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# TRENDS<sup>TM</sup> IN LITIGATION



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**AFTER THE STORM: NEW PARTNER JIM MOYLE DISCUSSES FINANCIAL SERVICES LITIGATION IN THE WAKE OF THE CREDIT CRISIS**

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**THE SUPREME COURT LIMITS FEDERAL WHITE COLLAR PROSECUTORS' USE OF A CHERISHED WEAPON—HONEST SERVICES FRAUD**

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This edition of *Trends* explores several litigation hot topics we have witnessed in recent months. First, Jim Moyle, who recently joined Alston & Bird as a partner in our New York office, is interviewed. Jim examines current trends in securities litigation and regulatory activity in the wake of the credit crisis. Next, Craig Carpenito and Leticia Plucknett explore a recent U.S. Supreme Court decision that limits the future use of the honest services fraud statute, a popular weapon in prosecutors' arsenals. Jason Rosenberg then analyzes the challenges and pitfalls that the increasingly popular social media pose for trademark and copyright owners. Patrick Fitch takes a look at the interplay between prosecutions of violations of the Foreign Corrupt Practices Act and U.S. export control laws in these times of heightened national security. Finally, Kit Weitnauer examines valuation issues in the bankruptcy context based on a recent watershed opinion.

We hope you enjoy *Trends*, and, as always, we value your comments.

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## AFTER THE STORM: NEW PARTNER JIM MOYLE DISCUSSES FINANCIAL SERVICES LITIGATION IN THE WAKE OF THE CREDIT CRISIS



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*In the latter part of 2009, Securities Litigation and Commercial Litigation partner Jim Moyle joined Alston & Bird's New York office. Jim's practice covers a broad range of matters, focusing on class actions, derivative claims and other complex litigation. He has represented a variety of public and private companies, including financial institutions, investment advisers and insurers in federal and state courts, before regulatory bodies and in sensitive internal investigations.*

*Recently, Jim sat down with Securities Litigation Chair, John Jordak, to discuss his career and the current state of financial services litigation in the wake of one of the worst financial crises in American history.*

*John Jordak:*

Jim, welcome to Alston & Bird. Tell us about your litigation practice.

*Jim Moyle:*

My practice focuses on the financial services sector, including, for example, investment banks, insurance companies, mutual fund advisory firms and private equity firms.

*John:*

What trends do you see in securities litigation in New York these days?

*Jim:*

There are a number of trends. In the last six to nine months, we've seen a significant decline in "credit crisis" cases, and it isn't totally clear yet what this means. Is the crisis finally receding? Or have most of the deep-pocketed defendants already been named in lawsuits, or even paid out money? As a result of the economy, bankruptcies and consolidation, are there simply fewer viable companies to be attacked in these types of suits? It's an interesting trend to watch.



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We also see plaintiffs' firms returning to cases they put on the back burner at the onset of the credit crisis. The average time between the end of a class period (when the "truth" allegedly is revealed) and the filing of a complaint has increased dramatically. In 2009, it was a staggering 270 days or so. Conversely, five years ago, there was a rush to the courthouse—stock prices would drop, and within days, multiple class actions would be filed.

Another trend relates to failed banks. Our Atlanta office has extensive experience with this, since Georgia leads the nation in bank failures, followed by Illinois, Florida and California. Clients are concerned about potential exposure to failed bank claims, typically on the D&O side. Also, litigation doesn't just follow large bank failures—it follows the smaller ones, too. Plaintiffs typically claim they were unable to make an informed investment decision because they didn't know about the bank's loan loss reserves. The FDIC is quite active in this area and will likely be aggressively pursuing bank failures themselves, leaving fewer claims to the private bar. Clients are also concerned that ERISA claims may flow from bank failures.

Also, we've been following an important securities law case, *Morrison v. National Australia Bank Ltd.*, that was just decided by the U.S. Supreme Court in late June. The issue before the Court was whether the district court and Second Circuit correctly applied the "conduct and effects" test to deny jurisdiction in a so-called "f-cubed" case.<sup>1</sup> In these types of cases, foreign investors sue foreign companies in U.S. courts under the federal securities laws, based on securities transactions on a foreign exchange. The defendant bank, as well as several "friends of the court," argued that a bright-line rule should be adopted that prohibits such cases without reference to the traditional conduct and effects test. The Supreme Court upheld the lower courts' dismissal, but the majority opinion (there were two concurring opinions) surprised many by setting forth a new jurisdictional test in such cases: Essentially, if a security is not purchased or sold in the U.S., then 10(b) does not apply. There is no reason to undertake a conduct and effects analysis. International clients are rightly relieved with this result, but plaintiffs lawyers no doubt are already looking for new hooks to help them assert claims.



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*In the mutual fund world, the Supreme Court's recent decision confirming the standards applicable to assessing the reasonableness of investment advisory fees has been a hot topic of discussion.*  
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*John:*

That is all very interesting. What securities litigation issues should companies pay attention to in the current environment?

*Jim:*

My advice is to renew focus on the traditional compliance issues we've highlighted for years. The Obama administration is planning to add thousands of positions at the Department of Justice and the SEC, which increases the likelihood of regulatory scrutiny. So even in the face of budget and staff cuts, companies still need to find a way to manage strong, thorough compliance programs. Otherwise, they should expect a knock on the door from regulators coming in for a closer look—and we all know that regulatory inquiries and class action litigation often go hand-in-hand.

In the mutual fund world, the Supreme Court's recent decision confirming the standards applicable to assessing the reasonableness of investment advisory fees has been a hot topic of discussion. In this case, *Harris Associates*, the Court came out the right way but arguably left the door open for more advisory fee claims under Section 36(b) of the Investment Company Act. Mutual fund directors will have to take this case into account when considering the fees charged by fund managers.

*John:*

Good advice.

You've had some extremely interesting trial experiences. Tell us about those.

*Jim:*

Well, they rarely present themselves in very large cases, so when they do, they tend to be quite memorable. One such trial arose from the Enron scandal. The plaintiff, SBA, was responsible for administering the \$140 billion Florida government employee pension plan. My client was one of the top-ranked money managers in America, and an investment adviser to the plan. Despite a return of 1,500 percent over the relevant period, the SBA sued my client when the plan lost around \$280 million from Enron investments.

The plaintiff asserted claims for breach of contract, negligence, gross negligence and breach of fiduciary duty, and sought \$280



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million in damages. That amount skyrocketed to over \$2 billion when the plaintiff added dozens of other, non-Enron investments to the complaint.

*John:*

What were the challenges of the case?

*Jim:*

Some special circumstances helped propel the case forward. For one, Enron was then the largest fraud in history. For another, pension plan trustees included then-Governor Jeb Bush, Florida Attorney General Charlie Crist (now Governor) and the head of Florida's insurance department. When the events at issue were unfolding, Governor Bush was running for re-election against former U.S. Attorney General Janet Reno, who criticized him for doing nothing to protect the state workers of Florida. Apparently the governor felt compelled to take strong action, and to not back down. Another challenge was that one of my client's senior executives also happened to be a director of Enron. So many people were wondering whether there somehow was a connection.

The plaintiffs benefited from some unfortunate public statements. For example, the fund manager was quoted as essentially saying "shame on me" for not acting on the Enron fraud earlier and described Enron's books as "black boxy." Naturally, people reading those quotes wondered why he invested hundreds of millions of pensioners' dollars in a company with books so dense he apparently couldn't understand them.

Discovery produced some really bad recordings, including conference calls where the client's managers said Enron's CEO and president were "slime balls" who should be locked away. Experts alleged there were numerous "red flags" that should have alerted smart investors of big problems, such as Jeff Skilling's sudden resignation, large insider stock sales and analyst reports that were highly critical of the company. Yet the plan manager continued to buy and hold Enron shares.

*John:*

I can see why this case stands out. It went to trial in Tallahassee, right?

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*[O]ur challenge was to explain to the jurors... why an investment advisor might think it was perfectly sensible to invest in Enron at \$80 per share and then continue to buy as the stock price plummeted to \$11.*

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*Alston & Bird stood out because it has a very robust, U.S.-focused litigation platform, serving clients across numerous industries, as well as a top nationwide corporate practice.*



*Jim:*

Yes, and our challenge was to explain to the jurors, many of whom didn't have any investment experience or even a savings account, why an investment advisor might think it was perfectly sensible to invest in Enron at \$80 per share and then continue to buy as the stock price plummeted to \$11. We had to explain a fairly complicated investment concept—the Modern Portfolio Theory—that essentially states that you can't judge a portfolio manager's performance on one investment in isolation. Instead, you have to examine how Enron fit into the context of the entire Florida Pension Plan portfolio.

We also benefited from several unexpected developments. For instance, one plaintiff expert testified that the red flags were so obvious that no prudent investment manager could have invested in Enron. Yet on cross examination, we demonstrated that the "expert" had invested in Enron for his children's trust funds. Needless to say, the jurors weren't impressed by his testimony.

In addition, while the plaintiff's employees tried to make the case at trial that my client's portfolio manager was on a downward spiral for some time, in interviews conducted by the Florida Attorney General before the lawsuit, they described the portfolio manager as "awesome" and said that "anyone could have ridden Enron stock all the way down." Jurors we spoke to after the trial said this "about face" was very troubling.

After a seven-week trial, a verdict was entered for our client on all counts. And the icing on the cake was that the jury awarded my client \$1.2 million in unpaid advisory fees. This was well-deserved redemption for the client.

*John:*

What a terrific result! Let's change gears for a moment and talk about your recent arrival at Alston & Bird. How did you conclude that our firm was the best platform for your practice?

*Jim:*

I spent the last nine years as a partner at Clifford Chance—the largest law firm in the world. There was much to like about the firm, but there was a heavy emphasis on international work, much of it outside the United States, and in the Americas, it has gradually become more and more focused on its transactional practices.



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In considering other firms, Alston & Bird stood out because it has a very robust, U.S.-focused litigation platform, serving clients across numerous industries, as well as a top nationwide corporate practice. The firm's clients are, like many Alston & Bird lawyers, leaders in their industries, and they demand sophisticated representation. Alston & Bird also has been growing in New York, while other firms are shrinking. Recent lateral partner hires like Craig Carpenito, John Doherty and John Weiss demonstrate a commitment to build on strength, adding capability and depth to an already impressive team of lawyers in New York. And after meeting with Todd David, John Cambria, Nelson Boxer, Karl Geerken and many others in New York, Atlanta and Washington, D.C., I knew I had found a powerful and dynamic team, one that I am proud to be a part of. It's really a wonderful opportunity to serve my clients and help grow the firm's business.

*John:*

Tell us about your community service work.

*Jim:*

I'd love to. I'm a director of Give Kids The World, a non-profit based in Orlando that helps children with life-threatening illnesses experience a cost-free vacation to Central Florida attractions while staying at Give Kids The World's whimsical, child-focused Village. There, the children and their families get a rest from needles and doctors, and the kids can just be kids. Through the generosity of our sponsors and thousands of volunteers, the Village never turns down a family—in fact, we've hosted more than 100,000 families from all over the world in the last 25 years. It's really heartwarming to see kids leave with a sense of hope and smiles on their faces, and to receive letters from parents who cherish the priceless memories.

*John:*

It's great you are involved in such a worthwhile cause, and we're pleased you're now at Alston & Bird.

## ***Endnote***

<sup>1</sup> See "Foreign Bank Issuer. Foreign Plaintiff. Foreign Transaction. Class Action Exposure in the U.S. Under Federal Securities Laws?" *The Banking Law Journal*, Vol. 127, No. 5 (May 2010), Jim Moyle's article examining f-cubed lawsuits.



## THE SUPREME COURT LIMITS FEDERAL WHITE COLLAR PROSECUTORS' USE OF A CHERISHED WEAPON—HONEST SERVICES FRAUD



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On June 24, 2010, the Supreme Court issued a landmark opinion severely limiting the scope of one of the federal government's favorite prosecutorial weapons—the honest services fraud statute, 18 U.S.C. § 1346. Section 1346 criminalizes “a scheme or artifice to deprive another of the intangible right of honest services.” For years, the lower courts have grappled with the application of Section 1346. One need only right-click on the word “intangible” and use the “Synonyms” function in Microsoft Word to understand why; the synonyms for “intangible” are “elusive,” “indefinable,” “indescribable” and “vague.” The statute’s inherent vagueness led to a 20-year love affair with federal prosecutors, leaving a staggering number of indictments against both public officials and private corporate officers in its wake. Many of these indictments, and convictions, are now called into question following the Supreme Court’s decision in *Skilling v. United States*,<sup>1</sup> one of the most heavily followed white collar criminal cases of the last two decades.

### ***Origins of Honest Services Fraud***

Prior to 1987, prosecutors and federal courts had routinely extended the mail and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343, to protect the intangible rights of the citizenry to honest and impartial government, as well as to a wide array of criminal conduct in the private sector. They did so by effectively arguing that Sections 1341 and 1343’s prohibitions on schemes or artifices “to defraud” and “for obtaining money or property by means of false or fraudulent pretenses, representations or promises” appeared in the disjunctive and therefore should be construed independently, so that “a scheme or artifice to defraud” may include a scheme designed to deprive parties of intangible rights, not just tangible items such as money and property.<sup>2</sup> This interpretation of the mail and wire fraud statutes was expressly rejected by the Supreme Court in its 1987 decision, *McNally v. United States*.<sup>3</sup> The Court there found no statutory support for the extension of Section 1341 to deprivations of intangible rights: “[W]e read § 1341 as limited in scope to the



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protection of property rights. If Congress desires to go further, it must speak more clearly than it has.”<sup>4</sup>

Less than a year later, Congress attempted to do just that when it enacted 18 U.S.C. § 1346. Section 1346 revives honest services fraud by defining the term “scheme or artifice to defraud” to include “a scheme or artifice to deprive another of the intangible right of honest services.” Over the past 20 years, prosecutors have used Congress’s amorphous definition to pursue a “staggeringly broad swath of behavior.”<sup>5</sup> At the same time, courts have struggled to give any kind of uniform guidance as to what might constitute a protectable “intangible right.”

### ***Constitutional Questions Raised by the Honest Services Fraud Statute***

As federal prosecutors began using Section 1346 as the ultimate catch-all criminal statute to reach all types of public and private conduct, the Supreme Court began to express doubts about the constitutionality of the statute. These constitutional concerns were crystallized by Justice Scalia in his acrid 2003 dissent from the Court’s denial of certiorari in *Sorich v. United States*.<sup>6</sup> The petitioners in *Sorich* were seeking review of their convictions under the honest services fraud statute for engaging in political-patronage hiring for local civil service jobs.<sup>7</sup> In his dissent, Justice Scalia expounded on Section 1346’s contravention of the Constitution, declaring that “federal prosecutors’ (or federal courts’) creating ethics codes and setting disclosure requirements for local and state officials” implicates principles of federalism.<sup>8</sup> Justice Scalia further opined that “there is a serious argument that § 1346 is nothing more than an invitation for federal courts to develop a common law crime of unethical conduct” and, therefore, violative of due process.<sup>9</sup>

Following Justice Scalia’s cue in *Sorich*, the petitioners in *Skilling*, along with the petitioners in two other cases involving honest services fraud convictions, *Black v. United States*<sup>10</sup> and *Weyhrauch v. United States*,<sup>11</sup> each mounted constitutional challenges to the validity of Section 1346. In *Skilling*, the former chief executive officer of Enron was convicted of multiple federal felony charges related to Enron’s collapse, including a violation of Section 1346.<sup>12</sup> The government alleged that Skilling violated 1346 because he was the CEO of a publicly traded company and deprived Enron’s shareholders of their right to his honest services by participating

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in a scheme to defraud them of accurate information about the company's finances.<sup>13</sup> Though the crux of the petitioner's argument focused on jury bias, the petitioner also asked the Court to declare Section 1346 unconstitutionally vague because the statute did not define what conduct it actually prohibited.<sup>14</sup>

*Black* involved senior executives convicted of honest services fraud based on their acceptance of payments made under bogus non-competition agreements designed to evade foreign tax obligations.<sup>15</sup> The petitioners in *Black* argued that Section 1346 should not apply where the defendant intends to inflict economic injury on a person other than the one to whom honest services are owed. They argued that doing so would implicate various constitutional principles, including separation of powers, federalism and the Fifth Amendment.<sup>16</sup>

Finally, the petitioner in *Weyhrauch*, a lawyer and former member of the Alaska House of Representatives, was indicted on charges of honest services fraud for his solicitation of future legal work from an oil field services company in exchange for voting on oil tax legislation as instructed by the company and taking other actions favorable to the company.<sup>17</sup> Relying on three constitutional principles—the “clear statement rule” (which protects the state's sovereign powers from intrusion by the federal government),<sup>18</sup> the doctrine of “constitutional avoidance” (which requires strict statutory interpretation to avoid constitutional issues)<sup>19</sup> and the “rule of lenity” (which requires that statutes be interpreted in favor of defendants)<sup>20</sup>—the petitioner in *Weyhrauch* argued for reversal of the Ninth Circuit's opinion that honest services fraud does not require proof of an independent state law violation.<sup>21</sup>

During oral argument in each of these cases, it was readily apparent that the Supreme Court intended to confront the constitutional issues presented by Section 1346 head-on. In *Black*, which was argued first, Justice Scalia told petitioner's counsel that he was disinclined to “turn somersaults” addressing their proposed limiting principles for Section 1346 (and thereby avoid the apparent constitutional issues), since he considered the constitutional questions paramount and unavoidable.<sup>22</sup> Justice Breyer noted that under the government's interpretation of the statute, “every instance in which a worker does not provide honest services to [his] employer” constitutes a violation of Section 1346; he estimated that 140 of the 150 million workers in the United States would likely



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“flunk” the government’s test and be susceptible to prosecution for honest services fraud.<sup>23</sup> Justice Breyer later compared the honest services fraud statute to a law making it a crime to “do wrong,” where what constitutes “wrong” is left to the interpretation of the Attorney General.<sup>24</sup> Justice Sotomayor repeatedly asked the government where the “line” should be “drawn” on the breadth of the statute’s reach.<sup>25</sup>

During oral argument in *Weyhrauch*, Justice Scalia, criticizing Section 1346 as a “mush of language,” declared that “if the Justice Department can’t figure out what is embraced by this statute, I don’t know how you can expect the average citizen to figure it out.”<sup>26</sup> Justice Scalia was not alone in his criticism, as Justice Breyer commented that he thought “there was a principle that a citizen is supposed to be able to understand the criminal law”<sup>27</sup> and Chief Justice Roberts noted that if a citizen is unable to understand the law, “then the law is invalid.”<sup>28</sup> Eventually, the Court’s questioning drove the government to capitulate and concede that “the question of vagueness” is “a legitimate concern.”<sup>29</sup>

Finally, despite its attempt to focus on jury bias, the government in *Skilling* found itself back on the honest services fraud hot seat when it argued that had the Houston-based jury been inherently biased, it would most certainly have convicted Skilling of insider trading, for which he was acquitted, because those counts reached “the defendant’s pockets personally.”<sup>30</sup> Chief Justice Roberts retorted that the jury would instead “go to the statute that says honest services” if it had such a visceral reaction to the petitioner.<sup>31</sup> This kicked off a storm of questioning by virtually every Justice concerning the constitutionality of the statute.<sup>32</sup> The Court appeared to reject the government’s argument that any ambiguity can be resolved by reference to pre-*McNally* case law. Justice Scalia stated his opinion that “[t]here was no solid content to what *McNally* covered”<sup>33</sup> and Chief Justice Roberts noted that “you need lawyers and research before [a potential defendant can] get an idea of what the pre-*McNally* state of the law was.”<sup>34</sup>

Given the Justices’ unremitting focus on the ambiguousness and arbitrary application of Section 1346, it is not surprising that the Court unanimously found that Section 1346 suffered from constitutional infirmities that required its application be limited to cases involving bribes and kickbacks.<sup>35</sup> The Court ultimately held: “In the main, the pre-*McNally* cases involved fraudulent schemes to deprive another of honest services through bribes or kickbacks



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supplied by a third party who had not been deceived. Confined to these paramount applications, § 1346 presents no vagueness problem."<sup>36</sup> Because the government did not allege that Skilling solicited or accepted side payments from a third party, the Court concluded that Skilling did not commit honest services fraud as now defined by the Court's interpretation of Section 1346.<sup>37</sup> Nonetheless, the Court did not invalidate Skilling's conviction. Instead, it remanded to the Fifth Circuit for a determination of whether the flaws in Skilling's conviction constituted harmless error.<sup>38</sup> Although the government argued that "[a]ny juror who voted for conviction based on [the honest-services theory] also would have found [Skilling] guilty of conspiring to commit securities fraud," the petitioner contended that the government "cannot show that the conspiracy conviction rested only on the securities-fraud theory, rather than the distinct, legally-flawed honest-services theory."<sup>39</sup>

Justice Scalia, honest services fraud's biggest critic, remained unimpressed by the compromise of limiting Section 1346. In a concurring opinion joined by Justice Thomas and Justice Kennedy, Justice Scalia disagreed with the majority on the clarity of pre-*McNally* caselaw, stating that "pre-*McNally* cases provide no clear indication of what constitutes a denial of the right of honest services," and that the Court's holding that the intangible right to honest services can be defined by reference to pre-*McNally* case law "is a step out of the frying pan into the fire."<sup>40</sup> Justice Scalia further contended that the Court's "paring down" of Section 1346 to cases involving bribes and kickbacks was beyond its judicial power and represents "not interpretation but invention."<sup>41</sup>

In light of the *Skilling* decision, the honest services jury instruction given in *Black* was erroneous and the case was remanded for a determination of whether the instructional error was ultimately harmless.<sup>42</sup> Similarly, the judgment in *Weyhrauch* was vacated and the case remanded to the Ninth Circuit for further consideration in light of *Skilling*.<sup>43</sup>

### **Conclusion**

The Court's decision in *Skilling* forces federal prosecutors to sheath the amorphous sword they have wielded so liberally for the past 20 years and turn back to more complex criminal statutes, such as securities fraud bastion Rule 10b-5 (17 CFR § 240.10b-5),



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and the relative insecurity of its esoteric jury instructions. In the meantime, the federal Courts of Appeal will have their hands filled with challenges, given federal prosecutors' rampant use of Section 1346 and the hundreds of honest services-related indictments and convictions. Indeed, the U.S. Supreme Court has already ordered a new review of the convictions in the government's corruption case against former Alabama Governor Don Siegelman and ex-HealthSouth CEO Richard Scrushy in light of *Skilling*. Similarly, New York State Senate Majority Leader Joseph Bruno's conviction of financial conflicts of interest under the honest services law may be reopened.

By severely curtailing the application of Section 1346, the Supreme Court has deprived federal prosecutors of their most cherished weapon and dramatically altered the terrain for the prosecution of public corruption cases. State and local officials now find themselves immune from federal prosecution for a wide variety of misdeeds, including undisclosed self-dealing and political patronage hirings that do not involve kickbacks or bribery. Only time will tell if Congress will make another attempt to "speak more clearly than it has" and expand the scope of the honest services fraud statute.

### ***Endnotes***

- <sup>1</sup> See *Skilling v. United States*, 561 U.S. \_\_\_, Slip Op. No 08-1394 (June 24, 2010).
- <sup>2</sup> *McNally v. United States*, 483 U.S. 350, 358 (1987).
- <sup>3</sup> 483 U.S. 350 (1987).
- <sup>4</sup> *Id.* at 360.
- <sup>5</sup> *Sorich v. United States*, 129 S.Ct. 1308, 1309 (2009).
- <sup>6</sup> 129 S.Ct. 1308 (2009).
- <sup>7</sup> *Id.* at 1311.
- <sup>8</sup> *Id.* at 1310.
- <sup>9</sup> *Id.*
- <sup>10</sup> See *Black v. United States*, 561 U.S. \_\_\_, Slip Op. No. 08-876 (June 24, 2010).
- <sup>11</sup> See *Weyhrauch v. United States*, 561 U.S. \_\_\_, Slip Op. No. 08-1196 (June 24, 2010).
- <sup>12</sup> See *United States v. Skilling*, 554 F.3d 529 (5th Cir. 2009).



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- <sup>13</sup> Br. for United States at 50, *United States v. Skilling*, No. 08-1394 (S. Ct. Dec. 11, 2009).
- <sup>14</sup> Petitioners' Br. at 38-48, *United States v. Skilling*, No. 08-1394 (S. Ct. Dec. 11, 2009).
- <sup>15</sup> *United States v. Black*, 530 F.3d 596, 599 (7<sup>th</sup> Cir. 2008).
- <sup>16</sup> Petitioners' Br. at 22-44, *Black v. United States*, No. 08-876 (S. Ct. July 30, 2009).
- <sup>17</sup> *United States v. Weyhrauch*, 548 F.3d 1237, 1239 (9<sup>th</sup> Cir. 2008).
- <sup>18</sup> Petitioners' Br. at 31-34, *United States v. Weyhrauch*, No. 08-1196 (S. Ct. Sept. 14, 2009).
- <sup>19</sup> *Id.* at 34-37.
- <sup>20</sup> *Id.* at 37-39.
- <sup>21</sup> *Id.* at 29-39.
- <sup>22</sup> Tr. of Oral Argument, *Black v. United States*, No. 08-876, at 17:25-18:9 (S. Ct. Dec. 8, 2009).
- <sup>23</sup> *Id.* at 30:18-31:2.
- <sup>24</sup> *Id.* at 36:5-10.
- <sup>25</sup> *Id.* at 33:12-25:10; 45:6-20.
- <sup>26</sup> Tr. of Oral Argument, *Weyhrauch v. United States*, No. 08-1196, at 42:12-13; 50:1-4 (S. Ct. Dec. 8, 2009).
- <sup>27</sup> *Id.* at 43:21-24.
- <sup>28</sup> *Id.* at 44:7-10.
- <sup>29</sup> *Id.* at 53:9-18.
- <sup>30</sup> Tr. of Oral Argument, *Skilling v. United States*, No. 08-1394, at 41:4-42:16 (S. Ct. Mar. 1, 2010).
- <sup>31</sup> *Id.*
- <sup>32</sup> *Id.* at 41:22-57:14.
- <sup>33</sup> *Id.* at 45:9-10.
- <sup>34</sup> *Id.* at 46:10-19.
- <sup>35</sup> *Skilling*, slip op. at 39.
- <sup>36</sup> *Skilling*, slip op. at 39-40.
- <sup>37</sup> *Skilling*, slip op. at 49-50.
- <sup>38</sup> *Skilling*, slip op. at 49-50.
- <sup>39</sup> *Skilling*, slip op. at 50.



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<sup>40</sup> *Skilling*, Scalia concurring op. at 6.

<sup>41</sup> *Skilling*, Scalia concurring op. at 8.

<sup>42</sup> *Black*, slip op. at 8.

<sup>43</sup> *Weyrauch*, slip op. at 1.

## ABOUT THE AUTHORS



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## SOCIAL MEDIA PRESENTS CHALLENGES FOR TRADEMARK AND COPYRIGHT OWNERS



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*L*ong before President Obama’s “historic” January 18, 2010, “tweet”—the first from a sitting President—brand owners became aware of the advantages—and pitfalls—that social media presents. Though difficult to define, social media is loosely described as a collection of Internet-based applications that allow for the creation and exchange of user-generated content. Prominent examples include Facebook, Twitter, MySpace and YouTube. Numerous well-known trademark owners, from The Coca-Cola Company to *The New York Times*, have established Facebook pages to promote their brands. Coca-Cola, for instance, boasts over 4.5 million fans who have voluntarily signed up to receive updates and information from the company about its products. Twitter allows companies such as Starbucks to provide real-time updates to their online followers (who number more than three-quarters of a million people), allowing for previously unprecedented immediate, direct consumer interaction.

Organizations of all types continue to debate whether and to what extent they derive economic benefit from participation in social media. Nevertheless, most large companies now participate in the space in some form. To avoid legal entanglements, companies need to pay special attention to their business practices in this emerging area. A few of the key issues are addressed below.

### *Advertising*

Most companies thoroughly vet their traditional advertising and marketing materials prior to distribution to make certain the advertisements are truthful and non-misleading, and to make certain that any necessary disclosures are included. However, in the social media space, many companies fail to employ the same rigor. Although Facebook sites and Twitter tweets are more informal and conversational in tone, if they include claims about the company or its products or services, they can constitute advertising and be subject to the same legal standards and administrative review as statements made in traditional advertising media (including review by the FTC and the National Advertising Division of the



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Better Business Bureau). Even a response to a single question from a single customer through a social media site can constitute advertising because of the visibility of the response to the millions of other users who may visit the site. Social media teams should thus be trained regarding traditional advertising and marketing legal issues, and their efforts reviewed periodically to make certain that postings are truthful, non-misleading and otherwise consistent with the company’s legal requirements.

***Trademark Infringement and Identity Theft***

Policing the use of a company’s trademarks on the Internet has been the bane of most corporate legal departments for years. While not creating the firestorm of issues that traditional domain name cyber-squatting has presented, social media sites are now adding to the workload by creating more sites and postings that need to be policed to prevent infringement and otherwise protect the company’s brands. Many fan pages have been established on Facebook and other social media sites to create discussion forums regarding particular products and services. Although legitimate fan pages are often acceptable, even desirable, other pages may be less so. For example, companies need be mindful that social media sites can be used to further the sale of counterfeit goods or to make false claims of association or sponsorship. Though many infringements may be deemed minor, more serious problems occasionally arise. Hasbro, for instance, filed suit in 2008 against individuals who created an online game named “Scrabulous,” which had been one of Facebook’s most popular applications. The case settled, and Scrabulous re-launched in 2009 with new rules, a new game board and a new name—“Lexulous.” Hasbro joined the party a bit later, with an online version of the official Scrabble game. Both are currently available on Facebook.

Companies, especially those not yet involved in social media platforms, should also be aware of a new phenomenon—social identity theft—wherein a user masquerades under the name of a famous individual or company. For a short period of time in the summer of 2009, Facebook allowed trademark owners to “block” the registration of usernames that incorporated their trademarks. That opportunity has ended, and currently Facebook, MySpace and other sites simply provide an online form to report trademark infringement on their sites. In the summer of 2009, baseball manager Tony La Russa filed suit against Twitter after a user

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assumed his name for an “@tonylarussa” account, an act now known as “Twitterjacking.” The case quickly settled, and Twitter now features a “Verified Account” feature (currently in beta testing) to help protect well-known individuals and public agencies from wrongful impersonations. Twitter is not currently offering this feature to businesses, but has stated that it hopes to in the future. In the meantime, companies should monitor the use of their trademarks and trade names on sites such as Twitter for identity theft and other brand protection issues.

### ***Copyright Infringement***

Social media sites, especially video-sharing sites like YouTube, present particularly vexing issues for copyright owners. Most companies with original content (music, television, etc.) are already expending substantial resources to monitor their works on social media sites. However, even companies with no connection to entertainment media are discovering that their copyrighted content, including written training materials and advertisements, are being displayed without authorization on YouTube and Facebook.

The Digital Millennium Copyright Act (DMCA) provides a safe harbor to social media sites for hosting infringing content, provided the site promptly takes the content down after receipt of a good faith “takedown notice” sent pursuant to the terms of the Act. What constitutes a “good faith” notice has not generally been the subject of debate. However, employing reasoning not yet adopted by other federal courts, the Northern District of California recently held that a company must first consider whether the offending material might be considered a “fair use” (*e.g.*, parody) under the Copyright Act before sending a DMCA takedown notice. *Lenz v. Universal Music Corp.*, 572 F. Supp. 2d 1150, 1152 (N.D. Cal. 2008). Prior to this decision, no court had held that fair use needed to be considered by a copyright owner to have a good faith basis for sending a takedown notice under the DMCA.

Regarding the penalties for sending a fraudulent takedown notice, the DMCA provides that anyone who “knowingly materially misrepresents” that material is infringing “shall be liable for any damages, including costs and attorneys’ fees.” Nevertheless, the *Lenz* Court held in late February 2010 that any damages must be proximately caused by the misrepresentation to the service provider and the provider’s reliance on that misrepresentation. Recovery of attorneys’ fees and costs for the misrepresentation, the *Lenz* Court



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held, are limited to *only* those incurred for work in responding to the takedown notice and prior to the institution of a lawsuit. Any further award of fees and costs—such as those incurred on a subsequent claim for misrepresentation—is subject to the Court’s discretion.

The *Lenz* Court’s holding regarding the consideration of “fair use” prior to sending a DMCA takedown notice has not been adopted by other courts and the case is ongoing. Nevertheless, copyright owners would be wise to consider in advance any relevant fair use issues prior to sending such a notice.

### *Conclusion*

The universe of social media continues to expand, and regardless of what “next year’s Twitter” might be, trademark and copyright owners will continue to face new challenges and obstacles as they strive to protect their valuable intellectual property in emerging media.

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## U.S. DEPARTMENT OF JUSTICE TARGETS EXPORT CONTROL AND FOREIGN CORRUPT PRACTICES ACT VIOLATIONS



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*S*trong export control and Foreign Corrupt Practices Act (FCPA) compliance programs will be more important than ever in 2010. The United States continues to deepen its commitment to enforce its export control laws,<sup>1</sup> with the Department of Justice’s (DOJ) current five-year strategic plan citing counter-terrorism and export control enforcement as the Department’s top goals through fiscal year 2012.<sup>2</sup> At the same time, DOJ continues to accelerate its enforcement of the FCPA and is increasingly linking these prosecutions to separate export control enforcement proceedings. We expect that prosecutions of export-related offenses will continue to increase in 2010 and that DOJ will aggressively continue FCPA enforcement, both as an adjunct to these cases and as stand-alone prosecutions. These trends make strong export control and FCPA compliance programs particularly critical for businesses in these areas.

### *National Export Enforcement Initiative*

One major reason for the increased enforcement activity is the National Export Enforcement Initiative (the “Initiative”), a collaboration between the National Security Division and various other federal agencies. The National Security Division was formed in 2006 within the Criminal Division at DOJ to consolidate export enforcement activities. It has taken the lead in prosecuting export control violations, and has collaborated with various other federal agencies to launch the Initiative. The goal of the Initiative is to educate prosecutors nationwide on how to bring export control cases, and to promote the formation of, and cooperation between, various government agencies, multi-agency task forces and U.S. Attorneys’ offices throughout the country.<sup>3</sup> The Initiative includes such measures as formation of the “Technology Protection Enforcement Group,” an inter-agency working group that aims to foster collaboration between DOJ and enforcement elements at the Department of State (including the Directorate of Defense Trade Controls), the Department of Commerce (including the Bureau



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of Industry and Security) and the Department of the Treasury (including the Office of Foreign Assets Control).<sup>4</sup>

These collaborative efforts have promoted an increased focus on enforcement activity. By the end of 2009, more than 1,000 federal agents and prosecutors were involved in foreign and counterintelligence-related investigations.<sup>5</sup> This number should increase in 2010, particularly given that penalties are increasing. Civil penalties for export control violations have risen about 25-fold since 2006, to the greater of \$250,000 or twice the value of the transaction per violation. Criminal penalties have also increased substantially.

Two major targets are export control violations involving the People's Republic of China and Iran.<sup>6</sup> In 2009, DOJ initiated more than 40 export enforcement actions, including at least 15 cases involving China and at least 14 involving Iran.<sup>7</sup> In 2008, approximately 43 percent of export prosecutions involved exports to Iran and/or China.<sup>8</sup> DOJ believes that these and other foreign governments have become more aggressive in acquiring sensitive U.S. technology in recent years. These governments allegedly target U.S. firms directly or employ them as consultants, and recruit students, professors and scientists to further their technology collection.<sup>9</sup> With respect to Iran in particular, DOJ has expressed heightened concern about exports of goods and technology related to missile guidance systems, improvised explosive device (IED) components, military aircraft parts and night vision equipment.<sup>10</sup> This focus should continue in 2010.

### ***Increased FCPA Enforcement***

Another major reason for increased enforcement activity is the DOJ's acceleration of its efforts under the FCPA. One aspect of this is the DOJ's increased linkage of the FCPA to export control enforcement actions. The theory is that FCPA violations often accompany export control violations, because the same companies that violate U.S. export control laws have corporate cultures that also tolerate the foreign bribery prohibited by the FCPA.<sup>11</sup> The DOJ, therefore, has increasingly looked for and prosecuted violations of the FCPA as an adjunct to its export control enforcement actions, including increased cross-collaboration with the Departments of Commerce and Treasury in this area. This was the case in several

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FCPA prosecutions flowing from the increased enforcement of economic sanctions laws after the September 11th terrorist attacks.<sup>12</sup> Publicly-traded companies had attempted to hide export control violations by altering their books and records to hide disbursements and expenses, and they found themselves subject to FCPA liability for failing to keep those books and records accurately.<sup>13</sup>

Another factor likely promoting increased FCPA enforcement activity, like in the export control arena, is increased fines. The increased focus on FCPA prosecutions as related to export control violations has led to recent record fines. In 2008, DOJ exceeded its previous \$44 million record for FCPA fines with a \$1.6 billion fine for Siemens and a \$579 million fine for Halliburton.<sup>14</sup> This trend is expected to continue in 2010.

A third factor is the DOJ's willingness to prosecute individuals and to take those prosecutions to trial. The DOJ has increased its prosecutions of individuals—even when the individual acted as an agent of a corporation—because the Department sees individual prosecution as a key mechanism to encourage corporate FCPA compliance. Assistant Attorney General Lanny Breuer remarked in a November 2009 speech that “prosecution of individuals is a cornerstone of [DOJ’s] enforcement strategy,” and that DOJ believes “the prospect of significant prison sentences to individuals should make clear to every corporate executive, every board member, and every sales agent that [DOJ] will seek to hold you personally accountable for FCPA violations.”<sup>15</sup> This helps to explain why FCPA actions now proceed to trial, as individuals are less willing to settle and agree to jail time. The DOJ took three major FCPA prosecutions to trial in 2009, the first such trials since 2004.

Finally, DOJ has begun relying less on voluntary disclosures and more on traditional investigative techniques, such as surveillance, to gather evidence and prosecute FCPA offenses—and this has cast a wider net. For example, on January 19, 2010, DOJ completed what it described as the first-ever undercover sting targeted at FCPA violators.<sup>16</sup> Federal officials arrested 22 corporate and sales executives for alleged corporate bribery violations under the FCPA.<sup>17</sup> All but one of the defendants were arrested at a widely attended Las Vegas firearms show.<sup>18</sup> Most of the individuals arrested in this operation were affiliated with small military and law enforcement supply companies, indicating that DOJ not only is having success with more traditional investigative techniques, but that it is also



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dedicated to FCPA enforcement beyond the largest multinational defense contracting companies.<sup>19</sup>

### *Cooperation with Foreign Authorities*

Higher levels of cooperation between U.S. law enforcement agencies and their foreign analogs have also helped fuel the increase in FCPA and export control prosecutions. For example, the \$1.6 billion FCPA penalty levied against Siemens in 2008 benefited largely from investigative cooperation between authorities in the United States and the German government. This cooperation will likely continue to increase, in part because of the facilitation of transnational cooperation by the Organization for Economic Cooperation and Development (OECD), which has informally encouraged its member countries to take tougher positions on corruption. For example, the OECD recommended that its members ban “small facilitation payments” currently permitted by the FCPA.<sup>20</sup> DOJ supports OECD’s initiative and, although Congress has not taken action to modify the FCPA in line with these recommendations, DOJ may interpret the FCPA more narrowly in 2010 to include as many of these payments as possible in its prosecutions.<sup>21</sup>

DOJ also has announced its intent to ramp up enforcement of drug and medical device exports that lack proper authorization from the Office of Foreign Assets Control and/or are in violation of the FCPA. Assistant Attorney General Breuer recently remarked that the “depth of government involvement in foreign health systems, combined with fierce industry competition and the closed nature of many public formularies, creates, in our view, a significant risk that corrupt payments will infect the process.”<sup>22</sup>

In conclusion, the federal agencies tasked with overseeing export control compliance—the Departments of Justice, State, Commerce and Treasury—are working more closely with each other to advance a coordinated approach to curtailing illegal exports of sensitive technology and equipment, particularly to Iran and China. Prosecutions increasingly rely on inter-agency collaboration through the National Export Enforcement Initiative and the related enhanced export control training given to U.S. Attorneys’ offices nationwide. We expect that prosecutions of export-related offenses will continue to increase and that DOJ will aggressively continue FCPA enforcement, both as an adjunct to these cases and as stand-

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alone prosecutions. These trends make strong export control and FCPA compliance programs more important than ever.

### *Endnotes*

- <sup>1</sup> The statutory basis for these enforcement actions derives from the Arms Export Control Act (AECA), the International Emergency Economic Powers Act (IEEPA), the Export Administration Regulations (EAR), the International Traffic in Arms Regulations (ITAR), the Iranian Transactions Regulations (ITR) and various other economic sanctions programs.
- <sup>2</sup> *See generally* U.S. Department of Justice, Office of the Attorney General, *Fiscal Years 2007-2012 Strategic Plan: Stewards of the American Dream*, available at <http://www.justice.gov> (last visited Jan. 22, 2010) (on file with author).
- <sup>3</sup> *See, e.g.*, Statement of James A. Baker, Associate Deputy Attorney General, Dep't of Justice, before the Committee on Foreign Relations, U.S. Senate (Dec. 10, 2009).
- <sup>4</sup> *See id.*
- <sup>5</sup> *See id.*
- <sup>6</sup> *See, e.g., id.*
- <sup>7</sup> *See* U.S. Department of Justice, Fact Sheet: *Major U.S. Export Enforcement Prosecutions (2007-Present)* (Dec. 30, 2009), available at <http://www.justice.gov> (last visited Jan. 22, 2010) (on file with author).
- <sup>8</sup> *See Baker, supra* note 3.
- <sup>9</sup> *See id.*
- <sup>10</sup> *See id.*
- <sup>11</sup> *See generally* "Exports Highlight Increased Focus on Individuals in FCPA Prosecutions," *Inside U.S. Trade*, 7 (Jan. 8, 2010), available at <http://www.insidetrade.com>.
- <sup>12</sup> *See id.*
- <sup>13</sup> *See id.*
- <sup>14</sup> *See generally* Lanny Breuer, Assistant Attorney General, U.S. Dep't of Justice, Keynote Address at the Foreign Corrupt Practices Act Forum (Nov. 17, 2009).
- <sup>15</sup> *Id.*
- <sup>16</sup> Diana B. Henriques, "F.B.I. Charges Arms Sellers with Foreign Bribes," *N.Y. Times*, Jan. 21, 2010, <http://www.nytimes.com> (last visited Jan. 22, 2010) (on file with author).
- <sup>17</sup> *Id.*
- <sup>18</sup> *Id.*
- <sup>19</sup> *Id.*



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<sup>20</sup> See, e.g., Organization for Economic Cooperation and Development, Working Group on Bribery in International Business Transactions, *Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, Nov. 26, 2009, available at <http://www.oecd.org> (last visited Jan. 22, 2010) (on file with author).

<sup>21</sup> *Exports Highlight Increased Focus on Individuals in FCPA Prosecutions*, *supra* note 11, at 6.

<sup>22</sup> *Breuer*, *supra* note 14.

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## VALUATION QUESTIONS RAISED BY THE TOUSA CASE



The valuation of a business is often a critical issue in litigation, and in fraudulent transfer litigation, it is almost always an issue. A recent decision in the TOUSA Inc. bankruptcy case<sup>1</sup> contains some rulings of interest on (i) the issue of business valuations (and, therefore, how insolvency can be determined) and (ii) the litigation benefit of obtaining a “solvency opinion” at the time of a transaction that is later challenged.

### *Insolvency Is a Key Element of a Fraudulent Transfer Case*

At its simplest, a transfer is “constructively fraudulent” if the debtor made the transfer without receiving a reasonably equivalent value in exchange for the transfer *and* the debtor was insolvent at that time. The Bankruptcy Code generally defines *insolvent* to mean an entity’s “financial condition such that the sum of such entity’s debts is greater than all of such entity’s property, at a fair valuation.”<sup>2</sup> This is often referred to as the “balance sheet test,” even though the fair value of the entity’s property, and the entity’s debts, will almost always bear little resemblance to the values shown on the entity’s balance sheet that is part of its financial statements.

### *Factual Background of the TOUSA Case*

TOUSA and its subsidiaries were in the business of selling homes. In June 2005, a wholly-owned TOUSA subsidiary formed a joint venture (the “JV”) with a third party, and the JV incurred debt to certain lenders. TOUSA and its subsidiary executed certain guarantees in favor of the lenders to the JV. Later, demand was made under these guarantees, and on July 31, 2007, a settlement was reached and TOUSA paid over \$421 million to these lenders to satisfy their claims.

TOUSA borrowed the money needed to make this payment. Certain TOUSA subsidiaries (the “Conveying Subsidiaries”), none of which had been partners in the JV or guarantors of the JV’s debts, became obligated on the new loans, and granted liens on substantially all of their assets to secure performance of their obligations (collectively, the “July 31 Transaction”).



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Just six months later, TOUSA and most of its subsidiaries, including all of the Conveying Subsidiaries, filed petitions under the Bankruptcy Code. The official committee of unsecured creditors sued the lenders who participated in the July 31 Transaction, seeking (among other things) to avoid the liens granted by the Conveying Subsidiaries as constructively fraudulent and recover the proceeds paid to the lenders for the JV.

### *The “Balance Sheet Test” of Insolvency*

The Bankruptcy Court found that the Conveying Subsidiaries were insolvent prior to the July 31 Transaction. The Bankruptcy Court focused on the “fair valuation” of the assets of the Conveying Subsidiaries, concluding that “fair valuation” is the same concept as “fair market value.”<sup>3</sup> The Court found that “fair market value is the price that a hypothetical, fully informed willing buyer would have paid a willing seller on the valuation date, assuming a reasonable time to sell the property and no undue pressure on either party.”<sup>4</sup> Said another way, the Court must determine what a buyer would be “willing to pay for the debtor’s *entire package* of assets and liabilities. If the price is positive, the firm is solvent; if negative, insolvent.”<sup>5</sup>

### *Methods of Valuation*

The Court approved use of the so-called “Observable Market Value” method.<sup>6</sup> The Court explained that “[t]he Observable Market Value method calculates a public company’s TEV [total enterprise value] on a certain date by adding the market value of the company’s publicly traded debt and equity securities on that date and subtracting its cash.”<sup>7</sup> Then, “the face value of the debt [less] ... cash (which could be used to pay off that debt)”<sup>8</sup> is subtracted from TEV. If the result is positive, the company is solvent; if not, it is insolvent.

While the Court characterized TEV as “a commonly used concept,” the Supreme Court in the *Daubert* case ruled that the long-standing “general acceptance” test for expert testimony was displaced with Federal Rule of Evidence 702.<sup>9</sup> Thus, finding only that a method is “commonly used” doesn’t appear to match the standards imposed by the Supreme Court. Also, the Court characterizes this method as a “balance sheet test,”<sup>10</sup> but admits the market values of the company’s securities are only a “proxy”<sup>11</sup> for the “fair value of the assets.” This acknowledgement alone casts doubt on the propriety

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the expert is conflicted.  
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of using this method when the Bankruptcy Code requires a “fair valuation” of an entity’s property.<sup>12</sup>

One of the responses made to the Observable Market Method was that “TOUSA’s positive market cap (the total value of outstanding public and private shares) ... cuts against [the TEV] opinion that TOUSA was insolvent.”<sup>13</sup> Indeed, other courts have relied heavily on a positive market cap when finding that a company was solvent at the time of a transfer that is later challenged as a fraudulent transfer.<sup>14</sup> In this case, however, the Court found that market value of common stock is almost completely unreliable as a measure of value when a company is perceived to be in financial distress.<sup>15</sup>

### *The “Time of Transaction” Solvency Opinion Was Unreliable*

Lenders often obtain “solvency opinions” from outside experts in connection with loans to corporate groups. If the transaction is later challenged, the contemporaneous valuation will, it is hoped, demonstrate solvency with no risk of hindsight bias and the lender’s good faith. In connection with the July 31 Transaction, a nationally recognized firm was retained to provide a solvency opinion. However, the Court discounted this opinion in its entirety for several reasons. Most importantly, the firm was compensated on a contingency fee basis. The firm could earn a \$2 million “premium” *only* upon the issuance of an opinion finding solvency, which sum dwarfed the amounts payable to the firm on a time and expense basis if it were unable to give an opinion of solvency.<sup>16</sup>

### *Conclusions*

The *TOUSA* opinion got at least one issue right: an expert’s “opinion” is worth little or nothing if the expert is conflicted. When an expert gets paid more for a particular answer, courts usually conclude that such an opinion lacks credibility. “Papering the file” won’t help a lender’s case when the “paper” can be dismissed out of hand as biased or lacking credibility.

It is not as clear that the *TOUSA* opinion was justified in approving the Observable Market Method as a reliable methodology to prove value. Given other language in the opinion, it may be correct to characterize it as *dicta*. Even so, this Court has approved it, and as such, it can be expected that it will be the subject of testimony where solvency or business valuations are at issue—or *Daubert* challenges—for some time to come.



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## Endnotes

- <sup>1</sup> *Official Comm. of Unsecured Creditors of TOUSA, Inc. v. Citicorp N. Am., Inc. (In re TOUSA, Inc.)*, No. 08-10928, 2009 WL 3261963 (Bankr. S.D. Fla. Oct. 13, 2009), amended, 2009 WL 3519403 (Bankr. S.D. Fla. Oct. 30, 2009).
- <sup>2</sup> 11 U.S.C. § 101(32).
- <sup>3</sup> 2009 WL 3519403, at \*70.
- <sup>4</sup> *Id.*
- <sup>5</sup> *Id.* at \*72 (quoting *Covey v. Commercial Nat'l Bank of Peoria*, 960 F.2d 657, 660 (7th Cir.1992)).
- <sup>6</sup> The Court's reliance on this method is puzzling because the Court had *rejected* the defendant's argument that the valuation should be performed on a common enterprise basis, and here the Observable Market Value method could *only* give an indication of value at the parent, or common enterprise basis, and could not directly value each Conveying Subsidiary. The other two methods relied on—the “comparable company” and discounted cash flow methods—are well-established valuation methods.
- <sup>7</sup> 2009 WL 3519403, at \*38.
- <sup>8</sup> *Id.*
- <sup>9</sup> *Daubert v. Merrill Dow Pharms., Inc.*, 509 U.S. 579, 593-94 (1993).
- <sup>10</sup> 2009 WL 3519403, at \*37.
- <sup>11</sup> *Id.*
- <sup>12</sup> 11 U.S.C. § 101(32).
- <sup>13</sup> 2009 WL 3519403, at \*39.
- <sup>14</sup> *See, e.g., Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283, 346-47 (Bankr. S.D.N.Y. 2007).
- <sup>15</sup> 2009 WL 3519403, at \*39. While it was argued that the market for debt instruments might not be “efficient” (and, therefore, not a reliable indication of value in this method), the Court found that there was no evidence the depressed trading prices for TOUSA's bonds “resulted from any factors other than the market's perception of the depressed fair value of TOUSA's assets.” *Id.*
- <sup>16</sup> 2009 WL 3519403, at \*52.



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## ABOUT THE AUTHOR



Kit Weitnauer is a partner in the firm's Atlanta office who concentrates his practice on bankruptcy and bankruptcy litigation matters. He is the co-author of a new book, *Business Valuation and Bankruptcy*, recently published by John Wiley & Sons. In 2006, he was trial counsel for the plaintiffs in a five-week jury trial in Oregon (with co-counsel from Oregon) that resulted in a jury verdict that (i) found over \$965,000,000 in transfers to have been made with the actual intent to hinder, delay or defraud plaintiffs and (ii) awarded \$350,000,000 in punitive damages to the plaintiffs. According to *The National Law Journal*, this was the largest verdict of 2006.







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