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IN LITIGATION



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We are pleased to present this issue of TRENDS in Litigation, which reflects the variety and complexity of our litigation practice.

It has been an exciting year for our 280 litigators. Some of our ranks have participated in the representation of our partner, Neal Batson, as the Examiner in the Enron bankruptcy. This engagement has involved us in a variety of interesting and timely issues. We are also actively engaged in numerous other challenging lawsuits, ranging from ERISA class actions to mass tort cases and everything in between.

We are also pleased to report that Ralph F. Boyd, Jr., formerly United States Assistant Attorney General of the Civil Rights Division, joined our firm as a partner in our Washington, D.C. office. While he was Assistant Attorney General, Ralph oversaw 375 U.S. Department of Justice attorneys responsible for enforcing the nation's laws prohibiting discrimination on the basis of race, gender, handicap, religion or national origin, as well as criminal statutes outlawing violence or threats of violence against people exercising their fundamental rights and laws against human trafficking and related crimes.

This issue of TRENDS includes articles from several members of our litigation group. We also include a new feature – a roundtable discussion on the role of younger trial lawyers. The roundtable was moderated by the Chair of our Partners' Committee, Bernard Taylor, a trial lawyer, who though no longer classified as "young," is widely and rightly known as one of the very best litigators in the country.

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COMBATING THE “CLASS CERTIFICATION EXPERT”: POTENTIAL STRATEGIES FOR DEFENDANTS*

Expert witnesses are utilized routinely by plaintiffs’ counsel to satisfy Rule 23 requirements for class certification, and often their testimony serves as the lynchpin for critical issues such as common proof and class-wide damages. But the extent to which defense counsel can attack experts’ testimony at the class certification stage varies among the circuits, primarily because of inconsistent interpretations and applications of the United States Supreme Court’s decision in *Eisen v. Carlisle*,¹ *Coopers & Lybrand v. Livesay*,² and *General Telephone Co. v. Falcon*.³ Where “rigorous analysis” ends and “examination of the merits” begins is a moving target at which federal courts must take aim in determining the appropriate level of scrutiny to be applied to class certification experts. Recognizing this fact, defendants must adjust their strategies for responding to these experts.

Motions to strike plaintiffs’ experts under *Daubert*⁴ have, heretofore, been an effective tool in combating the “class certification expert,” but in light of recent federal opinions, defense counsel must rethink how to frame their arguments against plaintiffs’ experts. To be sure, more and more courts are declining to engage in a *Daubert* analysis at the class certification stage on the ground that an inquiry into whether plaintiffs’ experts can satisfy the *Daubert* standard for admissibility is an inappropriate consideration of the merits of plaintiffs’ claims.

The Second Circuit’s analysis of *Daubert*’s role in class certification decisions in *In re VISA Check/MasterMoney Antitrust Litigation*⁵ is instructive in examining potential strategies for responding to experts at the class certification stage. In *VISA Check*, both parties introduced expert reports to support their competing positions for and against class certification in the district court. Defendants moved to strike the testimony of the plaintiffs’ expert based upon *Daubert*. The district court denied defendants’ motion to strike and certified a class, finding that plaintiffs’ experts’ methodology was

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“sufficiently reliable for class certification purposes.” The Second Circuit affirmed the decision of the district court and made the following significant rulings:

- A district court must ensure that the basis of the expert opinion is not so flawed that it would be inadmissible as a matter of law.
- A motion to strike expert evidence pursuant to *Daubert* involves an inquiry *distinct* from that for evaluating expert evidence in support of a motion for class certification.
- A district court may not weigh conflicting expert evidence or engage in “statistical dueling” of experts.
- The district court’s function at the class certification stage is not to determine whether plaintiffs have stated a cause of action or whether they will prevail on the merits, but rather whether they have shown, based on methodology that is not fatally flawed, that the requirements of Rule 23 are met.

In short, the Second Circuit held that *Daubert* scrutiny of plaintiffs’ expert at the class certification stage should be less exacting and rigorous than when the expert’s testimony addresses the merits of the case *after* class certification has been decided, but failed to define “fatally flawed” or to provide guidelines for district courts to follow in making Rule 23 determinations.

In the recent decision *In re St. Jude Medical, Inc. Silzone Heart Valves Products Liability Litigation*,⁶ the plaintiffs submitted expert testimony to support class certification. The district court held that a full analysis of the expert medical evidence under *Daubert* was not appropriate at the class certification stage, citing *VISA Check*. However, the court also stated that it carefully scrutinized plaintiffs’ medical evidence to determine whether it supported class certification. Finding that plaintiffs’ expert’s opinion was not so flawed as to be inadmissible as a matter of law, the court certified a “medical monitoring class.” The *St. Jude* decision is all the more significant because it is a products liability case, where defense counsel have traditionally used *Daubert* quite effectively in defeating “junk science.”

Significantly, the trend in federal courts, notwithstanding the type of class action – products, mass tort, consumer, or antitrust – is to limit the application of *Daubert* at the class certification stage.

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Despite this trend, the following strategies are recommended to combat “expert” testimony that otherwise fails to satisfy *Daubert* and Federal Rule of Evidence 702:

- Attack plaintiffs’ expert opinions as inadmissible legal opinions purporting to instruct the court on the law. Whether the requirements of Rule 23 have been met is within the sole discretion of the district court, and therefore, an expert witness cannot state his legal conclusion that the standards for class certification have been met.
- Attack the class certification experts under *Daubert*, but frame the motion to strike as being brought under Rule 702. In the motion itself, state specifically that defendants are not requesting a full-blown *Daubert* analysis of plaintiffs’ experts, but rather are seeking to strike the expert opinions because they are inadmissible as a matter of law. Argue that *Daubert* is helpful to the extent that it can assist the court in preventing the admission of flawed methodology.
- Attack the expert’s opinion as lacking a proper factual foundation. There must be a reliable factual predicate constituting a reasonable basis for an expert’s opinion. Otherwise, the expert’s testimony is simply untested hypotheses, lacking sufficient evidence to constitute anything other than guesswork and conjecture.

These strategies strike a balance by calling upon the court to engage in “rigorous analysis” of plaintiffs’ experts, but not engage in an impermissible, full-blown examination of the merits.

Endnotes

¹ *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974).

² *Coopers & Lybrand v. Livesay*, 437 U.S. 463 (1978).

³ *Gen. Tel. Co. of the Southwest v. Falcon*, 457 U.S. 147 (1982).

⁴ *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993).

⁵ *In re VISA Check/MasterMoney Antitrust Litig.*, 280 F.3d 124 (2^d Cir. 2001), *cert. denied*, 536 U.S. 917 (2002).

⁶ No. MDL 01-1396 JRTELN, 2003 WL 1589527 (D. Minn. Mar. 27, 2003).



OUR EXPERTISE ■

*A*lston & Bird's 280 litigation attorneys are engaged regularly by Fortune 250 companies to serve as regional and national counsel in high-stakes class action lawsuits in state and federal venues throughout the country. Our class action practice includes antitrust, consumer, employment, ERISA, products liability, toxic tort, and securities litigation, and we serve as members of national trial teams in the insurance, pharmaceutical, and telecommunications industries, among others. We have recently defeated putative class actions in Alabama, California, Colorado, Florida, Georgia, Illinois, Indiana, Louisiana, Maryland, Michigan, Missouri, New York, Oklahoma, Oregon, Pennsylvania, Texas, and Washington.





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BUILDING THE LITIGATORS OF TOMORROW: A ROUNDTABLE DISCUSSION WITH LITIGATION ASSOCIATES

*A*lston & Bird has a well-recognized reputation as a top litigation law firm, with dozens of our attorneys receiving local and national accolades for their work in the courtroom. But these litigators aren't created overnight – they are trained, nurtured, and challenged by legal mentors over many years. With the growing complexity of the firm's litigation practice, it is a constant challenge to provide our associates with the trial and other stand-up experience in the courtroom that they need as developing professionals, that our diverse client base demands, and that the firm's standards require.

So how are we doing? Recently, Bernard Taylor, Chair of the firm's Partners' Committee and past chair of the Products Liability Group, spoke to A&B associates Nowell Berreth, Scott Elder, Angela Payne James, and Caroline Keller to hear from the front lines how the firm's litigation training program is meeting the challenge.

***Bernard Taylor:** Why don't you tell us a bit about your recent courtroom experiences here at Alston & Bird.*

***Angela Payne James:** I've been an attorney for five and a half years. I was just involved in a lengthy trial in North Carolina. We worked with another law firm as co-counsel on the trial and it was a great experience. The issues were fraud, negligent misrepresentation and unfair trade practices. The charges stemmed from two parties who had negotiated to enter into a deal, but at the last minute the defendant decided not to go forward. I handled the arguments surrounding the introduction of deposition testimony by video and the introduction of evidence that came through those witnesses. I also cross-examined the former president of the company who had agreed to testify on the defense's behalf and was, therefore, a bit hostile. And, I helped prep witnesses and worked with our expert witnesses. After a lengthy trial, the jury came back on all counts for our client and awarded over \$152 million in damages.*

***Caroline Keller:** I've also been an attorney for five and a half years. My most recent trial was in Alabama; our client was United Investors, a subsidiary of Torchmark. We argued that the defendant switched*



some variable annuity business from our company into a competitor's company. The claims included breach of contract, tortious interference, and fraud. My team focused on the tortious interference and fraud claims. My role was to argue several evidentiary motions related to the fraud claims. I also assisted one of our partners with deposition testimony and helped prepare direct- and cross-examination questions for witnesses along those claims.

One of the first trials I worked on as a lawyer was another important case – the Mindis case. One of the highlights of that case was watching one of our senior partners in action. He is a great litigator, and it was educational to watch him think on his feet – to watch him take any situation and adapt to it. He also has this ability to read other lawyers, the jury, and the way the case is going. For a young litigator, watching that was truly an amazing experience.

Scott Elder: I've been an attorney for six years. Recently I've been involved with asbestos litigation cases in West Virginia, Florida, and Atlanta. In all three cases I did the directed verdict motions and the charge conference. In two of them, I did all of the document arguments and the charge conferences, and in two I cross-examined one of the plaintiff's expert witnesses.

Nowell Berreth: I have been an attorney for two and a half years. Recently, I worked on an interesting divorce trial in which our client was 85 years old, suffered from Alzheimer's disease, and couldn't attend the trial. She had a fortune of about \$200 million in real estate and had set up her estate to benefit several national and local charities. Her 80-year-old husband suddenly filed for divorce and asked for an award in equitable distribution. Our job was to protect our client's money and keep it going where it was supposed to go. I had several roles in the case, including taking most of the depositions and writing the motions that we filed. We prevented a large verdict against our client. The judge awarded the husband just \$5,000 a month in alimony and the marital residence. Everything else went to the charities as originally stipulated by our client.

Bernard Taylor: *You have described some exciting and interesting courtroom opportunities and experiences. Are these experiences consistent with those of your colleagues?*



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Angela Payne James: Definitely. In IP litigation we do a lot of TROs and preliminary injunction motions related cyber squatters, for instance, in which our clients request an immediate remedy by the court. These cases provide really good opportunities for younger associates. For example, my first courtroom experience was handling half of a motion to obtain a restraining order with one of our partners and then going back and getting the preliminary injunction later. Fortunately, our senior lawyers take training seriously. Recently I worked with another partner on a trial, and he was very conscious of using it as a training experience. He coached us on courtroom developments and took the time to explain what he was going to do and why.

Caroline Keller: In our Securities Litigation group, we handle many complex, big-dollar cases. The partners are very good at finding opportunities for younger lawyers to argue motions or portions of motions or to stand up in court on these cases. But they also look for smaller cases that allow the associates to have a more hands-on, ownership experience – to argue motions in court, and if a case goes to trial, to actually try it, as well. We also have some cases representing plaintiffs. Although the class actions don't go to trial, the other typical cases we handle have produced several trials or arbitrations each year, and the associates have played a significant role in all of those.

Scott Elder: Of course, most cases settle, and that's true everywhere, but I've been surprised by the number that do go to trial. Once a case goes to trial, the number of opportunities to stand up in front of the court or jury is greater than you'd think. There are pre-trial motions, post-trial motions and directed verdict motions, and you go almost every morning and argue about documents. In my trials a lot of testimony was introduced by deposition. Sometimes there would be short stretches when we didn't anticipate too much action, so the partners give the associates the responsibility for those days. If anything happened that day, it was my responsibility to respond to the judge.

Bernard Taylor: *Have you heard that the firm is building a mock trial courtroom?*

Angela Payne James: Yes, and it's a great idea. It will help remove the mystery from the courtroom. So much of being nervous about



standing up in court is that you don't know what's going to happen next logistically. The mock courtroom will allow associates to take a case from A to Z, and provide opportunities to practice and be critiqued by senior lawyers.

Bernard Taylor: *Have any of you had an opportunity to participate in any pro bono cases, and if so, have you found those to be useful?*

Scott Elder: Yes – the firm encourages us to take pro bono cases – another good learning opportunity. Just recently, I settled a case for a woman from Decatur. A company did some construction on her house, and there were some problems. I filed a default judgment against the contractor. It was fun because I was the only lawyer working on it. I decided how much to settle for, whom to depose, and what claims to assert. It didn't go to trial, but I took depositions, wrote a summary judgment motion, and negotiated the settlement. My client was happy – now she calls me all the time – I have a client for life, no doubt!

Bernard Taylor: *What is your most memorable trial or courtroom experience at this point in your careers?*

Scott Elder: The Fulton County trial that I had recently. The jury was out for three and a half days and it became apparent that there was a pretty big split; we later learned it was 10 to 2 in our favor. The last thing the jury did was ask to have read back my cross examination of one of the plaintiff's expert witnesses. So, the court read that back and the jury came out about an hour later. We won!

Bernard Taylor: *Both generally and in connection with a trial, how well do you get to know the clients? How often do you work with them and how do they receive you?*

Angela Payne James: The trial that we just had paints an interesting picture. Our client was a startup company that had been put out of business due to the fraudulent activities of the defendant. So the plaintiffs were a small group of people, and they were very close. They had all devoted their lives to the development of this real-time, 3-D, ultrasound technology to prevent heart disease. They were very passionate about their work and had been personally devastated by the defendant's actions. We really wanted them to win because they were the classic underdog and they were in the right, and we all became very close. As we approached trial, the associates worked



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with the clients almost daily preparing them for the trial – going back through factual details and the like. It was a very rewarding experience, particularly because we won! They were very satisfied with the trial experience.

Caroline Keller: In our practice group we have a lot of exposure to the client, particularly as a case advances. It means a lot to me that partners trust my judgment, and that carries over into trial work. You work hard with the client, even when it's only your little piece of the trial, to ensure that you've developed that portion of the case to the highest level possible. That is a very one-on-one experience, and it's very rewarding. I mean, that's what we're all about – working with our clients and making sure that we secure good results for them.

Scott Elder: For me it's been surprising that the bigger cases provide great opportunities to work directly with clients. An associate comes to know more about certain details of the case than the partner. The associate becomes a reliable source of information for the clients – even if they start out calling the partner, they realize that the associate is conferenced in every time. Eventually, they come to trust us, and then they just start going directly to the associate. So I think any case can lead to good client interaction.

Nowell Berreth: I try not to take the cases personally, but I do take my client's interests personally. I feel fortunate – I really feel for most of my clients and sometimes they're wronged and I really want to make it my job and my mission to right whatever wrong happened to them. Hopefully that comes across to them.

Bernard Taylor: *Thank you all.*



TERMINATING COMMERCIAL LEASES IN A SOFT MARKET: THE OWNER'S AND TENANT'S PERSPECTIVES

The weak economy has affected many companies that lease commercial property – some for better, some for worse. Terminations abound due to a variety of factors ranging from a decline in demand for space, insolvency or related financial pressures (affecting both landlords and tenants), and tenants' perceptions that they may be able to negotiate better terms.

From a rudimentary economic standpoint, the issue is a straightforward one: supply and demand. The economy produces a weakened supply of attractive tenants and yet, in many sectors, the supply of space grows. The property owner faces the challenge of maintaining revenue streams and occupancy rates with a reduced pool of attractive tenants. The result is that knowledgeable tenants have increased leverage to negotiate new leases on terms that are more favorable than they have been in over a decade.

The simplicity of the economic analysis should neither overly embolden tenants nor unduly discourage landlords, because in addition to the economic considerations, there are a slew of legal issues that impact whether, when, and how to terminate leases. Given the permutations, it is imperative that all parties to commercial leases thoroughly understand their legal rights and obligations before terminating a lease.

From the Owner's Perspective

Before terminating a lease or initiating legal action to collect past due rents, the prudent owner will assess many factors, including: (a) the amount owed; (b) the tenant's financial strength; (c) the likelihood of locating a replacement tenant at comparable rates for comparable terms; and (d) the options and remedies available under the lease.

Generally, it is appropriate to analyze termination and pursuit of collection of unpaid lease payments separately. It may make perfect sense to terminate and evict a tenant, but not pursue collection



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of unpaid rents.¹ For example, if the tenant is not solvent, it may make little sense to vigorously pursue collection.² Similarly, if there are replacement tenants willing to possess the premises and execute leases with terms similar to those of the defaulting tenant, it may not be cost-efficient to pursue collection because the cost of litigation (lawyers' fees, inconvenience to management, and risk of potentially meritorious counterclaims) might exceed any possible collection achieved through legal avenues. Conversely, there may be situations where it makes more sense to pursue collection, but not terminate the lease. Such an approach might be appropriate where, for instance: the tenant is solvent, but simply is not paying; the terms of the lease are unfavorable (e.g., owner cannot recover rental payments due after termination); or the supply of viable replacement tenants is limited.

Obviously, the amount owed and the likelihood of recovery will impact an owner's decision to pursue collection and, if so, how aggressively. Another key ingredient in assessing whether to terminate and pursue collection is the lease itself. Many commercial leases permit the landlord, at its option, to terminate the lease and accelerate the rent or to re-let the premises or a combination of both.³ Over the past decade, courts in many jurisdictions have examined the appropriateness of these acceleration provisions. Under Georgia law, for example, to justify the acceleration clause, the owner must show that (1) the injury caused by the breach is difficult to estimate accurately; (2) the parties intended to provide for damages rather than a penalty; and (3) the accelerated rents reflect a reasonable estimate of the owner's probable loss (i.e., a reasonable pre-contractual assessment of the value of the rental use of the property).⁴ Oddly, then, the longer the lease term and the more time remaining under the lease, the less likely the court will uphold an "acceleration of rents" clause.⁵ Thus, the owner has the least amount of protection for situations where it has the greatest amount of exposure.

Assuming both the acceleration provision is enforceable and termination does not affect the owner's ability to recover future rental payments, the owner should terminate and accelerate payments. Because courts generally require the fair market of the space for the remaining term to be deducted before acceleration occurs, however, the amount of recoverable damages may be minimal – particularly if



rental rates have escalated in the interim. Ideally (from the owner’s perspective), the lease also will relieve the owner from a common law duty to mitigate damages (i.e., the owner is not obliged to locate replacement tenants). Requiring an owner to mitigate adds a level of uncertainty because the owner will need to show that its efforts to mitigate were “reasonable” even if not successful. Unless the mitigation completely eliminates the outstanding rental payments (in which case the owner’s motivation to seek collection will be diminished), the owner will be unsure whether a jury would conclude the owner used “reasonable” efforts.

When confronted with a defaulting tenant, the owner (or the property manager) should assess whether it makes sense to terminate and, if so, whether it will be productive to collect the past due amounts. Although these decisions initially may appear obvious, it may be prudent to contact an attorney to assist with any latent dangers embedded in the written contract or the parties’ course of performance. The last thing an owner with an insolvent tenant wants to do is compound the loss of income by having to defend a lawsuit or by paying damages because of erroneous assumptions about the owner’s rights.

From the Tenant’s Perspective

In the current market, tenants should be opportunistic. Any default by the owner may provide the needed leverage to strike a better deal either with the existing owner or a new one. Even in the absence of an owner’s default, the tenant may be able to negotiate better terms. Also, a competing landlord may be willing to pay the Tenant’s remaining obligations under the old lease in exchange for a new long-term lease commitment from the tenant. Finally, in rare instances, the disparity between the terms of the lease that is in force and those of a lease that could be acquired in the soft market, it may be appropriate to walk away from the existing lease altogether irrespective of the owner’s conduct.

If the Tenant identifies reasons why it may justifiably terminate the lease due to the owner’s default (e.g., failure to maintain the premises), it should notify the owner of such issues. In order for tenant to terminate the lease, the default generally (but not always) must be a material term of the lease as opposed to a minor defect

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in the premises. Although it is unlikely that delivery of the default notice to the owner will terminate the lease absent more, the tenant should be willing to vacate if the owner accepts the declaration of default. In doing so, the tenant may be able to renegotiate the “old” lease on more favorable terms. Even if the notice does not result in termination or renegotiation, establishing a written record of problems may be useful in dissolving lease obligations in the future if similar problems arise.

If the owner is not willing to negotiate and does not rectify the default, the tenant may choose to terminate the lease itself. Whether such a tactic is wise will depend upon whether the owner has a duty to mitigate and locate another tenant; the amount of rent the tenant might be obligated to repay if it is later determined that the owner did not default; and the amount of savings the tenant expects to enjoy under the new lease.

Depending on the terms of the lease, in terminating the lease the tenant may be appropriately leveraging its market power or may have made a significant miscalculation. Unless the owner’s default is substantial and there is no option to cure, the Tenant may have committed a default, thereby exposing itself to liability. In many commercial leases, there is no obligation for the owner to mitigate its damages by seeking new tenants. Although there is a common law duty to mitigate damages generally, many leases expressly disclaim such a duty or permit the owner, at its option, to re-let the space. Absent language requiring the owner to use reasonable efforts to re-let the space, the tenant should assume that it will be liable for all the remaining rental payments. Furthermore, the tenant’s liability for paying the rents may be accelerated. Even if the owner re-lets the premises, given the economic climate, the new lease rates may be lower than the rates the tenant had been paying. Thus, the tenant may still be responsible for a sizeable sum.

In addition to the foregoing considerations, the tenant should factor legal expenses into the equation. Failure to do so will undermine an otherwise flawless assessment of the perceived savings by exiting an unfavorable lease early in exchange for more favorable terms of a new lease.



Endnotes

¹ See, e.g., *Good Ol' Days Commissary, Inc. v. Longierier Family Ltd. Partnership I*, 240 Ga. App. 111, 522 S.E.2d 249 (1999).

² If the Owner is aware of the tenant's shaky financial condition, the Owner may wish to initiate dispossession proceedings immediately upon default. Doing so may enable the Owner to avoid the effects of a bankruptcy stay that could prevent the Owner from evicting the tenant for an extensive period.

³ See, e.g., *Rucker v. Wynn*, 212 Ga. App. 69, 441 S.E.2d 417 (1994).

⁴ See *Nobles v. Jiffy Market Food Store Corp.*, ___ Ga. App. ___, 579 S.E.2d 63 (2003); *Peterson v. P.C. Towers, L.P.*, 206 Ga. App. 591, 426 S.E.2d 243 (1992). See also *Jones v. Clark*, 147 Ga. App. 687, 249 S.E.2d 619 (1978) and *Carter v. Tokai Fin. Serv.*, 231 Ga. App. 755, 759, 500 S.E.2d 638 (1998) (accelerated rent clause in lease for personal property held unenforceable because it allowed the lessor to retain possession and collect all future rent payments).

⁵ *Id.* (noting that acceleration clauses under short-term leases are more likely to reflect a reasonable pre-estimate of the landlord's losses).

OUR EXPERTISE ■

Alston & Bird's litigators handle all aspects of real estate related disputes, including lease enforcement, eminent domain and condemnation, zoning, governmental permitting, property management disputes, nuisance, brokerage commission disputes, premises liability, and restrictive covenant enforcement. Also, we counsel clients as to the risks and benefits afforded by each unique set of facts and assist them in choosing the best course of action for both their near and long-term interests. The circumstances may warrant filing suit or vigorously defending one, settling quickly or pursuing extensive discovery, or trying and appealing a significant matter or walking away without resort to the judicial process. In the past year, Alston & Bird has handled over a dozen lease disputes throughout the country, including, Georgia, Texas, Florida, Maryland, North Carolina, Tennessee, and Washington. Our real estate litigation practice is not limited to lease enforcement, but includes a wide range of matters for both defendants and plaintiffs. On the defense side, members of the real estate litigation team recently successfully



represented the largest manufacturer of aggregate construction materials in the United States in a matter that had a value of over \$65 million to the client. Our team also represented a large suburban mall operator in successfully prohibiting the sale of pornographic materials at one of the mall's out-parcels. Alston & Bird is currently defending a property owner from claims by 59 adjacent property owners who claim damage from blasting, vibration and nuisance. For a corporate plaintiff, Alston & Bird obtained a \$30+ million dollar judgment in federal court in California against a lender and its principals for issuing a fraudulent commitment letter to fund a significant project.



SURPRISE JURISDICTION OVER THE FOREIGN COMPANY – MANAGE YOUR CONTACTS

Companies may be surprised to learn that under certain circumstances they can be subject to the general personal jurisdiction of courts in a particular state as a result of their relationship with, and the activities of, their wholly-owned subsidiary active in that state. A recent decision by a federal court in New York found such general jurisdiction to exist over a large German corporation. Although the court did not find the New York subsidiary to be the “alter-ego” of the German parent company, it did find the subsidiary to be the parent’s “agent” for jurisdictional purposes, even though the parent did not control the subsidiary’s day-to-day activities.

In a case pending before the United States District Court for the Southern District of New York, the German company Siemens AG is currently defending itself against claims related to a ski train fire in Kaprun, Austria. The events underlying the plaintiffs’ claims in that case are wholly unrelated to any contact that Siemens AG had with New York. Siemens AG is being subjected to general personal jurisdiction in New York because of the nature and quality of its own contacts with New York and its relationship with its wholly owned New York subsidiary Siemens Corp.

What is the Role of Personal Jurisdiction in a Lawsuit?

In order for a plaintiff to maintain a lawsuit against a company, the court in which the case was filed must have personal jurisdiction over the company. If a court lacks personal jurisdiction, the court is incapable of adjudicating the plaintiff’s claims and the court must dismiss the plaintiff’s complaint.

There are two types of personal jurisdiction: specific personal jurisdiction and general personal jurisdiction. A court may have specific personal jurisdiction over a particular company if there is a relationship between the subject matter of the lawsuit and the state in which the court sits. For example, if a manufacturer sends a defective product to a customer in New York, then the manufacturer will be subject to the specific personal jurisdiction of a court sitting in New York concerning claims related to the defective product.



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In contrast to specific personal jurisdiction, a court that has general personal jurisdiction over a company can adjudicate any claim against the company, even if the claim is wholly unrelated to the company's contacts with the state in which the court sits. A court obtains general personal jurisdiction over a company if that company "does business" in the state in which the court sits. For the very purpose of avoiding personal jurisdiction or liability in a particular state (it is important to note that jurisdictional "agency" and "alter-ego liability" are two different issues), companies routinely choose not to "do business" in a particular state, but instead to operate in that state through a subsidiary.

Although each state has its own test concerning what it means to be "doing business," the scope of each state's test is limited by the Due Process Clause of Article V of the United States Constitution, which has been interpreted by the United States Supreme Court to mean that a court's exercise of jurisdiction cannot "offend notions of fair play and substantial justice." The New York test for general jurisdiction – which is generally representative of other states' tests – looks to whether the company satisfies the following five non-exclusive factors on a continuous, permanent and substantial basis:

- (1) Having an office in the state;
- (2) Having a bank account or other property in the state;
- (3) Having a phone listing in the state;
- (4) Doing public relations or advertising in the state; or
- (5) Having individuals permanently located in the state to promote its interests.

Why the Court Found the German Company Siemens AG Subject to Personal Jurisdiction in New York

In the case *In re Ski Train Fire in Kaprun Austria*, 230 F. Supp. 2d 376 (2002), decided by the U.S. District Court for the Southern District of New York, the plaintiff alleged that Siemens AG has the following contacts with the state of New York:

- (1) Its American Depository Receipts (ADR) are listed on the New York Stock Exchange;



- (2) It engages individuals in New York to conduct tasks related to its Exchange listing;
- (3) It engages a New York law firm to register its patents;
- (4) It brought a lawsuit in New York;
- (5) It has a website accessible by New York residents that invites the user to purchase its products; and
- (6) On its website, it holds itself out as being “an integral part of the U.S. economy for almost fifty years.”

Although the court recognized that each of these contacts would not, independently, confer general jurisdiction over Siemens AG, it found that “all of this activity, when viewed with the remaining contacts . . . demonstrates that Siemens AG conducts substantial and continuous business” in New York. The remaining contacts that supported the court’s finding that Siemens AG was “doing business” in New York were activities in New York carried out by Siemens AG’s wholly owned subsidiary. Specifically, the court held that under New York law:

When two corporations have common ownership and their activities are interrelated as here, they may have an agency relationship for jurisdictional purposes, even if the resident corporation is not controlled by the nonresident entity. . . . [the plaintiff] need only show that the subsidiary does all the business that the parent corporation could do were it here by its own officials. . . . To come within this rule, plaintiff need demonstrate neither a formal agency agreement, nor that the defendant exercised direct control over its putative agent. . . . The agent must be primarily employed by the defendant and not engaged in similar services for other clients. . . . [Where] a subsidiary is created by the parent for corporate finance purposes, or to carry on business on its behalf, its activities may properly be attributed to the parent for jurisdictional purposes. . . . Common ownership gives rise to a valid inference as to the broad scope of the agency in the absence of an express agency agreement.

The court found that the following activities conducted in New York by Siemens AG’s wholly owned subsidiary satisfied the foregoing test:



- (1) The business of Siemens Corp. was primarily to provide services for Siemens AG;
- (2) Siemens Corp. served as a holding company for Siemens AG;
- (3) Siemens Corp. provided accounting, management information support and financial reporting services for Siemens AG;
- (4) Siemens Corp. developed and implemented marketing communications, including corporate advertising and online communications, to build the Siemens brand;
- (5) Siemens Corp. executed mergers, acquisitions, divestitures and other transactions on behalf of Siemens companies;
- (6) Siemens Corp. oversaw compliance of Siemens companies with all federal and state income tax and securities laws;
- (7) Siemens Corp. purchased a New York corporation using funds provided by Siemens AG; and
- (8) Siemens Corp. conducted Siemens AG's core business.

As the recent decision in *In re Ski Train Fire in Kaprun* underscores, it is important for companies to review regularly not only the nature and quality of their own contacts with a state in which they do not want to be subject to suit, but they must also review the nature and quality of their relationship with subsidiaries conducting business in such states.

OUR EXPERTISE ■

*A*ston & Bird's International Litigation Group has extensive experience in counseling foreign companies about personal jurisdiction and liability arising from contacts with customers or businesses located in the United States. To help avoid the "surprise" of having to defend themselves in a court in the U.S., we routinely work closely with our clients to identify and constructively modify their contacts. Recently, for example, we assisted one of the world's largest and oldest enterprises of its type with the structure of its



Website that is hosted from outside the U.S. We developed a strategy for the client that minimized the chance that as a result of its Internet-related activities the client could be subject to the general jurisdiction of courts in the U.S. In addition to counseling our clients to minimize or avoid litigation, we have a proven track record of successfully defending our foreign clients on both procedural and substantive grounds against suits that are filed in U.S. Courts. In a recent decision issued by the United States District Court for the Southern District of New York, we successfully argued that the law of Brazil prevented the U.S. court from compelling our client to answer a complaint that had not been served in strict accordance with Brazilian procedural requirements.

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*Copies of In re Ski
Train Fire in Kaprun
can be obtained by
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A SETBACK FOR LANDLORD SECURITY FROM TENANT BANKRUPTCIES

On March 28, 2003, the Third Circuit Court of Appeals delivered a setback to a landlord's ability to recover all of its monetary damages arising from a tenant's bankruptcy. The case is *Solow v. PPI Enterprises (U.S.), Inc. (In re PPI Enterprises (U.S.), Inc.)*, and the ruling now governs bankruptcy cases filed in, among other places, Delaware, New Jersey and Pennsylvania. Because Delaware continues as a leading jurisdiction for corporate bankruptcy filings, landlords should understand *PPI's* impact on the amount a landlord may be able to draw from posted security and apply to its damages when a tenant files for bankruptcy.

Since its enactment in 1978, the Bankruptcy Code has limited landlord claims when a debtor "rejects" a real property lease. Specifically, Section 502(b)(6) of the Bankruptcy Code limits landlords to a claim for the greater of: (i) one year's rent; or (ii) rent for fifteen percent of the lease's remaining term, not to exceed three years. For example, if a debtor rejects a lease with ten years remaining on its term and rentals over such period are scheduled to remain steady or increase each year, as is typical, the landlord would have a claim for 1½ year's rent (that is, 15% of the remaining term, which is greater than one year's rent). Making matters worse, that claim is often unsecured, and thus paid, if it all, at pennies on the dollar or in illiquid stock of the reorganized debtor.

To avoid being left without an actual recovery, landlords may seek a cash security deposit from tenants. Unfortunately, this solution is not iron-clad. A cash security deposit can pay a landlord's claim in full, but cases have consistently held that any amount of the cash security deposit *in excess* of the "capped" claim under Section 502(b)(6) must be returned to the debtor. This is the case even if a landlord's actual damages are much higher.

To avoid being caught by the effective cap on cash security deposits, savvy landlords will sometimes obtain a letter of credit issued by a financial institution as security for tenant default. Letters of credit are better from a landlord's (or any creditor's) perspective, for a letter of credit is an *independent obligation* from a solvent financial institution. Moreover, the bankruptcy of the underlying debtor does not allow



the financial institution to deny the landlord's right to draw on the letter of credit. This doctrine of independence has been the bulwark for letter of credit transactions for over 700 years: (i) The creditor does not need to know (and may not even care) about the financial well-being of the debtor, for it is relying on the financial institution, a known quantity; (ii) the financial institution, which presumably knows the debtor from past dealings, can better evaluate the risk of nonpayment and make its own arrangement for collateral and/or fees from the debtor; and (iii) the debtor likely obtains cheaper credit from the financial institution than the creditor would provide to the debtor. Everybody wins.

These principles provide a compelling argument that a letter of credit entitles the landlord to a greater recovery on its damages claim, *i.e.*, one that is not limited like the cash security deposit. For example, assume the landlord holds a \$2 million letter of credit from a financial institution, suffers \$2 million in actual damages for lost rents and the like, but the Bankruptcy Code caps that claim *against the debtor* at \$500,000. Why should the financial institution, which is not in bankruptcy, and which has an independent obligation to pay the landlord \$2 million on the debtor's breach, benefit from the Bankruptcy Code? The financial institution bargained to pay the landlord \$2 million, and the parties certainly contemplated that the debtor could enter bankruptcy and reject or otherwise breach the lease (indeed, there is no reason for the letter of credit except to protect against the debtor's breach). Given that the landlord bargained for a \$2 million payment obligation from the financial institution, the financial institution should pony up the full amount, or so most landlords have argued prior to March 28, 2003.

On March 28, 2003, landlords suffered a blow when the *PPI* court rejected this argument. The Third Circuit noted that if the landlord collects the full amount of its claim against the financial institution, then the financial institution would have a corresponding claim against the debtor pursuant to their loan documents or a letter of credit agreement. Further, because the financial institution's claim arises from a separate contract with the debtor, the claim is *not* capped under Section 502(b)(6), as that section only relates to real estate damage claims, not claims arising from a draw of a letter of credit. Thus, reasoned the *PPI* court, allowing the landlord to draw on the letter of credit in an amount *exceeding* the Section 502(b)(6) cap

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Given that the landlord bargained for an obligation from the financial institution via a letter of credit, the financial institution should pony up the full amount – or so most landlords argued prior to March 28, 2003.

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Whether other courts will follow the PPI ruling is unknown, and that level of uncertainty should guide a landlord in the future in all lease negotiations with potentially troubled debtors.

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would, indirectly, result in a large claim against the debtor as a result of lease damages, contrary to the purpose of Section 502(b)(6).

This policy-based approach was not the sole basis for the Third Circuit's ruling. The Third Circuit noted also that the parties intended to equate a letter of credit to a security deposit, as the lease provided that the letter of credit would serve in lieu of a security deposit. Accordingly, the *PPI* court reasoned, if the parties intended the letter of credit to have the same purpose as a security deposit, the landlord cannot later assert that the letter of credit should be treated differently from a security deposit, for purposes of Section 502(b)(6) of the Bankruptcy Code. Accordingly, in *PPI*, the landlord's \$650,000 letter of credit largely went to waste. The landlord, with actual damages of \$4.7 million for the debtor's rejection of a long-term lease, had only a "capped" claim of \$100,000 under Section 502(b)(6). It could keep the letter of credit draw to the tune of \$100,000, and had to refund the rest to the debtor, for the benefit of all creditors.

Letters of credit are, generally speaking, still a better alternative than cash security, for a few reasons. First, careful structuring may be able to avoid some of the reasoning of the *PPI* decision, in which the court relied heavily on the lease's equating a letter of credit to a security deposit. Second, other courts may disagree with the balance of the *PPI* court's reasoning, that the policies of Section 502(b)(6) are more important than the principle of independence underlying all letter of credit transactions. However, whether other courts will follow the *PPI* ruling is unknown, and that level of uncertainty should guide a landlord in the future in all lease negotiations with potentially troubled debtors. Because recent events have taught that even a healthy company can spiral into bankruptcy very quickly, the universe of "potentially troubled debtors" should be read to include "all new tenants."



OUR EXPERTISE ■

The attorneys in Alston & Bird's Bankruptcy, Workouts, and Reorganization Group team with members of the firm's Real Estate Practice Group to provide the depth of expertise required for today's complex business issues. The Bankruptcy Group focuses on debtor and creditor representation in large bankruptcy cases throughout the country. The Real Estate Group represents real estate players in acquisitions, land assemblages, joint ventures, fund and portfolio creation and management, sales, financing, leasing and development, also throughout the nation. Both groups have substantial experience advising clients on leasing issues in bankruptcy and on structuring transactions to minimize the effect of counterparty insolvency.



OUR CREDENTIALS ■

A+B

- Our 700 attorneys are in five major markets, representing world-class companies, including UPS, AFLAC, Bertelsmann AG, Verizon Wireless, Delta Air Lines, Inc., Wachovia Corporation, and Fortis, Inc.
- The *Best Lawyers in America*® 2003-2004 features 55 of our attorneys.
- Our 280+ litigators include an Alston & Bird attorney named among *The National Law Journal's* "Ten of the Top Litigators in America" and another listed in their 2002 "Forty Under 40" showcasing rising litigators.
- Partner Neal Batson currently serves as the court-appointed Examiner in the Enron Corp. Chapter 11 bankruptcy.
- *Chambers USA: America's Leading Business Lawyers 2003-2004* ranked Alston & Bird as the top all-around firm in Georgia, stating "this ambitious firm has strength in finance, and tops the tables for banking, insolvency and tax, as well as litigation and environment."
- In 2003, *Corporate Counsel* ranked Alston & Bird as one of the top 10 law firms ("All-Around Champs") in its survey of the Fortune 250 concerning the firms they retain to handle litigation, corporate transactions, and intellectual property matters.
- In 2002, Mergerstat ranked Alston & Bird among the top 25 legal advisors based on the value of deals handled.
- In Euromoney's 2002 *Guide to the World's Leading Tax Advisors*, Alston & Bird tied for 5th among all U.S. law firms in the number of tax attorneys included.
- In 2003, *IP Law and Business* ranked Alston & Bird 6th among the top firms protecting the intellectual property rights of the Fortune 250, and in 2002, *The American Lawyer* named our firm to "IP America's Dream Team."
- Alston & Bird ranks 3rd on *Fortune*® magazine's 2003 "The 100 Best Companies to Work For™" list and is the first and only law firm ever named to the top five.



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