood*, 52 N.Y.2d 139, 143–44 (1981). The statute's utility and wisdom have been questioned "'throughout its history and the Legislature has often forcefully been urged to change or to modify [it, but it] nonetheless, has been consistently reenacted by the Legislature and remains a part of the law of this State.'" *Id.* at 144.

At the disciplinary hearing, the referee held that the statute was inapplicable, because the "attorney disciplinary proceeding was not 'against the executor, administrator or survivor of a deceased person.'" The referee further held that "while Zalk 'might be barred from testifying in an action brought by the sisters to recover the escrow funds,' he 'c[ould not] see how, in a disciplinary proceeding, he c[ould] be barred from offering his defense.'"

On appeal, the Appellate Division overturned the referee's interpretation of the applicability of the Dead Man's Statute, holding that Zalk's testimony fell within the statute's gamut because, should Zalk have prevailed, the outcome of the disciplinary proceeding would affect the rights of the daughters "in that [Zalk] would not be ordered to return to Ruth Gellman's estate the money he claims as his own."

On appeal, the Court of Appeals noted that the Appellate Division took "the position that, although the Gellman daughters are not parties to the disciplinary proceeding, the . . . doctrine of collateral estoppel endow[ed] them with a vital interest in a finding that Zalk converted estate monies." The Court held that this interpretation did not fall within the meaning of the Dead Man's Statute, which applies only to testimony "against the executor, administrator or survivor" of a decedent. "It does not foreclose testimony that potentially cuts against these parties' interests in a contingent future proceeding."

*Conclusion*

Accordingly, the Court held that the Dead Man's Statute did not apply to the disciplinary proceedings and remanded the case.

# Products Liability

## Preemption

### District Court Holds FDA Regulations Preempt Plaintiff's State Law Claims

*Holk v. Cadbury Schweppes Americas Beverages*, No. 07-cv-03018, 2008 BL 126589 (D.N.J. June 13, 2008)

On June 13, 2008, the U.S. District Court for the District of New Jersey held that plaintiff's state law claims of fraud, unjust enrichment and breach of warranty were preempted by regulations promulgated by the Federal Food and Drug

Administration (FDA). The court thus granted defendant's motion to dismiss.

*Factual Background*

Defendant Snapple Beverage Corporation (Snapple) manufactures and sells iced tea and juice beverages, which it describes in its advertisements and marketing materials as being "All Natural". On May 4, 2007 and at various times during the previous six years, plaintiff Stacy Holk purchased bottles of Snapple's Acai Blackberry Fruit Juice Drink.

Initiating this suit on behalf of herself and all others similarly situated, Holk alleged that she suffered losses as a result of Snapple's "misleading, inaccurate, and deceptive advertising" in that Snapple's "All Natural" beverages were in fact sweetened with high fructose corn syrup, which she argued is not derived from natural sources. Holk further contended that Snapple violated the New Jersey Consumer Fraud Act, N.J.S.A. 56:8-1 *et seq*., was unjustly enriched by its wrongful conduct, and breached certain warranties including the implied warranty of merchantability. Snapple moved to dismiss on the grounds that Holk's claims were preempted by certain FDA regulations.

*FDA Regulations*

Pursuant to Congressional authorization via the Federal Food, Drug, and Cosmetic Act (FFDCA), 21 U.S.C. 301 *et seq*., the FDA has promulgated extensive regulations, including those that govern the labeling of fruit or vegetable juices. In particular, the FDA regulations contain rules governing the names of diluted multiple-juice beverages or single-strength juice blends, juices made from concentrate, and labels of such products.

While the FDA has declined to establish a definition for "natural," its current policy regarding the term is to "(1) not restrict its use, except for added color, synthetic substances, and flavors, and (2) construe it as meaning that nothing artificial or synthetic (including all color additives regardless of source) has been included in, or has been added to, a food that would not normally be expected to be in the food." (Internal quotation omitted.) Moreover, the FDA has defined "natural flavor" as "the essential oil, oleoresin, essence or extractive, protein hydolysate, distillate, any product of roasting, heating or enzymolysis, which contains the flavoring constituents derived from a spice, fruit or fruit juice, vegetable or vegetable juice, edible yeast, herb, bark, bud, root, leaf or similar plant material, meat, seafood, poultry, eggs, dairy products, or fermentation products thereof, whose significant function in food is flavoring rather than nutritional." 21 C.F.R. 101.22 (a)(3).

*Preemption Analysis*

State statutory and common laws may be preempted by federal law in three circumstances: express, implied, and field preemption. Express preemption occurs when Congress dictates that a given federal statute preempts state law. Implied preemption arises when a state law comes into conflict with a federal law. Finally, state law is preempted if it attempts to regulate a field in which Congress intended the federal government to have exclusive authority.

Snapple argued that the FDA regulations governing nutrition labeling on beverages expressly preempted plaintiff's claims. Additionally, Snapple noted that plaintiff never alleged that it had violated the FFDCA and that the FFDCA does not provide a private right of action. Plaintiff countered that there was no express preemption since the FDA regulations do not directly apply to the term "All Natural" as used on the Snapple products. Snapple further argued that the "enormity and comprehensive nature of both the FFDCA and its implementing regulations" evidenced Congress' intent to reserve the food and beverage labeling field to the federal government, thereby impliedly preempting plaintiff's claims. Plaintiff contended that the FFDCA was not comprehensive in regulating the food and beverage labeling field, and that the state laws at issue did not conflict with the FFDCA.

Although it observed that there was no language in the FDA regulations that expressly preempted state law, the court agreed with Snapple with respect to the broad reach of the FDA's regulations. The court found that the FDA had "created a complex regulatory framework to govern beverage labeling," thereby preempting state law in that field. While the FDA did not define the term "natural," it defined "natural flavor" and had published policies regarding the use of "natural." The court thus concluded that "the FFDCA and FDA regulations so thoroughly occupy the field of the beverage labeling at issue in this case that it would be unreasonable to infer that Congress intended states to supplement this area." Moreover, the court determined that the FDA "with all its scientific expertise," rather than the courts, should decide how the terms "natural" and "all natural" should be applied on beverage labels.

Accordingly, the court granted Snapple's motion to dismiss, holding that plaintiff's claims were impliedly preempted by the FDA's regulatory scheme.

# Bloomberg News Daily Litigation Wrap Up

## June 16 – June 20, 2008

### Lawsuits/Pretrial

(June 16) TD Ameritrade Holding Corp., the third-largest U.S. online brokerage, failed to win approval of a settlement resolving customer lawsuits after the lead plaintiff in the case said he was threatened into signing the agreement. U.S. District Court Judge Vaughn Walker in San Francisco June 13 cited the plaintiff's allegation, an unwarranted $1.9 million fee award to lawyers in the case and the lack of any monetary relief to customers as among the reasons he refused to give preliminary approval to the settlement. Matthew Elvey, a plaintiff representing a group of TD Ameritrade customers, expressed numerous reservations about the settlement at a June 12 hearing, Walker said in an order. “He suggested that the gains the class would receive under the settlement had the appearance of benefiting the class but were, in operation, trivial,” Walker said. “Mr. Elvey stated that he was ‘threatened’ into signing the settlement agreement.” Computer hackers stole addresses and contact information for as many as 6.3 million clients and flooded them with stock tips, the company said last year. Customers accused the company of failing to do enough to protect against unwanted e-mail. The Omaha, Nebraska-based company offered customers a one-year subscription to anti-spam software that sells for $70 and said it would take steps to better protect client information under the settlement. Walker ordered lawyers for the customers to “clarify this situation” and explain the basis for the attorneys' fees. He also ordered TD Ameritrade's lawyers to provide the actual cost of the software offer by June 26. Alan Himmelfarb, an attorney for Elvey and the customers, and Lee Rubin, an attorney for TD Ameritrade, did not return messages left after business hours. The case is *Matthew Elvey v. TD Ameritrade*, No. 07-cv-02852, U.S. District Court, Northern District of California (San Francisco).

(June 16) *TCI, 3G Will Appeal Court Ruling on CSX Shareholding Disclosure*

TCI Fund Management LLP and 3G Capital Partners Ltd. will appeal a federal judge's finding that the hedge funds did not properly disclose stock ownership in CSX Corp. as they mount a proxy fight with the railroad. TCI and 3G, the third- and fourth-largest shareholders of CSX, said they “respectfully disagree” with U.S. District Judge Lewis Kaplan's opinion that the funds did not divulge ownership exceeding 5 percent when required to do so. The funds made the comments in a letter to CSX shareholders, released June 13 in a statement. The judge also ruled that TCI and 3G, which have nominated five candidates to CSX's board, could vote their shares at the third-largest U.S. railroad's annual meeting. Shareholders will vote June 25 on members for the 12-member board, and on a TCI proposal to let shareholders more easily call meetings. “The incumbent board and management of CSX would have you believe that, if elected, our nominees would advocate a reckless leveraging of the company's balance sheet or starving it of capital spending,” TCI Managing Partner Christopher Hohn and 3G Managing Director Alex Behring wrote in the letter. “This is simply untrue.” Behring and Hohn are two of the five board nominees. London-based TCI and New York-based 3G together say they own 8.7 percent of CSX's outstanding shares, a stake valued at about $2 billion. They have asked CSX to raise debt levels, reevaluate capital spending plans and separate the roles of chief executive officer and chairman, saying the company is underperforming compared with its peers. “In assessing the TCI group's claims, shareholders should consider the credibility problems of the TCI group principals, as demonstrated in the federal district court's recent opinion,” said Andrew Siegel, an outside spokesman for CSX. Jacksonville, Florida-based CSX is holding its annual meeting at a New Orleans rail yard.

(June 17) *Barclays Suit Over Bear Funds Might Aid Prosecutors*

A complaint by Barclays PLC, the U.K.'s third-biggest bank, over the implosion of two Bear Stearns Cos. hedge funds that invested in subprime mortgages may help guide prosecutors probing whether executives broke the law. Barclays Bank PLC, a unit of London-based Barclays, claimed it lost “hundreds of millions of dollars” in one fund because Bear Stearns Asset Management Inc. and two managers hid negative financial information, according to a complaint amended June 6 in federal court in New York. Managers Ralph Cioffi and Matthew Tannin might be criminally charged within a week, the *Wall Street Journal* reported yesterday, citing unidentified people familiar with the case. The U.S. Justice Department is examining the collapse of the funds, which helped trigger the credit crisis last year and led Bear Stearns to agree in March to sell itself to JPMorgan & Chase Co. Prosecutors will study the Barclays complaint, which claims Cioffi and Tannin engaged in “conscious deception of Barclays and others,” according to a lawyer not involved in the case. “I would expect prosecutors to pay close attention to those sets of allegations,” former federal prosecutor Andrew Hruska said yesterday in a phone interview. “The facts underlying the civil lawsuit could be become direct evidence in their case in chief if they file criminal charges.” Barclay's lost “almost all” of a $400 million investment made after August 2006 in a fund known as Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd., referred to as the Enhanced Fund, according to the complaint. Cioffi and Tannin convinced Barclays to become the sole shareholder after deceiving the bank about another fund, Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd., referred to as the High-Grade Fund, according to the complaint. Both the Enhanced Fund and the High-Grade Fund once had $20 billion in assets, Barclays claimed. The two Bear Stearns funds failed when prices for collateralized-debt obligations linked to subprime mortgages plummeted as late payments among U.S. borrowers with poor credit histories or heavy debts increased. Cioffi, 52, and Tannin, 46, wooed Barclays by touting the success of the High-Grade Fund, which began in March 2003 and had a 50 percent return by January 2007, according to the complaint. Bear Stearns Asset Management, Cioffi and Tannin hid “problems and disarray” in the High-Grade Fund including a failure to get approval from the board of directors for hundreds of self-dealing transactions, according to the complaint. Barclays also was not told that Bear Stearns had halted transactions with the High-Grade Fund, the bank said in its complaint. In its complaint, Barclays accuses Bear Stearns Asset Management, Cioffi and Tannin of fraud, conspiracy and breach of fiduciary duties. Barclays seeks unspecified compensatory and punitive damages. The case is *Barclays Bank Plc v. Bear Stearns Asset Management*, No. 07-cv-11400, U.S. District Court, Southern District of New York (Manhattan).

(June 17) *Yahoo Investors Lose Bid for Early Trial Over Offer*

Yahoo! Inc.investors lost a bid to have a judge set a July trial date for their lawsuit over the Internet company's decision to rebuff buyout offers from Microsoft Corp.Delaware Chancery CourtJudgeWilliam B. Chandler III yesterday refused to schedule an expedited trial over claims that Yahoo directors should be held financially responsible for snubbing Microsoft's offers and for setting up a severance plan designed to increase the cost of an acquisition. The judge said he'll consider the board's motion to throw out the suit. "The court is willing to and capable of deciding that motion before the Yahoo annual shareholders' meeting" on August 1, Chandler wrote in his two-page decision. Microsoft, the world's largest software company, withdrew a bid of more than $34 a share for Yahoo in May after the companies failed to agree on a price. Microsoft, based in Redmond, Washington, had offered $40 a share in January 2007, according to court papers. Two Detroit pension funds contend Jerry Yang, Sunnyvale, California-based Yahoo's chief executive officer, engineered the company's severance plan to thwart Microsoft's offer by giving employees incentives to quit rather than work for a buyer. Joel Friedlander, a lawyer representing the pension funds, declined to comment on yesterday's ruling. Yahoo spokeswoman Diana Wong did not return a phone call after business hours. Microsoft wanted to buy Yahoo to compete against Google Inc., the owner of the most-popular Internet search engine. Yahoo officials agreed last week to partner with rival Google in selling advertising. The case is *Police and Fire Retirement System of the City of Detroit v. Yahoo*, No. CA3561, Delaware Chancery Court (Wilmington).

(June 18) *Adidas Poised to Win $1.60/Share on Wal-Mart Copycats*

Adidas AG, which was awarded a $304.6 million verdict against Payless ShoeSource on May 5 for selling knockoff striped sneakers, is poised to win even more from Wal-Mart Stores Inc. in a lawsuit making similar claims. The world's second-biggest sporting-goods maker may collect at least $326 million in damages, the equivalent of $1.60 a share, if a jury agrees Wal-Mart copied Adidas's three-stripe sneakers by selling shoes with two- and four-stripe motifs as Payless did. A jury trial is set to start Oct. 6 in federal court in Portland, Oregon, the same courthouse where the Payless trademark-infringement case was decided. Wal-Mart, the world's largest retailer, settled two earlier suits by Adidas over striped sneakers. The company's repeated promises not to mimic Adidas may prompt a jury to award punitive damages much higher than those against Payless, said Steven Nataupsky, managing partner of the law firm Knobbe Martens Olson & Bear in Irvine, California. "Adidas will be arguing that a company has infringed twice, has agreed to stop twice and yet is marching forward with more infringing shoes," said Nataupsky, whose firm represents plaintiffs and defendants and is not involved in the Adidas case. Its clients include Starbucks Corp. and Ranbaxy Pharmaceuticals Inc. Adidas, based in Herzogenaurach, Germany, has sued about three dozen retailers since 1999 in the U.S. and Europe to keep what it considers knockoffs of its trademarked shoes and clothing from diluting the brand. The campaign is finally paying off. Wal-Mart, based in Bentonville, Arkansas, disagrees with Adidas's assertion that the stripe pattern, used since at least 1952, has significance in the sporting world. "Wal-Mart denies that the three-stripe mark has achieved international fame and tremendous public recognition," the company said in court papers. The Arkansas retailer "probably watched every step" of the Payless trial to develop its own strategy and recognizes problems in the Payless defense, Nataupsky said. "If Wal-Mart's going to take it to trial, then they have clearly in their own minds determined how they can avoid mistakes," he said. Daphne Moore, a spokeswoman for Wal-Mart, declined to comment on the likelihood of another settlement or any other aspect of the case. The suit, filed in 2005, claims Wal-Mart "maliciously" sold hundreds of thousands of imitation Adidas shoes in violation of a 2002 settlement that barred it from offering "confusingly similar" products. A previous settlement, in 1995, prohibited Wal-Mart from selling shoes with three parallel stripes or certain four-stripe designs. Topeka, Kansas-based Payless, which last year changed its name to Collective Brands Inc. after buying the Stride Rite chain, was told by a jury to pay Adidas $304.6 million. Two days later, Sears Holdings Corp.'s Kmart unit reached a confidential settlement of a suit Adidas filed in Portland in 2005. "You can see where Kmart stepped up and settled because there was now a precedent for an enormous award out there," Nataupsky said. "Adidas now has a game plan in place for seeking an enormous number and obtaining that result." The case is *Adidas Am. Inc. v. Wal-Mart Stores Inc.*, No. 05-cv-01297, U.S. District Court, District of Oregon (Portland).

(June 19) Bear Stearns Cos.settled at least 11 customer complaints for at least $10,000 each involving two former hedge-fund managers under U.S. criminal investigation, according to Financial Industry Regulatory Authorityrecords. Ralph Cioffi, 52, and Matthew Tannin, 46, are being investigated by federal prosecutors in Brooklyn and could be indicted as early as this week, according to people familiar with the matter. The U.S. Securities and Exchange Commission could also sue the men this week, the people said. Both ran hedge funds that once had $20 billion in assets and invested in subprime mortgages. The collapse of the funds helped trigger the credit crisis last year and led Bear Stearns to agree in March to sell itself to JPMorgan & Chase Co. Bear Stearns settled each complaint for more than $10,000, according to Finra records that don't detail the amounts or make the cases public. "Based on the evidence that we have seen to date, this is one of the most egregious violations of the public trust that I have ever seen in my career," said attorney Steven B. Caruso, who has filed three pending arbitration claims and plans to file 10 others on behalf of investor clients. The 11 settled cases involve customer complaints, arbitration proceedings or civil lawsuits, according to Finra records. Cioffi and Tannin were not parties to the settlements, which released them from claims by customers who alleged "inconsistency" between the investment strategy of the funds and their actual investments, according to the records. Prosecutors are examining the role of Cioffi and Tannin in the collapse of the Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd. and the Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd. Investigators also are examining possible insider trading by Cioffi, who removed $2 million from one of the funds, people familiar with the investigation said in December. Cioffi, who resigned last Nov. 28, is now an investor in RCAM Capital LP in Tenafly, New Jersey, where he lives. He declined to comment in an e-mailed statement. His attorney, Edward Little, did not returns call or e-mails seeking comment. Cioffi spokesman Andy Merrill declined to comment. Tannin's lawyer, Nina Beattie, declined to comment. A spokesman for JPMorgan & Chase Co., Brian Marchiony, didn't return a call seeking comment. One arbitration claim by Caruso involves a Barbados-based hedge fund that is seeking damages of $2.38 million for investments made between February 2005 and May 2005 in the funds, according to Finra records. Another Finra claim involves multiple customers seeking damages of $27.5 million. The records do not detail who filed the claim or the exact amount of any settlements.

(June 19) *Citigroup, ING Defeat $4 Billion in Adelphia Claims*

Citigroup Inc., ING Group NV and Bank of America Corp. were among hundreds of financial institutions and investment funds that won dismissal of claims by Adelphia Communications Corp. creditors seeking more than $4 billion. The creditors sued more than 400 banks and funds in 2003 in federal bankruptcy court, saying they helped Adelphia founder John Rigas and his son Timothy steal from the company. The suit sought recovery of about $3.4 billion in loan claims and $605 million in interest and fees, as well as a bar on claims by the funds against Adelphia, a bankrupt cable-television operator. U.S. District Judge Lawrence McKenna in New York June 17 dismissed both of the creditor requests. The creditors "have been paid in full," the judge wrote. David Friedman, an attorney for Adelphia's creditors from Kasowitz Benson Torres & Friedman, didn't return a call seeking comment. "The Rigas family misappropriated over $3.4 billion from Adelphia, funds knowingly and eagerly provided by defendants, rendering Adelphia bankrupt and insolvent," the creditors alleged in their complaint. McKenna did not rule on creditor claims that the banks and funds aided and abetted the fraud at Greenwood Village, Colorado-based Adelphia. The case was transferred to McKenna from the federal bankruptcy court in Manhattan in October 2005. "Every major institution on Wall Street" was sued in the case, said Richard Wynne, a partner at Kirkland & Ellis that represented many of the funds. Adelphia, once the fifth-largest U.S. cable-TV provider, was bought out of bankruptcy in 2006 by Time Warner Inc. and Comcast Corp. The bankruptcy case is *In re Adelphia Communications Corp.*, No. 02-41729, U.S. Bankruptcy Court, Southern District of New York (Manhattan). The case against the funds is *Adelphia Recovery Trust v. Bank of America NA*, No. 05-cv-9050, U.S. District Court, Southern District of New York (Manhattan).

(June 20) *Lehman Accused of Failing to Disclose Subprime Holdings*

Lehman Brothers Holdings Inc., the fourth-largest U.S. securities firm, was accused in a lawsuit of misleading investors by failing to disclose how much they had invested in subprime mortgages. The lawsuit, filed June 18 in Manhattan federal court, claims that New York-based Lehman failed to take timely writedowns of its positions on mortgage-backed securities and overstated their value. The suit also names Lehman Chief Executive Officer Richard Fuld and other executives. Lehman has lost more than 60 percent of its value on the New York Stock Exchange this year amid speculation mortgage-related writedowns will continue to depress earnings. After disclosing a wider-than-estimated second-quarter loss this month, the firm replaced its president and chief financial officer. "Defendants' knowing or reckless statements and inadequate disclosure artificially inflated the price of Lehman Brothers common stock" from September 13, 2006, to June 6, 2008, the plaintiffs said in the complaint. Lehman spokesman Mark Lane declined to immediately comment. The suit, which requests class-action, or group status, seeks unspecified damages. It was filed by the Operative Plasterers and Cement Masons International Association Local 262 Annuity Fund. The suit is *Operative Plasterers v. Lehman Brothers*, No. 08-cv-05523, U.S. District Court, Southern District of New York (Manhattan).

## New Suits

(June 19) *Hexion Sues to Cancel $10.6 Billion Huntsman Merger*

Hexion Specialty Chemicals Inc., a unit of Apollo Management LP, sued to cancel its $10.6 billion acquisition of Huntsman Corp. because banks probably won't provide debt financing. Huntsman stock plunged. Huntsman's net debt has increased and its earnings were lower than expected since the companies agreed to merge in July, Columbus, Ohio-based Hexion said in a complaint filed yesterday in Delaware Chancery Court in Wilmington. The capital structure for the combined entity is no longer viable and would render it insolvent, the company said. Huntsman, run from Salt Lake City and The Woodlands, Texas, agreed to be acquired by Hexion for $28 a share. Huntsman Chief Financial Officer J. Kimo Esplin said in May that Hexion, the biggest plywood-adhesives producer, still has financing commitments from Credit Suisse Group and Deutsche Bank AG. "The financing for the acquisition is predicated on a certain level of financial performance and, given the increase in Huntsman's total debt and decrease in earnings, Hexion does not believe that the transaction can be completed," Hexion Chief Executive Officer Craig O. Morrison said in a statement. Apollo, the New York-based private-equity firm run by Leon Black, assembled closely held Hexion through a series of acquisitions. Apollo did not commit any cash from its funds to the Huntsman transaction and isn't responsible for any portion of the termination fee, according to the suit. Huntsman spokesman Russ Stolle declined to immediately comment. Hexion spokesman John Kompa did not return a call for comment. Representative for Hexion's lenders, Deutsche Bank and Credit Suisse, declined to comment. The case is *Hexion Specialty Chemicals Inc. v. Huntsman Corp.*, No. CA3841, Delaware Chancery Court (Wilmington).

## Verdicts/Settlements

(June 16) *UBS, Credit Suisse Pay $548 Million to Settle Parmalat Claims*

UBS AG and Credit Suisse Group AG, Switzerland's two largest banks, agreed to pay almost 357 million euros ($548 million) to settle all legal claims related to their role in financing Parmalat SpA, the dairy company that collapsed five years ago in Italy's biggest bankruptcy. UBS will pay more than 184 million euros and Credit Suisse will pay 172.5 million euros, Parmalat said in separate statements June 13. Both banks are based in Zurich and Parmalat is based in Collecchio, Italy. Parmalat Chief Executive Officer Enrico Bondi filed lawsuits against dozens of Parmalat's banks, alleging they helped hide the true state of the company's finances from investors. The company foundered in 2003 under debts of 14 billion euros, almost eight times more than reported by former managers. With the settlements, Bondi has recovered about 1.5 billion euros. "The settlement will have a negligible effect on UBS's earnings in view of the provisions previously established by UBS in connection with these matters," UBS said in an e-mailed statement. Credit Suisse said in an e-mailed statement that it "has at all times acted properly in its dealings with the Parmalat Group and was unaware of Parmalat's insolvency at the time of entering into any transactions." Parmalat returned to the stock market on October 6, 2005, after a two-year reorganization under Bondi, who served as a court-appointed bankruptcy administrator before being appointed CEO. Jurors in New Jersey Superior Court began hearing claims last month by Bondi that Citigroup Inc., the biggest U.S. bank by assets, abetted looting by Parmalat employees. Jurors are also hearing a countersuit by Citigroup, which claims it lost $699 million because of Parmalat's fraud.

## On the Docket

(June 17) *BCE's $50 Billion Buyout Bid To Be Heard Today by Supreme Court*

BCE Inc., the country's biggest phone company, will ask the Supreme Court of Canada today to overturn an appeals court ruling that its C$52 billion ($50.7 billion) deal to complete the world's biggest leveraged buyout didn't adequately consider the negative effect on bondholders. The appeals court overturned a trial judge who approved a buyout led by Ontario Teachers' Pension Plan. The outcome may turn on a case in 2004, when the Canadian high court ruled unanimously that boards of directors have a duty to do what is in the best interest of a corporation, said Theo Peridis, a professor of strategic management at the Schulich School of Business at York University in Toronto. Directors' decisions may not necessarily be what is in the best interest of shareholders, he said. The trial judge's decision was appealed by the TD Asset Management unit of Toronto-Dominion Bank, Canada's third-biggest bank; Canadian Imperial Bank of Commerce, the fifth-largest bank; Manulife Financial Corp., the country's largest insurer; and the province of Alberta. The bondholders have argued the buyout violated agreements with BCE. The objecting bondholders own about C$1.4 billion of the C$5.2 billion of investment-grade debt maturing after 2010, according to the May 21 appeals court ruling. The case is Between BCE Inc. and a group of 1976 Debenture holders, No. 32647, Supreme Court of Canada (Ottawa).

*Litigation News by Elizabeth Amon, with reporting by David Altaner, Stephanie Bodoni, Caroline Byrne, Bill Callahan, Andrew Davis, Susan Decker, Anthony DiPaola, Edward Evans, Jef Feeley, Sara Gay Forden, Karen Freifeld, David Glovin, Karen Gullo, Cecile Gutscher, Christine Harper, Shannon D. Harrington, Patricia Hurtado, Tiffany Kary, Jack Kaskey, Angela Greiling Keane, Carlyn Kolker, Erik Larson, Bomi Lim, Edmond Lococo, James Lumley, Karin Matussek, Phil Milford, Cary O'Reilly, Sophia Pearson, Edvard Pettersson, Shannon Pettypiece, David Scheer, Joe Schneider, Christopher Scinta, Heather Smith, Jurjen van de Pol, David Voreacos and Thom Weidlich. Editors: Peter Blumberg, Steve Farr, Glenn Holdcraft and Michael Hytha.

# Bloomberg Law Reports®
## Litigation

### Managing Legal Analyst

Kevin McCarthy - Telephone: (212) 617-5934 or e-mail: kmccarthy11@bloomberg.net

### Bloomberg Contributing Legal Analysts

Michael Bahler, Marisa Brahms, Andrea Chiller, Robert Conrad, Denise Delgado-Kerman, David Kleiman, Kevin J. Lawner, Michelle Lewin, Sue J. Park, Heidi Schmitt, Tina Tolentino, Rebecca Tsai and Desiree Wise

Subscription Price: Free to Bloomberg Professional Service customers; $2500/year for non-customers
Discounts available for volume subscriptions.

The discussions set forth in this report are for informational purposes only. They do not take into account the qualifications, exceptions and other considerations that may be relevant to particular situations. These discussions should not be construed as legal advice, which has to be addressed to particular facts and circumstances involved in any given situation. Bloomberg Finance L.P. and its affiliated entities do not take responsibility for the content contained in this report and do not make any representation or warranty as to its completeness or accuracy. Any opinions expressed herein do not necessarily reflect the views or opinions of Bloomberg Finance L.P. or any of its affiliates.

© 2008 Bloomberg Finance L.P. All rights reserved. Bloomberg Law Reports® is a registered trademark and service mark of Bloomberg Finance L.P.