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B&B Hardware: The Preclusive Effect of TTAB Decisions in Court

Introduction

Issue preclusion is a familiar concept to most practicing attorneys. Under this doctrine, “later courts should honor the first actual decision of a matter that has been actually litigated.” Charles Alan Wright et al., *Federal Practice and Procedure* § 4416, at 386 (2d ed. 2002). However, courts have struggled with the question of whether a prior decision by an administrative agency, as opposed to the judgment of an Article III court, can serve as the basis for issue preclusion. The Supreme Court recently addressed this issue in *B&B Hardware Inc. v. Hargis Industries, Inc.*, 135 S. Ct. 1293 (2015), finding that, in certain circumstances, a prior decision by the Trademark Trial and Appeal Board (“TTAB”) can have a preclusive effect on an Article III court. This article explores the rationale behind *B&B Hardware* and the potential impact of that decision on practice before both the TTAB and other administrative agencies charged with deciding issues related to intellectual property.

I. B&B Hardware: Finding Preclusive Effect Based on TTAB Decisions

A. Procedural Background. In 1993, B&B Hardware (“B&B”) registered the trademark “SEALTIGHT” for use in connection with various metal fasteners for the aerospace industry. Three years later, Hargis Industries (“Hargis”) attempted to register the trademark “SEALTITE” for use in connection with certain metal screws for the manufacture of metal and post-frame buildings. B&B opposed Hargis’ registration on the grounds that SEALTITE was confusingly similar to B&B’s own SEALTIGHT mark, and instituted opposition proceedings before the TTAB.

While the TTAB proceeding was pending, B&B sued Hargis for trademark infringement in district court, based on its previously registered “SEALTIGHT” mark. Prior to any ruling in the district court on infringement, the TTAB issued a decision finding a likelihood of confusion between SEALTITE and the prior SEALTIGHT mark. Notably, Hargis did not

(continued on page 2)

INSIDE

One Year After *Nautilus*:
Application of the Reasonable
Certainty Standard for
Definiteness of Patent Claims
Page 4

Practice Area Updates:

Asia-Pacific Litigation
Update
Page 6

Entertainment Litigation
Update
Page 6

International Arbitration
Update
Page 8

Letter of Credit Victory and
Other Victories
Page 10

Quinn Emanuel Named “Antitrust Litigation Department of the Year”

The Recorder has named Quinn Emanuel “2015 Antitrust Litigation Department of the Year.” The firm was chosen from a pool of more than 100 nominees based on the degree of difficulty, dollar value, and importance of the antitrust cases it litigated. In selecting the firm, *The Recorder* identified several key achievements. In connection with the successful defense of a significant patent infringement case, the firm obtained a \$26 million monopolization jury verdict for its client Transweb on its *Walker Process* antitrust counterclaims—a rare and significant victory in the expanding interface between antitrust and intellectual property law. As a result of this victory, Los Angeles partners Michael Williams and Harold Barza were named “Litigators of the Week” by *The AmLaw Litigation Daily*. The firm was also recognized for its successful representation of DIRECTV in *BYBB v. DIRECTV*, where the firm obtained summary judgment on a Cartwright Act claim based on theories of monopsony, price fixing, group boycott, and market allocation. *The Recorder* also recognized the firm’s appellate win for Samsung against Panasonic and SD-3C LCC in a case involving secure digital (SD) memory cards. **Q**

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seek judicial review of this decision. In the district court, B&B then argued that the TTAB decision should be given preclusive effect against Hargis. The district court disagreed, holding that preclusion could not apply because the TTAB was not an Article III Court. The jury ultimately returned a verdict for Hargis, finding no likelihood of confusion.

B&B appealed, and the Eighth Circuit affirmed the district court's holding on somewhat different grounds. Specifically, the Eighth Circuit found that: (i) the TTAB used different factors than did the Eighth Circuit in its likelihood of confusion analysis; (ii) the TTAB placed too much emphasis on the sound and appearance of the marks in its decision; and (iii) the parties bore different burdens of persuasion before the TTAB and the district court.

B. Ordinary Principles of Issue Preclusion Apply to TTAB Decisions. In a 7-2 decision written by Justice Alito, the Supreme Court reversed the Eighth Circuit and remanded. The Supreme Court rejected the narrow approach taken by the Eighth Circuit, and instead held that ordinary principles of issue preclusion should apply to prior TTAB decisions. First, the Court addressed the general question of whether agency decisions could form the basis for issue preclusion. Relying on the Restatement (Second) of Judgments and its prior decisions in, e.g., *University of Tenn. v. Elliott*, 478 U.S. 788, 797-798 (1986), the Court held that “issue preclusion is not limited to those situations in which the same issue is before two courts. Rather, where a single issue is before a court and an administrative agency, preclusion also often applies.” *B&B Hardware*, 135 S. Ct. at 1303 (emphasis in original).

In reaching this holding, the Supreme Court noted that issue preclusion had been so “well established” at common law that “Congress has legislated with the expectation that the principle [of issue preclusion] will apply except when a statutory purpose to the contrary is evident.” *Id.* In view of this presumption, the Court held that nothing in the text or structure of the Lanham Act reflected a Congressional intent to bar issue preclusion. *See id.* at 1305.

The Court further held that, even though a TTAB decision could be subject to *de novo* review on appeal to a district court, it does not follow that unreviewed TTAB decisions cannot ground issue preclusion: “[O]rdinary preclusion law teaches that if a party to a court proceeding does not challenge an adverse decision, that decision can have preclusive effect in other cases, even if it would have been reviewed *de novo*.” *Id.* On the other hand, issue preclusion would not apply to cases in which exhausting an administrative process was a prerequisite to filing a suit in court. But *B&B Hardware* was not an appeal from the TTAB decision; it was a “separate proceeding to decide separate rights.” *Id.*

C. Differences in Procedure or Analysis May Not Be Sufficient to Defeat Issue Preclusion. The Court also

rejected the Eighth Circuit's reliance on the purported differences between the factors used by that court and those used by the TTAB to determine whether a likelihood of confusion exists. The Court observed that the TTAB applies the test for likelihood of confusion in the registration context; by contrast, “the Eighth Circuit looks to similar, but not identical, factors” when considering likelihood of confusion in the infringement context. *B&B Hardware*, 135 S. Ct. at 1306. Nevertheless, the Court found the factors used by the appeals court and the TTAB were “not fundamentally different,” and that any “[m]inor variations” did not defeat preclusion. *Id.* at 1307.

The Court did recognize that a distinction exists between the registration provision of the Lanham Act, which considers whether marks “resemble” each other, and the infringement provision, which considers the “use in commerce” of the marks. *Compare* 15 U.S.C. § 1052(d) with 15 U.S.C. § 1114(1). In view of this distinction, the Court noted preclusion would not apply if the “marketplace usage of the parties’ marks” were materially different from those disclosed in the trademark application. *B&B Hardware*, 135 S. Ct. at 1308. However, the Court concluded that “trivial” variations in marketplace usage cannot defeat preclusion, just as trivial variations in marks do not create different marks. *See id.*

The Court also found that, contrary to the Eighth Circuit's conclusion, the TTAB's reliance on the mark's sound and appearance did not defeat preclusion, noting that any such alleged error by the TTAB should have been raised in a direct review of the TTAB decision, rather than in re-litigation in a separate proceeding. In this, the Court implicitly criticized B&B's failure to seek judicial review of the TTAB decision: “Undoubtedly there are cases in which the TTAB places more weight on certain factors than it should. When that happens, an aggrieved party should seek judicial review.” *Id.* at 1308.

The Court further held that procedural differences (such as whether live testimony would be admitted), by themselves, do not bar issue preclusion. Instead, the Court explained that the “correct inquiry” should focus on whether the procedures in the first proceeding were “fundamentally poor, cursory, or unfair.” *Id.* at 1309.

Finally, the Court dismissed the notion that issue preclusion should not apply because the “stakes” in a TTAB proceeding are allegedly lower than in district court. The Court noted the “substantial” benefits of trademark registration, including that “registration is ‘prima facie evidence of the validity of the registered mark,’ and is a precondition for a mark to become ‘incontestable.’” *Id.* at 1310.

II. Impact of B&B Hardware Decision on TTAB Proceedings

A. Scope of Issue Preclusion in View of *B&B Hardware*.

The Supreme Court's decision in *B&B Hardware* expressly noted that issue preclusion would not apply to all determinations of likelihood of confusion by the TTAB. As highlighted in Justice Ruth Bader Ginsburg's concurrence: "The Court rightly recognizes that 'for a great many registration decisions issue preclusion obviously will not apply.' ... because contested registrations are often decided upon 'a comparison of the marks in the abstract and apart from their marketplace usage.'" *B&B Hardware*, 135 S. Ct. at 1310 (Ginsburg, J., concurring). Thus, for a significant percentage of such TTAB decisions (in which marketplace usage is not an issue), courts may reasonably find that issue preclusion does not apply to the prior TTAB determination.

On the other hand, the Court's reasoning is not limited to the issue of likelihood of confusion. A number of other issues decided in TTAB proceedings, including descriptiveness, genericness, acquired distinctiveness, abandonment, priority, and dilution determinations, may now give preclusive effect under the rationale of *B&B Hardware*. Thus, we may see a notable expansion in the number district court cases finding issue preclusion in the trademark context.

B. Impact on TTAB and Litigation Strategy. From a practical perspective, *B&B Hardware* may have a significant impact on how parties approach TTAB proceedings. First, TTAB proceedings are likely to become more complicated and expensive, as parties will seek both to develop more substantial evidentiary records and also to litigate such proceedings as thoroughly as possible, to avoid being bound by an adverse preclusive decision in a subsequent infringement suit. Parties also will likely be more motivated to seek *de novo* review of adverse TTAB decisions to avoid the risk that a failure to seek review might be counted against them in infringement proceedings.

Second, given the limitations on evidence in TTAB proceedings (including the inability to submit live testimony), parties may be more inclined to forego TTAB proceedings altogether and seek relief directly in district court, where traditional rules of evidence of apply and a more robust evidentiary record may be developed. Given the potential increased expense of TTAB proceedings, parties that were previously less inclined to litigate may now see federal court as a more favorable option than the TTAB.

Third, certain trademark holders, fearing the risk and expense of an opposition proceeding, may elect to forego registration entirely, and simply take any potential infringement action directly to court.

III. Issue Preclusion for Other Intellectual Property-Related Administrative Agencies

Notwithstanding the impact of *B&B Hardware* in the trademark context, the effect of *B&B Hardware* on decisions by other intellectual property related administrative agencies, such as the International Trade Commission ("ITC") and the Patent Trial and Appeal Board ("PTAB"), may be more limited.

A. Issue Preclusion in View of Prior ITC Cases. Unlike the Supreme Court's analysis of the Lanham Act, the Federal Circuit has held that issue preclusion does not apply to ITC decisions. As the Federal Circuit noted in *Texas Instruments Inc. v. Cypress Semiconductor Corp.*, 90 F.3d 1558 (Fed. Cir. 1996), Congress cautioned that "disposition of [an ITC] action by a Federal Court should not have res judicata or collateral estoppel effect in cases before such courts." *Texas Instruments*, 90 F.3d at 1569 (quoting S. Rep. No. 1298, 93d Cong., 2nd Sess. 196 (1974)). "[T]he [ITC's] findings neither purport to be, nor can they be, regarded as binding interpretations of the U.S. patent laws in particular factual contexts." *Id.* Thus, even under the framework set forth in *B&B Hardware*, ITC decisions would not give rise to issue preclusion, due to the evidence of a "statutory purpose to the contrary."

B. Issue Preclusion in View of PTAB Proceedings. The impact of *B&B Hardware* on the application of issue preclusion to PTAB proceedings (e.g., Covered Business Method ("CBM"), Inter Partes Review ("IPR"), and Post Grant Review ("PGR")) is likely to be limited. First, express statutory authority already sets out the binding effect of final decisions from PTAB proceedings on petitioners in subsequent district court cases. For example, in an IPR or PGR proceeding that proceeds to "a final written decision," a petitioner "may not assert either in a civil action arising in whole or in part under section 1338 of title 28 or in a proceeding before the [ITC] under section 337 of the Tariff Act of 1930 that the claim is invalid on any ground that the petitioner raised or reasonably could have raised" in the prior proceeding. *See* 35 U.S.C. §§ 315(e)(2), 325(e)(2). Similarly, petitioners in petitions that proceed to a final written decisions are precluded from asserting "that [a] claim is invalid on any ground that the petitioner raised during that transitional proceeding." AIA Sec. 18(a)(1)(D), 125 Stat. 284; 37 C.F.R. § 42.300.

Next, the results of PTAB proceedings can be binding on patent owners in subsequent litigation, but not due to issue preclusion. In considering a substantially analogous statutory provision to that governing IPR and PGR proceedings (*see* 35 U.S.C. §§ 307, 318, 328), the Federal Circuit in *Fresenius USA, Inc. v. Baxter Int'l, Inc.*, addressed "whether, under [that] statute, the cancellation of claims by the PTO is binding in pending district court infringement litigation." 721 F.3d 1330, 1336 (Fed. Cir. 2013). Reviewing the legislative history, the Court found that "when a claim is cancelled, the patentee loses any cause

of action based on that claim, and any pending litigation in which the claims are asserted becomes moot.” *Id.* at 1340. Cancellation “is binding not because of collateral estoppel, but because Congress has expressly delegated reexamination authority to the PTO under a statute requiring the PTO to cancel rejected claims, and cancellation extinguishes the underlying basis for suits based on the patent.” *Id.* at 1344. Thus, any canceled claims of a patent were void *ab initio* and any pending litigation before a district court was moot.

In issuing final written determinations on the ultimate issue of validity, the PTAB will often reach decisions on underlying issues, such as the scope and content of prior art and the level of ordinary skill in the art. The rationale of *B&B Hardware* provides some support for the proposition that PTAB decisions on these issues may be entitled to preclusive effect, “[s]o long as the other ordinary elements of issue preclusion are met.” See *B&B Hardware*, 135 S. Ct. at 1310.

However, unlike the TTAB proceedings addressed in *B&B Hardware*, PTAB proceedings are decided under a different standard of review (preponderance of the evidence) than is applied by a district court as to invalidity (clear and convincing). See 35 U.S.C. §§ 316(e), 326(e) (2012). Indeed, the Federal Circuit has relied on this

distinction in finding that district courts and the PTO can reach inconsistent decisions on the issue of validity. See, e.g., *In re Swanson*, 540 F.3d 1368, 1377 (Fed. Cir. 2008); *In re Baxter Int'l, Inc.*, 678 F.3d 1357, 1365 (Fed. Cir. 2012). Moreover, district courts are required to apply a presumption of validity, whereas no such presumption exists before the PTAB. Thus, even under *B&B Hardware*, courts may simply find that due to the differing burdens and standards, the “ordinary elements of issue preclusion” would not be met.

Conclusion

The Supreme Court’s holding in *B&B Hardware* may have a significant impact on how parties approach TTAB proceedings. As a practical matter, the risk of such a preclusive finding will result in parties spending more effort—and money—on such proceedings. Moreover, in certain circumstances, parties may elect to forego the TTAB route entirely and proceed straight to district court, where a more substantial evidentiary record can be developed. In the patent context, parties receiving adverse rulings before the ITC and PTAB should be prepared for their adversaries to argue that those decisions should also be given preclusive effect under *B&B Hardware*, although it appears unlikely that the Article III courts ultimately will do so. 

NOTED WITH INTEREST

One Year After *Nautilus*: Application of the Reasonable Certainty Standard for Definiteness of Patent Claims

Last year, in *Nautilus, Inc. v. Biosig Instruments, Inc.*, 134 S. Ct. 2120 (2014), the Supreme Court established a “reasonable certainty” standard for analyzing the definiteness of patent claims. In the twelve months since *Nautilus* was decided, the Federal Circuit has applied this standard in a number of cases—including recently on remand from the Supreme Court in *Nautilus* itself. See *Biosig Instruments, Inc. v. Nautilus, Inc.*, No. 2012-1289, 2015 WL 1883265 (Fed. Cir. April 27, 2015). These decisions provide useful guidance for patent litigants regarding the application of the new standard and how the analysis under *Nautilus* compares to the Federal Circuit’s earlier decisions.

The Supreme Court’s Decision in Nautilus: The Reasonable Certainty Standard

The Patent Act requires that a patent must “conclude with one or more claims particularly pointing out and distinctly claiming the subject matter which the applicant regards as [the] invention.” 35 U.S.C. § 112, ¶ 2. A patent that does

not satisfy this requirement is invalid for indefiniteness.

Nautilus involved a patent directed to a heart rate monitor used in exercise equipment. *Nautilus*, 134 S. Ct. at 2124. The asserted patent claims describe a hollow cylindrical bar that a user grips with both hands, such that each hand comes into contact with two electrodes, one “live” and one “common.” *Id.* at 2126. The claims require that the live electrode and common electrode are “mounted . . . in spaced relationship with each other.” *Id.* The district court granted summary judgment of indefiniteness, explaining that the term “spaced relationship” did not explain “what precisely the space should be,” or even supply “any parameters” for determining the appropriate spacing. *Id.* at 2127.

On appeal, the Federal Circuit reversed. Citing the standard articulated in its earlier cases, the Court stated that a claim is indefinite “only when it is ‘not amenable to construction’ or ‘insolubly ambiguous.’” *Nautilus, Inc. v. Biosig Instruments, Inc.*, 715 F.3d 891, 898 (Fed. Cir. 2013). Applying that standard, the Court found that

the patent survived indefiniteness review. *Id.* The Court explained that the intrinsic evidence makes plain that the distance separating the live and common electrodes on each half of the bar “cannot be greater than the width of a user’s hands” because the claims require “the live and common electrodes to independently detect electrical signals at two distinct points of a hand.” *Id.* At the same time, the intrinsic evidence teaches that this distance cannot be “infinitesimally small, effectively merging the live and common electrodes into a single electrode with one detection point.” *Id.* Also, the functional elements of the claimed apparatus shed additional light on the meaning of “spaced relationship” in that a skilled artisan would know that the recited functions of equalizing and removing unwanted signals could be attained by adjusting design variables, including the spacing of the electrodes. *Id.* at 899-900.

In a unanimous decision by Justice Ginsberg, the Supreme Court concluded that the Federal Circuit’s “insolubly ambiguous” test did not correctly frame the statute’s definiteness requirement. 134 S. Ct. at 2124. The Court explained that Section 112 “entails a ‘delicate balance.’” *Id.* at 2128. “On the one hand, the definiteness requirement must take into account the inherent limitations of language.” *Id.* “Some modicum of uncertainty . . . is the ‘price of ensuring the appropriate incentives for innovation.’” *Id.* Thus, absolute certainty is not realistic or required to satisfy the definiteness requirement. At the same time, a patent must be “precise enough to afford clear notice of what is claimed, thereby ‘appris[ing] the public of what is still open to them.’” *Id.* at 2129. “Otherwise there would be ‘[a] zone of uncertainty which enterprise and experimentation may enter only at the risk of infringement claims.’” *Id.* Balancing these competing concerns, the Court concluded that § 112, ¶ 2 requires that “a patent’s claims, viewed in light of the specification and prosecution history, inform those skilled in the art about the scope of the invention with reasonable certainty.” *Id.*

Application of the Standard: Federal Circuit Decisions Post-Nautilus

On remand, the Federal Circuit reached the same conclusion as before and reversed the district court’s summary judgment. *Biosig*, No. 2012-1289, 2015 WL 1883265, at *1. The Court held that even under a “reasonable certainty” standard, the asserted claims are not indefinite. *Id.*

The Court reviewed the intrinsic evidence and concluded that a skilled artisan would understand with reasonable certainty the scope of the invention. *Id.* at *6. The Court reiterated that the physical requirements of the claimed monitor require the “spaced relationship” to be “neither infinitesimally small nor greater than the width of a user’s hands.” *Id.* Additionally, the function of substantially removing unwanted signals is “highly relevant”

to ascertaining the boundaries of the “spaced relationship” between the live and common electrodes. *Id.* at *7. Thus, the Court concluded that “[t]he term ‘spaced relationship’ does not run afoul of ‘the innovation-discouraging ‘zone of uncertainty’ against which [the Supreme Court] has warned,’ and to the contrary, informs a skilled artisan with reasonable certainty of the scope of the claim.” *Id.* at *8.

On remand, the Federal Circuit did not squarely address the question of whether the reasonable certainty standard raises the bar for definiteness. *Id.* at *4. Instead, the Court stated only that the Supreme Court has “modified the standard by which lower courts examine allegedly ambiguous claims,” and concluded that “we may now steer by the bright star of ‘reasonable certainty,’ rather than the unreliable compass of ‘insoluble ambiguity.’” *Id.* The Court also noted that “[i]n the wake of [*Nautilus*], judges have had no problem operating under the reasonable certainty standard.” *Id.* at *4-*5.

For example, in *DDR Holdings, LLC v. Hotels.com*, 773 F.3d 1245 (Fed. Cir. 2014), the Federal Circuit considered the term “look and feel” in the context of claims directed to the visual elements of a web page. 773 F.3d at 1260-61. Analogizing to the facts in both pre- and post-*Nautilus* cases, the Court concluded that “look and feel” is not a facially subjective term, but instead, “has an established meaning in the art.” *Id.* Thus, the asserted claims inform those of ordinary skill in the art with reasonable certainty as to the scope of the invention and satisfy the definiteness requirement. *Id.* at 1261.

Similarly, in *Interval Licensing LLC v. AOL, Inc.*, 766 F.3d 1364 (Fed. Cir. 2014), the Federal Circuit applied the reasonable certainty standard to claims for a system that displays images on a device “in an unobtrusive manner that does not distract a user.” 766 F.3d 1367-1368. With respect to the term “unobtrusive manner,” the Court explained: “[w]e do not understand the Supreme Court to have implied in [*Nautilus*], and we do not hold today, that terms of degree are inherently indefinite.” *Id.* at 1370. “Claim language employing terms of degree has long been found definite where it provided enough certainty to one of skill in the art when read in the context of the invention.” *Id.* Nevertheless, the Court found that the term “unobtrusive manner” is “highly subjective” and “on its face, provides little guidance to one of skill in the art.” *Id.* at 1371. A term of degree, like “unobtrusive manner,” “fails to provide sufficient notice of its scope if it depends on the unpredictable vagaries of any one person’s opinion.” *Id.* [Q](#)

PRACTICE AREA NOTES

Asia-Pacific Litigation Update

New Japanese Consumer Class-Action System. The Japan legislature enacted laws in late 2013 that will implement a new consumer class-action system in 2016, with the stated purpose of protecting consumers. Critics contend, however, that this new system fails to address serious issues of the current consumer class-action system, that the changes are limited to favored business operators, and that the new system will actually reduce relief available to consumers.

Who Can Sue. The new law will not have a large effect on which parties can bring consumer class-action lawsuits but might incentive those parties to file more such actions. Unlike the American system, in which any individual with personal standing may file a lawsuit on behalf of himself or herself and all others similarly situated, in the current Japanese system, only a Qualified Consumer Organization (“QCO”) has standing to file a consumer class-action. A QCO must be certified by the Prime Minister as a non-profit organization engaged in consumer-related activities such as collecting and providing information on consumer affairs; currently, only 11 QCOs have been so certified. Importantly, a QCO cannot charge fees to its members for litigation services.

Similar to the old regime, the new regime provides that only a Certified Qualified Consumer Organization (“CQCO”) will be permitted to sue on behalf of consumers, and any CQCO must be certified by the Prime Minister; the current 11 QCOs are expected to seek certification as CQCOs. But under the new law, a CQCO will be able to collect fees and costs from the consumer class members at the second stage of the proceedings where damages are assessed. This unfound ability to recover fees and costs might well incentivize CQCOs to file more class-action suits.

Availability of Damages. The new system will not significantly change or broaden the causes of actions available in a consumer class-action; such suits will still have to be based in contract, not purely in tort, product liability, or personal injury. But unlike the current system, which permits only injunctive relief, the new system will allow recovery of certain monetary damages as well. Notably, damages will be limited to the value of the product or service at issue; consequential damages, lost profits, damages to life or health, and psychological damages will not be available.

Two-Stage Proceedings. A major change from the current system will be the implementation of a two-stage proceeding. In the first stage, the CQCO must request that the court find common liabilities owed to a group of consumers regarding a consumer contract

made with a business operator; this appears to be somewhat similar to the American requirement that class members must share a common question of fact or law. During this first stage, the CQCO will also have to demonstrate to the court that there are a “considerably large number” of members in the class; the Japanese government, in response to questions from the public, has stated that “considerably large number” means “tens of people,” unlike the American requirement that a class can be certified only if the “members of the class are so numerous that joinder of all members is impractical.” If during this first stage the court finds no common liabilities among the class members or that there is not a considerably large number of members, then the class proceedings will end, although the court’s findings will not stop any individual class member from pursuing a separate lawsuit.

If the court does find common liabilities, the proceedings will move to a second stage, during which the court will determine the potential liability of the business operator to each class member. The CQCO will notify the results of the first stage to each member of the class by internet, newspaper, TV commercial, etc. If the CQCO asks, the court may order the business operator also to notify the class members. After notification, the class member may “opt-in” and let the CQCO prosecute the consumer’s claim. This opt-in process is different from the American practice of inviting class members to “opt out” of a certified class. Critics have called Japan’s opt-in process business friendly and asserted that it is meant to reduce the number of class members and thus limit the amount of overall damages.

If the CQCO receives the class member’s authorization, the CQCO will be able to file a claim on behalf of the consumer. The business operator then must either admit or deny each consumer claim. Admission of the claim will end the inquiry and damages will be assessed. If the business operator denies the claim, the court will conduct a special procedure to determine the claim’s validity, based only on documentary evidence. If either the consumer or business operator contests the court’s decision, the case will be converted to a standard litigation, although commentators have suggested that the legislature hoped the special procedure’s outcome would induce the parties to settle and avoid further litigation.

Entertainment Litigation Update

How Proposed Changes at the Copyright Office Will Affect the Music Business. In February 2015, the U.S. Copyright Office released “Copyright and the Music Marketplace,” a report that details several

recommendations to overhaul the current music licensing regime. The recommendations aim to modernize music licensing regulations in light of technological changes that have altered the music marketplace, such as new outlets for online streaming. The report proposes specific changes to regulations as well as measures to implement those changes. The report's main recommendations are as follows:

1. Extend the public performance right in sound recordings to terrestrial radio broadcasts. The Copyright Office proposes that AM/FM radio stations ("terrestrial" radio stations) pay a public performance right for playing sound recordings. This requirement would have two major consequences. First, when a song is broadcast on AM/FM radio, the performing artist and record label would be compensated; under the current regime, only the songwriter and publisher are compensated. Second, because satellite radio providers (such as Sirius) and internet radio services (such as Pandora) currently have to pay for performance rights, while terrestrial radio stations do not, all of these music platforms would compete under the same regime, changing the current competitive balance.

2. Federalize pre-1972 sound recordings. Currently, pre-1972 sound recordings are protected only by state, rather than federal, copyright law. According to the Copyright Office, it is not always certain whether digital music providers need to pay royalties to stream pre-1972 sound recordings under state law. The Copyright Office proposes bringing all pre-1972 sound recordings completely under federal copyright protection, claiming that full federalization would "improve the certainty and consistency of copyright law."

3. Move to a uniform, market-based rate-setting standard. Two performance rights organizations ("PROs")—the American Society of Composers, Authors and Publishers ("ASCAP") and Broadcast Music Inc. ("BMI")—control the public performance rights of over 90 percent of songs available for licensing in the U.S. These two PROs are governed by Department of Justice antitrust consent decrees, which require that ASCAP and BMI grant a license to any entity that applies for one. Most such licenses are blanket licenses, which grant performance rights to any song in the PRO's repertoire for a flat licensing fee. Under the consent decrees, if the PRO and the licensee cannot agree on a fee, a federal court will determine a fair rate.

PROs and copyright owners contend that these court-determined rates are below true market value. Thus, the Copyright Office proposes adopting a single standard for rate-setting that would be based on fair

market value—what is often referred to as the "willing buyer/willing seller" standard. Under this proposal, all rate-setting procedures would be handled by the Copyright Royalty Board ("CRB"), which would have more expertise than federal courts. However, a market-based rate-setting approach, while perhaps more favorable to PROs and copyright owners, might increase costs for online music service providers. As a result, prices for streaming music online could increase for consumers.

4. Permit collective licensing of mechanical rights. Currently, licensees must obtain mechanical licenses to reproduce and distribute musical works on a song-by-song basis. Given the needs of online music services, which make an unprecedented number of musical works available to the public, the Copyright Office proposes that mechanical rights be licensed through a collective system, whereby licensees could obtain mechanical rights through a blanket license. This recommendation would allow for online music services to obtain licenses more efficiently.

5. Allow publishers to opt out of blanket licenses and bargain for licensing deals independently. The Copyright Office proposes that music publishers be able to withdraw certain songs from blanket licenses. After opting out, these music publishers would be free to bargain for higher rates directly with service providers. However, the Copyright Office recommends that withdrawal of public performance rights be limited to interactive streaming rights for digital services (such as, Spotify). This recommendation may also result in higher costs to interactive streaming service providers, again, perhaps at the expense of higher prices to consumers.

6. Create music rights organizations (MROs) to administer mechanical and public performance rights. The Copyright Office suggests that publishers and songwriters license both public performance and mechanical rights through proposed entities called MROs. MROs would effectively act as PROs by collecting and distributing royalties. But MROs would be authorized to license *both* public performance rights and mechanical rights. The Copyright Office also proposes the creation of a general MRO that would maintain a "publicly accessible database of musical works represented by each MRO." This information would include a list of musical works not represented by an MRO. By allowing licensees to potentially obtain all necessary rights from a single entity, this proposed framework might allow for greater efficiency and transparency in the licensing process.

All in all, the recommendations appear to focus on attaining greater consistency in regulation,

fairer compensation for music industry players, and mechanisms for more efficient and transparent licensing. The full report from the Copyright Office can be found at: <http://copyright.gov/policy/musiclicensingstudy/copyright-and-the-music-marketplace.pdf>.

International Arbitration Update

ISDS Arbitration Provisions—Worth the Investment. Trade agreements have always been the subject of intense public dialogue, so it should come as no surprise that negotiations over the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership have sparked strong opinions from public figures and citizens around the world. What is unique to the debate over these agreements is the intense focus on the technical subject of investment arbitration. Both treaties provide Investor-State Dispute Settlement systems (“ISDS”), international arbitration systems that allow private investors to enforce treaty obligations against a country that has failed to honor the substantive protections afforded to investors in the investment treaties. Although ISDS have long been a common feature in bilateral and multilateral investment treaties, in recent years the concern that these provisions may undermine governmental sovereignty and impede public interest regulations has increased, primarily because of perceived examples of abuse. But despite these criticisms, ISDS remain an efficient, useful, and fair mechanism for encouraging foreign investment and protecting the rights of foreign investors.

ISDS: Promoting the Rule of Law, and Investment. Before the 1960s, international law provided no direct remedy for foreign investors who were the targets of government takings, which was a relatively common occurrence at the time. When investors had grievances associated with measures implemented by a foreign government that negatively affected their investments, they had to seek the assistance of their “home” governments to advocate on their behalf and seek redress from the foreign government. This process was cumbersome and often ran into political and diplomatic obstacles. As a result, governments began to enter into investment agreements to establish binding rules that would govern the treatment of cross-border investors. These rules were specifically designed to encourage investment flows by protecting the property and other rights of foreign investors from nativist policies and expropriation. Today, these agreements typically require signatories to ensure fair and equitable treatment of foreign investments, promptly reimburse investors in the event of an expropriation of their investment, provide non-discriminatory treatment,

and participate in neutral, international arbitration of disputes that may arise for alleged breaches of the protections afforded by each country to foreign investors within the investment treaties.

ISDS offer a unique form of dispute resolution. Under the traditional trade agreements that existed before ISDS, treaty violations were addressed through state-to-state dispute resolution procedures; relief usually was prospective and individual investors rarely received compensation. In contrast, ISDS permit foreign investors to bring claims directly against host governments and receive monetary compensation for past wrongs. This ability to bring individual actions ensures that investors are made whole without being subject to the whims of the international political system.

By providing this protection, ISDS encourage companies to take advantage of economic opportunities around the world, giving them the comfort that should a foreign government act to impinge on their rights as investors in a way that violates the subject treaties, they will have a neutral forum that will address their grievances. Such treaties are particularly important in countries with weak legal systems and a history of expropriation, such as Argentina and Venezuela, two of the most frequent ISDS respondents. But even in countries with more efficient judicial systems, investment agreements still provide important remedies that would otherwise be absent for foreign investors. In a recent survey of senior corporate decision makers, 20 percent responded that they would not invest in a foreign country without the protection of an investment treaty and 60 percent considered the treaties to be a “very important” factor in their investment decisions.

The Potential Threat to the Regulatory System. Investment agreements in general, and ISDS in particular, are not without their critics. Investment agreements have risen in prominence since the 1990s, and today there are approximately 3,268 such agreements in force around the world. As the level of foreign investment has increased, the number of disputes also have risen. The outcomes of some of these disputes have led to intense scrutiny of the trade-offs that governments are required to make by agreeing to ISDS.

A primary concern is that ISDS might allow opportunistic corporations to intimidate governments into repealing democratically-enacted laws, or to prevent them from enacting laws that they believe might be challenged in an ISDS proceeding. Though ISDS do not permit arbitrators to enjoin governmental regulations, critics contend that corporations can threaten governments with billion-dollar claims,

forcing those governments to either repeal targeted laws or face massive expenditures of taxpayer dollars in defending them. An oft-cited example of this potential threat is Philip Morris Asia's challenge, brought in an ISDS proceeding under the 1993 Agreement between the Government of Australia and the Government of Hong Kong for the Promotion and Protection of Investments, to Australia's regulation of cigarette packing pursuant to the Tobacco Plain Packaging Act of 2011. Philip Morris Asia claims that Australia's regulation of cigarette packaging constitutes an expropriation of its Australian investments. Critics cite Philip Morris Asia's claim as an example of a corporation using an ISDS arbitration provision as leverage to pursue profits at the expense of the government's ability to regulate corporate activity for the sake of human health and safety (in this case, by requiring tobacco companies to take specific measures with respect to packaging—including minimizing branding and maximizing warning labels—in order to warn smokers of the health risks inherent in smoking cigarettes and otherwise to dissuade smokers from purchasing cigarettes). Philip Morris Asia's claim originally was filed in 2011 but have not yet proceeded to a merits hearing before the panel. Critics contend that the structure of ISDS will exacerbate these kinds of regulatory challenges. Compared to most judicial systems, there is a perceived lack of transparency in investment arbitrations and the awards themselves are subject to very limited review. As a result of such concerns, many public figures have called for the dissolution of existing ISDS provisions and the elimination of ISDS from proposed trade agreements. Such requests are short-sighted. There are ample protections built into the ISDS procedures for the selection and appointment of arbitrators, including mechanisms for challenging arbitrators who lack independence and impartiality. Eliminating ISDS from investment and trade agreements, as some have urged, would be harmful, as the present ISDS system,

generally speaking, works well.

The Path Forward. Eliminating ISDS would be a drastic step and would undermine foreign investment. While some critics have voiced legitimate concerns, the history of ISDS indicates that these concerns are largely exaggerated. Since the first Bilateral Investment Treaty was concluded in 1959, countries have not been stymied in their efforts to improve public welfare through regulation. Indeed, over 90 percent of all Bilateral Investment Treaties currently in force have never led to a single dispute. Moreover, there is no indication that ISDS arbitrations suffer from systemic bias. In disputes that actually reach a decision, investors prevail only one-third of the time. And there is strong evidence that, by providing a forum for foreign investors to protect their property rights, ISDS play an important role in encouraging foreign investment.

Conclusion. Investment agreements, and ISDS in particular, are important sources of protection for foreign investment. These agreements and dispute settlement procedures provide foreign investors with basic tools to protect their foreign investments from state abuse and establish arbitration systems that help depoliticize disputes and ensure that treaty violations can be remedied. Critics should bear in mind that ISDS have operated successfully for decades and have led to economic growth and greater respect for the rule of law. Thus, concerns that ISDS may inhibit governments from enacting legislation for the public good must be balanced against the public good that the provisions create. Debate over ISDS is healthy, to be sure, but the debate should focus on how to improve ISDS rather than whether they should be thrown out altogether because of a few perceived examples of abuse. 

Quinn Emanuel and Licks Attorneys to Host “Strategies and Trends on Intellectual Property, Technology Law, and Litigation in Brazil”

Quinn Emanuel and Brazilian law firm Licks Attorneys will host two seminars in Northern California entitled “Strategies and Trends on Intellectual Property, Technology Law, and Litigation in Brazil.” When asked what jurisdictions in the world they find most challenging, many U.S. companies, including in particular top tech companies, identify Brazil. These seminars will present a roadmap for staying out of trouble when successfully doing business in Brazil. The Keynote Speakers will be His Excellency Luiz Alberto Figueiredo Machado, Ambassador of Brazil to the U.S., and Virgílio Almeida, Secretary for Information Technology Policies at the Ministry of Science, Technology and Innovation of Brazil. The seminars will address topics ranging from data protection and privacy to legal issues for the private market. The seminars will take place on Tuesday, July 28th in San Francisco, CA and on Wednesday, July 29th in Palo Alto, CA. For more information or to RSVP please visit: <http://www.lickslegal.com/caseminar/>. 

VICTORIES

Letter of Credit Victory

In *Griffin Energy Group Pty Limited (Subject to Deed of Company Arrangement) & Anor v ICICI Bank Limited & Ors* [2015] NSWCA 29, the New South Wales Court of Appeal, in a joint judgment, reaffirmed an earlier decision of the New South Wales Supreme Court in holding in substance that: (i) letters of credit must be construed strictly according to their terms and not by reference to any supporting or related materials; and (ii) the letters of credit in question expired before the liabilities against which they were drawn became due and payable, with the result that any subsisting security derived from the existence of the credits was lost.

ICICI Bank Limited (“ICICI Bank”) was the issuing bank under the three letters of credit that together totalled \$150 million. Quinn Emanuel acted for ICICI Bank in the proceedings, obtaining orders relieving the bank from a \$150 million liability.

The letters of credit derived from the sale in 2011 of the Griffin Coal Mining Company (“Griffin”), a coal mining operation in Collie, Western Australia, by its then appointed administrators, KordaMentha, to Lanco Infratech Limited (“Lanco”), a large Indian coal miner. The purchase price was ~\$740 million. Of this, approximately \$490 million was paid at the time of acquisition in 2011, with the balance to be met by two deferred payments; the first, at the two year anniversary (for \$100 million) and the second at the four year anniversary (for \$150 million). All of this was documented in a lengthy sale agreement which was prepared by lawyers for KordaMentha (“Sale Agreement”).

Both of the deferred payments were supported by letters of credit issued by our client, ICICI Bank. The terms of the letters of credit were simple enough and expressly incorporated the International Standby Practices (ISP 98) for standby letters of credit.

The second letter of credit fell due on February 28, 2015. By this time, Griffin was in financial distress. ICICI Bank, as the primary funder to the purchaser, Lanco, was significantly exposed. As the maturity date on the final letters of credit drew near and the letters of credit were reflected upon once again, the following became clear:

- The due date under the Sale Agreement for the deferred payment was February 28, 2015, a Saturday.
- Under the Sale Agreement (Clause 1.1) a Business Day was defined as: “a day which is not a Saturday, Sunday or bank or public holiday in Perth, Western Australia”. Clause 1.2(g) of the Sale Agreement then provided that “if the date on or by which any act must be done under this document is not a Business Day, the act must be done on or by the next Business Day”.
- Monday, March 2, 2015 was a Labour Day public

holiday in Perth, Western Australia but was not a public holiday in any other state or territory of Australia.

- The expiry date under the letters of credit was March 1, 2015, a Sunday. Pursuant to the letters of credit, a business day was defined to mean “any day (other than a Saturday or a Sunday) on which banks are open for general business in Singapore and Australia;” the ISP 98 had the effect of extending the expiry day to the next business day (clause 3.13).

Quinn Emanuel’s construction of the letters of credit was that Monday, March 2, 2015 was a day in which banks “are open for general business in Australia” even if banks in one particular state of Australia (in this case, Western Australia) are not open on that day. This construction had the consequence that the letters of credit would expire at the end of business on Monday, March 2, 2015, and the corresponding liability under the Sale Agreement would only enliven on Tuesday, March 3, 2015. That is, the letters of credit would be rendered nugatory as against the liability. Griffin argued confidently that a legalistic interpretation must yield to the clear intention of the parties, being that the credits were there to support the liability under the Sale Agreement.

Quinn Emanuel successfully argued for ICICI Bank (at trial and on appeal) that: (i) when construing a letter of credit, an ordinary bank officer must have regard only to the material before the bank, which in this case was confined to the terms of the letter of credit alone (an important precedent in banking instruments of this kind); (ii) that it is thus improper to have regard to extraneous agreements—here the terms of the Sale Agreement—from which the parties’ *intentions* could be inferred, and (iii) more pointedly, that, on their proper construction, the letters of credit expired on Monday, March 2, 2015, before the liability against which they were drawn fell due for payment.

Griffin has sought special leave to appeal to the High Court of Australia (the equivalent of the U.S. Supreme Court) and Quinn Emanuel continues to act for ICICI Bank in those proceedings.

Pro Bono Victory

Quinn Emanuel responded to a request from the Federal Bar Council Public Service Committee to take on the pro bono representation of an individual defendant for limited-scope discovery purposes in a prisoner civil rights case. A mentally ill plaintiff-inmate asserted multiple claims against the City of New York, the New York City Health and Hospitals Corporation and several individual defendants, involving an incident that resulted in injuries for both the plaintiff and our client. This case entailed a very important decision for our client: whether and when to assert his Fifth Amendment privilege. Our client not

only faced liability in the civil action, but because there was also an ongoing criminal investigation, he might inadvertently incriminate himself criminally. After completing some initial discovery and participating in a settlement conference before the Court, Quinn Emanuel was able to secure a global settlement in which our client will pay nothing and obtain a complete release of all claims against him.

The client was a long time psychiatric social health technician at Bellevue Hospital in the prison psychiatric ward. He worked for the City for ten years without any incident. But last February, he had a run-in with a mentally ill inmate on consecutive days, which was captured on video surveillance. The inmate, through his pro bono counsel from a major national law firm, sued the City, Bellevue Hospital, and all the individuals who could be seen in the video surveillance, including our client, Corrections Officers, and other psychiatric social health technicians at Bellevue Hospital. The City refused to represent our client, who started attending, *pro se*, conferences in front of Judge Valerie E. Caproni. After the client filed an application for pro bono counsel on a limited scope discovery basis, Judge Caproni granted his request.

Quinn Emanuel volunteered and immediately initiated a counterclaim for assault and sought discovery from the plaintiff-inmate related to his competency and his violent past. Following the initial discovery, Judge Caproni referred the case to Magistrate Judge Henry Pitman for settlement. At the settlement conference, the plaintiff-inmate continued to demand a significant sum from our client. In the end, despite pressure from both the plaintiff-inmate and the co-defendants, Quinn Emanuel convinced the parties and the Court to allow our client to walk away in exchange for dropping our counterclaim against the plaintiff-inmate. The plaintiff-inmate took the offer from the City, and our client can now move on and look for a new job without any potential liability stemming from this incident.

Structured Financial Product Victory

On April 15, 2015, the United States Court of Appeals for the Second Circuit ruled that our client Financial Guaranty Insurance Company's ("FGIC") complaint was improperly dismissed under Rule 12(b)(6) and reinstated its claims for fraud, negligent misrepresentation and negligence against defendant The Putnam Advisory Group, LLC ("Putnam"). The decision is a significant victory for FGIC and constitutes an important precedent on the issue of loss-causation in the context of market-wide downturns. Under the Circuit's published decision, a claim is adequately stated so long as the complaint alleges that the defendant's activity "caused an ascertainable portion" of the plaintiff's losses. *Fin. Guar. Ins. Co. v. Putnam Advisory Co. LLC*, -- F.3d -- (2d Cir.

2015). The decision will make it significantly harder for parties who commit fraud resulting in losses that occur contemporaneously with market-wide downturns to shield themselves from liability.

The case arises out of a collateralized debt obligation ("CDO") called Pyxis ABS CDO-2006-1 ("Pyxis") for which Putnam served as collateral manager. A CDO is an investment vehicle that purchases and/or assumes the risk of a portfolio of assets and sells investment certificates to investors that entitle the investors to payment funded by the portfolio. Our client issued \$900 million of insurance on a senior tranche of Pyxis, without which Pyxis would not have closed. The complaint alleges that Putnam induced FGIC to provide the insurance on the basis of misrepresentations that Putnam—and Putnam alone—would select the collateral for Pyxis, acting independently and in good faith. FGIC alleges that Putnam in fact allowed a hedge fund, Magnetar Capital LLC ("Magnetar"), which had taken a significant short position in Pyxis, to control collateral selection for the CDO. Putnam's actions increased the riskiness of Pyxis's portfolio, and the CDO ultimately defaulted in 2008, exposing FGIC to substantial liability. FGIC would not have provided insurance on FGIC—and would not have been exposed to that liability—if it had known the truth about Magnetar's role in the collateral selection process.

Notwithstanding these allegations, the district court dismissed the complaint in full, reasoning that the complaint did not sufficiently establish that Putnam's misrepresentations about Magnetar's role in the CDO caused FGIC's losses, as opposed to the "global financial crisis." On appeal, Quinn Emanuel successfully argued that the complaint plausibly alleged that Putnam's conduct caused FGIC's losses by, among other things, alleging that specific assets selected by Putnam at Magnetar's direction performed worse than assets that Putnam would have selected acting independently. Thus, the complaint alleged that the fraud "caused an ascertainable portion" of FGIC's losses, and the question of which losses would have occurred irrespective of the fraud presents a triable issue of fact.

The Circuit also reinstated FGIC's claims for negligence and negligent misrepresentation, which the district court had dismissed on the basis that the complaint did not sufficiently allege a "special relationship" between FGIC and Putnam. Notwithstanding the lack of contractual privity between FGIC and Putnam, the Circuit held that FGIC's allegations, including face-to-face meetings and e-mails with Putnam, and the importance of Putnam's representations to FGIC's risk-assessment decisions, overcame the lack of privity such that a duty of care existed between the parties.

The case now proceeds to discovery in the Southern District of New York. **Q**

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business litigation report

quinn emanuel urquhart & sullivan, llp

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