FEDERAL BAR ASSOCIATION SOUTHERN DISTRICT OF NEW YORK CHAPTER

January 2015 The Newsletter of the Southern District of New York Chapter of the FBA

IN THIS EDITION

Letter from the President

Welcome SDNY Chapter members to a historic 225th anniversary year for the Southern District of New York. As we go forward into our anniversary year, I am honored to serve as President of our chapter and look forward to the wonderful events and festivities that are planned for the year.

As many of you attended our swearing in on October 7, 2014, I wanted to thank you for your support and encouragement as we head into this special year for our court. We are fortunate to have the support of Chief Judge Preska and are thankful for her ever present guidance in planning events and lectures that are relevant to our members, federal practitioners and the judiciary. There are many others at the Southern District who have provided incredible support for our officers, and members, as we plan and execute the various events we have scheduled for the year. This includes Southern District Clerk of the Court Ruby Krajick and District Executive Ed Friedland (including his incredible assistant, Elly Harrold). We are fortunate to have their support, and look forward to a meaningful and eventful year ahead as a result.

On November 5, 2014, we held a Town Hall covering mediation strategies, moderated by Past President Simeon Baum that brought together mediators from the Southern District, Eastern District as well as anyone interested in alternative dispute resolution. On November 13, 2014, our National Delegate Wylie Stecklow moderated an incredible panel featuring no less than seven magistrate judges, discussing pre-trial strategies in the SDNY. On November 18, 2014, our President-Elect Michael J. Zussman hosted a meet and greet for intellectual property law practitioners. We also expect to host a New Year's bash in January which I hope all of
you will be able to attend.

2015 will be equally filled with a series of events, including a January 27, 2015, CLE focusing on labor and employment law hprogram focusing on recent Supreme Court cases hosted osted by Steven Landis (our treasurer) and a March 18 by Rob Rando, a Past President of the Eastern District of New York chapter. On March 4, 2015 we will be holding a unique event honoring the four women Chief Judges of the Southern District and Eastern District of New York.

This is a historical first, and we hope to host it at Federal Hall, downtown. Additional programs include an all day Fashion Law CLE Conference on March 20, 2015, a panel focusing on Human Trafficking, and another highly anticipated Rule of Law Event. I encourage you to visit our website at **www.fbasdny.org** to learn more about upcoming events; we will be updating it as we continue working on the calendar.

As under Past President William Dahill's leadership we will continue to reach out to law schools to recruit new law school members. Of equal importance are young attorneys, early in their careers, who are such an important asset to bar associations as they grow and settle into their careers.

I encourage you to attend our events. I want to hear from you – your thoughts, your ideas, and where we can improve. I will listen and incorporate your suggestions into our next events. If you are a new member, introduce yourself, attend our board meetings, lectures and cocktails, you will be rewarded with friends and supportive colleagues that will last you a lifetime.

All members of the Chapter and those considering becoming members can contact me at (212) 785-0070 or email me at OMedenica@Medenicalaw.com anytime. I look forward to hearing from you.

Olivera Medenica, President (2014-2015)

SDNY Chapter Events

The swearing-in of new leadership at the Southern District of New York

OCTOBER 7, 2014

Pre-Trial Practice in the Southern District of New York

The event drew a crowd and brought together Magistrate Judges of the SDNY.

NOVEMBER 13, 2014

SDNY Chapter Events (cont.)

A CLE event, Town Hall on: Effective Representation in Mediation, was held at the Southern District of New York.

The event brought mediators and attorneys together for an informative and engaging evening.

November 5, 2014

The Rule B Afterlife: Five Years after *Jaldhi*

George M. Chalos, Esq. and Kerri M. D'Ambrosio, Esq.
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Introduction

Rule B of the Supplemental Rules for Certain Admiralty and Maritime Claims ("Rule B") permits a claimant with an *in personam* maritime claim to attach the property (tangible or intangible) of the defendant within a U.S. judicial district, provided that the defendant cannot be found within that district. A Rule B ancillary attachment proceeding allows a claimant to obtain jurisdiction over a defendant's property when there is no personal jurisdiction over the defendant, and it allows that property to secure the plaintiff's claim, which typically is litigated or arbitrated on the merits in a foreign jurisdiction.

From 2002-2009, the term "Rule B attachment" became synonymous with the practice of attaching electronic fund transfers ("EFTs") as they passed through intermediary banks located in New York City. By the time of the crash of the shipping market and financial crisis of fall 2008, the Southern District of New York had become the hotbed for Rule B EFT attachments in the United States. The declining market conditions coupled with the availability of EFT attachments led to the increased use of "paying agents" by companies attempting to avoid their debts, and widespread fishing expeditions by maritime claimants attempting to catch debtors' assets in the hands of these paying agents or alter-ego companies. Clearing House Association L.L.C. reported that from October 1, 2008 to January 31, 2009, maritime plaintiffs filed 962 lawsuits seeking to attach a total of $1.35 billion, and Rule B attachment actions constituted approximately one-third (1/3) of all lawsuits filed in the Southern District of New York. *See Shipping Corp. of India v. Jaldhi Overseas PTE Ltd.*, 585 F.3d 58, 62 (2d Cir. 2009) (citing Amicus Br. of The Clearing House Association L.L.C. at pp. 3-4).

Until one day, all that changed.

When the Second Circuit Court of Appeals issued its decision in *The Shipping Corporation of India v. Jaldhi Overseas Pte. Ltd.,* 585 F.3d 58 (2d Cir. 2009) on October 16, 2009, maritime claimants worldwide feared that the ability to pursue Rule B attachments had died. Jaldhi held, in sum and substance, that EFTs in the temporary possession of an intermediary bank were no longer attachable property of a Rule B defendant. The Second Circuit's decisions in *Jaldhi* and *Hawknet, Ltd. v. Overseas Shipping Agencies*, 590 F.3d 87 (2d Cir. 2009) (which held that *Jaldhi* applied retroactively), resulted in the vacatur of hundreds of Rule B EFT attachments then-pending in the United States District Court for the Southern District of New York, leaving shipping companies, marine insurers, foreign solicitors, and others throughout the world without security and, often times, with an unenforceable arbitration award or judgment.

Rule B Attachments Five Years After *Jaldhi*

Despite the fears felt around the world after *Jaldhi* was decided, five (5) years after this landmark decision was issued, Rule B remains alive and well. While *Jaldhi* prohibited the practice of attaching EFTs while in the temporary possession of intermediary banks, it did not eliminate or modify the rights and remedies under traditional maritime attachment principles. Although the attachment of EFTs is, broadly speaking, "off-limits" in the United States, attachment of a party's tangible or intangible property within a U.S. judicial district remains very much alive, provided that the other requirements of Rule B have been met (*i.e.* – that a

plaintiff has a *prima facie* maritime claim against a defendant who cannot be "found" in the judicial district where the attachment is sought).

Claimants can, and routinely do, attach vessels (as well as bunkers or containers located aboard those vessels) during their U.S. port calls. The attachment of a vessel may be pursued to secure an *in personam* claim against the owner of the vessel, even if the claimant lacks a maritime lien over the vessel itself. Unlike an EFT attachment, wherein the Courts would consistently order a "special process server" to serve the Order and writ of attachment on the garnishee bank, the attachment of a vessel requires the engagement of the U.S. Marshal to physically serve the attachment Order and writ upon the vessel. The U.S. Marshal requires an attaching party to pay a deposit (which, depending on the jurisdiction where the attachment is sought, may run in the range of USD 5,000 – USD 20,000) for its costs in attaching and maintaining the vessel. Once the vessel is arrested, custody is typically transferred to a substitute custodian to preserve the vessel during its attachment. The attachment of a vessel (or property on board the vessel) under Rule B is a particularly effective means of seeking settlement of the underlying dispute, as vessels are subject to time-sensitive contractual obligations to third-parties and owners are typically eager for the vessels to resume their trade.

In addition to the attachment of a debtor's hard assets such as vessels, bunkers, containers and other "tangible" property, Rule B continues to authorize the attachment of intangible property. If a foreign defendant conducts business with U.S.-based third-parties who owe debts to the defendant, a maritime claimant may serve the U.S. company, as garnishee, with an Order and writ of attachment, seeking to attach the unmatured debts/credits held by these third-parties. This is just one of the many creative uses of Rule B that have developed in response to *Jaldhi*'s ban on EFTs. In the years since *Jaldhi* was decided, Rule B claimants have also successfully pursued the attachment of property including, *inter alia*, bank accounts (including those maintained by U.S. agents on behalf of foreign debtor(s)); the debtor's own Rule B attachment(s) of a third-party's property as security for its own affirmative claim; port agent disbursements; charter hire, freight or other obligations from sub-charterers; stocks; and dividend payments. The unexpected attachment of these types of "non-traditional" property interests of a debtor (or those of a debtor's related companies) frequently results in the debtor promptly posting substitute security or settling the debt for terms favorable to the claimant.

Finally, the use of "alter-ego" attachments continues to be a common means of seeking security and/or enforcement of uncollected arbitration awards and judgments. Under U.S. law, to "pierce the corporate veil" and impose liability upon a party on an "alter-ego" theory, one party must have used the other party to perpetuate a fraud or have so dominated and disregarded the other party's corporate form that the other party primarily transacted the alleged alter-ego's business rather than its own. Courts throughout the United States have developed a myriad of factors to consider in imposing alter-ego liability, including but not limited to disregard of corporate formalities; inadequate capitalization; intermingling of funds; overlap in ownership, officers, directors and personnel; common office space, address and telephone numbers of corporate entities; and/or the existence of fraud, wrong-doing, or injustice to third parties. Although the factors to be considered vary from Circuit to Circuit, all courts agree that no one (1) factor is determinative and that the totality of the circumstances should be considered before deciding whether (or not) to impose alter-ego liability.

Conclusion

Rule B remains a robust remedy for maritime claimants and continues to broadly permit the attachment of any "tangible or intangible personal property." With the return to traditional maritime remedies, and the emergence of the creative use of the attachment process in the five (5) years following the abolishment of

EFT attachments, Rule B has proven to be more powerful a tool than ever before for maritime claimants seeking to obtain jurisdiction over an elusive counterparty; to obtain security, and/or to enforce judgments and/or arbitral awards in the United States.

George M. Chalos (gmc@chaloslaw.com) is the principal and founding member of Chalos & Co, P.C. – International Law Firm. Mr. Chalos has been engaged in the practice of maritime, admiralty and insurance law for nearly twenty (20) years, and is experienced in all facets of civil and criminal maritime matters, including casualty and pollution response, Marpol, Oil Pollution Act of 1990, Clean Water Act, and environmental matters, and insurance coverage, defense, and handling of primary, excess and reinsurance claims. Mr. Chalos has a known specialty in Marpol and other environmental pollution matters, including and particularly the defense of criminal pollution cases, as well as the complex third-party litigation arising from a pollution incident. He has been counsel of record in over six hundred (600) civil and criminal maritime matters, in over twenty (20) different U.S. District and Appellate Courts and is a Proctor in Admiralty, which is the highest distinction and honor bestowed upon U.S. maritime lawyers by the Maritime Law Association.

Kerri M. D'Ambrosio (kdambrosio@chaloslaw.com) has been an associate with Chalos & Co, P.C. – International Law Firm since 2008, specializing in Rule B pre-judgment and post-judgment enforcement attachment matters; Rule C arrest matters; and other civil litigation matters. Ms. D'Ambrosio is currently admitted to practice in seven (7) state and federal courts throughout New York, Connecticut, and Texas and was recently selected to the 2014 New York Metro Rising Stars list for the Transportation/Maritime practice area by *Super Lawyers Magazine*; an honor reserved for less than 2.5 percent of the lawyers in the state of New York.

The Federal Practitioners Guide to Pleading Standards in Derivative Actions Involving New York Limited Liability Companies Following *Yudell v. Gilbert*

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I. Introduction

Since the enactment of New York's Limited Liability Company Law ("LLC Law") in 1994, the LLC has become the preferred business model. From start-ups to billion dollar entities, the LLC offers unparalleled flexibility while retaining the benefits of doing business as a corporation. However, unlike New York's Business Corporation Law and Partnership Law, the LLC Law does not provide for derivative suits (claims brought on behalf of the company against a third party), leaving courts to struggle with whether such suits are permissible. The issue is of critical import to federal practitioners as whether a claim is derivative or direct is a matter of state law. This article addresses the effects of the Appellate Division, First Department's decision in *Yudell v. Gilbert,* which adopted Delaware's "nature of the wrong" test to establish whether a claim is direct, derivative or a hybrid of the two.

II. Derivative Actions Generally and the Demand Requirement

Federal practitioners should be well acquainted with Fed. R. Civ. P. 23.1, which establishes prerequisites, pleading requirements and settlement terms concerning derivative actions. "A derivative suit is one in which a 'shareholder sues on behalf of the corporation for *harm done to it*' whereas a direct action is one in which shareholders sue 'for *injuries done to them* in their individual capacities by corporate fiduciaries.'" *In re Adelphia Commc'ns Corp. Sec. & Derivative Litig.*, No. 05-C2700, 2013 WL 6838899 (S.D.N.Y. Dec. 27, 2013) *citing Kramer v. W. Pac. Indus. Inc.,* 546 A. 2d 348, 351 (Del. 1998) (emphasis in original). As stated in one seminal Delaware decision, when faced with an injury by directors "a stockholder is not powerless . . . The machinery of corporate democracy and the derivative suit are potent tools to redress the conduct of a torpid or unfaithful management." *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984). Indeed, derivative actions are powerful tools for minority members. *Ross v. Nelson*, 54 A.D.3d 258, 260 (1st Dept. 2008) (plaintiff was "entitled to a declaration that his removal from office was invalid, and to reinstatement.")

Despite the utility of derivative claims, they are not favored by the law because they seek to have the court second-guess the business judgment of the company's management. *Bansbach v. Zinn*, 1 N.Y.3d 1, 8 (2003). Accordingly, the default rule provides that prior to initiating a derivative claim, demand must be made upon the company's management to address the perceived harm to the corporation. Demand is excused only where it would be futile. "To claim futility, a plaintiff must plead with particularity that '(1) a majority of the directors are interested in the transaction, or (2) the directors failed to inform themselves to a degree reasonably necessary about the transaction, or (3) the directors failed to exercise their business judgment in approving the transaction.'" *Levinson v. Steiner Digital Studios, L.L.C.,* 2013 N.Y. Slip Op. 31249(U) (Sup. Ct. N.Y. Co. June 7, 2013) at *9, quoting *Marx v. Akers*, 88 N.Y. 2d 189, 198 (1996).

III. New York Limited Liability Companies

A New York LLC is a hybrid business entity that combines the advantages of both the corporation and partnership business models. A New York LLC is owned and operated by "members" rather than shareholders or partners. However, while shareholders and limited partners in New York are authorized by statute to bring derivative actions, the LLC Law does not authorize such. *See* N.Y. Bus. Corp. Law § 626; N.Y. P'ship Law § 115-a.

The LLC Law provides for internal governance procedures that in many cases may be altered by contract. N.Y. Ltd. Liab. Co. Law § 401. Relevant here, managers owe each other a fiduciary duty under the default rules, although such duties may be contracted away. *Pappas v. Tzolis*, 20 N.Y.3d 228, 233 (2012), *reargument denied,* 20 N.Y.3d 1075 (2013). That said, LLC agreements cannot eliminate liability for illegal or intentional tortious conduct. *Kagan v. HMC-New York, Inc.,* 94 A.D.3d 67, 71 (1st Dept. 2012), *appeal dismissed*, 19 N.Y.3d 918 (2012).

IV. The Courts' Struggle Concerning New York LLCs and Derivative Claims

For more than a decade after the LLC Law's passage, state and federal courts alike struggled with the issue of whether a member of a New York LLC was authorized to maintain a derivative action. Initially, the Appellate Division, Second Department answered the question in the negative. *Hoffman v. Unterberg,* 9 A.D.3d 386, 388-89 (2d Dept. 2004).

As noted by the trial court in the case that would ultimately find its way to the Court of Appeals for resolution of the issue, "[w]hen the (LLC Law) was enacted in New York in 1994, a conscious decision was made by the Legislature to eliminate the right of an LLC's individual members to bring derivative actions. Early drafts of the bill had included such a right, but such provisions were deliberately eliminated." *Tzolis v. Wolff,* 12 Misc. 3d 1151(A) (Sup. Ct. N.Y. Co. 2006), *aff'd as modified*, 829 N.Y.S.2d 488 (1st Dept. 2007) *aff'd,* 10 N.Y.3d 100 (2008) (citations omitted) ("*Tzolis*"). The Court of Appeals held that, the foregoing language notwithstanding, derivative actions involving LLCs were in fact permissible under the common law.

New York's failure to expressly provide for derivative actions affected federal practitioners and judges because "whether a claim is derivative or direct is a question of state law." *Bartfield v. Murphy*, 578 F. Supp. 2d 638, 645 (S.D.N.Y. 2008). In *Bartfield,* Judge Holwell cited *Tzolis* and noted that prior to *Tzolis*, "some state courts and most federal courts held that New York law gives LLC members standing to bring derivative suits." *Id*. at 646. Judge Holwell also noted that shareholders were afforded the right to bring a derivative action as early as 1832 and that the right of limited partners to bring a derivative action was recognized at common law prior to formal codification. *Id.* at 646 n.8. However, *Tzolis* only provided that derivative suits were permissible, leaving courts to grapple with the other complexities presented by derivative actions. *E.g. Cordts-Auth v. Crunk, LLC,* 815 F. Supp. 2d 778, 790 (S.D.N.Y. 2011) *aff'd*, 479 F. App'x 375 (2d Cir. 2012) (concerning equitable exceptions to derivative standing requirements); *Weidberg v. Barnett*, 752 F. Supp. 2d 301, 308 (E.D.N.Y. 2010) (concerning viability of failure to disclose claims under New York law).

V. *Yudell v. Gilbert* Adopts Delaware Pleading Standards

In addition to those issues mentioned above, following *Tzolis*, questions emerged about how to determine whether a claim was truly derivative in nature as well as what pleading standards should be applied in such actions. *Yudell v. Gilbert,* 99 A.D.3d 108, 115 (1st Dept. 2012) ("*Yudell*"). Whether a claim is derivative or not affects critical aspects of a case involving an LLC, most notably whether the plaintiff must make "demand" upon the LLC or whether the complaint adequately alleges that demand is futile. *Bansbach,* 1 N.Y.3d at 9.

In August 2012, the First Department adopted the test utilized in Delaware to determine whether a claim is direct or derivative. *Yudell* 99 A.D.3d at 115, quoting *Tooley v. Donaldson, Lufkin & Jenrette, Inc.,* 845 A.2d 1031, 1039 (Del. 2004). Essentially, courts must consider the "nature of the wrong." *Id.* Where a member claims an injury "independent of any injury to the corporation," a direct, rather than derivative, claim is stated. *Id.* The *Tooley* test considers "(1) who suffered the alleged harm (the corporation or the stockholders); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders individually)." *Id.* at 1035.

VI. Cases Following *Yudell* And Practice Pointers

Several cases following *Yudell* offer guidance concerning the relevant pleading standards. For instance, a claim can be a hybrid and a complaint may assert both direct and derivative claims. *Gjuraj v. Uplift Elevator Corp.,* 110 A.D.3d 540, 540 (1st Dept. 2013) ("a 15% minority shareholder . . . has standing to bring his breach of fiduciary duty claims as direct, as well as derivative, causes of action, since defendants' freezing him out of the corporation and failing to pay him his share of the profits harmed him individually, and he would receive the benefit of any recovery.") However, appellate courts will uphold the dismissal of alleged derivative complaints where damages are personal in nature and for failure to plead demand futility. *Najjar Grp., LLC v. W. 56th Hotel LLC*, 110 A.D.3d 638 (1st Dept. 2013).

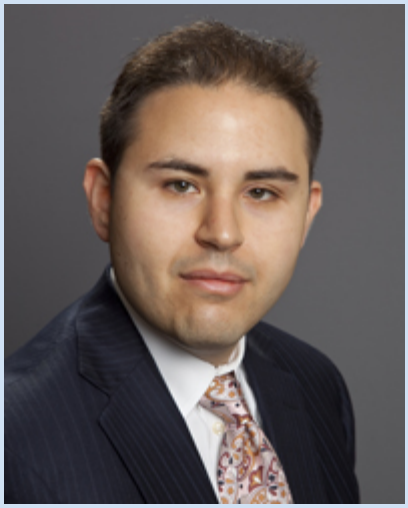
A failure to specify whether a claim is direct or derivative will not be countenanced and dismissal will be awarded. *Grand Food Serv. LLC v. Grand Gifts & Cafe Inc.,* 2013 N.Y. Slip Op. 31500(U) (Sup. Ct. N.Y. Co. July 3, 2013) ("Complaints which contain allegations that confuse the shareholders' derivative rights with individual rights are

dismissable.") In order to avoid such a result, plaintiffs must ensure that their claims are "pleaded with sufficient clarity to determine whether they are made individually or derivatively. . ." *Bencosme v. Rodriguez,* No. 150352/12, 2013 N.Y. Slip Op. 31786(U) (Sup. Ct. N.Y. Co. Aug. 1, 2013). Luckily (depending on one's perspective), even where "the causes of action are a confusing mixture of allegations which should be specifically identified as either direct or derivative," leave to replead may be granted. *Resource Fin. Co. and RFC I, LLC v. Cynergy Data, LLC*, No. 650142/11, 2013 N.Y. Slip Op. 32944(U) (Sup. Ct. N.Y. Co. Nov. 19, 2013).

Plaintiffs seeking to bring direct suits in federal court must also note that an LLC is deemed to have the citizenship of each of its members. *Lotan v. Horizon Properties LLC,* No. 14 CIV. 3134 PAC, 2014 WL 2210536, at *1 (S.D.N.Y. May 27, 2014). Accordingly, a plaintiff seeking to utilize diversity as a grounds for federal jurisdiction of a derivative action must ensure that diversity exists. *Id.* Moreover, a plaintiff bringing a direct claim cannot fail to join the LLC as a party in order to preserve diversity. *Bischoff v. Boarshead Provisions Co., Inc.,* 436 F.Supp.2d 626, 634 (S.D.N.Y.2006) ("There is no dispute that as long as [Plaintiff] may bring derivative claims on behalf of [the LLC], then [the LLC] is a true defendant that destroys complete diversity in this case."). Finally, "a member of a limited liability corporation, lacks standing to sue in its individual capacity for losses derived solely from injury to the limited liability company." *Usha Soha Terrace, LLC v. Robinson Brog Leinwand Greene Genovese & Gluck, P.C.,* 2014 NY Slip Op 31813(U) (Sup. Ct. N.Y. Co. July 9, 2014)

VII. Conclusion

The viability and relevance of pleading standards concerning derivative actions in New York have now been established. Practitioners in the federal courts must take care, however, to ensure that their pleadings comport with New York law. The adoption of *Tooley* is a significant development. That said, New York courts will likely have occasion to further address pleading standards applicable to LLCs in the near future.



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Mr. Blaustein is admitted to practice in New York State, the U.S. District Courts and Bankruptcy Courts for the Southern and Eastern Districts of New York, and the U.S. Court of Appeals for the Second and Federal Circuits. He encourages you to contact him at sblaustein@dunnington.com.

Antitrust Liability after *Actavis* and in the Wake of *FTC v. Cephalon* "Reverse Payment" ANDA Litigation

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For the past decade and a half, the so-called "reverse payment" or pay-for-delay patent settlements have captured the attention of the Federal Trade Commission (FTC). Until the U.S. Supreme Court addressed this issue last year in *FTC v. Actavis*, 133 S.Ct. 2223 (2013), there was a split in the circuits as to the legality of these agreements from an antitrust perspective. In *Actavis*, the Supreme Court held that reverse payment deals – where a branded drug company settles a patent litigation against a generic manufacturer by paying the generic to delay its entry into the market – could violate antitrust laws. The *Actavis* decision has reinvigorated the FTC to challenge these types of deals.

In a 5:3 split decision, the *Actavis* court held that pay-for-delay agreements are not presumptively illegal and that such agreements must be analyzed under the traditional rule of reason test applied in antitrust cases. *See Actavis,* 133 S. Ct. at 2237. The relevant inquiry is whether there is a large payment in reverse – from brand to generic – without justification. If there is, then the traditional antitrust factors must be examined – whether there is an anticompetitive effect, whether the brand has the market power to bring about that effect, and whether there are other ways to resolve the dispute. The court explained that a payment may be justified if it is an approximation of the litigation expenses saved by settlement or reflects compensation for services provided by the generic. But the court was silent on what constitutes "payment," what is considered "large," or what would be an unjustified explanation. The court also noted that "it is normally not necessary to litigate patent validity to answer [an] antitrust question."

In the wake of *Actavis*, two major questions have arisen: (i) what constitutes a reverse payment and (ii) can patent strength be litigated. Trial courts have just begun to address some of these unanswered questions.

The first post-*Actavis* case brought by the FTC and decided by a district court was *FTC v. Cephalon*, No. 08-C2141, 2014 U.S. Dist. LEXIS 102958 (E.D. Pa. July 29, 2014). The Eastern District of Pennsylvania has not yet ruled on whether the $200M reverse payment settlement between Cephalon and four generics for the narcolepsy drug Provigil® violates antitrust law – that issue is set for trial. However, the court did decide a very important issue left open by *Actavis* – whether the parties can litigate the strength of the patent and whether they can rely on litigation uncertainty to defend against antitrust claims. The court held that in certain cases patent strength can be litigated and parties can rely on litigation uncertainty. However, in this case, Cephalon was estopped from doing so because of a prior court decision finding the patent invalid and unenforceable.

The court found that a later invalidity determination will not preclude proof of litigation uncertainty because it is reasonable that, at the time of the settlement, the parties disagree in good faith about the merits of the validity claim. However, a later unenforceability determination will be preclusive because it is unreasonable for parties to disagree in good faith about the merits of the enforceability claim since "one who acted fraudulently in obtaining a patent necessarily knows its patent is unenforceable." Hence Cephalon was precluded from presenting any evidence on validity, enforceability or litigation uncertainty at trial.

In addition to FTC's pending case against Cephalon, there have been several post-*Actavis* cases brought by private plaintiffs – direct purchasers like consumers and indirect purchasers like pharmacies – that have been decided in district courts and offer some guidance on the other question: what constitutes a reverse payment.

Most district courts have held that reverse payments are not limited to cash payments. In *In re Nexium Antitrust Litig.*, No. 12-MD-2409, 2014 WL 4370333 (D. Mass. Sept. 4, 2014), Teva, a non-first-to-file generic, settled with no cash payment but a contingent launch provision, i.e., Teva could enter the market if another generic entered. The deal also resolved Teva's prior at-risk launch liability in a different litigation involving Prilosec®. The court found that the contingent launch served as sufficient "consideration" as it prevented all generics from entering into the market prior to a certain date, even though the generics entered into settlements without knowledge of the other generics' deals. *See Time Ins. v. Astra Zeneca*, No. 14C-4149, 2014 WL 4933025 (E.D. Pa. Oct. 1, 2014) (reverse payments under *Actavis* "may take forms other than cash").

In a related class action case, *In re Nexium Antitrust Litig.* No. 12-MD-2409 (D. Mass. Dec. 5, 2014), the first pay-for-delay case to go to trial post *Actavis*, the jury found that Astrazeneca and Ranbaxy did not violate antitrust laws even though there was a "large and unjustified" reverse payment because Ranbaxy simply could not have entered the market prior to its settlement date given its production problems.

Similarly, a no-authorized generic provision, whereby the brand agrees not to introduce an authorized generic to compete with the generic manufacturers, "works exactly as would a payment of cash" because a generic company would likely agree to a later entry date if it knows that when it does enter the market, it would not be competing against an authorized generic. *See In re Niaspan Antitrust Litig*, No. 13-MD-2460, 2014 WL 4403848 (E.D. Pa. Sept. 5, 2014).

In *In re Lipitor Antitrust Litig.*, No. 12C-2389, 2014 U.S. District LEXIS 127877 (D.N.J. Sept. 12, 2014), Ranbaxy, a generic company, agreed to delay its entry into the market in exchange for the release of a $1M damages claim in a separate non-ANDA litigation and settlement of two dozen other pending litigations. The district court held that reverse payment need not be cash but "non-monetary payment must be converted to a reliable estimate of its monetary value" to analyze if it is "large." The antitrust claims were dismissed because no valuation basis was offered.

In *In re Effexor XR Antitrust Litig.*, No. 11C-5479, 2014 WL 4988410 (D.N.J. Oct. 6, 2014), the District of New Jersey laid out a three-step process for analyzing a "reverse payment" that is instructive: (i) value any consideration flowing from patentee to generic, (ii) subtract avoided litigation costs from that valuation, and (iii) subtract the value of any services provided by the generic as part of the same or linked transactions. The resulting net amount is "otherwise unexplained" and a "reverse payment."

On the other hand, the District of Rhode Island has taken a strict view of "payment," holding that *Actavis* limited "reverse payment" to only cash payments because otherwise the Supreme Court "could simply have said so." *In re Loestrin 24 Fe Antitrust Litig.*, No. 13-MD-2472, 2014 WL 4368924 (D.R.I. Sept. 4, 2014) (antitrust claims dismissed in the absence of a cash payment despite a no-authorized generic provision).

In terms of what constitutes a "large" payment, the District of New Jersey in *Lipitor* noted that a payment is large if the amount is "larger than what the generic would gain in profits" if it won the litigation. The *Effexor* court provided a different perspective and explained that "large" could be "anything more than the value of avoided litigation costs" in the absence of other services.

Another unsettled question post *Actavis* that is yet to be adjudicated is how the district courts must balance the harms and benefits of reverse payments under the rule of reason analysis, especially where the benefits to consumers are not clear-cut. For example, a no-authorized generic deal may not provide any consumer benefit but if it is tied to an early entry date for a different drug, there could be a plausible benefit.

Conclusion

There is no bright-line test – at least for now – as to what circumstances will push a valid settlement of an ANDA patent litigation into an unlawful restraint on trade, running afoul of antitrust laws. It is a highly fact specific inquiry. But one thing is clear: both brand and generic companies need to be more cautious and think creatively when structuring these settlements. Considerations to keep in mind include:

1. Avoid cash payments where possible;
2. Identify the monetary value for any services (e.g., distribution) provided by the generic beforehand;
3. Perform the 3-step analysis of *Effexor* for net amount and aim lower;
4. Obtain the FTC's approval before filing the settlement agreement with a court as it may show lack of antitrust intent, which in turn, may defeat "unexplained" payment;
5. Antitrust plaintiffs should have a clear basis for how to value claims and will be subject to stricter scrutiny on motions to dismiss;
6. Brand companies should be liberal in disclosing information to the Patent Office. A finding of unenforceability will not only kill the patent, it will also handicap the antitrust defense by precluding arguments as to patent strength;
7. Pay attention to traditional antitrust factors as companies may not be able to rely on litigation uncertainty or litigate patent strength in every case; and
8. Prior adverse rulings against a patentee will likely be asserted against them in subsequent antitrust actions.

Until the post-*Actavis* dust settles, pharmaceutical companies can expect to see more antitrust challenges – both from the FTC and private plaintiffs; and potentially more litigation costs as courts evaluate reverse payments more closely under the rule of reason standard.

Padmaja Chinta is an experienced intellectual property attorney and trial lawyer. Paddy has counseled clients on all aspects of intellectual property with an emphasis on litigation. Paddy has extensively litigated cases from inception of suit through trial and appeal. Her cases span a broad spectrum of technologies with a particular focus on Hatch-Waxman ANDA litigation and the electrical field. She has obtained significant victories in claim constructions, summary judgment, pre-trial, and discovery motions for her clients. She has also represented clients in arbitration, trademark, breach of contract, and antitrust litigation.

Paddy practiced for several years at Fish & Neave (subsequently part of Ropes & Gray). Paddy spent some time at the New York Attorney General's Office in the Antitrust Bureau. She also served as senior in-house counsel for Teva Pharmaceuticals.

Paddy obtained her Masters in Law from the University of Pennsylvania Law School.

Mark Your Calendar!

January

CLE Program: Labor & Employment Issues
Speaker: Steve S. Landis, Steven S. Landis, P.C.
SDNY Courthouse, Room 850. January 27, 2015

February

CLE Program: Social Media Ethics
Speaker: Michael J. Zussman, Glen McMurry
New York Law School. February 17, 2015

March

Event Honoring Chief Judges of the Southern and Eastern District
Organizer: Danielle Lesser
Court of Appeals for the Second Circuit. March 4, 2015

CLE Program: Overview of Supreme Court Cases, Patent Law
Speakers: Rob Rando, Cynthia Augello
SDNY Courthouse, Room 850. March 18, 2015

CLE Program: All day Fashion Law CLE.
Organizers: Olivera Medenica, Frances Hadfield
Court of International Trade. March 20, 2015

April

Second Annual Rule of Law Event
Honoree: Bryan Stevenson, Equal Justice Initiative
April 2015

Human Trafficking Panel
Organizer: Stacy E. Yeung
SDNY Courthouse, Room 850. April 28, 2015

Town Hall on Effective Representation in Mediation
November 5, 2014 at SDNY

On November 5, 2014, the FBA's SDNY Chapter and ADR Section held a "Town Hall" on Effective Representation in Mediation in the new SDNY Courthouse ceremonial Room 850. The program was a great success, due in no small measure to the Section/Chapter collaboration and the generosity of ADR Section Chair, Jeff Kichaven, who joined the program panelists.

SDNY Chapter President, Olivera Medenica, introduced the program and its moderator, Simeon Baum who passed the baton to Chief Judge Loretta A. Preska. Panelists Rebecca Price, the SDNY'S Mediation Supervisor, and Jeff Kichaven discussed the nature of winning and the role of evaluation, among other topics.

The event was co-sponsored by the New York State Bar Association's Sections on Dispute Resolution, Commercial and Federal Litigation, and Labor and Employment; as well as by New York City's Metropolitan Black Bar Association.

*****CALL FOR WRITERS*****

The Federal Bar Association's Labor and Employment Law section is seeking writers for its 2nd Circuit, "Circuit Updates" section of "The Labouring Oar." The Circuit Updates section consists of updates and summaries of U.S. Court of Appeals cases related to labor and employment law. The Circuit Updates are emailed to all members of the Labor and Employment Section nationwide, and credit is given to the contributors who prepare the updates for each Circuit. The monthly updates will consist of a short summary of the cases with a more detailed summary sent out as an attachment. Author photo, biography, and firm name will be included with the monthly updates. For more information, contact: Corie J. Tarara at ctarara@seatonlaw.com or at (952) 921-4615.