The LEXIS PRACTICE ADVISOR Journal

The LEXIS PRACTICE ADVISOR Journal™

Practical guidance backed by leading attorneys from Lexis Practice Advisor®

MOTION TRADEMARKS GROW IN POPULARITY

Drafting Choice-of-Law Provisions

New Emphasis on the Need for Cyber Insurance

WINTER 2019 / 2020

www.lexispracticeadvisor.com

LexisNexis®

Winter 2019 / 2020

Introducing

Evolving Guidance, a new feature of Lexis Practice Advisor, the fastest track from awareness to action.

Only **Evolving Guidance** delivers the latest high-impact news—First Analysis, changing rules and regs—and the deep practical guidance together in one convenient place. **Now you can always be the first to know and act.**

Combining the latest analytical thinking and trusted guidance of **Lexis Practice Advisor** with industry-leading practice area news from **Law360®**, **Evolving Guidance helps you:**

- Connect developing legal news to deep practical guidance all together in a single, location.
- Stay apprised of the latest news and key developments to hit your practice.
- Know the impacts to your stakeholders with deep analysis at your fingertips.
- Plus, follow news and issues as they develop—always have access to the latest thinking.

See Evolving Guidance in action.
LexisNexis.com/**EvolvingGuidance**

LexisNexis®

Contents

WINTER 2019 / 2020

Practice News

Current Awareness

Practice Tips

Practice Trends

Practice Notes

Litigation Tips

The
LEXIS PRACTICE ADVISOR Journal™

WINTER 2019 / 2020 (Volume 5, Issue 1)

PRINTED BY — **Cenveo Publisher Services**
3575 Hempland Road
Lancaster, PA 17601

The Lexis Practice Advisor Journal (Pub No. 02380; ISBN: 978-1-6328t-895-6) is a complimentary publication published quarterly for Lexis Practice Advisor® subscribers by LexisNexis, 230 Park Avenue, 7th Floor, New York, NY 10169. Email: lexispracticeadvisorjournal@lexisnexis.com | **Website:** www.lexisnexis.com/lexispracticeadvisorjournal

Send address changes to: The Lexis Practice Advisor Journal, 230 Park Avenue, 7th Floor, New York, NY 10169. Periodical Postage Paid at New York, New York, and additional mailing offices.

Eric Bourget, Editor-in-Chief

AS WE BEGIN A NEW YEAR, TECHNOLOGY continues to drive a host of new laws and protections facing our firms, companies, and clients. The California Consumer Protection Act is now in effect, along with New York's new Stop Hacks and Improve Electronic Data Security (SHIELD) Act, requiring additional care in the way companies handle and protect customer data. In this edition of the Lexis Practice Advisor Journal, we provide guidance to help make sure you and your clients are ready for upcoming changes associated with these new laws.

Data privacy issues are propelling companies to do more than re-examine and shore up their data management solutions to comply with new state laws. With the ever-present dangers posed by data breaches, ransomware, and other cyber threats, many businesses that handle consumer data are turning to cyber insurance policies to help protect their own survival in case of a catastrophic event. This issue provides insights on cyber insurance coverage and on how to help ensure that you and your clients have the right protection. This edition also features data integrity enforcement guidance for life sciences companies, including drug, biologic, and medical device manufacturers regulated by the FDA. This article provides strategies you can use to help your clients in this industry identify potential data integrity compliance gaps.

A recent consideration in the intellectual property space is the growth of animated "motion" trademarks. Brand owners are increasingly using digital technology to create innovative forms of trademarks that incorporate motion, holograms, and other multimedia features. In the United States trademark law has typically protected these types of multimedia marks for decades. This is not the same throughout much of the international trademark community. In this edition we include guidance about how modernized intellectual property laws are evolving in much of Europe, Asia, and North America to help protect motion marks.

Another emerging consideration we analyze in this issue is the obligation of land developers to comply with the Endangered Species Act (ESA). In the United States, there are more than 1,600 species listed as endangered or threatened under the ESA. The presence of any of these species on private or public land may impose heightened responsibilities on potential buyers and real estate developers. This article provides an overview of the ESA and review of many of the obligations the ESA may require of your real estate development clients.

Our drafting advice in this edition focuses on Choice-of-Law provisions. Often glossed over as "boilerplate" by drafters and readers alike, choice-of-law provisions can be crucial to successfully prosecuting or defending contract disputes. Courts often find that such provisions are unenforceable in whole or in part, primarily because of drafting pitfalls. Learn about important factors to be considered when drafting choice-of-law clauses—such as varying state contract laws and public policy considerations—and get helpful tips on drafting these all-important provisions.

We wish you a productive year and hope that the guidance and insights Lexis Practice Advisor offers will assist you and your clients in having a successful 2020.

Our mission

The Lexis Practice Advisor Journal™ is designed to help attorneys start on point. This supplement to our online practical guidance resource, Lexis Practice Advisor®, brings you a sophisticated collection of practice insights, trends, and forward-thinking articles. Grounded in the real-world experience of our 850+ seasoned attorney authors, the Lexis Practice Advisor Journal offers fresh, contemporary perspectives and compelling insights on matters impacting your practice.

AMAZON'S DATA STORAGE VIOLATES ILLINOIS BIOMETRIC PRIVACY LAW, STATE RESIDENTS ALLEGE

AMAZON WEB SERVICES IS VIOLATING THE ILLINOIS Biometric Information Privacy Act (BIPA), 740 Ill. Comp. Stat. Ann. 14/1, by allowing commercial customers to use its cloud storage services to house employees' biometric data without obtaining permission or disclosing the purpose for the storage, a group of Illinois residents alleges in a suit filed in state court. Ragsdale v. Amazon Web Services Inc., No. 2019-CH-13251, Ill. Cir. Ct., Cook Cty.

Martin Ragsdale, filing on his own behalf and a class of state residents, alleges that Amazon stores data and information generated as a result of the collection of biometric identifiers, such as fingerprints, for commercial clients, including employers.

The BIPA, enacted in 2008, requires private entities to develop and make available to the public written policies establishing a retention schedule and guidelines for destruction of biometric identifiers. Collectors of biometric data must inform subjects that the data is being collected and stored, disclose the purpose and length of time for which the information is being collected and stored, and receive written consent for collection of the information.

"Despite obtaining, storing, and processing biometric information of thousands of Illinois residents, including Plaintiff's biometrics, on behalf of scores of its customers, Defendant failed to comply with BIPA," the class plaintiffs allege.

The plaintiffs seek injunctive relief, statutory and compensatory damages, costs, and attorney's fees.

RESEARCH PATH: *Data Security & Privacy > State Law Surveys and Guidance > State Guidance > Articles*

PENNSYLVANIA SUPREME COURT STRIKES DOWN FLUCTUATING OVERTIME PAY METHOD

THE FLUCTUATING WORK WEEK (FWW) METHOD OF calculating overtime pay violates state law, the Pennsylvania Supreme Court has ruled in Chevalier v. Gen. Nutrition Ctrs., Inc., 2019 Pa. Lexis 6521 (Nov. 20, 2019).

While acknowledging that federal law allows employers to use the FWW method, the court said that the practice violates the state Minimum Wage Act (MWA).

The justices affirmed the award of $1.7 million in back overtime pay to employees of General Nutrition Centers (GNC). The employees filed suit in the Allegheny County Court of Common Pleas, arguing that GNC's use of FWW to pay them overtime at a diminishing rate depending on how many hours are worked during a week violates state law. The FWW rate is calculated by dividing the employee's weekly salary by the number of hours, including hours in excess of the standard 40, actually worked in a week, then multiplying the hours in excess of 40 by one-half the regular pay rate and adding that amount to the regular salary. The employees argued that the MWA's mandate that workers be paid at least "one and one-half times" their regular rate for hours in excess of 40 hours requires that the excess hours be calculated by multiplying the regular rate by 1.5.

The FWW method was adopted by the U.S. Department of Labor (DOL) in a guidance issued in 1940. The U.S. Supreme Court affirmed its use in Overnight Motor Transp. Co. v. Missel, 316 U.S. 572 (1942). The DOL issued a regulation codifying its use in 1950. The MWA was adopted by the Pennsylvania legislature in 1968.

The trial court entered summary judgment for the employees, finding that the language in the MWA is ambiguous and that the ambiguity has not been addressed by a Pennsylvania appellate court. The court awarded the employees almost $1.4 million in unpaid overtime, plus interest, costs, and attorney's fees. The state Superior Court affirmed.

Affirming, the Supreme Court acknowledged the ambiguity in the MWA and held that "the rules of statutory construction favor Plaintiffs' interpretation requiring application of the 1.5 Multiplier." The court cited the "unmistakable intent of the General Assembly to use the Commonwealth's police power to increase wages to combat the 'evils of unreasonable and unfair wages'" and its failure to specifically adopt the FWW method in promulgating state regulations.

RESEARCH PATH: *Labor & Employment > Wage and Hour > Compensation > Articles*

EEOC, DOLLAR GENERAL REACH $6 MILLION SETTLEMENT IN CRIMINAL BACKGROUND CHECK SUIT

RETAILER DOLLAR GENERAL AND THE U.S. EQUAL Employment Opportunity Commission (EEOC) have entered into a $6 million settlement in a six-year-old case alleging that the company discriminated against a nationwide class of black applicants by way of its criminal background check policy. EEOC v. Dolgencorp LLC d/b/a Dollar General, No. 13 C 4307, N.D. Ill.

Under the terms of a three-year consent decree approved by U.S. Judge Andrea Wood of the Northern District of Illinois, Dollar General did not admit to liability for the allegations in the complaint, and the EEOC did not accept any of the defenses raised by Dollar General. Individuals whose job offers were rescinded as a result of the background check policy dating back to 2004 are eligible to receive a part of the monetary settlement. Additionally, if Dollar General opts to use criminal conviction history to inform its hiring decisions during the three-year term of the decree, it must hire a criminology consultant to develop a new criminal background check based on specific factors outlined in the decree.

The settlement comes in a suit alleging that Dollar General refused to consider the age of job applicants at the time of the alleged criminal offense or the nexus of the crime and the duties of the job for which they applied. For instance, the EEOC alleged that the company disqualified an applicant for three years who was convicted of improperly supervising a child and disqualified another for 10 years based on a conviction for possession of drug paraphernalia. The policy resulted in the elimination of about 10% of black applicants as opposed to 7% of non-black applicants, the EEOC said.

The lawsuit stemmed from EEOC guidance from 2012 that warned employers of violating Title VII if they used criminal background results to screen potential employees, and the practices were not "job-related and consistent with business necessity" and performed on a case-by-case basis.

RESEARCH PATH: *Labor & Employment > Screening and Hiring > Recruiting and Screening*

SUPREME COURT TO DECIDE ON REGISTRABILITY OF BOOKING.COM TRADEMARK

THE U.S. SUPREME COURT WILL DECIDE LATER THIS TERM whether the name Booking.com is sufficiently distinctive to merit registration as a trademark for an online travel site. U.S. Patent and Trademark Office v. Booking.com BV, 2019 U.S. Lexis 6782 (Nov. 8, 2019).

The justices granted a petition by the U.S. Patent and Trademark Office (PTO) for review of a decision by the U.S. Court of Appeals for the Fourth Circuit affirming a lower court ruling finding the mark protectable under the federal Lanham Act.

Booking.com applied for registration of the mark in 2011. The PTO rejected the application, finding the mark generic as applied to travel services and holding that Booking.com had failed to establish secondary meaning for the mark. On appeal, the Trademark Trial and Appeal Board affirmed on genericness grounds.

Booking.com filed suit in the U.S. District Court for the Eastern District of Virginia, citing a survey indicating that almost 75% of consumers recognize the mark as a brand rather than a generic service. The district court entered summary judgment for Booking.com, finding that while "booking" is a generic term for travel services, the mark Booking.com, taken as a whole, is descriptive in nature. Further, the court said, the company has met its burden of proof on the issue of secondary meaning.

On appeal, the Fourth Circuit affirmed, finding that the composite created by the addition of .com to a generic term "may be non-generic where evidence demonstrates that the mark's primary significance to the public as a whole is the source, not the product."

In seeking review by the high court, the PTO argued that the lower court ruling "is likely to have serious and immediate anticompetitive effects" by discouraging competitors "from using the generic names of their goods or services in their own domain names." In response, Booking.com argued that to deny registration would "free unscrupulous competitors to prey on its millions of loyal consumers by falsely advertising as 'Booking.com' or making deceitful direct promotions."

Arguments are expected in the spring, with a decision to be released before the end of the high court's term in late June.

RESEARCH PATH: *Intellectual Property & Technology > Trademarks > Trademark Registration > Articles*

NEW YORK SHIELD ACT STRENGTHENS DATA SECURITY REQUIREMENTS FOR BUSINESSES

KEY PROVISIONS OF NEW YORK'S NEW DATA SECURITY statute that took effect recently impose new requirements on businesses to notify consumers of data breaches and extend the period during which the state attorney general can file suit for violations of the statute. Stop Hacks and Improve Electronic Data Security (SHIELD) Act (N.Y. Gen. Bus. Law § 899-aa).

The notification provisions of the statute, signed into law by Governor Andrew Cuomo in July and effective as of October 23, require businesses that suffer a data breach to notify affected persons "in the most expedient time possible and without reasonable delay." Notification must be made by written, electronic, telephonic, or some other method, including email, posting on a business web site, or notification to major statewide media.

An exception is available if the exposure of private information was "an inadvertent disclosure by persons authorized to access private information" and the disclosing person or business "reasonably determines" that the exposure will not result in misuse or harm. Such an exposure must be reported to the state attorney general within 10 days if it affects more than 500 New York residents.

Additional provisions of the statute, which require businesses to adopt "reasonable safeguards" against data breaches, are scheduled to go into effect on March 21, 2020. (N.Y. Gen. Bus. Law § 899-bb). The statute sets forth a list of items to include in a compliant data security program, including administrative, technical, and physical safeguards.

The statute does not include a private cause of action; enforcement is left to the state attorney general. In addition to injunctive relief, violations of the statute can result in actual damages and civil penalties of $5000 or up to $20 per instance of failed notification, provided that the latter amount does not exceed $250,000. The statute of limitations is three years after the date on which the attorney general becomes aware of the violation.

RESEARCH PATH: *Data Security & Privacy > Data Breaches > Response > Articles*

The California Consumer Privacy Act is in Effect: What to do Now

Andrew L. Rossow, Esq.

WITH THE CALIFORNIA CONSUMER PRIVACY ACT (CCPA) now in effect, is your firm and/or business ready for the new compliance requirements? The CCPA is codified under Cal. Civ. Code § 1798.100.

Background

On May 25, 2018, the European Union's (EU) General Data Protection Regulation (GDPR) took effect, replacing the previous EU Directive. Under the GDPR, any individual in the EU who processes the personal data of an EU citizen is subject to the GDPR's 99 articles setting forth privacy requirements.

However, the United States has lacked a comprehensive consumer privacy law—until now. California was the first state to enact such a law, granting California residents new rights regarding how their personal information is collected, managed, utilized, and distributed, while imposing various data protection obligations on certain entities conducting business in California.

While the CCPA incorporates several GDPR concepts, including rights of access, portability, and data deletion, as it rightfully should, the scope and territorial reach of the GDPR is much broader than the CCPA, and substantially different as to which parties are regulated.

What's Been Added? (Amendments)

To date, the California legislature has passed seven amendments to the CCPA—AB 25, 874, 1130, 1146, 1202, 1355, and 1564. Collectively, these amendments modify the definition of personal information, alleviating many concerns surrounding a business's ability to verify consumer requests under the Act.

Clarifying Personal Information

Under the GDPR, personal data is defined as any information relating to an identified or identifiable data subject. The GDPR prohibits the processing of defined special categories of personal data unless a lawful justification for processing applies.

However, the CCPA gets more in-depth with its definition. Prior to the enactment of the amendments, the CCPA's definition of personal information failed to include the use of the term reasonably in two locations and failed to clarify the definition of publicly available.

With the enactment of the amendments, personal information is defined as any information that "identifies, relates to, describes, is reasonably capable of being associated with, or may reasonably be linked, directly or indirectly, with a particular consumer or household."

Checklist of Important Considerations

Do You Have An Opt-Out Clause Visible on Your Page?

Businesses must now enable and comply with a consumer's request to opt out of the sale of personal information to third parties, subject to certain defenses.

With the GDPR, there was no specific right to opt out of such sales, unless they involved processing data for marketing purposes.

Related Content

For additional information on the General Data Protection Regulation (GDPR), see

> **GENERAL DATA PROTECTION REGULATION (GDPR)**

RESEARCH PATH: *Data Security & Privacy > International Compliance > General Data Protection Regulation (GDPR) > Practice Notes*

For a comparison between the GDPR and the CCPA, see

> **CCPA COMPLIANCE: COMPARING KEY PROVISIONS OF THE GDPR AND CCPA**

RESEARCH PATH: *Data Security & Privacy > International Compliance > General Data Protection Regulation (GDPR) > Practice Notes*

For an overview of the requirements of the CCPA, see

> **CALIFORNIA CONSUMER PRIVACY ACT (CCPA) RESOURCE KIT**

RESEARCH PATH: *Data Security & Privacy > State Law Surveys and Guidance > California Consumer Privacy Act (CCPA) > Practice Notes*

For guidance on mapping data in anticipation of compliance with the CCPA, see

> **CCPA COMPLIANCE: DATA MAPPING CHECKLIST**

RESEARCH PATH: *Data Security & Privacy > State Law Surveys and Guidance > California Consumer Privacy Act (CCPA) > Checklists*

For the steps to take to update a consumer-facing privacy policy, see

> **CCPA COMPLIANCE: UPDATING A PRIVACY POLICY CHECKLIST**

RESEARCH PATH: *Data Security & Privacy > State Law Surveys and Guidance > California Consumer Privacy Act (CCPA) > Checklists*

Under the CCPA, businesses must comply with a consumer's request to opt out of the sale of personal information to third parties by including a "Do Not Sell My Personal Information" link clearly and conspicuously enough on the website's homepage so that it cannot be missed.

Does Your Business Qualify for an Exception Under the CCPA?

Two notable exceptions appear in the amendments adopted before the end of California's legislative session on Sept. 13, 2019.

The Business-to-Business Exception

As of January 1, 2020, the CCPA will not apply:

- When personal information is conveyed between a business and a consumer that is acting as an employee, owner, director, officer, or contractor of an entity
- When that communication or transaction occurs solely within the context of the business conducting due diligence regarding, or providing or receiving, a product or service to or from the consumer that is acting as an employee, owner, director, officer, or contractor of an entity

The Human Resources Exception

Additionally, the amendments listed above provide a limited exception up and until January 1, 2021, by which the CCPA will not apply to:

- Personal information collected by a business about a person acting as a job applicant to an employee, owner, director, officer, medical staff member, or contractor of that business
- Personal information that is collected and used by the business solely within the context of the person's role or former role as a job applicant

This exemption also applies to certain emergency contact information and information necessary to administer benefits.

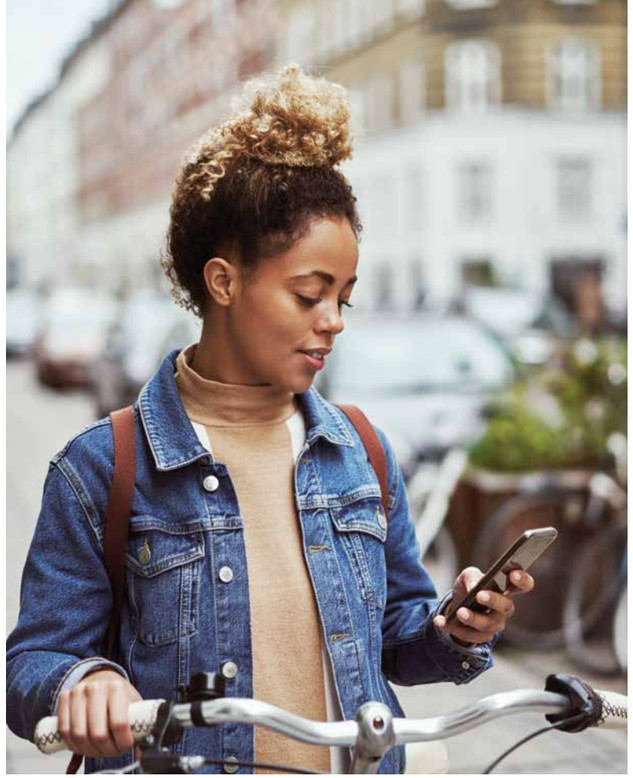
Consequences

Like the GDPR, failure to comply with the CCPA purposely comes at an extremely high price and harsh cost. Once the California Attorney General begins to implement enforcement actions on July 1, 2020, individuals and/or businesses who fail to comply with the CCPA's requirements could be fined at least $2,500 per violation. Of course, the enforcement penalties do lend favor to good faith and reasonable efforts to comply, but it is ultimately up to the California Attorney General's office whether it chooses to seek civil penalties.

So, what do you and your firm need to do right now to ensure you don't have to come into a conversation with the Attorney General in July?

Disclose, Disclose, Disclose!

Right now, go look at your firm's website and privacy policies and check the language. Reviewing the company's privacy policy is usually the first step a regulator (or consumer) will take to see if your business is complying with the CCPA.



Make sure you are posting plain, straightforward language that the average consumer would be able to understand—don't pull a Facebook or any other social media company that buries those provisions in hundreds of thousands of words. Put it right there upfront, large enough for the consumer to see.

Prepare for a Crisis

The chances of something happening are high, almost inevitable. In preparation for this and avoiding both CCPA and GDPR penalties, you will want to:

- Brainstorm potential crisis scenarios and appoint a person of contact to lead the initiative.
- Put together a roundtable of people from the firm.
- Identify your firm's key audiences.
- Determine who the lead contact will be to respond to the media and other audiences.

Create and Monitor Your Internal Data Privacy Team

The next step would be to grab your IT department, IT consultant, and/or technical consultant (preferably someone with Certified Information Systems Security Professional certification) and bring them into a meeting with your firm's partners and create the internal data privacy team.

Begin by:

- Appointing a director of crisis communication or your firm's quarterback
- Appointing a representative for your entire legal team
- Establishing a 2-3 person group from the firm's leadership team
- Identifying and retaining internal subject matter experts, including a chief information officer, chief technology officer, and most importantly, a media spokesperson who knows exactly how to handle the never-ending media pressure

Create Your Incident Response Plan

Depending upon the federal regulations your firm is bound by, you will want to create and establish your firm's internal incident response plan.

Before moving forward, identify whether you are bound by the Gramm-Leach-Bliley Act, the Health Insurance Portability and Accountability Act, and of course, California's CCPA and privacy statutes.

Then you will want to:

- Document how your firm's data is stored and protected
- Understand the cost and impact if that data were stolen (in whole or in part)
- Create tailored policies, procedures, and guidelines for handling each type of information security incidents
- Ensure visibility into the critical activity and behavior in the business environment
- Practice and implement it. L

Andrew L. Rossow *is an internet attorney, licensed to practice law in Ohio, and an adjunct cybersecurity professor at The University of Dayton School of Law. Rossow focuses on helping individuals minimize harms caused through social media crime and ensures clients' digital footprints are positively managed. He has been published in Law360, Forbes, and HuffPost, and regularly provides analysis for national news outlets, including Cheddar, ABC, CBS, FOX, and NBC. In addition, he is a Research Solutions Consultant with LexisNexis.*

RESEARCH PATH: *Data Security & Privacy > State Law Surveys and Guidance > California Consumer Privacy Act (CCPA) > Articles*

Data Privacy Laws, Hackers Put New Emphasis on Cyber Insurance

Rich Ehisen

THE CALIFORNIA CONSUMER PRIVACY ACT (CCPA)[1] and other state data privacy laws have done more than motivate companies to rethink how they manage consumer data; they also have many organizations thinking more than ever about how they manage their cyber insurance coverage.

Once considered a niche product, cyber insurance policies have become common for companies that handle large amounts of consumer data. With increased exposure under new data privacy laws like the CCPA, such policies are rapidly turning into a must-have, with global premiums expected to grow[2] from about $2.5 billion today to approximately $7.5 billion by next year.

"The wolf at the door right now is CCPA readiness," says Scott Ferber, a partner with King & Spalding's Data Privacy and Security practice in Washington, D.C., who often works with the mergers and acquisitions side of the company. "How well a company is prepared for the CCPA is now a consideration point for assessing an acquisition target's valuation."

Data laws are hardly the only concern. In its annual MidYear Quick View Data Breach Report, cybersecurity firm Risk Based Security said it had tracked[3] more than 3,800 data breaches and ransomware attacks in the first six months of 2019 alone, a remarkable 53% increase over the same time period in 2018. A recent World Economic Forum report[4] listed data fraud or theft and cyber attacks as the fourth and fifth most likely risks companies face in the world today, and good cyber hygiene as a top three tenet for good business leadership.

But cyber compliance experts say just having a cyber insurance policy may not be enough. With hundreds of carriers in the United States alone and no single set of standards for what a policy should cover—and with greater likelihood than ever of litigation over breaches and privacy violations—ensuring adequate protection from liability may actually be harder than ever.

"Even for companies that have worked hard to put cyber insurance policies in place, those policies may not provide the coverage they need," says Jones Day Insurance Recovery partner Rich DeNatale in a video[5] on the company's website. He notes that claims against a company under the CCPA for failing to adequately protect consumer data might not be covered under many of the policies currently available on the market.

Judy Selby, principal at Judy Selby Consulting LLC, an insurance and privacy advisory services firm in New York City, says many companies right now might believe they are fully covered for any eventuality, when in reality their policies have significant holes that could leave them high and dry in the case of a breach or lawsuit.

"The cyber insurance market is really challenging right now, and there are no shortcuts around closely reviewing every single form in your cyber insurance policy," she says.

And there is definitely a lot to know. Similar to the European Union's General Data Protection Regulations,[6] the CCPA requires companies to inform their customers upon request exactly what personal data they've collected, why they did so, and with whom they have shared it.

There are some major limitations to the law's grasp: it applies only to for-profit entities doing business in California that derive more than 50% of their income from selling personal data, or which have annual gross revenues over $25 million, or which hold the personal information of 50,000 or more Golden State consumers. Violators face potential fines of $7,500 per record, with enforcement power residing with California Attorney General Xavier Becerra.

Selby says the CCPA's fine structure is one of the most troubling aspects of the law for insurers.

"With damages now defined under the CCPA, we're going to see a lot more breach litigation over smaller and smaller breaches," she says.

It is also likely to spur those with policies to pay very close attention to every detail in a way they might not have before.

"Does a policy cover only a data breach? Or does it cover a data privacy violation as well?" Selby says.

Different policies may also define a security event or other terms in very different ways, leading some companies to believe they are covered for such an event when they are not. A policy might also have specific requirements, such as obtaining the carrier's consent before paying a ransomware attack ransom.

These complexities have led to some high-profile disputes[7] between hacking victims and their insurers, which have consequently led to media reports claiming that cyber carriers are looking for ways out of honoring their policies. But Selby believes a failure to properly scrutinize a policy is the real culprit.

"You really have to watch for the definitions and requirements in a policy," she says. "Oftentimes the company simply didn't buy the right policy."

State laws play a major role as well. Andrew Lipton of White and Williams LLP in New York City recently noted[8] that California, Delaware, and New York are just a few states with laws that bar insurance from bearing the cost of civil penalties, meaning policies that otherwise cover those liabilities might not apply in those states.

The CCPA and other state laws are not the only elements driving interest in cyber insurance, and the private sector isn't the only one feeling the sting of data mishaps.

Related Content

For an examination of issues related to obtaining cyber insurance for data breach risks, see

> **CYBER INSURANCE, RELATED COVERAGE LITIGATION, AND INSURANCE COVERAGE FOR DATA BREACH RISK**

RESEARCH PATH: *Insurance > Assessing Claims and Coverage > Types of Insurance > Practice Notes*

For a discussion of the types of risks to an enterprise that may be covered by cybersecurity insurance, see

> **CYBERSECURITY INSURANCE**

RESEARCH PATH: *Insurance > Assessing Claims and Coverage > Types of Insurance > Practice Notes*

For an overview of cyber risks in M&A transactions, including best practices and potential pitfalls for acquiring companies, see

> **EXPERT INSIGHTS: INSURANCE FOR CYBER RISKS IN M&A TRANSACTIONS**

RESEARCH PATH: *Insurance > Advising on Business Transactions > Mergers and Acquisitions > Practice Notes*

For an outline of the key issues and risks that should be considered when reviewing a cybersecurity insurance policy, see

> **CYBERSECURITY INSURANCE POLICIES REVIEW CHECKLIST**

RESEARCH PATH: *Insurance > Assessing Claims and Coverage > Types of Insurance > Checklists*

1. https://oag.ca.gov/privacy/ccpa. **2.** https://www.pwc.com/gx/en/industries/financial-services/publications/insurance-2020-cyber.html. **3.** https://pages.riskbasedsecurity.com/hubfs/Reports/2019/2019%20MidYear%20Data%20Breach%20QuickView%20Report.pdf. **4.** http://www3.weforum.org/docs/WEF_Cybersecurity_Guide_for_Leaders.pdf.

5. https://www.youtube.com/watch?v=lk2os3TOUy4. **6.** https://eugdpr.org/. **7.** https://www.cpomagazine.com/cyber-security/aig-case-highlights-complexities-of-covering-cyber-related-losses/. **8.** https://www.whiteandwilliams.com/resources-alerts-Will-California-Law-Permit-Insurance-Coverage-for-Civil-Penalties-Assessed-Under-the-California-Consumer-Privacy-Act.html.

According to the cybersecurity firm Recorded Future, at least 230 ransomware attacks[9] have been carried out against local governments since 2013, with at least 140 of those in 2019. Many have come against smaller cities, or police departments, or even hospitals, but size definitely is not the determining factor. And given the significant amount of personal data local governments hold on their citizens—far more than what is held by private companies—the potential impact of those attacks is perhaps even greater.

When hackers infected key parts of Baltimore's data network earlier this year, the city refused to pay the demanded ransom. The city did not have cyber coverage, and the resulting cost to restore lost data is estimated at over $18 million. A similar attack in Atlanta cost an estimated $17 million.

With that hit fresh in their minds, Baltimore officials last month signed off on the purchase of $20 million in cyber insurance spread out equally over two policies. The policies' terms are for one year, but a spokesperson for Mayor Bernard C. "Jack" Young told the *Baltimore Sun*[10] that officials expect to continue carrying the coverage for the foreseeable future.

Charm City is not likely to be the only municipality to come on board the cyber insurance train. Cooper Martin, Director of Sustainability and Solutions for the National League of Cities (NLC), said a recent survey[11] the NLC conducted found that about 70% of respondents had some form of cyber insurance. Conversely, 50% said they did not know the amount of that coverage or the extent of its protection.

That's not optimal, Martin said, but he noted the NLC is seeing a greater interest from its members all the time.

"The kind of high-profile attacks we've seen now in states like Florida,[12] Maryland, and Texas[13] are definitely raising alarm bells," he says.

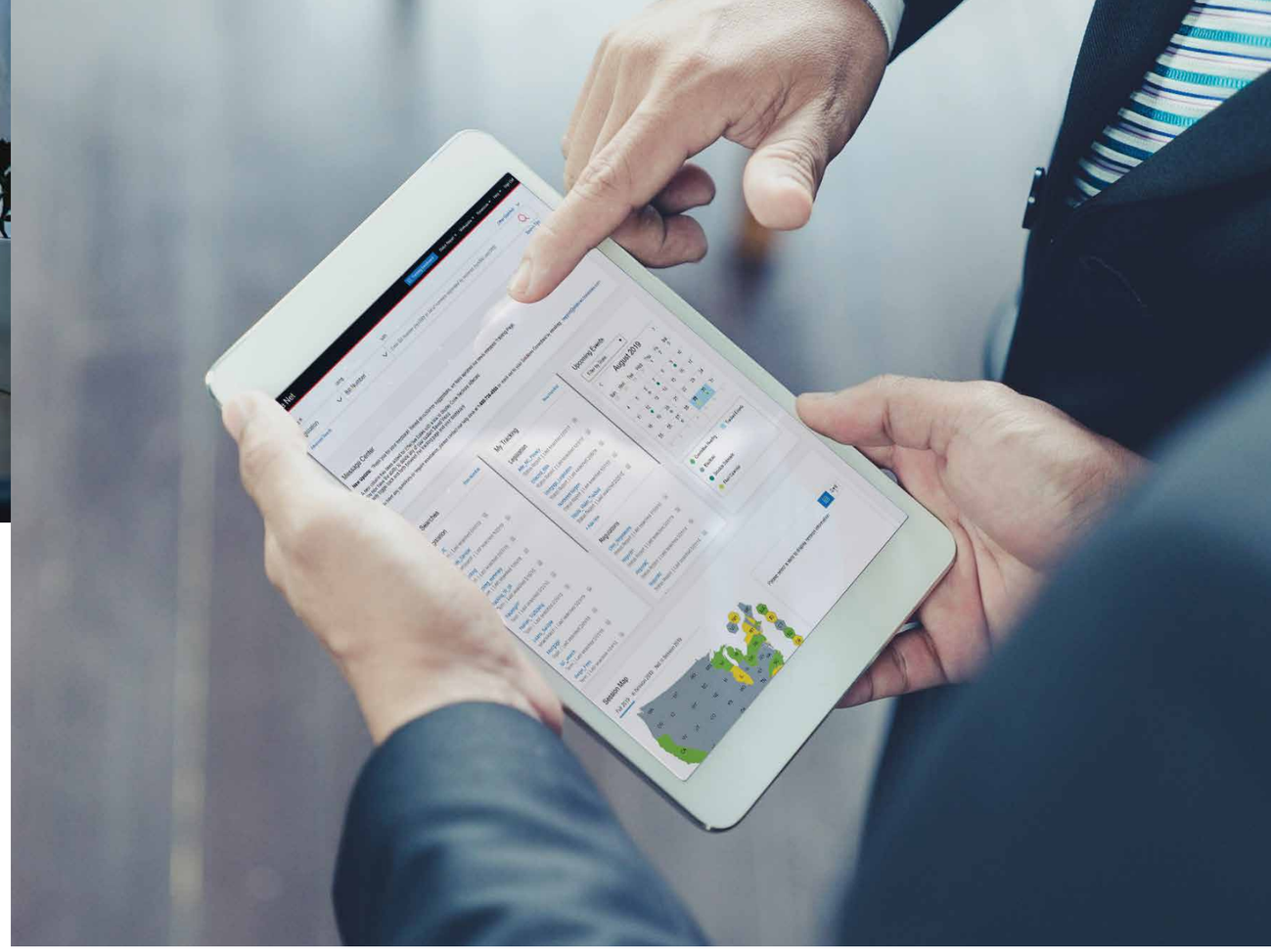
Those bells were also going off in Ohio, where at least three local governments endured ransomware attacks this year. To help mitigate the cost of such attacks, Gov. Mike DeWine (R) signed legislation[14] that creates a volunteer "cyber reserve" of computer and information technology experts who will help local governments that get hit with ransomware.

Even the insurers are not safe. Like municipalities, insurance carriers often possess a deep trove of consumer data, making them a rich target for cyber attacks.

Because of that, the National Association of Insurance Commissioners has developed a cybersecurity model law[15] specifically for insurance carriers, based on a 2017 New York statute that imposed strict guidelines on financial securities companies. To date eight states have adopted the model law or variations of it, with South Carolina, Ohio, and Michigan adopting it last year and Mississippi, Alabama, Delaware, New Hampshire, and Connecticut coming on board this year. Many more are expected to consider it this year. L

RESEARCH PATH: *Insurance > Assessing Claims and Coverage > Types of Insurance > Articles*

9. https://www.recordedfuture.com/state-local-government-ransomware-attacks-update/. 10. https://www.baltimoresun.com/maryland/baltimore-city/bs-md-ci-cyber-attack-insurance-20191016-4owu233bmfgnjmqu3yf2rzjxt4-story.html. 11. https://bit.ly/2Pzv37n. 12. https://www.nytimescom/2019/06/19/us/florida-riviera-beach-hacking-ransom.html. 13. https://www.npr.org/2019/08/20/752695554/23-texas-towns-hit-with-ransomware-attack-in-new-front-of-cyberassault. 14. 2019 Ohio SB 52. 15. https://www.naic.org/store/free/MDL-668.pdf.



Timothy Murray MURRAY, HOGUE & LANNIS

Drafting Choice-of-Law Provisions

ONE TIME I FOUND MYSELF ON THE SET OF A HOLLYWOOD soundstage for a popular television show about a lawyer. In the law library of the fake TV law firm, I noticed something that viewers at home couldn't see: the case reporters containing judicial decisions were all out of order—the volumes were shelved randomly, not according to number. That, of course, would have made the books useless if this were a real law library.

I was amused. of course, if it had been *Corbin On Contracts* out of order, I would have been aghast and appalled.

But then it occurred to me: a fair number of attorneys who draft contracts would feel right at home in such a library—for too many attorneys, judicial decisions have little to no bearing on what we do, and the law library might as well be a fake Hollywood set. That is unfortunate. We ignore the judicial decisions at our clients' peril because the courts tell us how to draft.

Perhaps nowhere is this more evident than with choice-of-law provisions. Nothing screams boilerplate more than these, and if the dictionary had a picture of the word afterthought next to it, it might well be a choice-of-law provision. But a jaw-dropping number of judicial decisions hold that choice-of-law provisions are entirely or partly unenforceable because the drafters failed to pay attention to the caselaw. That ought to be unacceptable.

The subject of choice-of-law provisions is exceedingly complex—there is no possibility of covering everything important in a short article. But when you are considering drafting a choice-of-law provision, the following should help you get started. Here are things to keep in mind.

You Have to Know the Law

I've done a lot of contract law seminars with Steven M. Richman, a really smart friend of mine. When we get together, we don't waste time talking sports or politics—we debate important things, like which provision of the contract is the most important. Mr. Richman makes a compelling case for choice-of-law provisions: "Leaving choice-of-law to the end of a contract negotiation," he says, "is like leaving the blueprint until after the building is finished."

That's a point that can't be disputed. Lawyers drafting contracts often have well-informed reasons for insisting on the law of a certain jurisdiction in their choice-of-law provisions. But, then again, often they don't. Too often, they select the law of the jurisdiction where they practice and where their clients have their principal places of business based on nothing more than a general feeling that they are comfortable with that law—that if there was something weird or awful about that state's law, they would know about it. When pressed for specifics about what makes them so comfortable, they often can't articulate any.

Although it is said that "contract law is not at its core 'diverse, nonuniform, and confusing,'"[1] there are important differences in the law from state to state. The judicial decisions demonstrate that these differences can have a critical impact on disputes. By way of example, consider the following fundamental contract law principles where the law differs depending on the state. In each of these, the selection of a state's law in the choice-of-law provision could have a significant impact on a dispute:

- Does the drafter's preferred law regard merger clauses as conclusive?[2]
- What test for integration (as opposed to interpretation) does the law follow?[3]
- What about time is of the essence clauses—are they regarded as conclusive?[4]
- What does the law of the state say about the enforceability of no oral modification clauses?[5]
- For anti-assignment clauses, does the court require magic words to remove the power (not just the right) to assign?[6]
- Do broadly drafted indemnity clauses apply to first-party claims—that is, breach of contract claims between the contracting parties? (That can be important if, for example, the indemnity clause awards attorney's fees to the party to be indemnified).[7]

On and on it goes—the examples are innumerable—these are just a few with respect to common clauses. To the extent attorneys who draft contracts can't answer these fundamental questions, that probably accounts for why choice-of-law provisions are often afterthoughts—the drafters themselves aren't convinced that they matter very much.

---

1. Am. Airlines v. Wolens, 513 U.S. 219, 233, n. 8 (1995), citation omitted.**2.** This one might be enough to impact my choice-of-law preference. "Merger clauses are not everywhere deemed to be conclusive on the issue of whether the writing is a completely integrated agreement—it depends on the jurisdiction." John E. Murray, Jr. & Timothy Murray, 1 Corbin on Contracts Desk Edition, § 25.05. *E.g.*, Bonner v. City of New Haven, 2018 Conn. Super. LEXIS 1285, *11 (June 22, 2018) (merger clause conclusive); Posephny v. AMN Healthcare Inc., 2019 U.S. Dist. LEXIS 18593 (N.D. Cal. Feb. 5, 2019) (merger clause a persuasive but not controlling factor). **3.** For example, some states follow the "natural omission test" where "an oral agreement is not superseded by a subsequent writing if the agreement is not inconsistent with the writing and 'is such an agreement as might naturally be made as a separate agreement by parties situated as were the parties to the written contract.' First Restatement of Contracts §240(b)." John E. Murray, Jr. & Timothy Murray, 1 Corbin on Contracts Desk Edition, § 25.06. *See, e.g.*, Dugan v. Towers, 2012 U.S. Dist. LEXIS 175599 (E.D. Pa. Dec. 12, 2012). Others follow the appearance test. *See* J&B Steel Contractors v. C. Iber & Sons, 162 Ill. 2d 265 (1994) (a judge must decide integration questions solely by looking at the four corners of the last writing). Some courts have expressed allegiance to both tests, even though the tests might lead to inconsistent results. *E.g.*, Gianni v. R. Russell & Co., 281 Pa. 320 (1924). **4.** 184 Joralemon, LLC v. Brklyn Hts Condos, LLC, 117 A.D.3d 699, 985 N.Y.S.2d 588, 2014 NY Slip Op 3245 (2014) (conclusive); Handler v. Anderson, 2018 IL App (1st) 170338-U (2018) (not conclusive). **5.** *Compare* Pennsylvania (Wagner v. Graziano Constr. Co., 390 Pa. 445, 448 (1957) holds that a contract can be orally modified despite such a clause) with New York (N.Y. Gen. Oblig. Law § 15-301(1) provides: "A written agreement or other written instrument which contains a provision to the effect that it cannot be changed orally, cannot be changed by an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the change is sought or by his agent.") **6.** Some courts hold that "unless the contractual provision eliminates both the power and the right to assign, an assignment may give rise to damages for breach but will not render the assignment ineffective" while other courts "are less insistent on the use of any particular phraseology and simply uphold anti-assignment provisions if the prohibitive language utilized is clear and unambiguous . . . ." *In re* Kaufman, 2001 OK 88, 9-10, 37 P.3d 845, 851-52 (2001). **7.** Only "some states allow attorneys' fees to be recovered in *first-party actions* (that is, direct actions between the parties to the contract where no third party is involved)." John E. Murray, Jr. & Timothy Murray, 1 Corbin on Contracts Desk Edition, § 57.05. Not all courts agree. Two courts interpreting the same contract language and applying the law of the same state reached different conclusions about whether an indemnity provision allows recovery for first-party claims. *See* GMFS, LLC v. Cenlar FSB, 2019 U.S. Dist. LEXIS 4527 (M.D. La. Jan. 9, 2019) (language envisions first-party claims); myCUmortgage, LLC v. Cenlar FSB, 2019 U.S. Dist. LEXIS 53184 (S. D. Ohio Mar. 28, 2019) (first-party claims not encompassed by language).

All in all, the practicing bar can do better than it does in making informed choice-of-law decisions. For starters, we ought to know what our state says about the sort of boilerplate clauses that pop up in contract after contract. We need to have a healthier respect for the daunting complexities of the caselaw.

Your Client Doesn't Think About These Provisions the Way You Do

When it comes to drafting choice-of-law provisions, you are on your own—don't expect any help from the client. Clients primarily care about what the late, great Karl Llewellyn called the "dickered" terms—the immediate commercial terms of the deal: description of the product, quantity, price, and delivery terms. Lawyers have to care about those, too—but lawyers also have to worry about the terms that deal with "what if something goes wrong?" The traditional boilerplate terms in contracts largely address that question. Choice-of-law provisions—like a lot of boilerplate provisions—generally won't be an issue unless something goes wrong. Clients rely on us to get these provisions right.

Unless they've had prior experience with the issue, clients likely don't even know that a contract can select the law to be applied. Why would they? And even if they know, they would rely on the lawyers to tell them which state's law is most advantageous. Clients may actually care more about choice-of-forum than choice-of-law provisions—but they may not understand the difference between the two unless it is explained to them. If the contract goes bad and the dispute ends up in trial, the client may not care much if the law to be applied is some other state's, but the client is much more likely to be unhappy if the litigation has to occur in some far-away place, with all the attendant inconvenience and costs (including retaining local counsel).

Freedom of Contract Is Not Absolute

Although parties generally have freedom of contract to draft contracts in whatever manner they choose, that's not always true. Courts do not always respect the choice-of-law provision selected by the parties. It is important to know in advance if a choice-of-law provision likely will not be enforced so that the contract can be drafted accordingly.

In most states, "the chosen jurisdiction must have some reasonable relation to the parties, transaction, or dispute."[8] New York and Delaware have notable exceptions for certain contracts.[9] In most states, a court might well ignore altogether a choice-of-law provision that selects a state with no relation to the parties or the transaction in dispute. The choice-of-law provision will also be ignored if it contravenes the forum state's public policy.[10]

For certain types of contracts, the state legislature might mandate that a statute overrides the parties' choice-of-law provision.[11]

Presumption: Choice-of-Law Provisions Refer to the Chosen State's Local Laws

There is a simple and widely followed presumption that every drafter ought to know. "The most widely held view on this issue, that of the Restatement (Second) of Conflict of Laws, is that, absent contrary language in a choice-of-law provision, the 'laws' selected are the local or internal laws of the chosen state, exclusive of its conflict-of-laws rules."[12] To hold otherwise could require application of the law of another state despite the choice-of-law clause, which would undermine the salutary goals of certainty and predictability that such provisions are intended to foster.

To ensure that the presumption is followed with respect to a given contract, it doesn't hurt to draft the choice-of-law provision to make it clear that the chosen law means only the internal or local laws of the state.

Presumption: Choice-of-Law Provisions Refer to the Chosen State's Substantive Law

For the sake of achieving certainty and uniformity, parties may want the law they select in a choice-of-law provision to apply to every aspect of the parties' relationship, including the statutes of limitations.

But choice-of-law provisions generally apply only to substantive and not procedural law. In many states, statutes of limitations are regarded as procedural matters,[13] and in those states, garden-variety choice-of-law provisions may have no bearing on limitations periods. Instead, the law of the forum generally will dictate the statute of limitations to be applied.[14] If the drafter wants certainty, this presumption can be overcome—the choice-of-law provision can control the statute of limitations if it expressly says so.[15]

Other states hold that statutes of limitations are substantive, "and so the statute of limitations of the parties' chosen forum applies where there exists a contractual choice-of-law provision."[16]

Things can get complicated if the state has a "borrowing statute" designed to curb forum shopping. For example:

> For a claim that accrued in a foreign jurisdiction, . . . Pennsylvania courts turn to the state's "borrowing statute" to resolve statute-of-limitations disputes. . . . The borrowing statute directs that the "period of limitation applicable to a claim accruing outside [Pennsylvania] shall be either that provided or prescribed by the law of the place where the claim accrued or by the law of [Pennsylvania], *whichever bars the claim first*." 42 Pa. Cons. Stat. § 5521(b) (emphasis added). Courts applying the borrowing statute have abided by the statute's sometimes harsh result of barring claims that may have been timely under the accrual state's longer limitations period.[17]

New York's borrowing statute mandates that if suit is filed in New York by a nonresident based on a cause of action that accrued in a state other than New York, the claim must be timely under the statute of limitations for both New York and the other state.[18]

Drafting Choice-of-Law Provisions to Cover Extra-Contractual Claims

In disputes between contracting parties, the plaintiff often doesn't limit its claims to breach of contract. It is common for plaintiffs to tack on tort and statutory claims along with breach of contract. If the contract contains a choice-of-law provision, it may—or may not—be construed to cover the extra-contractual claims, depending on the jurisdiction and the way it is worded.

When drafting a choice-of-law provision, for the sake of achieving certainty and uniformity, parties usually want the law they select to apply to every aspect of their dealings that stems from the contract. But note that if the parties have other dealings, those other dealings might be covered by a different choice-of-law provision. If the parties desire to keep their various transactions (and the choice of laws) separate, they need to ensure that the choice-of-law provision cannot be read too broadly.

But generally, parties to contracts want to ensure that the choice-of-law provision covers extra-contractual claims relating to or arising out of the present contract. Yet, in case after case, even though the parties have agreed upon a choice-of-law provision, they find themselves embroiled in a resource-draining court battle over whether some claims are covered by that provision. Those are disputes that often can be avoided.

8. John E. Murray, Jr. & Timothy Murray, 1 Corbin on Contracts Desk Edition, § 83.04. **9.** New York: N.Y. Gen. Oblig. Law § 5-1401 ("[t]he parties to any contract . . . arising out of a transaction covering in the aggregate not less than two hundred fifty thousand dollars . . . may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state."). Delaware: For contracts involving $100,000 or more, "a choice-of-law provision designating Delaware law 'shall conclusively be presumed to be a significant, material, and reasonable relationship with [Delaware] and shall be enforced whether or not there are other relationships with [Delaware].' *See* Del. Code Ann. tit. 6, § 2708(a) (2018)." Capstone Logistics Holdings, Inc. v. Navarrete, 2018 U.S. Dist. LEXIS 216940, at *69 (S.D.N.Y. Oct. 25, 2018). **10.** "When application of a choice-of-law provision would result in the contravention of California's public policy, the contract provision can be ignored to the extent necessary to preserve public policy." Roadrunner Intermodal Servs., LLC v. T.G.S. Transp., Inc., 2019 U.S. Dist. LEXIS 53278, *14 (E.D. Cal. Mar. 28, 2019). **11.** For example, in Texas, a claim by a motor vehicle manufacturer against a franchised dealer must be brought in Texas "[n]otwithstanding the terms of any franchise . . . " Tex. Occ. Code § 2301.478. **12.** Volvo Grp. N. Am., LLC v. Forja De Monterrey S.A. de C.V., 2019 U.S. Dist. LEXIS 172435, *6-7 (M.D. N.C. Oct. 4, 2019). **13.** *E.g.*: "Under New York law, a choice-of-law provision typically applies to only substantive issues and not to statutes of limitations, which are considered procedural." Keurig Green Mt., Inc. v. Global Barstas U.S., LLC, 2018 U.S. Dist. LEXIS 175499, *9 (S.D.N.Y. Oct. 8, 2018). **14.** Reclaimant Corp. v. Deutsch, 332 Conn. 590 (2019) (Florida law). **15.** *See, e.g.*, Integrity Global Sec., LLC v. Dell Mktg. L.P., 579 S.W.3d 577, 587 (Tex. App. 2019). **16.** CDG Int'l Corp. v. Q Capital Strategies, LLC, 2018 U.S. Dist. LEXIS 832, *15 (S.D. Fla. Jan. 3, 2018).

17. Goellner-Grant v. JLG Indus., 2019 U.S. Dist. LEXIS 191353, *8 (M.D. Pa. Nov. 5, 2019). **18.** N.Y. C.P.L.R. § 202; Deutsche Bank Nat'l Tr. Co. v. Barclays Bank PLC, 2019 N.Y. LEXIS 3251 (Nov. 25, 2019).

> The law in this area is complex, even chaotic, and the rules change from jurisdiction to jurisdiction. In drafting a choice-of-law provision, it will be necessary to consult the judicial decisions in the states that might be applicable.

Scope test. In deciding whether extra-contractual claims are covered by the contract's choice-of-law provision, many courts focus on the scope of the provision. Where, for example, a choice-of-law provision stated that "Ohio law 'appl[ied] to this [financing agreement],'" the court construed the provision as narrow and held that it applied only "to this contract," not to statutory and tort claims.[19] A provision stating that "[t]his Agreement shall be construed in accordance with, and be governed by, the laws of the State of New York" was held to be a narrow provision that did not cover extra-contractual claims.[20]

But a choice-of-law provision that covers any disputes "arising out of or relating to the contract" has been held to be a broad provision covering extra-contractual claims.[21] A clause that encompasses the entirety of the parties' relationship has been held to be a broad provision. For example: "Delaware law 'govern[s] this user agreement and any claim or dispute that has arisen or may arise between you and PayPal.'"[22]

Even courts that follow the scope test do not always agree on the language that is broad or narrow.

Relatedness test. Many other courts eschew the scope test. Instead of focusing on the words of the choice-of-law clause, they start from the premise that when parties have agreed upon a generic choice-of-law provision, they intend for the clause to cover related tort claims. Many states hold that "torts that are 'related' to a contract claim are generally governed by the same law set forth in the contract's choice-of-law clause." But "[a] number of courts" hold "that only those claims 'closely related to the interpretation of the contracts' may be encompassed by a generic choice-of-law provision."[23] This raises the issue of how closely related the tort claim must be?[24]

Presumption: Choice-of-Law Provisions Incorporate Federal Law, Including the United Nations Convention on Contracts for the International Sale of Goods (CISG)

Arbitration. When a contract designates the law of a state in a choice-of-law provision, that designation includes federal law.[25] This principle is important where a party seeks to argue that a choice-of-law provision excuses it from the default rules of the Federal Arbitrations Act (FAA). Many courts hold that a garden-variety choice-of-law provision is insufficient to opt out of the FAA's default rules.[26] If the parties intend to apply state arbitration laws where the matter otherwise would be covered by the FAA, the parties must expressly incorporate those laws in the contract.[27]

CISG. The same principle is important when it comes to the interaction of choice-of-law provisions and the CISG.

The CISG is a treaty adopted by most of the major trading nations of the world, including the United States. It is roughly analogous to Article 2 of the Uniform Commercial Code (UCC) with many similarities but some important differences. "[I]t applies to most of the international contracts for the sale of goods made by parties with their principal places of business in different CISG countries."[28] For contracts where the CISG applies, the CISG applies and the UCC does not.

The parties may opt out of the CISG per Article 6. Attorneys steeped in the traditions of American commercial law often do just that because they feel uncomfortable with some of CISG's provisions—most notably the absence of a parol evidence rule per Article 8. Why is the absence of a parol evidence rule important? Because it means that where the CISG is applicable, courts may, as a matter of course, allow the admission of evidence of the parties' prior negotiations to interpret the parties' intentions.

19. McDonald v. Wells Fargo Bank, N.A., 338 F. Supp. 3d 458 (W.D. Pa. 2018). **20.** DelMonaco v. Albert Kemperle, Inc., 2014 Conn. Super. LEXIS 2965 (Conn. Super. Ct. Nov. 26, 2014). **21.** Grey Mt. Partners, LLC v. Insurity, Inc., 2017 Conn. Super. LEXIS 4721 (Oct. 18, 2017). *See also* Barnes v. StubHub, Inc., 2019 U.S. Dist. LEXIS 172846 (S.D. Fla. Oct. 3, 2019). **22.** Maynard v. PayPal, Inc., 2019 U.S. Dist. LEXIS 130240, *10 (N.D. Tex. Aug. 5, 2019). **23.** Volvo Grp. N. Am., LLC v. Forja De Monterrey S.A. de C.V., 2019 U.S. Dist. LEXIS 172435, *11-12 (M.D. N.C. Oct. 4, 2019). **24.** *See, e.g.*, Volvo Grp. N. Am., LLC v. Forja De Monterrey S.A. de C.V., 2019 U.S. Dist. LEXIS 172435 (M.D. N.C. Oct. 4, 2019) (fraudulent inducement claim was "closely related" to breach of contract, so the claim was covered by a choice-of-law provision). **25.** World Fuel Servs. Trading v. Hebei Prince Shipping Co., 783 F.3d 507 (4th Cir. 2015). **26.** Berryman v. Newalta Envtl. Servs., 2018 U.S. Dist. LEXIS 186789 (W.D. Pa. Nov. 1, 2018). **27.** MegaForce v. Eng, 2019 U.S. Dist. LEXIS 16495 (D. Minn. Feb. 1, 2019). **28.** John E. Murray, Jr. & Timothy Murray, 1 Corbin on Contracts Desk Edition, § 1.01.

Related Content

For a discussion on the drafting of choice-of-law and choice-of-forum clauses in commercial contracts, see

> **CHOICE OF LAW AND CHOICE OF FORUM CLAUSES**

RESEARCH PATH: *Commercial Transactions > General Commercial and Contract Boilerplate > Contract Boilerplate and Clauses > Practice Notes*

For choice-of-law clauses for commercial contracts that provide for the governing law to be used to interpret an agreement, see

> **CHOICE OF LAW CLAUSES**

RESEARCH PATH: *Commercial Transactions > General Commercial and Contract Boilerplate > Contract Boilerplate and Clauses > Clauses*

For drafting tips and guidance to assist counsel in properly addressing choice-of-law issues in their clients' agreements, see

> **CONFLICT OF LAWS IN UNIFORM COMMERCIAL CODE AND RESTATEMENT OF CONFLICT OF LAWS CONTRACTS**

RESEARCH PATH: *Commercial Transactions > General Commercial and Contract Boilerplate > Contract Boilerplate and Clauses > Practice Notes*

For choice-of-forum clauses that can be used in a commercial contract to determine the court and location where a dispute will be resolved see

> **CHOICE OF FORUM CLAUSES**

RESEARCH PATH: *Commercial Transactions > General Commercial and Contract Boilerplate > Contract Boilerplate and Clauses > Clauses*

But in some situations, the CISG might be preferable to the UCC. For example, in a battle-of-the-forms scenario, the CISG is probably preferable for sellers in most cases.[29]

The parties to a contract cannot opt out of the CISG merely by relying on a garden-variety choice-of-law provision. "[A] number of American courts have held that simply selecting a particular forum's laws is not enough to opt out of the CISG when the CISG is itself part of the laws of that forum."[30] For example, if the parties

to a contract under the CISG provided that the contract would be governed and construed according to the laws of the state of New York, that alone is not enough to opt out of the CISG because the CISG, itself, is part of the law of New York. To opt out of the CISG via a choice-of-law provision, the provision must expressly state that the parties exclude the application of the CISG.

Putting It All Together

This short article has just scratched the surface—by necessity, much has been left out. The law in this area is complex, even chaotic, and the rules change from jurisdiction to jurisdiction. In drafting a choice-of-law provision, it will be necessary to consult the judicial decisions in the states that might be applicable. The draft provision below is merely to help you get started—drafting-by-formbook alone is never a good idea. The language below contains the principles discussed above, and it is designed for one party—and it is not even a party to the contract—it is designed for a judge who might be called upon to decide what it means.

29. Timothy Murray, 1 Corbin on Contracts § 3.37. **30.** Orica Austl. Pty. Ltd. v. Aston Evaporative Servs., LLC, 2015 U.S. Dist. LEXIS 98248, *9 (D. Colo. July 28, 2015). *See* Metso Minerals Indus. v. JTL Mach., Ltd., 2016 U.S. Dist. LEXIS 9113 (M.D. Pa. Jan. 27, 2016); It's Intoxicating, Inc. v. Maritim Hotelgesellschaft mbH, 2013 U.S. Dist. LEXIS 107149 (M.D. Pa. July 31, 2013); Topp Paper Co. v. ETI Converting Equip., 2013 U.S. Dist. LEXIS 193161 (S.D. Fla. May 6, 2013).

Related Content

For practice tips to use when drafting or reviewing a commercial contract, see

> **COMMERCIAL CONTRACT DRAFTING AND REVIEW**

RESEARCH PATH: *Commercial Transactions > General Commercial and Contract Boilerplate > Contract Boilerplate and Clauses > Practice Notes*

For an outline of what counsel should consider when drafting or reviewing a commercial contract, see

> **COMMERCIAL CONTRACT DRAFTING AND REVIEW CHECKLIST**

RESEARCH PATH: *Commercial Transactions > General Commercial and Contract Boilerplate > Contract Boilerplate and Clauses > Checklists*

For practical guidance to assist counsel in drafting and interpreting standard contractual and boilerplate clauses commonly used in commercial contracts, see

> **GENERAL COMMERCIAL CONTRACT CLAUSE RESOURCE KIT**

RESEARCH PATH: *Commercial Transactions > General Commercial and Contract Boilerplate > Contract Boilerplate and Clauses > Practice Notes*

For information on the common issues and potential problems, including choice-of-law conundrums, to consider when drafting a sale of goods agreement, see

> **SALE OF GOODS AGREEMENTS: AVOIDING COMMON PITFALLS**

RESEARCH PATH: *Commercial Transactions > Supply of Goods and Services > Contract Formation, Breach, and Remedies under the UCC > Practice Notes*

The draft language is a broad choice-of-law provision designed to include within its scope all claims, contractual and extra-contractual, between the parties. It seeks to have essentially the entirety of the parties' relationship governed by Pennsylvania law, including Pennsylvania's statute of limitations. If the parties have other dealings governed by other choice-of-law provisions, this language is too broad—it will have to be tailored to ensure that the present provision doesn't override the others. The clause does not incorporate Pennsylvania's arbitration laws to override the FAA—any decision to do that would be unusual, and would need to be made by weighing the merits of the federal and state laws, a matter that is beyond the scope of this short article. The provision makes clear that it does not include Pennsylvania's conflict-of-laws rules. The

reference to CISG at the end would only be necessary if the contract possibly involved the sale of goods and if the parties wanted the UCC, not the CISG, to apply.

The draft language:

> This agreement and all matters arising out of or relating to this agreement, and all claims, causes of action, controversies, or matters in dispute between the parties to this agreement—whether sounding in contract, tort, statute, regulation, or otherwise, and including but not limited to those arising out of or relating to this agreement—shall be governed by, construed, interpreted, and enforced in accordance with the substantive and procedural laws of the Commonwealth of Pennsylvania, including its statutes of limitations, without giving effect to any choice of law or conflict of laws rules or provisions, whether of the Commonwealth of Pennsylvania or any other jurisdiction, that would cause the application of the laws of any jurisdiction other than the Commonwealth of Pennsylvania. The parties exclude application of the United Nations Convention on Contracts for the International Sale of Goods. L

***Timothy Murray**, a partner in the Pittsburgh, PA law firm Murray, Hogue & Lannis, writes the biannual supplements to Corbin on Contracts, is author of* **Volume 1, Corbin on Contracts** *(rev. ed. 2018), and is co-author of the* **Corbin on Contracts Desk Edition** *(2019).*

RESEARCH PATH: *Commercial Transactions > General Commercial and Contract Boilerplate > Contract Boilerplate and Clauses > Articles*

Anna Pinedo, Brian Hirshberg, and Raffi Garnighian MAYER BROWN LLP

Negotiating an **Underwriting Agreement**

In connection with a registered securities offering, the underwriters of the offering typically enter into an underwriting agreement with the issuer of the securities and any selling stockholders.

THE UNDERWRITING AGREEMENT SETS FORTH THE TERMS and conditions pursuant to which the underwriters will purchase the offered securities and distribute them to the public. Both the issuer's and underwriters' legal counsel play critical roles in negotiating key provisions of the underwriting agreement that have significant effects on the offering. Below are 10 practice tips to consider in drafting and negotiating an underwriting agreement.

Form of Underwriting Agreement

The lead underwriter's counsel is expected to provide the initial draft of the underwriting agreement. A good starting point would be the form underwriting agreement of the lead underwriter, which will contain the representations, warranties, and covenants generally sought by the underwriter. The form can then be tailored to address the specific facts and circumstances and can be negotiated with the issuer's counsel, which may request carve-outs, changes to the language of specific representations or warranties, or changes to key definitions. In adapting a lead underwriter's form underwriting agreement, consider whether the offering relates to securities of a domestic or a foreign issuer, whether the offering will involve selling stockholders, and whether the offering is the issuer's initial public offering or a follow-on offering. For a follow-on offering, it is often instructive to review the underwriting agreements the issuer entered into for the prior offerings. The issuer's counsel ought to review current precedent by examining the underwriting agreements entered into in other recent offerings in the same industry led by the

same underwriter in order to gauge the willingness of the lead underwriter and its counsel to accede to requests for changes to the underwriting agreement.

Tailored Representations and Warranties

During the drafting process, both the underwriters' and issuer's counsel should focus on tailoring the representations and warranties to the current market precedent based on recent offerings in the issuer's industry. The representations and warranties provide both parties an opportunity to focus on and resolve any open diligence issues, and industry-tailoring can help both parties identify the protections or issues that are most important to them given the issuer's line of business,

> When drafting an underwriting agreement, underwriters will require the issuer to make representations about the state of its business and the marketability of its securities.

regulatory considerations, and market precedents. Both parties also should consider the type of offering, which may range from a new issuer's initial public offering of common stock to a seasoned issuer's follow-on offering of debt, equity, or equity-linked securities, when tailoring representations and warranties in order to ensure that they address issues that relate to the particular offering.

Definition of Material Adverse Change

An underwriting agreement should define an event that triggers a material adverse change (MAC) or material adverse effect (MAE). Depending on how these terms are defined, a breach in a representation or warranty may result in a MAC or MAE in the issuer's business and results of operations and therefore allow the underwriters the opportunity to exit the transaction, because the occurrence of the MAC or MAE resulted in it being impracticable or inadvisable to pursue the offering (commonly referred to as a market-out). The underwriter will want to draft the MAC or MAE provision as broadly as possible in order to allow the most flexibility to exit the deal if a representation or warranty is breached. Form underwriting agreements may also include forward-looking language that defines a MAC or MAE as a material change in the issuer's prospects, granting the underwriters additional flexibility if a breach occurs that may not be material at present but could potentially lead to material adverse effects in the future. The issuer may insist on narrowing the definitions of MAC and MAE so as to not give the underwriters the freedom to walk away from the transaction, and they may seek to minimize or remove any language that provides the underwriters full discretion to determine on their own whether a particular event has risen to the level of a MAC or MAE. The issuer also may seek to strike any forward-looking language to prevent the underwriters from exiting a transaction upon the occurrence of a nonmaterial breach.

Knowledge Qualifiers

When drafting an underwriting agreement, underwriters will require the issuer to make representations about the state of its business and the marketability of its securities. In respect of certain issuer representations and warranties that relate to assets or disputes as to which diligence may be costly or where there may be some difficulty associated with accessing information related to third parties, there is often negotiation as to whether these representations will be given without qualification or whether a particular representation should be given subject to a knowledge qualifier. An issuer will want to limit any representations about itself and its business to what it knows or reasonably should know in order to avoid an unanticipated breach. The underwriter, however, will seek to limit the knowledge qualifiers included in the underwriting agreement as much as possible, because the issuer is in the best position to provide accurate information about its business. If a knowledge qualifier is included, legal counsel for the underwriters should consider adding a due inquiry provision to provide support.

FCPA, OFAC, and AML Representations

In the underwriting agreement, the issuer is often expected to make representations relating to its compliance with the Foreign Corrupt Practices Act of 1977 (FCPA), the sanctions administered by the Office of Foreign Assets Control (OFAC) of the U.S. Department of the Treasury, and anti-money laundering (AML) laws. Underwriters have typically placed increased importance on these compliance representations because of recent increases in enforcement activity by federal authorities and severe civil and criminal penalties that result from violations. The underwriters therefore should focus on maintaining the standard FCPA, OFAC, and AML representations in the form underwriting agreement designated by the lead investment bank. Nonetheless, the issuer may want to tailor these representations and warranties to its specific circumstances. A common negotiation point is the scope of the parties subject to the representation. Most form underwriting agreements certify compliance by the issuer, its subsidiaries, and their respective directors, officers, employees, and agents. The issuer may be able to agree on a narrower selection of parties, identifying those parties that the issuer has more direct control over, or oversight of, as it may be costly or impractical to locate every one of its agents. Additionally, the issuer may be able to add a knowledge qualifier to a representation or warranty that certifies compliance of one or more parties over which it does not have direct control.

Underwriter Information Carve-out

When drafting the underwriting agreement, the underwriters will typically provide a short list of information that it is providing to the issuer that will be included in the prospectus. This information is typically limited to the underwriters' contact details and intended distribution and stabilization methods. The underwriters often agree to indemnify the issuer for any claims arising from the use of some or all of the information on the list. The underwriters will want to identify a very limited list of the information it provides the issuer, either prepared by the underwriters or third parties selected by them, in order to define clearly the scope of the indemnity. Because this information will be used for the prospectus and any road show presentations, the issuer will want to draft the information carve-out as broadly as possible in order to protect itself from claims caused by misinformation or misstatements made by the underwriter.

Indemnification and Termination

Underwriters' counsel typically insists on few to no changes being made to the indemnification and termination sections from the language included in the representative underwriter's form underwriting agreement. Underwriters want as much flexibility as possible in order to exit the transaction in the event of a termination and as much protection as possible in the event of litigation. Beyond negotiating the definitions of MAE or MAC as described above, which would by consequence limit the scope of the termination provision in the underwriting agreement and what situations indemnification would trigger, the issuer and their counsel are unlikely to convince the underwriters to make any substantive changes to these sections and thereby create a narrower public market precedent. Notwithstanding the issuer's inability to materially amend the form indemnity section, the issuer and their counsel should insist that the indemnity provided by the underwriters to the issuer, as described above, uses the same protective language as the indemnity provided by the issuer to the underwriters.

Issuer Lockup

During and following the transaction, the underwriters will want to prevent the issuer from issuing, and its directors and senior executives from selling, any securities that could negatively affect the pricing of the securities in the offering. A large issuance of the issuer's shares could dramatically decrease the demand, and thus the price, of the securities to be offered in the transaction or cause investors to become more skeptical about the potential risk of investing in the securities to be offered by the underwriter. The underwriters will seek to obtain lock-up agreements from all or substantially all existing security holders for a period of 180 days. The issuer should seek carve-outs that will prevent the lockup from interfering with existing agreements. These include, but are not limited to, carve-outs for already planned issuances or transfers of securities, ordinary course lending or capital markets activities, and issuances for employees under existing agreements or to attract or retain key talent.

Offering Expenses

The issuer is expected to pay for or reimburse the underwriters for any offering-related expenses. The issuer is also expected to reimburse the underwriters for counsel expenses relating to the Financial Industry Regulatory Authority (FINRA) review. The issuer typically includes a limitation on the amount reimbursable for underwriter counsel fees in connection with the FINRA review. The underwriting agreement may also include a provision requiring the underwriters to reimburse the issuer for certain offering expenses if the underwriters breach the underwriting agreement. For example, an issuer may request reimbursement if the underwriters fail to market the securities in a manner consistent with the underwriting agreement. Notwithstanding the limited reimbursement obligation, the underwriters are expected to pay for their own counsel.

Related Content

For more practice tips on lock-up agreements, see

> **TOP 10 PRACTICE TIPS: LOCK-UP AGREEMENTS**

RESEARCH PATH: *Capital Markets & Corporate Governance > IPOs > Conducting an IPO > Practice Notes*

For practical guidance on due diligence planning, see

> **DUE DILIGENCE PLANNING CHECKLIST**

RESEARCH PATH: *Capital Markets & Corporate Governance > Private Offerings > Private Placements > Checklists*

For a sample underwriters agreement form, see

> **AGREEMENT AMONG UNDERWRITERS (IPO)**

RESEARCH PATH: *Capital Markets & Corporate Governance > IPOs > Conducting an IPO > Forms*

For a discussion of managing the due diligence process, see

> **DUE DILIGENCE: MANAGING THE PROCESS FOR AN IPO**

RESEARCH PATH: *Capital Markets & Corporate Governance > IPOs > Conducting an IPO > Practice Notes*

Deliverables

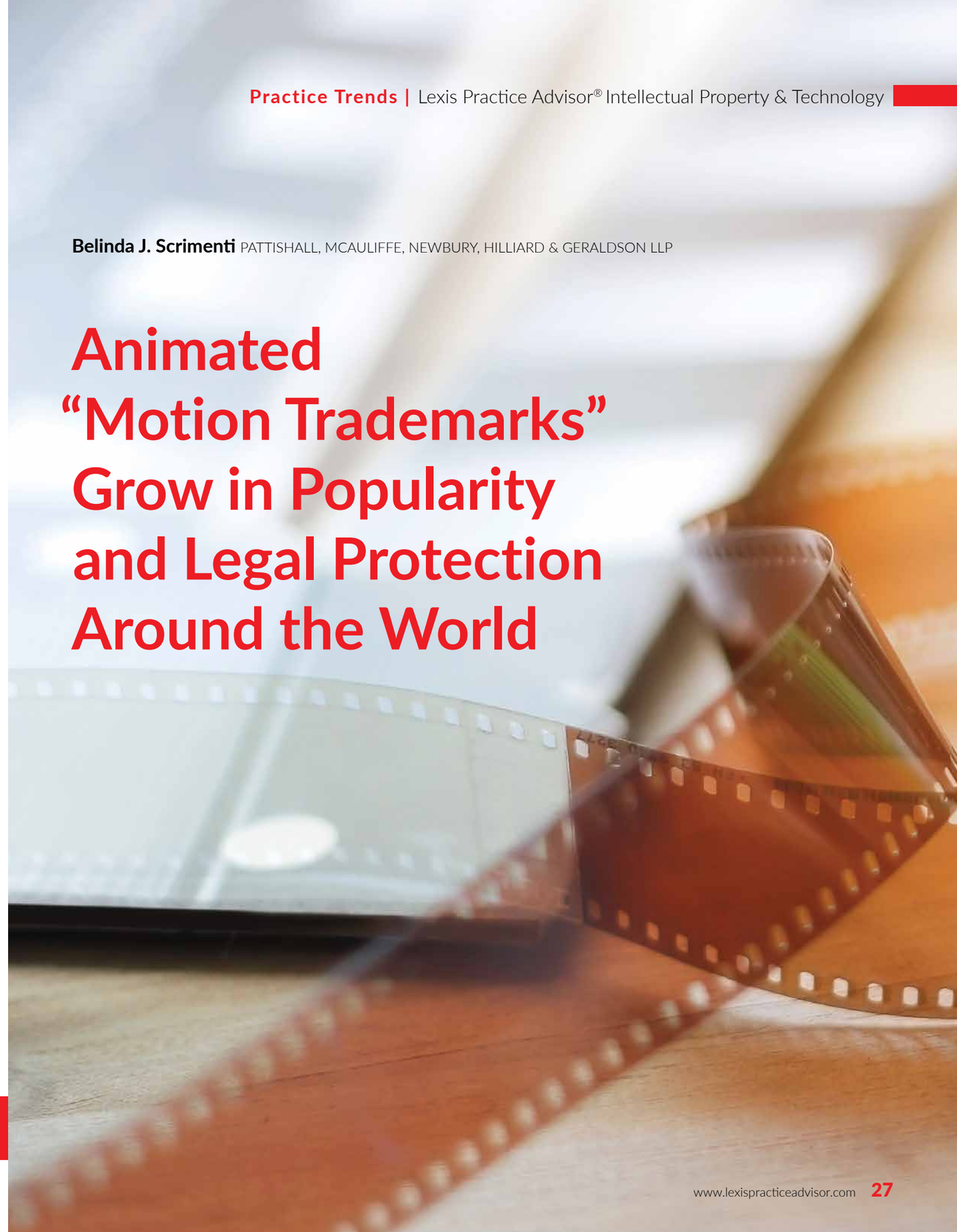
The underwriting agreement will specify the documents that are required to be delivered to the underwriters as a condition to completing the offering. Deliverables include legal opinions to be delivered by each party's counsel, officers' and secretary's certificates, good standing certificates, and a comfort letter from the issuer's independent auditor. Both counsels should also deliver negative assurance letters to the underwriters that confirm that no material misstatements or omissions were included in the prospectus. This letter allows either party to establish a due diligence defense against claims that missing or misstated material information has misled investors. The comfort letter delivered by the issuer's auditor provides certain assurances regarding the independence of the auditors, their completion of an audit for the annual financial statements, their completion of a review for interim financial statements, the conformity of the issuer's financial statements to U.S. GAAP or the International Financial Reporting Standards, as well as certain agreed-upon procedures in relation to other financial information contained in the offering documents and derived from the financial statements. Depending on the nature of the issuer's business and the laws and regulations applicable to their business, underwriters' counsel should also seek additional specialist opinions from counsel to the issuer, such as tax matters, regulatory matters, or intellectual property matters. Due to the short period between signing and closing (typically two business days), the underwriters' and issuer's counsel should negotiate as far in advance as possible the scope of all legal opinions. L

Anna Pinedo *is a partner in Mayer Brown's New York office and a member of the Corporate & Securities practice. She concentrates her practice on securities and derivatives. Anna represents issuers, investment banks/financial intermediaries, and investors in financing transactions, including public offerings and private placements of equity and debt securities, as well as structured notes and other hybrid and structured products. She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including technology, telecommunications, healthcare, financial institutions, REITs, and consumer finance. Anna has worked closely with foreign private issuers in their securities offerings in the United States and in the Euro markets. She also works with financial institutions in connection with international offerings of equity and debt securities, equity- and credit-linked notes, and hybrid and structured products, as well as medium term note and other continuous offering programs.* ***Brian Hirshberg*** *is counsel in Mayer Brown's New York office and a member of the Capital Markets practice. He focuses on representing issuer, sponsor, and investment bank clients in registered and unregistered securities offerings. He has led a variety of transactions, including public equity and debt offerings; Rule 144A offerings; tender and exchange offerings; preferred stock offerings; and debt offerings for companies in various industries, including specialty finance, real estate and real estate investment trusts, business development, life science, healthcare, and aviation. Additionally, he assists public company clients with ongoing securities law compliance requirements, including stock exchange obligations, shareholder-related disputes, and corporate governance matters. Associate* ***Raffi Garnighian*** *also assisted with this article.*

RESEARCH PATH: *Capital Markets & Corporate Governance > IPOs > Conducting an IPO > Practice Notes*

Belinda J. Scrimenti PATTISHALL, MCAULIFFE, NEWBURY, HILLIARD & GERALDSON LLP

Animated "Motion Trademarks" Grow in Popularity and Legal Protection Around the World



Digital technology has led to innovative advertising and marketing. Brand owners are increasingly using the technology to create and protect new forms of trademarks, consisting of motion, holograms, and other multimedia features.

WHILE U.S. TRADEMARK LAW HAS PROTECTED THESE types of marks for many years, much of the international trademark community had trailed behind. But that is changing as modernized intellectual property laws now allow trademark holders in much of Europe, Asia, and North America to embrace and protect the motion mark movement.

The United States Led the Way in Multimedia Marks

Now one of the oldest motion marks still on the U.S. trademark register, Columbia Pictures registered in 1996 its iconic multimedia logo featuring a woman carrying a torch and wearing a drape, known as "Columbia, a personification of the United States."[1]

In 2003, the author registered on the U.S. Register a mark unique in format—covering live motion—for the famous March of the Ducks held twice daily at the Peabody Hotel in Memphis.[2] The March has delighted hotel guests and fans for over 80 years. The registration covers actions of the "Duckmaster" rolling out a red carpet and five trained ducks marching down the carpet, up steps, and into the ornate hotel fountain. The ducks swim all day in the fountain and then march back at night.

Motion mark registrations in the United States span many formats. Many consist of animated computer sequences and short videos, ranging from an animated Microsoft Windows® logo,[3] to the United Airlines "Big Metal Bird®,"[4] the opening Lamborghini wing door,[5] and the launching of the Quicken Loans' Rocket Mortgage rocket.[6]

A U.S. applicant must describe the motion mark and provide a drawing that either shows a single point in the movement or "up to five freeze frames showing various points in the movement." The specimen must show the "entire repetitive motion in order to depict the commercial impression conveyed by the mark (e.g., a video clip, a series of still photos, or a series of screen shots)."[7]

International Modernized Laws Permit Multimedia Mark Registrations

The European Union Intellectual Property Office (EUIPO) updated its regulations in October 2017 to permit easier registration of non-traditional marks, by eliminating the requirement of a mark's "graphical representation." In 2019, most EU countries harmonized their laws with the EUIPO directive. Now, a mark needs only to be represented in a manner "which enables the competent authorities and the public to determine the clear and precise subject matter of the protection."[8] The representation must be "self-contained, easily accessible, intelligible, durable and objective." The motion mark must be represented by either a video file or a series of still sequential images showing the movements or position changes.

Prior to the new regulations, as in the United States, Microsoft had successfully registered a motion mark for its logo sequence.[9] Exemplary EUIPO registrations under the new directive include a mark owned by a Danish pump manufacturer, Grundfos Holding A/S, featuring an animated logo,[10] and Google's registered hologram of its iconic "G."[11]

After the U.K.'s January 2019 amendments brought the U.K. in line with the EUIPO,[12] Toshiba registered the first U.K. motion mark, featuring origami-style folding colored triangles.[13] St. Modwen Properties PLC, a real estate developer, also registered a complex animation of its swan logo followed by the motion of drawing of an urban skyline.[14]

Germany implemented the EU directive in January 2019, and the French government published February 2019 amendments to conform with the directive[15] that are expected to come into force soon.

European counsel caution that there is little legal certainty regarding such non-traditional marks. Many are likely to be refused as non-distinctive, and proving acquired distinctiveness is difficult and held to strict standards. Appeals have had limited success. However, a Turkish applicant was partially successful on appeal to the EUIPO Board of Appeal (Board) in registering a video of a chef "salting meat" in an unusual (and allegedly distinctive) movement. The Board ruled the mark lacked distinctiveness for food-providing services but allowed registration for goods and other Class 43 services.[16]

Some Asian jurisdictions have also been forerunners in protecting motion marks. Korea requires proof of acquired distinctiveness, typically through extensive evidence of use in Korea over a long period. Nevertheless, motion marks and holograms were registered

1. U.S. Reg. No. 1,975,999. A video of the mark is viewed at http://bit.ly/2IZJbdm. 2. U.S. Reg. No. 2,710,415. A video of the mark is viewed at http://bit.ly/2krMlpF. 3. U.S. Reg. No. 3,926,321 (now cancelled). 4. U.S. Reg. No. 5,187,557. A video incorporating the animated bird logo is viewed at http://bit.ly/2mlhZFV. 5. U.S. Reg. No. 2,793,439. 6. U.S. Reg. No. 5,040,974. A video of the mark is viewed at http://bit.ly/2lXqqqR. 7. 37 C.F.R. §2.52(b)(3). *See* 8 Trademark Manual of Examining Procedure § 807.11; 8 Trademark Manual of Examining Procedure § 904.03(1). 8. Article 4 of EUTM Regulation (Regulation No. 2017/1001). 9. EUIPO Reg. No. 008553133. 10. EUIPO Reg. No. 018020711. A video of the mark is viewed at http://bit.ly/2lXqFSN. 11. EUIPO Reg. No. 017993401; Also registered in the UK, Reg. No. UK00003375918. A video of the mark is viewed at http://bit.ly/2kxtWYM. 12. Section 1(1) of the UK Trade Mark Act 1994 (as amended). 13. UK Reg. No. UK00003375593. A video of the mark is viewed at http://bit.ly/2lYu2cj. 14. UK Reg. No. UK00003395854. A video of the mark is viewed at http://bit.ly/2krN6z1. 15. Article L.711-1 of the French Intellectual Property Code. 16. D Et Ve Et Ürünleri Gida Pazarlama Ticaret Anonim Sirketi, EUIPO Board of Appeal, Case R 2661/2017-5 (June 8, 2018).

> ...protection for motion marks is far from universally accepted. Progress is slow in much of Latin America and several Asian countries, where many non-traditional marks are still prohibited.

there years ago, including Sony's nearly decade-old animated "Make Believe" logo[17] and a Korean product certification hologram.[18]

Since 2015, Japan has permitted registration of "dynamic design" marks, as long as distinctiveness is proven. Numerous motion marks have since registered, including United's "Big Metal Bird" mark, based on an International Registration under the Madrid System.[19]

Canada's and Mexico's recently amended trademark laws now officially allow such registrations. Canada's new law, effective June 17, 2019,[20] specifically authorizes "moving image" marks and an array of other non-traditional marks. Even before implementation, the Canadian Trademark Office granted a very few moving image registrations, including the famed James Bond gun barrel sequence.[21]

A Canadian application must include an electronic representation of the trademark in the form of a moving image (animation) clip that shows the full range of the moving image and must include "a clear and concise description of the whole visual effect of the animation from start to end."[22] However, Canadian counsel warn that allowance will require extensive evidentiary proof of acquired distinctiveness in Canada as of the date of filing, probably three to five years of use across Canada, and possibly even survey evidence.

Mexico's new 2018 law deleted the bar against registering "animated or changing shapes." The law now recognizes that a registrable mark requires only that the "sign" (the term for a not-yet registered mark) need only be "perceptible to the senses and susceptible to representation in a manner that clearly and precisely allows the subject matter of protection to be determined."[23] Draft regulations are still pending, and further legislative amendments are possible.

Nevertheless, protection for motion marks is far from universally accepted. Progress is slow in much of Latin America and several Asian countries, where many non-traditional marks are still prohibited. But the most glaring exception to protection is China, where such marks are still expressly barred from registration. Until that changes, workarounds include copyright protection of works analogous to films, and filing for a series of trademarks reflecting static images of steps in a mark's animation.

17. Korea Reg. No. 45-0033542. In Korea, the registration certificates bear a series of images reflecting the animation. 18. Korea Reg. No. 41-0354050. 19. International Register, Reg. No. 1290466. 20. Section 30(2)(c) and (d) of the Trademarks Act and paragraph 31(e) of the Regulations. 21. Canada Reg. No. TMA980395. *See also* Reg. No. TMA969658 (United "Big Metal Bird" motion mark). 22. *See* June 17, 2019 Practice Notice for Non-Traditional Trademarks. 23. Mexico Industrial Property Law, Articles 88-89.

Overall, the good news is that global trademark laws are making progress in keeping up with the realities and demands of advertising and marketing. Animated motion marks—once somewhat rare—are becoming more important and valuable to brand owners. The current trend shows they are also becoming more protectable under the trademark laws. So brand owners should be bold in adopting and registering these creative new types of trade identifiers.

Ms. Scrimenti thanks her foreign colleagues for their assistance with updates on their respective jurisdictions: Canada – Marijo Coates, Deeth Williams Wall LLP; China – Spring Chang and Laura Li, Chang Tsi & Partners; France and EU – Pascal Lefort, Duclos, Thorne, Mollet-Viéville & Associés; Germany and EU – Claus Eckhartt and Christine Fluhme, Bardehle Pagenberg; Korea – Young-June (Jay) Yang, Alex Hyon Cho, and Hyun-Joo Hong, Kim & Chang; Mexico – John Murphy, Arochi & Lindner; and United Kingdom – Edmund Harrison, Mewburn Ellis. Other information is sourced from International Trademark Association Non-Traditional Marks Committee summaries and data.

Belinda J. Scrimenti *is a partner with Pattishall, McAuliffe, Newbury, Hilliard & Geraldson LLP. She has over 30 years of experience practicing in trademark, copyright, unfair competition, and trade dress law counseling; domestic and international trademark prosecution; and litigation in all these areas. Her national litigation experience has encompassed cases in these areas in more than 40 federal court districts and divisions and before the Trademark Trial and Appeal Board. She also has unique experience in counseling on and protecting internationally non-traditional marks, such as single-color, sound, and motion marks. She has been recognized by the World Trademark Review in its WTR 1000 list of top-ranked trademark attorneys internationally and selected repeatedly by "Super Lawyers" for Intellectual Property Litigation and by "Who's Who Legal: Trademarks" as a leading trademark lawyer. She has written and spoken frequently on trademark and related topics. She is admitted to practice in the District of Columbia, Virginia, Illinois, and Ohio, as well as numerous federal courts. She currently is Co-Chair of the Steering Committee of the D.C. Bar's Intellectual Property Community.*

Related Content

For an overview of key trademark law principles, see

> **TRADEMARK FUNDAMENTALS**

RESEARCH PATH: *Intellectual Property & Technology > Trademarks > Trademark Counseling & Transactions > Practice Notes*

For more information on trademark protection of images and characters, see

> **MARKETING IMAGES, CHARACTERS, AND SLOGANS: COPYRIGHT VS. TRADEMARK PROTECTION**

RESEARCH PATH: *Intellectual Property & Technology > Trademarks > Trademark Counseling & Transactions > Practice Notes*

For an extensive list of international guides addressing essential aspects of trademark law and policy, see

> **TRADEMARKS IN INTERNATIONAL JURISDICTIONS**

RESEARCH PATH: *Intellectual Property & Technology > Trademarks > International Trademark Considerations > Practice Notes*

For a discussion on the absolute and relative grounds for refusal that may bar the registration of a United Kingdom or European Union trademark, see

> **ABSOLUTE AND RELATIVE GROUNDS FOR REFUSAL TO REGISTER A TRADEMARK (UK AND EU)**

RESEARCH PATH: *Intellectual Property & Technology > Trademarks > International Trademark Considerations > Practice Notes*

For a detailed analysis on trademark protection of nontraditional trademarks such as motion trademarks, see

> **NONTRADITIONAL TRADEMARKS: BEYOND WORDS AND LOGOS, 1 GILSON ON TRADEMARKS § 2.11**

RESEARCH PATH: *Intellectual Property & Technology > Trademarks > Trademark Counseling & Transactions > Secondary Materials*

RESEARCH PATH: ***Intellectual Property & Technology > Trademarks > International Trademark Considerations > Articles***

Parker Moore and Katrina Krebs BEVERIDGE & DIAMOND PC

Guidance for Real Estate Developers on Complying with the Endangered Species Act

This article provides an overview of the Endangered Species Act (ESA)[1] and discusses the obligations of real estate developers and property owners with respect to the ESA.

CONGRESS ENACTED THE ESA IN 1973 TO PROTECT AND recover imperiled species and their habitats. The U.S. Fish & Wildlife Service (FWS) and the National Marine Fisheries Service (NMFS) (collectively, the Services) together administer the ESA. The FWS has jurisdiction over terrestrial and freshwater species, whereas the NMFS has jurisdiction over marine wildlife and anadromous fish (fish that live the majority of their life in the sea but for spawning in freshwater). More than 1,600 species are currently listed as endangered or threatened under the ESA in the United States.

The presence of an endangered or threatened species on private or public land that overlaps with real estate development may impose certain duties, such as avoiding unauthorized take and, in the case of federal agencies, requiring consultation with the FWS or NMFS before issuing a federal permit or other authorization that may affect those species. The ESA broadly defines take to include a broad range of actions, such as to harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect an endangered wildlife species, or any attempt to engage in such conduct.[2] As violation of the ESA's prohibition on unauthorized take can lead to civil and criminal penalties if unauthorized take occurs, property owners and developers should follow the necessary steps to ensure ESA compliance early in the real estate development planning stages. Real estate developers must also understand the requirements imposed by the Migratory Bird Treaty Act, the Bald and Golden Eagle Protection Act, the Lacey Act, and other federal laws, as well as state species protection laws, though these are beyond the scope of this article.

Listing Species and Designating Critical Habitat

A species, subspecies, or distinct population segment of a species may be listed as endangered or threatened under Section 4 of the ESA upon petition or by voluntary review by the Services. Endangered species are those that the FWS or NMFS determines to be in danger of extinction throughout all or a significant portion of their range. In comparison, threatened species are those that are likely to become endangered in the foreseeable future—meaning so long as the Services can reasonably determine that the future threats and species' responses are likely (i.e., not simply speculative).

Species Listing Process

Individuals or organizations may initiate the species listing process by submitting a petition to the FWS or NMFS explaining why they believe a particular species should be classified as threatened or endangered. The agency then must determine within 90 days, to the extent practicable, whether there is substantial information indicating that listing the species may be warranted. If it makes an affirmative 90-day finding, the FWS or NMFS then must complete a Species Status Assessment within 12 months, evaluating whether listing the species is (1) warranted, (2) warranted but precluded as other species are of higher listing priority, or (3) not warranted (known as a 12-month finding). In practice, however, the Services often miss these deadlines, resulting in legal challenges from the petitioning party.

If the FWS or NMSF determines that listing is warranted, it must publish a proposed rule to list the species in the Federal Register and solicit public comment for 60 days. Real estate owners and other stakeholders may wish to comment on the proposed rule if the species occurs within their property, they believe the species may be affected by their activities, or they believe the proposed listing is not appropriate or should be downgraded (i.e., from endangered to threatened). The Services analyze all public comments and publish a final rule in the Federal Register listing the species, assuming they still believe listing is warranted. The listing will take effect no sooner than 30 days after publication.

If the agency determines that listing the species is warranted but precluded, the species becomes a candidate for future listing. Candidate species are not protected under the ESA but are subject to special review requirements under Section 7 of the ESA. The Services must annually reassess a candidate species' status to determine whether its listing priority should change.

The Services follow a similar procedure when voluntarily choosing to list a species or when delisting or changing a species' listing status.

Species Listing Criteria

The Services determine whether listing a species as threatened or endangered is warranted based on the following factors:

- The present or threatened destruction, modification, or curtailment of the species' habitat or range
- Overutilization for commercial, recreational, scientific, or educational purposes
- Disease or predation
- The inadequacy of existing regulatory mechanisms
- Other natural or man-made factors affecting the species' continued existence

1. 16 U.S.C.S. § 1531 et seq. 2. 16 U.S.C.S. § 1532(19).

The Services may not consider economic impacts in deciding whether to list a species, although recent revisions to the Services' ESA regulations provide the agencies with discretion to publish this information in the listing decision for transparency purposes. The listing decision may only be based on the best available science, which initially is compiled in the Species Status Assessment and must be supplemented whenever additional information meeting this standard becomes available. The Species Status Assessment can thus serve as a valuable resource for the regulated community to identify information about a species' current condition, its range and habitat, and the threats to the species.

The ESA directs the Services to review all listings every five years to determine whether the species should be reclassified or delisted based on the factors listed above. Delisting rarely occurs—only about 1% of species have been delisted to date.

Designating Critical Habitat

The ESA directs the Services to designate, to the maximum extent prudent and determinable, critical habitat for listed species, meaning geographic areas essential to the species' conservation. The Services have been unable to keep pace with this obligation, having designated critical habitat for fewer than 900 species to date. Critical habitat, which may include public and private lands, is generally not coextensive with the entire range occupied by the listed species. It instead is limited to:

- Occupied habitat containing physical or biological features essential to the conservation of the species that may require special management considerations or protection
- Unoccupied habitat that the Services determine are essential for the conservation of the species

The ESA regulations, most recently revised in 2019, further restrict areas that may be designated as critical habitat. Unoccupied habitat may only be designated as critical habitat where (1) the designation of all occupied areas as critical habitat is inadequate to ensure the conservation of the species, (2) it is reasonably certain that the unoccupied habitat will contribute to the species' conservation, and (3) it is reasonably certain that the unoccupied area contains physical or biological features essential to the species' conservation.

Unlike the listing process, critical habitat must be based on the best available science, after taking into consideration economic impacts, national security, and other considerations.

Prohibited Acts

Section 9 of the ESA bans the import, export, transport, and sale of endangered fish, wildlife, and plants in interstate and foreign commerce. Public and private individuals and organizations are further prohibited from engaging in the acts described below. Real estate owners and developers must understand these prohibitions because violations can result in civil and criminal liability.

Endangered Fish and Wildlife Prohibitions

The intentional or unintentional take of endangered fish and wildlife species without authorization is prohibited under Section 9 on private and public lands. The ESA broadly defines take as to harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect a species, or to attempt to engage in any such conduct.

Harassment refers only to intentional or negligent acts that create a likelihood of injury to wildlife by annoying it to such an extent as to significantly disrupt normal behavioral patterns. The FWS recently recognized that harassment does not include incidental take that results from otherwise lawful activities. By contrast, harm requires that the individual or organization actually kill or injure wildlife through, for example, significant habitat modification that significantly impairs essential behavioral patterns. Harm can include incidental take, but mere potential to harm a species does not constitute take.

Endangered Plant Prohibitions

The ESA's protection of endangered plants is more limited than that for endangered wildlife because the take prohibition does not extend to plant species. Nevertheless, individuals or organizations may not remove, possess, or maliciously destroy or damage endangered plants on federal land. Furthermore, these parties are prohibited from removing, cutting, digging up, damaging, or destroying endangered plants on private property in knowing violation of any state law or regulation.

Threatened Species Prohibitions

The ESA does not automatically extend these prohibitions to threatened wildlife and plant species. Section 4(d) instead gives the Services the authority to issue regulations necessary and advisable to provide for the conservation of threatened species.

Pursuant to this authority, in 1978, the FWS (but not the NMFS) issued a blanket 4(d) rule extending the take prohibition to all threatened wildlife species unless the FWS promulgated a specific 4(d) rule for a species prescribing different treatment. The FWS revised its ESA regulations in 2019, however, and withdrew the blanket 4(d) rule going forward, restoring the ESA's distinction between endangered and threatened wildlife species in future listing decisions. For newly listed threatened wildlife species, if the FWS determines that a take prohibition or other protection is necessary, it will promulgate a species-specific rule establishing that prohibition or protection. Otherwise, take of a wildlife species newly listed as threatened after September 26, 2019, is not prohibited. Take of previously listed threatened wildlife species still is prohibited by regulation absent FWS authorization or a species-specific 4(d) rule.

Because the NMFS never adopted a blanket 4(d) rule, the FWS's new regulations create more consistent regulation of threatened species between the agencies.

Section 7 Consultation

Section 7 of the ESA requires federal agencies to consult with the FWS or NMFS whenever they carry out, fund, or authorize an action that may affect any threatened or endangered species or cause the destruction or adverse modification of designated critical habitat for any listed species. Section 7 consultation most frequently affects the regulated community when private activities require a federal permit or are planned to occur on federal lands, all of which trigger an obligation for the authorizing federal agency to consult with the FWS or NMFS before the agency may permit the activity if a listed species may be affected. Consultation ensures that federal agency authorization of the activity will not jeopardize the continued existence of the species or result in the destruction or adverse modification of critical habitat.

To determine whether consultation is necessary, real estate owners and developers and the federal action agency first identify any endangered or threatened species or critical habitat in the project area. The FWS's Information for Planning and Conservation (IPaC)[3] database is a helpful resource that can provide general species and critical habitat location information. The IPaC database is not definitive, however, and real estate owners and developers should consider surveying their lands for suitable listed species habitat and/or the species themselves.

If no listed species or critical habitat occurs within the project area and/or the action agency determines that the proposed federal action will have no effect on listed species or critical habitat, Section 7 consultation is not required. The federal action agency does not need to seek the Services' concurrence in making a no-effect determination but may choose to confer with the FWS or NMFS. If, on the other hand, the action agency determines that the proposed federal action may affect a listed species or critical habitat, it must proceed with Section 7 consultation.

Informal Consultation

Federal action agencies engage in informal consultation with the Services to determine whether their proposed actions may affect a listed species or critical habitat. Informal consultation results in the issuance of a biological assessment by the action agency, which identifies potential impacts to endangered or threatened species and critical habitat.

Informal consultation ends if the action agency finds, and the FWS or NMFS concurs, that the agency action (1) will have no effect on any listed species or critical habitat or (2) that it may affect but is not likely to adversely affect, any listed species or critical habitat. Under the revised ESA regulations, the Services have 60 days after receiving a written request from the action agency to concur that the project is not likely to adversely affect listed species or critical habitat.

Property owners and developers may wish to adopt avoidance and minimization measures to ensure that the action agency makes a not-likely-to-adversely-affect finding and, thus, avoids the need for formal consultation. Avoidance and minimization measures are developed by conferring with the involved state and federal agencies and may include timing restrictions and best management practices. For example, for the federally endangered Indiana bat, which roosts in trees during summer, property owners and developers may restrict tree removal to the time of year when bats are not likely to be present, direct temporary lighting away from bat habitat, and use bright colored flagging or fencing to ensure that tree clearing only occurs in the specified areas.

In contrast, if the action agency finds that the project is likely to adversely affect some or all listed species or critical habitat, it must initiate formal consultation with the FWS or NMFS.

Formal Consultation

After receiving the request for formal consultation, the FWS or NMFS initiates consultation once the agency determines that it has a complete initiation package. A complete initiation package includes:

- A description of the proposed action and its duration, timing, and location
- Maps or blueprints
- Information from the action agency or project proponent about the impacts to listed species or critical habitat
- Other relevant information

The FWS or NMFW must then complete consultation within 135 days unless this period is extended by the action agency or, if the extension is for more than 60 days, by the property owner. The Services may seek information, such as data about potential effects to species, from the property owner throughout the consultation process.

3. https://ecos.fws.gov/ipac/.

Formal consultation concludes with the issuance by the FWS or NMFS of a biological opinion, which is based on the best available science and examines the potential impacts of the agency action as compared to the environmental baseline and cumulative effects. The biological opinion determines whether the project will result in jeopardy to endangered or threatened species or the destruction or adverse modification of critical habitat.

Actions that are likely to adversely affect a listed species or critical habitat may proceed so long as they do not result in jeopardy or destruction/adverse modification. In these circumstances, the Services issue an incidental take statement that exempts a specified amount of incidental take (i.e., take that results from but is not the purpose of the project) from the ESA's take prohibition and mandates that the property owner adopt reasonable and prudent measures to minimize species impacts.

While extremely rare, actions that the FWS or NMFS determines will result in jeopardy or adverse modification may not proceed unless one of two requirements is met:

- The Services propose reasonable and prudent alternatives that avoid jeopardy and adverse modification.
- The action agency receives a rarely granted exemption from a committee of federal officials, referred to as the God Squad.

Contents of a Biological Opinion

Potential impacts. The Services were previously required to consider the direct, indirect, interrelated, and interdependent effects of the project on endangered and threatened species and critical habitat. However, the revised ESA regulations issued in 2019 instead specify that the Services must evaluate the consequences of the project that would not occur "but for" the proposed action and that are reasonably certain to occur.

Environmental baseline. The environmental baseline is defined as the condition of the listed species or critical habitat in the action area, without the consequences to the listed species or critical habitat caused by the proposed development. The environmental baseline includes:

- The past and present impacts of federal, state, and private actions and other human activities in the project area
- The anticipated impacts of all proposed federal projects in the project area that have already undergone formal or early Section 7 consultation
- The impact of contemporaneous state or private actions

> Property owners and developers should consider applying for…
> an incidental take permit under Section 10 of the ESA for private activities that do not require federal permits and are reasonably certain to take listed fish and wildlife to ensure that their activities comply with the ESA.

The revised ESA regulations explicitly include the consequences of ongoing agency action or existing agency facilities not within the agency's discretion to modify in the environmental baseline.

Cumulative effects. Cumulative effects are defined differently under the ESA than in other contexts, such as under the National Environmental Policy Act (NEPA). The ESA provides that cumulative effects are the effects of proposed action, together with other state or private (but not federal) activities, which are reasonably certain to occur.

Best available science. The FWS and NMFS must base the analysis in their biological opinions on the best available science, which may include species and habitat surveys, information from previous biological opinions, the Species Status Assessment, and other scientific studies. In some circumstances where the best available science does not adequately allow the Services to predict species impacts, the Services may work with the action agency and project proponents to request development of additional species information, but the action agency does not necessarily have to develop new information to comply with the best available science standard.

Conference reports. Species proposed for listing and proposed critical habitat areas also undergo Section 7 review, though it is not as demanding as the Section 7 consultation process. Specifically, the ESA requires a federal action agency to confer with the FWS or NMFS if a proposed federal action could jeopardize the continued existence of a proposed species or cause destruction or adverse modification of proposed critical habitat. The conference may result in the issuance of a conference opinion containing preliminary findings of no jeopardy or no adverse modification and recommending means of avoiding and minimizing potential adverse impacts. Project owners and developers can benefit from the issuance of a conference report because, if the species is listed or the critical habitat is designated before the project is complete, the FWS or NMFS may adopt the conference opinion as the biological opinion, avoiding the need to reinitiate Section 7 consultation.

Reinitiation of Consultation

The Section 7 consultation requirement does not end once the FWS or NMFS issues the biological opinion and incidental take statement. The action agency must continue to evaluate new information about potential impacts from the federal action for as long as that action continues (e.g., in the case of a federal permit, for as long as the permit remains in effect) and must reinitiate consultation if one of the following conditions is met:

- The amount or extent of taking specified in the incidental take statement is exceeded.
- New information reveals effects of the action that may affect listed species or critical habitat in a manner or to an extent not previously considered.
- The identified action is subsequently modified in a manner or to an extent that causes an effect to the listed species or critical habitat not previously considered in the biological opinion.
- A new species is listed, or critical habitat is designated, that may be affected by the identified action.

Reinitiation of consultation may occur formally or informally, depending on the likelihood of new species or critical habitat impacts, and must be requested by the action agency—though the FWS or NMFS may suggest that the action agency reinitiate consultation.

Irreversible and Irretrievable Commitment of Resources

Section 7(d) limits the project activities that may proceed after the Services initiate or reinitiate consultation. It prohibits federal action agencies and project owners from making any irreversible or irretrievable commitment of resources that has the effect of foreclosing the formulation or implementation of reasonable and prudent measures deemed necessary to avoid jeopardy or adverse modification. Non-jeopardizing activities (i.e., those not expected to cause take) may therefore proceed during the consultation and reinitiated consultation processes.

In some circumstances, the action agency may choose to prepare a Section 7(d) determination that identifies the activities that may proceed during consultation. Oftentimes, an action agency will solicit technical assistance from FWS or NMFS when developing a 7(d) determination. While the Services typically welcome such requests, they generally do not review or approve final Section 7(d) determinations.

Incidental Take Permits and Habitat Conservation Plans

Property owners and developers should consider applying for (but are not required to) an incidental take permit under Section 10 of the ESA for private activities that do not require federal permits and are reasonably certain to take listed fish and wildlife to ensure that their activities comply with the ESA. (An incidental take permit is not necessary for private activities that are reasonably certain to affect listed plant species as the ESA does not prohibit their take.) An incidental take permit, which must be supported by an applicant-prepared habitat conservation plan (HCP), authorizes a specified amount of take to provide the property owner with greater certainty and flexibility.

Incidental take permits further benefit property owners and developers by providing assurances that—in the event that unforeseen circumstances arise—the Services will not require the commitment of additional land, water, or financial compensation or further restrict the use of land, water, or natural resources beyond the level agreed to in the HCP without the property owner's consent. The Services honor these "No Surprises" assurances so long as the project owner implements the terms and conditions of the HCP, incidental take permit, and any other associated documents in good faith.

Habitat Conservation Plans

HCPs are a key component of an application for an incidental take permit and become binding following the issuance of the permit. They are a detailed plan of development that ensure the impacts of the authorized incidental take are adequately minimized and mitigated. Each HCP must address the following:

- The potential effects of the proposed taking
- Monitoring, minimizing, and mitigating impacts, such as through payments into an established conservation fund or enhancement of degraded or former habitat
- Funding the HCP
- Procedures to deal with unforeseen or extraordinary circumstances
- Alternative actions to the taking and an explanation as to why the property owner or developer is not adopting these alternatives
- Other measures that the Services deem necessary or appropriate

HCPs need not be limited to listed fish and wildlife species—they may cover any species regardless of listing status so long as at least one fish or wildlife species is listed as endangered or threatened. Property owners and developers therefore should consider including candidate species or species proposed for listing in HCPs so that they can receive incidental take authorization for those species once the listing takes effect. Property owners and developers must recognize, however, that this approach may require them to implement minimization and mitigation measures that might not be otherwise required.

Property owners and developers are encouraged to engage a consultant and regularly meet with the FWS or NMFS when developing an HCP. Drafting the HCP is an iterative process that involves negotiating its size and scope with the Services.

Approving an Incidental Take Permit Application

The Services must comply with NEPA's requirements before issuing an incidental take permit. HCPs with minor potential impacts to the environment might qualify for a categorical exclusion, meaning further environmental analysis is not required under NEPA. For HCPs with more significant potential effects on resources, the NMFS or FWS (or, to expedite the permit application process, the property owner with oversight by the Services) prepares an environmental assessment or environmental impact statement.

Incidental take permits also are subject to Section 7 of the ESA, meaning that the FWS or NMFS must consult with itself before issuing the permit. The FWS or NMFS issues a biological opinion evaluating the potential impacts of the HCP and determining whether it will result in jeopardy or adverse modification. Based on the Services' long-standing position, property owners and developers may not cover only one listed fish or wildlife species in the HCP and rely on this intra-Service consultation to exempt take of other listed species with an incidental take statement.

The Services provide a 60-day period for public comment on the incidental take permit application and the NEPA analysis. Following this comment period, the Services issue the permit after finding:

- The taking will be incidental to the project.
- Impacts will be minimized and mitigated to the maximum extent practicable.
- Adequate funding exists.
- The taking will not appreciably reduce the survival and recovery of the species.
- Any other necessary measures are met.

The term of the incidental take permit can be of any duration and may be negotiated with the Services. But the agencies typically have a preference for permits of 10 years or less because they offer the greatest level of certainty of species impacts.

Candidate Conservation Agreements with Assurances and Safe Harbor Agreements

Landowners may be reluctant to improve habitats for listed or candidate species or take other actions that would encourage such species to inhabit their property and potentially limit the activities that can lawfully be conducted there. Candidate conservation agreements with assurances (CCAAs) and safe harbor agreements,

however, encourage property owners to take beneficial actions for these species while providing assurance that they will not be subject to additional restrictions due to their voluntary conservation actions. Participating in a CCAA or a safe harbor agreement can therefore offer a net benefit to species and provide greater certainty in the project development process.

Candidate Conservation Agreement with Assurances

Property owners may participate in a CCAA when their property includes a candidate species, a species proposed for listing, or an at-risk species that may become a candidate in the near future in order to address concerns about the potential regulatory implications of listed species presence. By agreeing to a CCAA, landowners can obtain an enhancement of survival permit that provides that, if they implement the proactive conservation measures, they will not be subject to restrictions beyond those in the CCAA without their consent if the species becomes listed as endangered or threatened in the future. Examples of beneficial activities include restoring or enhancing habitat, expanding habitat connectivity, and controlling invasive plants or wildlife.

A CCAA may cover one or multiple species and need only address threats that property owners can control on their property. A CCAA may be developed in coordination with the Services in six to nine months or longer depending on its complexity.

Safe Harbor Agreement

Safe harbor agreements are voluntary agreements between the Services and property owners whose actions contribute to the recovery of a species already listed as endangered or threatened. In exchange for fulfilling the requirements of the safe harbor agreement by implementing actions (similar to those implemented under a CCAA) that aid in the recovery of the listed species, the property owner receives formal assurances through an enhancement of survival permit that the Services will not require additional management activities without the property owner's consent. The enhancement of survival permit also authorizes incidental take of a species that may result from the conservation actions undertaken by the property owner under the safe harbor agreement.

As with CCAAs, a safe harbor agreement may be developed in coordination with the Services in six to nine months or longer depending on the complexity of the agreement.

Civil and Criminal Enforcement

Property owners and developers must understand the potential impacts of their activities on listed species as an unauthorized take of a listed fish or wildlife species may be subject to civil or criminal liability under Section 11 of the ESA. An individual or organization may receive fines or imprisonment, as well as the additional penalties described below, for each violation—meaning each individual of a listed animal species taken without authorization—of Section 9.

While the ESA imposes liability for Section 9 violations related to listed plant species, it does not prohibit the take of such plants; therefore, this section focuses on liability for the unauthorized take of animal species.

Civil Liability

As of 2019, the ESA authorizes the FWS to assess the following civil penalties for each violation of the take prohibition:

- $52,596 for knowingly taking an endangered animal
- $25,246 for knowingly taking a threatened animal
- $1,329 for otherwise violating a provision of the ESA, including by negligently harassing a listed animal or unintentionally taking a listed species

A knowing act only requires a general intent to commit the act impacting the species. A defendant need not know that the species is endangered or threatened or intend to violate the ESA to be held liable.

Related Content

For an overview of environmental impact reviews in the context of federal environmental statutes, see

> **ENVIRONMENTAL IMPACT REVIEW IN REAL ESTATE TRANSACTIONS**

RESEARCH PATH: *Real Estate > Commercial Purchase and Sales > Due Diligence > Practice Notes*

For guidance for developers contemplating the purchase or development of real property that contains or is likely to contain regulated wetlands, see

> **WETLANDS REGULATIONS: CONSIDERATIONS FOR PROJECT DEVELOPERS**

RESEARCH PATH: *Real Estate > Commercial Purchase and Sales > Due Diligence > Practice Notes*

For a summary of state laws and regulations governing wetlands protection, see

> **WETLANDS PROTECTION STATE LAW SURVEY**

RESEARCH PATH: *Real Estate > Commercial Purchase and Sales > Due Diligence > Practice Notes*

For a discussion of stormwater permitting and management requirements and information on the federal stormwater program, see

> **STORMWATER PERMITTING AND MANAGEMENT REQUIREMENTS**

RESEARCH PATH: *Real Estate > Commercial Purchase and Sales > Due Diligence > Practice Notes*

Criminal Liability

The Services may criminally prosecute an individual or organization when it knowingly takes a listed animal species in violation of Section 9. Knowingly taking an endangered animal is a Class A misdemeanor that may result in imprisonment of no more than one year and/or a fine. Under the ESA, a fine for a Class A misdemeanor is no more than $50,000. The Criminal Fine Improvements Act increases this amount to $100,000 for an individual or $200,000 for an organization.

Knowingly taking a threatened animal is a Class B misdemeanor that may result in imprisonment of no more than six months and/or a fine. The ESA authorizes a fine of no more than $25,000 for a Class B misdemeanor, whereas the Criminal Fine Improvements Act authorizes a fine of no more than $5,000 for an individual or $10,000 for an organization. In a non-binding opinion, a federal district court has held that the penalty amount in the ESA controls over that in the Criminal Fine Improvements Act.[4] However, this remains an unsettled issue.

Additional Penalties

The ESA further authorizes the federal government, as well as citizens, to seek additional remedies for the unauthorized take of listed animal species, including the following:

- The Attorney General or citizen may seek to enjoin the activity causing the take.
- A federal agency that issued a lease, license, permit, or other agreement authorizing the use of federal lands to a person convicted of a criminal ESA violation may immediately modify, suspend, or revoke the lease, license, permit, or other agreement.
- All equipment, vehicles, and other means of transportation used to aid the taking are subject to forfeiture after a person is convicted of a criminal violation.
- The federal government may seek restitution for ESA violations or impose conditions of probation on the individual or organization.

ESA Section 11(g): Citizen Suits

The ESA also gives the public the right to bring a citizen suit to enforce the statute's provisions. Under Section 11(g), citizens may file a civil suit to:

- Enjoin any person or organization, including a federal or state agency, alleged to be in violation of the ESA
- Compel the Services to enforce the ESA's take prohibitions or to list a species or designate critical habitat

A 60-day notice of intent to sue is a prerequisite to bringing a citizen suit. The notice requirement is intended to give the alleged violator or the Services time to redress the violation and potentially avoid the lawsuit. L

***Parker Moore** is a principal in the Washington, DC office of Beveridge & Diamond PC, where he co-chairs the firm's Natural Resources and Project Development practice group and its NEPA, Wetlands and ESA Section. Parker focuses his practice on successful project development, complex permitting, and regulatory compliance for a variety of industries. Before attending law school, Parker worked as a professionally-trained wetlands and species ecologist for a regional environmental consulting firm. **Katrina Krebs** is an associate in the New York office of Beveridge & Diamond PC, where she focuses her practice on project development and litigation. Katrina advises clients on project permitting and other activities implicating the NEPA, wetlands regulation, and the ESA. She also represents trade associations and businesses in complex environmental and toxic tort litigation. Before attending law school, Katrina worked for the U.S. Fish & Wildlife Service on several national wildlife refuges.*

RESEARCH PATH: ***Real Estate > Commercial Purchase and Sales > Miscellaneous Ownership Issues > Practice Notes***

4. *See* United States v. Eisenberg, 496 F. Supp. 2d 578, 583 (E.D. Pa. 2007).


Amara Gossin BARCLAYS **and Bob Lewis** SIDLEY AUSTIN LLP

Sustainability-Linked Loans: Financing the Green Transition

Sustainability-themed debt instruments represent one response of the financial community to the need to channel capital towards facilitating a carbon transition. Since green bonds debuted in 2012, the types and numbers of these instruments have grown.

ONE OF THE NEWEST ENTRANTS TO THE MARKET IS sustainability-linked loans, which first began to appear in 2017[1] and have become mainstream following the publication of the Sustainability Linked Loan Principles (the Principles) in March 2019 by the Loan Syndications and Trading Association, the Loan Market Association, and the Asia Pacific Loan Market Association, the loan industry bodies in the United States, United Kingdom and Asia Pacific, respectively.

This article provides a brief summary of some key features, benefits, and drafting considerations of sustainability-linked loans.

What is a Sustainability-Linked Loan?

A sustainability-linked loan is a loan or similar facility that includes an economic incentive for the borrower to achieve certain defined sustainability performance targets (for example, increasing the percentage of power generated by a utility from renewable sources or increasing the certified-sustainable space operated by a real estate operator). This incentive typically takes the form of a secondary pricing mechanism that adjusts pricing up or down depending upon the borrower's performance of the sustainability targets. Aside from that pricing incentive, the sustainability-linked loan is largely identical to any other loan product or contingent facility and may be used for any purpose (including general corporate purposes). In contrast, a green bond, green loan, or similar sustainability-themed debt instrument focuses on the proceeds of the debt being used for sustainable purposes.

The four components of a sustainability-linked loan set out in the Principles are the following:

- **Relationship to the borrower's overall corporate social responsibility strategy.** Any borrower of a sustainability-linked loan should have sustainability objectives that are core to its business and align with the performance targets set out in the loan documentation.
- **Target setting—measuring the sustainability of the borrower.** The sustainability objectives chosen should be ambitious and meaningful in relation to the borrower's business.
- **Reporting.** The borrower should be able to provide up-to-date information relating to its performance and, where possible, should publicly report on its performance.
- **Review.** Where no public review or audit is undertaken, it is strongly recommended that a borrower receive a third-party review of its performance against the documented targets. If no third-party review is available, the borrower should have the internal expertise necessary to validate its reporting of its performance.

Why Would a Borrower Want a Sustainability-Linked Loan?

Companies are increasingly focused on integrating sustainability considerations into their core businesses—whether because of strategic decisions or in response to pressure from investors, regulators, employees, customers, local communities, or other stakeholders. Sustainability-linked loans allow companies to demonstrate their commitment to achieving key sustainability-related performance targets by tying loan pricing to their achievement. This sends a powerful message of alignment across a company's core business, contrasting this integration to the historic treatment of sustainability as the purview of a single team or business area. At the same time, by linking the incentive to pricing rather than a more damaging event of default, the company can set ambitious targets without significant contractual risk. In addition, achievement of the sustainability targets results in a pricing benefit.

> These loans are also responsive to stakeholders' demands that lenders be well-positioned to address the economic impact of environmental change on their loan portfolio. The more lenders encourage clients to consider and prepare for these economic costs, the stronger the lenders' portfolios are likely to be in the face of it.

Why Would a Lender Want to Provide a Sustainability-Linked Loan?

To date, sustainability-linked loans have been made in relationship-based revolving credit facilities. In these cases, lenders expect a long-term working relationship with the borrower. Helping the borrower to achieve its sustainability-related business targets is an important part of that relationship. These loans are also responsive to stakeholders' demands that lenders be well-positioned to address the economic impact of environmental change on their loan portfolio. The more lenders encourage clients to consider and prepare for these economic costs, the stronger the lenders' portfolios are likely to be in the face of it.

What Are Some Key Drafting Considerations when Creating a Sustainability-Linked Loan?

- **Metric alignment with borrower's business.** The value of the sustainability-linked loan rests on its ability to incentivize a genuine transition in the borrower's business to more sustainable practices. So, the chosen sustainability metric must be (1) core to the borrower's business and (2) a demonstrable marker of sustainability in that business. For example, renewable energy generated is a good metric for a utility, but would not be appropriate to a retailer that also happened to generate its own power on-site. In some cases, the sustainability-linked loan is tied to a sustainability rating supplied by a third-party ratings provider. A lender should carefully consider the benefits and pitfalls to using a third-party sustainability metric.
- **Establishing an ambitious target**. Once an appropriate metric has been selected, there are a number of drafting decisions to be made in order to ensure that the transition being rewarded is sufficiently ambitious.

1. The first known sustainability linked loan was completed by Royal Philips in April 2017 and sold in Europe.

- **Description of initial benchmark**. The benchmark against which improvement is measured must accurately reflect the current state of the business and must be easily identifiable to all parties. This may mean, for example, that an average of performance over some recent period of time is used instead of a single-year benchmark.
- **Target improvement over benchmark.** Consider whether an escalating target over the several years of the facility may be more appropriate than a single static benchmark during the life of the facility.
- **Pricing incentive**. Best practice is to include a bilateral economic incentive (i.e., achievement of the sustainability performance target results in a pricing or other benefit, while regression of performance results in a pricing or other penalty). Consider whether a pricing incentive should apply to interest rates across the facility or, as has more often been the case in the United States to date, only to drawn amounts under the facility.

- **Ensuring accurate reporting.** To ensure accurate and reliable reporting of a borrower's performance of its sustainability targets, creditors must receive at least annual reports, which, when they are provided by the borrower, should be certified by the borrower in its annual compliance certificate. These certifications will be most reliable where they include information that is either publicly filed and subject to securities laws or verified by third parties. Where a third-party sustainability rating is used, however, borrowers will have little control over the frequency or quality of the rating, which should be reflected in the documentation.
- **Reviewing the reports.** Third-party review is likely to be most helpful in cases where the selected sustainability performance metric is relatively complicated. In cases where the metric is simple to calculate from the borrower's disclosures and the disclosures themselves are reliable, third-party review may not be particularly beneficial. Where reports are found to be inaccurate, however, a best drafting practice is to ensure that the borrower does not retain the benefit of any improperly obtained lower pricing and must instead retroactively repay amounts that would have been payable but for the inaccuracy. Whether such inaccuracy gives rise to an event of default under the agreement has typically been left to an interpretation of the standard reporting representations and covenants.

Conclusion

Proper drafting and structuring of sustainability-linked economic incentives into general-purpose loan documentation can have a material impact on both the borrower's and its creditor's environmental, social, and governance objectives. If done well, the structure can be straightforward from a legal perspective. Moreover, such financings facilitate the integration of sustainability metrics with business metrics and can send a powerful message to both the borrower's and creditor's stakeholders. Done poorly, sustainability-linked mechanisms may risk opening borrowers or lenders to charges of greenwashing for seeking the public relations benefits of a purportedly greener type of loan without attendant meaningful business change. L

Amara Gossin *is Vice President, Legal at Barclays in New York, where she advises the U.S. corporate bank on its transactions and strategic activities. She is co-founder and co-chair of the bank's employee environment network in the Americas and advised the bank from an in-house legal perspective on the first sustainability-linked loan facility completed in the United States. Prior to Barclays, Amara practiced in the bank finance group at Weil, Gotshal & Manges LLP in New York.* ***Bob Lewis*** *is head of Sidley Austin's Chicago Global Finance practice. Bob focuses his practice on representing clients in the global financial services industry. Bob assists with structuring, negotiating, and administering syndicated financings, structured finance transactions, corporate restructurings, and workouts in a variety of industries and sectors. Bob has acted as counsel to the lead arrangers in connection with several initial sustainability-linked syndicated loan transactions in the United States in both the power and utilities sector (CMS Energy, Consumers Energy) and the REIT sector (HCP).*

Related Content

For an overview of sustainability-linked loan principles, see

> **MARKET TRENDS 2018/19: SUSTAINABILITY LINKED LOAN PRINCIPLES**

RESEARCH PATH: *Finance > Trends and Insights > Market Trends > Practice Notes*

For a discussion of sustainability reporting, see

> **CORPORATE SUSTAINABILITY**

RESEARCH PATH: *Capital Markets & Corporate Governance > Corporate Governance and Compliance Requirements for Public Companies > Corporate Governance > Practice Notes*

For an introduction to renewable energy projects, see

> **RENEWABLE ENERGY FINANCE**

RESEARCH PATH: *Finance > Project Finance > Renewable Energy > Practice Notes*

For a review of corporate social responsibility concepts, see

> **CORPORATE SOCIAL RESPONSIBILITY AND THE SUPPLY CHAIN**

RESEARCH PATH: *Corporate Counsel > General Commercial Agreements > Distribution Agreements > Practice Notes*

For an explanation of third-party credit rating agencies, see

> **CREDIT RATING PROCESS AND CREDIT RATING AGENCIES**

RESEARCH PATH: *Finance > Fundamentals of Financing Transactions > Credit Facility Basics > Practice Notes*

For factors to consider when working with a clean energy company, see

> **CLEAN AND RENEWABLE ENERGY INDUSTRY GUIDE FOR CAPITAL MARKETS**

RESEARCH PATH: *Capital Markets & Corporate Governance > Capital Markets by Industry > Practice Notes*

RESEARCH PATH: *Finance > The Credit Agreement > The Loan > Practice Notes*

Kevin Cloutier SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

Discovery on Behalf of Plaintiffs in Trade Secret Misappropriation and Breach of Restrictive Covenant Actions

This article discusses both written discovery and depositions in misappropriation of trade secret and restrictive covenant actions. Specifically, the article addresses the following topics: expedited discovery, written discovery requests, and best practices for restrictive covenant and trade secret depositions.

Expedited Discovery

Expedited discovery is an important tool in trade secret misappropriation and breach of restrictive covenant cases. A motion for expedited discovery allows you to exert pressure on the defendant at the outset of the litigation and may be essential to protect and obtain important documents.

Expedited Discovery Standards

Motions for expedited discovery in federal courts are governed by Rule 26(d) of the Federal Rules of Civil Procedure,[1] which dictates when and how parties may engage in discovery. Courts grant these motions where "the request for expedited discovery is reasonable under the circumstances and good cause exists for granting the motion."[2]

In making this decision, courts consider a variety of factors, including "(1) whether a preliminary injunction is pending; (2) the breadth of the discovery requests; (3) the purpose for requesting the expedited discovery; (4) the burden on the defendants to comply with the requests; and (5) how far in advance of typical discovery process the request was made."[3] Further, courts permit expedited discovery where "a fuller record for the court" is necessary "when deciding whether to issue a preliminary injunction."[4]

1. Fed. R. Civ. P. 26. 2. *See* JTH Tax, Inc. v. M&M Income Tax Serv., 2013 U.S. Dist. LEXIS 15843, at *5 (D.S.C. Feb. 6, 2013) (granting motion for expedited discovery to aid the court in making a determination at the preliminary injunction hearing). 3. *Id.* at *5 (internal citation omitted). 4. Nobel Biocare USA, Inc. v. Lynch, 1999 U.S. Dist. LEXIS 23252, at *10 (N.D. Ill. Sept. 16, 1999).

Timing, Drafting, and Filing of Expedited Discovery Motion

Timing of Expedited Discovery Motion

Consider making a motion for expedited discovery very early in the litigation, either immediately after filing the complaint or contemporaneously with a motion for injunctive relief. Further, if at any time you feel as though relevant evidence is at risk for loss or destruction, and you have evidence to support the motion, consider filing a motion for expedited discovery on an emergency basis.

Drafting of Expedited Discovery Motion: Background Facts

When making the motion, carefully consider why you need expedited discovery and be prepared to defend those reasons in front of a judge. Motions for expedited discovery must be narrowly tailored, straightforward, and to the point. You are essentially asking the court to take action it otherwise would not and must provide a compelling reason to do so. Also, if you are practicing in state court, it is important to closely review the local rules as some courts use specific criteria in determining expedited or emergency motions.

Set forth the background facts, emphasizing the factual circumstances necessitating a motion for expedited discovery. For example, if there is a preliminary injunction hearing pending, you should highlight that a fuller record is necessary for the hearing. You should explain that the discovery you are seeking is narrowly tailored and not overly broad. Avoid drafting a lengthy motion and instead focus on the practical reasons why the court should grant your motion.

You should consider attaching the tailored discovery requests you intend to propound in the event your motion is granted. Some courts and/or judges require a party to attach the discovery requests for review prior to ruling on the motion itself. Ensure that you attach only limited and pointed discovery requests. Avoid including unnecessary or overreaching interrogatories or overly burdensome requests for production. You want to show the judge that your motion and related requests are reasonable and practical and thus it is not unreasonable to require the other side to respond in an expedited period of time.

Also consider whether a supporting declaration may be useful. For example, in a trade secrets case, you may be able to obtain a statement from an IT professional or computer forensic investigator setting forth the possibility that without expedited discovery, the employer risks destruction or loss of evidence. Or, if you have evidence that trade secret or other confidential information has already been taken, consider including a declaration supporting these facts to persuade the judge to allow expedited discovery to recover stolen information and/or determine the extent of the theft.

... consider whether there are third parties from whom you need to obtain expedited discovery. You may need to request permission to issue a third-party subpoena in an expedited timeframe.

What to Request in a Motion for Expedited Discovery

After concisely setting forth the background facts and reasons why expedited discovery is necessary, you should request an order requiring the defendant to respond to a limited number of interrogatories, document requests, and requests for admission in a shorter time period than provided for under Rules 33[5], 34,[6] and 36[7] of the Federal Rules of Civil Procedure (or any applicable local rules). Again, it is important to keep in mind that many courts will request to review the proposed interrogatories, document requests, and requests for admission in considering whether to grant your motion. Accordingly, you should draft limited and strategic written requests that are narrowly tailored to the issues that must be addressed on an expedited basis.

For example, depending on the timing of a temporary restraining order and the pendency of a preliminary injunction hearing, you could move for a response and/or production date within 10 or 14 days of service instead of the 30 days provided for under Rules 33 and 34.

Additionally, you could request an order requiring the defendant, and any other witnesses relevant to the expedited discovery, to appear for a deposition within a period of days after production of written discovery.

Finally, consider whether there are third parties from whom you need to obtain expedited discovery. You may need to request permission to issue a third-party subpoena in an expedited timeframe.

Attach a Proposed Order

You should also attach a proposed order setting forth each expedited discovery request and a provision stating that the court grants each request, if doing so is appropriate in the jurisdiction. You can attach a proposed order as an exhibit to

5. Fed. R. Civ. P. 33. 6. Fed. R. Civ. P. 34. 7. Fed. R. Civ. P. 36.

the motion itself (and refer to the order within the body of the motion). Also, be sure to check the local rules to determine whether the judge requires parties to submit proposed orders to a certain email address or other mailboxes for consideration. By attaching a proposed order, you are reducing the work for the court, and the judge may be more likely to sign (or slightly modify) your proposal following a hearing or even based on the papers.

Consider Moving for a Protective Order

Always keep in mind that a motion for a protective order early in the litigation is another litigation tool available, especially in trade secret misappropriation cases. Rule 26(c) of the Federal Rules of Civil Procedure governs protective orders in federal court. Specifically, as it relates to trade secrets, Rule 26(c)(1)(G) provides for a protective order "requiring that a trade secret or other confidential research, development, or commercial information not be revealed or be revealed only in a specified way."[8]

Even if your case does not involve trade secrets, you should still consider filing a motion for a protective order to protect other confidential or proprietary information of the plaintiff's business disclosed during discovery. That is, if you allege a restrictive covenant is necessary to protect confidential information or trade secrets, then you should expect defendant will test such an assertion in discovery. A protective order will help protect against disclosure in such circumstances. To the extent the defendant will agree, you should consider filing a joint motion for a protective order.

Opposing Requests for Expedited Discovery

As discussed above, motions for expedited discovery under Rule 26(d) require a showing that the request is reasonable. Accordingly, an opposition to a request for expedited discovery should focus on the reasonableness of the motion and/or the actual requests.

Consider the following questions when opposing requests for expedited discovery:

- Is there a motion for preliminary injunction pending?
- Are these requests overbroad?
- How burdensome is compliance with the requests?
- Could these requests have been made earlier in the litigation?
- Would the defendant be prejudiced if the motion is not granted?

These questions should set forth legitimate grounds for opposing a motion for expedited discovery and explain why the requests are unreasonable. Your response should highlight why expedited discovery is unnecessary and impractical at the particular time in the litigation. A judge may appreciate an argument in favor of practicality more than an attack on the defendant's requests generally. Any opposition should be short and to the point. As a final note, you should file your response as soon as practicable to avoid any semblance of delay.

Written Discovery

There are competing interests in drafting and responding to written discovery in trade secret misappropriation and restrictive covenant cases. You want to exert pressure on the defendant and obtain as much information as possible, but also protect your client's proprietary information in the process. This is especially true in a case of trade secret misappropriation where your claims hinge on potential disclosure of trade secrets and other extremely confidential and proprietary information during discovery. You need to balance your desire to seek broad discovery with the possibility that your client's trade secrets may be disclosed in the process.

Identifying Trade Secrets

You may not consider the actual identification of trade secrets as part of the discovery process, but many jurisdictions (e.g., California and Delaware) require a plaintiff to identify the trade secrets at issue to guide the discovery process very early in the litigation.

Initial Identification of the Trade Secrets at Issue

When do you first need to identify the trade secrets at issue? Of course, you must identify what you believe are trade secrets in your complaint, but at what point do you need to identify trade secrets beyond a general statement? Many jurisdictions require a plaintiff to "identify with reasonable particularity the matter which it claims constitutes a trade secret, before it will be allowed (given a proper showing of need) to compel discovery of its adversary's secrets."[9] In fact, in California, a plaintiff is statutorily required to identify the trade secrets at issue with "reasonable particularity" prior to "commencing discovery."[10]

Even in jurisdictions without statutory or case law regarding this specific point, it is possible that a defendant will object to responding to any written discovery absent sufficient identification of the alleged trade secrets at issue. Because a defendant may refuse to answer discovery based on insufficient identification or notice of the alleged trade secrets, you should consider identifying the trade secrets with enough specificity to avoid discovery disputes that will only delay the proceedings.

8. Fed. R. Civ. P. 26(c)(1)(G). 9. Engelhard Corp. v. Savin Corp., 505 A.2d 30, 33 (Del. Ch. 1986). 10. *See* Cal. Civ. Proc. Code § 2019.210.

Reasonable Particularity

So, what does reasonable particularity mean? Unfortunately, reasonable particularity will differ depending on the type of trade secret at issue. As one court stated:

> "Reasonable particularity" . . . does not mean that the party alleging misappropriation has to define every minute detail of its claimed trade secret at the outset of the litigation. Nor does it require a discovery referee or a trial court to conduct a miniature trial on the merits of a misappropriation claim before discovery may commence. Rather, it means that the plaintiff must make some showing that is reasonable, i.e., fair, proper, just and rational . . . under all of the circumstances to identify its alleged trade secret in a manner that will allow the trial court to control the scope of subsequent discovery, protect all parties' proprietary information, and allow them a fair opportunity to prepare and present their best case or defense at a trial on the merits.[11]

Best Practices

As the court in *Brescia* advised, a plaintiff must provide enough information regarding the trade secrets at issue to allow the court to control the scope of discovery and protect information. Courts address this issue on a case-by-case basis.

As a best practice, you should begin with a broad identification of the trade secrets in the complaint. As discovery commences, you should carefully define trade secrets in your written discovery requests to sufficiently identify the trade secrets at issue. Avoid using generalizations such as formula, plans, or drawings, and instead use as much detail as possible without disclosing truly confidential or proprietary information. Also, consider entering a protective order or even filing documents under seal for further protection.

Drafting Interrogatories, Document Requests, and Requests for Admission

As an initial matter, if you are seeking discovery in conjunction with a motion for expedited discovery, many courts will request to review the proposed document requests, interrogatories, and requests for admission in considering whether to grant the motions. You should draft limited and strategic written requests for discovery. As discussed above, courts grant motions for expedited discovery based on necessity and reasonableness. If your requests are overbroad or do not address the issues essential to an emergency motion for injunctive relief, a court may be less likely to grant the motion and permit your requests. Importantly, if your case will continue beyond a hearing on preliminary injunction or other emergency relief, be sure to keep in mind the limitations on interrogatories, document requests, and requests for admission under the applicable federal and local rules. You do not want to exhaust all of your discovery power too early in the litigation.

Even if you are not seeking expedited discovery, you should tailor your written discovery requests to obtain the most relevant evidence as early as possible in the litigation. In trade secret misappropriation cases, you are seeking discovery that will prove the defendant accessed, used, or disclosed the employer's trade secrets without authorization.

11. Brescia v. Angelin, 90 Cal. Rptr.3d 842, 849 (Cal. Ct. App. 2009).

For breach of restrictive covenant actions, you are seeking discovery that will prove the defendant violated a contractual term of an employment agreement by working for a competitor, by disclosing confidential information, or by soliciting customers, clients, or employees. Also, you want to avoid serving discovery that is vague, overbroad, or otherwise objectionable, which will only delay the process and lead to unnecessary discovery disputes.

Interrogatories

In federal court, Rule 33 of the Federal Rules of Civil Procedure governs interrogatory requests. Under Rule 33, you are limited to serving 25 interrogatories on the defendant and must ask the court for permission to serve more. Also, remember to check your local rules to ensure the court in which you are practicing does not have any additional rules regarding interrogatory requests. For example, Texas state courts allow a party to serve unlimited interrogatories, which may give a party a crucial advantage as discovery continues.

You should use interrogatories to obtain information about the defendant's past conduct, actions in leaving plaintiff's employ, recruitment by his or her new employer, current employment, employee and customer contacts, and knowledge of your trade secrets. Interrogatories also serve to identify the witnesses the defendant believes have information relevant to his or her defense. Additionally, you should ask the defendant to identify any current or former employees, or current customers with whom he or she has had contact since leaving his or her former employer.

Your interrogatory requests should request, at a minimum, the following types of information (where applicable):

- Identification of witnesses the defendant expects to call at trial
- A description of the defendant's current employment or job position, including identification of the defendant's current employer, job duties, and whether or not the defendant entered into an employment contract or restrictive covenant
- Identification of the trade secret or confidential information that the defendant accessed while working for the plaintiff
- Identification of the trade secret or confidential information still in the defendant's possession
- Identification of all the plaintiff's current or former employees with whom the defendant has contacted or communicated (in any format) since leaving the plaintiff's employment
- Identification of all of the plaintiff's current or former customers or clients with whom the defendant has contacted or communicated (in any format) since leaving the plaintiff's employment
- Identification and description of the recruitment process by the defendant's new employer
- Identification and description of any training provided by the defendant's new employer
- Identification of the defendant's current customers or clients
- Identification of the defendant's LinkedIn or other professional networking pages

Document Requests

In federal court, Rule 34 of the Federal Rules of Civil Procedure governs document requests. Rule 34 does not impose a limit on document requests. Remember to check your local rules to ensure the court in which you are practicing does not have any additional rules regarding document requests. For example, Arizona state courts limit parties to only 10 document requests without leave of court.

Your document requests should request, at a minimum, the following types of documents (where applicable):

- Any and all employment contracts or agreements entered into with a new employer or business entity
- Any and all emails sent to or from the defendant regarding trade secret or confidential information
- Any and all emails and/or documents sent from the defendant's company email address to his or her personal email address (when working for the plaintiff)
- Any and all offer letters
- Any and all documents that contain trade secret or confidential information
- Communications (in any format) with current or former employees of the plaintiff
- Communications (in any format) with current or former customer or clients of the plaintiff
- Copies of social media messages, chat programs, or postings regarding the defendant's employment with the plaintiff, termination or resignation of employment, and/or new employment
- Copies of any LinkedIn or other professional networking pages
- Any documents regarding the formation of a new corporation or other business entity, including bank statements, corporate documents, and communications regarding the formation of the entity

It is important to keep in mind that your requests should be as broad as possible concerning different types of communications and new technology. For example, you should request copies of text messages, instant messages, chat programs, emails, SMS messages, LinkedIn or Facebook messages, or any other form of electronic communication.

Requests for Admission

In federal court, Rule 36 of the Federal Rules of Civil Procedure governs requests for admission. Requests for admission are a set of statements served from one party to an adversary for the purpose of having the adversary admit or deny the specific statements or allegations therein. You should draft requests for admission as statements or allegations that require a simple admission or denial. The requests for admission should not require any explanation. If admitted, the statement is considered to be true for all purposes of the litigation. Remember to check your local rules to ensure the court in which you are practicing does not have any additional rules regarding requests for admission.

You should use requests for admission somewhat sparingly and very strategically. Consider using requests for admission to ask very specific questions for denial or admission, for example:

- Admit that you signed an employment contract with Plaintiff that prohibits you from "[insert restrictive covenants]."
- Admit that you had access to Plaintiff's trade secret and confidential information during your employment.
- Admit that you received training [identify training] from Plaintiff.
- Admit that you worked for Plaintiff in the capacity of [insert title and duties].
- Admit that you are now employed by [new employer].
- Admit that you now work for [new employer] in the capacity of [insert title and duties].
- Admit that [new employer] and Plaintiff are competitors.

Requests for admission should be used to narrow down the critical issues in discovery and tie the defendant to an admission or denial that can later be refuted.

Drafting Responses to Defendant's Discovery Requests

A plaintiff's discovery responses may serve to support its position if it has evidence of trade secret misappropriation, breach of a restrictive covenant, or incriminating emails or communications recovered from the defendant's company file. You may be able to exert pressure on the defendant by producing inflammatory documents, emails, or other communications in response to discovery requests.

Respond to discovery requests as fully as possible and only object where appropriate. Many judges frown upon unnecessary or unfounded objections in discovery. In cases where plaintiffs are seeking emergency or other injunctive relief, unnecessary discovery motions only slow or impede the process. Of course, where discovery requests are truly overbroad or are not reasonably calculated to lead to the discovery of admissible evidence, you should object to the request and be prepared to defend your objection in the face of a motion to compel.

The written discovery process is a critical component to winning a trade secrets misappropriation or breach of restrictive covenant case. Thus, it is in your best interest

to comply with all federal or local rules and avoid creating unnecessary discovery disputes in the process.

Best Practices for Restrictive Covenant and Trade Secret Depositions

This section addresses best deposition practices and strategies in trade secret and restrictive covenant cases. It discusses both taking and defending depositions in these types of cases. It also addresses depositions of different types of witnesses, including (1) individual defendants, (2) employer representatives, and (3) expert witnesses.

Preparing for and Taking Depositions of Individual Defendants

Preliminary Issues

In federal court, Federal Rules of Civil Procedure Rule 30[12] governs depositions of individual witnesses. Remember to check your local rules to ensure the court in which you are practicing does not have any additional rules regarding depositions. Also, remember to review any discovery-related orders issued by the court in the event depositions are limited in some capacity (e.g., duration, location, etc.).

Protective Order

As noted above, before beginning discovery and depositions, be sure to consider whether a protective order is appropriate for your case. Cases involving trade secret misappropriation will necessitate discussion of confidential, proprietary, and other trade secret information on the record during depositions. The parties may use exhibits that you may wish to protect as trade secrets or confidential documents. Propose a joint motion for a protective order to opposing counsel that protects any testimony or other information either side wishes to designate "Confidential." For particularly sensitive information, you can also create an "Attorneys' Eyes Only" designation.

Reasonable Written Notice to Defendant

You must provide reasonable written notice to the defendant prior to scheduling the deposition, setting forth the date, time, and location of the deposition, as well as whether a stenographer and/or videographer will record the deposition. While Rule 30 does not define what constitutes a reasonable amount of time, avoid giving such short notice that it would be impossible for the witness to comply.

Videotaping Depositions

Videotaping a deposition is a strategic decision you should consider as some witnesses present well on video while others do not. It is difficult to capture tone, evasiveness, silence, and other nonverbal cues in a written record. A videotaped deposition may serve an important purpose in your litigation depending on the situation.

Preparing to Take the Individual Defendant's Deposition

When taking a deposition, you are in control and can take as much time on any area of inquiry or document you choose. You must take the time to carefully review all facts, documents, declarations, or other information at your disposal and plot out a strategy for using your time wisely at the deposition.

In trade secret and restrictive covenant cases, depending on the procedural posture of your case, it is possible that your first deposition of the individual defendant will not be your only bite at the apple, and you may have another opportunity to depose the same witness later in the case.

12. Fed. R. Civ. P. 30.

> You should take a nuanced approach to building a record question-by-question. This is not to say that direct questions are not effective and useful, but consider using various strategies to obtain as much information as possible depending on both the witness and your personal deposition style.

For example, courts often grant motions for expedited discovery which include expedited depositions conducted for the purpose of obtaining testimony to prepare for a preliminary injunction hearing. This means that you will likely have another opportunity to depose the same witness and can thus mostly focus on issues that relate to the preliminary injunction hearing.

Draft an Outline of Key Topics and Questions

When preparing for a deposition, you should first draft a general outline of topics you wish to cover during the deposition. Your outline will ultimately serve as your guide throughout the deposition. Your topics can start broadly, such as employment with plaintiff, knowledge and misappropriation of trade secrets, employment with competitor, solicitation of customers, and any other big picture topics relevant to your trade secret and/or restrictive covenant case. Listing comprehensive topics can help frame the major issues in the case as well as help you identify exactly what facts you need on the record to support your case and generate strategic questions aimed at eliciting key testimony.

Once you have identified your key topics and goals for the deposition, outline specific questions you plan to ask, or at least the facts about which you want to inquire, to guide the deposition. You can organize your questions by topic, in chronological order, or whatever way makes the most sense for your case. The goal is not to list every single possible question you want to ask about a certain topic, but instead you should brainstorm about how to elicit the key testimony you need on the record to establish the elements of your causes of action.

Example—Breach of contract: Non-compete provision. If you are litigating a breach of contract case based on the defendant's breach of his or her non-compete agreement, you must generally establish all of the following:

- There is a valid contract.
- The plaintiff performed its obligations under the contract.
- The defendant breached the contract.
- The plaintiff was damaged as a result of the defendant's breach of the contract (e.g., plaintiff lost an account because of the breach).

Even though you need to establish each of these elements in your case, you do not necessarily have to ask direct questions such as "Did you breach your contract?" or "Did the plaintiff perform its obligations under your employment agreement?" Rather, you should elicit testimony concerning all of the following key issues:

- The defendant entered into a non-compete agreement with the plaintiff company.
- The plaintiff employed defendant for a period of time.
- There are protectable interests supporting enforcement of the non-compete agreement.
- The defendant understood the terms of the non-compete agreement.
- The defendant is now working for a competitor.

Taken together, this testimony will help establish three of the four elements necessary to prove a breach of contract claim based on a breach of a non-compete agreement. You should take a nuanced approach to building a record question-by-question. This is not to say that direct questions are not effective and useful, but consider using various strategies to obtain as much information as possible depending on both the witness and your personal deposition style.

Review All Relevant Documents

When building your outline, be sure to review all relevant documents that will aid in preparing questions or serve as exhibits in the deposition. Having an exhaustive knowledge of relevant documents, particularly applicable agreements and emails demonstrating contract formation, underlying protectable interests, and breach is essential. Refer directly to the document in your outline to remind yourself to use it as an exhibit.

Example—Breach of restrictive covenant action. In a restrictive covenant case, the defendant's employment agreements (or separately signed restrictive covenants) will be key exhibits that you will want to enter into the record. You should be prepared to ask questions regarding the creation of the employment relationship, entering into the agreements, the defendant's understanding of the terms, and the specifics of the terms therein. You can also plan to ask the witness to read relevant provisions directly into the record during the deposition to avoid missing any specific provision or detail.

Taking the Individual Defendant's Deposition

In the deposition itself, remember that you are in control of the situation, the tempo of the deposition, and the topics at issue. Be sure to listen to the answer the witness provides to determine (1) whether he or she actually answered the question asked or (2) whether he or she disclosed information that leads to another line of questioning. Do not be afraid to deviate from your outline. Take your time when moving on from one line of questioning to another and feel free to jump around topics in an effort to keep the witness on his or her toes.

At the end of your questioning, take a few minutes to review your outline and notes very carefully. Ask yourself whether you covered everything you wanted to cover concerning the trade secret(s) and/or restrictive covenant(s) at issue, whether there are any questions or answers on which you wanted to follow up, and whether there are any documents you want to enter into the record during the deposition. Taking your time at the end of a deposition may save you from later stress when realizing that you may have forgotten to ask a certain question or introduce a specific document.

Taking Depositions of Representatives of Defendant's Employer

Depositions of corporate representatives are governed by Rule 30(b)(6) and are often referred to as a Rule 30(b)(6) deposition. Rule 30(b)(6) provides:

> Notice or Subpoena Directed to an Organization. In its notice or subpoena, a party may name as the deponent a public or private corporation, a partnership, an association, a governmental agency, or other entity and must describe with reasonable particularity the matters for examination. The named organization must then designate one or more officers, directors, or managing agents, or designate other persons who consent to testify on its behalf; and it may set out the matters on which each person designated will testify. A subpoena must advise a nonparty organization of its duty to make this designation. The persons designated must testify about information known or reasonably available to the organization. This paragraph (6) does not preclude a deposition by any other procedure allowed by these rules.[13]

Be sure to review your local jurisdiction's rules and case law regarding Rule 30(b)(6) depositions as well.

The most important points to note from Rule 30(b)(6) are the following:

- The noticing party must "describe with reasonable particularity the matters for examination" during the deposition.
- The organization must identify witnesses for each designated topic on the organization's behalf.
- And, most importantly, "[t]he persons designated must testify about information known or reasonably available to the organization."

As set forth in Rule 30(b)(6), if you are noticing the Rule 30(b)(6) deposition, you must "describe with reasonable particularity the matters for examination," or designate specific topics on which you wish to depose a corporate representative.[14]

Taking Rule 30(b)(6) Depositions in Restrictive Covenant and Trade Secret Misappropriation Cases

In trade secret and restrictive covenant cases, competing employers are frequently named as parties in the litigation on tortious interference with contract and/or misappropriation of trade secrets grounds. You should request leave to depose a corporate representative witness of the defendant's new employer, whether or not the new employer is a party to the lawsuit. A corporate witness speaks for the company and is very different than a regular witness who testifies solely on his or her personal knowledge.

You will likely want to depose a Rule 30(b)(6) witness on the circumstances regarding the defendant's employment with the company, which would include when the new employer hired the defendant, in what position, whether the defendant disclosed any confidential or trade secret information, and whether the defendant signed a restrictive covenant. Or, you may want to depose a witness with company knowledge regarding the company's business, its client base, its pricing, and other company-specific information. You can designate as many topics as you choose, but be prepared for the other side to object to the scope or breadth of your proposed topics. If possible, try to resolve issues regarding the topics prior to the deposition to avoid unnecessary disputes and delay during the deposition itself.

13. Fed. R. Civ. P. 30(b)(6). 14. *Id.*

Taking a Rule 30(b)(6) Deposition to Prepare for a Preliminary Injunction Hearing

If you are conducting a Rule 30(b)(6) deposition on an expedited basis to prepare for a preliminary injunction hearing, be sure to tailor your topics to what is necessary for the hearing to avoid unnecessary disputes with opposing counsel. However, do not overly limit your topics and risk missing important testimony. Again, it is important to consider what facts you need established on the record to prove your case. Tailor your topics around obtaining that testimony.

Best Practices for Preparing for and Taking Rule 30(b)(6) Depositions

You should be prepared to depose a number of different witnesses designated for different topics. An employer is not obligated to produce one witness for all topics but instead the person most knowledgeable for that topic.

Also, be prepared for more objections from the attorney defending the Rule 30(b)(6) deposition. Because a Rule 30(b)(6) deposition is limited to certain topics, the witness does not have to answer questions that fall outside that topic. Take some time to think through why a certain line of questioning relates to the designated topic so that you are prepared to respond to an objection.

You should prepare for a Rule 30(b)(6) deposition as you would any other deposition, thoroughly and thoughtfully. Create outlines for each designated topic to keep your questioning clean and concise. Organize your documents according to topic for ease of reference and use during the deposition. During the deposition, remember that you are in control of the proceeding and can take as much time as you need to work through the topics with each witness.

Deposing Defendant's Expert Witnesses

Expert witness disclosures and reports are governed by Federal Rule of Civil Procedure 26.[15] Assuming the defendant has already disclosed its expert witness in accordance with Rule 26(a)(2)(A), and there is no court order or stipulation otherwise, the expert will likely be required to submit an extensive written report that must contain:

- A complete statement of all opinions the witness will express and the basis and reasons for them
- The facts or data considered by the witness in forming his or her opinions
- Any exhibits that will be used to summarize or support the witness's opinions
- The witness's qualifications, including a list of all publications authored in the previous 10 years
- A list of all other cases in which, during the previous four years, the witness testified as an expert at trial or by deposition
- A statement of the compensation to be paid for the study and testimony in the case[16]

This report will serve as a starting point for your deposition preparation and will guide you through the deposition itself. Remember to check your local rules, which may set forth different requirements for expert reports.

Types of Experts in Trade Secret and Restrictive Covenant Litigations

Expert witness depositions are common in restrictive covenant and trade secret misappropriation cases. Below are some examples of potential types of expert testimony in these cases:

- **Technical issues concerning trade secrets.** Parties often hire experts to testify on technical issues as to whether a trade secret exists (e.g., whether the employer took sufficient steps to keep the information secret or whether the information was readily ascertainable).
- **Computer forensics.** There may be a dispute about whether, when, and/or how the defendant accessed the former employer's confidential electronic data. The parties may hire computer forensic experts to provide their input on this issue.
- **Irreparable harm.** To obtain a preliminary injunction in restrictive covenant and trade secret misappropriation litigations, a plaintiff employer must show irreparable harm to its business. Often the parties will engage experts to provide their input on whether or not the employer will incur irreparable harm due to a breach of a restrictive covenant or the misappropriation of trade secrets.
- **Reasonableness of restrictive covenants.** The parties may engage experts to address why the restrictive covenant at issue is reasonable or unreasonable in light of the type of work defendant performs and available positions in relevant job markets.
- **Damages calculations.** It is often complicated to calculate damages in restrictive covenant and trade secret misappropriation cases. The parties frequently hire experts to assist them with these complex damages calculations.

15. Fed. R. Civ. P. 26. 16. Fed. R. Civ. P. (26)(a)(2)(B).

Conduct Research on Defendant's Expert

As with any other witness, you will want to prepare a thorough outline and review relevant documents. However, there are additional key steps in the preparation process for an expert witness. For example, be sure to thoroughly research the expert. This may include studying the expert's publications, previous trial testimony (if available), credentials, and other publicly available information. The expert's report as required by Rule 26(a)(2)(B) should provide a list of the expert's publications, but you should conduct your own research as well to determine whether the expert has published additional material. Previous testimony can also serve as a very valuable resource and provide insight into how the expert presents at deposition or trial and the substance of his or her testimony.

Scrutinize the Expert's Report

Next, analyze the expert's report as it relates to your specific case. Consider whether this report is inconsistent with other publications issued by the expert, or whether the report is based on inaccurate information. Or, is the expert deviating from testimony in a previous case on similar facts? Is this expert even qualified to opine on the subject matter? It is important to identify specific areas or conclusions in the report that you can challenge during the deposition.

Consider Hiring Your Own Expert to Help You Prepare

Consider retaining your own expert as well. Not only will your own expert be able to educate you on the issues at hand, but an expert can also help you identify flaws or other inconsistencies in the defendant's expert's report. Compare your expert's report to the defendant's expert's report to identify areas of disconnect for further questioning at the deposition.

Best Strategies at Deposition

At deposition, you may want to use the expert's testimony to tie the expert to certain admissions that create inconsistencies in his or her report and ultimately undermine the expert's conclusion. Or, you may be eliciting testimony to make a *Daubert* motion—named after *Daubert v. Merrell Dow Pharmaceuticals, Inc.*—which is a specific type of motion *in limine* in federal court and most state courts to exclude the testimony of the expert witness who either (1) does not possess the requisite level of expertise or (2) used questionable methods to obtain data.[17] Beware that *Daubert* motions have a high standard. Pursuant to Rule 702 of the Federal Rules of Evidence—which codifies *Daubert* and its progeny—the motion *in limine* must show at least one of the following:

- The expert's specialized knowledge will not assist the trier of fact in determining a fact at issue in the case.
- The expert's testimony is not based on sufficient facts or data.
- The expert's testimony is not the product of reliable principles and methods.
- The expert has not applied reliable principles and methods to the facts of the case.[18]

Note that many judges dislike *Daubert* motions *in limine*.

17. 509 U.S. 579 (1993). **18.** Fed R. Evid. 702.

Expert witnesses are often experienced witnesses who have been deposed numerous times. Ask direct questions and do not hesitate to repeat questions if the witness is evasive, vague, or circular. Remember, you are in control of the deposition and can wait out a reluctant witness. As with any other deposition, take time to review your outline at the end of each section and at the end of the deposition. Take your time to ensure that you ask all pertinent questions and spend enough time dissecting the expert's report, previous testimony, and other publications. Evaluate whether you have fulfilled your goal during the deposition, whether it was to obtain enough information to sustain a *Daubert* challenge or simply to point out inconsistencies in the expert's report.

Defending Depositions of Your Client's Corporate Witness(es)

Defendants sometimes choose to move for expedited discovery in trade secret and restrictive covenant cases. For instance, the defendant may seek expedited discovery on the employer's polices concerning the preservation of electronic information. In another example, the defendant may seek expedited discovery concerning the company's procedures for ensuring that it keeps information confidential. Furthermore, the defendant may seek expedited discovery concerning the employer's record of enforcing its restrictive covenants and/or other relevant employment policies.

Thus, it is possible that you will find yourself in a situation where you need to (1) prepare a corporate, or Rule 30(b)(6), witness to testify about company policies and (2) defend a deposition in a very short period of time. Because you must prepare a witness (or witnesses) to testify on designated topics that may encompass broad timeframes, complicated processes, and the knowledge of many current and former employees, there are many potential pitfalls in preparing Rule 30(b)(6) witnesses to testify. You should take the following steps in defending employer representative witnesses in trade secret and restrictive covenant cases.

Review the Designated Topics and Try to Narrow Them

Before the deposition, you should scrutinize the designated topics and make objections where appropriate. For example, suppose defendant's counsel states one of the designated topics as: "All employment policies **including but not limited to** policies on protection of confidential information and trade secrets." (Emphasis added.) Here you should object on the grounds that you cannot reasonably be expected to prepare a witness on a topic if the topic is not sufficiently specific about the issues that it covers. Narrow the topics as much as possible and confirm your understanding of the topics, in writing, with opposing counsel to avoid potential issues during the deposition.

Related Content

For sample annotated document requests, see

> **DOCUMENT REQUESTS (TRADE SECRET MISAPPROPRIATION AND BREACH OF RESTRICTIVE COVENANT ACTION) (PLAINTIFF EMPLOYER TO DEFENDANT)**

RESEARCH PATH: *Labor & Employment > Non-competes and Trade Secret Protection > Restrictive Covenants > Forms*

For information on defending expert witness depositions in an employment litigation, see

> **DEFENDING DEPOSITIONS OF EMPLOYER WITNESSES IN AN EMPLOYMENT LITIGATION**

RESEARCH PATH: *Labor & Employment > Employment Litigation > Other Employment Litigation > Practice Notes*

For examples of essential deposition questions to ask in restrictive covenant and trade secret misappropriation cases, see

> **DEPOSITION QUESTIONS (TRADE SECRET MISAPPROPRIATION AND BREACH OF RESTRICTIVE COVENANT ACTION) (PLAINTIFF EMPLOYER TO DEFENDANT)**

RESEARCH PATH: *Labor & Employment > Employment Litigation > Restrictive Covenants and Trade Secrets > Forms*

For assistance in drafting interrogatories for trade secret misappropriation and breach of restrictive covenant actions, see

> **INTERROGATORIES (TRADE SECRET MISAPPROPRIATION AND BREACH OF RESTRICTIVE COVENANT ACTION) (PLAINTIFF EMPLOYER TO DEFENDANT)**

RESEARCH PATH: *Labor & Employment > Employment Litigation > Restrictive Covenants and Trade Secrets > Forms*

For further detail on preparing for and defending depositions of employer witnesses, see

> **DEFENDING DEPOSITIONS OF EMPLOYER WITNESSES IN AN EMPLOYMENT LITIGATION**

RESEARCH PATH: *Labor & Employment > Employment Litigation > Discrimination, Harassment, and Retaliation > Practice Notes*

Select the Appropriate Witnesses for Each Topic and Thoroughly Prepare Them

As Rule 30(b)(6) witness testimony is binding on the employer, it is essential that you designate the appropriate witness for a topic and thoroughly prepare the witness for the deposition. This does not mean that you must produce the witness with the most personal knowledge on a topic or the person who has spent the most time in a certain position within the company. Although there are certainly situations where it makes sense to produce a Rule 30(b)(6) witness with the most extensive knowledge of a specific topic or even of the case itself, it is not necessary, and may not be advisable.

Example: A witness with extensive knowledge concerning the employer's restrictive covenant agreements with its employees, but who is unprepared to testify on the employer's policies concerning protection of its proprietary and confidential information, may easily fall prey to questioning by an attorney strategically trying to obtain certain admissions from him or her. Or that particular witness may not present well and may be unnecessarily aggressive or cagey, which could lead to credibility issues.

You need to produce the best witness, even if that means you must take additional time to adequately prepare someone with less personal or institutional knowledge on a matter. Your ideal witness will be someone who is knowledgeable, adequately prepared to testify on his or her designated topic, and will answer the question asked without providing unnecessary or additional information.

Preparation of your employer representative witness(es) is essential. Rule 30(b)(6) obligates counsel to adequately prepare the designated witness. While a party is not required to take extreme measures to obtain all possible information relevant to a topic and educate the witness on such information, it is "required to educate an appropriate Rule 30(b)(6) designee to provide knowledgeable answers . . . which includes information ascertainable from claims files, documents produced in this case, information from past employees, witness testimony and exhibits, or any other sources available to the corporation."[19] A court may order you to produce another witness if it determines your witness was not adequately prepared and you could face sanctions for blatant violations of Rule 30(b)(6).

Do Not Allow Opposing Counsel to Deviate from the Designated Topics When Defending the Deposition

When defending the deposition, take a hard line on the designated topics and do not let opposing counsel stray from them. You may have to be prepared to call the judge or arbitrator overseeing your matter to resolve an issue during the deposition. Be prepared to stand your ground on why a question or line of questioning is outside the designated topic and thus improper.

Consider Asking Follow-Up Questions to Your Witness

At the end of opposing counsel's questioning, consider whether there are any points on which you want to follow up with your own questioning. It is often advisable to refrain from asking any additional questions that may confuse the witness, muddy the testimony, or create inconsistent testimony. Assess whether there were any blatant issues in the deposition that require attention, but note that it is frequently cleaner to end the deposition without further questioning.

Kevin Cloutier *is a partner in the Labor and Employment practice group and co-leader of the Non-Compete and Trade Secrets team in the Chicago office of Sheppard, Mullin, Richter & Hampton LLP. His national practice focuses on all areas of labor and employment law, with an emphasis on employment-related litigation and proactive counseling of management-side clients. He has litigation and first-chair trial experience before state and federal trial and appellate courts all over the country, arbitrators, FINRA, the NLRB, and administrative agencies, and has successfully argued multiple law-changing and precedent-setting federal appeals on behalf of his clients.*

RESEARCH PATH: *Labor & Employment > Employment Litigation > Restrictive Covenants and Trade Secrets > Practice Notes*

19. Kelly v. Provident Life & Accident Ins. Co., 2011 U.S. Dist. LEXIS 66066, at *17 (S.D. Cal. June 20, 2011).



Kevin Cloutier, Shawn Fabian, and Mikela Sutrina
SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

Deposition Questions in a **Trade Secret Misappropriation and Breach of Restrictive Covenant Action** (Plaintiff Employer to Defendant)

The deposition questions in this form are provided by way of example only. Each question should be followed with appropriate further inquiry. You should review all rules concerning depositions applicable in the jurisdiction where your case is pending.

These annotated deposition questions do not cover all potential state law distinctions concerning restrictive covenants and trade secret protection. You should check any relevant state and local laws.

Section 1. Non-Compete Deposition Questions

1. Did you work at [Plaintiff company]?
2. For what period of time did you work at [Plaintiff company]?
3. What was your position at [Plaintiff company]?
4. What were your duties and responsibilities at [Plaintiff company]?
5. Did you sign a non-compete agreement at [Plaintiff company]?
6. Do you remember its contents?
7. You agreed that during [insert the period set forth in the non-compete agreement] you would not engage in any competitive activity, is that correct?
8. When did your employment with [Plaintiff company] end?
9. Where have you worked since your employment with [Plaintiff company] ended?
10. During what period have you worked for your new company?
11. What type of business is your new company?
12. What is your position at your new company?
13. What have been your duties and responsibilities with your new company?

Section 2. Customer Non-Solicitation Deposition Questions

1. Did you work at [Plaintiff company]?
2. For what period of time did you work at [Plaintiff company]?
3. What was your position at [Plaintiff company]?
4. What were your duties and responsibilities at [Plaintiff company]?
5. Did you sign a customer non-solicitation agreement at [Plaintiff company]?
6. Do you remember its contents?
7. You agreed that during [insert the period set forth in the customer non-solicitation agreement] you would not engage in the solicitation of [Plaintiff company's] customers, is that correct?
8. While working at [Plaintiff's company], did you work with customers of [Plaintiff's company]?
9. Which customers did you work with?
10. How were you introduced to these customers?
11. How did you interact with these customers?
12. How often did you interact with these customers?
13. When did your employment with [Plaintiff company] end?
14. Where have you worked since your employment with [Plaintiff company] ended?
15. During what period have you worked for your new company?
16. What type of business is your new company?
17. What is your position at your new company?
18. What have been your duties and responsibilities with your new company?
19. Have you spoken with any [Plaintiff's company] customers since you separated from employment with [Plaintiff company]?
20. If yes, which customers?
21. What did you talk about with each customer?
22. Have you completed any sales to any [Plaintiff's company] customers since you separated from employment with [Plaintiff company]?
23. Have you contracted with [Plaintiff's company] customers since you separated from employment with [Plaintiff company]?
24. Have you attempted to engage in business with any [Plaintiff's company] customers since you separated from employment with [Plaintiff company]?

Section 3. Employee Non-Solicitation Deposition Questions

1. Did you work at [Plaintiff company]?
2. For what period of time did you work at [Plaintiff company]?
3. What was your position at [Plaintiff company]?
4. What were your duties and responsibilities at [Plaintiff company]?
5. Did you sign an employee non-solicitation agreement at [Plaintiff company]?
6. Do you remember its contents?
7. You agreed that during [insert the period set forth in the employee non-solicitation agreement] you would not engage in the solicitation of [Plaintiff company's] employees, is that correct?
8. When did your employment with [Plaintiff company] end?
9. Where have you worked since your employment with [Plaintiff company] ended?
10. During what period have you worked for your new company?
11. What type of business is your new company?
12. What is your position at your new company?
13. What have been your duties and responsibilities with your new company?
14. Have you spoken with any [Plaintiff's company] employees since you separated from employment with [Plaintiff company]?
15. If yes, who?
16. When?
17. What did you talk about with each employee?
18. Have you tried to recruit any of [Plaintiff's company] employees to work for any company for which you have worked since you separated from employment with [Plaintiff company]?
19. If yes, who?
20. When?
21. What efforts did you take in trying to recruit each of these employees?
22. Have you successfully recruited any of [Plaintiff's company] employees to work for any company for which you have worked since you separated from employment with [Plaintiff company]?
23. If yes, which [Plaintiff's company] employees have worked at any company for which you have worked since you separated from employment with [Plaintiff company]?
24. During what periods of time have each of these employees worked at any company for which you have worked since you separated from employment with [Plaintiff company]?
25. What efforts did you take to recruit each of these employees?

Section 4. Misappropriation of Trade Secrets/Breach of Confidentiality Agreement Deposition Questions

1. Did you work at [Plaintiff company]?
2. For what period of time did you work at [Plaintiff company]?
3. What was your position at [Plaintiff company]?
4. What were your duties and responsibilities at [Plaintiff company]?
5. Did you sign a confidentiality agreement?
6. Do you remember its contents?
7. You agreed that you would not disclose [Plaintiff company's] confidential information, is that correct?
8. Did you receive an employment handbook or other policy with confidentiality and/or non-disclosure obligations?
9. What kind of training did [Plaintiff company] provide to you?
10. What confidential information did [Plaintiff company] allow you to access during the course of your employment with [Plaintiff company]?
11. Did [Plaintiff company] limit access to such information?
12. How?
13. Did [Plaintiff company] take other measures to keep this information confidential?
14. If yes, what measures?
15. When did your employment with [Plaintiff company] end?
16. Where have you worked since your employment with [Plaintiff company] ended?
17. During what period have you worked for your new company?

Related Content

For detailed information on state laws concerning restrictive covenants and trade secrets, see

> **NON-COMPETES AND TRADE SECRET PROTECTION STATE PRACTICE NOTES CHART**

RESEARCH PATH: *Labor & Employment > Non-competes and Trade Secret Protection > Restrictive Covenants > Practice Notes*

For additional information on restrictive covenants and trade secrets, see

> **NON-COMPETE AGREEMENTS: KEY NEGOTIATION, DRAFTING AND LEGAL ISSUES**

RESEARCH PATH: *Labor & Employment > Non-competes and Trade Secret Protection > Restrictive Covenants > Practice Notes*

For guidance on drafting non-compete agreements, see

> **NON-COMPETE AGREEMENTS CHECKLIST (BEST DRAFTING PRACTICES FOR EMPLOYERS)**

RESEARCH PATH: *Labor & Employment >Non-competes and Trade Secret Protection Restrictive Covenants > Checklists*

For relevant considerations in drafting customer and employee non-solicitation agreements, see

> **CUSTOMER AND EMPLOYEE NON-SOLICITATION AGREEMENTS: KEY NEGOTIATION, DRAFTING, AND LEGAL ISSUES**

RESEARCH PATH: *Labor & Employment > Non-competes and Trade Secret Protection > Restrictive Covenants > Practice Notes*

18. What type of business is your new company?
19. What is your position at your new company?
20. What have been your duties and responsibilities with your new company?
21. What knowledge do you rely on to perform your job duties?
22. Where did you gain your knowledge of that specific information?

To review the full list of drafting notes and alternate clauses please see the complete form in Lexis Practice Advisor by following the research path. L

Kevin Cloutier *is a partner in the Labor and Employment practice group and co-leader of the Non-Compete and Trade Secrets team in the Chicago office of Sheppard, Mullin, Richter & Hampton LLP. His national practice focuses on all areas of labor and employment law, with an emphasis on employment-related litigation and proactive counseling of management-side clients. He has litigation and first-chair trial experience before state and federal trial and appellate courts, arbitrators, the Financial Industry Regulatory Authority, the National Labor Relations Board (NLRB), and administrative agencies, and has successfully argued multiple law-changing and precedent-setting federal appeals on behalf of his clients. Mr. Cloutier advises clients on a wide range of employment-related issues and has particular expertise in restrictive covenant and non-competition matters, whistleblower claims, and internal investigations. He has successfully enforced restrictive covenant, non-compete, and trade secret claims on behalf of his clients in more than 20 states. He also operates as a general employment counselor to his clients and regularly advises and coaches human resource professionals and other business executives on how to comply with various human resources and employment laws.* ***Shawn Fabian*** *is an associate in the firm's Labor and Employment practice group. He represents management-side clients before federal and state courts across the country and before administrative agencies including the Department of Labor, the Equal Employment Opportunity Commission, the NLRB, and various state and municipal human rights commissions and labor agencies. He can be reached at sfabian@sheppardmullin.com.* ***Mikela Sutrina*** *is an associate in the firm's Labor and Employment practice group. She advises private and public employers on a range of workplace issues, such as compliance with all applicable federal, state, and local laws, discrimination and harassment, safety, performance management, leaves of absence, safety, compensation, and terminations. She can be reached at msutrina@sheppardmullin.com.*

Related Content

For essential elements of a non-disclosure agreement, see

> **NON-DISCLOSURE AGREEMENTS: KEY NEGOTIATION, DRAFTING, AND LEGAL ISSUES (PRO-EMPLOYER)**

RESEARCH PATH: *Labor & Employment > Non-competes and Trade Secret Protection > Restrictive Covenants > Practice Notes*

For direction on drafting enforceable employee confidentiality agreements, see

> **CONFIDENTIALITY AGREEMENTS CHECKLIST (BEST DRAFTING PRACTICES FOR EMPLOYERS)**

RESEARCH PATH: *Labor & Employment > Non-competes and Trade Secret Protection > Restrictive Covenants > Checklists*

For an overview of key trade secret law principles, see

> **TRADE SECRET FUNDAMENTALS**

RESEARCH PATH: *Labor & Employment > Non-competes and Trade Secret Protection > Protecting Trade Secrets > Practice Notes*

For guidance on substantive and procedural considerations involved in pursuing legal action to protect employer trade secrets, see

> **RESTRICTIVE COVENANT AND TRADE SECRET MISAPPROPRIATION CLAIMS: KEY INITIAL CONSIDERATIONS AND TIPS FOR SEEKING TROS, PRELIMINARY INJUNCTIONS, AND OTHER RELIEF**

RESEARCH PATH: *Labor & Employment > Employment Litigation > Restrictive Covenants and Trade Secrets > Practice Notes*

RESEARCH PATH: *Labor & Employment > Non-competes and Trade Secret Protection > Restrictive Covenants > Forms*

Scott Bass and Deeona Gaskin SIDLEY AUSTIN LLP

Data Integrity Risk Management for Life Sciences Companies

This article addresses key topics related to the management of data by drug, biologic, and medical device companies whose products are regulated by the U.S. Food and Drug Administration (FDA). This includes strategies for identifying potential data integrity compliance gaps and questions to ask drug, biologic, medical device, and other life sciences clients.

ALTHOUGH THIS ARTICLE FOCUSES PRIMARILY ON THE FDA's approach to data integrity, you and your client should be aware that other agencies in Europe, China, Japan, and Australia have adopted similar approaches in trying to ferret out sneaky or sloppy recordkeeping practices by drug and medical device companies. To the extent that your client's business operations extend to countries other than the United States, you and your client must understand the applicable laws, regulations, and agency guidance in those other jurisdictions. Where necessary, consult with an attorney with expertise in advising clients in those jurisdictions.

Overview of Data Integrity Enforcement

In the 1970s, the FDA finalized the current good manufacturing practice (GMP) requirements for drugs. The FDA included specific data integrity requirements in the GMPs and the related good laboratory practices (GLP) regulations.

In the late 1980s, Congress investigated allegations of widespread fraud in the newly emergent generic drug industry. Wholesale document forgeries and manufacturing lapses were discovered. Senior executives went to jail, and companies closed down.

The FDA then finalized a policy entitled "Fraud, Untrue Statements of Material Facts, Bribery, and Illegal Gratuities; Final Policy" (1991), which became known as the Application Integrity Policy (AIP). When the FDA decided that wrongful acts merited the withdrawal of an application or deferral

of substantive review of an application, this was known as "Invoking AIP." The FDA has publicly listed companies for which it had invoked AIP because of data reliability concerns, and this AIP policy continues today.

In 1997, the FDA finalized 21 C.F.R. pt. 11, which addresses, in part, controls needed to ensure the data integrity of electronic records.

> … in the laboratory, if there is a required test based on the specifications in the approved application and a failing test result occurs, the failing test result still needs to be recorded in the batch record, even if the test is later invalidated due to laboratory error.

The FDA is not the only regulatory agency focused on data integrity. Following the United States' lead, many other regulators have developed guidance. For example, in 2018, the United Kingdom's Medicines and Healthcare Products Regulatory Agency (MHRA) published "'GXP' Data Integrity Guidance and Definitions," which emphasizes the importance of complete, consistent, and accurate data and Attributable, Legible, Contemporaneous, Original, and Accurate (ALCOA) principles. Similarly, Health Canada has a "Good Manufacturing Practices Guide for Drug Products."

A bad inspection with a regulator in one country can have negative ramifications with regulators in other countries. For example, the FDA has mutual recognition agreements with many European Union (EU) countries, including the United Kingdom's MHRA, France's Agence Nationale de Sécurité du Medicament et des Produits de Santé, and Ireland's Health Products Regulatory Authority.

Data Integrity and Good Manufacturing Practices

Data integrity requirements are found in the FDA's GMP regulations located at, for example, 21 C.F.R. pt. 211, with greater detail in FDA guidance documents.

The FDA views data integrity compliance as essential to ensuring that drug and medical device products are safe, effective, and high quality. Noncompliance with data integrity rules affects the FDA's ability to rely on and make sound decisions based on data provided by your client to the agency as part of an application or report.

Once the FDA raises a data integrity issue related to information provided by your client, the FDA no longer trusts your client. In practice, that means it will be significantly more challenging for you and your client to obtain necessary approvals from the agency, and your client may be subject to regulatory or enforcement actions (described further below).

Under GMPs, GLPs, and related guidance, a drug or medical device company's quality assurance department is responsible for ensuring that its safety and manufacturing records accurately document the company's actual operating procedures and reported results.

The FDA expects that your client's data will be "attributable, legible, contemporaneously recorded, original or a true copy, and accurate." This concept is referred to within the sciences industry as the ALCOA principle. Essentially, ALCOA means that data must be accurate and legible and contemporaneously recorded. For example, your client's quality assurance team should be able to know from reviewing data included in internal batch records which operators completed specific tasks and the test results. Moreover, FDA investigators should be able to review batch records during inspections because the information is legible.

Additionally, data must be contemporaneously recorded, which means that manufacturing results are recorded as they occur and not hours or days later or before based on expected results.

ALCOA principles are not limited to internal GMP documents. Information submitted to the agency, like adverse event reports, new drug application supplements, or premarket approval supplements must also have accurate, legible information and must include originals or true copies of underlying, relevant data.

Under 21 C.F.R. § 211.100(b), your company's production and process control procedures must (1) be followed in the execution of your company's various production and process control functions and (2) be documented at the time of performance.

In addition, under 21 C.F.R. § 211.188(a), your client must keep "[a]n accurate reproduction of the appropriate master production or control record, checked for accuracy, dated, and signed." To comply with this requirement, your client must make sure that copies are complete and match the originals. If the original record includes metadata, the copy must include this metadata as well.

Under 21 C.F.R. § 211.194, your client's records must "include complete data derived from all tests necessary to assure compliance with established specifications and standards." For example, in the laboratory, if there is a required test based on the specifications in the approved application and a failing test result occurs, the failing test result still needs to be recorded in the batch record, even if the test is later invalidated due to laboratory error.

Understanding the FDA's Regulatory and Enforcement Tools

Data integrity violations can lead to serious consequences, including:

- **Bad press.** Companies are put on a publicly accessible list and customers may refuse to deal further with the manufacturer. Since the products are rendered adulterated, both federal and state prosecutions, and private litigation, may follow a company's failure to follow current GMP regulations related to data integrity.
- **Warning Letters.** Increasingly, FDA Warning Letters have included data integrity violations. Often, these Warning Letters are a prelude to prosecution. They can also be considered by some states as evidence of consumer fraud or other statutory violations. This is the most common action FDA takes for violations uncovered during FDA inspections. An unsatisfactory response by your client could lead the FDA to take stronger actions, such as injunctions, seizures, or criminal prosecution. Although Warning Letters often come before prosecution due to internal agency guidelines, there is no requirement that a company receive a Warning Letter first.
- **Withdrawal or suspension of drug/device applications.** The FDA has an AIP which includes the option of withdrawing an application in cases of material fraud. Data integrity problems uncovered during GMP inspections or prior approval inspections may also lead to delays in application or supplement approvals.
- **Stopping product at the border.** The FDA can impose import alerts to prevent the import of the products by a manufacturer pursuant to Section 801(a)(3) of the federal Food, Drug, and Cosmetic Act. Once a product is subject to an import alert, it may be detained without physical examination at the time of entry.
- **Injunctions shutting companies down and imposing monitors.** The FDA may enjoin a company from distributing product to the market and require that third parties audit and certify the facilities, and then that the FDA reinspect the facilities, before a company can resume manufacturing and selling product.
- **Seizure of product.** This can take place at a customer's warehouse or at the manufacturer's premises. The FDA may administratively detain or request that the U.S. Marshals Service seize millions of dollars of product and the goods may be destroyed.
- **Senior executive criminal liability.** Senior executives who have supervisory responsibility—even if they had no knowledge of the violations—can be prosecuted for strict liability misdemeanors[1] and in cases where mens rea is established, for felonies.
- **Billion-dollar penalties under health-care laws and possible onerous corporate integrity agreements.** GMP has become a part of the fraud and abuse panoply of underlying health-care offenses. The U.S. Department of Justice also frequently charges criminal defendants under false statements theories. Exclusion from Medicaid and Medicare reimbursement is another possible consequence.

1. United States v. Park, 421 U.S. 658 (1975).

Risk Management Strategies

The following are basic steps a company can take to comply with the FDA's data integrity regulations and guidance:

- **Perform data integrity assessments.** Your client should perform an assessment, using internal resources or experienced third parties, to evaluate current data controls. Questions to ask include:
  - Does your firm have a signature log?
  - Are there unique usernames and passwords?
  - How often are audit trails reviewed?
  - Are spreadsheets validated? If gaps are identified, you can devise a plan to address them in a prioritized fashion based on risk.
- **Examine both lab and production activities.** In the past, the FDA has focused on labs and the integrity of laboratory data. However, the FDA is increasingly focused on production processes and areas. Consider the controls in place throughout your facility, such as user access to equipment.
- **Institute a quality on the floor program.** The presence of quality personnel during production can encourage personnel to comply with procedures describing how to appropriately generate and handle data. Quality personnel may also be able to witness critical activities that are being documented.
- **Be suspicious of data that is too perfect.** Sometimes perfect data masks fraud. If your client never sees failing test results for a particular laboratory test, or if environmental monitoring data looks too good, or if employees are too efficient (too many steps are completed in too short of a time period), then your client should examine controls in place to prevent the falsification of data.
- **Create a culture where employees feel comfortable raising concerns.** If an employee raises a legitimate concern, promptly investigate. Additionally, find ways to incentivize this behavior so that transparency is valued and rewarded. There have been times when the FDA investigators have begun an inspection with advance knowledge about specific data integrity lapses because they have received information from informants, who may be current or former employees. Bear in mind that employees may become whistleblowers if they feel that the quality issues they raise are ignored or if they believe that the company is engaged in wrongdoing.
- **Impose a 10,000-foot perspective.** Complying with data integrity requirements is more than being able to say with confidence that no one at your company is committing fraud (e.g., intentionally falsifying records). The FDA cares about systemic controls. The FDA wants you to be able to prevent data integrity lapses and detect it if it ever occurs, even if you have no reason to believe any employee would engage in deceptive practices.

Responding to Data Integrity Violations

Take the following steps to adequately address and mitigate data integrity incidents and to ensure preservation of the attorney-client privilege and work product protection for certain company materials:

- **Open a documented investigation promptly.** Make it a high priority to determine whether the incident could and does have a quality impact. If so, batches may need to immediately be put on hold and the FDA may need to be notified.
- **Determine the scope of the issue and the root cause.** First, determine who was involved in the incident and how widespread the problem may be. Interview employees, under privilege as a best practice, to determine scope and root cause.
- **Determine appropriate corrective and preventive actions (CAPAs).** Based on the root cause determination, CAPAs should be developed. An example might be additional training, with quizzes to ensure comprehension. A preventive action might be modifying standard operating procedures and batch records so that certain manufacturing steps require second person verification, meaning that another person must witness the event and document his or her involvement in the batch record. A corrective action could be performing a retrospective review of records to ensure that past records are accurate. Some corrective actions may be more systemic and take time to implement. You should consider whether interim controls are necessary. Also, you should work with your client's human resources department to determine appropriate employment actions for employees involved in data integrity incidents.
- **Engage third parties.** If the FDA discovers a data integrity issue before your client, then your involvement, the involvement of counsel specializing in life sciences data integrity investigations, or the involvement of a consultant becomes more important. The agency has stopped trusting what the company says, and many independent third parties have strong reputations with the agency. The FDA may request (in a Warning Letter, for example) that your client engage a third-party consultant. However, hiring a third-party consultant before the FDA requests that your client do so will show the agency that your client is committed to compliance and uncovering any systemic issues arising from a data integrity lapse.

Related Content

For a checklist to assist with data integrity compliance risk management, see

> **DATA INTEGRITY RISK MANAGEMENT FOR LIFE SCIENCES CHECKLIST**

RESEARCH PATH: *Life Sciences > Manufacturing and Recalls > Checklists*

For information about data integrity-related U.S. Food and Drug Administration (FDA) enforcement activity and FDA regulatory activity related to data collection and maintenance standards, see

> **FDA WARNING LETTERS TRACKER, FDA DRUG REGULATORY ACTIVITY TRACKER, and FDA MEDICAL DEVICE REGULATORY ACTIVITY TRACKER**

RESEARCH PATH: *Life Sciences > FDA Approval Process > Practice Notes*

For information about FDA inspections, see

> **FDA FORM 483 INSPECTION OBSERVATIONS AND RESPONSES**

RESEARCH PATH: *Life Sciences > Regulatory Enforcement > Practice Notes*

For an overview of FDA drug and medical device regulation generally, see

> **FDA REGULATION OF PHARMACEUTICALS and FDA REGULATION OF MEDICAL DEVICES**

RESEARCH PATH: *Life Sciences > FDA Approval Process > Practice Notes*

For an overview of life sciences industry regulation in international jurisdictions, see

> **HEALTHCARE ENFORCEMENT AND LITIGATION IN INTERNATIONAL JURISDICTIONS**

RESEARCH PATH: *Life Sciences > International Considerations > Practice Notes*

- **Determine if FDA Disclosure is needed.** If the data integrity violation impacts the quality of distributed batches or could lead to adverse health consequences, the FDA must be notified. Depending on the circumstances, a Field Alert Report, Adverse Event Report, Medical Device Report, or Biological Product Deviation Report may be the appropriate communication tool. L

***Scott Bass** heads Sidley Austin's Global Life Sciences team, coordinating pharmaceutical, medical device, food, and dietary supplement matters in the United States, Europe, and Asia. He is ranked internationally among the top authorities on FDA-related enforcement and regulatory issues and has led GMP audits and investigations in the United States, EU, and China. **Deeona Gaskin** served as Associate Chief Counsel for Enforcement at the U.S. FDA and is now a senior associate in Sidley's Food, Drug and Medical Device Compliance and Enforcement group. She handles current Good Manufacturing Practice, Quality System Regulation, data integrity, product recalls, and adverse event reporting matters on several continents, and also represents companies in False Claims Act enforcement actions and investigations.*

RESEARCH PATH: *Life Sciences > Manufacturing and Recalls > Practice Notes*


Timothy B. Howell and Alex Petrossian CAHILL GORDON & REINDEL LLP

Financial Definitions in **High-Yield Indentures**

The defined terms in any agreement are considered as the building blocks upon which the rest of the agreement is based, particularly when it comes to the negative covenants in a bond indenture.

THIS ARTICLE WILL INTRODUCE A FEW KEY FINANCIAL definitions found in high-yield indentures, with a particular focus on how they are derived from the income statement and used in the negative covenants. It will flag certain items within the financial definitions that company and underwriter's counsel often focus on as they review and negotiate the negative covenants in the typical high-yield indenture. Finally, it will discuss generally accepted accounting principles (GAAP) and the manner in which high-yield indentures typically regulate the issuer's accounting principles. This short introduction should not be considered a substitute for the careful review of proposed defined terms and their use in an indenture's covenants as these provisions are often extensively negotiated.

A typical high-yield bond indenture will include a suite of customary incurrence-based negative covenants. At a very high level, these negative covenants are intended to limit the ability of the issuer, the guarantors, and their restricted subsidiaries to engage in conduct that could potentially impair the issuer's ability to pay its interest and principal obligations in respect of the bonds. In order to provide the issuer with the flexibility to operate (and potentially grow) its business within the constraints of the negative covenants, the company and its counsel will negotiate with the underwriters and their counsel certain baskets and exceptions to each of the negative covenants. Given this article's focus on financial definitions, the discussion will be limited to how the financial definitions interact with the negative covenants governing the incurrence of debt and liens, as well as those governing the making of dividends, other restricted payments, and investments.

Consolidated Net Income

The calculation of consolidated net income starts with GAAP net income (or loss) of a company and its subsidiaries whose actions are restricted by the indenture (the Restricted Group). Net income as set forth on the income statement is the difference between two primary figures: (1) revenue and (2) the combination of costs and expenses. Although GAAP net income is a useful metric for evaluating a company's performance, companies prefer to present, and investors find it useful to review, other metrics that are intended to more closely approximate the usual and ordinary ongoing performance of the business. One such metric is Consolidated Net Income (CNI).

CNI has two principal uses in a high-yield bond indenture. First, it is the primary component of the builder basket in the restricted payments covenant. Under this basket, the issuer accrues additional capacity to make dividends, restricted payments, and investments based on a percentage (almost uniformly 50%) of the issuer's CNI, as reported in its quarterly and annual financial statements. The second use of CNI in a bond indenture is as the starting point for the calculation of earnings before interest, taxes, depreciation, and amortization (EBITDA), which is used primarily in the covenants limiting the incurrence of debt and liens.

In order to calculate CNI, GAAP net income is adjusted to include or exclude certain items. Although the adjustments vary from deal-to-deal, adjustments to net income generally fit into one of three types: (1) control adjustments, (2) normalizing adjustments, or (3) deal-specific adjustments.

Control Adjustments

In making control adjustments to GAAP net income, the intent is to eliminate the net income (or loss) of persons other than the issuer and its subsidiaries that make up the Restricted Group. These adjustments are made to ensure that consolidated net income (or loss) is not impacted by the income (or loss) of unrestricted subsidiaries and non-subsidiaries that are not bound by the indenture covenants.

Additionally, control adjustments are made to exclude items to which the issuer and guarantors (the Credit Group) do not have ready access. Therefore, net income from entities in which any member of the Credit Group has a minority interest is excluded from CNI even if it would otherwise be included in a calculation of GAAP net income. Similarly, when calculating CNI for purposes of the builder basket in the restricted payments covenant, the net income of a restricted subsidiary of the issuer that is not a guarantor is excluded to the extent that the income of such subsidiary is unable to be distributed to an entity within the Credit Group, whether by contract, law, or otherwise. Notably, the net loss of any such subsidiary is typically not excluded from the calculation. The reasoning is that, even though the issuer is unable to access the net income of such subsidiary, the issuer should not be insulated from such subsidiary's losses given that under a typical high-yield indenture, an issuer retains substantial capacity to make investments in restricted subsidiaries that are not guarantors. Importantly, if a member of the Restricted Group actually receives cash dividends from an unrestricted subsidiary or a non-subsidiary, that amount is added back to CNI in order to fairly reflect the value of the Restricted Group.

Normalizing Adjustments

The intent in adjusting GAAP net income for normalizing adjustments is to remove those financial statement items that are not considered to be reflective of the ongoing daily operations of the issuer. Normalizing adjustments may include:

- Adjustments for after-tax nonrecurring, unusual, or extraordinary gains, losses, income, expenses, or charges
- One-time gains or losses
- Noncash impairment charges
- Unrealized gains or losses from hedging activities
- Effects of purchase accounting adjustments or changes in accounting practices
- Infrequent or nonrecurring business expenses
- Transaction fees or expenses for financing or mergers and acquisition activities
- Income (or loss) from nonoperating assets (e.g., discontinued operations)
- Other similar (and often heavily negotiated) items

Negotiating normalizing adjustments to CNI often entails gaining a good understanding of the issuer's business, as the goal of including such adjustments (both positive and negative) is to reflect the performance of an issuer's ongoing ordinary-course business operations. Practitioners should be careful to understand specific items proposed to be considered nonrecurring, unusual, or extraordinary, particularly when an item (e.g., public company costs or human resources costs) has appeared in the financial statements on a regular basis in the past or is expected to appear on a regular basis in the future.

Frequently, gains from asset sales are excluded from the calculation of CNI, so that the disposition of an income-generating asset does not build the restricted payments basket and enable the issuer to pay dividends. Similarly, losses from asset sales may be excluded from CNI, although in some cases such losses are not excluded, given that the asset base of the issuer has been reduced.

Deal-Specific Adjustments

It is not uncommon for an issuer to seek adjustments and add-backs to the definition of CNI that are specific to that issuer. It is important to understand why an issuer would want a particular adjustment included in CNI and the implications of that adjustment. For example, an adjustment to CNI would affect the amount of restricted payments that the issuer could make through the builder basket. While the extent and range of additional adjustments will vary from deal to deal, issuers often seek adjustments for noncash compensation expenses and certain other cash items such as net pension or other post-employment benefit costs, the costs associated with becoming a public company or earn-out obligations, and purchase price adjustments.

Another important EBITDA adjustment typically included in a high-yield indenture will allow an issuer to include the EBITDA of an acquired business in the calculation of Consolidated EBITDA as if the acquisition of that business had been consummated as of the first day of the relevant financial reporting period.

Consolidated EBITDA

Another financial definition common in high-yield indentures is Consolidated EBITDA. Although EBITDA is not defined under GAAP, the interest, taxes, depreciation, and amortization components can be derived from an issuer's income statement without too much difficulty. Consolidated EBITDA is intended to measure the operating cash flow of a company's ordinary-course business in order to assess the issuer's ability to service debt on a run-rate or recurring basis. The starting point for calculating Consolidated EBITDA (sometimes referred to as consolidated cash flow) is CNI.

As mentioned above, the primary use for Consolidated EBITDA is in the calculation of the performance-based ratios that govern when an issuer can take certain restricted actions, such as incurring debt or liens, paying dividends, or making investments. These covenants rely on either meeting or exceeding a fixed charge coverage ratio or not exceeding a specified leverage ratio in order to take the desired action. Consolidated EBITDA is used in the numerator when calculating the fixed charge coverage ratio and the denominator when calculating the leverage ratio. The calculation of Consolidated EBITDA is therefore of central importance to the issuer and bondholders, as a greater Consolidated EBITDA will make it easier for the issuer to satisfy its fixed charge coverage and/or leverage ratios for purposes of those covenants. Additionally, certain exceptions to the covenants limiting the incurrence of debt, liens, restricted payments, and investments may also include a Consolidated EBITDA-based grower component, which gives the issuer the ability to benefit from any improvements in the performance of its business by increasing capacity under those baskets.

Complexity arises in the definition of Consolidated EBITDA, however, as adjustments, add-backs, and carve-outs to EBITDA are introduced. Issuers will seek to reverse many of the normalizing adjustments to CNI and to add back all other noncash items that reduce CNI. Another category of EBITDA adjustments is exceptional or one-time costs. Although the premise behind these add-backs is that adjusting for exceptional or one-time costs more accurately reflects the operating cash flow of the underlying business, these add-backs should be fully understood in order to ensure that they are not overly inclusive. Examples of add-backs of this nature include adjustments for restructuring charges or expenses, management, consulting and advisory fees, and expenses paid to sponsor private equity owners.

The adjustment to Consolidated EBITDA that gets the most attention and requires the most skill in negotiating is the add-back for run-rate cost savings, business optimization expenses, or synergies. Broadly, this add-back allows an issuer to adjust EBITDA for the anticipated financial impact of certain specified planned actions or business changes. These savings could include those related to a reduction in the company's workforce, an operating improvement or business initiative, or perhaps the closure of a business unit. This add-back to Consolidated EBITDA is calculated on a pro forma basis, assuming the underlying action has already taken place even if it may not occur for quite some time. Accordingly, the issuer will be allowed to adjust for those actions that have either already been taken, or are expected to be taken or committed to be taken within a specified period of time (often 12 or 18 months, but sometimes longer) after the current financial reporting period. In addition, this EBITDA add-back may only permit adjustment for those cost savings or synergies that are actually realized during the relevant period of time or potentially for cost savings or synergies that are projected in good faith to be realized before a specific date. To mitigate the prospect of pure conjecture, the cost savings and synergies are required to be reasonably identifiable and factually supportable and, in many indentures, require a written certification regarding their accuracy from an officer of the issuer. The aggregate amount of adjustments pursuant to a cost-savings or synergies add-back is typically subject to an aggregate maximum amount, or cap, for the applicable reporting period, calculated based either on a dollar amount or on a percentage of Consolidated EBITDA (typically calculated prior to giving effect to the cost-savings adjustments).

Another important EBITDA adjustment typically included in a high-yield indenture will allow an issuer to include the EBITDA of an acquired business in the calculation of Consolidated EBITDA as if the acquisition of that business had been consummated as of the first day of the relevant financial reporting period.

Consolidated Interest Expense and Consolidated Fixed Charges

Another income statement item that is important in high-yield indentures is consolidated interest expense, which is both a component of consolidated fixed charges (the denominator for the fixed charge coverage ratio) and an adjustment to Consolidated EBITDA. Interest expense is a nonoperating expense included on the income statement that represents interest payable on the issuer's debt instruments. Under GAAP, interest expense is the cost of the funds that have been loaned to a company. Interest expense on the income statement represents the accrued interest liability during the relevant financial reporting period.

Under the typical high-yield indenture, the calculation of consolidated interest expense starts with GAAP interest expense, which is then adjusted to include consolidated capitalized interest, the interest component of capitalized lease obligations, and certain other items, including amortization of original issue discount. Certain other items that are treated as interest expense under GAAP, such as administrative agency fees, noncash interest expense (e.g., paid-in-kind interest), and additional interest attributable to registration rights obligations are then excluded. In order to calculate consolidated fixed charges from interest expense, an issuer will also adjust for net payments and receipts pursuant to interest rate hedging obligations. This adjustment is common because issuers with variable rate debt (such as London Interbank Offered Rate– or Secured Overnight Financing Rate–based term loans or floating rate bonds) will customarily enter into hedge agreements or swaps in order to protect against a potential increase in interest rates (and the associated impact on their interest expense).

Related Content

For a discussion of the market trends and outlook for high-yield debt offerings, see

> **MARKET TRENDS 2018/19: HIGH YIELD DEBT OFFERINGS**

RESEARCH PATH: *Capital Markets & Corporate Governance > Trends & Insights > Market Trends > Practice Notes*

For a detailed contrast between the covenants contained in a high-yield indenture and the covenants contained in an investment grade indenture, see

> **HIGH-YIELD VS. INVESTMENT-GRADE COVENANTS**

RESEARCH PATH: *Capital Markets & Corporate Governance > Debt Securities Offerings > Rule 144A/ Regulation S Debt Offerings > Practice Notes*

For additional information on high-yield offerings, see

> **TOP 10 PRACTICE TIPS: HIGH YIELD DEBT OFFERINGS**

RESEARCH PATH: *Capital Markets & Corporate Governance > Debt Securities Offerings > Rule 144A/ Regulation S Debt Offerings > Practice Notes*

For a general overview of debt securities, see

> **CORPORATE DEBT SECURITIES IN U.S. CAPITAL MARKETS**

RESEARCH PATH: *Capital Markets & Corporate Governance > Debt Securities Offerings > Rule 144A/ Regulation S Debt Offerings > Practice Notes*

Consolidated interest expense is also typically calculated net of any interest income earned during such period on the reasoning that if any cash interest was received it would be applied to reduce the company's interest expense burden.

Accounting Principles in Indentures

Given that there is so much reliance on the income statement for the financial definitions, the typical high-yield indenture will specify the accounting principles that apply when interpreting the indenture. U.S. issuers typically will prepare their financial statements in accordance with U.S. GAAP. Certain issuers that are either foreign or have substantial overseas operations will adopt the International Financial Reporting Standards (IFRS). The standard approach in high-yield indentures is to adopt the auditing and reporting standards in effect on the date the notes are issued, at least for purposes of the negative covenants. Although GAAP (or IFRS) is typically fixed at issuance for purposes of the negative covenants, many indentures will permit the company to prepare its financial statements in accordance with GAAP (or IFRS) as in effect from time to time, given that the accounting rules require financial statements to reflect the then-current GAAP.

There are two relatively recent exceptions to having a uniform set of accounting principles in an indenture. First, certain indentures provide issuers with the flexibility to switch the agreed-upon accounting principles in the indenture from GAAP to IFRS, assuming that they are also switching the accounting principles for their financial statements from GAAP to IFRS. The indenture will provide that once this switch has been made, it is irrevocable. Second, a handful of recent indentures permit issuers to convert, by written notice to the trustee, the accounting principles for purposes of the indenture from GAAP (or IFRS) as of the issue date to a version of GAAP (or IFRS) as of the date the notice is given. Some of these indentures will also permit issuers to exclude certain accounting changes that were adopted between the issue date and the date the issuer opted to switch to the current version of the accounting principles, so long as they clearly identify the changes to the accounting principles that are being excluded. As with a conversion from GAAP to IFRS, any switch to a more recent version of GAAP is also irrevocable. L

Timothy B. Howell *is a member of Cahill Gordon & Reindel LLP's corporate practice group. He represents leading investment banking firms, commercial banks, and public and private corporations with a focus on leveraged finance transactions involving high-yield debt securities, syndicated institutional loans, and asset-based lending facilities. Tim advises clients on the high-yield bond and bank sides of acquisition financings and debt refinancings as well as on asset-based lending facilities and equity offerings. He has experience in a variety of industries including media and communications, technology, retail, pharmaceuticals, healthcare, gaming, telecommunications, and natural resources.* ***Alex Petrossian*** *is an associate in the New York office of Cahill Gordon & Reindel LLP where he focuses his practice on corporate matters with an emphasis on matters relating to capital markets and lending. Alex represents leading investment banks, institutional investors, and commercial banks in connection with public and private capital markets transactions and bank financings, including high-yield bond offerings, equity offerings, syndicated institutional loans, asset-backed loans, tender offers, exchange offers, and consent solicitations in connection with acquisition financings, leveraged buyouts, going-private transactions, recapitalizations, bridge lending and loan commitments, and other financing transactions.*

Related Content

For practice tips on drafting high-yield indentures, see

> **INDENTURE DRAFTING FOR A RULE 144A/ REGULATION S ISSUANCE**

RESEARCH PATH: *Capital Markets & Corporate Governance > Debt Securities Offerings > Rule 144A/ Regulation S Debt Offerings > Practice Notes*

For a sample indenture for debt securities issued in a Rule 144A/Regulation S transaction, see

> **INDENTURE (RULE 144A AND/OR REGULATION S DEBT OFFERING)**

RESEARCH PATH: *Capital Markets & Corporate Governance > Debt Securities Offerings > Rule 144A/ Regulation S Debt Offerings > Forms*

For a review of the U.S. federal securities laws and rules applicable to indentures, see

> **INDENTURES AND TRUSTEES: APPLICABLE LAWS AND REGULATIONS**

RESEARCH PATH: *Capital Markets & Corporate Governance > Debt Securities Offerings > Medium-Term Note Programs > Practice Notes*

RESEARCH PATH: ***Capital Markets & Corporate Governance > Debt Securities Offerings > Rule 144A/ Regulation S Debt Offerings > Practice Notes***

Jim Wagstaffe AND THE WAGSTAFFE GROUP

Removal and Remand: **Tips for Making Your Case Disappear from Your Opponent's Choice of Forum**

This article addresses new strategies based on recent case law for a party seeking to remove a case to federal court or to avoid removal and stay in state court. The article covers topics such as forum selection clauses, pleading claims, ambiguity in the complaint, federal preemption, and amendments to the complaint.

BEFORE WE BEGIN, LET'S UNDERSTAND THE APPEARANCE and disappearance nature of federal removal jurisdiction. The plaintiff makes the case appear initially in state court, presumably choosing that sovereignty as best suited for the client. In response and generally only if the action as filed could have been brought there originally, the defendant can unilaterally remove the action to federal court. And then if the removal was jurisdictionally or procedurally improper, the plaintiff can move to remand causing the action to disappear from the federal stage teleported back to its original forum.[1]

So, what magic wands can you wave per the very recent case law to ensure that your client's case lands in the desired state or federal court? There are seven new and improved tricks to work your removal and remand magic.

One – Plaintiffs Can Prevent Removal by Sprinkling State Court Fairy Dust in Their Forum Selection Clauses

In recent years, the U.S. Supreme Court has strongly affirmed the right of parties contractually to plan the shape and location of anticipated litigation.[2]

For example, if the parties enter into a contract with a clause providing that all claims must be litigated exclusively in a described state court, this will constitute a waiver of the right to remove.[3]

1. *See* Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial Ch. 8: Analyzing Removal Jurisdiction (LexisNexis 2019). 2. *See* Atl. Marine Constr. Co., Inc. v. U.S. Dist. Ct., 571 U.S. 49 (2013); *see also* Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 12-III[H]. Specifically, the parties may contractually waive the right to remove a case by doing so in a valid forum selection clause limiting venue to state court. 3. *See* Medtronic Sofamor Danek, Inc. v. Gannon, 913 F.3d 704 (8th Cir. 2019) (forum selection clause providing claims must be litigated in specific state court precludes removal); FindWhere Holdings, Inc. v. Sys. Env't Optimization, LLC, 626 F.3d 752 (4th Cir. 2010) (same); Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-VII[A][2].

> With rare exceptions, even if there is a federal issue in the case, if the complaint contains only state law claims, removal on federal question grounds is not available.

By the same token, if the forum selection clause designates a county in which there is no federal courthouse, this too constitutes a waiver of the right to remove.[4]

Significantly, if a served codefendant (whose joinder ordinarily is required to remove) signed such a contractual removal waiver, it will also waive it for all removing parties.[5]

The tips for plaintiffs seeking to thwart removal are:

- First, name and serve the defendant(s) who are parties to the contractual waiver
- Make any motion to remand within 30 days of removal as this waiver itself can be waived

The tip for a removing defendant who was not a party to the waiver agreement is:

- Remove before service on a codefendant who was a party to the waiver agreement

Two – Plaintiffs Can Keep the State Court Rabbit in the Hat: Avoid Pleading Federal Jurisdiction in State Court Complaints

The magic trick for plaintiffs seeking to avoid removal of their case to federal court is to:

- Plead only state claims (to avoid federal question removal)
- Sue at least one party from the same state (to avoid diversity removal)[6]

When it comes to keeping the state court complaint jurisdictionally pristine, it is important to keep the defendant from successfully trying to make it seem like there nevertheless is a federal rabbit in the hat.

With rare exceptions, even if there is a federal issue in the case, if the complaint contains only state law claims, removal on federal question grounds is not available.[7]

By the same token, plaintiffs can keep the diversity jurisdiction rabbit in the hat by being sure to include a properly named party who is nondiverse. This includes a nondiverse member of any noncorporate entity.[8]

Three – Putative Plaintiffs Can Use the Magic Sauce of *Home Depot v. Jackson* by Filing Their Affirmative CAFA or Federal Claims as Third-Party Complaints

The U.S. Supreme Court in *Home Depot U.S.A., Inc. v. Jackson* confirmed that the right to remove actions to federal court is limited to defendants.[9] In particular, the high court ruled that even if there is a right to remove (say per Class Action Fairness Act of 2005 (CAFA), 28 U.S.C.S. § 1453), if the removing party was sued in a counterclaim or a third-party complaint, removal is not allowed.[10]

Thus, if a party wants to make the removal risk disappear, the brand new trick (called a "tactic" by the *Home Depot* dissenters) is to wait until one is sued (e.g., on a one-off collection case) and then include the otherwise removable CAFA or federal claim as a counterclaim or third-party complaint. Tactical magic.

Four – Defendants Can Use Procedural Sleights of Hand to Remove on Diversity Grounds

Plaintiffs often draft their complaints to include nondiverse codefendants or include a forum-based opponent to thwart efforts to remove the action to federal court. In response, defendants desiring to remove can use two sleight of hand magic tricks to change the focus:

- Declare that the nondiverse parties are sham and can be ignored
- Avoid the bar on local defendants by removing before service of process

The first effort is to argue that the parties otherwise defeating complete diversity are sham parties who have been joined improperly because there is no basis for recovery.[11] The sham joinder rule allows defendants to press the delete key on the nondiverse party only if there is no possible basis for recovery as ascertained on a summary basis.[12]

Related Content

For a discussion of how to remove a case to federal court, see

REMOVING A CASE TO FEDERAL COURT (FEDERAL)

RESEARCH PATH: *Civil Litigation > Initial Pleadings and Documents > Removing a Case to Federal Court > Practice Notes*

For an overview of the process for removing a case to federal court, see

REMOVING A CASE TO FEDERAL COURT CHECKLIST (FEDERAL)

RESEARCH PATH: *Civil Litigation > Initial Pleadings and Documents > Removing a Case to Federal Court > Checklists*

For step-by-step guidance on filing a motion to remand in federal court, see

MOTION TO REMAND: MAKING THE MOTION CHECKLIST (FEDERAL)

RESEARCH PATH: *Civil Litigation > Initial Pleadings and Documents > Removing a Case to Federal Court > Checklists*

For information on remanding a case in federal court, see

MOTION TO REMAND: MAKING THE MOTION (FEDERAL)

RESEARCH PATH: *Civil Litigation > Initial Pleadings and Documents > Removing a Case to Federal Court > Practice Notes*

In these extraordinary situations, the sham party's citizenship is ignored, and the remaining defendant(s) magically can then remove the case to federal court. The examples of sham joinder, while fairly rare, find support in the recent case law.[13]

The second sleight of hand removal tactic serves to divert attention away from the general bar on diversity removal by local defendants. Even if there is complete diversity, the removal statute provides that if one of the defendants is from the forum state (a so-called local defendant), then removal cannot take place.[14] The rationale for this prohibition is that even if there is complete diversity (e.g., out-of-state plaintiffs), a local defendant does not need removal to avoid local prejudice.[15]

However, the sleight of hand flows from the statutory language limiting this removal prohibition to served local defendants. Therefore, courts have recently authorized what is known as snap removal (i.e., removal by the local defendants before service).[16]

The trick thus is for the local defendant to scan the filings through available litigation databases and voluntarily appear and file a notice of removal before being served.

Five – Defendant's Houdini Escape Act from Late Removal: Seize upon Ambiguity in Complaint to Explain Delayed Removal

The normal rule is that a defendant must remove a case within 30 days of proper service.[17] And if the service is proper, ordinarily removal is unavailable if not accomplished within that 30-day window.[18]

So the Houdini escape act from this missed deadline is to:

- Seize upon a perceived ambiguity in the plaintiff's complaint as to federal jurisdiction (e.g., complaint doesn't identify parties' citizenship, no amount in controversy stated, ambiguous reference to origin of claim)
- Generate a paper trail in the case (e.g., interrogatory response as to amount in controversy)
- Remove 30 days from receipt of that paper[19]

If the ambiguity is actual, the governing case law confirms that the defendant may wait to remove until receipt of the paper providing clarity.[20]

Importantly, this seized upon the ambiguity trick can be used even if the defendant subjectively knew or should have known of the basis for removal.[21]

4. *See* Bartels v. Saber Healthcare Group, LLC, 880 F.3d 668 (4th Cir. 2018) (forum selection clause limiting venue to county in which there is no federal court precludes removal); Grand View v. Helix Electric, 847 F.3d 255 (5th Cir. 2017) (same); City of Albany v. CH2M Hill, Inc., 924 F.3d 1306 (9th Cir. 2019) (same). **5.** *See* Autoridad de Energia Electrica v. Vitol S.A. 859 F.3d 140 (1st Cir. 2017). **6.** *See* Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-II[B]. **7.** *See, e.g.*, Burrell v. Bayer Corp., 918 F.3d 372 (4th Cir. 2019) (state law claim for damages caused by sterilization product not properly removed simply because device regulated by FDA); Estate of Cornell v. Bayview Loan Servicing, 908 F.3d 1008 (6th Cir. 2018) (no removal of state law claim). *See also* Sec'y of Veteran Affairs v. Smith, 2018 U.S. Dist. LEXIS 48530 (S.D. Cal. March 28, 2018) (no removal of unlawful detainer action removed under federal Protecting At Foreclosure Act) (12 U.S.C.S. § 5220)); Jackson County Bank v. Dusablon, 915 F.3d 422 (7th Cir. 2019) (no federal jurisdiction in trade secret violation suit by bank against former employee even if implicating federal securities law); Mays v. City of Flint, 871 F.3d 437 (6th Cir. 2017) (no substantial federal question over tainted drinking water case simply because state officers working with EPA). **8.** *See, e.g.*, Settlement Funding LLC v. Rapid Settlements, 851 F.3d 530 (5th Cir. 2017) (any nondiverse member of LLC defeats removal); Purchasing Power LLC v. Bluestem Brands, Inc., 851 F.3d 1218 (11th Cir. 2017) (same). **9.** 139 S. Ct. 1743 (2019). **10.** *See also* Renegade Swish, L.L.C. v. Wright, 857 F.3d 692 (5th Cir. 2017) (no removal based on federal counterclaim); Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-V[C]. **11.** Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-VI[D]. **12.** *See* Grancare, LLC v. Thrower, 889 F.3d 543 (9th Cir. 2018) (nursing facility administrator could be personally liable and hence was not a sham defendant).

13. *See* Couzens v. Donahue, 854 F.3d 508 (8th Cir. 2017) (defendant not properly sued in individual capacity); Alviar v. Lilllard, 854 F.3d 286 (5th Cir. 2017) (no evidence of required willful intent for agent's individual liability for tortious interference); Casias v. Wal-Mart Stores, Inc., 695 F.3d 428 (6th Cir. 2012) (joinder of nondiverse corporate manager a sham party in wrongful termination suit because he did not actively participate in termination decision); *see also* Hoyt v. Lane Constr. Corp., 927 F.3d 287 (5th Cir. 2019) (removal permitted even if sham party involuntarily eliminated by summary judgment). **14.** 28 U.S.C.S. § 1446(b); Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-VI[E][4]. **15.** *Id.* **16.** Gibbons v. Bristol-Myers Squibb Co., 919 F.3d 699 (2d Cir. 2019); Encompass Insur. Co. v. Stone Mansion Rest. Inc., 902 F.3d 147 (3d Cir. 2018); *contra* Gentile v. Biogen Idec, Inc., 934 F. Supp. 2d 313 (D. Mass. 2013). **17.** 28 U.S.C.S. § 1446. **18.** *Compare* Shakouri v. Davis, 923 F.3d 407 (5th Cir. 2019) (defendant not properly served need not yet remove, although snap removal allowed); Elliott v. Am. States Ins. Co., 883 F.3d 384 (4th Cir. 2018) (service on statutory agent does not start 30-day removal clock); Anderson v. State Farm Mut. Auto Ins. Co., 917 F.3d 1126 (9th Cir. 2019) (same). **19.** *See* Morgan v. Huntington Ingalls, 879 F.3d 602 (5th Cir. 2018) (no need to remove until receipt of deposition transcript); Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-X[D]. **20.** *See* Cutrone v. Mortgage Electronic Registration Systems, Inc., 749 F.3d 137 (2d Cir. 2014) (if plaintiff's pleading is ambiguous, defendant may wait to remove until receipt of pleading or paper providing clarity); *see also* Quinn v. Guerrero, 863 F.3d 353 (5th Cir. 2017) (if state court complaint is uncertain and does not clearly refer to a federal claim for relief, removal need not take place until and if the claims are clarified by amendment or otherwise as arising under federal law). **21.** Harris v. Bankers Life & Cas. Co., 425 F.3d 689 (9th Cir. 2005); Graiser v. Visionworks, 819 F.3d 277 (6th Cir. 2016) (CAFA removal time not triggered until defendant receives sufficient information from plaintiff).

> If the defendant indeed has properly removed the action, the plaintiff may still perform a sovereign-changing remand magic trick by seeking to amend the complaint post-removal.

Six – Defendants Can Wave a Magic Federal Wand to Transform Seeming State Law Claims into Federal Removal Jurisdiction

Ordinarily, removal on federal question grounds is allowed only if the well-pleaded complaint shows on its face that the action arises under federal law. However, there are several exceptions to this doctrine, and removal can take place by defendants waving a magic federal wand to remove the action to their preferred forum. In four main circumstances, this happens when the state court claims are recharacterized as federal in defendant's notice of removal:

- **Claims raise a substantial and disputed federal question.** There may be limited situations in which a case is removable even though only state law claims are stated because they necessarily raise a substantial and disputed federal question.[22] Of course, such situations are rare and occur only when allowing removal would not disturb the federal-state balance approved by Congress.[23]
- **Preemption.** There are also limited areas where federal law completely preempts the artfully pled state law claims and replaces them with the necessary federal claim. This occurs primarily in the areas of Labor Management Relations Act, Employee Retirement Income Security Act of 1974, and copyright law.[24]
- **Federally chartered corporations.** Removal jurisdiction is allowed as to claims involving federally chartered corporations if they have a charter that provides that the entity may sue and be sued in federal court.[25]
- **Federal officer.** The federal officer removal statute, 28 U.S.C.S. § 1442, allows removal if the federal officer raises a colorable federal defense and establishes that the suit is for an act under color of office.[26] The statute also authorizes removal to federal court by persons acting under an officer or agency of the United States who are sued for acts "for or relating to any act under color of such office." This also includes such persons raising colorable federal defenses.[27] Thus, even private persons or corporate entities who acted under the direction of a federal officer or agency can remove actions to federal court if there is a causal nexus to their actions under color of federal office.[28]

22. *See* Hornish Joint Living Trust v. King Cty., 899 F.3d 680 (9th Cir. 2018) (state claims to declare property rights in railway corridor raised substantial federal question under National Trails System Act due to federal interest to preserve shrinking rail trackage); Bd. of Comm'rs v. Tenn. Gas Pipeline Co., 850 F.3d 714 (5th Cir. 2017) (suit by local flood protection authority alleging oil companies' activities damaged coastal lands raised substantial federal question since federal law provides standard of care); Turbeville v. Fin. Indus. Regulatory Auth., 874 F.3d 1268 (11th Cir. 2017) (removal jurisdiction existed over case against Financial Industry Regulatory Authority for defamation based on its federally regulated disclosure and investigation). **23.** Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-V[B][5][c]. **24.** Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-V[E]. *See, e.g.*, Cavallaro v. UMass Mem'l Healthcare, Inc., 678 F.3d 1 (1st Cir. 2012) (claims for money had and received, unjust enrichment, and conversion brought by union employee essentially were ones for unpaid wages, hinging on an interpretation of the collective bargaining agreement and hence removal proper on complete preemption doctrine); *but see* Dent v. NFL, 902 F.3d 1109 (9th Cir. 2018) (state discrimination suit not completely preempted). **25.** Fed. Home Loan Bank of Bos. v. Moody's, 821 F.3d 102 (1st Cir. 2016); *but see* Lightfoot v. Cendant Mortg. Corp., 137 S. Ct. 553 (2017) (Fannie Mae's charter providing for jurisdiction in "any court of competent jurisdiction" does not provide for federal jurisdiction since it contemplates court in which there is an otherwise existing source of subject matter jurisdiction); *see also* Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-VII[A][1]. **26.** Jefferson Cty. v. Acker, 527 U.S. 423 (1999). **27.** *See* Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-VIII[B][2]. **28.** *See* Butler v. Coast Elec. Power Ass'n, 926 F. 3d 190 (5th Cir. 2019) (federal officer removal allowed to cooperatives raising federal preemption defense arising from federal loan agreements); Zeringue v. Crane Co., 846 F.3d 785 (5th Cir. 2017) (federal officer removal over asbestos claim against government contractor supplying product to Navy and lawfully assisting federal officer in performance of officer's duties); Sawyer v. Foster Wheeler LLC, 860 F.3d 249 (4th Cir. 2017) (same); Hammer v. U.S. Dept. of Health and Human Services, 905 F.3d 517 (7th Cir. 2018) (federal officer removal of civil actions includes motions for declaratory relief); *but see* Mays v. City of Flint, 871 F.3d 437 (6th Cir. 2017) (rejecting federal officer removal when state officials not acting under supervision of federal agency); Fidelitad, Inc. v. Insitu, Inc., 904 F.3d 1095 (9th Cir. 2018) (no federal officer removal if not acting at federal officer's direction); Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-VII[B][2][d].

Seven – Plaintiff's Post-removal Fortune Telling Efforts to Change the Future Course of the Action

If the defendant indeed has properly removed the action, the plaintiff may still perform a sovereign-changing remand magic trick by seeking to amend the complaint post-removal. The fortune telling change-effort occurs when the plaintiff files an amendment:

- To dismiss the federal claim
- To add a nondiverse party

The defendant may then file a follow-up remand motion.

Section 1447(e) of Title 28 clearly authorizes courts to consider a plaintiff's post-removal changes to the case and remand the case to state court if appropriate (e.g., by the destruction of diversity with the joinder of a nondiverse party). However, since removal jurisdiction is measured at the time of removal, the court has discretion to deny the requested changes—especially if the plaintiff's motives are transparently unjustified.[29]

Related Content

For a review of the personal jurisdiction requirements in federal court, see

PERSONAL JURISDICTION (FEDERAL)

RESEARCH PATH: *Civil Litigation > Initial Pleadings and Documents > Assessing Jurisdiction and Venue > Practice Notes*

For guidance on moving for dismissal for lack of federal subject matter jurisdiction, see

MOTION TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION: MAKING THE MOTION (FEDERAL)

RESEARCH PATH: *Civil Litigation > Motions > Dispositive Motions > Practice Notes*

For information on raising federal question jurisdiction, see

FEDERAL QUESTION JURISDICTION: PLEADING AND CHALLENGING FEDERAL QUESTION JURISDICTION (FEDERAL)

RESEARCH PATH: *Civil Litigation > Initial Pleadings and Documents > Commencing a Civil Action > Practice Notes*

If the plaintiffs succeed in achieving a remand, they may move for attorney's fees and costs if there was no objectively reasonable basis for the defendant to have removed the action.[30] However, plaintiffs may well decide not to seek such relief as there often is no magic in sanctions because—unlike the remand decision itself—an award of sanctions is subject to an appeal. Such an appeal almost certainly will cost more than what is at stake.

Conclusion

When it comes to the magic of removal and remand, attorneys should keep up on the most recent case law.

James M. Wagstaffe *is a renowned author, litigator, educator, and lecturer, and the premier industry authority on pretrial federal civil procedure. He is a partner and co-founder of Kerr & Wagstaffe LLP, where he heads the firm's Federal Practice Group. He maintains a diverse litigation practice, including complex litigation, professional and governmental representation, will and trust disputes, legal ethics, First Amendment cases, and appeals in state and federal courts. He has particular expertise on virtual world issues, including electronic discovery and Wi-Fi technology. In 2017, California Lawyer named him Attorney of the Year for his successful representation of The State Bar of California in a high-profile privacy trial. He has authored and co-authored a number of publications, including The Wagstaffe Group® Practice Guide: Federal Civil Procedure Before Trial. As one of the nation's top authorities on federal civil procedure, Jim has helped shape the direction and development of federal law.*

RESEARCH PATH: *Civil Litigation > Initial Pleadings and Documents > Removing a Case to Federal Court > Articles*

29. *See* Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-XI[B][H]. **30.** Martin v. Franklin Capital Corp., 546 U.S. 132 (2005); Wagstaffe Prac. Guide: Fed. Civ. Proc. Before Trial § 8-XI[G].

LexisNexis Receives UN Foundation Global Leadership Award

The United Nations Foundation's Global Leadership Award was presented to LexisNexis Legal & Professional CEO Mike Walsh in recognition of the company's contributions to advancing the rule of law across the globe.

THE AWARD RECOGNIZES LEXISNEXIS' "EXTRAORDINARY commitment to advancing the rule of law globally by strengthening equality under the law, transparency of law, independent judiciaries, and accessible legal remedy."

"I'm honored and humbled to receive this award from the United Nations Foundation and accept on behalf of the dedicated people of LexisNexis," Walsh said. "Our mission to advance the rule of law makes LexisNexis a special company and place to work because our people can see the clear connection between advancing the rule of law and creating a better society." Prior winners of the award include Desmond Tutu and former President Barack Obama.

Walsh was honored at the Foundation's annual Global Leadership Dinner in New York City on November 20. Other honorees were Mary Robinson, former president of the Republic of Ireland and UN High Commissioner for Human Rights; author and feminist activist Chimamanda Ngozi Adichie; and Dr. Gunhild Stordalen, chair of the Stordalen Foundation and founder of EAT Foundation.

In a statement announcing the awards, the Foundation said, "From transforming the global food system to defending human rights to using literature to connect with individuals on issues of equality, the honorees continue to make invaluable contributions to our world. Their work brings to life the goals enshrined in the UN Charter—to promote peace, justice, and fundamental human rights for all people."

Founded in 1998 by entrepreneur and philanthropist Ted Turner, the UN Foundation works with philanthropic, corporate, government,

and individual partners "to help the United Nations mobilize the ideas, people, and resources it needs to drive global progress and tackle urgent challenges." Additional information about the Foundation is available at www.unfoundation.org.

LexisNexis has advanced the rule of law through its core operations and by mobilizing the business community to engage in the rule of law with projects such as the United Nations Global Compact's Business for the Rule of Law Framework. The company also partnered with the International Bar Association in developing the eyeWitness to Atrocities app, which allows witnesses to verify atrocities and report them to the appropriate agencies. In support of its rule of law activities, LexisNexis established LexisNexis Rule of Law Foundation in 2019.

Lexis Practice Advisor®

LexisNexis®

Your Life Sciences practice is complex. Your legal resources don't have to be.

From biotech deal clauses to insight into the latest FDA activity, get your Life Sciences "know-how" in one convenient place.

Comprehensive practical guidance for your life science practice. Lexis Practice Advisor® for Life Sciences offers a dedicated, task-based tool to help you:

- **Navigate your complex regulatory landscape with greater ease, speed, and confidence.** Only Lexis Practice Advisor offers sophisticated regulatory trackers and state surveys for at-a-glance of coverage of FDA activity and state laws and regulations.
- **Access superior content focused exclusively on practical guidance for life science matters.** Find deep and trusted "how-to" materials organized around specific life sciences tasks covering regulatory approval, clinical research, IP issues, transactional matters and more.
- **Find timely, topical forms and agreements expressly developed for, and vetted by, life science practitioners.** Gain efficiency and time with access to these trusted resources all in one place.

Request your free trial of Lexis Practice Advisor today.

Call 800-628-3612 or www.lexisnexis.com/practice-advisor.

The industry's leading docket research solution just got better

CourtLink® now offers the same unmatched court coverage with the added power of the Lexis Advance® platform.

Staying on top of litigation activity has never been easier with:

- Streamlined search form
- One-click Alerts and Tracks setup
- Familiar Lexis Advance filters

Lexis Advance CourtLink
The best way to perform docket research.

LexisNexis.com/**CourtLink**

LexisNexis®