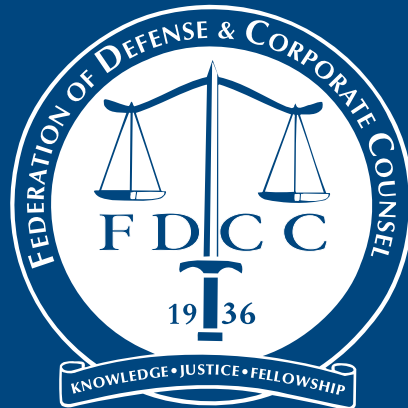


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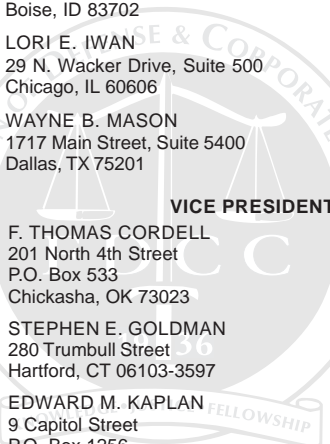
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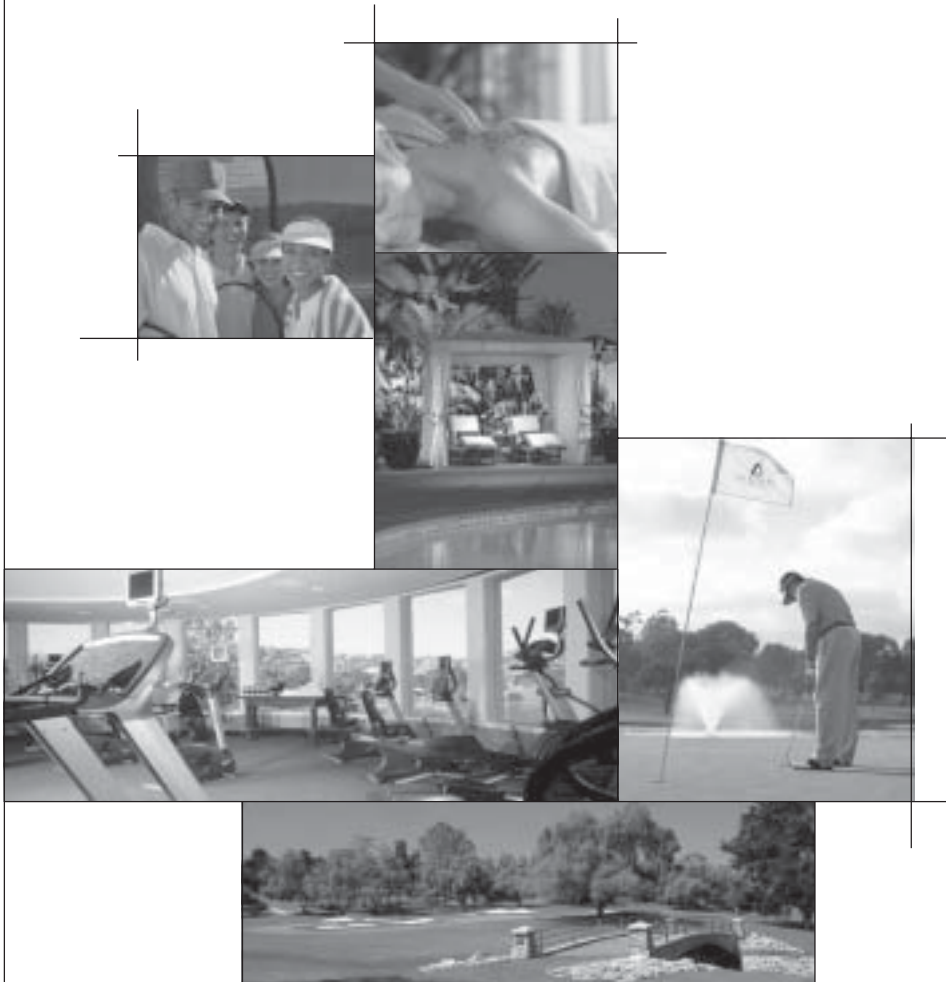
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Proposed Federal Rules of Civil Procedure Amendments Concerning Electronic Discovery: Will They Be Enough?

Thomas E. Rice
Thomas N. Sterchi
Tina M. Boschert

I. INTRODUCTION

As advancements in technology continue to dominate American culture, a correlative question dominates the judicial arena: can American courts keep pace with a society that is no longer dominated by paper production? American culture has become increasingly reliant upon electronic records. In terms of legal process, this reliance has generated an array of issues related to the discovery of electronic documentation.

Electronically generated media dominates document production. In the year 2002 alone, nearly ninety-two percent of all information created was digitally produced by computers, leaving a mere eight percent produced by traditional non-electronic media.¹ Other estimates suggest that between thirty and seventy percent of evidence in litigated disputes is typically generated electronically.² This modern trend presents an “array of challenges” for trial attorneys, litigants, and the court system as they function today.³

Are litigants, attorneys and courts up to the challenge of discovery in the computer age? With the computer age spawning terms such as active data, replicant data, residual data, backup data, cache files, cookies and metadata, assessing what can be sought or pro-

¹ David J. Waxse, “*Do I Really Have to Do That?*” *Rule 29(a)(1) Disclosures and Electronic Information*, 10 RICH. J. L. & TECH. 50, ¶ 11 (2004), available at <http://law.richmond.edu/jolt/v10i5/article50.pdf>.

² Lynn Jokela, *Electronic Discovery Disputes: Will the Eighth Circuit Courts Move Beyond Ad-Hoc Decision Making?*, 30 WM. MITCHELL L. REV. 1031, 1032 (2004).

³ *Id.* at 1031-32; see Waxse, *supra*, note 1, at ¶ 11.



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duced through discovery has become increasingly complicated.⁴ Although “[c]ourts have devised ‘creative’ ways to balance the broad scope of discovery permitted by Rule 26(b)(1) with the cost-consciousness of Rule 26(b)(2),” no generic authority exists to control what actually is discoverable in litigation.⁵ Given that milieu, it appears that the Civil Rules Advisory Committee may be making some attempt to conquer or clarify the confusing world of electronic discovery.

In December of 1937, when the United States Supreme Court formally adopted the Federal Rules of Civil Procedure, there was no provision for computers or contemplation that information might be electronically generated within the rules.⁶ Although the Federal Rules of Civil Procedure have been amended since their initial adoption to adapt to emergent changes in technology,⁷ however, this may not be enough. Federal judicial rule-makers have recognized that with the dominant change in focus from paper documentation to electronically produced media, even the amended discovery rules may not adequately address the issue of electronic discovery.⁸ Thus, since as early as 2000, the Discovery Subcommittee of the Advisory Committee on Civil Rules has viewed the need to address the

⁴ See James P. Flynn & Sheldon M. Finkelstein, *A Primer on “E-VIDE-N.C.E.”*, 28 LITIGATION 34, 37 (2002).

⁵ Stephen D. Williger & Robin M. Wilson, *Negotiating the Minefields of Electronic Discovery*, 10 RICH. J.L. & TECH. 52, ¶ 11 (2004).

⁶ See Waxse, *supra* note 1, at 1; see also 19 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE § 4508 (2d ed. 1996).

⁷ Waxse, *supra* note 1, at ¶ 1.

⁸ See *id.* at ¶ 13.



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realm of electronic discovery as its unique focus.⁹ Now, after nearly four years of generated input and analysis, the proposed electronic discovery amendments to the Federal Rules of Civil Procedure are completed and scheduled to be posted for a six-month public comment period.¹⁰ Examining these proposed amendments in light of flourishing electronic data utilization, the ultimate question accurately becomes, “will they be enough?”

By specific reference to the Committee Notes addressing the purpose and reasoning behind the proposed changes, this article will discuss the proposed amendments to the Rules of Civil Procedure regarding electronic discovery. Additionally, it will analyze the proposed amendments by focusing on public comments from the bar and from the Lawyers for Civil Justice (LCJ), previously submitted to the Discovery Subcommittee — especially those expressing areas of concern and the need to modify the Civil Rules. Finally, this article will identify residual issues that were not addressed or were insufficiently addressed by the proposed amendments, focusing the impact of such issues on the need for additional public comment or changes to the Civil Rules.

⁹ Advisory Committee on Federal Rules of Civil Procedure, Report of the Civil Rules Advisory Committee at 5 (Aug. 3, 2004), available at <http://www.uscourts.gov/rules/comment2005/CVAug04.pdf> [hereinafter Committee Report].

¹⁰ See Richard Acello, *NEW E-DISCOVERY RULES PROPOSED: Judicial Conference Considers 'Safe Harbor' for Data Destruction*, 3 No. 29 ABA JOURNAL E-REPORT 4, July 23, 2004.



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II. DISCUSSION

As alluded to earlier, the proposed amendments to the Federal Rules of Civil Procedure relating to the discovery of electronically stored information are drafted and scheduled for public comment from early-August 2004 through February 15, 2005.¹¹ The Advisory Committee's proposed amendments attempt to address the long-heard concerns about the inadequacy of the current Civil Rules in dealing with the unique and challenging features of electronically stored information in the discovery process.¹² In drafting the proposed amendments, the Committee has invoked "the accumulation of experience in this area, reflected in case law, the expanded treatment in the Manual for Complex Litigation, and [the] . . . 'best practices' protocols drafted by the ABA Litigation Section and others."¹³ Hoping to forestall a proliferation of local rules concerning the discovery of electronically stored information, the Committee has chosen to act now, offering the proposed changes to the Civil Rules for public comment in an effort to achieve national consistency and uniformity regarding discovery, as originally intended.¹⁴

When drafting the proposed amendments, the Advisory Committee focused on the problems associated with electronic discovery as identified by the practicing bar. These

¹¹ See Advisory Committee on Federal Rules of Civil Procedure, Memorandum to the Bench, Bar, and Public on Proposed Amendments to the Federal Rules (Aug. 9, 2004), available at <http://www.uscourts.gov/rules/comment2005/Memo.pdf>.

¹² See Committee Report, *supra* note 9, at 2, 20.

¹³ *Id.* at 5.

¹⁴ *Id.* at 4.

included such issues as: (1) the sheer volume of electronic information; (2) the dynamic nature of such information; (3) the potential increase in burden and expense of production; and (4) the uncertainty of applicable standards concerning electronic discovery.¹⁵ The Committee further confronted the challenge of drafting proposed amendments that would guide current practice for managing electronic discovery while maintaining sufficient flexibility to adapt to future changes in practice.¹⁶

The Committee's proposed amendments are as follows:

amending Rules 26(f) and 16(b) and Form 35 to prompt early discussion of issues relating to electronically stored information and of handling of privilege issues, and to call for the results of such discussions to be reported to the judge; amending Rule 34(a) to clarify and modernize the definition of discoverable material; amending Rule 34(b) to provide for the form of producing electronically stored information; amending Rule 33(d) to provide for electronically stored information a parallel option to produce business records to answer interrogatories; amending Rule 26(b)(2) to provide that electronically stored information that is not reasonably accessible need not be produced unless a court so orders on a showing of good cause; amending Rule 26(b)(5) to provide a procedure that applies when a party asserts an inadvertent production of information privileged or protected from discovery, carefully avoiding any determination on the outcome of the privilege assertion; and amending Rule 45 to incorporate these changes.¹⁷

The Discovery Committee was virtually unanimous in recommending public comment for each proposal.¹⁸ With respect to Rule 37, the Committee has proposed the addition of a safe harbor provision but continues to debate the conditions under which sanctions should apply. Accordingly, this article will address the breadth of those amendments as well.

A. *Discussion of Electronic Discovery Issues*

The first proposed area of change to the Civil Rules suggests that early discussion and planning is necessary when issues of electronic discovery are involved in litigation.¹⁹ This proposed change requires amendments to Rule 26(f), Form 35 and Rule 16(b).²⁰ Overall,

¹⁵ See *id.* at 2-3.

¹⁶ *Id.* at 20.

¹⁷ Advisory Committee on Federal Rules of Civil Procedure, Report of the Civil Rules Advisory Committee (May 17, 2004), available at <http://www.kenwithers.com/rulemaking/civilrules/report051704.pdf>.

¹⁸ See *id.* at 21.

¹⁹ Committee Report, *supra* note 9, at 6.

²⁰ *Id.* at 6.

the Committee Notes accompanying these changes suggest that the Committee generally attempted to address the distinctive and repetitious problems typically associated with electronic discovery.²¹ Such problems include: volume, dynamic databases not compatible with hard copies, documents which are automatically created and deleted, and the form of production for electronic information.²²

In fact, the proposed changes to Rule 26(f) involve the addition of language to include: (1) early discussion of issues relating to the preservation of discoverable information; (2) amending the discovery plan to include the parties' views on disclosure or discovery of electronically stored information, including the form of production for such information; and (3) whether the court should enter a protective order, if the parties agree, to allow the assertion of privilege after the production of such information.²³ Specifically, the Committee Note to Rule 26(f) suggests that the Advisory Committee wished to facilitate discussion and prevent subsequent discovery problems.²⁴ The Committee indicated that the early discussion of electronic discovery issues and forms of production would lessen waste and duplication in the discovery process.²⁵ Early discussion of electronic discovery would focus parties on the nature and extent of the contemplated discovery, the respective parties' information systems, the accessibility of desired information and the burden of retrieval, as dependent upon the specific facts of each case.²⁶

Further, the Committee suggested in its Note that, when addressing issues of what should be preserved in anticipation of litigation, the parties should aim to balance the need for preservation with the need for continued operations, since a blanket preservation order is likely to be both expensive and unduly burdensome.²⁷ By asking parties to discuss the issues relating to electronic discovery up front, the Committee anticipates preventing subsequent uncertainty and controversy regarding what is discoverable.²⁸ Relying on the *Manual for Complex Litigation*, the Committee Note also proposes the availability of procedures such as "quick peek" agreements or "clawback" agreements, accompanied by judicial case management orders permitting their execution, in order to reduce cost and delay in elec-

²¹ See Advisory Committee on Federal Rules of Civil Procedure, *Proposed Amendments to the Federal Rules of Civil Procedure*, available at <http://www.uscourts.gov/rules/comment2005/CVAug04.pdf>, at 3 [hereinafter Proposed Amendments].

²² *Id.* at 11.

²³ *Id.* at 8-9.

²⁴ See *id.* at 17.

²⁵ *Id.* at 18. (citing MANUAL COMPLEX LITIG. (4th) § 11.446).

²⁶ See *id.* at 17.

²⁷ *Id.* at 18-19 (citing MANUAL FOR COMPLEX LITIG. (4th) § 11.422); see also Committee Report, *supra* note 9, at 8.

²⁸ See Committee Report, *supra* note 9, at 6-7.

tronic discovery.²⁹ Finally, the Advisory Committee Note suggests that mandated discussion of electronic discovery is not necessary when electronic discovery is not an issue in the litigation.³⁰

Proposed changes to Form 35 require that parties submit a description of how electronically stored information will be handled for discovery purposes within their discovery plan.³¹ If the parties agree to a plan, they are also requested to provide a brief description of the provisions of the proposed order necessary to protect any applicable privilege.³² The accompanying Committee Note suggests that Form 35 was simply amended to reflect the changes in Rule 26(f) that required a report to the court regarding the parties' discovery plan.³³ This report is critical because it should include any calls for action by the parties, such as the extent of the information to be searched, the parties' plan for evidence preservation and/or the cost allocation.³⁴

Finally, the proposed changes to Rule 16 would allow courts to issue scheduling orders that provide for the disclosure and discovery of electronically stored information, in addition to implementing the parties' agreement for protection against privilege waiver.³⁵ Again, the Advisory Committee Notes suggest that Rule 16 has been changed essentially to accommodate the efforts of Rule 26(f) to protect against privilege waiver.³⁶ The Committee makes it clear, however, that such an order cannot be issued unless the parties expressly stipulate and agree to the contents.³⁷

Given the spiraling world of electronic data, most parties favor modifications to the Civil Rules to accommodate and guide litigants on how to deal with the advancing technological changes affecting the field of discovery.³⁸ Commentators, as well as federal district

²⁹ *Id.* at 8.

³⁰ *Id.*

³¹ Proposed Amendments, *supra* note 21, at 18.

³² Committee Report, *supra* note 9, at 6.

³³ Proposed Amendments, *supra* note 21, at 18.

³⁴ *Id.*

³⁵ *Id.* at 1-2.

³⁶ Committee Report, *supra* note 9, at 6.

³⁷ Proposed Amendments, *supra* note 21, at 18.

³⁸ See Michele Schroeder, *Emerging Law: State and Federal Statutes Address E-Discovery*, DIGITAL DISCOVERY & E-EVIDENCE, Jan. 2002, reprinted at <http://www.krollontrack.com/Publications/emergingddee.pdf>; see *McPeck v. Ashcroft*, 212 F.R.D. 33 (D.D.C. 2003) (holding that there is no controlling authority for whether backup tapes should be produced); see generally *The Sedona Principles for Electronic Discovery*, January 15, 2004 [hereinafter *Sedona*] (noting that the Civil Rules only provide broad standards and offering the Sedona Principles as a supplement to such rules regarding electronic discovery), available at <http://www.thesedonaconference.org/miscFiles/SedonaPrinciples200401> or <http://www.thesedonaconference.org/publications-html>.

courts, favor the requirement that Rule 26 conferences include mandatory discussion of electronic discovery issues.³⁹ Most interested parties also agree with the Advisory Committee that a Rule 26 conference mandating early discussion of electronic discovery issues could be an important tool in avoiding subsequent litigation disputes.⁴⁰

That being said, there are others who believe that mandatory discussion of electronic discovery should be optional and confined to notes appended to the Rule, rather than included in the Rule itself.⁴¹ Supporters of this theory cite the proposition that electronic discovery or the preservation of electronic data is not always an issue in every case. Thus, mandating its discussion might lead to fishing expeditions by litigants.⁴² Responding to this argument, the Committee addressed the circumstances when electronic discovery would not be an issue in its Note to Rule 26(f), proposing that changes affecting electronic discovery would not apply in actions where such discovery is not an issue.⁴³ Prospective fishing expeditions will likely remain a valid concern, however, since the rule specifically requires discussion of any issues relating to discoverable information.⁴⁴ Even in simple cases where electronic discovery may not be an issue, a mandatory discussion of “discoverable information” might encourage parties to impose expensive and burdensome preservation measures in anticipation of future electronic discovery needs.⁴⁵ Nevertheless, only time and utilization of the proposed changes to the Civil Rules will accurately predict the course of litigation in the future.

The “quick peek” and “clawback” agreements suggested in the Committee Note to the proposed Rule 26(f) amendments currently are generating discussions that are likely to continue. Although listed only as optional methods for reducing burden and cost, most interested parties adamantly disfavor the use of such agreements, suggesting that unreviewed

³⁹ See Sedona, *supra* note 38, at Comment 3.a. (citing U.S. Dist. Ct. Ark. R. 26.1, U.S. Dist. Ct. N.J. L. R. 26.1(d) and U.S. Dist. Wyo. L. R. 26.1(f) as supporting the proposition that electronic and computer-based media should be discussed in Rule 26 disclosures); see also Letter from Walter J. Sinclair, IADC president-elect, to the Civil Rules Advisory Committee, received June 26, 2003, available at <http://www.kenwithers.com/rulemaking/civilrules/ed14.pdf> [hereinafter Sinclair] (suggesting that it is imperative that parties meet and discuss e-discovery issues at the earliest possible opportunity).

⁴⁰ Sedona, *supra* note 38, at Comment 3.a.; see also Sinclair, *supra* note 39; Letter from Hon. John J. Hughes, U.S. Magistrate Judge District of New Jersey, to the Civil Rules Advisory Committee, received February 3, 2004, available at <http://www.kenwithers.com/rulemaking/civilrules/ed53.pdf>. [hereinafter Hughes].

⁴¹ Letter from Michael Gabel, Senior Attorney for FedEx Litigation, to the Civil Rules Advisory Committee, received April 9, 2004, available at <http://www.kenwithers.com/rulemaking/civilrules/ed68.pdf> [hereinafter Gabel].

⁴² See Gabel, *supra* note 41.

⁴³ See Proposed Amendments, *supra* note 21, at 17.

⁴⁴ *Id.* at 9.

⁴⁵ See Gabel, *supra* note 41.

documents should not be produced for opposing parties.⁴⁶ Further, opponents to the “quick peek” and “clawback” methods advise that these approaches simply will not work and do not pose reasonable alternatives to privilege review.⁴⁷ Parties should never turn everything over to opposing counsel because this practice unacceptably invades the client’s privacy as well as protected client work-product.⁴⁸

The Sedona Conference in particular addressed the issue of “clawback” or “quick peek” agreements. The Conference Working Group did not expressly reject their use, but suggested that such agreements are not to be lightly entered.⁴⁹ Recognizing that such agreements advantageously reduce the cost associated with pre-production review, the Sedona Conference Working Group nevertheless acknowledged a host of problems associated with the use of such agreements.⁵⁰ Specifically, the conference group observed that: (1) “voluntary production of privileged and confidential materials to one’s adversary, even in a restricted setting, is inconsistent with the tenets of privilege law;” (2) no effective means of limiting the privilege arguments of non-parties exists, despite the inclusion of strong language to that effect; (3) attorneys have an ethical duty to protect the client’s privileged information; and (4) a “Pandora’s box” of issues concerning privacy rights are implicated by such agreements.⁵¹ Given their reservations, the Working Group recommended utilizing such agreements, but only in extremely limited circumstances and in conjunction with a court order.⁵²

The Advisory Committee appears to have adopted a view similar to that expressed by the Sedona Conference Working Group regarding the use of “quick peek” and “clawback” agreements. Public commentary, however, might still call for a change in the proposed amendments regarding their use since the dominant controversy concerns privilege and privacy rights. On the other hand, the Committee’s existing draft may prove the wiser course because it relegates these agreements to options requiring the consent of both parties. Undoubtedly, time and public comment will prove the value of these measures.

⁴⁶ See Sedona, *supra* note 38, at Comment 10.d.; Letter from Thomas W. Burt, Vice President & General Deputy Counsel for Microsoft Corporation, to Civil Rules Advisory Committee, received March 9, 2004, available at <http://www.kenwithers.com/rulemaking/civilrules/ed57.pdf> [hereinafter Burt]; LCJ Comments to the Civil Rules Advisory Committee, *The Search for Standards: How Amendments to the Federal Rules of Civil Procedure Can Help Solve the E-Discovery Crisis*, LAWYERS FOR CIVIL JUSTICE, March 12, 2004 [hereinafter LCJ, *The Search for Standards*], available at <http://www.lfcj.com/documents/E-Disc%20LCJ%20Comments%20to%20AdvCom%20031204+WhitePaperNov03.pdf>.

⁴⁷ See LCJ, *The Search for Standards*, *supra* note 46; see Burt, *supra* note 46.

⁴⁸ See Burt, *supra* note 46; see also Robert Douglas Brownstone, *Collaborative Navigation of the Stormy E-Discovery Seas*, 10 RICH. J.L. & TECH. 53, ¶ 23 (2004).

⁴⁹ Sedona, *supra* note 38, at Comment 10.d.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² See *id.*

B. *Option to Produce Electronically Stored Information in Response to Interrogatories*

Rule 33(d) addresses the proposed amendments to the Civil Rules in limited fashion, adding only the language, “including electronically stored information.”⁵³ The Advisory Committee Note proposes incorporation of that change to parallel the change in Rule 34(a) (which will be discussed later), recognizing the importance of electronically stored information.⁵⁴ Given the minimal nature of this change and its limited purpose, no identifiable public comment exists addressing this particular amendment. However, the Committee Note contains some interesting language.

Depending upon case circumstances, it appears that responding parties may need to provide technical support, informational software, or other pertinent computer assistance to requesting parties.⁵⁵ Some commentators counter that the Civil Rules should not require provision of a computer expert, as the Committee suggests.⁵⁶ Thus, this portion of the proposed Rule 33(d) amendment asking producing parties to bear discovery responsibility has the potential to spawn additional discussion among interested parties, given their existing concern about the cost and burden of electronic discovery.⁵⁷

C. *Definition of Electronically Stored Information*

The proposed amendments change Rule 34(a) to include “electronically stored information” as an item for inspection or for other purposes.⁵⁸ Beyond explicitly designating “electronically stored information” or “data . . . in any medium” as discoverable, this change allows parties to test and sample any request within the scope of Rule 26.⁵⁹ The Advisory Committee amended Rule 34(a) specifically to acknowledge the increasing importance and variety of electronically discoverable information.⁶⁰ According to the Committee, the Rule 34(a) definition should be expansively construed to include “any type of information that can be stored electronically,” utilizing the accompanying terminology of “in any me-

⁵³ Proposed Amendments, *supra* note 21, at 23.

⁵⁴ *Id.*

⁵⁵ *Id.* at 24.

⁵⁶ *Id.*; Letter from Robert D. Hunter, General Counsel Altec, Inc., to Civil Rules Advisory Committee, received June 26, 2003, available at <http://www.kenwithers.com/rulemaking/civilrules/ed15.pdf> [hereinafter Hunter].

⁵⁷ See generally *Zubulake v. UBS Warburg, LLC*, 217 F.R.D. 309 (S.D.N.Y. 2003); *Rowe Entertainment Inc. v. William Morris Agency, Inc.*, 205 F.R.D. 421 (S.D.N.Y. 2002); *McPeck v. Ashcroft*, 202 F.R.D. 31 (D.D.C. 2001).

⁵⁸ Proposed Amendments, *supra* note 21, at 24.

⁵⁹ *Id.* at 24-25.

⁶⁰ *Id.* at 28.

dium,' to encompass future developments in computer technology."⁶¹ Finally, the Committee suggests that the Rule 34(a) amendments are intended to clarify that parties may sample the materials requested in electronic discovery under the Civil Rules, in addition to copying or inspecting such materials.⁶²

Again, almost every interested party favors amending the Civil Rules to include definitions relating to electronic discovery in an effort to provide better guidance to courts and litigants.⁶³ However, some parties argued that any amendment should be limited to recognizing e-discovery, short of any attempt to manage that discovery in the computer age.⁶⁴ Proponents of this position indicate that changes to the Civil Rules should not identify what information must be produced by specific mention of metadata or embedded data.⁶⁵ These issues are dependant upon individual circumstances and their resolution should be left to case law.⁶⁶

The Committee Note to Rule 34(a) indicates that the Advisory Committee impliedly heeded such advice since the Advisory Committee clearly suggests that the terminology of Rule 34 should be viewed expansively to encompass future changes in technology.⁶⁷ Likewise, the proposed modifications to Rule 34(a) principally serve to update the Civil Rules in order to include electronically discoverable information. This move is likely to elicit little controversy, although some litigants and attorneys might favor a more tailored definition denoting precisely what information must be produced. A clarification of this nature, however, will likely occur by operation of other proposed amendments to the Civil Rules.

D. *Form of Production*

Proposed changes to Rule 34(b) also allow the requesting party to "specify the form in which electronically stored information is to be produced."⁶⁸ Under this change, the producing party may object only to the requested form, offering its reasons for such objection, unless no form of production is specified by the requesting party.⁶⁹ If no form is specified, the responding party may produce electronic information either in the "form in which it is ordinarily maintained, or in an electronically searchable form."⁷⁰

⁶¹ *Id.* at 28-29.

⁶² *Id.* at 29.

⁶³ See Jonathan M. Redgrave, *The Rules of Civil Procedure in the Electronic Age: An Opportunity to Be Heard*, 51 FED. LAW. 5 (June, 2004).

⁶⁴ See Hughes, *supra* note 40.

⁶⁵ See Burt, *supra* note 46.

⁶⁶ See *id.*

⁶⁷ See Proposed Amendments, *supra* note 21, at 29.

⁶⁸ *Id.* at 30.

⁶⁹ *Id.* at 26.

⁷⁰ *Id.* at 27.

The Advisory Committee suggests that this amendment is intended essentially to provide a form for producing electronically stored information.⁷¹ Specification of the desired form hopefully will facilitate “orderly, efficient, and cost-effective discovery of electronically stored information.”⁷² As noted, the proposed amendment also gives the requesting party the initial right to choose a preferred form for producing electronic documents,⁷³ allowing the producing party to generate such documents either in the form they are ordinarily maintained or a searchable form only when the requesting party specifies no form for production.⁷⁴ The producing party’s only other option is to object to the form requested or to object if no form is requested, leaving the court to decide what form should be used.⁷⁵ Equally important, the Advisory Committee’s Note suggests that a court can order electronically stored information to be produced in more than one form on a showing of good cause.⁷⁶

The proposed changes concerning “form of production” is another area of the Civil Rules likely to elicit strong comments following a public posting. Several interested parties have already submitted comments to the Advisory Committee that favor leaving the choice of production form to the producing party.⁷⁷ These parties suggest that the producing party is best situated to determine the practicalities of such data production. Adopting a more centrist approach, others have suggested that the requesting party should hold the option to request production of electronic information in preferred form.⁷⁸ When such a request is made, both parties are responsible to reach an agreement regarding data production.⁷⁹

Despite such suggestions, the Advisory Committee clearly opted to leave the matter to the requesting party, likely generating some concern among producing parties.⁸⁰ Although given the opportunity to object under the proposed amendment, responding parties may be producing electronically stored information in forms that are not the most cost-effective or efficient methods available to them. Additional comments to this proposed amendment are likely to come from those parties who already have grappled with costly e-discovery. Those

⁷¹ See Committee Report, *supra* note 9, at 16.

⁷² Proposed Amendments, *supra* note 21, at 30.

⁷³ See *id.*

⁷⁴ See *id.*

⁷⁵ See *id.* at 31.

⁷⁶ See *id.*

⁷⁷ See Sinclair, *supra* note 39; Letter from Peter J. Osterling, Assistant General Counsel Nationwide Insurance Companies, to the Civil Rules Advisory Committee, received Dec. 19, 2002, available at <http://www.kenwithers.com/rulemaking/civilrules/ed08.pdf>; Gabel, *supra* note 41.

⁷⁸ See Burt, *supra* note 46.

⁷⁹ See *id.*

⁸⁰ See Proposed Amendments, *supra* note 21, at 30.

who fear a burdensome demand are more likely to be concerned about their diminished input into forms for production of electronically discoverable information. Accordingly, those individuals are likely to register the greatest response.

E. *Reasonably Accessible Information*

Proposed amendments to the Civil Rules alter Rule 26(b)(2) to add a section dealing specifically with “electronically stored information.”⁸¹ The proposed section 26(b)(2) affirms that a responding party need not produce electronically stored information that is not reasonably accessible.⁸² However, the responding party bears the burden to show that such information is not reasonably accessible.⁸³ Once this showing is made, only the court can require that such information be produced upon a showing of good cause.⁸⁴

As the accompanying Committee Note suggests, Rule 26(b)(2) is “designed to address some of the distinctive features of electronically stored information,” such as the volume, the storage location, the effort, and the expense associated with discovery.⁸⁵ The Committee suggests that consideration of what is “reasonably accessible” depends upon a variety of circumstances that are likely to change as technology evolves.⁸⁶ However, the Committee proposes that electronic information is considered not “reasonably accessible” if it “can be located, retrieved, or reviewed only with very substantial effort or expense.”⁸⁷

As previously noted, once the responding party proves that electronically stored information is not reasonably accessible, only the court can require production of such information upon a showing of good cause.⁸⁸ In evaluating good cause, it is suggested that courts should balance the need for such information with the burden likely faced by the responding party to produce the material.⁸⁹ The Advisory Committee relies on the *Manual for Complex Litigation*, suggesting that “‘the rule should be used to discourage costly, speculative, duplicative, or unduly burdensome discovery of computer data and systems,’” and that “[m]ore expansive forms of production . . . should be conditioned upon a showing of need or sharing expenses.”⁹⁰

⁸¹ *Id.* at 6.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.* at 11.

⁸⁶ *See id.* at 12.

⁸⁷ *Id.* at 11.

⁸⁸ *Id.* at 14.

⁸⁹ *Id.*

⁹⁰ *Id.* (citing MANUAL FOR COMPLEX LITIG. (4th) § 11.446).

How much electronically stored information should be discoverable was debated by the Discovery Subcommittee as well as by other outside parties interested in the developing Civil Rules.⁹¹ The Discovery Subcommittee spent considerable time debating whether electronic discovery obligations should be limited when a party is producing electronically stored information that is difficult to access or not routinely accessed in the ordinary course of business.⁹² By analysis, the Civil Rules amendment proposed by the Discovery Committee most closely resembles that recommended by the Lawyers for Civil Justice (LCJ) in its *White Paper*, seeking a limitation against extraordinary measures.⁹³ The LCJ suggested that any amendment should follow the “Texas” principle, whereby “initial production obligations of a producing party extend only to electronic material which is specifically sought and which is reasonably accessible in the ordinary course of business,” unless a court orders more extensive discovery upon a showing of good cause.⁹⁴

Other interested parties likewise favor adoption of this two-tiered approach in the area of electronic discovery. The two-tiered approach to electronic discovery allows discovery of what is reasonably accessible and kept in the ordinary course of business, presumptively limiting the burden and cost to producing parties.⁹⁵ Adoption of this rule still allows for discovery of backup or inaccessible data, but reserves this type of retrieval for rare circumstances predicated upon a showing of need.⁹⁶ Supporters of this proposal favor “smart” discovery requests that are tailored to the discovery of information reasonably available.⁹⁷ Similarly, the proposed amendments to the Civil Rules also favor such an approach.⁹⁸

In the area of cost allocation, however, the newly-proposed amendments might not provide the resolution desired by litigants. In the proposed amendments, cost allocation is mentioned only briefly by Committee Notes which suggest that courts “should” condition

⁹¹ See Memorandum from Profs. Myles Lynk and Richard Markus to the Advisory Committee on Civil Rules, dated April 6, 2004, available at <http://www.kenwithers.com/rulemaking/civilrules/marcus040604.pdf>.

⁹² See *id.*

⁹³ See LCJ White Paper: Reshaping the Discovery Rules for the 21st Century, *The Need for Clear, Concise, and Meaningful Amendments to the Rules Governing Electronic Discovery*, LAWYERS FOR CIVIL JUSTICE, November 2003 [hereinafter LCJ, *White Paper*], available at <http://www.lfcj.com/documents/E-Disc%20LCJ%20Comments%20to%20AdvCom%20031204+WhitePaperNov03.pdf>.

⁹⁴ *Id.* (citing Association of Trial Lawyers of America, *Discovery of Computerized Materials: The Things We've Heard!*, (Winter 2002)); see also Thomas Y. Allman, *The Need for Federal Standards Regarding Electronic Discovery*, 68 DEF. COUNS. J. 206 (2001).

⁹⁵ See Burt, *supra* note 46; see also The Lawyers for Civil Justice, *LCJ Comments to the Civil Rules Advisory Committee Regarding E-Discovery Proposals for Discussion at the April 2004 Meeting*, April 13, 2004 [hereinafter LCJ, *Discussion at the April 2004 Meeting*] (on file with authors).

⁹⁶ See Burt, *supra* note 46.

⁹⁷ See LCJ, *Discussion at the April 2004 Meeting*, *supra* note 95.

⁹⁸ See Committee Report, *supra* note 9, at 12.

expansive electronic discovery on the sharing of costs.⁹⁹ Although relegating cost allocation in electronic discovery to case law development may be wise, the Advisory Committee's avoidance of the issue in e-discovery may elicit some objection from parties who fear burdensome electronic discovery. In fact, some supporters who favor changing the Civil Rules to accommodate electronic discovery would prefer a uniform cost-sharing structure,¹⁰⁰ which directs the courts to consider all the necessary costs (i.e., production costs, review costs, search costs) in their cost-shifting analysis.¹⁰¹ On the other hand, these same parties agree that decisions in cases such as *Zubulake*¹⁰² and *Rowe*¹⁰³ are effectively managing cost allocation both fairly and reasonably.¹⁰⁴

Since the proposed amendments briefly mention cost sharing as an option to mandating any other method, they invite further comment and discussion by the public, allowing again for the prospect of additional future amendments.¹⁰⁵ Whether the amendments sufficiently guide litigants, attorneys and courts when dealing with expensive and burdensome electronic discovery issues remains open to future deliberation.

F. *Belated Assertion of Privilege*

The change proposed for Rule 26(b)(5)(B) simply allows for belated assertion of privilege. Specifically, it allows a party who inadvertently produces privileged information to notify the party receiving the information of the belated claim of privilege within a reasonable time.¹⁰⁶ Upon notification, the receiving party must return, sequester or destroy the specified information.¹⁰⁷ The proposed amendment also provides a procedure in which parties can recover inadvertently produced privileged documents.¹⁰⁸ However, it does not

⁹⁹ Proposed Amendments, *supra* note 21, at 14.

¹⁰⁰ See LCJ, *White Paper*, *supra* note 93; see also Letter from Ashish S. Prasad, litigation partner and head of electronic discovery group at Mayer, Brown, Rowe and Maw, to Civil Rules Advisory Committee, received July 3, 2003, available at <http://www.kenwithers.com/rulemaking/civilrules/ed37.pdf> [hereinafter Prasad].

¹⁰¹ See LCJ, *White Paper*, *supra* note 93; see also Prasad, *supra* note 100.

¹⁰² *Zubulake v. UBS Warburg, LLC*, 217 F.R.D. 307 (S.D.N.Y. 2003) (presenting a seven-factor test for "relatively inaccessible" material production).

¹⁰³ *Rowe Entertainment, Inc. v. William Morris Agency, Inc.*, 205 F.R.D. 421 (S.D.N.Y. 2002) (identifying an eight-factor test to be utilized in determining whether the costs of producing electronically stored data should be shifted to the requesting party).

¹⁰⁴ See LCJ, *White Paper*, *supra* note 93; see also Prasad, *supra* note 100.

¹⁰⁵ See Committee Report, *supra* note 9, at 12.

¹⁰⁶ Proposed Amendments, *supra* note 21, at 7.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 16.

clarify the substantive issues of waiver and privilege under the circumstances.¹⁰⁹ Likewise, the proposed change does not prescribe any particular method of providing timely notice, but does denote those factors bearing on reasonableness. They include: (1) the date on which the producing party learned of the inadvertent production; (2) the extent to which the requesting party made use of the information; (3) the difficulty in discerning that the information was privileged; and (4) the magnitude of the production.¹¹⁰

Similar to others among the proposed amendments, this provision is likely to generate little dispute. Most interested parties favor protection against the inadvertent disclosure of privileged documents.¹¹¹ Such protection is embedded in the concepts of what is “fair and reasonable” concerning electronic discovery.¹¹² Although advocating the use of an inadvertent privilege proposal, some also caution that such protection should not be used to pressure litigants or attorneys to produce electronic media prematurely.¹¹³

G. *Safe Harbor on Sanctions*

The proposed changes to Rule 37 sanctioning failure to cooperate or disclose information in electronic discovery are new.¹¹⁴ These proposals address specific problems relating to automatic computer data destruction systems that routinely operate to save and destroy documents or recycle backup tapes.¹¹⁵ The Committee concluded that electronically stored data must be treated differently than other forms of discovery, based on the dynamic nature of such data.¹¹⁶ The Advisory Committee adopted a provision requiring that reasonable steps be taken to prevent the loss of discoverable information.¹¹⁷ However, the Committee continues to examine whether sanctions should be imposed only for intentional or reckless conduct (as opposed to ordinary negligence), and whether culpability should factor into the proposed Rule 37 changes.¹¹⁸

¹⁰⁹ Committee Report, *supra* note 9, at 14 (emphasizing that “courts have developed principles to decide whether waiver or forfeiture results from inadvertent production of privileged information”).

¹¹⁰ *Id.* at 13

¹¹¹ See Burt, *supra* note 46; see also LCJ, *The Search for Standards*, *supra* note 46.

¹¹² See LCJ, *The Search for Standards*, *supra* note 46.

¹¹³ See Burt, *supra* note 46.

¹¹⁴ Committee Report, *supra* note 9, at 17.

¹¹⁵ See *Id.*

¹¹⁶ Proposed Amendments, *supra* note 21, at 32.

¹¹⁷ See *id.*; Hunter, *supra* note 56.

¹¹⁸ See The Lawyers for Civil Justice, *LCJ Comments to the Civil Rules Advisory Committee Regarding E-Discovery Proposals for Discussion at the April 15-16 Meeting*, April 20, 2004; Burt, *supra* note 46; Thomas Y. Allman, *A Preservation Safe Harbor in E-Discovery*, available at <http://www.abanet.org/anti-trust/source/07-03/allman.pdf> [hereinafter Allman, *Preservation*]; Proposed Amendments, *supra* note 21, at 32.

The Safe Harbor provision seeks to limit sanctions, while it avoids articulating what is actually required under the duty to preserve electronic data.¹¹⁹ The Safe Harbor provision proscribes sanctions against a party who fails to produce electronically discoverable information if that party “took reasonable steps to preserve the information after it knew or should have known the information was discoverable.”¹²⁰ The Committee continues to debate whether sanctions should be limited only to those situations where electronically stored media loss results from “intentional or reckless” conduct.¹²¹ As currently proposed, however, sanctions are not warranted if the failure to produce information results from the “routine operation of the party’s electronic system,” so long as a court order was not violated.¹²² In proposing sanctions, the Committee essentially burdens the responding party to show that the information was lost due to routine operations and “without a conscious human direction to destroy that specific information.”¹²³

The Committee suggests that reasonableness can be based upon statutory standards and that a party is insulated from sanctions so long as sufficient steps were taken to preserve electronic data in light of foreseeable litigation.¹²⁴ This reasonableness standard is measured, or limited, by three different dimensions.¹²⁵ The first limitation is set by Rule 26(b)(1) which governs the scope of discovery. The second limitation is set by the new Rule 26(b)(2), which mandates production of electronically-stored information not reasonably accessible only upon a court order that follows a showing of good cause. The third and final limitation is effected by the party’s knowledge of the nature of the litigation.¹²⁶

A clear majority of parties interested in amending the Civil Rules favors a safe harbor provision.¹²⁷ In fact, most parties favor a clear provision mandating that companies are not subject to spoliation claims for operating within their normal course of business.¹²⁸ Parties should not be required to suspend or alter the good-faith operations of their disaster recov-

¹¹⁹ Proposed Amendments, *supra* note 21, at 34.

¹²⁰ *Id.* at 32.

¹²¹ Committee Report, *supra* note 9, at 19.

¹²² Proposed Amendments, *supra* note 21, at 31-32.

¹²³ *Id.* at 34.

¹²⁴ Proposed Amendments, *supra* note 21, at 35.

¹²⁵ *Id.* at 34.

¹²⁶ *Id.* at 34-35.

¹²⁷ See Burt, *supra* note 46; Letter from Steve Gerber, managing partner Gerber & Samson, LLC, to the Civil Rules Advisory Committee, received June 27, 2003, available at <http://www.kenwithers.com/rulemaking/civilrules/ed42.pdf> [hereinafter Gerber]; Letter from Michael Aylward, Morrison Mahoney & Miller, LLP, to the Civil Rules Advisory Committee received June 30, 2003, available at <http://www.kenwithers.com/rulemaking/civilrules/ed19.pdf> [hereinafter Aylward]; Gabel, *supra* note 41.

¹²⁸ See Burt, *supra* note 46; Gerber, *supra* note 127; Aylward, *supra* note 127; Gabel, *supra* note 41.

ery systems or backup systems unless there is a clear showing of need justifying the disruption of ordinary business practice.¹²⁹ However, there are some that feel a safe harbor provision is unnecessary because Rule 37 currently requires that sanctions must be reasonable.¹³⁰ Currently, the language of Rule 37 mandates production of documents only if they are available in the ordinary course of business.¹³¹ This phraseology supports the suggestion that a safe harbor provision is unnecessary because the present Rule 37 can be construed expansively to include electronically produced media.¹³² Likewise, addition of a safe harbor provision relating only to electronic discovery prompts another legitimate concern as to why the proposed provision is applicable only to electronically stored information rather than discovery in general.¹³³ Additional public comment likely will sway resolution of this controversy as well. Responsibility for costs of production and preservation of data is another concern that accompanies the proposed changes to Rule 26(b)(2)(C) when the data is not reasonably available in the ordinary course of business.¹³⁴ Some fear that such costs force defendants to settle when cost-shifting some of the burden would allow defendants to deal with production in a responsible manner.¹³⁵ Likewise, cost-shifting some of the production burden will force requesting parties to better manage their obligations in litigation as well.¹³⁶

Presently, Rule 37 in no way suggests that cost sharing should be considered with regard to the preservation of electronically stored information. The Committee Notes accompanying Rule 26(b)(2), however, hint that cost allocation can be considered in circumstances requiring extraordinary production of such information.¹³⁷ An expanded or pronounced rule governing cost considerations and the preservation of data is likely in order.

¹²⁹ See Burt, *supra* note 46; see also Allman, *Preservation*, *supra* note 118.

¹³⁰ See Letter from Alan B. Morrison, Public Citizen Litigation Group, to Civil Rules Advisory Committee, received March 11, 2004, available at <http://www.kenwithers.com/rulemaking/civilrules/ed58.pdf>.

¹³¹ See *id.*

¹³² See *id.*

¹³³ See *id.*

¹³⁴ See Letter from Marc E. Williams, Huddleston Bolen Beatty Porter & Copen, LLP, to Civil Rules Advisory Committee, received June 28, 2003, available at <http://www.kenwithers.com/rulemaking/civilrules/ed46.pdf> [hereinafter Williams]; Aylward, *supra* note 127; Letter from Charles A. Beach, to Civil Rules Advisory Committee received June 20, 2003, available at <http://www.kenwithers.com/rulemaking/civilrules/ed16.pdf>.

¹³⁵ See Aylward, *supra* note 127.

¹³⁶ See Williams, *supra* note 134.

¹³⁷ See Proposed Amendments, *supra* note 21, at 14.

H. *Subpoena for Electronically Stored Information*

Proposed amendments to Rule 45, similar to Rule 33(d), merely update subpoena requirements to reflect the changes proposed in other discovery rules.¹³⁸ Proposed amendments change Rule 45(a)(1)(A)(iii) to recognize electronically stored information; proposed amendments change Rule 45(a)(1)(B) to recognize a designated form for the production of electronically stored data.¹³⁹ Similarly, Rule 45(c)(2) and 45(d)(1)(B) are amended to reflect the changes in Rule 34(b) allowing the responding party to object to the requested form of production.¹⁴⁰ As with Rule 34(b), if no form is requested, the subpoenaed information can be produced in the form in which the data is ordinarily maintained, or produced in an electronically searchable form.¹⁴¹

Amendments affecting Rule 45(c) are designed to protect against undue impositions on non-parties, and 45(d)(1) changes reflect that only “reasonable accessible” data must be produced unless a court order requires more.¹⁴² Finally, Rule 45(a)(1) is amended to permit sampling and testing as reflected in Rule 34(a)(1), and Rule 45(d)(2) is amended to reflect the changes in Rule 26(b)(5) regarding inadvertent production of privileged information.¹⁴³ Since the proposed amendments to Rule 45 merely reflect the proposed changes in other amendments, comments, questions and concerns regarding these changes have been addressed in the corresponding sections.

III. CONCLUSION

Only time will sufficiently assess whether the proposed amendments to the Civil Rules are adequate to guide litigants, attorneys, and courts as they face the uncertain future of electronic discovery. Commendably, the Civil Rules Advisory Committee has assumed the challenging task of attempting updates to accommodate discovery issues of the 21st Century and beyond. The proposed amendments attempt to clarify and manage electronic discovery in the new computer age. Inevitably, of course, some areas of concern are likely to elicit further scrutiny under public comment. Will the proposed changes to the Civil Rules offer sufficient guidance generally? Will they provide certainty or clarity as to what electronically generated data can be requested in litigation? Will they provide certainty or clar-

¹³⁸ Committee Report, *supra* note 9 at 20.

¹³⁹ Proposed Amendments, *supra* note 21, at 49-50.

¹⁴⁰ *Id.* at 50.

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.* at 50-51.

ity as to what electronically generated data must be produced in litigation? Will they resolve responsibility issues regarding the burden and cost of producing electronically generated information?

Hopefully, public concern and comment¹⁴⁴ will generate proposals for managing discovery to which all can parties can agree. Until then, despite their marginal progress in areas such as cost allocation, the proposed amendments may prove to be the best method for handling the looming challenge of electronic discovery.

¹⁴⁴ Comments on the Proposed Amendments to the Civil Rules continued to flow into the Advisory Committee up until the very last day of the comment period. See U.S. Chamber Institute for Legal Reform and Lawyers for Civil Justice, *Comments to the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States Proposed Amendments to the Federal Rules of Civil Procedure Governing the Discovery of Electronically Stored Information* (Feb. 15, 2005) (copy on file with authors).

The Impact of HIPAA's Privacy Rules on the Discovery of Health Information During Litigation[†]

Michael D. Shalhoub
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I. INTRODUCTION

The Health Insurance Portability and Accountability Act of 1996¹ (hereinafter "HIPAA") was enacted by Congress to "improve portability and continuity of health insurance coverage in the group and individual markets."² To achieve this end, Congress enacted Subtitle F of Title II of HIPAA, which is entitled "Administrative Simplification."³ The "Administrative Simplification" provisions require the implementation of standards by the Secretary of Health and Human Services (hereinafter "the Secretary") to facilitate the electronic transmission of health information.⁴ The "covered entities" required to comply with these regulations include health plans, health care clearinghouses, and health care providers.⁵

The enactment of HIPAA has materially changed the way that medical records are treated during litigation involving claims of personal injury or wrongful death. The purpose of this article is to briefly define the regulatory framework, and then analyze the published cases concerning the application of HIPAA to medical records in litigation involving personal injury allegations.

[†] Submitted by the authors on behalf of the FDCC Healthcare Practice Section.

¹ Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936 (1996).

² H.R. Rep. No. 104-496, at 1 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1865, 1865-66.

³ Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936 (1996), codified as 42 U.S.C.A. §§ 1320d - 1320d-8 (West 2004).

⁴ *Id.*

⁵ 42 U.S.C.A. § 1320d(1)(a) (West 2004).



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Section 1320d-2 of HIPAA states the following:

- (a) Standards to enable electronic exchange.
 - (1) In general. The Secretary shall adopt standards for transactions, and data elements for such transactions, to enable health information to be exchanged electronically⁶

A plain reading of the statute suggests that Congress provided the Secretary with the authority to promulgate regulations concerning “electronically” exchanged health information only. The Secretary nevertheless established regulations governing the disclosure, privacy, and protection of medical information existing in both electronic and non-electronic form.⁷ These regulations can be found in Title 45 of the Code of Federal Regulations, Parts 160 and 164, and are referred to as the “Privacy Rules.” The Privacy Rules provide the circumstances under which a “covered entity” may disclose “protected health information.”

⁶ 42 U.S.C.A. § 1320d-2(a) (West 2004).

⁷ 45 C.F.R. 45 §§ 160.103, 164.500; *but see* 42 U.S.C.A. §§ 1320d-2, 1320d-4 (West 1998), which require health plans to conduct electronic transactions when requested, either directly or through a clearinghouse. Since these statutes imply that the information must be kept in electronic form anyway, the significance of the distinction between health information in electronic and non-electronic form may not be that important with respect to judicial interpretation of the Privacy Rules; *see also* Eric Wymore, *It's 1998, Do You Know Where Your Medical Records Are? Medical Record Privacy After the Implementation of the Health Insurance Portability and Accountability Act of 1996*, 19 *HAMLIN J. PUB. L. & POL'Y* 553, n.14 (1998) (discussing the Federal Privacy Act of 1974 and the prerequisites to the application of the “Administration Simplification” provision of HIPAA).



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“Protected health information,” as defined by the Secretary, concerns health information that is individually identifiable.⁸ “Health information that does not identify an individual and with respect to which there is no reasonable basis to believe that the information can be used to identify an individual” is not “protected health information” and therefore does not fall under the auspices of the Privacy Rules.⁹

The Secretary's authority to promulgate regulations concerning the privacy of health records that do not exist in electronic form has been challenged unsuccessfully.¹⁰ The Fourth Circuit Court of Appeals and a Texas federal trial court have determined that since the definition of “Health Information,” as provided by Congress in Section 1320d-1, includes information “whether oral or recorded in any form or medium,” the Secretary is empowered to regulate the privacy of medical records that exist in either electronic or non-electronic form.¹¹ The district court in *Association of American Physicians & Surgeons* reasoned that “regulating non-electronic as well as electronic transmissions of health information effectuates HIPAA's intent to promote the computerization of medical information and to protect the confidentiality of this health information.”¹² The court also wrote that, “[t]herefore, even if HIPAA did not expressly allow [the Secretary] to regulate the transmission of non-electronic as well as electronic health information, the provisions of the

⁸ 45 C.F.R. § 160.103 (2004).

⁹ 45 C.F.R. § 164.514 (2004).

¹⁰ See *S.C. Med. Ass'n v. Thompson*, 327 F.3d 346, 353-354 (4th Cir. 2003); *Ass'n of Am. Physicians & Surgeons, Inc. v. U.S. Dept. of Health & Human Services*, 224 F. Supp. 2d 1115 (S.D. Tex. 2002).

¹¹ *S.C. Med. Ass'n*, 327 F.3d at 353 (quoting 42 U.S.C.A. § 1320d(4) (2003)) (emphasis deleted); *Ass'n of Am. Physicians & Surgeons*, 224 F. Supp. 2d at 1127.

¹² *Ass'n of Am. Physicians & Surgeons*, 224 F. Supp. 2d at 1127.

Privacy Rule promulgated by [the Secretary] are reasonably related to the purpose of HIPAA, the enabling legislation, and should be sustained.”¹³

The Fourth Circuit held that Congress did not unconstitutionally delegate legislative power to the Secretary and that the HIPAA preemption provisions are not impermissibly vague under the Due Process Clause of the Fifth Amendment.¹⁴ Further, a challenge to the validity of HIPAA under the First, Fourth, and Tenth Amendments also has failed.¹⁵

II. OVERVIEW OF THE “PRIVACY RULES”

In general, the Privacy Rules provide that a “covered entity” may disclose protected health information to the patient,¹⁶ in compliance with a HIPAA compliant authorization,¹⁷ for the treatment, payment, or management of health care operations,¹⁸ and pursuant to an agreement between the covered entity and the patient.¹⁹ The Privacy Rules also permit disclosure of otherwise protected health information in the context of judicial and administrative proceedings.²⁰

With regard to the latter, disclosure specifically is permitted in response to a court order.²¹ Further, disclosure is permitted in response to a “subpoena, discovery request, or other lawful process” if either the “covered entity receives satisfactory assurance . . . that reasonable efforts have been made by such party to ensure that the individual who is the subject of the protected health information that has been requested has been given notice of the request” or “the covered entity receives satisfactory assurance . . . that reasonable efforts have been made . . . to secure a qualified protective order.”²² In short, without a court order, the HIPAA regulations require a party to a litigation seeking protected health information to choose between providing the covered entity with proof of “notice” to the patients at issue that the information has been requested, or seeking a “qualified protective order.”²³

¹³ *Id.* (citation omitted).

¹⁴ *S.C. Med. Ass’n*, 327 F.3d at 349-52, 354-55.

¹⁵ In *Ass’n of Am. Physicians & Surgeons* the district court held that the plaintiffs did not have standing to sue. *See id.*

¹⁶ 45 C.F.R. § 164.502(a)(1)(i) (2004).

¹⁷ 45 C.F.R. §§ 164.502(a)(1)(iv), 164.508 (2004).

¹⁸ 45 C.F.R. §§ 164.502(a)(1)(ii), 164.506 (2004).

¹⁹ 45 C.F.R. §§ 164.502(a)(1)(v), 164.510 (2004).

²⁰ 45 C.F.R. § 164.512(e) (2004).

²¹ 45 C.F.R. §§ 164.512(e)(1)(i), 164.512(e)(1)(ii) (2004).

²² *Id.*

²³ 65 F.R. 82462; *see Campos v. Payne*, 766 N.Y.S. 2d 535, 538 (Civ. Ct. 2003).

The regulations provide that a “covered entity” receives “satisfactory assurances” that the patients affected by the disclosure of the health information have notice when the covered entity receives a “written statement and accompanying documentation” that demonstrates the following:

- (A) The party requesting such information has made a good faith attempt to provide written notice to the individual (or, if the individual’s location is unknown, has mailed a notice to the individual’s last known address);
- (B) The notice included sufficient information about the litigation or proceeding in which the protected health information is requested to permit the individual to raise an objection to the court or administrative tribunal; and
- (C) The time for the individual to raise objections to the court or administrative tribunal has elapsed, and:
 - (1) No objections were filed; or
 - (2) All objections filed by the individual have been resolved by the court or the administrative tribunal, and the disclosures being sought are consistent with such resolution.²⁴

The Privacy Rules also provide that a covered entity “receives satisfactory assurance” that reasonable efforts have been made to secure a qualified protective order if:

- (A) The parties to the dispute giving rise to the request for information have agreed to a qualified protective order and have presented it to the court or administrative tribunal with jurisdiction over the dispute; or
- (B) The party seeking the protected health information has requested a qualified protective order from such court or administrative tribunal.²⁵

A “qualified protective order” is defined in the Privacy Rules as an order of a court or of an administrative tribunal or a stipulation by the parties to the litigation or administrative proceeding that:

- (A) Prohibits the parties from using or disclosing the protected health information for any purpose other than the litigation or proceeding for which such information was requested; and

²⁴ 45 C.F.R. § 164.512(e)(1)(iii) (2004).

²⁵ 45 C.F.R. § 164.512(e)(1)(iv) (2004).

- (B) Requires the return to the covered entity or destruction of the protected health information (including all copies made) at the end of the litigation or proceeding.²⁶

The Privacy Rules also permit disclosure for law enforcement purposes in compliance with a court-ordered warrant, a subpoena or summons issued by a judicial officer, a grand-jury subpoena, or an administrative request, such as an administrative subpoena or summons, and a civil or an authorized investigative demand.²⁷

There is no federal physician-patient privilege, either by statute or at common law.²⁸ Further, in general, the federal courts have not recognized a constitutional right to privacy in one's medical records.²⁹ Rather, Congress primarily has left it to the states to determine the level of privacy afforded to medical information maintained by health care entities.³⁰ The HIPAA Privacy Rules therefore could potentially protect a patient's medical records in federal question cases when that protection otherwise would not occur.³¹ Although a number of states have enacted legislation protecting patients' medical information,³² the HIPAA regulations impact the discovery of health information in state court litigation, as well as in federal courts applying state law, because of the HIPAA preemption provision.³³ Specifically, a state privacy statute is preempted by HIPAA unless "the provision of State law relates to the privacy of individually identifiable health information and is more stringent than a standard, requirement, or implementation specification" of the Privacy Rules.³⁴

²⁶ 45 C.F.R. § 164.512(e)(1)(v) (2004).

²⁷ 45 C.F.R. § 164.512(f)(1) (2004).

²⁸ See *Whalen v. Roe*, 429 U.S. 589, 602 n.28 (1977); *Gilbreath v. Guadalupe Hosp. Found. Inc.*, 5 F.3d 785, 791 (5th Cir. 1993).

²⁹ See *Whalen*, 429 U.S. at 589; *Doe v. Wigginton*, 21 F.3d 733, 740 (6th Cir. 1994); *Taylor v. Best*, 746 F.2d 220, 225 (4th Cir. 1984); *Adams v. Drew*, 906 F. Supp. 1050 (E.D. Va. 1995); but see *Doe v. City of New York*, 15 F.3d 264, 267 (2d Cir. 1994) (holding that "individuals who are infected with the HIV virus clearly possess a constitutional right to privacy regarding their condition"); *A.L.A. v. West Valley City*, 26 F.3d 989, 990 (10th Cir. 1994) ("There is no dispute that confidential medical information is entitled to constitutional privacy protection.") (citation omitted).

³⁰ See *Confidential Medical Information, Hearing Before the Senate Comm. on Labor & Human Resources*, 105th Cong. (1997) (testimony of Donna Shalala, Sec'y of Health & Human Servs.), available at 1997 WL 566029 (F.D.C.H.); Wymore, *supra* note 7.

³¹ *United States v. Sutherland*, 143 F. Supp. 2d 609, 612 (W.D. Va. 2001) (the regulations promulgated by the Secretary indicate a "strong federal policy to protect the privacy of patient medical records"); *United States ex. rel. Mary Jane Stewart v. Louisiana Clinic*, 2002 U.S. Dist. LEXIS 24062 (E.D. La. 2002).

³² For analysis on the diversity of state statutes covering the privacy of medical records, see Wymore, *supra* note 7.

³³ 45 C.F.R. § 160.203 (2004).

³⁴ 45 C.F.R. § 160.203(b) (2004).

Covered entities were not required to comply with the Secretary's regulations until April 13, 2003.³⁵ Despite this compliance date, some courts required that covered entities, when disclosing health information, comply with the Privacy Rules on grounds that the privacy regulations manifested a strong federal policy towards protecting the privacy of a patient's medical records.³⁶ One court, however, when presented with the issue of whether a criminal defendant's medical records should be suppressed because the disclosure of these records to law enforcement personnel did not accord with the Secretary's regulations, would not ground its decision on the Privacy Rules because the disclosure was done in the "pre-enforcement stage." The court reasoned that such disclosure would risk an impermissible advisory opinion by the court.³⁷

Although HIPAA does not create a private right of action,³⁸ "covered entities" that were not parties to the litigation have refused to disclose health information in that litigation, fearing penalties for impermissible disclosure either under state laws or HIPAA.³⁹ Given these circumstances, courts thus far have been willing to craft protective orders requiring disclosure of pertinent health records to the parties involved in litigation while simultaneously ensuring that the privacy rights of non-parties are protected in accord with the Privacy Rules.⁴⁰

³⁵ 45 C.F.R. § 164.534 (2004); "Small Health Plans," however, which are defined under 45 C.F.R. § 160.103 as health plans with annual receipts of \$5 million or less, are not required to comply with these regulations until April 14, 2004.

³⁶ See *United States v. Sutherland*, 143 F. Supp. 2d 609, 612 (W.D. Va. 2001); *United States ex rel. Mary Jane Stewart v. Louisiana Clinic*, 2002 U.S. Dist. LEXIS 24062 (E.D. La. 2002).

³⁷ *Tapp v. Texas*, 108 S.W.3d 459, 462-63 (Tex. App. 2003). However, since the medical records in this case were obtained by a grand-jury subpoena, the disclosure of the medical records was authorized under 45 C.F.R. § 164.512(f)(1)(ii)(B) (2004). For example, in *Harmon v. Texas*, 2003 Tex. App. LEXIS 6172 (Tex. App. 2003), a criminal defendant drove his car into a concrete barrier in April of 2001. The defendant was taken to the hospital where a blood test was performed, revealing that his blood alcohol content was 0.18. The prosecution obtained a grand-jury subpoena for his medical records. The defendant moved to suppress the records, in part, under HIPAA. The court held that even if the HIPAA regulations were "effective" at the time the grand-jury subpoena was issued, disclosure "under HIPAA is permissible without an individual's permission when the information is disclosed for law enforcement purposes and is obtained pursuant to a grand-jury subpoena." *Id.* at * 6-7 (footnote omitted; citation omitted).

³⁸ *Swift v. Lake Park High School Dist.*, 2003 U.S. Dist. LEXIS 18684 (N.D. Ill. 2003); see J.S. Christie, Jr., *The HIPAA Privacy Rules from a Litigation Perspective*, 64 ALA. LAW. 126, 133 (2003) (suggesting that since the HIPAA Privacy Rules create duties of care with respect to health information, "one might expect to see the HIPAA Privacy Rules used as part of state law tort actions.").

³⁹ See *United States v. Sutherland*, 143 F. Supp. 2d 609, 612 (W.D. Va. 2001); *Hutton v. City of Martinez*, 2003 U.S. Dist. LEXIS 19852 (N.D. Cal. 2003).

⁴⁰ See *Sutherland*, 143 F. Supp. 2d 609; *Hutton v. City of Martinez*, 219 F.R.D. 164 (N.D. Cal. 2003); see also 45 U.S.C. §§ 1320d-5, 1320d-6 (2004) (provides the monetary penalties and periods of incarceration that can be assessed for a covered entity's non-compliance or wrongful disclosure of protected health information).

Some parties to litigation also have objected to the scope of health information disclosure under the HIPAA Privacy Rules.⁴¹ In these cases, the courts have been unwilling to permit a litigant to use the protections afforded by the Privacy Rules as a shield to deny adversaries access to health information that is relevant to the litigation.

III.

IMPACT OF HIPAA'S PRIVACY RULES ON DISCOVERY OR DURING LITIGATION

Turning now to the extant cases concerning the scope and effect of HIPAA regulations on the collection of medical records in litigation, the following cases are relevant as of this writing. In *National Abortion Federation v. Ashcroft*,⁴² a lawsuit was commenced by a "professional organization of abortion providers" and seven physicians in the Southern District of New York challenging the constitutionality of the Partial Birth Abortion Ban Act of 2003 ("PBABA"). PBABA prohibits certain late-term abortion procedures. One of the physicians, Dr. Hammond, was an attending at Northwestern Memorial Hospital. In support of plaintiffs' motion for a temporary restraining order, Dr. Hammond asserted that he performed PBABA-banned abortions on women with a variety of medical conditions for the protection of their health.

The government served Dr. Hammond with a demand to identify the relevant patient medical record numbers for the "medically necessary abortion procedures" allegedly performed by Dr. Hammond and to produce the medical records concerning those patients. The court wrote that the government's demand was designed to obtain impeachment material against Dr. Hammond.

Dr. Hammond responded to the government's demand by asserting that he did not possess or control the records requested. The government then served Northwestern Memorial Hospital ("Northwestern") with a subpoena under Federal Rule of Civil Procedure 45. The subpoena was accompanied by an order signed by the district court judge sitting in New York who presided over the action. The order authorized Northwestern to disclose the records, and the government agreed to accept records that redacted any identifying information.

Northwestern moved to quash the subpoena on grounds that the records were privileged under HIPAA and Illinois law. The court held that the subpoena complied with HIPAA because a court order authorizing disclosure was attached.⁴³ However, the court recognized

⁴¹ See *United States ex rel. Mary Jane Stewart, et al. v. The Louisiana Clinic*, 2002 U.S. Dist. LEXIS 24062 (E.D. La. 2002); *Horn v. Hernandez*, N.Y.L.J., October 15, 2003, at 19 (Sup. Ct.); *Lewis v. Clement*, 766 N.Y.S.2d 296 (Sup. Ct. 2003).

⁴² 2004 U.S. Dist. LEXIS 1701(N.D. Ill. 2004), *aff'd*, 302 F.3d 923 (7th Cir. 2004).

⁴³ Citing 45 C.F.R. § 164.512(e)(1)(i).

that “a contrary state health information privacy law will not be preempted by a HIPAA regulation if the state law is ‘more stringent’” than the HIPAA regulation.⁴⁴ The court held that Illinois statutory law did not permit disclosure of the records, even if the identifying information was redacted. The court therefore granted Northwestern’s motion to quash.

In *A Helping Hand, LLC v. Baltimore County, Maryland*,⁴⁵ the plaintiff, “A Helping Hand,” alleged that the defendant violated the Americans with Disabilities Act and the Due Process Clause of the Fourteenth Amendment. Arguing that the defendants improperly prevented it from locating a methadone treatment clinic in Baltimore County, the plaintiff moved for a protective order to bar defendants from obtaining medical information concerning Helping Hand’s patients during discovery. The court considered this information important because whether Helping Hand’s patients were “individuals with disability” under the ADA was a threshold issue in the litigation. If they were not, then plaintiff had no grounds to argue that the defendants interfered with the ADA rights of plaintiff’s patients.

Defendants countered that since the issue whether a person was afforded “disability status” required “individual assessment,” they were entitled to the information about Helping’s Hand’s clients. Helping Hand responded that the information was privileged under HIPAA and Maryland’s patient-psychotherapist privilege.

The court determined that HIPAA did not prevent disclosure of the information to defendants. The court held that, “[e]ven assuming the patient data is covered by HIPAA, the HIPAA regulations permit discovery of protected health information so long as a court order or agreement of the parties prohibits disclosure of the information outside the litigation and requires return of the information once the proceedings are concluded.”⁴⁶ The court reasoned that, “while no such order or agreement is yet in effect, the parties presumably could obtain one.”⁴⁷

The court also held that the Maryland provision cited by plaintiff did not apply since the lawsuit was governed by federal law under Federal Rule of Evidence 501. Given that the privilege for confidential communications between a patient and a psychotherapist applied under federal law, state law would not apply. And, since Helping Hand had not even asserted the federal privilege, disclosure of the records was warranted.

Notwithstanding its determination regarding the privilege, the court noted that it would be sufficient for purposes of the lawsuit if defendants were to obtain only: (1) Helping Hand’s general policies and practices in accepting patients, and (2) the typical characteristics of the patients served by Helping Hand. The court reasoned that the “general” informa-

⁴⁴ 2004 U.S. Dist. LEXIS 1701 at *8 (citing 45 C.F.R. § 160.203 (b)).

⁴⁵ 295 F.Supp.2d 585 (D.C. Md. 2003).

⁴⁶ *Id.* at 592 (citing 45 C.F.R. § 164.512(e)).

⁴⁷ *Id.*

tion about the “typical patients” served by Helping Hand was sufficient in light of the “extremely sensitive” nature of the information and because “association with even a single person meeting the statutory criteria may afford Helping Hand a claim.”⁴⁸

The issue now dominating this analysis is whether these two cases can be reconciled. The court in both engaged a balancing test by weighing the probative value of the information requested with the privacy concerns at stake. Both courts likewise reasoned that the information requested was extremely sensitive. However, the probative value varied with each determination.

The court in *National Abortion Federation* stated that a woman’s decision to undergo an abortion involves “issues indisputably of the most sensitive stripe.” The court then balanced this privacy concern against the minimal, “any probative value,” that the information might have on the case and “the ready availability of information traditionally used to challenge the veracity of Dr. Hammond’s scientific assertions and medical opinions.”⁴⁹ The court reasoned that, “when contrasted with the potential loss of privacy that would ensue were these medical records used in a case in which the patient was not a party, the balance of harms resulting from disclosure severely outweighs the loss to the government through non-disclosure.”⁵⁰ In *A Helping Hand*, however, the court recognized that the information requested was probative to a “threshold issue” in the case, i.e., whether the clients of Helping Hand were “individuals with disability” under the ADA.

A further discrepancy between the cases concerned the issue of HIPAA preemption. The court in *A Helping Hand* stated that the Maryland privacy provisions did not apply because federal and not state law governed the lawsuit. The court did not analyze whether the Maryland provisions were more stringent than HIPAA. In contrast, the court in *National Abortion Federation* rested its federal decision on state privacy statutes, despite its determination that a federal physician-patient privilege existed concerning a woman’s decision to undergo an abortion. It is at least arguable that each court’s decision on the preemption issue was predetermined by the balancing act.

In another relevant decision, the defendant physician in *United States v. Sutherland*⁵¹ was accused of unlawfully distributing and dispensing controlled substances. The government issued subpoenas to a non-party hospital to compel production of the pharmacy records of the defendant’s patients. The hospital moved to quash the subpoena on grounds that disclosure of the requested information would subject it to civil liability under state law in West Virginia.

⁴⁸ *Id.* at 593.

⁴⁹ 2004 U.S. Dist. LEXIS 1701, at *19.

⁵⁰ *Id.*

⁵¹ 143 F. Supp. 2d 609 (W.D. Va. 2001).

The district court reasoned, however, that as “this is a federal criminal matter[;] state laws of procedure do not apply,” and “patients have no expectation of privacy in medical records with regard to federal criminal proceedings because there is no federal physician-patient privilege.”⁵² Although compliance with the Secretary’s regulations was not required at the time the subpoena issued, the district court considered the regulations to be “persuasive in that they demonstrate a strong federal policy of protection for patient medical records.”⁵³

The court held that the government in this criminal proceeding had a “compelling interest” in obtaining the prescription records.⁵⁴ Since the government’s subpoena was not accompanied by a court order and was not a grand-jury subpoena, however, the court did not rely on Section 164.512(e)(1)(i) or 164.512(f) to justify disclosure of the pharmacy records at issue. Instead, consistent with Section 164.512(e)(ii), the court crafted a protective order it considered sufficient to provide “reasonable assurances” to the hospital that the affected patients would have notice and an opportunity to object to the disclosure of their records.

“[I]n accord with the Standards issued by the Secretary,” the court ordered the government to “provide written notice prior to production of the subpoenaed records to the last known address of each individual whose records are sought under the subpoena.”⁵⁵ The court also ruled that any “notice must inform the individual that he or she may object to the disclosure within five business days” and that “all objections by the government or by affected individuals” would be resolved prior to the start of trial.⁵⁶

The case of *Hutton v. City of Martinez*⁵⁷ is likewise relevant. The plaintiff there alleged that his civil rights were violated when an out-of-shape police officer shot him in the back because the officer was incapable of pursuing the plaintiff on foot. The police officer was named as a defendant. Plaintiff served various discovery demands seeking information about the officer’s physical condition on the day of the alleged shooting. The officer’s worker’s compensation carrier, however, declined to produce any medical records concerning the officer’s work-related back injury. (Apparently, the defendant-officer raised no objection to the production of these records for the purposes of this litigation). The plaintiff also subpoenaed for deposition the claims person who handled the officer’s worker’s compensation claim regarding the back injury. When the claims person was produced for the

⁵² *Id.* at 611 (citations omitted).

⁵³ *Id.* at 612.

⁵⁴ *Id.* at 613.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ 219 F.R.D. 164 (N.D. Cal. 2002).

deposition, however, her attorney instructed her not to answer any questions regarding the officer's worker's compensation file on grounds that such testimony was not permitted under HIPAA.

The court held that HIPAA did not preclude the production of the records requested in the case at issue because, consistent with Section 164.512(e)(iv), the parties agreed to a protective order that would adequately safeguard the defendant officer's privacy interests. Although the court's decision did not state the terms of the protective order, the order presumably required that the information be used only within the pending litigation and that the material be returned to the covered entity or destroyed at the end of the litigation, in keeping with the spirit of 45 CFR Section 164.512(e)(v).

In *Lemieux v. Tandem Health Care of Florida, Inc.*,⁵⁸ the plaintiff was involved in a car accident and was hospitalized at Lakeland Regional Medical Center (hereinafter "Lakeland"). A non-party, Dr. Greenberg, treated him at that site. The patient later was transferred to Arbors, an in-patient rehabilitation facility and a named defendant in the case. While at Arbors, the plaintiff was treated by non-party Dr. Fielding. The plaintiff also received treatment at Arbors from non-party Dr. Goll, the physician who eventually discharged him from Arbors. Drs. Goll, Greenberg, and Fielding were not employees or agents of Arbors.

The plaintiff sued Arbors for negligent hiring and retention, and "for various violations of Chapter 400 of the Florida statutes."⁵⁹ During discovery proceedings, the plaintiff filed a motion seeking court approval to conduct ex-parte discussions with the aforementioned physicians. Florida's physician-patient privilege, grounded in statutory law,⁶⁰ authorizes disclosure of a patient's medical records under four circumstances: (1) to other health care providers involved in the care and treatment of the patient; (2) if permitted by written authorization from the patient; (3) if compelled by subpoena; and (4) to attorneys, experts, and other individuals necessary to defend the physician in a medical negligence action in which the physician is or expects to be a defendant.⁶¹

⁵⁸ 862 So. 2d 745 (Fla. Dist. Ct. App. 2003).

⁵⁹ *Id.* at 747; see FLA. STAT. ch. 400.0061 ("Chapter 400 of the Florida statutes" refers to laws governing the "safety, and welfare of the residents" of long-term care facilities.). Although the court also noted that it was "[g]ermane to our analysis" that the complaint did not state a cause of action for medical malpractice, the decision does not address why the analysis would have been different if this claim had been alleged. *Lemieux*, 862 So. 2d at 747.

⁶⁰ FLA. STAT. ch. 456.057(6) provides that:

Except in a medical negligence action or administrative proceeding when a health care practitioner or provider is or reasonably expects to be named as a defendant, information disclosed to a health care practitioner by a patient in the course of the care and treatment of such patient is confidential and may be disclosed only to other health care practitioners and providers involved in the care and treatment of the patient, or if permitted by written authorization from the patient or compelled by subpoena at a deposition, evidentiary hearing, or trial for which proper notice has been given.

⁶¹ *Id.*

Under the Florida statute, the court determined that Drs. Goll, Fielding, and Greenberg could not engage in an *ex parte* discussion with Arbors' attorneys since the physicians were not employees of Arbors and were not currently treating the patient. Furthermore, the disclosure was not made from one health care provider to another; instead, it was made from one health care provider to the attorney of another health care provider. The court also noted that nothing prevented Arbors from serving the treating physicians with a subpoena to appear for a deposition.

In a footnote, the court wrote that HIPAA did not preempt Florida's statutory physician-patient privilege even though the Florida statute did not require that the entity disclosing medical information provide written notice to the patient that the patient could object to the disclosure. The court reasoned that the Florida statute, although "procedurally" less strict, was "substantively" more strict than the Privacy Rules because 45 CFR Section 164.512(e)(1)(ii) requires only that a covered entity receive "satisfactory assurance" that the patient who is the subject of the protected health information has been given notice of the intended disclosure. Under the Florida statute, however, disclosure based on notice alone was not permitted.

The court in *United States ex rel. Mary Jane Stewart v. Louisiana Clinic*⁶² addressed similar issues. The plaintiffs in that case brought a *qui tam* action alleging that the defendant-physicians and medical clinic defrauded the federal government by presenting false claims for reimbursement of medical services provided to Medicare and Medicaid participants. The plaintiff requested various medical records concerning non-party patients. The defendant Dr. Flood moved for a protective order, asserting that the medical records would result in civil liability to the non-party patients under Louisiana state law if produced with patient identifying information.

In that regard, a Louisiana statute provided that disclosure of medical records was authorized only "after a contradictory hearing with the patient . . . and after a finding by the court that the release of the requested information is proper."⁶³ The court held that the Louisiana statute did not apply, however, because the action was commenced under the authority of a federal statute, giving rise to exclusive federal question jurisdiction. It was also preempted by HIPAA. The court reasoned that since the Louisiana statute permitted disclosure under the given facts without the patient's consent, it did not adequately address the "form, substance, or the need for express legal permission from an individual, who is

⁶² 2002 U.S. Dist. LEXIS 24062 (E.D. La. 2002).

⁶³ LA. REV. STAT. § 13:3715.1(B)(5) (2004).

the subject of the individually identifiable health information,” as required by 45 CFR Section 160.202(4).⁶⁴

Nevertheless, the court held that disclosure of the medical information at issue was permitted under 45 CFR Section 164.512(e). It observed that since the plaintiffs and defendants “have complied with the HIPAA regulations at issue by seeking an appropriate protective order and that the court has authority to order disclosure of nonparty patient information, subject to such a protective order, without conducting a contradictory hearing or having the parties obtain the patients’ consent,” disclosure was warranted.⁶⁵

The court therefore crafted a protective order that required a “twofold” production of the records. First, the defendants were required to provide a set of “unredacted” documents to plaintiffs’ counsel. The court reasoned that the plaintiffs “must be allowed to see the patient names so that they can investigate the validity of the claims for services rendered to those patients.”⁶⁶ Second, a set of “redacted” records were to be provided and were permitted to be used by any party for any pretrial purpose.

The court order also provided that “no more than two paralegals employed by counsel of record and one expert per party retained in connection with this litigation” should review those records.⁶⁷ Further, “[a]ll persons to whom such information is disclosed must sign an affidavit that must be filed into the record, agreeing to the terms of the protective order and submitting to the jurisdiction of this Court for enforcement of those terms.”⁶⁸ Finally, the court ordered that the scope of health information disclosure was restricted only to the litigation at hand.

In *Horn v. Hernandez*,⁶⁹ the plaintiff commenced an action in New York State Supreme Court to recover damages arising from two motor vehicle accidents. The plaintiff alleged in the bill of particulars that she became “sick, sore, lame and disabled . . . and suffers great

⁶⁴ 45 U.S.C. § 160.202 (2004) provides, in pertinent part:

More stringent means, in the context of a comparison of a provision of State law and a standard, requirement, or implementation specification adopted under subpart E of part 164 of this subchapter, a State law that meets one or more of the following criteria: . . . (4) With respect to the form, substance, or the need for express legal permission from an individual, who is the subject of the individually identifiable health information, for use or disclosure of individually identifiable health information, provides requirements that narrow the scope or duration, increase the privacy protections afforded (such as by expanding the criteria for), or reduce the coercive effect of the circumstances surrounding the express legal permission, as applicable.

⁶⁵ Stewart, 2002 U.S. Dist. LEXIS 24062, at *16-17.

⁶⁶ *Id.* at *19.

⁶⁷ *Id.* at *20 (quoting protective order).

⁶⁸ *Id.*

⁶⁹ N.Y.L.J., October 15, 2003, at 19 (Sup. Ct.).

physical and mental pains.”⁷⁰ One of the defendants requested that the plaintiff provide an authorization for her psychiatric records. In response, the plaintiff moved for a protective order, claiming that the court was without authority to compel production of the authorizations because of HIPAA preemption.

The court rejected plaintiff’s argument that it was without jurisdiction to require the release of her psychiatric records. It stated that the Privacy Rules specifically permitted the court to compel production of the authorization under Section 164.512(e)(1)(i). The court reasoned that HIPAA does not impede “the authority of this court to order a party in action before it to disclose medical, dental or other health information and/or records to adversarial parties by directing the party whose physical, emotional and/or mental condition is in controversy to execute authorizations permitting the release of health information deemed conditionally protected under the general provisions of HIPAA and its regulatory framework.”⁷¹ The court held that since the plaintiff had placed her mental and emotional condition in controversy in the lawsuit, she waived her psychiatrist-patient privilege. Consequently, it ordered production of an authorization for the release of those records.

The case of *Lewis v. Clement*⁷² involved the dissolution of a dental partnership. The issue before the New York State Supreme Court was whether the plaintiff, who was one of the group’s partners, was entitled to the patient records of the other members of the dental practice. The defendants asserted that the plaintiff was only entitled to the records of those patients that he actually treated while a partner with the group. In its decision, the court recognized the New York common law principle that a former partner is only entitled to the records of patients with whom a patient-physician relationship was created during the existence of the partnership.

The defendants, however, also argued that under HIPAA they were not permitted to share any files with the plaintiff. The court ruled that since the “parties herein do not dispute that [the group] transmitted health information in electronic form,” the partnership group was a “covered entity” under HIPAA.⁷³ The court held that the records relating to plaintiff’s patients required disclosure to the plaintiff since “HIPAA cannot be used as a sword or shield in disputes between partners as it relates to the sharing of patient records.”⁷⁴ The court continued, noting that if “the physician (the covered entity) has a relationship with a patient, the remaining partners may not refuse to provide files by virtue of HIPAA,” as long as there was a physician-patient relationship.⁷⁵

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² 766 N.Y.S.2d 296 (Sup. Ct. 2003).

⁷³ *Id.* at 298.

⁷⁴ *Id.*

⁷⁵ *Id.*

IV. ANALYSIS

As of this writing, the date by which ‘covered entities’ were required to comply with the HIPAA Privacy Rules is eight months passed. This article has discussed each of the reported decisions addressing the impact of the Privacy Rules on the discovery of health information during litigation. Of course, these decisions are few. However, the practical effects of the Privacy Rules already have impacted litigation practice.

The HIPAA regulations have changed the way that defense firms gather medical records, protect those records once gathered, send records to experts and others for review, and ultimately dispose of those records. In those jurisdictions where *ex parte* communications with treating physicians were permitted, that practice must be re-examined in light of HIPAA regulations.

Another area of potential concern for covered entities and their business associates is civil tort liability for impermissible disclosure of identifiable health information. As discussed above, the Privacy Rules expressly state that no federal private right of action has been created. The question whether a state law cause of action exists will depend, of course, on each individual state. One commentator acknowledges the potential for such an action, since the HIPAA Privacy Rules create duties of care with respect to health information.⁷⁶ To date, however, there are no reported cases in this regard.

As demonstrated by the holdings in *Sutherland* and *Louisiana Clinic*, some federal courts have interpreted HIPAA as creating a ‘pseudo’ federal statutory physician-patient privilege. The HIPAA Privacy Rules only restrict the disclosure of health information by “covered entities.” In both cases, the courts determined that the health information at issue was relevant and material. However, instead of simply ordering the covered entity to disclose the health information, which would have addressed the concerns of the “covered entities” under Section 164.512(e)(1), the courts used the Privacy Rules as a guideline to impose conditions on disclosure in order to protect the privacy of non-parties.

One important question left unanswered by the decision in *United States of America v. Sutherland* is the following: What grounds, if asserted by a non-party, would be sufficient to deny a party to a litigation access to health information of a non-party that is otherwise material and relevant? Although this question remains open, the potential clearly exists for significant litigation delays based on this court’s interpretation of HIPAA. The court ordered that, insofar as a non-party objects to the disclosure of his or her health information, a pre-trial hearing must “resolve” the issue. Depending on the number of non-parties objecting to the disclosure of their health information, the burden of such additional litigation

⁷⁶ See Christie, note 38 *supra*.

could be significant. In contrast, the court in *Louisiana Clinic* did not allow for the possibility of several pre-trial "hearings" to determine whether non-parties' health information is discoverable. That court, however, crafted a "twofold" protective order and limited access of these records to two paralegals and one expert within each party's law firm. The question that remains affecting this limitation is what relief will be available if a further expert is needed. One surmises that at least they will be required to show cause why additional disclosure of the health information is necessary.

These issues, however, do not appear to surface when the health information involves a party. As demonstrated by the *Hutton* and *Horn* decisions, a litigant will not be permitted to use HIPAA as a means to deny access to material health information to an adversary. As demonstrated in *Hutton*, however, a litigant must be required at a minimum to obtain an authorization or seek a "qualified protective order" before obtaining health information from a non-party "covered entity."

Although published decisions concerning application of the Privacy Rules during litigation are few in number, it is clear that the Privacy Rules must be addressed by litigants whenever the potential exists to discover health information for the prosecution or defense of their cases. For this reason, it is important for all practitioners to become reasonably acquainted with the Privacy Rules and understand their potential impact. Further, insofar as covered entities are potentially exposed to statutory penalties under HIPAA and state tort claims, covered entities should ensure that their legal departments remain abreast of the Privacy Rules and corresponding case law.

Until the HIPAA Privacy Rules are addressed with greater frequency by appellate courts, some degree of uncertainty for litigants and non-party "covered entities" will continue. Issues regarding when or under what conditions identifiable health information must be properly disclosed under the Privacy Rules will predominate.

FUTURE MEETINGS

2005

ANNUAL 2005

Sunday, July 17 – Sunday, July 24

La Costa Resort and Spa

Carlsbad, California

WINTER 2006

Sunday, March 5 – Sunday, March 12

Hyatt Regency Lake Las Vegas Resort, Spa & Casino

Las Vegas, Nevada

ANNUAL 2006

Sunday, July 23 – Sunday, July 30

Fairmont Southampton

Southampton, Bermuda

2006

2007

WINTER 2007

Sunday, February 25 – Sunday, March 4

Fairmont Scottsdale Princess

Scottsdale, Arizona

ANNUAL 2007

Sunday, July 22 – Sunday, July 29

Sun Valley Resort

Sun Valley, Idaho

Trade Meetings and the Antitrust Laws: What Business Competitors Need to Know About Antitrust Liability

Bradley C. Nahrstadt

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.

—Adam Smith

THE WEALTH OF NATIONS (1776)

I.

INTRODUCTION

From its very inception, this country has been dedicated to the principles of capitalism and the free market economy. And undoubtedly, one of the cornerstones of these principles is open competition in the marketplace. We as a nation are so concerned about the ability of market competitors to take advantage of free and open competition that for more than 100 years the executive, legislative and judicial branches of government have used their constitutional powers to protect and advance free competition and to regulate those business activities viewed as having harmful market effects.¹

¹ Indeed, the Supreme Court has suggested that competition policy is so significant that it rises to the level of constitutional importance. In *United States v. Topco Assoc., Inc.*, 405 U.S. 596 (1972), the Supreme Court stated that “[a]ntitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms.” *Topco*, 405 U.S. at 610.



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There is, as a general rule, nothing worrisome or sinister about members of the same trade meeting to discuss mutually beneficial interests. Indeed, trade meetings can allow members to, among other things, disseminate trade information, encourage product standardization through the promulgation of industry standards, and regulate and police the actions of trade members. However, trade meetings, since they attract competitors within a particular industry, can also, absent proper guidance, serve as the catalyst – intentionally or unintentionally – for numerous antitrust violations. The purpose of this article is to apprise those who wish to meet as a group of what generally can and cannot be discussed in accordance with the applicable antitrust laws.

II.

THE RELEVANT FEDERAL ANTITRUST LAWS

A. *The Sherman Antitrust Act*

The Sherman Antitrust Act,² the very first federal antitrust statute, was passed in 1890 in order to promote full and fair competition in the interstate and overseas commerce of the United States.³ Various analysts have categorized the Sherman Act as a natural outgrowth of common law concerns with restraint of trade;⁴ as a political response to the Populist and other agrarian political forces of the late Nineteenth Century;⁵ as an effort to protect small

² 15 U.S.C. §§ 1-7 (1994).

³ Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 4 (1958).

⁴ See, e.g., George J. Stigler, *The Origin of the Sherman Act*, 14 J. LEGAL STUD. 1 (1985).

⁵ See, e.g., HANS B. THORELLI, *THE FEDERAL ANTITRUST POLICY: ORGANIZATION OF AN AMERICAN TRADITION* 58-60 (1955).

businesses from rampant monopolization;⁶ and, as an attempt to maximize consumer welfare.⁷ No matter what the reason for its enactment, one thing is certain: the Act was given a broad, conceptual wording. As a result, courts and legislators have been able to fashion multitudinous remedies under the Act to protect competitive activity in an ever-evolving marketplace. In short, the Sherman Act continues to “retain[] its vitality and effectiveness . . . almost a century after its enactment.”⁸

Section 1 of the Sherman Act prohibits agreements that unreasonably restrain trade.⁹ It provides as follows:

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.¹⁰

Section 2 of the Sherman Act outlaws monopolies and attempts or conspiracies to monopolize. It states:

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.¹¹

⁶ See, e.g., WILLIAM F. BAXTER, *THE POLITICAL ECONOMY OF ANTITRUST* (Robert D. Tollison, ed., 1980).

⁷ See, e.g., Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J. L. & ECON. 7 (1966).

⁸ See, e.g., David E. Ledman, *Northwest Wholesale: Group Boycott Analysis and a Role for Procedural Safeguards in Industrial Self-Regulation*, 47 OHIO ST. L. J. 729, 732 (1986).

⁹ 15 U.S.C. § 1 (1994).

¹⁰ *Id.*

¹¹ 15 U.S.C. § 2 (1994).

As the reader can discern, the Sherman Act sets forth both civil sanctions and criminal penalties for those individuals or corporations found guilty of violating its provisions. In addition, plaintiffs who prove direct damages because of antitrust violations can recover three times the actual damages (treble damages) from the offending party or parties.¹²

In practice, the Sherman Act is subjective and relatively lenient, requiring actual adverse impact on competition before finding a violation and subjecting the violator to criminal penalties and civil suits.¹³ The federal courts, in interpreting the application of the Sherman Act, have found most restraints of trade to be lawful if (1) they are connected to a legitimate business purpose, and, (2) they are deemed, as interpreted by the courts, to be economically efficient.¹⁴

That is not to say, however, that all agreements among competitors will be viewed with a favorable eye. Some types of agreements are deemed to be automatic (“per se”) violations of the Act. In other words, proof of the wrongful act automatically proves an antitrust violation.¹⁵ Actions that are deemed to be illegal under the per se rule are price fixing, group boycotts, production quotas, certain horizontal territorial limitations or market divisions, and some “tying arrangements.” These per se violations are discussed in greater detail subsequently.

B. *The Clayton Act*

In 1914, in an effort to “arrest the creation of trusts, conspiracies, and monopolies in their incipiency and before consummation,”¹⁶ Congress passed the Clayton Act.¹⁷ That Act is much more strict on allegedly monopolistic activities than is the Sherman Act, since Clayton Act violations require only a probable adverse impact on competition (i.e., anti-competitive tendencies) rather than proof of completed anticompetitive effects.¹⁸

¹² 15 U.S.C. § 15 (1994).

¹³ ROBERT W. EMERSON & JOHN W. HARDWICKE, *BUSINESS LAW* 443 (4th ed. 1997).

¹⁴ *Id.*

¹⁵ As one court has noted, “[p]er se treatment is warranted, in certain areas because ‘there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.’” *Ron Tonkin Gran Turismo, Inc. v. Fiat Distributors, Inc.*, 637 F.2d 1376, 1382 (9th Cir. 1981) (quoting *Northern Pac. Ry. Co. v. United States*, 356 U. S. 1, 5 (1958)).

¹⁶ S. Rep. No. 63-698, at 1 (1914).

¹⁷ 15 U.S.C. § 12 - 27 (1996).

¹⁸ Emerson & Hardwicke, *supra* note 13, at 447.

The government or private parties can obtain federal court injunctions for the following practices that the Clayton Act forbids:

1. Exclusive dealing and tying arrangements for the sale of commodities when such contracts may substantially reduce competition or tend to create monopolies;
2. Two or more significantly competing companies having the same individual serve as a director or high-level officer chosen by the board of directors;¹⁹ and
3. Monopolistic mergers that substantially lessen competition or tend to create monopolies in either a product market or a geographic market. The three types of forbidden monopolistic mergers are horizontal mergers (where the merged entities operate the same type of business at the same level), vertical mergers (where the merged entities operate the same type of business, but at different levels), or conglomerate mergers (where the merged entities are in unrelated businesses).²⁰

C. *The Federal Trade Commission Act*

The Federal Trade Commission Act,²¹ also passed in 1914, outlaws “unfair or deceptive [business] practices” and “unfair methods of competition.”²² The Act grants the Federal Trade Commission sole authority to investigate possible violations and to enforce the law. The Federal Trade Commission essentially considers the following factors when deciding whether a business activity violates the Act: (1) Is it against public policy? (2) Is it immoral, oppressive, unscrupulous, or otherwise unethical? and (3) Does it cause substantial harm to consumers?²³

¹⁹ This type of interlocking directorship is unlawful if each company has capital, surplus and undivided profits exceeding \$10,000,000. “Significant competition” means that competing activities account for at least 4% of one company’s total sales and — for each company— the directly affected sales amount to more than \$1,000,000 and at least 2% of total sales. Emerson & Hardwicke, *supra* note 13, at 447.

It should be noted that a 1990 Clayton Act amendment requires that each year, starting in 1991, these figures (\$10,000,000 and \$1,000,000, respectively) are to increase by a percentage amount equal to the percentage increase in gross national product. *Id.*

²⁰ Emerson & Hardwicke, *supra* note 13, at 448.

²¹ 15 U.S.C. §§ 41-51 (1994).

²² 15 U.S.C. § 45 (2004).

²³ Emerson & Hardwicke, *supra* note 13, at 450.

The Federal Trade Commission has been empowered to stop unfair or deceptive business practices and unfair methods of competition through a variety of enforcement mechanisms. In order to eliminate unfair business activity, the Federal Trade Commission can issue advisory opinions counseling businesses on the legality of a proposed activity, issue consent decrees (wherein the Federal Trade Commission agrees not to impose severe penalties on the business in return for its agreement to stop engaging in illegal activity), issue cease and desist orders telling businesses to stop breaking certain laws (violations can subject the offending businesses to fines of up to \$10,000 per day), or take “extreme measures” (e.g., require divestiture of a business’ assets or subsidiaries or order that the business be dissolved).²⁴

D. *The Robinson-Patman Act*

The Robinson-Patman Act was passed by Congress in 1936.²⁵ The Act forbids price discrimination, which occurs when a seller charges different prices to different buyers for commodities of like grade and quality. Section 1 of the Robinson-Patman Act prohibits:

[D]iscriminat[ion] in price between different purchasers of commodities of like grade and quality . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly . . . or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them²⁶

The Robinson-Patman Act is invoked when sellers in interstate commerce make sales that occur fairly close in time and if the effect of those sales may be to substantially lessen competition, to tend to create a monopoly, or to otherwise harm or prevent competition.²⁷ As a legal matter, price differences are usually only allowed if they result from disparities in costs (e.g., shipping or manufacturing expenses), from a good-faith reduction in price to meet competition in a particular region, or from changing market conditions (e.g., imminent deterioration of perishable goods, distress sales, or end-of-season sales of obsolete goods).²⁸

²⁴ *Id.* at 451.

²⁵ 15 U.S.C. §§ 13(a), 13(b), 21(a) (2004).

²⁶ 15 U.S.C. § 13 (1996).

²⁷ Emerson & Hardwicke, *supra* note 13, at 449-50.

²⁸ *Id.*

III.

THE BIG FIVE: PER SE VIOLATIONS OF THE FEDERAL ANTITRUST LAWS

As the author previously mentioned, the courts and regulatory agencies deem five activities to be per se violations of the federal antitrust laws. Those activities are price fixing, group boycotts, production quotas, horizontal territorial limitations, and some tying arrangements. Each of these per se violations will be addressed *seriatim*.

A. *Price Fixing*

Price fixing is, at its most basic, the setting of prices for products or services in the marketplace. It should be noted that the courts have broadly defined the term “price-fixing.” For example, credit terms and discounts cannot be fixed, since they are inextricably related to price.²⁹ The same holds true for agreements to set freight prices, since such arrangements can eliminate competition based upon a purchaser’s distance from a supply source.³⁰ In addition, agreements among competitors to set a price ceiling (i.e., maximum price agreements) are illegal, since fixing low prices can drive out competitors from the market and reduce non-price competition for product services or optional benefits.³¹ Moreover, competitors may not agree among themselves to buy any excess amounts of their commodities nor may they exchange information or disclose or discuss future actions, plans, intentions or recommendations regarding employee compensation, salaries or benefits.³²

It is also important to note that competitors need not meet and explicitly fix prices or related terms in order to be found guilty of price-fixing. If only a few companies control a given market, those companies, if they follow the pricing policies of the leading firm in that industry – or otherwise mimic one another’s pricing behavior – may effectively restrict competition.³³ This type of conscious parallelism is legal only if there is no evidence of arrangements, understandings, or practices, however informal, that take from each individual business its capacity to set prices independent of what other businesses have done or may do.³⁴

The Department of Justice and the Federal Trade Commission recognize that certain activities among competitors that may, at first glance, appear to have anti-competitive tendencies, can occur as long as certain “antitrust safety zone” guidelines are followed.³⁵ Two

²⁹ *Id.* at 443.

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.* at 444.

³⁴ *Id.*

³⁵ See Anthony J. Dennis, *Assessing the Risks of Competitive Intelligence Activities Under the Antitrust Laws*, 46 S.C. L. REV. 263, 280 (1995).

of those activities are the exchange of information about wages, salaries or benefits and the creation and endorsement of joint purchasing agreements.³⁶ In order for surveys regarding wages, salaries, benefits, prices or costs to comply with the antitrust laws, they must have all of the following characteristics:

- The survey should be in writing;
- It must be managed by a third party (e.g., a consultant, a government agency, academic institution, or trade association);
- The data collected and analyzed in the survey must be at least three months old;
- There must be at least five companies reporting data upon which any disseminated statistic is based;
- No individual company's data may represent more than 25 percent on a weighted basis of each statistic reported; and
- Any information disseminated through the survey must be sufficiently aggregated such that the recipients cannot identify the prices charged or compensation paid by any particular company.³⁷

Informal phone surveys of competitors do not meet these requirements.³⁸ Nor do surveys reporting results on an identified individual company basis, either by name or by code (e.g., A, B, C).³⁹ Such informal surveys must be avoided. In addition, the Department of Justice and the Federal Trade Commission have stated that exchanges of information as to future prices for services or goods or exchanges as to future compensation of employees are very likely to be considered anti-competitive since they might lead to coordination among competitors on price or other commercially sensitive variables.⁴⁰

³⁶ On September 15, 1993, the Department of Justice and the Federal Trade Commission jointly issued six statements of antitrust enforcement policy for health care organizations. See 1993 Department of Justice and Federal Trade Commission Antitrust Enforcement Policy Statements in the Health Care Area, 4 Trade Reg. Rep. (CCH) (Trade Cas.) 1-13 (1993). These antitrust guidelines were issued to reduce uncertainty by "describing the circumstances under which the Agencies will not challenge conduct as violative of the antitrust laws as a matter of prosecutorial discretion." Dennis, *supra* note 35, at 278.

Although the guidelines issued by the Department of Justice and the FTC were specifically aimed at the health care industry, the FTC has recognized that these antitrust policy statements can be applied to competition issues faced by any trade group or association. *Id.* at 280.

³⁷ *Id.* at 281.

³⁸ Theresa J. Arnold, *The How To's of Salary Surveys*, AMACO NEWSLETTER (Oct. 24, 1997).

³⁹ *Id.*

⁴⁰ Dennis, *supra* note 35, at 281.

Agreements among competitors to combine their purchases and jointly acquire goods and services have generally been upheld by the courts in part due to the recognition that they can lower the buyers' costs, which can in turn be passed on to the ultimate consumers.⁴¹ The guidelines issued by the Department of Justice and the Federal Trade Commission provide an antitrust safety zone for joint purchasing arrangements that meet "both of the following criteria: (1) The purchases account for less than thirty-five percent of the total sales of the purchased product or service in the relevant market; and (2) The costs of products and services purchased jointly account in the aggregate for less than twenty-five percent of the total revenue from all goods or services . . . sold by each competing participant in the arrangement."⁴²

It should be noted that joint purchasing agreements falling outside of the safety zone would not necessarily result in antitrust liability. The Department of Justice and Federal Trade Commission policy sets forth three means of lessening potential liability for joint purchasing agreements that do not meet the criteria set forth above. A joint purchasing agreement is likely to meet with Department of Justice and Federal Trade Commission approval if (1) members are not required to use the arrangement for all of their purchases of a particular product or service, (2) negotiations are conducted by an intermediary rather than an employee of a participant, and (3) communications between the purchasing group and each individual participant are not disseminated to other participants.⁴³

B. *Group Boycotts*

A group boycott is defined as a concerted refusal to deal among traders with the intent or foreseeable effect of exclusion from the market of direct competitors of some of the conspirators or a concerted refusal to deal with the intent or foreseeable effect of coercing the trade practices of third parties.⁴⁴ Almost all such activity is deemed to be illegal under the Sherman Act.⁴⁵

As with every general rule, there is an exception to the prohibition against group boycotts. Boycotts organized for non-economic political expression are protected under the First Amendment of the Constitution. This protection of political boycotts is often referred to as the *Noerr-Pennington* immunity doctrine.

⁴¹ Murray S. Monroe & William J. Seitz, *Health Care Under the Antitrust Guidelines*, 64 U. CIN. L. REV. 71, 87 (1995).

⁴² *Id.*

⁴³ *Id.*; see also, Statement of Department of Justice and Federal Trade Commission Enforcement Policy on Joint Purchasing Arrangements Among Health Care Providers, 4 Trade Reg. Rep. (CCH) (Trade Cas.) 113, 152 (Sept. 30, 1994).

⁴⁴ See BLACK'S LAW DICTIONARY 169 (1979).

⁴⁵ Congress, in Section 20 of the Clayton Act, has exempted labor "boycotts" from antitrust liability. 15 U.S.C. § 52 (1996).

The *Noerr-Pennington* doctrine is the culmination of three separate Supreme Court cases: *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*,⁴⁶ *United Mineworkers of America v. Pennington*,⁴⁷ and *California Motor Transport Co. v. Trucking Unlimited*.⁴⁸ In the *Noerr* case, the Supreme Court stated that the Sherman Act does not prohibit two or more persons from associating together in an attempt to persuade the legislature or the executive branch to take a particular action with respect to a law that would produce a restraint on trade or a monopoly.⁴⁹ The Court further stated that the right to petition the government is one of the essential freedoms protected by the Bill of Rights and, as such, the Court would not impute to Congress an intent to invade that freedom when it passed the Sherman Act.⁵⁰

The scope of the petitioning immunity first recognized in *Noerr* was further extended by the Court in the *Pennington* case. To begin with, the *Pennington* decision extended the *Noerr* holding to include lobbying efforts to influence executive officials who exercise commercial functions.⁵¹ In addition, the Supreme Court further broadened the scope of *Noerr* immunity by holding that the intent of the actor was irrelevant, stating, “*Noerr* shields from the Sherman Act a concerted effort to influence public officials regardless of intent or purpose.”⁵²

In the *California Transport* case, the plaintiff filed a complaint asserting that the defendant had instituted a number of administrative proceedings to resist and defeat the plaintiff’s applications for operating rights as a highway carrier. The Supreme Court concluded that it would be “destructive of rights of association and of petition to hold that groups with common interests may not, without violating the antitrust laws, use . . . state and federal agencies and courts to advocate their causes and points of view respecting resolution of their business and economic interests *vis-à-vis* their competitors.”⁵³ Accordingly, the Court extended the *Noerr-Pennington* immunity doctrine to apply to the petitioning of courts and regulatory agencies.

Product manufacturers and service providers should not assume that as long as they include a political element with their boycotts they would be immune from antitrust liability. In fact, competitors may not engage in boycotts, or other activity that may be cloaked

⁴⁶ 365 U.S. 127 (1961).

⁴⁷ 381 U.S. 657 (1965).

⁴⁸ 404 U.S. 508 (1972).

⁴⁹ See *Noerr*, 365 U.S. at 136.

⁵⁰ See *id.* at 138.

⁵¹ See *Pennington*, 381 U.S. at 670.

⁵² *Id.*

⁵³ *California Transport*, 404 U.S. at 510-11.

with the protection of the First Amendment, where anti-competitive consequences are the *direct result* of the seemingly protected activity. As the Court noted in *California Transport*, “First Amendment rights may not be used as the means or the pretext for achieving ‘substantive evils’ . . .”⁵⁴ When an injury to a business competitor is the direct result of an antitrust defendant’s petitioning the government, rather than from a government decision, the courts will find the petitioning activity to be a sham and will impose liability. Some activities found to be “shams” include:

opposing administrative agency approval of some new device or process with no realistic hope of success; opposing agency action in order to delay competitive entry [into the marketplace]; initiating administrative actions against a competitor, knowing that the agencies involved lack jurisdiction over the dispute; filing tariffs that effectively force a competitor to litigate in 49 different forums in order to establish its rights . . . ; taking up the time of federal and state regulatory processes to such an extent as to deny competitors access to the same agencies; instituting judicial proceedings “without probable cause and in complete disregard of the law in order to interfere with the business relationships of a competitor . . .”; imposing heavy legal costs on the competitor in the hope of deterring it and other firms from [entering the marketplace]; and sending copies of a judicial complaint to the competitor’s customers.⁵⁵

It appears from reviewing the applicable case law that in order for *Noerr-Pennington* immunity to apply, the political speech component of a boycott or other petitioning activity must outweigh the antitrust interests.⁵⁶ “For example, if a number of companies entered into a horizontal agreement to have an industry board set rates in the hopes of having those rates adopted by the government, the courts would be [in all likelihood] hesitant to grant antitrust immunity.”⁵⁷ However, “if an interest group representing an industry successfully lobbies the government to set rates, rather than a number of companies setting prices on their own in the hopes of persuading the government to adopt those prices, *Noerr-Pennington*

⁵⁴ *Id.* at 515 (citation omitted).

⁵⁵ James S. Wrona, *A Clash of Titans: The First Amendment Right to Petition vs. the Antitrust Laws*, 28 NEW ENG. L. REV. 637, 644 n.38 (1994) (quoting PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW 20-21 (Supp.1992)).

⁵⁶ See *Crown Cent. Petroleum Corp. v. Waldman*, 486 F. Supp. 759 (M.D.Pa. 1980); *Video Int’l Prod., Inc. v. Warner-Amex Cable Communications, Inc.*, 858 F.2d 1075 (5th Cir. 1988).

⁵⁷ Wrona, *supra* note 55, at 646-47.

immunity would most likely apply.”⁵⁸ The key element necessary to maintain immunity under the *Noerr-Pennington* doctrine is that the discussions must relate to plans to support or oppose legislation, regulatory action or judicial proceedings through traditional lobbying methods.

C. *Production Quotas*

Production quotas are, as the name implies, an arbitrary restriction in the supply of certain goods in order to increase prices. Since production quotas have the effect of artificially inflating the prices that are charged for certain goods, they are deemed to be illegal under the Sherman Act.⁵⁹

D. *Horizontal Territorial Limitations or Market Divisions*

This illegal activity refers to competitors dividing up and retaining control of exclusive geographic areas for the sale of their products. This type of market division effectively restricts the number of competitors dealing in a particular region or with specific customers. As such, this territorial allocation or division of markets is illegal per se since it gives the producer for each distinct market segment an effective monopoly.⁶⁰

E. *Tying Arrangements*

Tying arrangements occur when vendors will sell one product (the tying product) only on the condition that the buyer also purchases another, different product (the tied product).⁶¹ Usually, the tying product is the more highly desired of the two. An illegal tying arrangement has two anticompetitive impacts: it forecloses the seller’s competitors in one market (the tied market) through the use of market leverage and power developed in another market (the tying market) and it compels the purchaser to buy a product it may not want in order to obtain one it desires.⁶² Some examples of tying arrangements deemed to be

⁵⁸ *Id.* at 647-48.

⁵⁹ *Id.*

⁶⁰ Emerson & Hardwicke, *supra* note 13, at 444.

⁶¹ *N.W. Controls, Inc. v. Outboard Marine Corp.*, 333 F. Supp. 493, 494 (D. Del. 1971).

⁶² *Id.*

illegal by the courts include conditioning the sale of highly successful dry cleaning franchises on the purchase of a package of dry cleaning equipment and incidental materials⁶³ and requiring purchasers of electric shift outboard and stern drive boat engines to also purchase remote control engine cables.⁶⁴ A tying arrangement is essentially illegal if it affects a substantial portion of commerce in the tied product and if the seller has strong economic power in the tying product's market, that is, it can force a tie-in due to a patent or to a large market share in the tying product.⁶⁵

IV. PRACTICAL ADVICE

Obviously, the most practical advice for business competitors who are meeting as a group is to avoid, at all costs, discussion of the five areas that are deemed to be per se violations of the antitrust laws. In addition, when business competitors meet as a group, it is advisable for the group to appoint someone who, ideally, is familiar with the antitrust laws and their implications and can thereby serve as an informal compliance officer. The compliance officer is charged with steering the discussions away from any of the areas of potential antitrust liability. Also, an antitrust attorney should review the meeting agenda, in order to insure that none of the per se illegal activities are included therein. Moreover, competitors are well advised to stay within the formal agenda of the meeting and to avoid any formal or informal discussions relating to illegal topics or specific company plans. Finally, if minutes of the meeting are kept, they should be reviewed by an attorney who is familiar with antitrust regulations in order to insure that information which does not give rise to an antitrust violation has not been inadvertently characterized in such a way that an argument could be made that an antitrust violation has occurred.

⁶³ See, *Northern v. McGraw-Edison Co.*, 542 F.2d 1336 (8th Cir. 1976).

⁶⁴ See, *N.W. Controls, Inc.*, 333 F. Supp. 493.

⁶⁵ *Emerson & Hardwicke*, *supra* note 13, at 445. If the tying or tied products are "goods, wares . . . or other commodities," the case falls within the ambit of the Clayton Act and the plaintiff need only show that "a substantial volume of commerce in the 'tied' product is restrained." *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 608-09 (1953). If the tie does not involve a commodity but concerns land, services or credit, which do not fit the Clayton Act's language, the case is governed by the Sherman Act and the plaintiff is required to bear the additional burden of proving that the defendant's economic power with respect to the tying product is sufficient to produce an appreciable restraint. However, the "sufficient economic power" test for per se illegality may be inferred if it appears that the seller has the power to impose other burdensome terms, such as a tie-in, with respect to any appreciable number of buyers within the market. *N.W. Controls, Inc.*, 333 F. Supp. at 500.

V.
CONCLUSION

Not all meetings and discussions between competitors result in monopolistic activities or the fixing of prices. Oftentimes, meetings of members of the same trade result in an increased awareness of the marketplace, increased safety and uniformity of products, and the sharing of information which directly benefits consumers. For these reasons, meetings of business competitors, and the sharing of information between competitors, when governed by the principles set forth herein, should be actively encouraged and supported.

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LIMITING CORPORATE LIABILITY FOR PUNITIVE DAMAGES

The FDCC Quarterly is pleased to continue its inclusion of analytical perspectives on punitive damages. Given the severity of their impact on corporate liability, the three punitive damage articles featured within this issue discuss strategies for limiting or challenging corporate liability for punitive damages. Proving once again the value of symposia discussions of such important topics, these articles result from presentations at the FDCC Corporate Counsel Symposium held at the Milwaukee Hilton on September 9-10, 2004. The Editors join in thanking the authors for their submissions.

Eds.

Problems with Plaintiffs' Experts and Punitive Damages in Class Action and Mass Tort Litigation

William V. Johnson

I.

INTRODUCTION

In recent years, astonishing amounts of punitive damages have been awarded nationwide in mass tort cases. In a 1999 diet drug case, \$20 million in punitives were awarded.¹ Asbestos defendants were hit with punitive damages totaling \$100 million in 2001.² That same year, in a tobacco industry case, plaintiffs were awarded \$1.45 billion in punitives.³ Then in 2003, in the widely publicized *Price v. Phillip Morris* case, \$3 billion in punitive damages were entered against tobacco industry defendants.⁴ This steady increase in punitive damage awards in class action and mass tort cases gives defendants good reason for concern. This is especially true in light of the recent *Dukes v. Wal-Mart*⁵ decision.

On June 21, 2004, in what may be the largest employment discrimination class action in this country's history, United States District Court Judge Martin Jenkins certified a nationwide class of over one-and-a-half million current and former female Wal-Mart employees. In addition to its massive class size, *Dukes v. Wal-Mart* could potentially be the very first billion-dollar employment discrimination case ever. With so much at stake, it is important to address the impact this case will undoubtedly have on future class actions.

¹ Lovett v. Wyeth Ayerst, No. 97-00665 (County Ct. Van Zandt County, Tex. Aug. 1999).

² Bell v. Dressler Indus., No. A-920, 961-SC-19 (128th Judicial Dist. Ct., Orange County, Tex. Sept. 12, 2001).

³ Engle v. R.J. Reynolds Tobacco Co., No. 94-08273 CA-22 (Miami-Dade County Cir. Ct., Fla. July 17, 2000).

⁴ Price v. Phillip Morris, Inc., No. 00-L-112 (Madison County Cir. Ct., Ill. Mar. 31, 2003).

⁵ Dukes v. Wal-Mart Stores, Inc., 222 F.R.D. 137 (N.D. Cal. 2004).



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II.

MISUSE OF EXPERT OPINIONS IN CLASS ACTIONS

A. *Dukes v. Wal-Mart*

In the *Wal-Mart* opinion, Judge Jenkins focused mainly on issues of “commonality” and “manageability.” In support of their commonality claim, the plaintiffs presented three types of evidence: (1) facts and expert opinions that support the existence of company-wide policies and practices that are discriminatory against women; (2) expert statistical evidence of class-wide gender disparities that are attributable to discrimination; and (3) anecdotal evidence of class members from all over the country of discriminatory attitudes held or tolerated by management.⁶ As to their manageability claim, the plaintiffs’ experts offered a formula, as opposed to individualized findings, to be used in the determination of damages. A significant portion of the opinions of the plaintiffs’ experts was based on subjective reasoning and questionable methodology. Hence, the acceptance of this evidence as reliable expert testimony is, at the very least, controversial.

Perhaps the most problematic evidence proffered by the plaintiffs was the testimony of their sociology expert, Dr. Bielby:

In sum, consistent with the organizational research on this topic, Wal-Mart’s distinctive corporate culture is sustained by focused efforts of the firm through ongoing training and socialization, communication specifically designed to reinforce its distinctive elements, promotion from within and relocating managers from store

⁶ *Id.* at 143.

to store, and shared experiences among employees that build commitment to shared beliefs and values. As a result of these efforts, employees achieve a common understanding of the company's ways of conducting business.⁷

Judge Jenkins acknowledged the deficiencies in the opinions of the plaintiffs' sociology expert by stating, "it is true that Dr. Bielby's opinions have a built-in degree of conjecture. He does not present a quantifiable analysis; rather, he combines the understanding of the scientific community with evidence of Defendant's policies and practices, and concludes that Wal-Mart is 'vulnerable' to gender bias."⁸ Yet, after brushing aside the defendant's challenges that Dr. Bielby's opinions were "unfounded and imprecise," he determined that the opinions "could add probative value to the inference of discrimination that plaintiffs allege."⁹

Additionally, Judge Jenkins accepted the external benchmarking analysis of a labor economist, Dr. Bendick. This data, which compared Wal-Mart to twenty other large retailers, was proffered in support of an inference that *if* Wal-Mart had given women the chance to apply for management positions, a certain percentage would have.¹⁰ The defendant opined that Dr. Bendick had biased his analysis by "cherry-picking" the companies to be included in the comparison.¹¹ Nonetheless, the Dr. Bendick's criteria were found to be sufficient.

The defendant disputed other statistical experts' methodology and opinions on several grounds. For example, the defendant contested the aggregation of data at the regional rather than the store, or store department, level. In addition, the defendant made the following challenges to the opinions of the plaintiffs' experts: failing to use actual applicant flow data when considering promotions, ignoring the key variables of recent promotion or demotion, excluding seniority from analyses, and neglecting to use the size of each store in arriving at pay conclusions. Unacceptably, all of these arguments were rejected and the biased testimony in support of the plaintiffs' allegations was accepted.

In *Wal-Mart*, the plaintiffs' experts were permitted to offer evidence that flies in the face of the traditional requirements for expert testimony. While *Wal-Mart* involved expert opinions at the class certification stage, the court's acceptance of such questionable testimony is good cause for concern at the pre-trial and trial stages in class actions. Thus, it is imperative for defense counsel to realize the *Wal-Mart* decision's sweeping ramifications in order to protect against future misuse of experts by plaintiffs in class actions.

⁷ *Id.* at 152.

⁸ *Id.* at 154.

⁹ *Id.* at 143.

¹⁰ *Id.* at 164.

¹¹ *Id.* at 165.

B. *Defending Misuse of Expert Opinions in Class Actions*

Wal-Mart may well have opened the floodgates for an increased use of the opinions of plaintiffs' experts in class actions. However, there are several tactics available to defendants who wish to nullify an opinion of the plaintiffs' expert. These techniques, while practical at the class certification stage, are most useful for keeping the plaintiffs' experts opinions out of trial through motions *in limine*.

1. Rule 702 or Equivalent State Rule

One technique is to attack an expert's testimony under Rule 702 of the Federal Rules of Evidence, or under an equivalent state rule where appropriate. Defense counsel can argue that the expert is testifying as to issues of law, which is prohibited under 702.¹² Rule 702 mandates a quantitative rather than a qualitative analysis:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.¹³

When a plaintiff's expert's opinion is based on highly subjective, unquantifiable data, the opinion may be considered an opinion of law. As such, this testimony should be excluded under 702. This is because while experts "may provide an opinion to aid a jury or judge to comprehend complex facts, experts may not testify as to the ultimate legal conclusions based on those facts."¹⁴ An attack under 702 will, at the very least, create uncertainty as to the reliability of the plaintiff's expert testimony.

2. Daubert Challenges

In addition to an attack under Rule 702, defense counsel should challenge the expert on *Daubert* grounds.¹⁵ While a *Daubert* inquiry is not ordinarily appropriate at the class

¹² Dwight J. Davis & Karen Kowalski, *Use and Misuse of Expert Opinions at the Class Certification Stage*, 69 DEF. COUNS. J. 285 (July 2002).

¹³ FED. R. EVID. 702.

¹⁴ Davis & Kowalski, note 12 *supra*, at 290 (citing *United States v. Bilzerine*, 926 F.2d 1285, 1294 (2d Cir. 1991)).

¹⁵ *Daubert v. Merrell Dow Pharms.*, 509 U.S. 579 (1993).

certification stage,¹⁶ *Daubert* challenges should be considered indispensable tools during pre-trial and trial. It should also be noted that while *Daubert* is proper in federal actions, not all states use the *Daubert* standard. Still, many states will conduct a similar inquiry under the *Frye* standard, or an essentially similar test. The *Frye* standard is a test of “general acceptance,” whereby the scientific principles on which an expert relies must be “generally accepted” by the expert’s peers within that particular field of science.¹⁷ The *Daubert* and *Frye* tests are fundamentally the same; they mandate an inquiry into the reliability of expert testimony. In fact, the *Frye* “general acceptance” test is incorporated into the fourth factor of the *Daubert* test.

In *Daubert v. Merrell Dow Pharmaceuticals*,¹⁸ the Supreme Court articulated four specific factors to be considered when assessing the reliability of scientific expert testimony. The factors announced by the *Daubert* Court are:

- Whether a “theory or technique . . . can be (and has been) tested”;
- Whether it “has been subjected to peer review and publication”;
- Whether, in respect to a particular technique, there is a high “known or potential rate of error” and whether there are “standards controlling the technique’s operation”; and
- Whether the theory or technique enjoys “‘general acceptance’” within the “‘relevant scientific community.’”¹⁹

Daubert developed the four-factor inquiry into the reliability of a *scientific* expert. In 1999, The Supreme Court expanded the holding of *Daubert* to non-scientific expert testimony in *Kumho Tire Co. v. Carmichael*.²⁰ There the Court held that the *Daubert* factors could apply when assessing the reliability of a non-scientific expert’s testimony, depending on “the particular circumstances of the particular case at issue.”²¹

¹⁶ At the class certification stage, some courts have rejected the use of a full *Daubert* inquiry. Others have determined that a lower *Daubert* standard is appropriate at this stage. See *Thomas & Thomas Rodmakers, Inc. v. Newport Adhesives & Composites, Inc.*, 209 F.R.D. 159, 162-63 (C.D. Cal. 2002); see also *O’Connor v. Boeing N. Am., Inc.*, 184 F.R.D. 311, 321 (C.D. Cal. 1998) (*Daubert* inquiry inappropriate at class certification stage).

¹⁷ See *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923).

¹⁸ 509 U.S. 579 (1993).

¹⁹ *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 149-50 (1999) (quoting *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579, 592-94 (1993)).

²⁰ *Id.*

²¹ *Id.* at 150.

In response to the *Daubert* and *Kumho Tire* cases, Rule 702 was amended to reflect the higher standard imposed upon non-scientific expert testimony. The 2000 amendment “rejects the premise that an expert’s testimony should be treated more permissively simply because it is outside the realm of science.”²² Since non-scientific subject matter calls for a less technical analysis, “the expert may not be able to resort to the classic methodology of controlled experimentation and induction. Nevertheless, logic dictates that there be some showing that the use of the theory or technique enables the expert to accurately make the determination the proponent offers the opinion to establish.”²³

To challenge expert testimony in federal cases under *Daubert*, or in state cases under *Frye* or an analogous test, defense counsel should be prepared to demonstrate that a plaintiff’s experts have applied methodologies that are not recognized in the particular field in which they are testifying. For example, “[i]n Illinois, the admission of expert testimony is governed by the *Frye* standard: whether the methodology or scientific principle upon which the opinion is based is sufficiently established to have gained general acceptance in the particular field in which it belongs.”²⁴ Therefore, defense counsel, when trying an Illinois case, would contest the admissibility of the opinion of a plaintiff’s expert on ground that the methodology used by the expert does not enjoy “general acceptance” within its particular field. Defense counsel would then, under the *Frye* standard, attack the testimony of a plaintiff’s expert on grounds that the expert had chosen an unconventional method as opposed to those “generally accepted.”

More reprehensible than choosing a lesser used methodology, is the instance in which an expert exploits specific techniques that have been created for the sole purpose of achieving a result most favorable to the plaintiff. Also known as “junk science,” this type of methodology purports to prove a particular result through the use of unfounded tactics. For example, a “defendant’s future dangerousness based on the contours of the defendant’s skull”²⁵ would constitute “junk science” under *Daubert*, *Frye*, or other similar standards. Whether under *Daubert*, *Frye*, or an analogous state law standard, challenges should be viewed as an effective technique for keeping the “junk science” of a plaintiff’s expert out.

²² FED. R. EVID. 702 (advisory committee’s notes).

²³ Edward J. Imwinkelried, *What is the Question? What is the Answer? How Should the Court Frame a Question to Which Standards of Reliability Are to be Applied? Commentary and Question: The Relativity of Reliability*, 34 SETON HALL L. REV. 269, 276 (2003).

²⁴ *In re Commitment of Field*, 813 N.E.2d 319, 325 (Ill. App. Ct. 2004) (citing *Donaldson v. Cent. Ill. Pub. Serv. Co.*, 767 N.E.2d 314, 324 (Ill. 2002)).

²⁵ *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 154 (1997).

3. Use of Defense Experts

Another approach to attacking the validity of a plaintiff's expert is the use of a defense expert. While it is true that many courts try to avoid a "battle of the experts,"²⁶ defense counsel should at least offer their own expert for the purpose of making a record. This can be a highly effective tactic, for even if a court denies a motion to strike or exclude the testimony of a plaintiff's expert, the record will force "the court to examine, and the plaintiff to defend, the reliability and the methodology employed by the plaintiff's expert."²⁷ In addition to attacking the opinion of a plaintiff's expert, the defense expert should attack the steps taken by the plaintiff's expert in arriving at the opinion.

It is wise for defense counsel to work with defense experts "from the inception of the case" and to keep them involved "in all major aspects" of the proceedings.²⁸ This will yield more efficient results than would the hiring of defense experts in the later stages of litigation. By keeping a defense experts involved, the quality and lucidity of the experts' testimony will be enhanced; they will have gained a thorough understanding of various aspects of the litigation.

Finally, the use of a defense expert is critical when preparing to depose or cross-examine a plaintiff's expert. Not only should defense counsel have the defense expert assist with preparing for a deposition, consideration should be given to having the defense expert *present* when deposing the plaintiff's expert.²⁹ This will ensure that the defense expert has immediate notice of any unexpected information revealed by the plaintiff's expert during the deposition.

III.

PUNITIVE DAMAGES IN CLASS ACTIONS

Defendants involved in mass tort litigation are often faced with the prospect of paying an enormous amount of punitive damage awards. Consequently, defendants are continually pressured into settlement agreements. This is especially true when class-wide punitive dam-

²⁶ *Dukes v. Wal-Mart, Inc.*, 222 F.R.D. 189, 191 (N.D. Cal. 2004) (citing *Caridad v. Metro-North Commuter R.R.*, 191 F.3d 283, 292-93 (2d Cir. 1999) (district court cannot weigh conflicting expert evidence or engage in "statistical dueling" of experts)).

²⁷ *Davis & Kowalski*, *supra* note 12, at 295.

²⁸ Joel S. Feldman, et al., *Expert Witnesses in Insurance Class Actions and Individual Cases—Defense Perspective*, 80 A.L.I. 249, 303 (2000).

²⁹ *Id.*

ages are viable. With the recent certification of a class of over one-and-one-half million plaintiffs, *Dukes v. Wal-Mart*³⁰ has the potential of becoming a billion-dollar case. Defendants, then, have good reason to be concerned about the “sky rocketing amount of punitive damage awards” being awarded to plaintiffs in class actions.³¹

A. *History of Punitive Damages*

In 1989, the Supreme Court, for the first time, addressed the issue of due process in relation to punitive damages in *Browning-Ferris Industries of Vermont v. Kelco Disposal*.³² The defendant challenged punitive damages under the Excessive Fines Clause of the Eighth Amendment. The Court rejected the defendant’s challenges and held that the Excessive Fines Clause was inapplicable to “awards of punitive damages in cases between private parties.”³³ Additionally, the Court held that punitive damages are not limited by federal common law.³⁴ However, the Court decided to leave open the inquiry into when the imposition of punitive damages by a state violates the Due Process Clause of the Fourteenth Amendment.³⁵

Then in 1991, the Court upheld a punitive damages award four times greater than the amount of compensatory damages awarded in *Pacific Mutual Life Insurance Co. v. Haslip*.³⁶ In its opinion, the Court explained that due process would act as a “meaningful constraint” on punitive awards that would be deemed unacceptable.³⁷ The Court reasoned that the punitive damages in this case, however, did “not cross the line into the area of constitutional impropriety.”³⁸

However, just two years later, in *TXO Production Corp. v. Alliance Resources Corp.*,³⁹ the Court upheld a punitive damages award 526 times greater than the compensatory damages awarded by the jury. This decision is troubling because it seems to undermine the due

³⁰ *Dukes v. Wal-Mart Stores, Inc.*, 222 F.R.D. 137 (N.D. Cal. 2004).

³¹ Kenneth R. Meyer & Jennifer A. Schettino, *Campbell v. State Farm: A Ray of Hope for Mass-Tort Defendants in Punitive Damage Cases*, Int’l Ass’n of Def. Couns. Newsl., Toxic and Hazardous Substances Litigation Committee, June 2002, No. 5, at 1, available at, <http://www.iadclaw.org/pdfs/ToxicJuneIssue5.pdf>.

³² 492 U.S. 257 (1989).

³³ *Id.* at 260.

³⁴ *Id.* at 279.

³⁵ *Id.* at 277; see also *id.* at 280 (Brennan, J., concurring) (emphasizing decision in *Browning-Ferris* “leaves the door open” for later due process challenges to punitive damages).

³⁶ 499 U.S. 1 (1991).

³⁷ *Id.* at 22.

³⁸ *Id.* at 24.

³⁹ 509 U.S. 443 (1993).

process limits imposed on punitive damage awards in *Pacific Mutual*. If a punitive damages award 526 times greater than the compensatory damages is acceptable, then when will the “meaningful constraint” of due process kick in?

The Court finally began to apply that “meaningful constraint” in 1994. In *Honda Motor Co. v. Oberg*,⁴⁰ the Court considered a provision of the Oregon Constitution that prohibited judicial review of excessive punitive damage awards “unless the court can affirmatively say there is no evidence to support the verdict.”⁴¹ The Court held that it violated the Due Process clause of the Fourteenth Amendment. It reasoned that “[j]udicial review of the size of punitive damages awards was a safeguard against excessive awards.”⁴² With this decision, the Court took its first affirmative step towards limiting excessive punitive damage awards.

Finally, in *BMW of North America, Inc. v. Gore*,⁴³ the Court reversed an award of punitive damages 500 times the amount of the compensatory award on grounds that it was “grossly excessive.”⁴⁴ In *Gore*, an Alabama Jury had awarded \$4,000 in compensatory damages and \$4 million in punitive damages. Even though the Alabama Supreme Court had already reduced the punitive award to \$2 million, the United States Supreme Court determined that the reduced amount violated due process. Justice Stevens outlined three prongs, or “guideposts,” to be used when evaluating an award of punitive damages:

- (1) the “degree of reprehensibility” of the defendant’s conduct;
- (2) the “disparity between the harm or potential harm suffered” by the plaintiff and the “punitive damages award”; and
- (3) the difference between the punitive damages and “the civil penalties authorized or imposed in comparable cases.”⁴⁵

The defendant’s misconduct in *Gore* was failing to disclose to the buyer of a car that it had been repainted prior to its sale. Since the misconduct in this case caused economic as opposed to physical injury, the “degree of reprehensibility” under the first prong was low.

⁴⁰ 512 U.S. 415 (1994).

⁴¹ *Id.* at 435.

⁴² *Id.*

⁴³ 517 U.S. 559 (1996).

⁴⁴ *Id.* at 574.

⁴⁵ *Id.* at 574-75.

In addition, there was a “breathtaking” ratio, 500 to 1, of punitive to compensatory damages, establishing great disparity under the second prong.⁴⁶ Finally, the civil penalty Alabama could have imposed on BMW’s conduct was only \$2,000, and the highest fine in other states was \$10,000. Thus, the Court concluded that these civil penalties did not provide BMW with fair notice that its conduct “might subject them to a multimillion dollar penalty.”⁴⁷

While *Gore* stands for the proposition that the Supreme Court can, and will, reverse punitive damages when they are excessive under the three “guideposts” test, the opinion left several important questions unanswered. First, *Gore* involved relatively harmless conduct. The Court offered little guidance on how to address misconduct of a more serious nature. In addition, the Court failed to address the “scope of conduct a state may legitimately punish, both in the state (harm to people other than the plaintiff) and outside the state (where defendant’s out-of-state conduct is unlawful.)⁴⁸ Finally, *Gore* offered no insight into resolving the complex issues surrounding punitive damages in the context of class actions or mass torts. The Court, however, would be forced to revisit the issue of punitive damages again in *State Farm Mutual Automobile Insurance Co. v. Campbell*.⁴⁹

B. *State Farm v. Campbell*

In *State Farm*, after an investigation concluded that the insured, Campbell, was responsible for an automobile accident that killed one person and disabled another, State Farm, his insurer, contested liability.⁵⁰ State Farm refused to settle the claims for the amount of the policy limit and took the case to trial. The jury ended up returning a verdict more than three times the policy limit. After refusing to appeal, State Farm’s counsel suggested to the insureds that they should sell their house in order to pay the damages entered against them.⁵¹ Although State Farm paid the entire amount of the judgment, the insureds sued the insurer for fraud, bad faith, and intentional infliction of emotional distress.

At trial, the insureds were permitted to introduce evidence of State Farm’s national practices. In their opening statement, counsel for the insureds told the jury that they would

⁴⁶ *Id.* at 583.

⁴⁷ *Id.* at 584.

⁴⁸ Laura J. Hines, *Due Process Limitations on Punitive Damages: Why State Farm Won’t be the Last Word*, 37 AKRON L. REV. 779, 786 (2004).

⁴⁹ 538 U.S. 408 (2003).

⁵⁰ *Id.*

⁵¹ *Id.* at 413.

be “evaluating and assessing, and hopefully requiring State Farm to stand accountable for what it’s doing across the country, which is the purpose of punitive damages.”⁵² State Farm’s motion to exclude such evidence, under *BMW v. Gore*, was denied. Initially, the jury awarded \$2.6 million in compensatory damages and \$145 million in punitives.

Although the trial court reduced those awards to \$1 million and \$25 million, respectively, the Utah Supreme Court reinstated the jury’s original award of \$145 million in punitive damages. After a grant of certiorari, the Supreme Court used the “guideposts” set forth in *Gore* to strike down \$145 million in punitives in a decision that was “neither close nor difficult.”⁵³

The Court recognized that the Utah “courts awarded punitive damages to punish and deter conduct that bore no relation to the [insureds’] harm.”⁵⁴ State Farm, then, was being punished for its nationwide practices that had absolutely nothing to do with their treatment of the plaintiffs. The Court’s holding illuminates the purpose of punitive damages; to punish the defendant for its misconduct as it affects *only* the plaintiffs. “Due process does not permit courts, in the calculation of punitive damages, to adjudicate the merits of other parties’ hypothetical claims against a defendant under the guise of the reprehensibility analysis.”⁵⁵

While *State Farm* involved individual plaintiffs, the “decision bodes well for defendants in mass tort cases, as the guidelines for the award of punitive damages enunciated by the Supreme Court could result in more reasonable punitive damage awards in mass tort cases.”⁵⁶ Perhaps most promising is the Court’s treatment of the first prong, or “guidepost,” of the *Gore* excessiveness test for punitive damages. In its opinion, the Court reiterated the issues to be considered under the “most important indicium of a punitive damages award’s reasonableness,”⁵⁷ the defendant’s reprehensibility. Under this first prong of the *Gore* inquiry, “a court must consider whether: the harm was physical rather than economic; the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; the conduct involved repeated actions or was an isolated incident; and the harm resulted from intentional malice, trickery, or deceit, or mere accident.”⁵⁸ Hence, the *State*

⁵² *Id.* at 420.

⁵³ *Id.* at 418.

⁵⁴ *Id.* at 422.

⁵⁵ *Id.* at 423.

⁵⁶ Meyer & Schettino, *supra* note 31, at 1.

⁵⁷ *State Farm*, 538 U.S. at 409.

⁵⁸ *Id.* (citing *Gore*, 517 U.S. at 1515-16).

Farm court concluded that punitive damages are *only* appropriate in situations in which the defendant's conduct is so reprehensible that sanctions beyond compensatory damages are necessary to achieve punishment or deterrence.

It follows, then, that when punitive damage awards are at issue in the context of class actions and mass torts, a court should carefully examine the precise nature of the defendant's conduct in making its determination. For example, in class actions and mass torts, if a defendant's misconduct was an accidental, isolated incident, a court should exercise extreme care when determining punitive damages. In such a situation, punitive damages may not even be appropriate. Still, the *Gore* inquiry is intended for use when a court is *reviewing* an award of punitive damages. Therefore, it is incredibly important that defense counsel be prepared to fight punitive damages well before they are awarded.

C. *Defending Class-Wide Punitive Damages*

One trend in class action and mass tort litigation is for plaintiffs to present evidence of a defendant's historical pattern of conduct. In cases involving conduct within one state or region, plaintiffs may also introduce an expert's analysis of a defendant's conduct in different states, regions, or across the country.⁵⁹ This is highly prejudicial towards defendants in the jury's determination of punitive damages, because they will undoubtedly factor this evidence into their decision. Even with a limiting instruction, it may be difficult for a jury to resist the opportunity to "punish" a defendant for other conduct that had nothing to do with the plaintiff.⁶⁰ This is why it is crucial that such evidence is excluded before a jury ever has the opportunity to hear it. The most effective weapon in the fight against soaring punitive damages is the motion *in limine*.

1. *Motions in Limine*

Under *State Farm*, punitive damages should only reflect a defendant's "direct conduct" toward plaintiffs.⁶¹ Defense counsel has the best opportunity to attack punitive damages before trial even begins by filing motions *in limine*. By excluding evidence of a defendant's non-related conduct pre-trial, the opportunity for outrageous punitive damages decreases. Since a defendant's reprehensibility is the single most important factor when determining punitive damages, it is critical for defense counsel to attack every piece of evidence that points to conduct that did not specifically affect the plaintiffs. Through motions *in limine*, defense counsel may effectively eliminate, or at least limit, evidence that is impermissible under the *State Farm* framework.

⁵⁹ Meyer & Schettino, *supra* note 31, at 4.

⁶⁰ *Id.*

⁶¹ *Id.*

2. Appeals

When punitive damages have been arbitrarily imposed, defense counsel may have several grounds to appeal. Under *State Farm*, defense counsel can challenge the award on grounds that it is “duplicative, either because the defendant has already been punished through the compensatory damages award or because of the likelihood of multiple punishments for the same act.”⁶² *State Farm* could also be used to support a reduction of punitives as they were applied to specific, individual plaintiffs within the class. Finally, a general appeal premised on the “trend towards soaring punitive damages awards” may result in a reduction of the amount.⁶³

IV. CONCLUSION

While *Wal-Mart* may have lowered the standard for the testimony of plaintiffs’ experts in class actions to some degree, the decision involved opinions at the class certification stage. The standards for expert testimony at the pre-trial and trial stages remain more stringent. Federal Rule 702, *Daubert*, and *Fry* (or other state rules) remain available as tools for keeping unreliable expert testimony and “junk science” away from the ears of the jury. In addition, defense counsel can always offer defense experts, even if solely for the purpose of making the record.

The trend of larger punitive damage awards in class actions, is cause for concern. However, *State Farm* can be used effectively to defend against outrageous awards. The use of motions *in limine*, coupled with creating a solid record for appeal, may assist defense counsel to bring the cost of punitive damages back down to acceptable amounts.

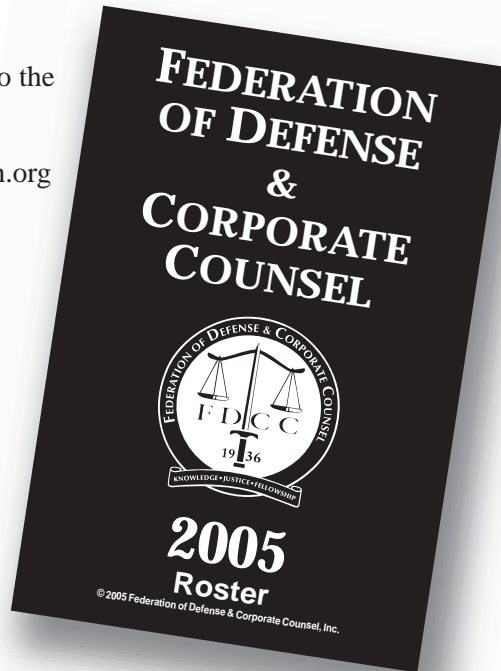
Due to the influx of class action and mass tort litigation, limiting the size of punitive damages awards is more important than ever. With the increased use of expert testimony by plaintiffs, the threat of excessive punitive damages remains great. Any permanent solutions to the problem of excessive punitive damages awards will have to come from the courts. Until then, defense counsel must continue to develop strategies to limit punitive damages on a case-by-case basis.

⁶² *Id.* at 7.

⁶³ *Id.*

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Making the Most of Your Opportunities: *State Farm*-Based Litigation and Non-Litigation Strategies to Limit Corporate Liability for Punitive Damages[†]

Timothy A. Pratt
Laura Clark Fey

I. INTRODUCTION

Punitive damages liability remains one of the most important contemporary issues affecting corporate litigation. Even within the last two decades, punitive damage awards have become more common and more sensational. As the dollar value of punitive damage awards has skyrocketed, it has become increasingly important for corporate counsel to develop innovative strategies to confront punitive damages proactively. In 2003, the Supreme Court addressed some of the punitive damages issues facing corporate defendants in *State Farm Mutual Automobile Insurance Co. v. Campbell*.¹ In *State Farm*, the Supreme Court overturned a \$145 million punitive damage award against State Farm Insurance Company. In doing so, the Supreme Court articulated certain principles and guidelines that can be used by corporate defendants to circumscribe rising punitive damage awards. This article examines how *State Farm* assists in that effort, identifying in particular the due process principles that govern and limit punitive damage awards. The article also identifies litigation strategies available to reduce corporate exposure to, and liability for, punitive damages. Consistent with the dictates of *State Farm*, it concludes by offering a series of non-litigation law reforms that corporations might support to strengthen and complement *State Farm*'s due process protections.

[†] This article is submitted by the authors on behalf of the FDCC Drug, Device and Biotech Section. Special thanks go to William Northrip and Scott Kaiser, associates at Shook, Hardy and Bacon L.L.P., whose contributions helped make this article possible.

¹ 538 U.S. 408 (2003).



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II.

DUE PROCESS ASSISTANCE TO CORPORATE DEFENDANTS

With its opinion in *State Farm*, the Supreme Court cited several principles that can assist corporate counsel in defending against punitive damage claims. The Court focused on issues affecting jury instruction and the admissibility of misconduct evidence, which have adverse impact upon corporate defendants in the trial courts. The Court also established a context for these issues by clarifying the guideposts in *BMW of North America v. Gore*,² providing lower courts with clearer directives for review of punitive damage awards.³

A. *The Supreme Court's Approach – Refine and Clarify the Gore Guideposts*

1. Reprehensibility

Critical to its analysis and to the general premise of corporate defense, *State Farm* stressed the high level of reprehensibility required before punitive damages can be used to punish corporate misconduct. In that regard, the Supreme Court emphasized that the reprehensibility of a defendant's conduct is "[t]he most important indicium of reasonableness" of a punitive damage award.⁴ Thus, when analyzing reprehensibility, courts should consider whether: (1) "the harm caused was physical as opposed to economic;" (2) the conduct

² 517 U.S. 559, 575 (1996).

³ Laura Clark Fey, Scott D. Kaiser & William F. Northrip, *The Supreme Court Raised Its Voice: Are the Lower Courts Getting the Message? Punitive Damages Trends after State Farm v. Campbell*, 56 BAYLOR L. REV. 807 (2004).

⁴ *State Farm*, 538 U.S. at 419 (quoting *BMW*, 517 U.S. at 575).



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evinced “an indifference to or a reckless disregard of the health or safety of others;” (3) the target of the conduct was financially vulnerable; (4) the conduct was repeated or isolated, and (5) the harm resulted from “intentional malice, trickery, or deceit” or was accidental.⁵ In addition, the Court stated that a jury may not award damages to punish conduct that bears no relationship to the plaintiff’s harm: “A defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business.”⁶

2. Ratio

State Farm’s ratio guidepost assists corporate counsel by using a multiple of compensatory damages to impose an outer limit on the amount of punitive damages. Although the Supreme Court declined to “impose a bright-line ratio which a punitive damages award cannot exceed,” it noted that “few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.”⁷ On the other hand, greater ratios “may comport with due process where ‘a particularly egregious act has resulted in only a small amount of economic damages.’”⁸ And a lesser ratio, “perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee” when substantial compensatory damages are awarded.⁹

⁵ *Id.*

⁶ *Id.* at 423.

⁷ *Id.* at 425.

⁸ *Id.* (quoting *BMW*, 517 U.S. at 581–82).

⁹ *Id.* at 425.

3. Comparable Penalties

Like its ratio guidepost, *State Farm's* comparable penalties guidepost offers additional assistance by establishing a reference point from which to judge the constitutionality of a punitive damage award. The Supreme Court stressed that lower courts must examine the difference between a punitive award and the civil penalties authorized or imposed in comparable cases. Although courts have cited to and compared criminal penalties in the past, the Court noted in *State Farm* that while “[t]he existence of a criminal penalty does have bearing on the seriousness with which a State views the wrongful action,” it has “less utility” in determining the amount of a punitive damage award.¹⁰

4. Dissimilar Conduct

State Farm's discussion of dissimilar conduct is likewise helpful by limiting the type of corporate conduct punishable by an award of punitive damages. *State Farm* holds that a defendant may be punished only for conduct having “a nexus to the specific harm suffered by the plaintiff.”¹¹ “A defendant’s dissimilar acts, independent from the acts upon which liability was premised, may not serve as the basis for punitive damages. A defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business.”¹²

This oft-cited *State Farm* nexus requirement in fact offers a test for whether conduct is sufficiently similar to warrant punishment. The “evidence of other acts need not be identical;” rather, it must be “similar to that which harmed the [plaintiff].”¹³ In *State Farm*, the Utah courts had erred by failing to apply this nexus requirement since they “awarded punitive damages to punish and deter conduct that bore no relation to the Campbells’ harm.”¹⁴

5. Out-of-State Conduct

In the same manner, *State Farm's* discussion of out-of-state conduct serves to limit the kind of conduct for which a corporate defendant can be punished by an award of punitive damages. Reaffirming *Gore's* ruling that “[a] State cannot punish a defendant for conduct that may have been lawful where it occurred,” the Supreme Court in *State Farm* found that lawful out-of-state conduct may not be used to support the imposition of punitive damages.¹⁵ Moving beyond *Gore*, however, the Supreme Court also addressed punishment based on unlawful out-of-state conduct, an issue left unanswered in *Gore*.¹⁶ In *State Farm*, the

¹⁰ *Id.* at 428.

¹¹ *Id.* at 422.

¹² *Id.* at 422–23.

¹³ *Id.* at 423–24.

¹⁴ *Id.* at 422.

¹⁵ *Id.* at 421 (citing *BMW*, 517 U.S. at 572).

¹⁶ *BMW*, 517 U.S. at 573 n.20 (1996) (“[W]e need not consider whether one State may properly attempt to change a tortfeasor’s *unlawful* conduct in another State.”).

Supreme Court observed generally that a state has no “legitimate concern in imposing punitive damages to punish a defendant for unlawful acts committed outside of the State’s jurisdiction.”¹⁷ Thus, a general rule emerges indicating that out-of-state conduct — whether lawful or unlawful — may not be used as a basis for awarding punitive damages.

Notwithstanding this general limitation, the Supreme Court did allow an exception (with the requisite nexus to plaintiff’s harm) for the limited purpose of proving reprehensibility: “Lawful out-of-state conduct may be probative when it demonstrates the deliberateness and culpability of the defendant’s action in the State where it is tortious, but that conduct must have a nexus to the specific harm suffered by the plaintiff.”¹⁸ While the majority did not elaborate on this measure, it did cite *BMW v. Gore*, which offers that out-of-state conduct “may be relevant to the determination of the degree of reprehensibility of the defendant’s conduct.”¹⁹ Moreover, in her *State Farm* dissent, Justice Ginsburg suggested that the reference to “deliberateness and culpability” is another way of asking whether “the harm was a result of intentional malice, trickery or deceit, or mere accident” — the factors likewise contained in the reprehensibility analysis.²⁰ Accordingly, *State Farm* implies that out-of-state conduct with the requisite nexus to plaintiff’s harm may be used to prove reprehensibility (though not for the purpose of imposing punishment) by showing that the conduct in the case at hand was, for example, a “repeated action” or committed with “intentional malice.”²¹

¹⁷ 538 U.S. at 421.

¹⁸ *Id.* at 422.

¹⁹ *BMW*, 517 U.S. at 574 n.21.

²⁰ *State Farm*, 538 U.S. at 437 (Ginsburg J., dissenting) (internal quotations omitted).

²¹ *Id.* To appreciate the distinction between proving reprehensibility and imposing punishment, consider the following example. In *Sand Hill Energy, Inc. v. Smith*, 142 S.W.3d 153 (Ky. 2004), the court vacated and remanded a \$15 million punitive damage award in a wrongful death action against Ford Motor Company because the trial court failed to instruct jurors that they could not punish the company based on out-of-state conduct. At the trial, nationwide evidence had been introduced concerning the numbers of vehicles sold with defective transmissions, similar incidents of actual malfunctions, and individuals killed. While the court noted that there was a nexus between those nationwide acts and the specific harm suffered by the plaintiff, the court held that those acts should have been considered only to “determin[e] Ford’s culpability,” and found that a new trial was necessary because there were “no limitations on extraterritorial punishment.” *Id.* at 157. In ordering a new trial, the court suggested that an instruction providing a “safeguard from extraterritorial punishment” would resemble the following jury instruction provision:

Evidence of Ford Motor Company’s conduct occurring outside Kentucky may be considered only in determining whether Ford Motor Company’s conduct occurring in Kentucky was reprehensible, and if so, the degree of reprehensibility. However, you must not use out-of-state evidence to award the Estate of Tommy Smith punitive damages against Ford Motor Company for conduct that occurred outside Kentucky.

Id. at 167.

III. LITIGATION STRATEGIES

A. *Addressing Punitive Damage Claims in the Answer*

1. Challenging the Constitutionality of Punitive Damages

A corporate defendant's challenge to the constitutionality of punitive damages begins with its answer. By asserting in an affirmative defense that an award of punitive damages will violate procedural due process, substantive due process or its equal protection rights, a corporate defendant demonstrates at the outset that it intends to vigorously challenge any punitive damage claims. The parameters articulated in *State Farm* provide the framework for making this constitutional challenge. Thus, a corporate defendant should consider raising the following defenses in its answer: (1) there can be no punishment for legal conduct, such as the mere selling of a legal product;²² (2) punishment may not be based on a corporate defendant's extraterritorial conduct;²³ (3) the existing pattern jury instructions provide unconstitutional standards for determining punitive damages;²⁴ and (4) punitive damages expose the corporate defendant to multiple punishments and fines for the same act.²⁵

2. Raising Substantive State Law Issues

The answer also provides a corporate defendant with the first opportunity to emphasize the high burden of proof placed on any plaintiff who will succeed on a claim for punitive damages under the respective state law.²⁶ Thus, depending on the law of the forum

²² *State Farm*, 538 U.S. at 421. ("A State cannot punish a defendant for conduct that may have been lawful where it occurred.")

²³ *Id.* ("Nor, as a general rule, does a State have a legitimate concern in imposing punitive damages to punish a defendant for unlawful acts committed outside of the State's jurisdiction.")

²⁴ *Id.* at 418 ("Vague instructions, or those that merely inform the jury to avoid 'passion or prejudice' . . . do little to aid the decision maker in its task of assigning appropriate weight to evidence that is relevant and evidence that is tangential or only inflammatory.")

²⁵ *Id.* at 423 ("Due process does not permit courts, in the calculation of punitive damages, to adjudicate the merits of other parties' hypothetical claims against a defendant under the guise of the reprehensibility analysis Punishment on these bases creates the possibility of multiple punitive damages awards for the same conduct; for in the usual case nonparties are not bound by the judgment some other plaintiff obtains.")

²⁶ *See, e.g., Letz v. Turbomeca Engine Corp.*, 975 S.W.2d 155, 164 n.5 (Mo. Ct. App. 1997) ("Because punitive damages are extraordinary and harsh, the Missouri Supreme Court recently concluded that the higher 'clear and convincing' standard of proof is required The clear and convincing standard of proof does not apply to this case, however, because the issue was not raised or preserved.")

state, the affirmative defenses might include a claim that the plaintiff cannot present evidence sufficient to overcome the exceedingly high burden of proof required to support his or her punitive damage claim.

B. *Striking Punitive Damage Claims*

A corporate defendant also should seek to strike punitive damage claims where appropriate. Moreover, to the extent that the following arguments do not coincide with the common law of a particular state, they may be raised as good-faith arguments to change the law.

1. Defendant's Conduct Is Not Sufficiently Reprehensible

Motions to strike punitive damages should focus on the specific state's underlying requirements for punitive damages. Currently, state standards prescribing the conduct necessary to support punitive damages run from "gross negligence" to "actual malice." Punitive damages are meant to punish the most egregious misconduct. Claims based on strict products liability theories generally will fall short of this requirement. This is particularly true when the product is heavily regulated, must meet governmental safety standards, or must be approved by a governmental body. If facts support the position, a corporate defendant should argue that its conduct, as alleged by the plaintiff in the particular case, does not justify a punitive award. Conduct that is not reprehensible cannot support punitive damages. Thus, mere negligence should fall short of this standard as well.

2. Punitive Damages Would Create Multiple Punishments

The Supreme Court in *State Farm* determined that punitive damage awards based on evidence of harm to nonparties are improper because they create the possibility of multiple punitive damage awards for the same conduct. A corporate defendant who already has paid punitive damages should seek to strike punitive damage claims in future cases based on multiple punishment. The corporate defendant should argue that multiple punishments contravene the goals of punishment and deterrence. One award of punitive damages is sufficient to accomplish both goals, and any subsequent award would lead to over-deterrence and excessive punishment. This argument is particularly appropriate in the context of products liability litigation since a corporate defendant may be punished repeatedly through different individual judgments for the same product design or warnings.²⁷

²⁷ For further discussion of the problems caused by multiple punitive damage awards based on the same conduct, see Victor E. Schwartz & Leah Lorber, *Death by a Thousand Cuts: How to Stop Multiple Imposition of Punitive Damages*, National Legal Center for the Public Interest, Perspectives on Legislation, Regulation, and Litigation, No. 12 (2003), available at <http://www.nlcpi.org/books/pdf/Briefly-Dec03.pdf>.

3. Punitive Damages Are Not Necessary

Punitive damages are only justified to punish or deter. When circumstances have changed so that the likelihood of repeated misconduct is low, and the need for punishment has diminished, the corporate defendant should seek to strike punitive damages because they are not necessary for deterrence. A variety of factors can contribute to changed circumstances. These include the passage of time, previous punitive damage awards, a change in management or personnel, the discontinuation of a product line, or a product recall. Particularly in the context of a fraud claim, external factors such as widespread disclosure and dissemination of the allegedly concealed or misrepresented information can make continued perpetration of the same alleged fraud impossible. Punishment is not necessary when a corporation is no longer selling the disputed product or when the persons who managed the company when the conduct took place are no longer with the company. When circumstances have changed, a corporate defendant should seek to have punitive damage claims dismissed because they are no longer “reasonably related to the goals of deterrence and retribution.”²⁸

C. *Excluding or Limiting Use of Certain Punitive Damage Evidence*

1. *State Farm* and Punitive Damage Evidence

State Farm requires that trial courts exclude or limit certain types of punitive damage evidence. The forum state cannot punish a corporate defendant for conduct occurring outside that state, or for conduct that was lawful where it occurred.²⁹ *State Farm* recognizes that a defendant risks being punished repeatedly for the same conduct if juries routinely are permitted to hear evidence of other claims against the same defendant. For evidence of other bad acts to be admissible, there must be a nexus with the specific harm the plaintiff suffered.³⁰ Finally, a corporate defendant’s wealth can never be used to justify an otherwise unconstitutional award.³¹

²⁸ *Pac. Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 21 (1991).

²⁹ *State Farm*, 538 U.S. at 421 (“A State cannot punish a defendant for conduct that may have been lawful where it occurred.”).

³⁰ *Id.* at 422 (“[C]onduct must have a nexus to the specific harm suffered by the plaintiff.”).

³¹ *Id.* at 427 (“The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award.”).

2. Consideration of Various Motions *In Limine*

Motions *in limine* should be filed at the outset to control the admissibility of unconstitutional punitive damage evidence. Such motions also can be used as a vehicle for educating a court on *State Farm* limitations or state-law jurisprudence regarding the application of punitive damages to a particular case *before* the litigation enters its final stages. For example, a corporate defendant should consider filing motions that seek to exclude the following: (1) evidence of the corporate defendant's out-of-state business or sales practices; (2) evidence of the corporate defendant's nationwide net worth; (3) arguments for punitive damages that exceed the compensatory damage award (e.g., a 1:1 ratio between punitive and compensatory damages); (4) evidence unrelated to plaintiff's alleged harm; (5) evidence regarding plaintiff's intended use of any punitive damage award; (6) statements that the jury should increase its award as a "safety valve" in the event the award is later reduced; and (7) statements urging the jury to punish lawful conduct (i.e., selling a lawful product). Defense counsel also should object to introduction of that evidence during trial, or request limiting instructions as necessary and appropriate.

D. Proposing *State Farm*-Compliant Jury Instructions

State Farm provides corporate defendants with the opportunity to argue for more specific jury instructions, since the Supreme Court criticized vague instructions in *State Farm*.³² Subsequent lower-court decisions have held that jury reform is necessary to make state instructions comport with *State Farm*. Many states have adopted pattern jury instructions from which trial courts typically will not deviate. In states with pattern jury instructions, initiatives should be taken with the drafters to make those instructions compliant with *State Farm*. Furthermore, while trial judges in these states may reject a *State Farm*-compliant jury instruction that deviates from the pattern instruction, *State Farm*-compliant instructions nevertheless should be proposed at trial in order to preserve any appellate argument that the state pattern instructions are unconstitutional. In states where trial judges have greater flexibility, defense counsel must be prepared to propose and vigorously argue for *State Farm*-compliant punitive damage jury instructions. Defense counsel also must be aware that the instructions proposed, like the themes adopted and the arguments advanced, may differ depending on whether the trial is bifurcated. Because many of the instructions imperative to mitigating a punitive damage award hinge on the evidence presented during the liability phase of a bifurcated trial, a corporate defendant should prepare its proposed jury instructions well before trial, carefully considering the type of evidence necessary to assure that a factual basis is laid to support those instructions.

³² *Id.* at 417 ("Jury instructions typically leave the jury with wide discretion in choosing amounts, and the presentation of evidence of a defendant's net worth creates the potential that juries will use their verdicts to express biases against big businesses, particularly those without strong local presences.") (internal quotations omitted).

The issues surrounding punitive damages often are confusing. Jury instructions should guide the jury and should be written in lay terms to the extent possible. Instructions also should be concise and to the point, imparting the legal framework necessary to render a verdict. A corporate defendant must appreciate the dynamics between jury instruction format and the process by which jurors make decisions. Ideally, punitive damage instructions should frontload threshold issues, making it clear that the analysis need proceed no further unless the jurors respond affirmatively to the threshold issues. Using this approach avoids jury confusion and prevents threshold issues from becoming lost in the debate about reprehensibility and the size of a punitive award. Given these concerns, a corporate defendant should consider addressing the following factors in its proposed jury instructions.

1. Punitive Damages Are Not Favored

Juries should be instructed that punitive damages are not favored; they are an extraordinary remedy for extraordinary conduct.³³ Jurors should know that the plaintiff is not entitled to an award of punitive damages just because the jury finds an entitlement to compensatory damages. Juries should be instructed that the plaintiff receives complete compensation by an award of compensatory damages, and it is permissible for them to award no punitive damages at all. Accurate and precise instructions also should articulate the burden of proof necessary for the plaintiff to succeed on the punitive damage claim, reminding the jury about the high degree of reprehensibility plaintiff must show before the defendant's conduct can be sanctioned by a punitive award. The instructions should emphasize in plain language that an assessment of punitive damages is not required simply because the plaintiff has made such a claim.

2. High Standard for Any Punitive Award

A corporate defendant should ensure that jury instructions focus on the proper standards for awarding punitive damages. These standards differ from state to state. Punitive damage standards run from gross negligence to intentional malice. A growing number of states have adopted a clear-and-convincing evidentiary standard. Juries should be advised that if the plaintiff cannot meet these standards, no award of punitive damages is permissible.

³³ *Id.* at 419 (“[P]unitive damages should only be awarded if the defendant’s culpability, after having paid compensatory damages, is so reprehensible as to warrant the imposition of further sanctions to achieve punishment or deterrence.”).

3. Punitive Damages May Be Unnecessary

Juries should be instructed that punitive damages exist to punish and deter. If these goals are adequately served by the compensatory damage award, there is no need for punitive damages. Furthermore, in *State Farm*, the Supreme Court recognized that some forms of compensatory damages, such as damages for emotional distress, contain a punitive element.³⁴ If appropriate, a corporate defendant should argue for an instruction about the deterrent effect provided by an award of compensatory damages. Furthermore, jurors should be reminded that the plaintiff will be made whole by the imposition of a compensatory award, and a punitive damage award may not be made for the purpose of providing additional compensation to the plaintiff.

4. No Punitive Damages for Lawful Conduct

Some jurors may believe that, although lawful, the conduct of the corporate defendant should be outlawed. It is therefore important that jurors are instructed not to award punitive damages for lawful conduct. *State Farm* reinforces that a jury may not punish a defendant for lawful conduct.³⁵

5. Reasonable Relationship Between Harm Suffered and Punitive Damages

In accord with *State Farm*, jurors should be instructed that a punitive damage award must be reasonably related to the harm plaintiff suffered. Juries cannot base their punitive damage awards on speculation or on arbitrary factors. *State Farm*'s ratio guideline assists in keeping the jury properly focused on the relationship between punitive damages and the harm suffered by the plaintiff. If the punitive damage award is based on factors such as the

³⁴ *Id.* at 426. The Court stated the following:

The compensatory damages for the injury suffered here, moreover, likely were based on a component which was duplicated in the punitive award. Much of the distress was caused by the outrage and humiliation the Campbells suffered at the actions of their insurer; and it is a major role of punitive damages to condemn such conduct. Compensatory damages, however, already contain this punitive element.

Id.

³⁵ *Id.* at 421 (“A State cannot punish a defendant for conduct that may have been lawful where it occurred.”).

defendant's profit, harm to persons other than the plaintiff, or the net worth of the defendant, the jury's award may have no relationship to the harm suffered and may be unconstitutional.³⁶

6. Wealth and Net Worth

Juries should be instructed that they cannot use the wealth of a corporate defendant to justify an excessive punitive damage award. Under *State Farm*, the wealth of the defendant cannot justify an otherwise unconstitutional award. Despite this proscription, some courts still allow juries to consider net worth when fixing an award of punitive damages. In those jurisdictions, a corporate defendant should consider arguing for instructions informing the jury that it cannot base its punitive damage award solely on the defendant's wealth, and that the punitive damage award cannot be excessive when compared to the plaintiff's harm. Corporate defendants might even propose an instruction suggesting that jurors can consider wealth only for purposes of determining a punitive damage amount within a range of constitutional amounts that are controlled by their ratio to compensatory damages.

7. Out-of-State Conduct

In cases where evidence of a corporate defendant's out-of-state conduct is admitted, the jury should be instructed that it may not award an amount of punitive damages to punish the defendant for out-of-state conduct. The instruction should explain to jurors that the out-of-state conduct cannot be used as an independent basis for punishment by punitive damages.³⁷ Under *State Farm*, a state has no interest in punishing a defendant for out-of-state conduct. The jury therefore must understand that it cannot punish the corporate defendant for any alleged harm to persons in other states.

³⁶ While ratio is a helpful tool for explaining that a reasonable relationship is required between the harm suffered and punitive damages, plaintiffs may cite *State Farm*'s "harm, or potential harm" language to "pump up" the compensatory side of the ratio with potential harm or other damages not reflected in the jury's compensatory award. See Editorial, *Punitive Justice*, WALL ST. J., Dec. 1, 2003, at A14 ("[T]he tort bar and activist courts turned their clever minds to figuring out ways to skirt [*State Farm*]. One popular strategy has been to add in all kinds of creative 'damages' to the compensatory portion of awards, thereby pumping up the base number and justifying much larger punitive handouts."). This tactic of plaintiffs is designed to keep the punitive-to-compensatory ratio within the constitutionally permissible single digits. In *Alabama v. Exxon Corp.*, the court considered Exxon's motion for remittitur based on \$102.8 million in compensatory damages and \$11.8 billion in punitive damages – a punitive-to-compensatory damages ratio of almost 115:1. See No. 99-2368, slip op. at 1 (Montgomery County Ct., Ala. Mar. 29, 2004). But only \$45.5 million of the \$102.8 million was attributable to fraud; the remaining damages were allocated for breach of contract. *Id.* In applying *State Farm*, the court examined the potential harm "likely to result" from Exxon's fraud. *Id.* at 50. After remitting the punitive damages to \$3.5 billion, the court concluded that the true ratio was only 3.75:1, after \$930 million in "anticipated gains" (i.e., potential harm) was considered. *Id.* at 57. The court concluded that the ratio was constitutional because it was approximately 3.75:1 – the ratio of \$3.5 billion to \$930 million.

³⁷ See, e.g., discussion *supra* in Part II A.5.

8. Punishing Only for Harm to the Plaintiff

If the court allows evidence of harm to persons other than the plaintiff, a corporate defendant should propose instructions noting that harm to persons other than the plaintiff may not be used to calculate the corporate defendant's punishment. It is important for jurors to understand the limitations on the consideration of conduct affecting other persons in determining the reprehensibility of the corporate defendant's conduct toward the plaintiff.³⁸ *State Farm* emphasized that punitive damages may only punish a defendant for harm to the plaintiff.

E. *Developing Winning Themes and Revisting Those Themes*

A corporate defendant must develop compelling themes for its punitive damage cases. These themes must be woven into *voir dire*, presented in opening statements and re-emphasized throughout the trial. They should be reiterated and driven home in closing arguments. Themes should be carefully selected based on the facts of the case — a winning theme in one case can be a loser in another. Defense counsel should be aware of the facts and of the strengths and weaknesses of particular themes before selecting them in a particular trial. The themes outlined below may hold a certain potential.

1. No Windfall to Plaintiff

Jurors may be disinclined to financially reward a plaintiff who is viewed as undeserving. In some cases, it makes sense, therefore, to communicate the concept that a large punitive damage award will only offer a windfall to the plaintiff, who has been fully compensated already in the liability phase for his or her injuries.

2. Vigorous Defense of Corporate Conduct

If the facts are present, counsel should vigorously defend the corporate conduct throughout trial. There is strong empirical evidence suggesting that liability drives punitive damages, and that a corporate defendant's punitive damage case must begin at the liability stage with a vigorous defense of the corporate conduct, insofar as that conduct can be credibly defended.

3. "Mea Culpa"/Changed Conduct

If the facts demonstrate that relevant company conduct has changed for the better over time, counsel may want to consider a "mea culpa" or changed conduct approach. Existing empirical evidence indicates that demonstrating a break with past conduct or implementing correctional policies and practices can assuage juror anger and eliminate the need for punitive damages as a means of deterring future misconduct. On the other hand, this approach

³⁸ For an example of such an instruction, see the discussion of *Sand Hill*, *supra* note 21.

may meet with skepticism if the corporate defendant suffers from compromised credibility. Jurors may view even substantive changes as hollow gestures if they believe them to be motivated by expediency rather than a sincere repudiation of the past. In addition, although it may obviate the need to deter future misconduct, this approach does little to address the punishment aspect of punitive damages.

4. Message Received

If the facts support it and the corporate defendant agrees, counsel should consider arguing that the corporate defendant has “gotten the message” communicated by jurors via the compensatory verdict awarded in the case. (Of course, this theme can be utilized only in a bifurcated trial where liability is decided in the first phase of the trial and the amount of punitive damages is decided subsequently). When this approach is taken, counsel must be certain that the corporate defendant’s actions, press releases, and appellate strategy are consistent with this theme.

F. *The Punitive Damages Argument*

Closing argument at the end of trial, or at the end of the punitive damages phase of a bifurcated trial, provides one last opportunity to counter a large award of punitive damages. The argument should revisit defendant’s primary themes, introduce the jury to key jury instructions, weave in key defense evidence, and lay the roadmap for the jury to follow in deciding against punitive damages (or depending on the stage of the trial, against awarding a large amount of punitive damages). While the punitive damages argument will, of course, largely be dictated by the facts of the particular case, a good argument should incorporate a few general strategies and themes.

1. Provide Clarity and Limits

The punitive damage phase of a bifurcated trial can be more confusing than at any other trial phase because the punitive damage jury instructions often are incomprehensible. Where jurors are confused, they are apt to superimpose their own ideas onto the legal framework with the “likely” result of a higher punitive damage award. It is therefore imperative for defense counsel to provide structure, clarity and limitations to the extent that is possible.

2. Empower the Jurors to Say “No”

Jurors should be reminded that punitive damages are disfavored. Therefore, it is acceptable to award no punitive damages even when the evidentiary predicate for an award has been established.

3. Explain the Make-Up of “The Company”

Some jurors may have limited awareness of how a large company operates, or the potential effects of a large punitive damage award on a company, its shareholders and consumers. Particularly in the context of a publicly held company, it may be helpful to

address the ownership profile of the corporate defendant, especially if that ownership is largely composed of mutual funds (including funds owned by persons in the community) and institutional investors, as opposed to corporate “insiders.” The fact that a company employs thousands, or even tens-of-thousands, of “real people” also may be useful to bring before the jury. Courts should allow a corporate defendant to explain “who the company is” so that the jury understands who is being punished.

4. Be Passionate

Plaintiffs’ lawyers are often masters at arguing with passion. A closing argument presents defense counsel with the same opportunity to be passionate in defense of the corporate client. Often, the defendant is a good corporate citizen with a good story to tell regarding its conduct. In such circumstances, counsel should passionately defend their client.

5. Appeal to Reason

At the same time, defense counsel should appeal to the jurors’ reason by stressing their charge to follow the law as instructed, reminding them to base their verdict on the evidence and to resist plaintiff’s rhetoric and emotional appeals. Even in this situation, defense counsel can be passionate while appealing to reason.

IV.

OTHER STRATEGIES FOR LIMITING CORPORATE PUNITIVE LIABILITY

A. *Company Conduct Solutions*

First, corporations must be aware of the types of conduct and records that support an award of punitive damages. Company policies should demonstrate that the company has high expectations regarding appropriate employee conduct. Company policies and communications should accurately and fully set forth their intended message so as to minimize the likelihood of future misinterpretation.

B. *Other Non-Litigation Solutions*

Secondly, corporations should consider supporting legislative initiatives aimed at reasonable measures to limit punitive damage awards. These efforts are best focused on state legislatures, but counsel may pursue arguments for changing the law in the trial and appellate courts. In that regard, the following reform initiatives hold some potential.

1. Eliminate Punitive Damages Where the Product Conforms with Government Standards

Punitive damages should not be available when a corporate defendant’s product complies with federal regulations or has been approved by a governmental agency. For example, the New York State Assembly recently considered and referred to the judiciary a bill that would prohibit punitive damages against the makers of drugs or medical devices that

have acquired FDA approval.³⁹ This bill can be used as a model in other states for similar legislation. Notwithstanding the example, however, these reforms need not and should not be limited to the context of prescription drugs. Many products are subject to governmental regulation and must conform to government standards. A manufacturer who conforms to these regulations and standards in good faith should not later be liable for punitive damages when that product is used as allowed.

2. Seek a Statute of Repose on Punitive Damages

Corporations should consider encouraging state legislatures to adopt statutes of repose that limit the time period during which a defendant may be subject to punitive damages for its conduct. To serve the goals of deterrence and punishment, punitive damages should be temporally related to the reprehensible conduct. There is little sense in punishing a corporate defendant for conduct that took place many years ago if the employees and supervisors involved have left and company policies have changed. A statute of repose does not harm the plaintiff who will still receive complete compensation through compensatory damages. At the very least, the age of the misconduct and the absence of wrongdoers in the current company hierarchy should be mitigating factors in calculating any punitive damage award.

3. Raise the Standard for Punitive Damages

Punitive damages developed as part of the common law surrounding intentional torts. Over time, the intent requirement has dissipated and has been replaced by a variety of lesser standards. Corporations should consider asking state legislatures to raise their punitive damage standards so that those standards more closely reflect historical intentional tort requirements. When punitive damages are used to punish unintentional conduct, they create the potential for over-deterrence, leaving corporate defendants with little or no ability to control their exposure to ruinous judgments. To the extent that states allow punitive damages for less than intentional acts, the corporate defendant's liability should be absolutely clear before punitive damages are recoverable.

4. Raise the Burden of Proof for Punitive Damages

Several states have considered legislation that raises the burden of proof on a punitive damage claim from preponderance of the evidence to clear and convincing evidence. Many states already embrace this higher standard. In other states where similar efforts are underway, those efforts should be supported.

³⁹ See Bill No. A04476, NY Assembly (2004), available at <http://assembly.state.ny.us/leg/?bn=A04476> (last visited Dec. 29, 2004).

5. Implement Punitive Damage Limitations

Corporations also should consider supporting efforts to set appropriate limits on the amount of punitive damage awards. *State Farm's* ratio provisions provide corporate defendants with additional authority to argue for tort reform legislation that limits the amount of punitive damages to a fixed multiple of compensatory damages. Several states have considered and adopted such reforms.⁴⁰ Although punitive damage caps linked to a multiple of compensatory damages are helpful and should be considered, they may lose their value if the plaintiff's counsel attempts to circumvent those reforms by inflating compensatory damages. Addressing this problem to some extent will involve seeking traditional damage caps that also serve as an absolute maximum for punitive damages. While a few states have adopted rigid punitive damages caps,⁴¹ there is need for greater reform in this area.

V. CONCLUSION

Punitive damages stand at the forefront of important litigation issues facing corporations today. In the last two decades, punitive damage awards have skyrocketed and appeared with greater frequency. The Supreme Court's decision in *State Farm v. Campbell* provides useful refinements on the principles and guidelines that circumscribe this trend, and numerous lower courts have reduced the size of punitive damage awards in the wake of the *State Farm* decision. Corporate defendants should embrace *State Farm's* guidelines as welcome tools in defending against punitive damage claims.

⁴⁰ See, e.g., COLO. REV. STAT. § 13-21-102 (2004) (limiting the amount of punitive damages to no more than the amount of compensatory damages); CONN. GEN. STAT. § 52-2406 (2004) (limiting punitive damage awards to twice compensatory damages).

⁴¹ See, e.g., VA. CODE § 8.01-38.1 (2004).

FUTURE MEETINGS

2005

ANNUAL 2005

Sunday, July 17 – Sunday, July 24

La Costa Resort and Spa
Carlsbad, California

WINTER 2006

Sunday, March 5 – Sunday, March 12

Hyatt Regency Lake Las Vegas Resort, Spa & Casino
Las Vegas, Nevada

ANNUAL 2006

Sunday, July 23 – Sunday, July 30

Fairmont Southampton
Southampton, Bermuda

2006

2007

WINTER 2007

Sunday, February 25 – Sunday, March 4

Fairmont Scottsdale Princess
Scottsdale, Arizona

ANNUAL 2007

Sunday, July 22 – Sunday, July 29

Sun Valley Resort
Sun Valley, Idaho

Punitive Damages: A National Trend

Edward B. Ruff, III
Michael A. Hayes

I. HISTORY OF PUNITIVE DAMAGES

The modern concept of punitive damages developed in Thirteenth Century England. Amercements and monetary penalties were imposed at the discretion of the court or a lord, or were arbitrarily assessed by the peers of delinquent taxpayers. This system led to abuses later to be countered by provisions in the Magna Carta requiring a reasonable, proportional, and sensible relationship between the offense and its consequential punishment. Such provisions were justified by the offender's need to continue to earn a living in his trade. The Eighth Amendment to the United States Constitution was based upon these provisions of the Magna Carta. Punitive damages were first and formerly recognized by the United States Supreme Court in 1818; however, punitive damage demands were rare until recent years. If punitive damages were sought, they were usually denied by the court prior to trial.

II. THE CURRENT TREND

Punitive damage awards are an ever-present possibility in the world of tort litigation. Plaintiffs actively seek them. The United States General Accounting Office conducted a study of 305 product liability cases filed in five states during the mid-1980's. Of those cases surveyed, 108 (35%) sought punitive damages.¹ Thus, for the trial practitioner, the availability of punitive damages within the trial courts has become a fact of life. In the past, punitive damage awards were limited to outrageous acts or other intentional or reckless acts of great consequence. However, these parameters shifted in the late 1950's and early 1960's. As the consumer movement gained strength, large companies were subject to punitive damage awards for unsafe or impure products arising from design defects, testing or manufacture, or for their failure to warn consumers of known or inherent risks.

¹ *Product Liability: Verdicts and Case Resolution in Five States*, GAO/HRD-89-99.



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Ruff was a mechanical engineer for one year in heat transfer technology, successfully passing examination requirements as a licensed professional engineer. Mr. Ruff is a member of the Chicago, Illinois (Lecturer and Committee Chair) and American Bar Associations (Product Liability and TIPS Committees); the American Society of Mechanical Engineers; the Defense Research Institute (Product Liability and Environmental Committee); the Seventh Circuit Bar Association (Administrative and Justice Committees); the Illinois Association of Defense Counsel (Committee Chair, Fall, 1997 Seminar and Lecturer), the Federation of Defense & Corporate Counsel (Products Liability, Mass Tort, Environmental Committees and Lecturer 1998), and the Society of Trial Lawyers.

Modern business has felt the affects of these increased punitive damage awards, especially as punitive damages have grown to exceed by many times the compensatory damages awarded. Since a defendant's financial status is often scrutinized by the plaintiff in court to support these awards, the jury is given to understand the defendant's wealth, creating an opportunity to "send a message" to the defendant by means of a large punitive damage verdict.

The United States Supreme Court has recognized the escalating problem of runaway punitive verdicts in two noteworthy decisions, issued within the last several years:

- *Honda v. Oberg*,² (the Supreme Court ruled that, as a matter of federal constitutional law, judicial review of the amount of a punitive award assessed by a jury is required).

² 512 U.S. 415 (1994).



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- *BMW of North America v. Gore*,³ (the Supreme Court held that a \$2 million punitive damage verdict against BMW was unconstitutionally excessive, outlining general guidelines for reviewing courts when evaluating whether a punitive damage award is excessive.

Both of these decisions demanded that reviewing courts articulate a meaningful basis for affirming an award for punitive damages.

State legislatures reacted by passing laws that limit the frequency and size of punitive damage verdicts. The following restrictions exemplify the type of statute most frequently enacted: (1) defendant must have acted with malice; (2) plaintiff must prove the required conduct by clear and convincing evidence; (3) a monetary ceiling is placed on punitive damage awards; (4) trials are bifurcated, and (5) punitive damage awards are apportioned for some placement in a state fund.

III. SEVERITY AND FREQUENCY OF PUNITIVE DAMAGES

Since the late 1970's, several punitive damage verdicts have been highly publicized. Texaco was subject to a \$10 billion punitive award for tortious interference in the merger between Getty Oil Company and Pennzoil Company in 1986.⁴ As a result, Texaco filed for bankruptcy. In 1978, the jury awarded a punitive verdict of \$120 million in a personal

³ 517 U.S. 559 (1996).

⁴ 784 F.2d 1133 (2d Cir. 1986).

injury case. *Grimshaw v. Ford Motor Co.*⁵ involved but a single injured claimant. The case tested automobile crash worthiness and resulted in an enormous verdict against Ford.

A. *Rand Corporation Study*

The Rand Corporation's Institute for Civil Justice conducted a study of the mean punitive damage verdicts in San Francisco County, California, and in Cook County, Illinois, over the course of the 1980's. This study found that in San Francisco County, the median punitive damage award was \$63,000, and in Cook County it was \$43,000.⁶ Moreover, from 1985 to 1994, punitive damages were awarded in 20% of the cases in general and 2% of products liability cases, within selected jurisdictions. The trend demonstrated that punitive damage awards generally increased from 1985 to 1989 and from 1990 to 1994.

Furthermore, in a 1990 article analyzing the future of punitive damages,⁷ the authors predict that the frequency and severity of punitive damages will continue to increase. This increase will be evident especially in bad faith, medical malpractice, and products liability claims.

B. *Early Frequency of Punitive Damages*

In a similar five-state study of 305 product liability cases from 1983 to 1985, alluded to earlier, the United States General Accounting Office found that compensatory damages were awarded in only fifty-five of those cases. What's more, punitive damages also were awarded in only twenty-three of those fifty-five (41%) cases.⁸ The punitive damage awards ranged from \$500 to \$7 million. These awards, however, manifested a high correlation between the size of the compensatory damages and the punitive damages. Furthermore, from 1965 to 1980, only six punitive damage awards occurred in products liability cases in Cook County and San Francisco County.⁹

IV.

TRIAL PHASING OF PUNITIVE DAMAGE CASES

A. *Preparing for Appeal*

The United States Supreme Court in *BMW v. Gore* essentially recognized three guideposts for reviewing the size of any punitive damage award:

⁵ 174 Cal. Rptr. 348 (Ct. App. 1981).

⁶ R-3311-ICJ.

⁷ Stephen Daniels & Joanne Martin, *Myth and Reality in Punitive Damages*, 75 MINN. L. REV. 1 (1990).

⁸ *Product Liability: Verdicts and Case Resolution in Five States*, GAO/HRD-89-99.

⁹ *Id.* at 29.

- (1) reprehensibility of the defendant's conduct;
- (2) ratio between punitive and compensatory damages; and
- (3) comparison to fines or penalties assessed for similar conduct.

All of these factors must be evaluated in determining whether the punitive damage award is excessive. Typically, parties will probe all three factors at trial to preserve the appeal of the punitive damage award.

Given these parameters, the most efficient trial strategy occurs in three phases:

- (1) determining liability and compensatory damages;
- (2) determining whether punitive damages are to be awarded; and
- (3) assessing the amount of any punitive damages awarded.¹⁰

Thus, judicial resources are preserved by reserving evidence and testimony regarding punitive damages until a determination is made that liability exists for compensatory damages. The same holds for the amount of the punitive damage award.

B. *Dictating the Trial Phasing*

Eighteen states (Alaska, California, Connecticut, Georgia, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nevada, New Jersey, New York, North Carolina, North Dakota, Oklahoma, Texas, and Virginia) have adopted statutes that codify trial phasing.¹¹ These statutes range in their requirements. Typically, they require that the trial proceed in two to three phases; that the trial proceed in phases if the defendant requests it; that the trial proceed in phases if any party requests it; that the amount of punitive damages be decided apart from liability for punitive damages, and that compensatory and punitive damage liability and/or their respective amounts be decided independently.

Minimizing the potential for bias that attached to information regarding a defendant's wealth was critical to the Supreme Court determination in *Honda v. Oberg*.¹² Punitive damages pose an acute danger of arbitrary deprivation of property. Jury instructions typically leave the jury with wide discretion in choosing amounts, and the presentation of evidence of a defendant's net worth creates the potential that juries will use their verdicts to express biases against big businesses, particularly those without strong local presence.¹³

¹⁰ RICHARD L. BLATT ET AL., PUNITIVE DAMAGES: A STATE-BY-STATE GUIDE TO LAW AND PRACTICE § 1.7 (2004).

¹¹ *Id.*

¹² 512 U.S. 415 (1994).

¹³ *Id.* at 432.

Federal courts are permitted to conduct trials in as many phases as they deem appropriate in the interests of furthering convenience, avoiding prejudice and promoting judicial economy. Most states have adopted Federal Rule of Civil Procedure 42(b), allowing the courts to exercise discretion in this matter. Federal Rule of Civil Procedure 42(b) provides:

The court, in furtherance of convenience or to avoid prejudice, or when separate trials will be conducive to expedition and economy, may order a separate trial of any claim, cross-claim, counterclaim, or third-party claim, or of any separate issue or of any number of claims, cross-claims, counterclaims, third-party claims, or issues, always preserving inviolate the right of trial by jury as declared by the Seventh Amendment to the Constitution or as given by a statute of the United States.

Only Connecticut, Illinois, Louisiana, Nevada, and New Hampshire have failed to adopt a similar provision.

C. *Recovery of Punitive Damages*

There is a similar range of conduct required in order to recover punitive damages against a defendant. The standards typically require malice, conduct more egregious than gross negligence but not requiring proof of malice, or gross negligence. Other conduct may be deemed sufficient as identified by statute or arbitration.

1. Malice

Twelve states employ a standard of malice, defined by statute. These are: Arizona, California, Delaware, Kentucky, Maine, Maryland, Montana, Nevada, North Dakota, Ohio, Rhode Island, and Virginia.¹⁴ An injured party must show that the alleged wrongdoer intended to harm the injured party.

2. Conduct More Egregious than Gross Negligence but Not Requiring Proof of Malice

There are twenty-five states that employ a statutory standard requiring conduct more egregious than gross negligence, exclusive of malice. These are: Alabama, Alaska, Arkansas, Colorado, Connecticut, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Minnesota, Missouri, New Jersey, New Mexico, New York, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Utah, Vermont, Wisconsin, and Wyoming.¹⁵ An injured party must

¹⁴ BLATT, *supra* note 10, § 3.2 (2004).

¹⁵ *Id.*

show that the alleged wrongdoer intentionally acted with wanton or reckless disregard for the rights of others. Proof of culpability exceeding gross negligence is needed, and in many of the states enumerated, proof of gross negligence is sufficient to award punitive damages.¹⁶ This standard is less difficult to meet than the standard of malice because willful indifference, or wanton or reckless conduct, is sufficient to satisfy the standard.¹⁷

3. Gross Negligence

Seven states employ gross negligence as defined by statute. These include: Florida, Illinois, Missouri, North Carolina, Tennessee, Texas, and West Virginia.¹⁸ The injured party must show that the alleged wrongdoer was unusually careless in disregarding the possible injurious consequences that could result from his or her conduct. There is no requirement of showing that the alleged wrongdoer had any intention of harming the injured party.¹⁹

4. States with Statutes Requiring Proof of Varying Types of Conduct

Other states require conduct of a varying nature in order to sustain an award for punitive damages. Louisiana and Massachusetts are typical of these states.²⁰

V.

JURY INSTRUCTIONS

Jury instructions are intended to assist the members of the jury in reaching a verdict by applying the necessary legal requirements to the facts of the case. Jury instructions can be divided into the following categories: those providing virtually no guidance; those listing factors for consideration; those providing substantive guidance, and those with no published standards.²¹

A. *Instructions that Provide Virtually No Guidance (Illinois)*

The standard punitive damage jury instruction for fifteen states offers virtually no guidance on the amount of the punitive damages to award. For example, the standard jury instruction in Illinois provides as follows:

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*, § 3.3.

If you find that the defendant's conduct was wilful and wanton and proximately caused injury to the plaintiff, and if you believe that justice and the public good require it, you may, in addition to any damages to which you find the plaintiff entitled, award an amount which will serve to punish the defendant and to deter others from similar conduct.²²

Because of the lack of guidance in this type of jury instruction, the punitive damage awards within the jurisdiction are susceptible to constitutional challenge as excessive. Furthermore, the punitive damage awards arguably can be challenged as resulting from bias or passion, or some otherwise improper condition.²³

B. *Instructions that Specify Factors for Consideration*

There are twenty-two states that specify factors for consideration in awarding punitive damages. These include: Alabama, Alaska, Arizona, Arkansas, California, Florida, Idaho, Iowa, Kentucky, Maine, Maryland, Minnesota, Nevada, New Jersey, New Mexico, Ohio, Oregon, Pennsylvania, South Carolina, South Dakota, Wisconsin, and Wyoming.

The standard jury instructions for Arkansas, Florida, Idaho, Maryland, New Jersey and Wyoming allow the defendant's financial condition to be used by the jury in determining the amount of any punitive damage award.²⁴ Such latitude is sometimes viewed as permitting jurors to redistribute wealth rather than prescribing a punishment that fits the conduct. For example, a New Mexico instruction provides:

In the event you find that plaintiff should recover actual or nominal damages, and if you further find that the acts of defendant were [wilful, wanton, malicious, reckless, grossly negligent, fraudulent and in bad faith], then you may award exemplary or punitive damages. Such additional damages are awarded for the limited purposes of punishment and to deter from the commission of like offenses.

The amount of exemplary or punitive damages must be based on reason and justice taking into account all the circumstances, including the nature of the wrong and such aggravating and mitigating circumstances as may be shown. The amount awarded, if any, must be reasonably related to the actual damages and injury and not disproportionate to the circumstances.²⁵

²² ILL. PATTERN JURY INSTR.—CIV. 35.01 (2005 ed.).

²³ BLATT, *supra* note 10, § 3.3.

²⁴ *Id.*

²⁵ *Id.*

Likewise, a Florida instruction provides:

If you find for (claimant) and find also that [the defendant] [any defendant whom you find to be liable to (claimant)] acted with malice, moral turpitude, wantonness, willfulness or reckless indifference to the rights of others, you may, in your discretion, assess punitive damages against such defendant as punishment and as a deterrent to others. If you find that punitive damages should be assessed against [the] [any] defendant, you may consider the financial resources of such defendant in fixing the amount of such damages. [You may assess punitive damages against one defendant and not the other(s) or against more than one defendant in different amounts].²⁶

C. *States Providing Substantive Guidance*

Three states (Connecticut, Kansas, and Oklahoma) provide substantive guidance by which to determine an amount which may be awarded as punitive damages. A formula is specified for calculating damages or applying a limit on the amount of any punitive damage award. Challenges to punitive damages lodged in these jurisdictions appear as challenges to the judicially imposed caps that violate due process requirements.²⁷

By way of example, a Connecticut instruction provides:

If the plaintiff has proven to you that the conduct of the defendant had any one of these characteristics, then he is entitled to have you add to the damages given in compensation for his losses and injury an additional sum as exemplary damages. The measure of these damages is the reasonable expense which he has incurred, including counsel fees, in prosecuting this action, less taxable costs, which if he recovers, will be included in the judgment, and which I instruct you, will amount to \$____.²⁸

D. *States without Published Standard Jury Instructions*

There are ten states (Delaware, Hawaii, Louisiana, Massachusetts, Michigan, Nevada, Rhode Island, Utah, Vermont, and Washington) without any published jury instructions on punitive damages. Constitutional challenges vary from case to case depending upon the language contained within the instructions given to the jury at the time it is instructed.²⁹

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

VI. CHALLENGES TO PUNITIVE DAMAGES

A. *Constitutional Amendments*

The First Amendment guarantees freedom of speech and freedom of the press. In the case, *Gertz v. Robert Welch, Inc.*,³⁰ the Supreme Court observed:

... [a] jury[']s discretion to award punitive damages unnecessarily exacerbates the danger of media self-censorship . . . [t]hey are not compensation for injury. Instead, they are private fines levied by civil juries to punish. In short, the private defamation plaintiff who establishes liability . . . may recover only such damages as are sufficient to compensate him for actual injury.³¹

The Eighth Amendment commands that excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted. Finally, the Fourteenth Amendment states that all persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States, nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny any person within its jurisdiction the equal protection of the laws.

B. *Supreme Court Cases*

The Supreme Court has considered several relevant cases within the context of punitive damages. In *Aetna Life Insurance Co. v. Lavoie*,³² the Court suggested in dicta that the constitutionality of large punitive damage awards was subject to question. This pronouncement has cleared the way generally for numerous cases challenging the constitutionality of punitive damage awards. Though provided with an initial opportunity, the Supreme Court failed to rule on the issue of the constitutionality of punitive damages in *Bankers Life & Casualty Co. v. Crenshaw*.³³ Later, in *Browning-Ferris Industries of Vermont v. Kelco Disposal, Inc.*,³⁴ the Court rejected the Eighth Amendment challenge to punitive damages, but expressly allowed for a future challenge under the Fourteenth Amendment.

³⁰ 418 U.S. 323 (1974).

³¹ *Id.* at 350.

³² 475 U.S. 813 (1986).

³³ 486 U.S. 71 (1988).

³⁴ 492 U.S. 257 (1989).

Furthermore, in *Pacific Mutual Life Insurance Co. v. Haslip*,³⁵ the Supreme Court addressed that Fourteenth Amendment challenge, holding that large punitive damage awards do not violate the Due Process Clause of the Fourteenth Amendment *per se*. However, because this decision only validated the Alabama scheme for assessing punitive damage awards, it did not finally decide all aspects of a Fourteenth Amendment challenge. Instead, and more importantly, it allowed for constitutional challenge to any state scheme that framed a process for assessing punitive damages.

Considering a broadened spectrum of constitutional issues in *TXO Production Corp. v. Alliance Resources*,³⁶ the Supreme Court observed that there is no mathematical “bright line” between an award that is constitutionally acceptable and one that is not. In *Haslip* the Court had observed that a punitive damage award four times that of compensatory damages was “close to the line” of “constitutional impropriety.”³⁷ However, in *TXO* it affirmed punitive damages that were 526 times greater than the actual damages. The Court found such an award to be reasonable in that it might deter the defendant from engaging in the same potentially harmful conduct. In determining whether such a punitive damage award was excessive, the Court adopted a reasonableness standard, rather than specific objective criteria, to guide lower courts as they review punitive damage awards. Such a standard takes full account of a lower court’s determination concerning the potential harm that might result from the defendant’s conduct. Furthermore, where the actual or potential harm stemming from the defendant’s conduct is great, a disproportional punitive damage award also may be reasonable.

Subsequently, in *Honda v. Oberg*,³⁸ the Supreme Court reasoned that a 1910 amendment to the Oregon Constitution, which prohibited judicial review of a jury’s punitive damage award “unless the court can affirmatively say there is no evidence to support the verdict,” violated the Due Process Clause of the Fourteenth Amendment. Thus, the Fourteenth Amendment imposed some limitation on the size of a punitive damage award. Most importantly, it required that the courts engage in a meaningful review of the punitive damage award. Any restriction on the ability of a court to review the amount of such an award is unconstitutional.

Finally, in *BMW of North America v. Gore*,³⁹ the Court invoked the notice requirements of the Fourteenth Amendment and determined that a punitive damage award might be unconstitutional because the defendant “did not receive adequate notice of the magnitude of

³⁵ 499 U.S. 1 (1991).

³⁶ 509 U.S. 443 (1993).

³⁷ *Haslip*, 499 U.S. at 24.

³⁸ 512 U.S. 415 (1994).

³⁹ 517 U.S. 559 (1996).

the sanction.”⁴⁰ As such, punitive damages could not be imposed by state courts for out-of-state conduct. The Court also introduced three guideposts to be used by trial and appellate courts in evaluating whether a punitive damage award was unconstitutionally excessive. Appellate courts might substitute their own judgment for such punitive damage awards when lower courts exceed the range of the guideposts. These guideposts were identified by the *BMW* Court as follows:

- (1) the reprehensibility of the defendant’s conduct;
- (2) the ratio between punitive and compensatory damages awards; and
- (3) the comparison with criminal fines or civil penalties available for similar conduct.

1. Reprehensibility of the Conduct

This guidepost requires an independent evaluation of the nature of defendant’s conduct. The conduct is not considered reprehensible when it reflects reasonable executive decisions or an intention to comply with existing laws. *BMW* had attempted to comply with the relevant disclosure laws; therefore, a punitive damage award based upon *BMW*’s conduct was improper.

2. Ratio between Punitive and Compensatory Damage Awards

A reviewing court must evaluate the ratio between punitive and compensatory damages. In *BMW*, the \$2 million punitive damage award, when compared with the \$4,000 compensatory damages award, was 500 to 1. Such awards must “raise a suspicious judicial eyebrow”⁴¹ to warrant invalidation on this ground.

3. Comparison with Criminal Fines or Civil Penalties Available for Similar Conduct

A punitive damage award exceeding the maximum statutory civil or criminal fine for similar conduct may be unconstitutional. The Court found that the \$2 million punitive damage verdict was substantially greater than statutory fines available in Alabama or elsewhere for similar conduct. In the absence of a history of noncompliance with known statutory requirements, there is no basis for assuming that a more modest sanction would not have been sufficient to motivate full compliance with the disclosure requirement imposed by the Alabama Supreme Court in this case.

⁴⁰ *Id.* at 574.

⁴¹ *Id.* at 583 (quoting *TXO*, 509 U.S. at 481).

In *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*,⁴² the Supreme Court ruled that reviewing courts must apply a de novo standard when examining the constitutionality of punitive damage awards. The Court, therefore, reversed the Ninth Circuit's application of abuse of discretion in affirming a jury award of \$50,000 compensatory damages and \$4.5 million in punitive damages. Unlike the measure of actual damages suffered, which presents a question of historical or predictive fact, the level of punitive damages is not a factual issue tried by the jury in the same manner. The Court therefore ordered remand, noting that "our own consideration of each of the three *Gore* factors reveals a series of questionable conclusions by the District Court that may not survive *de novo* review."⁴³ Thus, appellate courts must apply the three guideposts identified in *BMW v. Gore* for the purpose of effecting de novo review.

C. Most Recent Pronouncements

The Supreme Court's most recent pronouncement in this area occurred in the case of *State Farm Mutual Automobile Insurance Co. v. Campbell*.⁴⁴ The Court there re-emphasized the principles by which punitive damage awards must be scrutinized:

- (1) degree of reprehensibility of the defendant's misconduct;
- (2) disparity between the actual or potential harm suffered by plaintiff and the punitive damages awarded; and the
- (3) difference between the punitive damage award and any civil penalties imposed in comparable cases.

Given this analysis, the Court in *State Farm* held that the \$145 million punitive damage award was grossly excessive and violated the Due Process Clause of the Fourteenth Amendment. *State Farm* involved the claim by an insured against the insurer alleging bad faith, fraud and intentional infliction of emotional distress. The Court's comments on the three factors or guideposts are instructive.

1. Reprehensibility of Defendant's Conduct

"The most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct."⁴⁵

⁴² 532 U.S. 424 (2001).

⁴³ *Id.* at 441.

⁴⁴ 538 U.S. 408 (2003).

⁴⁵ *Id.* at 419.

We have instructed courts to determine the reprehensibility of a defendant by considering whether: the harm caused was physical as opposed to economic; the tortious conduct evinced an indifference to or a reckless disregard of the health of others; the target of the conduct had financial vulnerability; the conduct involved repeated actions or was an isolated incident; and the harm was the result of intentional malice, trickery, or deceit, or mere accident. The existence of any one of these factors weighing in favor of plaintiff may not be sufficient to sustain a punitive damages award; and the absence of all of them renders any award suspect. It should be presumed [that] a plaintiff has been made whole for his injuries by compensatory damages, so punitive damages should only be awarded if the defendant's culpability, after having paid compensatory damages, is so reprehensible as to warrant the imposition of further sanctions to achieve punishment or deterrence.⁴⁶

The Court went on to note that the State does not "have a legitimate concern in imposing punitive damages to punish a defendant for unlawful acts committed outside of the State's jurisdiction."⁴⁷

When calculating punitive damages, due process does not permit the courts of one jurisdiction to adjudicate the merits of other parties' hypothetical claims against a given defendant under the guise of the reprehensibility analysis. "A defendant's dissimilar acts, independent from the acts upon which liability was premised, may not serve as the basis for punitive damages."⁴⁸

2. Size of Punitive Damage Awards

Addressing the second guidepost, the Supreme Court in *State Farm* declared:

We decline again to impose a bright-line ratio which a punitive damages award cannot exceed. Our jurisprudence and the principles it has now established demonstrate, however, that, in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process. In *Haslip*, in upholding a punitive damages award, we concluded that an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety. . . . When compensatory damages are substantial, then a lesser ratio perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee. . . . In sum, courts must ensure that the measure of punishment is both reasonable and proportionate to the amount of harm to the plaintiff and to the general damages recovered.⁴⁹

⁴⁶ *Id.*

⁴⁷ *Id.* at 422.

⁴⁸ *Id.* at 425-26.

⁴⁹ *Id.* at 425.

3. Disparity between Punitive Damages and Similar Civil Penalties

Likewise, when addressing the third guidepost, the Court asserted:

Great care must be taken to avoid use of the civil process to assess criminal penalties that can be imposed only after the heightened protections of a criminal trial have been observed, including, of course, its higher standards of proof. Punitive damages are not a substitute for the criminal process, and the remote possibility of a criminal sanction does not automatically sustain a punitive damages award.⁵⁰

Punitive damages should only be awarded in narrow circumstances where the plaintiff has established particularly egregious behavior on the part of the defendant, which is also part of a pattern of similar conduct and which is unlikely to be deterred by an award of compensatory damages alone. Moreover, where punitive damages are awarded, such an award must be reasonable and must be proportional to the harm caused and the compensatory damages awarded. As the Supreme Court has noted, punitive damages are not a substitute for criminal penalties; those penalties may be awarded only upon a criminal trial with all its due process protections and heightened burden of proof.

VII.

DEVELOPMENTS BEYOND *STATE FARM V. CAMPBELL*: CHALLENGING THE GUIDEPOSTS

A. *Reprehensibility of Defendant's Conduct*

As a post-script to the decision in *State Farm*, some courts have yet to interpret what conduct warrants punitive damages. Lower courts have applied different guidelines in determining reprehensible conduct. As such, the *State Farm* reprehensibility guidepost has not become a national standard in determining what conduct is sufficiently reprehensible to warrant a punitive damage award.

In *Werremeyer v. K.C. Auto Salvage Co.*,⁵¹ a couple sought damages after buying an automobile at a salvage auction and later learned that the automobile had been created in a “chop shop.” The court affirmed a punitive damage award of fourteen times the compensatory award. Acknowledging that the plaintiffs suffered no physical harm, the court determined that the defendant’s actions were singularly reprehensible because the automobile held the possibility of creating a future safety risk. Furthermore, although the court acknowledged that the plaintiffs were not financially vulnerable, it ruled them to be so because they were individuals rather than a corporate or government entity.

⁵⁰ *Id.* at 428.

⁵¹ No. WD61179, 2003 Mo. App. LEXIS 1074 (Mo. Ct. App., June 30, 2003).

Addressing the same reprehensibility guidepost in *Roth v. Farner-Bocken Co.*,⁵² the court there used a different rationale to interpret *State Farm*. In *Roth*, an employer opened a package from a lawyer addressed to the plaintiff at the employer's office. The package returned notes and a tape recording of a meeting between the employer and the plaintiff during which the plaintiff was fired. After copying the contents of the package and forwarding them to higher managers, the materials were re-packaged so as to conceal that they had been opened and sent on to the plaintiff. The jury awarded the plaintiff \$25,000 in compensatory damages and \$500,000 in punitive damages. Since the award represented a twenty-to-one ratio of punitive to compensatory damages, the case was remanded for a new trial on damages. The court noted that the initial intrusion was not intentional, since the package was opened in the ordinary course of business, the package bore the employer's business address, and the package was not marked "personal and confidential." However, reading and photocopying the contents of the package exceeded company policy. Nevertheless, this had been only the second occurrence. Furthermore, there was no threat to any person's health or safety; the harm was purely economic. Thus, in terms of a reprehensibility analysis, the punitive damage award might be excessive.

B. *Ratio between Punitive and Compensatory Damages*

Since the decision in *State Farm*, one-third of all cases where the punitive damage award exceeded a nine-to-one ratio have been affirmed. In *Mathias v. Accor Economy Lodging Inc.*,⁵³ the plaintiffs sued after they were bitten by bedbugs while spending a night at a Motel 6 in Chicago. Each plaintiff was awarded \$5,000 in compensatory damages and \$186,000 in punitive damages by the jury — a ratio in excess of 37-to-1. The Seventh Circuit affirmed the decision although the bedbug bites resulted in no lasting harm. The consequential injuries consisted of short-term minor discomfort and itching. The court ruled, however, that the hotel's history of past conduct warranted the punitive award. In 1998 the exterminator noticed bedbugs and recommended spraying the entire motel, at a cost of \$500. The motel refused. In 1999, motel personnel paid to spray a specific room after finding bedbugs yet again. The same personnel then asked the exterminator to spray the rest of the motel at no charge. The exterminator refused. In 2000, the motel management subsequently became aware of frequent room refunds after customer complaints of bug bites. Thereafter, the motel maintained a "do not rent" list of infested rooms. However, they routinely rented rooms on this list when other rooms were not available.

⁵² 667 N.W.2d 651 (S.D. 2003).

⁵³ 347 F.3d 672 (7th Cir. 2003).

In affirming the award, the Seventh Circuit first noted that the Supreme Court had not established firm limits on the ratio of punitive to compensatory damages; rather, it had only set guidelines. The court then looked to longstanding principles of law to justify affirming the punitive damage award. First, the “punishment must fit the crime,” i.e., it should be proportional to the wrongfulness of the defendant’s actions. Second, defendants are entitled to reasonable notice of the sanction for specified wrongful acts, and third, the punishment must be based on the wrong done, not the status of the defendant. When considering the facts of the case in light of these principles, the court affirmed the punitive damage award.

C. *Comparison with Criminal Fines or Civil Penalties for Similar Conduct*

Very few courts have had occasion to interpret this *State Farm* guidepost. However, when confronted with it, many courts misinterpret it. In *Motherway, Glenn & Napleton v. Tehin*,⁵⁴ the court affirmed a punitive damage award after comparing the punitive damage award to the criminal sanction for theft. The court reasoned that since the punitive award was only six times the theft sanction, it was reasonable since it was considerably lower than the ratios (over 100-to-1) at issue in *BMW v. Gore* and *State Farm*.

Similarly, in *Romo v. Ford Motor Co.*,⁵⁵ the plaintiffs sued Ford after they suffered injuries in an automobile collision that killed their brother and parents. The plaintiffs alleged a defective design in their used 1978 Ford Bronco, with a roof that was two-thirds fiberglass. The jury awarded plaintiffs \$6.2 million in compensatory damages as well as \$290 million in punitive damages, finding that Ford executives had acted with malice in failing to warn buyers about a lack of rollover protection. The 5th District upheld the punitive damage award, which was later denied review by the California State Supreme Court. In light of its *State Farm* ruling, the United States Supreme Court remanded the case for further review. The court of appeals then reduced the punitive damage award from \$290 million to nearly \$23.7 million, a five-to-one ratio of punitive to compensatory damages. Following an extensive review of the analysis in *State Farm* and a look at the history of punitive damages, the California appeals court held that the high court had “impliedly disapproved” of the broad view “of the goal and measure of punitive damages” as accepted in California, adopting instead a constitutional view that the permissible punishment is restricted to “the harm inflicted on the present plaintiffs.”⁵⁶

⁵⁴ No. 02-C-3693, 2003 U.S. Dist. Ill. LEXIS 10928 (N.D. Ill., June 26, 2003).

⁵⁵ 6 Cal. Rptr. 3d 793 (Ct. App. 2003).

⁵⁶ *Id.* at 801.

The court noted that, under this standard, deterrence “arises as a natural result of imposing damages over and above traditional compensatory damages, not from the imposition of sanctions in an individual case that are actually disabling to the defendant.”⁵⁷ While the court of appeals recognized the United States Supreme Court’s view that most punitive awards should be limited to single-digit multipliers of compensatory damages, it made an exception for the wrongful-death causes of action, where the trial court could not award damages for pain and suffering. “[P]ublic policy and legitimate interests of the state in the protection of its people require a mechanism to punish and deter conduct that kills people. It would be unacceptable public policy to establish a system in which it is less expensive for a defendant’s malicious conduct to kill rather than injure a victim.”⁵⁸

Alluding to the further prohibition against punishing a defendant for everything it might have done wrong,⁵⁹ Justice Steven Vartabedian noted that this decision marked a substantial change in California punitive damages law from that outlined in the 1981 ruling in *Grimshaw v. Ford Motor Co.*⁶⁰ Punitive damages may be awarded only in relation to the harm done to the plaintiffs in a particular case — not as a bludgeon to deter similar acts in the future. The court also remarked that a defendant’s general wealth can be considered only to determine the appropriate punishment for any particular malicious conduct, not for its conduct across-the-board.

The 5th District also released an unpublished companion ruling. In *Johnson v. Ford Motor Co.*,⁶¹ the court used its rationale about *State Farm* to reduce a punitive damages award of \$10 million to approximately \$53,000 in a lemon law case.

D. Wisconsin Case Law

When considering the reprehensibility of the conduct, courts can consider similar conduct of the defendant on other occasions. However, courts differ widely about what constitutes similar conduct as opposed to an isolated incident. In *Trinity Evangelical Lutheran Church v. Tower Insurance Co.*,⁶² the plaintiff church sued its insurer for bad faith after the parties discovered that, as the result of a mutual mistake, the church’s insurance policy did not provide hired and non-owned auto insurance. The church was awarded \$15,750 in compensatory damages and \$3.5 million in punitive damages, a ratio of approximately 200-to-1. The appellate court affirmed the punitive damage award, in part because the same insurer had been brought into court on another occasion, 30 years earlier, on a similar issue.

⁵⁷ *Id.* at 802.

⁵⁸ *Id.* at 810-11.

⁵⁹ *Id.* at 802.

⁶⁰ 174 Cal. Rptr. 348 (Ct. App. 1981).

⁶¹ F040188 and F040529.

⁶² 661 N.W.2d 789 (Wis. 2003).

Trinity had intended to purchase insurance for “hired and non-owned” vehicles. It was not until after an accident that the parties discovered that the insurance agent failed to check the appropriate box on the insurance form requesting such coverage. Once discovered, the agent notified Trinity of the mistake, requiring that Tower Insurance remedy the situation and backdate the coverage. During the litigation, however, Tower Insurance filed a summary judgment motion seeking to dismiss for lack of coverage, even though a former Tower underwriter acknowledged during discovery that he had been asked to include such coverage in Trinity’s policy at the agent’s request.

Tower eventually stipulated to reform Trinity’s policy, providing coverage for the accident. Trinity then amended its complaint to allege a bad faith claim against Tower. The trial court granted summary judgment on the bad faith claim but held a jury trial on the punitive damages claim.

On appeal to the Wisconsin Supreme Court, Tower Insurance argued that the intermediate appellate court erred in upholding a “grossly excessive” punitive damage award in violation of due process constraints. In its determination, the Wisconsin Supreme Court stated that the factors necessary for an award of punitive damages require a showing of: (1) evil intent deserving of punishment or of something in the nature of special ill-will; (2) wanton disregard of duty; or (3) gross or outrageous conduct.⁶³ According to Wisconsin law, the award of punitive damages in a particular case is within the discretion of the jury. Consequently, the Wisconsin Supreme Court is reluctant to set aside an award merely because it is excessive.⁶⁴

In determining whether an award of punitive damages is excessive, the United States Supreme Court has applied a three-part test as set forth in *State Farm*. Applying a virtually identical test, Wisconsin courts have been urged to consider, from the following, those factors that are most relevant to the case at bar in order to determine whether a punitive damage award is excessive: (1) the grievousness of the acts; (2) the degree of malicious intent; (3) whether the award bears a reasonable relationship to the award of compensatory damages; (4) the potential damage that might have been caused by the acts; (5) the ratio of the award to civil or criminal penalties that could be imposed for comparable misconduct; and (6) the wealth of the wrongdoer.⁶⁵

When applied to the facts of the instant case, the record disclosed sufficient evidence that Tower acted with intentional disregard of Trinity’s rights, which justified the submission of punitive damages to the jury. The award thus met the three-part test for assessing

⁶³ *Id.* at 797.

⁶⁴ *Id.* at 798.

⁶⁵ *Id.* at 800.

whether punitive damages were “grossly excessive.” In addition, the state had a legitimate interest in ensuring that insurance companies fulfill their fiduciary and contractual obligations. Furthermore, the supreme court stated that the \$3.5 million punitive damage award against Tower Insurance would serve the legitimate state interest in deterrence, as well as in punishment.⁶⁶

VIII. CONCLUSION

This article has examined punitive damages awards in the United States from a historical perspective, with particular attention to recent decisions of the United States Supreme Court. Because of its critical impact in setting guidelines for the review of punitive damages, specific focus has attached to the decision in *State Farm v. Campbell*, and the approach of individual states following *State Farm*. In retrospect, it is clear that the Supreme Court has provided a framework by which to limit the expansion of punitive damage verdicts. Only time will tell if the trend to hold punitive damages in check will continue.

⁶⁶ *Id.*

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