

## Dispute Resolution

## Tokyo Disputes Practice

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## How Resort to US Courts and Discovery Can Backfire in International Arbitration

When faced with an international business dispute, most lawyers are inclined, instinctively, to resort to the procedures of their own legal system. This is natural and understandable, especially if a lawyer is familiar only with the courts and procedures of that jurisdiction. But this can be a fatal mistake when an international arbitration arises, as the case below illustrates.

**The background**

Our client contracted with a US-based contractor for certain construction works. Their contract provided for ICC arbitration in Paris. Thereafter, our client terminated the contract because the contractor's work was defective. While the contract (and its arbitration clause) was between only our client and the contractor, our client had noticed that the contractor's parent had become increasingly involved in the contract's performance.

Accordingly, our client wanted to find a way to bring the US parent company into the arbitration it intended to bring against the contractor. To do so, we needed to argue that the US parent company was bound by the contract's arbitration clause. One of our legal arguments was that the contractor's corporate veil should be pierced because of the parent's disregard for the contractor's corporate form.

Consequently, when our client began an ICC arbitration, it named the contractor and the contractor's US parent company as respondents. However, while information about disregard of the corporate form was known by the contractor and its parent, the limited discovery generally available in an ICC arbitration did not seem likely to lead to disclosure of this information.

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## Arbitration Standards of Discovery

The 1999 IBA Rules on the Taking of Evidence on International Arbitration—which the tribunal chose to apply in this case—provide for more limited discovery than in common law jurisdictions, but for more expansive discovery than in the civil law world.<sup>1</sup> It would have been particularly difficult to demonstrate to the arbitrators' satisfaction that the case was an appropriate one in which to pierce the corporate veil—a notoriously difficult standard under practically all systems of law.

### Extensive US discovery

But then the contractor's parent applied to a US District Court to enjoin the Paris-based ICC arbitration, arguing that it was not bound by the arbitration clause. Part of the District Court's inquiry into whether to grant the parent company's motion for a preliminary injunction included an inquiry into its probable success on the merits, which in turn involved an inquiry into whether the corporate veil would likely be pierced.

Therefore, our client became entitled to discovery under the US Federal Rules of Civil Procedure on whether the corporate veil of the contractor could be pierced and the parent company brought into the ICC arbitration in Paris. This enabled our client to conduct far more extensive discovery than would normally have been available in an ICC arbitration and to obtain substantial evidence that the parent had wholly disregarded the contractor's corporate form, justifying the piercing of its corporate veil. This information would almost certainly never have become available to our client under the more limited document disclosure provided for by the IBA Rules.

### The Award

While the US District Court dismissed the parent company's case for lack of jurisdiction over our client, we were able to use the information that we had acquired in the ongoing arbitration. Based on this information, the ICC arbitral tribunal decided, unanimously, to pierce the corporate veil and hold the parent company bound by the arbitration clause in the contract, leading the parent company to settle the case.

## Conclusion

While the parent company and its US-based lawyers resorted to US courts presumably because this is what they were most familiar with, had they been more familiar with international arbitration and foreign rules of civil procedure, they would almost certainly not have begun a US court action that exposed their client to US discovery. Consequently, when involved in an international arbitration, it is vital that a party's lawyers have a good command of international arbitration practice.

A longer version of this article was written by Christopher R. Seppälä and Elizabeth Oger-Gross, "How Resort to US Courts—with US Discovery—Can Backfire on a US Party to an International Arbitration," in *International Disputes Quarterly* (Summer 2010), at <http://www.whitecase.com/idq/summer-2010-3/>.

# Recent Prosecutions under the Japanese FCPA

The following is a summary of the recent Japanese FCPA case.

In the last year, four Japanese construction consultants were found guilty of violating Article 18 of Japan's Act Against Unfair Competition (which acts as Japan's Foreign Corrupt Practices Act) for bribing a

Vietnamese government official who had authority over road construction projects. All four consultants were sentenced to suspended prison terms. Under Article 18 of the Act, an individual may be punished with up to 5 years of imprisonment or up to JPY 5 million in fines and a legal entity may

be punished with up to JPY 300 million in fines. A court will likely consider how well a legal entity trained its employees and agents concerning anticorruption compliance when determining the extent of the legal entity's liability for a violation of Article 18.

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<sup>1</sup> See International Bar Association, IBA Rules on the Taking of Evidence in International Commercial Arbitration (June 1, 1999), Rules 3(3)(a) and (b). The revised Rules adopted in 2010 do not change this standard as regards paper documents.

# The Risk of Sending Cease and Desist Letters Pre-filing in Patent Litigations

## Introduction

In the US, Japan and other countries, it is common practice for a rights holder to send cease and desist letters to a third party believed to be infringing its intellectual property rights. If the third party infringer ignores the cease and desist letter or if the resulting settlement negotiations prove unsuccessful, the rights holder then brings an infringement suit to enforce its rights and to enjoin the third party from future infringement. While this practice may be familiar to many readers, recent decisions of the Court of Appeals for the Federal Circuit (the "Federal Circuit") dramatically lowered the bar for what constitutes a "case or controversy," a pre-condition for bringing a declaratory judgment under US law. As a result, it is now easier for infringers to file for declaratory relief before being sued for infringement, thereby securing a venue more favorable to the infringer. Consequently, many rights holders no longer send cease and desist letters and instead file suit against the infringer before giving notice to the infringer of the claimed infringing activity.

A case or controversy is generally understood to mean an actual, as opposed to *potential*, dispute between two parties. In the past, the standard for determining whether a case or controversy existed was relatively high and required more than a letter from a rights holder demanding that the infringer cease its infringing activities.<sup>1</sup> The thinking was that a demand letter by

itself could not be viewed as a threat of litigation in all cases. Hence, rights holders could send such letters and still later sue in the district court of their choice (so long as jurisdiction and venue requirements were met) if settlement negotiations were unsuccessful. In 2007, the standard for determining whether a case or controversy existed began to be lowered making it easier for declaratory actions to be brought. Who sues first, the infringer or the rights holder, is an important consideration in US patent litigations because there are significant differences between district courts in how they adjudicate patent infringement actions. Data compiled over the last several years clearly shows that rights holder have a greater chance of success (sometimes with a 70% chance of success) in prevailing if the claim is brought in courts such as the Eastern District of Texas, the Eastern District of Virginia, the Western District of Wisconsin and others. Conversely, courts such as the District Court of Connecticut tend to be more hostile to rights holder claims and the chances of success are much lower. The result is that rights holders are sending cease and desist letters after filing their complaint in the district court of their choice. Once an action is filed by a rights holder, an infringer is prevented from bringing a declaratory action involving the same patents (i.e., first to file wins). The next strategic consideration for rights holders is whether to promptly serve the complaint on the infringer or to delay service as permitted under the local rules.

## MedImmune, Inc. v. Genentech, Inc.

In March 2007, the Supreme Court handed down the **MedImmune, Inc. v. Genentech, Inc.** decision.<sup>2</sup> **MedImmune, Inc.** and its progeny lowered the bar for declaratory actions to be brought in patent infringement cases. Consequently, patent holders now face substantial risk that cease and desist letters will be answered with a complaint for declaratory relief in a district court more convenient or friendly to non-rights holder. The lower standard applied to requests for declaratory relief means that infringers can now more readily take control of timing and venue away from patent holders.

## Discussion

### A. Declaratory Judgment Jurisdiction: Cases and Controversies

Article III of the US Constitution limits the judicial power of the United States to the resolution of "cases" and "controversies,"<sup>3</sup> and the Declaratory Judgment Act permits a court to declare the rights and other legal relations of a party seeking such declaration only in "a case of actual controversy."<sup>4</sup>

<sup>1</sup> The existence of a case or controversy is important because a federal court may only adjudicate when a case or controversy exists. Absent a case or controversy, federal courts have no jurisdiction to hear the alleged dispute.

<sup>2</sup> 549 US 118 (2007).

<sup>3</sup> US CONST. art. III, § 2, cl. 1; *Valley Forge Christian Coll. v. Ams. United for Separation of Church & State, Inc.*, 454 US 464, 471 (1982).

<sup>4</sup> 28 U.S.C. § 2201.

Until the Supreme Court's 2007 decision in **MedImmune, Inc.**, the long-standing test used by the Federal Circuit for determining whether there was an "actual controversy" was the reasonable apprehension test. This two-part test required the plaintiff to prove the existence of the following:

- (1) an explicit threat or other action by the patentee, which creates a reasonable apprehension on the part of the declaratory plaintiff that it will face an infringement suit; and
- (2) present activity which could constitute infringement or concrete steps taken with the intent to conduct such activity.

But even when this two-part test was seemingly satisfied, a court could exercise its discretion to decline declaratory judgment jurisdiction.

In **MedImmune**, the Supreme Court held that a party seeking the declaratory relief of patent invalidity or non-infringement must prove that "the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment."<sup>5</sup>

In **SanDisk Corp. v. STMicroelectronics, Inc.**, the first Federal Circuit decision to consider declaratory judgment jurisdiction after **MedImmune**, the Court held that "where a patentee asserts rights under a patent based on certain identified ongoing or planned activity of another party, and where that party contends that it has the right to engage in the accused activity without license, an Article III case or controversy will arise and the party need not risk a suit for infringement by engaging in the identified activity before seeking a declaration of its legal rights."<sup>6</sup>

### B. **Hewlett-Packard Company v. Acceleron LLC**

In **Hewlett-Packard Co. v. Acceleron LLC**,<sup>7</sup> the US Court of Appeals for the Federal Circuit reversed a lower court's dismissal of HP's declaratory judgment suit for non-infringement and invalidity of Acceleron's US Patent No. 6,948,021 relating to blade servers ("'021 Patent").

On September 14, 2007, Acceleron sent a letter to HP, calling its attention to the '021 Patent and the fact that it relates to Blade Servers.<sup>8</sup> Acceleron also asked HP to agree that "all information exchanged between the parties will not be used for any litigation purposes whatsoever...or [that it] otherwise created any actual case or controversy regarding the enclosed patent."<sup>9</sup> Acceleron imposed a deadline to reply within two weeks, and stated that if it did not hear back by that time, it would assume that HP had no interest in discussing the '021 Patent.<sup>10</sup>

On October 1, 2007, HP sent a letter to Acceleron, stating that it was interested in discussing the '021 and that it would be willing to agree not to file a declaratory judgment action for a period of 120 days if Acceleron would agree not to file an action against HP during the same 120-day period.<sup>11</sup>

On October 5, 2007, Acceleron sent a letter to HP, stating that it believed that HP had no basis for filing a declaratory judgment action.<sup>12</sup> Acceleron once again requested HP's response within two weeks, and stated that if it did not hear back by that time, it would understand that HP is not interested in discussing the '021 Patent and does not have anything to say about the merits of the '021 Patent or its relevance to HP's Blade Server products.<sup>13</sup>

On October 17, 2007, only twelve days after Acceleron's second letter and slightly more than one month after its first letter, HP filed a declaratory judgment action in the US District Court for the District of Delaware, seeking a declaratory judgment of non-infringement and invalidity of the '021 Patent.<sup>14</sup>

After weighing the totality of the circumstances, the Court held that "it was not unreasonable for HP to interpret Acceleron's letters as implicitly asserting its rights under the '021 Patent."<sup>15</sup> The Court noted that declaratory judgment jurisdiction cannot be defeated simply by avoiding the use of certain words such as "litigation" or "infringement," and citing **MedImmune** and post **MedImmune** decisions, raised the following factors as weighing in favor of finding declaratory judgment jurisdiction:

- Patentee is a patent holding company (i.e., a patent troll)
- Patentee asserted that a patent is "relevant" to the other party's specific product line
- Patentee imposed a short deadline for a response
- Patentee insisted that the other party not file suit
- Patentee refused to enter into a mutual standstill agreement

On the other hand, the Court also noted that "a communication from a patent owner to another party, merely identifying its patent and the other party's product line, without more, cannot establish adverse legal interests between the parties,"<sup>16</sup> which gives at least some guidance to a patent owner wishing to avoid facing a declaratory judgment suit.

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<sup>7</sup> 587 F.3d 1358 (2009).

<sup>8</sup> *Id.* at 1360.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 1361.

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<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 1363.

<sup>16</sup> *Id.* at 1362.

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<sup>5</sup> 549 US at 127.

<sup>6</sup> 480 F.3d 1372, 1381 (Fed. Cir. 2007).

### C. The effect of MedImmune

Under the **MedImmune** standard for determining declaratory judgment jurisdiction, sending cease and desist letters could mean handing over control of potential litigation to infringers. Infringers could be given the opportunity to drive the timing and location of the lawsuit. Similarly, cease and desist letters could result in dragging patent holders into litigation when they hoped to resolve disputes without lawsuits.

### D. File first

In light of the risk patent holders face that infringers may respond to cease and desist letters—no matter how carefully drafted—by filing potentially successful declaratory complaints, it may not be advantageous to send cease and desist letters. Instead, patent holders who want to control timing and venue of lawsuits, which is typically all rights holders, are advised to file suit first and decide whether to immediately serve the infringer or to delay service. Federal Rule of Civil Procedure 4(m) affords plaintiffs 120 days to effectuate service on defendants. This means that patent holders have the option to file first and notify infringers of the pending suit without immediately serving the complaint. This approach may provide patent holders with an opportunity to engage in settlement discussions with infringers without handing them control of timing and venue since a placeholder lawsuit would already be pending.

## Conclusion

**MedImmune** and its progeny create substantial risks for patent holders that cease and desist letters will be answered by declaratory judgment complaints. To maintain control over the timing and location of patent litigations, patent holders should carefully consider the use of cease and desist letters.

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