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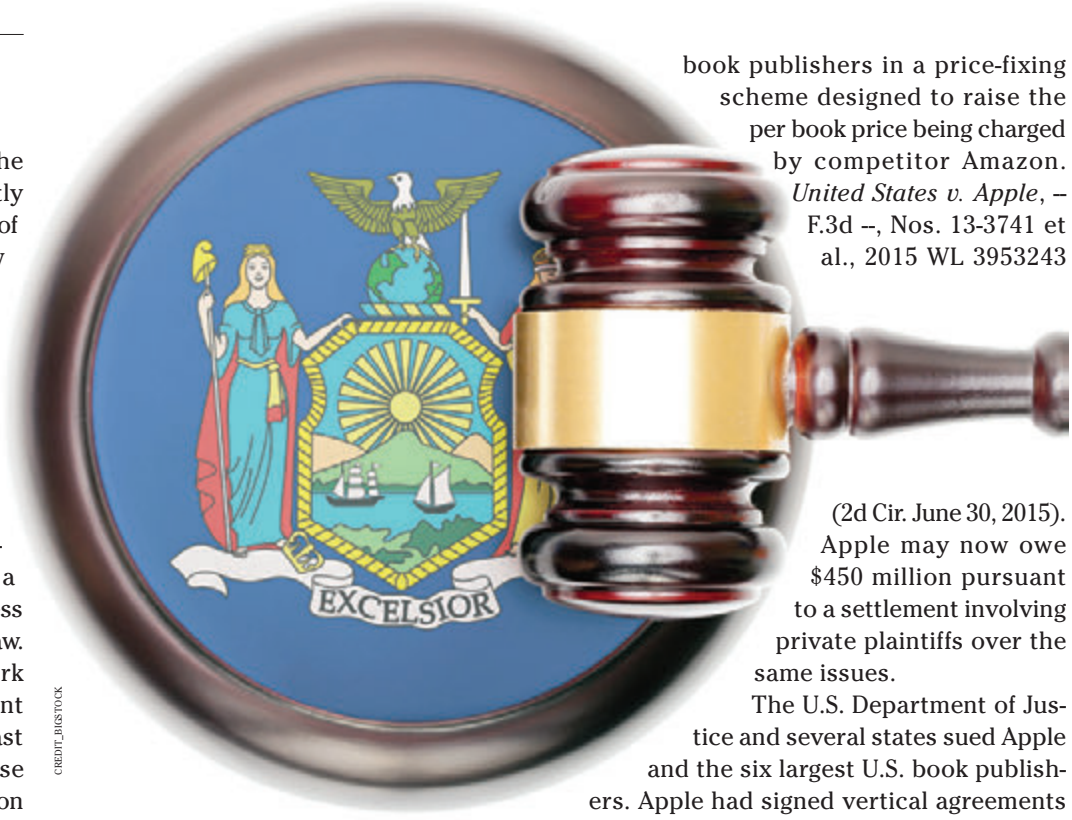
New York Courts: A Continued Tradition of Important Commercial Decisions

BY JUDITH A. ARCHER AND JAMI MILLS VIBBERT

Judge Loretta Preska, Chief Judge of the Southern District of New York, recently gave a speech entitled "The Elements of Commerce in the Twenty-First Century: How Commercial Courts Enhance a City's Position as a Financial, Commercial and Legal Hub." Preska summarized the factors necessary for a city to be a commercial hub in the 21st Century, including an educated populace, safe investment environment, business transactions and infrastructure upgrades. She emphasized the importance of a fair process of dispute resolution to ensure continued investment, the key attributes of such a system being independence, non-arbitrariness and even application of a predictable rule of law.

Preska noted the historical role New York courts have played in deciding important commercial cases. Her speech recalled past important New York cases, including those involving the Titanic, the disaster at the Union Carbide plant in Bhopal, India; and numerous multi-district litigations involving the largest financial, pharmaceutical and auto companies.

Today, New York state and federal courts routinely decide significant commercial disputes in a variety of industries and continue to play an important role in New York's sustained status as a commercial center. These courts are populated with sophisticated judges who not only preside over such disputes, but many of whom practiced in those areas before taking the bench. New York courts decide cases that impact businesses in New York and worldwide, and this article will summarize several recent ones with just such an impact.



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JUDITH A. ARCHER *is a partner and* JAMI MILLS VIBBERT *is a senior associate at Norton Rose Fulbright in New York.*

Antitrust

In June, the U.S. Court of Appeals for the Second Circuit upheld the district court's finding that Apple coordinated with several book publishers in a price-fixing scheme designed to raise the per book price being charged by competitor Amazon. *United States v. Apple*, –F.3d –, Nos. 13-3741 et al., 2015 WL 3953243 (2d Cir. June 30, 2015). Apple may now owe $450 million pursuant to a settlement involving private plaintiffs over the same issues.

The U.S. Department of Justice and several states sued Apple and the six largest U.S. book publishers. Apple had signed vertical agreements with each publisher for its e-bookstore under an agency model in which the publishers determined the price and Apple took a percentage, with each contract requiring the books in Apple's e-bookstore to have the lowest price offered. The court found this model would only be attractive if all of the major publishers cooperated because, under Apple's contracts, the publishers could make less money per sale, but more money on new releases and bestsellers.

The Second Circuit found that the price-

fixing conspiracy was a horizontal restraint on trade warranting a per se standard under Sherman Act §1, as opposed to a rule of reason analysis, which would apply if the conspiracy was a vertical restraint. This required the court to find the relevant agreement was not the individual vertical agreements between Apple and the publishers, but an unwritten one "to raise consumer-facing ebook prices by eliminating retail price competition." Had there only been vertical agreements, noted the court, Apple would only have been liable if it actually agreed to the illegal activity. The Second Circuit found that the vertical agreements created the framework allowing and were evidence of the horizontal restraint to collectively challenge Amazon's price.

A lengthy dissent by Judge Dennis Jacobs noted that Apple's agency structure was the only way it could enter the market against Amazon, which had 90 percent market share. Because no one proposed "less restrictive means" by which Apple could have achieved the same procompetitive benefits, the dissent found Apple was merely deconcentrating the ebook market and removing a barrier to entry, which effectuate the goals of antitrust law.

Given the court's broad interpretation of a horizontal restraint, this case may have lasting effects for vertical transactions in the future.

Employment

The Second Circuit just decided *Glatt v. Fox Searchlight Pictures*, Nos. 13–4478–cv et al., 2015 WL 4033018 (2d Cir. July 2, 2015), a putative class action of unpaid interns seeking compensation as employees under the Fair Labor Standards Act (FLSA) and New York Labor Law (NYLL). Both require an employer to pay employees a specified minimum wage, as well as applicable overtime pay, a requirement that employees may not waive. The district court had granted plaintiffs' motion for partial summary judgment, holding they had been improperly classified as unpaid interns rather than employees. The district court also certified a New York class and conditionally certified a nationwide collective action.

The Second Circuit vacated the district court's order.[1] In determining the appropriate standard under which an unpaid intern must be deemed an employee, an issue of first impression in this circuit, the court recognized that no Supreme Court decision decided the issue but reviewed a 1947 Supreme Court decision that railroad trainees should not be treated as employees.[2] It also considered a 2010 Department of Labor (DOL) fact sheet providing that an employment relationship does not exist if all of six factors applied. The district court had applied the DOL test and classified the interns as employees using only four of the factors.

The Second Circuit refused to defer to the DOL test, finding it too rigid and unpersuasive. Instead, the court agreed with defendants and adopted a primary beneficiary test, which determines whether benefits to the intern are greater than the intern's contribution to the business. It set forth a non-exhaustive set of seven considerations for use by courts along with other relevant evidence, and remanded to the district court to apply this standard.

New York state and federal courts **routinely decide significant commercial disputes** in a variety of industries and continue to play an important role in New York's sustained status as a commercial center.

As to class certification, the Second Circuit found an intern's employment status is "a highly individualized inquiry" in light of evidence below that different internship programs varied across departments. Because common questions would not predominate and the most important question "cannot be answered with generalized proof," the court vacated the grant of class certification. For substantially the same reason, plaintiffs in the proposed collective action were not similarly situated, and the Second Circuit vacated the district court's conditional certification.

Glatt, one of many class actions around the country challenging the status of unpaid interns, will certainly impact internship programs in a variety of industries.

Statute of Limitations

In a June decision, New York's highest court reestablished that certainty in contract actions outweighs other policy considerations. In *Ace Securities v. DB Structured Products*, the trustee for a trust of pooled residential mortgage loans brought a breach of contract action against the transaction sponsor for failing to repurchase loans allegedly in nonconformance with its representations and warranties. – N.E.3d –, N.Y. Slip Op. 04873, 2015 WL 3616244 (N.Y. June 11, 2015).

Defendant DB Structured Products (DBSP) purchased 8,815 mortgage loans, which were sold to ACE Securities through a Mortgage Loan Purchase Agreement (MLPA), and then transferred to a Home Equity Loan Trust. The Trust issued $500 million in certificates, which had the individual mortgage loans as collateral. Certificateholders were paid principal and interest on their certificates when borrowers made payments on their loans.

DBSP made more than 50 representations and warranties in the MPLA regarding the loans' characteristics and credit quality. The MPLA, dated March 28, 2006, allowed the Trust to examine and exclude any loan that did not comply with the representations and warranties, but also disclaimed any obligation by the Trust or certificateholders to conduct any due diligence. The Trust's sole remedy for breach of these was for DBSP to cure or repurchase the nonconforming loan. If DBSP failed to cure the breach within 60 days after notice, the trustee was authorized to enforce the repurchase obligation.

A few years after the MPLA was executed, borrowers began defaulting and certificateholders lost nearly $330 million. Two certificateholders had the loans reviewed as against the representations and warranties; 99 percent of them allegedly failed to conform with at least one. The certificateholders gave notice of the breach to the Trust and asked the Trust to seek DBSP repurchase. The trustee filed a complaint against DBSP on Sept. 13, 2012.

DBSP moved to dismiss the action as time-barred because it was brought more than six years from the MPLA's execution. The Court of Appeals affirmed the First Department's decision granting the motion.

The court noted its longstanding policy to enforce statutes of limitation for finality, certainty and predictability. Because the representations and warranties were stated in the contract, the last day to bring an action for breach would have been March 28, 2012, nearly six months before the Trustee's complaint. The court squarely rejected the notion that the MPLA required DBSP to guarantee the future performance of the loans and found that if the MPLA was breached, it was breached on the date the contracts were executed, not when

DBSP allegedly failed to cure or repurchase the loans as the Trustee argued.

The Court of Appeals has again shown its favor for a bright-line rule with respect to the six-year limitations period in contract actions, even against the interests of investors. The decision may impact investors' willingness to invest in these securities or at least the type of due diligence they will undertake before purchasing.

Insider Trading

The Second Circuit recently changed the landscape for insider trading actions, overturning two high-profile government convictions against former hedge fund traders Todd Newman and Anthony Chiasson. *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014). The government had alleged that analysts at various hedge funds and investment firms obtained material, nonpublic information from insiders of publicly-traded technology companies, shared it amongst each other, and then with their companies' portfolio managers. Defendants were charged and found guilty of trading on the insider information obtained by the analysts.

The Second Circuit relied heavily on *Dirks v. SEC*, 463 U.S. 646 (1983), which requires that the tipper in an insider trading case receive a personal benefit for providing the inside information. *Dirks* outlined three requirements for tippee liability: (1) the trader's liability derives from the tipper's breach of fiduciary duty; (2) the insider does not breach that duty unless he receives a personal benefit from disclosure; and (3) a tippee is liable only if he knows or should have known of the breach. The last prong is critical. *Dirks* was standard in insider trading law prior to *Newman*, but *Newman* redefined the law by requiring that the tippee know of the personal benefit to the tipper to be liable. Knowledge of an insider's breach of a duty of confidentiality is not enough. Based on this standard, the Second Circuit determined that the district court's jury instruction was deficient in not advising the jury that defendants had to know the insider acted for personal benefit. Although the government argued that this instruction was harmless error, the Second Circuit disagreed and overturned defendants' convictions.

Case law has a large effect on shaping the law on insider trading because insider trading is not specifically prohibited by statute. *Newman* may well lead to fewer insider trading prosecutions. It has already impacted pending cases; several convictions have been overturned based on *Newman* and more motions have been filed.

International Arbitration

The Southern District recently addressed the interplay between sovereign immunity and recognition of an international arbitration award. In *Mobil Cerro Negro v. Bolivarian Republic of Venezuela*, No. 14 Civ. 8163(PAE), 2015 WL 631409 (S.D.N.Y. Feb. 13, 2015), Arbitration award creditors (hereinafter, Mobil) had received a $1.6 billion arbitration award from the International Centre for Settlement of Investment Disputes (ICSID). Mobil had brought the arbitration under a bilateral investment treaty challenging Venezuela's expropriation in 2007 of Mobil's interests in certain oil projects.

Mobil had brought an ex parte petition immediately after the award issued, which the court granted, entering final judgment on the award. Venezuela moved to vacate the judgment, but the court denied the motion.[3]

Venezuela argued that the ICSID convention enabling statute, 22 U.S.C. §1650a, did not permit resort to an ex parte New York state recognition procedure rather than a plenary proceeding. Noting that the enabling statute states that ICSID awards "are entitled to full faith and credit as if the award were a final judgment of a court of general jurisdiction of one of the several States," the court noted that, although awards from other arbitral forums are subject to limited substantive review, ICSID awards are binding, subject to review only by ICSID. Nothing in the statute prescribes the procedure for recognition, however.

The court noted the Second Circuit has held that federal courts are to borrow state law to fill in gaps in a federal statutory scheme, including where, as here, the "subject matter presents a quintessentially federal concern." Venezuela had identified no significant conflict between a federal policy and the use of state law; its claimed need for uniformity is "dubious" because ICSID awards are enforced in more than 140 member states; and the foreign sovereign may still challenge attempted execution on its assets, which proceeds only after notice and a waiting period. The court also rejected Venezuela's argument that it should use the two-step procedure for registering a state-court judgment as a federal judgment, which necessarily involves a federal court determination on whether the state judgment is entitled to full faith and credit, not necessary here. Thus, the application of the state ex parte proceeding was valid.

Venezuela next argued that the Foreign Sovereign Immunities Act (FSIA), 28 U.S.C. 1330, 1602 et seq., supervenes the ICSID enabling statute, governs recognition of an ICSID award against a foreign sovereign and provideed no basis for subject matter jurisdiction over this proceeding. The court rejected Venezuela's argument, one of first impression in the S.D.N.Y., finding that exceptions to FSIA sovereign immunity applied and the FSIA itself exempts pre-existing treaty obligations, which would include the ICSID convention. Thus, the court had subject matter jurisdiction.

The court also rejected the argument that use of an ex parte procedure is inconsistent with the FSIA's personal jurisdiction, service and venue requirements. Because the FSIA is silent on the issue, the court noted that it must construe the FSIA, where fairly possible, so as not to conflict with the ICSID treaty and enabling statute. It concluded that the history and language of the ICSID convention reflected the contracting states' intent that ICSID awards were subject to expedited and automatic recognition. Thus, a plenary lawsuit was not necessary to recognize an ICSID award.[4]

This decision allows an ICSID award against a foreign sovereign to be expeditiously converted to a U.S. judgment, which would also allow the award creditor to take advantage of post-judgment discovery available under U.S. law regarding assets potentially subject to execution. It may well encourage increased resort to the S.D.N.Y. for ICSID conversion actions.

1. *Wang v. The Hearst Corp.*, No. 13-4480-cv, 2015 WL 4033091 (2d Cir. July 2, 2015), is a companion decision remanded for further proceedings consistent with Glatt.

2. *Walling v. Portland Terminal Co.*, 330 U.S. 148 (1947).

3. The court stayed enforcement of that judgment because ICSID had stayed enforcement pending resolution of Venezuela's motion to revise the award.

4. Venezuela has appealed to the Second Circuit.