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Articles

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Publisher's Note

Welcome to Volume 14 of *The Sedona Conference Journal*® (ISSN 1530-4981), an annual collection of articles originally presented at our Conferences, and commentaries prepared by our Working Groups, over the past year. The Sedona Conference® was founded in 1997 to provide a forum for advanced dialogue by the nation's leading attorneys, academics and jurists of cutting-edge issues of law and policy in the areas of antitrust, intellectual property rights, and complex litigation. We host Regular Season Conferences, international programmes, TSCI conferences and several Working Group meetings each year, providing unique and rewarding opportunities to seriously explore the boundaries of various areas of the law with those who are creating them. This volume of the *Journal* contains articles selected from our most recent Regular Season Conferences on antitrust law and litigation (Fall 2012), patent litigation (Fall 2012), and complex litigation (Spring 2013), our annual International Programme on cross-border discovery & data privacy (Summer 2013), and three Working Group commentaries published during the last year.

We hope that you will find that the papers in this Journal reflect the same mix of theory and experience found at our Conferences and Working Group Meetings, including the creativity and constructive irreverence required to challenge traditional thinking. The views expressed herein are those of the authors, and we encourage the submission of counterpoint pieces. Submissions can be sent electronically to info@sedonaconference.org, or by mail to The Sedona Conference®, 5150 North 16th Street, Suite A-215, Phoenix, AZ 85016, USA. If you are interested in participating in one of our Regular Season Conferences, our TSCI conferences or international programmes, or in joining our Working Group Series℠, please visit our website for further information (www.thesedonaconference.org).

Richard G. Braman
Founder & Executive Director Emeritus
The Sedona Conference
September 2013

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CONTROLLING GOVERNMENT CONTRACTORS: CAN THE FALSE CLAIMS ACT BE MORE EFFECTIVE?

Reuben Guttman[1] *and Jennifer Williams*[2]
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I. INTRODUCTION

As the federal government seeks to reduce its deficit, there has been significant dialogue around the question of which programs to cut. The answer to this question is secondary to that of whether the government is actually securing the benefits of the bargain for existing programs. One can, for example, debate the benefits of the Department of Education's $25 million yearly expenditure to keep public school libraries open on the weekends when the public already benefits from local libraries. Before making the decision to cut the program, however, one might first ask: are the private contractors who are tasked to keep these libraries open even showing up for work?

More than fifty percent of all federal discretionary spending is paid out to private firms. Spending on direct contracts rose from $205.6 billion in FY 2000 to more than $538 billion in FY 2011, while the total number of government employees has remained almost constant, increasing from 4,126,000 employees to 4,403,000 employees. Medicare and Medicaid spending has also risen dramatically over the last decade, cumulating in combined spending of over $900 billion in FY 2011.

Managing the conduct of government contractors, or those operating with government monies, in the era of government privatization is essential to both managing the government's debt and, quite simply, good governance. Unfortunately, this has been a challenge for at least three reasons. First, the federal government lacks the ability to manage and oversee contractor conduct and enforce compliance where laws, regulations and the contracts themselves have been violated. Second, compliance enforcement is increasingly complex as contractors now perform inherently governmental functions, including establishing policy and implementation of compliance enforcement mechanisms.[3] Third,

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2 Jennifer Williams is an Attorney with the Grant & Eisenhofer False Claims Litigation group and co-authored "Collecting Evidence in Financial Fraud Cases: Insider Trading," used during a training program for prosecutors in Shanghai China.

3 *See, e.g.* Guttman, Daniel, The Shadow Government, (Pantheon 1976); Guttman, R., *Fraudsters Lobby to Muzzle Whistleblowers*, Market Watch (Feb. 8, 2011), http://articles.marketwatch.com/2011-02-08/commentary/30720145_1_whistleblowers-corporate-misdeeds-tyco-international.

the volume of federal contracts and the myriad of terms governing compliance renders it impossible for government compliance personnel to catch every dereliction and bring the wrongdoer to terms.

With their *qui tam* provisions, False Claims Acts at both the Federal and State levels offer opportunities for private-public civil law enforcement partnerships for the purposes of enforcing compliance where public-private partnerships have broken down through malfeasance or outright fraud. Whistleblower lawsuits under the False Claims Act alert the government to wrongful or fraudulent schemes while providing additional resources to enforce compliance.

Whistleblowers seeking relief under the False Claims Act must retain counsel because pro se actions are not proper where the government is the party in interest; that is to say that the government's interests must be represented by counsel. At the initial intake process, private counsel serve the important role of weeding out cases that are non-meritorious. Counsel bear the initial burden of conducting an investigation to ascertain that the complaint is indeed meritorious.[4]

In 2012, the Department of Justice (DOJ) reported the resolution of $4.9 billion in cases involving civil fraud or malfeasance against the government[5], a slight increase from the $3.3 billion recovered the previous year. Yet, the following is noteworthy with regard to a deeper analysis of this aggregate recovery:

1. Of the $4.9 billion recovered in 2012, $2 billion came from cases involving healthcare fraud. This lofty recovery was approximately 2.5% of the estimated $80 billion annual cost of healthcare fraud to the federal government.[6]

2. Some of the wrongdoers – such as Abbott Laboratories – are repeat offenders who were not deterred by hefty sanctions and administrative remedies (i.e., corporate integrity agreements) imposed through earlier enforcement actions.[7]

3. Of the top 30 recoveries in FY 2012, 20 came from the healthcare sector, 2 came from the defense sector, and none were principal contractors for the Departments of Energy, Environment or Education.

All of this raises questions about whether this potentially powerful statute is being used broadly (or even efficiently) and whether regulators need to rethink questions about penalties, targets, the role of Agency Inspector Generals, the effect of extending the seal, and the role played by the private plaintiffs' bar.

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4 Rule 11 requires attorneys to certify that (1) the case is not being presented to harass, (2) the legal contentions are warranted by existing law, and (3) the factual contentions have evidentiary support. F.R.C.P. Rule 11(b). Sanctions may be imposed on attorneys that do not follow these requirements. F.R.C.P. Rule 11(c).

5 The False Claims Act is not technically a fraud statute as "reliance" is not an element of the claim but the statute is also broad enough to capture fraudulent conduct.

6 The Federal Bureau of Investigation, "Rooting out health care fraud is central to the well-being of both our citizens and the overall economy," Health Care Fraud, http://www.fbi.gov/about-us/investigate/white_collar/health-care-fraud (last visited Apr. 18, 2013).

7 2003 pleading and resolution of civil claims for $600 million overall (http://www.nytimes.com/2003/06/27/business/abbott-to-pay-622-million-to-end-inquiry-into-marketing.html); 2010 settlement of false claims act allegations for $421 million (http://www.justice.gov/opa/pr/2010/December/10-civ-1398.html); 2012 settlement of False Claims Act and criminal allegations for $1.5 billion (http://www.justice.gov/opa/pr/2012/May/12-civ-585.html).

II. IS IT TIME TO CHANGE COURSE?

A. Are Current Penalties Effective Deterrents?

Do existing False Claims Act enforcement paradigms merely establish a fee for the license to break the law? Disparity between fraud recovery and revenue streams, market resilience – and even growth – in response to settlement announcements, and unenforced boilerplate corporate integrity agreements prompt questions about the effectiveness of the False Claims Act as a deterrent.

The recovery-to-revenue ratio in pharmaceutical cases alone is revealing. In 2009, Pfizer paid $2.3 billion to resolve civil and criminal allegations that it had unlawfully marketed 13 drugs.[8] The revenue stream for those drugs during the damage period, however, exceeded $171 billion. In 2010, AstraZeneca settled claims with the government involving the off-label marketing of the drug Seroquel for $550 million. That drug, however, brought in revenue of $4.5 billion annually. Interestingly enough, after the settlement was announced, the market capitalization for AstraZeneca increased 1.35% as seen in the chart opposite.

Company	Settlement	Date of Settlement	Market Cap Change After Settlement Announced	Market Cap Prior to Settlement	Percentage Change
GlaxoSmithKline	$3.0 billion	2-Jul-12	$1,940,000,000	$115,739,632,800	1.68%
Pfizer	$2.3 billion	2-Sep-09	($72,000,000)	$109,876,054,700	-0.07%
Abbott Laboratories	$1.5 billion	7-May-12	$63,000,000	$98,288,023,400	0.06%
Eli Lilly	$1.4 billion	15-Jan-09	$91,000,000	$42,692,597,700	0.21%
TAP Pharmaceutical Products	$875 million	3-Oct-01	Not a public company		
Amgen	$762 million	19-Dec-12	($598,000,000)	$67,903,265,600	-0.88%
GlaxoSmithKline	$750 million	26-Oct-10	$343,000,000	$104,315,500,000	0.33%
Merck	$650 million	7-Feb-08	unchanged	$99,469,132,800	unchanged
Purdue Pharma	$601 million	10-May-07	Not a public company		
Allergan	$600 million	1-Sep-10	$554,000,000	$19,459,351,600	2.85%
AstraZeneca	$520 million	27-Apr-10	$850,000,000	$63,076,109,400	1.35%
Bristol-Myers Squibb	$515 million	28-Sep-07	($312,000,000)	$57,003,332,000	-0.55%
Schering-Plough	$500 million	17-May-02	$2,250,000,000	$38,294,964,800	5.88%
Schering-Plough	$435 million	29-Aug-06	$918,000,000	$31,018,914,100	2.96%
Pfizer	$430 million	13-May-04	($274,000,000)	$270,121,031,300	-0.10%
Cephalon	$425 million	30-Sep-08	($84,000,000)	$5,267,870,100	-1.59%
Novartis	$423 million	30-Sep-10	($839,000,000)	$152,111,718,800	-0.55%
AstraZeneca	$355 million	20-Jun-03	($1,090,000,000)	$73,923,460,900	-1.47%
Schering-Plough	$345 million	30-Jul-04	($115,000,000)	$28,642,316,400	-0.40%

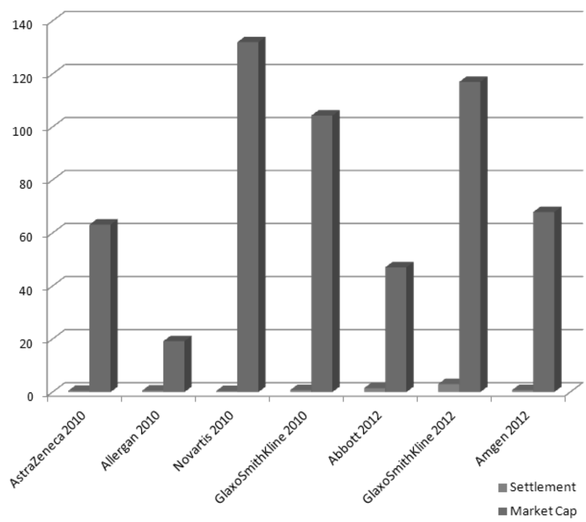
A recent article in *Health Affairs* by researchers from Harvard Medical School and Brigham and Women's Hospital in Boston concluded that the large damages paid as part of False Claims Act settlements do not act as deterrents. The article examined prescribing data and spending for the Neurontin epilepsy medication and found that "[a]lthough False

8 The criminal allegations pertained to one drug.

Claims Act prosecutions of off-label promotion of pharmaceuticals have recovered some improper payments for the government, [the Neurontin] case suggests that such legal approaches may have little or no impact on commercial behavior by the manufacturer under investigation."[9]

An analysis of nineteen of the largest settlements over the past decades, as seen in the chart above, indicates that in eight cases the market capitalization of the defendant company increased, in eight cases the market capitalization of the company dropped, and in one case the market capitalization of the company remained the same with the announcement of the settlement of a False Claims Act case. The largest percentage increase was 5.88%, while the biggest drop was 1.59%.[10] Undoubtedly, earlier revelations in SEC filings had the market at least partially accounting for the prospect of litigation or settlement. While few concrete conclusions can be drawn, it is easy to surmise that the market does not view these cases as having a long term impact.

When the DOJ announced its $1.6 billion settlement with Abbott Laboratories on May 7, 2012, Abbott's share price jumped 61 cents for the day.[11] When the Department announced its $3 billion settlement with GlaxoSmithKline on July 2, 2012, the company's share price increased 74 cents.[12] Even when False Claims Act settlements seem to cause a drop in share price, that drop is usually less than 50 cents and is recovered, with gains, within two days.[13] Another way to look at these settlements when answering the question of the materiality to the Defendant is to compare the settlement size to market capitalization, as demonstrated in the chart on page 6.



9 Aaron S. Kesselheim, Devan Darby, David Studdert, Robert Glynn, Rasia Levin and Jerry Avorn, *False Claims Act Prosecution Did Not Deter Off-Label Drug Use in the Case of Neurontin*, 30 Health Affairs 2318 (2011).

10 The largest percentage increase was seen after the announcement of the settlement of the whistleblower case about off-label marketing of Claritin. The biggest drop was seen after the announcement of the settlement of the whistleblower case against Cephalon.

11 ABT share price opened on May 7, 2012 at $41.90 per share and closed at $62.51.

12 GSK share price opened on July 2, 2012 at $45.62 per share and closed at $46.36.

13 Merck share price dropped 19 cents on April 19, 2012, the day of the DOJ announcement of the False Claims Act settlement; however, by the close of April 20, 2012, the share price had recovered and even gained 18 cents. When the DOJ announced the AstraZeneca False Claims Act settlement on April 27, 2010, AstraZeneca's share price dropped 34 cents, but recovered and even gained 42 cents by April 29th.

If it is correct that the monetary penalties are small in comparison to the market capitalization, then the corporate integrity agreements arguably take on greater significance as a deterrent. Corporate Integrity Agreements, however, at least in the healthcare sector that are drafted by the agency, are frequently boilerplate and appear to be written without accounting for the evidence and schemes uncovered during the investigation. In 2009, Pfizer settled claims that it had paid kickbacks to induce sales and misbranded its drugs. The alleged kickbacks were paid to doctors. While the corporate integrity agreement mandated the disclosure of Pfizer's payments to doctors, the required disclosure – which was to be made one year after settlement – only covered payments made after the date of settlement. Patients were left not knowing whether Pfizer had paid their own doctor during the damage period.

The existence of repeat offenders is troubling as these are entities that have – in some cases – violated existing corporate integrity agreements. These circumstances might counsel for the use of independent monitors that have been the norm with the resolution of large Title VII cases, including those brought against Texaco and Coca Cola. *Abdallah v. Coca-Cola Co.*, 133 F. Supp. 2d 1364 (N.D. Ga. 2001); *Roberts v. Texaco, Inc.*, 979 F. Supp. 185 (S.D.N.Y. 1997). Yet, with limited exception, independent monitors have not been utilized to monitor compliance with resolutions of False Claims Act cases. *U.S. ex rel. Anti-Discrimination Center of Metro New York, Inc. v. Westchester County, N.Y.*, No. 06-Civ-2860, 2012 WL 13777 (S.D.N.Y. Jan. 4, 2012) (discussing the consent decree establishing a monitor to ensure that the county meets its obligations as part of the resolution of a False Claims Act case).

B. Who should be Targeted?

When President Abraham Lincoln signed the False Claims Act into law in 1863, the immediate target of enforcement was undoubtedly on wrongdoing by civil war defense contractors. In 2012, a majority of the top thirty settlements were related to healthcare fraud and did not involve direct government procurements. What can be done to expand the use of the statute to other sectors and are there means to expand the targets to better utilize the statute as a deterrent? This raises three subordinate questions: (1) which captains of industry should be held accountable? (2) is agency capture by direct procurement contractors impacting enforcement? and (3) are there circumstances where delegations of government oversight to the private sector actually deterred or has the potential to deter compliance enforcement?

1. Individual Liability

While arguments could be made on both sides about whether the dollar value of each of the top 20 settlements in 2012 was fair and reasonable, even if the recoveries were doubled, the settlement values would remain small in comparison to the market capitalization of the wrongdoers. This is not to say that efforts should *not* be made to maximize corporate recoveries. Large recoveries send a message to the public and when the recoveries are significant enough or involve criminal penalties, shareholders are incentivized to take action. As Professors Greenfield and Gertner explained in their Amicus Curie Brief in *Lampers v. Hershey Company*, "Shareholders have an interest in monitoring whether the corporation is acting unlawfully." Greenfield and Gertner Amicus Brief, *Lampers v. Hershey Company*, C.A. No. 7996-ML (Del. Ch. filed April 12, 2013).

While the market may take action, as in the Pfizer case where a derivative action followed the resolution of the False Claims Act case,[14] an initial step may be to focus attention on the wrongdoers within the corporation. No individual directors or officers in any of the top nineteen cases listed in the chart on page 4 were held accountable under the False Claims Act, or any other statute, for the fraudulent or wrongful conduct of the corporation. It is axiomatic that corporations are ships that are guided to wrongful paths by their captains who are temporary caretakers incentivized to maximize their own immediate gain. Enron, WorldCom and Tyco exemplify pervasive fraud schemes that would not have occurred but for the actions – and greed – of corporate insiders.[15] While pervasive wrongful schemes – as in the case of off-label marketing of drugs – bring massive revenue to wrongdoers, insiders who are rewarded with bonuses from tainted profits are seldom if ever pursued. This is curious in light of the logic articulated in the "Thompson Memo."

In that memo, the then Deputy Attorney General emphasized, "Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation." Larry D. Thompson, Memorandum to the Heads of Department Components & U.S. Attorneys, (Jan. 20, 2003), http://www.justice.gov/dag/cftf/corporate_guidelines.htm. The memo explains that because corporations can act only through individuals, individual liability may "provide the strongest deterrent against future corporate wrongdoing." *Id.*

While evidence is of course necessary to pursue wrongdoers, one question exists as to whether the absence of oversight, as perhaps required by corporate law, satisfies the "reckless" standard of the False Claims Act. The Delaware Chancery Court highlighted this question in *In re Caremark Int'l Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996). There, Chancellor Allen required corporations to establish reporting and information systems such that the directors are adequately informed. *Caremark*, 698 A.2d at 970. Directors may be held personally liable for losses caused by non-compliances if they fail to assure that this reporting system exists and is adequate. *Id.* The House Judiciary Committee stated, when issuing its report on the 1986 amendments to the False Claims Act, that the inclusion of the term "reckless disregard" in defining knowledge was intended to mean that people who play "ostrich" would be liable under the False Claims Act. *See* H.R. Rep. No 660, 99th Cong., 2d Sess. 2 (1986). Thus, if directors are required to be aware of what is going on, but ignore the "red flags" that the information being provided is inaccurate, then they are possibly acting recklessly under the False Claims Act, and should be held liable.

2. Agency Cooperation

The DOJ must have agency cooperation to pursue a whistleblower case. Absent agency cooperation, the DOJ is without a client. Outside the healthcare arena, and occasional cooperation by the Department of Health and Human Services and the Food and Drug Administration (FDA), there has been a dearth of successful large dollar enforcements. Of the DOJ's reports of the thirty largest False Claims Act settlements for fiscal year 2012, twenty involved the healthcare industry, four involved banks, and two involved the United States military. There were no major settlements involving Department of Education contractors, Environmental Protection Agency contractors, Department of Homeland Security contractors, or Department of Energy contractors. The dearth of settlements involving the military sector is particularly stunning considering the magnitude of private sector involvement.

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14 *In re Pfizer Shareholder Derivative Litig.*, 722 F. Supp. 2d 453 (S.D.N.Y 2010).
15 *See*, *e.g.*, Kurt Eichenwald, Conspiracy of Fools: A True Story (Broadway Books, 2005).

What accounts for this? One possible explanation is that some agencies are very protective of their contractors; hence, it is extremely difficult for the DOJ to get agency cooperation when confronted with claims against contractors. Do agencies that depend on contractors overlook small derelictions for fear of disrupting relations? Does enough money, if any, from the recovery flow back to the agency to make the risk of disruption worthwhile?

The protection that some agencies afford their contractors can sometimes be seen in the actual agreements. Some Department of Energy (DOE) contracts actually provide indemnification for contractors who prevail in defending claims brought by the government. These contracts, which eliminate the "American Rule," add a layer of complexity to the government's decision to intervene in litigation. The question is not simply whether the government will prevail but what will the costs be to the government if it partially prevails or fails to prevail in entirety? Even where the government does intervene, these clauses alter the "judicial laws of nature" which would implicate a process through motions and discovery that would otherwise prompt settlement in the ordinary course of events. Where the Defendant has something to gain by staying the course of litigation, its settlement analysis calculates both the potential for gain and the potential for loss.

3. Governmental Functions

Does the delegation of inherently governmental functions impact compliance enforcement? In 2011, the Centers for Medicare-Medicaid Services (CMS) hired Northrop Grumman to do a predictive model for healthcare fraud. Perhaps the logic of the retention was that "it takes a thief to catch a thief" as Northrop, itself, had been a violator of the False Claims Act.[16]

The Northrop example is an interesting anecdote which perhaps punctuates a more pervasive concern. Two examples:

1. The Department of Education delegates authority to private entities which certify educational institutions so that students may pay for their tuition with government monies.

2. Even though the FDA establishes the indications for specific drugs, the CMS approves of private entities that publish "compendia" that purportedly document uses for the drug outside the FDA indication, which then are used to justify the payment of Medicare funds. Ironically, CMS also delegates some authority to the insurance industry to interpret the compendia.

When oversight is delegated by the government to the private sector, or when the private sector can re-write government regulations, as in the constructive expansion of FDA indications through the back-door channel of the compendia, contractor oversight and compliance enforcement is complicated. Moreover, these types of situations promote conflicts of interest or potential conflicts of interest that cannot be cured. For-profit colleges and universities now have a seat on the board of the private regulatory bodies that provide licensing and are thus the gatekeeper for government dollars. Compendia publishers, which also may sell their services to the pharmaceutical industry, have the ability to expand the orbit for which their customers' drugs will receive government reimbursement.

16 Guttman, R., *Fraudsters Lobby to Muzzle Whistleblowers*, Market Watch (Feb. 8, 2011), http://articles.marketwatch.com/2011-02-08/commentary/30720145_1_whistleblowers-corporate-misdeeds-tyco-international.

C. Is the Process as Efficient and Transparent as Possible?

The False Claims Act litigation process to some degree re-writes the Federal Rules of Civil Procedure. Instead of serving the complaint on a Defendant within 120 days of filing, F.R.C.P. Rule 4, the case is placed under seal, the Defendant is not served, and the government conducts an investigation.

The process requires the relator to file under seal, serve the government with the complaint, and provide the government with information supporting the allegations. While the statute provides for a 60-day seal, the seal is often extended for months and sometimes years depending on the complexity of the case. "The Government may, for good cause shown, move the court for extensions of the time during which the complaint remains under seal." 31 U.S.C. § 3730(b)(3).

Before the case is fully unsealed, the government and the relator may ask the court for a partial unsealing for the purposes of showing the complaint to the Defendant or for discussion of the allegations with the Defendant. This occurs before the Defendant has formally been served and before the complaint is aired to the public. In the False Claims Act case against AstraZeneca relating to the marketing of Seroquel, the Government's press release announcing settlement apparently alluded to a partial unsealing: "In March 2006, AstraZeneca brought certain conduct to the attention of the government and then cooperated in the investigation of the allegations being settled today."[17]

Ultimately, the government must decide whether it wants to intervene in the relator's case. If it does, the False Claims Act provides that the government "shall have the primary responsibility for prosecuting the action," but does not deny the right of the relator to continue as a party to the action. If the government decides not to intervene in the case, the relator has the right to conduct the action, but must serve the government with copies of all pleadings filed in the case. The government may also choose to dismiss the action, settle the action, or pursue any alternative remedy, notwithstanding the objections of the relator. Additionally, even before the government decides whether it wants to intervene in the relator's suit, it can issue Civil Investigative Demands in accordance with 31 U.S.C. § 3733.

Each of these steps deserves a closer look, but two issues are examined in depth below: (1) the ramifications of allowing a case to remain under seal for an extended period of time and (2) the role of private False Claims Act lawyers both during the government investigation stage and once the government intervenes.

1. The Seal

Most False Claims Act cases remain under seal up until the time of settlement or dismissal. The documents and statements discovered through the use of Civil Investigative Demands, which can produce hundreds and thousands of documents, never see the light of day. Cases are settled with agreements that summarily memorize the basic allegations and with corporate integrity agreements that lack detailed transparency of the underlying conduct. In the healthcare arena, these settlements leave doctors, patients, and pharmacists with little or no guidance on how drugs, allegedly misbranded for years, should be used or have been inappropriately used. In other areas, contracting officers are left without

17 Department of Justice, Office of Public Affairs, *Pharmaceutical Giant AstraZeneca to Pay $250 Million for Off-label Drug Marketing*, Justice News (Apr. 27, 2010), http://www.justice.gov/opa/pr/2010/April/10-civ-487.html.

guidance on schemes that repeat and, thus, there is no basis for root cause analysis to develop contracting paradigms to control the private sector. Does keeping cases under seal for extended periods conflict with the public interest? What about cases in which unsealing the case could alert the public to a health hazard?

The mandatory seal provision is not original to the False Claims Act. It was added in 1986 with the amendments that expanded the scope of the False Claims Act, increased the penalties, lowered the requisite standard of knowledge and intent, and strengthened the *qui tam* provisions. Congress gave four reasons for its addition of the seal provisions: (1) to permit the United States to determine whether it already was investigating the fraud allegations; (2) to permit the United States to investigate the allegations to decide whether to intervene; (3) "to prevent an alleged fraudster from being tipped off about an investigation"; and, (4) to "protect the reputation of the defendant in that the defendant is named in a fraud action brought in the name of the United States, but the United States has not yet decided whether to intervene." *ACLU v. Holder*, 673 F.3d 245, 250 (4th Cir. 2011) (citing S. Rep. No. 99-345, at 24-25 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5266, 5289-90).

In *ACLU v. Holder*, the Fourth Circuit held that the seal provisions were narrowly tailored to a compelling government interest for three reasons: (1) by adopting a detailed process for initiating and pursuing a *qui tam* complaint under the False Claims Act, Congress accounted for the complex nature of modern fraud investigations, the government's limited resources, and the unique nature of *qui tam* action under the False Claims Act; (2) the "good cause" requirement to extend the seal does not require heightened First Amendment scrutiny; and (3) the seal provisions "limit the relator only from publicly discussing the filing of the *qui tam* complaint." *Id.* at 254. The majority opinion stated, "Nothing in the [False Claims Act] prevents the *qui tam* relator from disclosing the existence of the fraud." *Id.*

But the *ACLU* case was a challenge to the constitutionality of the statute's seal provisions and not its application as applied to particular circumstances. It did not address the question of partial unsealing or seals extending for years. It did make clear that the seal is limited as it applies only to the existence of the case and does not preclude public dialogue about the underlying facts. There may be an opportunity for Judges to take a careful look at the seal, particularly in cases that raise collateral issues of health and safety. Where a complaint alleges misbranding by a pharmaceutical company, perhaps there is a need to explore whether relevant information needs to be made public? Or perhaps the court should make clear in its seal order that no party is precluded from public discussion of facts which would implicate health and safety concerns?

This leaves the question of what information should be made public at the end of the case where the matter is settled under seal and there is no public proceeding. Should there be a summary of the evidence or some public report that provides information at least in cases where the complaint and investigation raised matters involving safety and health? As a matter of law, False Claims Act cases must be approved by the Court. 31 U.S.C. § 3730(c)(2) (the court must allow the relator a hearing on a motion to dismiss by the government and must determine that a proposed settlement is fair, adequate, and reasonable under all circumstances). Is there an opportunity for the Court to raise questions and ensure that cases are resolved with sufficient public record?

2. Balancing Counsel

While the number of filed False Claims Act cases has expanded, the question is whether these claims are meritorious. The optimal scenario is one where private sector counsel weed out non-meritorious claims and allocate the time and effort to put cases together, applying fact to law and utilizing outside experts where necessary, before presenting matters to the government in the form of a sealed complaint. While there appears to be some perception among the private bar that pursuit of a False Claims Act case is like a ride on a Greyhound Bus – leave the driving to the DOJ – the reality is that efficiencies under the statute cannot be achieved if the private bar does not diligently prepare cases and pursue them as if they were required to litigate the matter absent government support.

Part of the disconnect may be that the private attorneys and government prosecutors are sometimes guided by different standards in their prosecutorial decisions. The standard by which the government makes a decision to prosecute – whether civil or criminal – in most cases reflects an intricate investigation where a determination is made that the facts as applied to the law mandate a finding of culpability. The fact gathering process is highly front loaded. With the notice pleading requirements as articulated in *Conley v. Gibson*, 355 U.S. 41 (1957), it is perhaps a fair observation that private lawyers have not historically front loaded their investigation of cases. Of course this has changed with the Supreme Court's decisions in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009), which will create a dynamic where fact investigation must occur at the pre-filing stage; otherwise the complaint will not be sustained.

Whether *Twombly* and *Iqbal* will place private counsel and government lawyers more in sync remains to be seen. Perhaps the DOJ should consider very targeted outreach to potential whistleblower counsel outlining steps that can be taken to create efficiencies? Would it be worthwhile for DOJ to promulgate a guidance document for those representing whistleblowers? Clearly the relationship needs refinement.

III. CONCLUSION

A number of questions have been raised in this paper with only some hints for solution. We have, to some degree, thrown a rock at a hornets' nest with the hope that we will see what the hornets look like. Our goal is to generate dialogue and receive input from those within the government and those who adjudicate these matters. Undoubtedly, much of what we have discussed here may look quite different from other perspectives.

COMPELLING A CORPORATION TO PRODUCE PRIVILEGED DOCUMENTS IN INDIVIDUAL PROSECUTIONS: *A CRITIQUE OF THE EMERGING COMPROMISE**

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The Supreme Court has declared that the power to assert or waive the corporate attorney client privilege "rests with the corporation's management and is normally exercised by its officers and directors."[1] During and since the corporate scandals of the early 2000's, corporations have often used their power over the privilege by waiving it, typically in an attempt to obtain leniency from government regulators.[2] But more recently, a new conflict concerning the corporate privilege has come to the fore: corporations have begun to assert the corporate privilege over the objection of current or former officers, sometimes in government proceedings arising from corporate misconduct the corporation has already settled, to prevent those individuals from offering corporate privileged information in their defense.[3] This paper examines closely how federal courts are currently resolving the conflict, raises several issues with respect to the current doctrine, and suggests a modest improvement.

I. Current Law

The modern doctrine emerging in the federal courts is illustrated clearly by the case of *United States v. Mix*.

United States v. Mix is one of four criminal prosecutions against former and current employees of BP Plc ("BP") or BP affiliates for alleged misconduct in connection with the Deepwater Horizon oil spill and the government's ensuing criminal investigation, all of which – as of April 11, 2013 – are pending in the U.S. District Court for the Eastern

1 *CFTC v. Weintraub*, 471 U.S. 343, 349 (1985).

2 *See, e.g.*, Abbe D. Lowell & Christopher D. Man, *Federalizing Corporate Internal Investigations and the Erosion of Employees' Fifth Amendment Rights*, 40 GEO. L.J. ANN. REV. CRIM. PRO. iii, xiv (2011).

3 *See, e.g.*, *United States v. Mix*, No. 12-cr-171, 2012 WL 2420016 (E.D. La. June 26, 2012); *United States v. Weisberg*, No. 08-cr-347, 2011 WL 1327689 (E.D.N.Y. Apr. 5, 2011); *United States v. Renzi*, No. 08-cr-212, 2010 WL 582100 (D. Ariz. Feb. 18, 2010); *United States v. W.R. Grace*, 439 F. Supp. 2d 1125, 1145 (D. Mont. 2006). In a thoughtful treatment of the subject, one commentator has proposed a contractual solution, suggesting that corporate directors can "insist, as part of their employment contracts, that their employers agree to waive the privilege if necessary to the directors' defense" in legal proceedings. Mark A. Kressel, *Making the Advice of Counsel Defense Available for Corporate Directors* (Commentary), 116 Yale L.J. Pocket Part 258, 258 (2007); *see also* Mark A. Kressel, *Contractual Waiver of Corporate Attorney Client Privilege* (Note), 116 Yale L.J. 412 (2006). Without taking a position on the theoretical merits of that approach, this paper focuses on how federal courts are currently handling the issue in the absence of a private agreement.

District of Louisiana.[4] The defendant, Kurt Mix, is a former BP drilling engineer who took part in BP's efforts to halt the flow of oil into the Gulf following the initial drilling rig explosion on April 20, 2010.[5] According to the indictment, in the weeks following the explosion, Mix exchanged text messages with other BP employees and contractors concerning the rate at which oil was flowing from the well and BP's attempts to halt the flow.[6] The indictment further alleged that Mix, despite receiving the legal hold notice that BP issued shortly after the explosion, deleted the text messages from his PDA before BP's internal investigators could image his hard drive.[7] Based on these allegations, the government has charged Mix with two counts of obstruction of justice.[8]

From the outset of the proceedings, Mix has asserted that certain evidence in BP's possession "conclusively demonstrates that [he] did not commit the crimes charged in the Indictment."[9] The problem? The exculpatory evidence is subject to BP's attorney client privilege, which BP has not waived.[10] On May 14, 2012, Mix filed a motion for a protective order to "allow for immediate disclosure and, if necessary, use at trial of exculpatory information" in BP's possession, despite acknowledging that the information he requested is subject to BP's attorney client privilege and that only BP can waive it.[11] In support of his motion, Mix asserted that the Sixth Amendment to the U.S. Constitution entitles him to discover and use exculpatory evidence over BP's assertion of attorney client privilege.[12]

The legal test that Mix proposed to determine what privileged information should be admitted at trial comes from *United States v. W.R. Grace*, in which the U.S. District Court for the District of Montana held that a criminal defendant's Sixth Amendment "right to present evidence" can, in limited circumstances, override a third party's assertion of the attorney client privilege.[13] The test is designed to strike the proper balance between two sometimes incompatible entitlements: the attorney client privilege, the "oldest of the privileges for confidential communications known to the common law,"[14] and the Sixth Amendment to the U.S. Constitution, which "guarantees criminal defendants a meaningful opportunity to present a complete defense."[15] Under the *W.R. Grace* test, a criminal defendant may introduce evidence over a corporation's assertion of attorney client privilege if the evidence is "of such probative and exculpatory value as to compel admission."[16] The court explained that "[s]uch determinations will be made on a document-by-document basis at trial, where the probative value of each bit of evidence

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4 As of April 11, 2013, the grand jury has returned three indictments against four individuals for acts relating to the Deepwater Horizon oil spill and the government's ensuing investigation. *See United States v. Mix*, No. 12-cr-171 (E.D. La. May 2, 2012) (drilling engineer indicted for obstruction of justice) (trial scheduled for June 10, 2013); *United States v. Rainey*, No. 12-cr-291 (E.D. La. Nov. 14, 2012) (regional manager indicted for false statements and obstruction of Congress) (trial scheduled for September 15, 2013); *United States v. Kaluza, et al.*, No. 12-cr-265 (E.D. La. Nov. 14, 2012) (drilling supervisors indicted for involuntary manslaughter, seaman's manslaughter, and violations of the Clean Water Act) (joint trial scheduled for January 13, 2014). Of these cases, only *United States v. Mix* has raised issues of corporate privilege.

5 *United States v. Mix*, No. 12-cr-171, slip op. at 1 (E.D. La. Dec. 11, 2012), ECF No. 155.

6 Indictment ¶ 4, *Mix* (May 2, 2012), ECF No. 7.

7 *Id.* ¶¶ 5-16.

8 *Id.* ¶¶ 17-20. On March 20, 2013, the government filed a superseding indictment against Mix, adding allegations that Mix also deleted several voicemails covered by the litigation hold. Superseding Indictment, *Mix* (March 20, 2013), ECF No. 215.

9 Memo. in Support of Def.'s Motion for Prot. Order at 1, *Mix* (May 14, 2012), ECF No. 26-1.

10 Statement of Third-Party Interest at 5, *Mix* (May 30, 2012), ECF No. 43.

11 Memo. in Support of Def.'s Motion for Prot. Order at 57, *Mix* (May 14, 2012), ECF No. 26-1.

12 *Id.* at 5-6 (citing *United States v. W.R. Grace*, 439 F. Supp. 2d 1125, 1145 (D. Mont. 2006)).

13 439 F. Supp. 2d 1125, 1142 (D. Mont. 2006) (holding that scheduled joint trial must be severed because co-defendants – two employees asserting the Sixth Amendment right to present evidence – intended to introduce evidence that another codefendant – the corporation that held the privilege – intended to exclude by asserting privilege).

14 *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

15 *Crane v. Kentucky*, 476 U.S. 683, 690 (1986) (citation omitted).

16 439 F. Supp. 2d at 1142.

can be evaluated in the context of the government's case and in light of what the evidence shows."[17] The court also noted that the corporation's interest in confidentiality would be sacrificed only in "limited circumstances."[18]

In response to Mix's motion, the government filed a brief that, although casting doubt on the evidentiary value of any evidence in BP's possession,[19] did not contest the general proposition that Mix's Sixth Amendment rights could, in limited circumstances, trump a third party's claim of attorney client privilege.[20] The government observed that "[n]either the Fifth Circuit nor the United States Supreme Court has directly addressed whether, or in what circumstances, a properly-invoked attorney client privilege may be overcome by a defendant's constitutional rights," and even presented one of its arguments within the framework of the *W.R. Grace* balancing test.[21] The government further acknowledged that "[w]hen a privilege is overcome by a criminal defendant's constitutional rights, the compelled disclosure is not deemed to constitute a general waiver of the third party's privilege."[22]

As the holder of the privilege at issue, BP filed a statement of third-party interest, in which BP took "no position on whether [the materials requested] meet the applicable standard for disclosure."[23] In its statement, BP reaffirmed that the attorney client privilege protects the materials Mix requested,[24] asserted that the attorney client privilege "must be given significant weight" and "need not yield to a [criminal] defendant's request for disclosure,"[25] and requested that any order granting Mix's motion be tailored narrowly and make clear that "BP has not elected to waive its attorney client or work product privileges."[26]

On June 26, 2012, the court ruled on Mix's motion and, essentially, appeased all sides.[27] To begin, the court adopted wholesale the *W.R. Grace* balancing test,[28] and, subject to case-by-case admissibility determinations at trial, granted Mix's motion to obtain exculpatory privileged evidence ("EPI") from BP.[29] In a nod to the government, the court emphasized that it was not ruling on the admissibility of the requested documents, noting that such determinations were impossible at that "relatively nascent stage in the proceedings."[30] Finally, in respect of BP's attorney client privilege, the court limited its order in three important ways:

(1) "Mix is entitled to disclose the EPI only to counsel for the United States in this proceeding,"

(2) "Mix's use and disclosure of the EPI does not vitiate the attorney client privilege that [BP] has over the EPI and [BP] shall not be considered as having waived its attorney client privilege for the EPI or any other privileged information," and

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17 *Id.*
18 *Id.* at 1143.
19 United States' Response to Def.'s Motion for Prot. Order at 9-11, *Mix* (May 30, 2012), ECF No. 40.
20 *Id.* at 7.
21 *See id.* at 11 (asserting, after casting doubt on the exculpatory value of any information in BP's possession, that "it is difficult to see how the material the defendant seeks is 'so valuable that to prohibit its admission would violate the defendant's constitutional right to present a defense.'" (quoting *United States v. Weisberg*, No. 08-cr-347, 2011 WL 1327689, at *5 (E.D.N.Y. Apr. 5, 2011) (citing *W.R. Grace*, 439 F. Supp. 2d at 1140-42))).
22 *Id.* at 8 (citing *W.R. Grace*, 439 F. Supp. 2d at 1145).
23 Statement of Third-Party Interest at 1, *Mix* (May 30, 2012), ECF No. 43.
24 *Id.* at 2-3 ("Mix [in his Motion for Protective Order] recognizes that BP holds an attorney client privilege over the requested materials." (quotation marks omitted)).
25 *Id.* at 3-4 (observing that "[t]he attorney client privilege['s] position is 'special' and 'venerated' and courts are particularly mindful to guard against needless erosions of the privilege's protections" (citation omitted)).
26 *Id.* at 5.
27 *See* Order Granting in Part Def.'s Motion for Prot. Order, *Mix* (June 26, 2012), ECF No. 65 ("Protective Order").
28 *Id.* at 3 (citing *W.R. Grace*, 439 F. Supp. 2d at 1137).
29 *Id.* at 5.
30 *Id.*

(3) "the United States shall not use the EPI outside of its litigation with Mix. In particular, the United States is precluded from using the EPI in any investigation or litigation against [BP]."[31]

In a subsequent order, the court set forth a protocol for BP's delivery of, and the parties' access to, the EPI requested in Mix's subpoena.[32] The order called for BP to deliver into the court's custody a hard drive containing the subpoenaed materials, and further declared that "[a]ny party to this matter seeking access to the hard drive returned by BP . . . shall file a motion with the Court."[33] The court thereafter granted both Mix's and the government's motions to access the BP materials.[34] Trial is scheduled for June 10.[35]

II. Critique of the *W.R. Grace* Test

The *W.R. Grace* balancing test seems to offer a win–win solution to the dilemma courts face when an individual defendant seeks access to exculpatory evidence over his employer's or former employer's claim of attorney client privilege. When the trial court determines that privileged information, viewed in camera, is too exculpatory to constitutionally exclude, the court will admit the evidence, thereby reducing the likelihood of an incorrect conviction. At the same time, to protect the corporation's interest in the confidentiality of its privileged information, the court can issue an order expressly declaring that admission of privileged information does not trigger waiver of the corporation's privilege, and prohibiting the litigants from using the admitted EPI in future legal proceedings. A sensible solution, it would seem, but the test raises several concerns.

A. Supreme Court Case Law

To begin, the balancing nature of the test is arguably inconsistent with the Supreme Court's decision in *Swidler & Berlin v. United States*, where the Court reversed a holding by the D.C. Circuit that information covered by a decedent's attorney client privilege could be introduced into evidence when it would have "substantial importance to a particular criminal case."[36] Although *Swidler & Berlin* addressed the ability of a federal prosecutor to compel incriminating information subject to the privilege,[37] and thus is distinguishable from the case in which a criminal defendant asserts a Sixth Amendment right to introduce evidence showing his innocence,[38] the Court's underlying reasoning leaves less room to maneuver: according to the Court, "[b]alancing *ex post* the importance of the information against client interests, even limited to criminal cases, introduces substantial uncertainty into the privilege's application. For just that reason, we have rejected use of a balancing test in defining the contours of the privilege."[39]

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31 *Id.* at 5-6.
32 Order Addressing Protocol for BP EPI at 1, *Mix* (Feb. 28, 2013), ECF No. 207.
33 *Id.*
34 Order Granting Def.'s Motion for Access to BP EPI, *Mix* (Mar. 1, 2013), ECF No. 209; Order Granting United States' Motion for Access to BP EPI, *Mix* (Mar. 26, 2013), ECF No. 224.
35 Renotice of Trial, *Mix* (Jan. 24, 2013), ECF No. 185.
36 524 U.S. 399, 403 (1998).
37 *Id.* at 401-02.
38 *E.g.*, *Mix*, 2012 WL 2420016, at *3; *W.R. Grace*, 439 F. Supp. 2d at 1140-42.
39 524 U.S. at 409 (citing *Upjohn*, 449 U.S. at 393). Some litigants have made much of the fact that the government in *Swidler & Berlin* "concede[d] that exceptional circumstances implicating a criminal defendant's constitutional rights might warrant breaching the privilege," and that the Court said it did not need to reach that issue, "since such exceptional circumstances [were] not present [there]." *Id.* at 409 n.3. But it is the privilege-holder, not the government, whose concession would be legally significant, and, despite dicta about not needing to reach the issue, the Court's unequivocal rejection of *ex post* balancing seems to demonstrate its position.

Indeed, Justice O'Connor, writing in dissent to *Swidler & Berlin*, apparently construed the majority's reasoning to be unequivocal, stating at the outset of her opinion that "I do not agree with the Court that [the attorney client privilege] inevitably precludes disclosure of a deceased client's communications in criminal proceedings. In my view, a criminal defendant's right to exculpatory evidence or a compelling law enforcement need for information may, where the testimony is not available from other sources, override a client's posthumous interest in confidentiality."[40]

Additionally, the *Swidler & Berlin* opinion casts further doubt on the *W.R. Grace* test in stating that "there is no case authority for the proposition that the privilege applies differently in criminal and civil cases . . . . [A] client may not know at the time he discloses information to his attorney whether it will later be relevant to a civil or a criminal matter, let alone whether it will be of substantial importance."[41] Yet the *W.R. Grace* test, rooted firmly in the Sixth Amendment, gives the privilege lesser status in criminal proceedings.

B. The *W.R. Grace* Test in Practice

Its doctrinal vulnerabilities aside, the *W.R. Grace* balancing test, like any true compromise, leaves all sides less than satisfied.

From the perspective of individual officers and employees, the *W.R. Grace* test provides only limited relief. Although the test is an improvement over an absolute bar to introducing privileged information, it nonetheless requires individual defendants to seek admission of exculpatory evidence on a case-by-case basis, with virtually no way of predicting how the trial court will exercise its broad discretion under the test. Additionally, because the *W.R. Grace* procedure provides no mechanism for pre-indictment disclosure, it offers little comfort to individuals for whom indictment alone will cause irreparable harm. Similarly, and perhaps even more concerning, the test provides no relief whatsoever to civil defendants, even though civil enforcement actions can often result in serious monetary and other penalties. The Securities Exchange Commission, for instance, in addition to imposing stiff penalties and fines, can suspend or disqualify participants from the securities industry through purely civil proceedings.[42] Thus, subject to broad judicial discretion, available only at trial, and confined entirely to criminal proceedings, the *W.R. Grace* test leaves a substantial gap in protection for individual officers and employees.

From the perspective of the government and the public, it could be argued that the one-sided nature of the test will impair the factual integrity of trial. Notably, by virtue of the test's formulation, which permits a court to admit evidence that is "of such probative and exculpatory value as to compel admission,"[43] the test essentially creates a one-way street – whereas a defendant may prevail upon the court to admit evidence that exonerates, incriminating privileged information would apparently never come in. Similarly, because the *W.R. Grace* test provides defendants – but not prosecutors – the ability to discover privileged information, criminal defendants can presumably draft their Rule 17 subpoenas to target carefully any exculpatory privileged evidence in the corporation's possession, while excluding privileged evidence that tends to incriminate. Ironically, with the rules tilted in

40 *Id.* at 411 (O'Connor, J., dissenting, joined by Scalia, Thomas, JJ.).
41 *Id.* at 408-09.
42 *See, e.g.*, *Markowski v. SEC*, 34 F.3d 99, 101 (2d Cir. 1994).
43 *W.R. Grace*, 439 F. Supp. 2d at 1142.

this way, a culpable defendant may, in some circumstances, be better off if the corporation asserts privilege, because the defendant might then be able to selectively reveal only exculpatory privileged information.[44]

From the corporation's perspective, the test may pose much greater risk than the courts applying *W.R. Grace* have suggested. Although courts applying *W.R. Grace* impose strict protective orders over any privileged information produced, and reassure the corporation that privileged evidence will be admitted at trial only in "limited circumstances,"[45] it is unclear what real comfort those measures provide, when, as illustrated in *Mix*, the court nonetheless grants the prosecution unrestricted access to an entire hard drive of the corporation's privileged information.[46] While the *Mix* court ordered broadly that the United States "shall not use the EPI outside of its litigation with Mix," and provided expressly that the United States "is precluded from using the EPI in any investigation or litigation against the privilegeholder,"[47] these stipulations are susceptible to limiting interpretation. For instance, if the term "use" is construed consistently with how that term was used in Mix's original motion for protective order (i.e., "*use at trial*"),[48] it might apply only to the formal introduction of evidence in legal proceedings, while leaving the government free to conduct additional factfinding based on the privileged documents, or, depending on their content, to argue that the documents are not privileged at all.[49] Further, though arguably a technical point, the order binds only "the United States,"[50] inviting the question whether the order would be binding on other litigants who may obtain the information, either inadvertently during transfer or when it is introduced at trial.[51] Thus, while a corporation that is ordered to produce privileged documents under *W.R. Grace* surely welcomes some protective orders over none, protective orders like those issued in *United States v. Mix* expose the corporation to more risk than first meets the eye.

III. Modest Improvement to *W.R. Grace*

It is no secret that *W.R. Grace* represents a compromise, and, as such, it cannot be expected to fully satisfy all sides. For individual defendants to be able to introduce exculpatory information over a corporation's claim of attorney client privilege, the corporation must be compelled against its will to produce privileged information. That much is unavoidable.

But while some degree of compromise may be necessary, there is room for refinements to *W.R. Grace* that mitigate the concerns outlined above, without sacrificing the underlying goal of allowing individual criminal defendants to mount a full defense.

44 Ordinarily, where the privilege rests with the defendant and not a third party, this kind of strategic disclosure would be foreclosed – the privilege cannot be "both sword and shield," so the maxim goes, *see, e.g.*, *In re Seagate Tech., LLC*, 497 F.3d 1360, 1372 (2d Cir. 2007) – but courts applying *W.R. Grace* have not invoked this language, *see, e.g.*, Protective Order, *supra* note 27, and for good reason, as it would be the shield-bearing corporation, not the sword-wielding defendant, that would be exposed.

45 *W.R. Grace*, 439 F. Supp. 2d at 1143.

46 Order Granting United States' Motion for Access to BP EPI, *Mix* (Mar. 26, 2013), ECF No. 224.

47 Protective Order, *supra* note 27, at 6.

48 Memo. in Support of Def.'s Motion for Prot. Order at 1, *Mix* (May 14, 2012), ECF No. 26-1.

49 One ground on which the prosecutor might challenge the corporation's claim of privilege is the crime-fraud exception. *See United States v. Zolin*, 491 U.S. 554, 563 (1989). Hypothetically, the prosecution could review the privileged documents to develop evidence that the corporation's communications to counsel were in furtherance of a crime or fraud. If this were successful, the documents would arguably no longer be subject to a protective order like the one in *Mix*, which by its terms applies only to "exculpatory *privileged* information." Protective Order, *supra* note 27, at 6 (emphasis added).

50 Protective Order, *supra* note 27, at 6.

51 In a similar vein, because the court's order explicitly precludes the government from using exculpatory privileged information "against the privilege-holder," Protective Order, *supra* note 27, at 6, it is susceptible to the negative inference that the government may be able to use the information against other officers or employees of the corporation, whether as the basis for additional fact-finding, in grand jury proceedings, or otherwise.

The protective orders accompanying a disclosure order under *W.R. Grace* should be more tightly drawn than those in *United States v. Mix*. At a minimum, courts ordering production under *W.R. Grace* should expressly preclude the prosecution from using the documents as the basis for additional fact-finding, or as the basis for challenging the privileged status of the documents after viewing their contents. To give meaningful effect to these prohibitions, the court should order the prosecution to erect a wall around the prosecutorial team who obtains access to the corporate privileged information, as is commonly undertaken by prosecutors who receive immunized testimony in other settings.[52]

Notably, although this modification by no means resolves the fundamental compromise that *W.R. Grace* represents, it could be implemented without impairing the Sixth Amendment interests that animate the test.

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The conflict outlined in this paper does not lend itself to simple resolution. The Supreme Court has made clear that the power to assert or waive the corporate attorney client privilege "rests with the corporation's management and is normally exercised by its officers and directors."[53] Further bolstering that ruling, federal courts have held uniformly that a former officer or employee cannot waive the privilege on behalf of the corporation,[54] and that current officers and employees, because they are bound to "exercise the privilege in a manner consistent with their fiduciary dut[ies],"[55] may not exercise privilege in a purely self-exculpatory manner.[56] In short, the background rules governing a corporation's claim of privilege are fairly airtight.

Ultimately, at least in the criminal setting, the balancing approach in *W.R. Grace* may represent the best among imperfect solutions, provided that future courts tailor their protective orders to better safeguard against misuse of corporate privileged information. As to civil proceedings, however, given the consensus around the inviolability of the corporate attorney client privilege,[57] a solution favoring individuals would appear to require a legislative fix.

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52 *See* Karen Reynolds & Mandie Landry, *Procedural Issues*, 41 AM. CRIM. L. REV. 973, 990 n.116 (2004) (collecting cases).

53 *CFTC v. Weintraub*, 471 U.S. 343, 349 (1985).

54 *See, e.g.*, *W.R. Grace*, 439 F. Supp. 2d at 1143 ("It is the company's current managers, not displaced managers, who have control over the assertion of the privilege. This is the case regardless of whether the communication at issue occurred during the tenure of previous management." (citing *Weintraub*, 471 U.S. at 349)); *Criswell v. City of O'Fallon, Mo.*, No. 06-cv-1565, 2008 WL 250199, at *3 (E.D. Mo. Jan. 29, 2008) ("Plaintiff is no longer a City employee, and is not in a position to waive the privilege on its behalf.").

55 *Weintraub*, 471 U.S. at 34849.

56 *See, e.g.*, *Pensacola Firefighters' Relief and Pension Fund Bd. of Dirs. v. Merrill Lynch, Fenner & Smith, Inc.*, No. 09-cv-53, 2010 WL 4683935, at *5-6 (N.D. Fla. Nov. 10, 2010) (holding corporate privilege not waived where officer's disclosure was "more of an effort to exculpate himself personally . . . than an effort by the company to disclose selective confidential statements that would benefit the company in litigation"); *In re Fedex Ground Package Sys., Inc.*, No. 05-MD-527, 2007 WL 1109115, at *4-5 (N.D. Ill. Apr. 10, 2007) (same); *see also In re Grand Jury Proceedings*, 219 F.3d 175, 188 (2d Cir. 2000) ("[T]he [waiver] issue [turns on] . . . whether [the statement] was a deliberate attempt on the part of the corporation to exculpate itself, as opposed to [the] [w]itness's effort to exculpate himself personally.").

57 *See generally* American Bar Association, Report of the Presidential Task Force on Attorney Client Privilege (2006), *available at* http://apps.americanbar.org/buslaw/attorneyclient/materials/hod/emprights_ report_adopted.pdf.

THE FUTURE OF OFF-LABEL PROMOTION ENFORCEMENT IN THE WAKE OF *CARONIA* – TOWARD A FIRST AMENDMENT SAFE HARBOR

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On December 10, 1862, a paper reported that William Hammond, the Surgeon General of the United States Army, traveled from Washington, D.C. to Philadelphia, Pennsylvania to "investigate alleged frauds in the [Army's] Medical Purveying Department."[1] After "suspecting from strong evidence that all was not right there," the Surgeon General dispatched a medical inspector to make further inquiries into this case of health care contracting fraud.[2] Nearly one hundred and fifty years later, the United States Department of Justice issued a press release touting the fact that in fiscal year 2012, it recovered nearly $5 billion under the Civil War-era False Claims Act, of which recoveries for health care fraud amounted to over $3 billion.[3] While the government's tactics and focus have changed over the past century and a half, one thing is clear: health care fraud perpetrated against the government has been, and will continue to be, a prime law enforcement concern.

One particular concern in this area in recent years is fraud stemming from the off-label promotion.[4] In fact, the largest False Claims Act recoveries have all been off-label promotion cases.[5] It may come as a surprise to some then that the off-label *use* of drugs is perfectly legitimate, and that in certain circumstances the FDA has recognized that the off-label use of drugs may actually constitute the accepted medical standard of care.[6] Moreover, the term "off-label promotion" appears nowhere in the relevant statutory and regulatory text. Furthermore, notwithstanding aggressive enforcement in this area for many years, there remains minimal guidance and unclear statutes and regulations, which makes it challenging for drug manufacturers as they grapple with the government's expanding theories of liability for off-label promotion.[7]

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1 *Frauds in the Medical Department*, N.Y. TIMES, Dec. 10, 1862, *available at* http://www.nytimes.com/1862/12/10/news/washington-important-matters-under-discussion-congress-question-arbitrary.html.

2 *Id.*

3 *See* DOJ Press Release, United States Department of Justice, Justice Department Recovers Nearly $5 Billion in False Claims Act Cases in Fiscal Year 2012 (Dec. 4, 2012), *available at* http://www.justice.gov/opa/pr/2012/December/12-ag-1439.html.

4 For the sake of clarity, the remainder of this Article will focus on the regulation of pharmaceutical drugs, and not medical devices. However, although the statutory citations may differ, the following discussion is generally applicable equally to medical devices.

5 *See Supra*, note 3.

6 *See, e.g.*, John E. Osborn, *Can I Tell You the Truth? A Comparative Perspective on Regulating Off-Label Scientific and Medical Information*, 10 Yale J. Health Pol'y, L. & Ethics 299, 303-04 (2010); James E. Beck and Elizabeth D. Azari, *FDA, Off-Label Use, and Informed Consent: Debunking the Myths and Misconceptions*, 53 Food & Drug Law. J. 71, 80 (1998) (estimating that off-label uses account for between 25 to 60 percent of all prescriptions written each year); *see also* Good Reprint Practices for the Distribution of Medical Journal Articles and Medical or Scientific Reference Publications on Unapproved New Uses of Approved Drugs and Approved or Cleared Medical Devices, 74 Fed. Reg. 1694 (Jan. 13, 2009) (hereinafter, "Good Reprint Practices").

7 *See id.* at n.21 and accompanying text.

In the past, many off-label investigations focused on statements made, or materials disseminated by, manufacturers' sales representatives. Recent trends in off-label enforcement, however, show that the government is branching out from a purely sales and marketing focus and is now peeking under the hood of activities that were not, until recently, heavily scrutinized. The Food and Drug Administration ("FDA") and the Department of Justice ("DOJ") are now focusing on areas that historically have not generally been considered "promotional" in nature, including post-market clinical study design and conduct, the use (and misuse) of clinical data by manufacturers, and the use of continuing medical education programs and activities.

Recent cases, settlements, and enforcement actions illustrate this new focus for government in off-label promotion enforcement. This Article will analyze these actions. In recent years, manufacturers, their counsel, and other interested parties, have maintained that truthful off-label promotional speech is protected by the First Amendment of the United States Constitution.[8] While First Amendment challenges to the government's position on off-label promotion have not, generally, been well received by prosecutors,[9] manufacturers have been able to advance the argument over the years – notwithstanding the relative paucity of judicial review in cases of corporate prosecution.[10] Late last year, the United States Court of Appeals for the Second Circuit issued its decision in *United States v. Caronia*, holding that the government cannot prosecute pharmaceutical manufacturers and their representatives for speech promoting the lawful, off-label use of an FDA-approved drug.[11] While much ink has been spilled in the wake of the *Caronia* decision, it is already clear that the decision will not stop the government's enforcement focus on off-label promotion.[12] It will, however, force the government to focus on the truth or falsity of the alleged off-label promotional speech. In other words, the truthfulness of promotional speech will be a central issue in any off-label investigation, and the recent trend towards scrutiny of clinical data and the scientific exchange of information will become *de rigueur*.

This article will first provide a brief overview of the government's regulation of off-label medical and scientific information. Second, it will discuss the trend towards scrutiny of clinical data and the scientific exchange process. Third, the Article will discuss the intersection of the First Amendment and off-label promotion, and will highlight the *Caronia* decision. Fourth, with the First Amendment and *Caronia* cases as backdrop, this Article will analyze the implications of the *Caronia* decision, the current state of off-label promotion enforcement, and the possibility of a First Amendment safe harbor for truthful off-label speech. Finally, the Article will provide concluding remarks.

I. Off-Label Promotion Enforcement – The Regulatory Framework

As noted above, the phrase "off-label promotion" is not found anywhere in the Food, Drug, and Cosmetic Act of 1938 ("FDCA"), the statutory framework under which

8 The authors' law firm, King & Spalding LLP has had significant involvement in arguing for Constitutional protection of truthful off-label promotional speech. *See, e.g.*, *infra* note 60.
9 *See* Osborn, *supra* note 6, at 314, n.45 (noting that "[k]ey government prosecutors have confirmed that it does not matter whether or not the questionable speech is truthful or misleading, so long as it is 'off-label.'") (citing statements made by Assistant United States Attorney Michael Loucks at an industry-sponsored panel).
10 *Id.* at 327-29.
11 __ F.3d __, 2012 WL 5992141, *15 (2d Cir. Dec. 3, 2012).
12 The FDA has indicated that it will not appeal the *Caronia* decision. *See* Thomas M. Burton, *FDA Won't Appeal Free-Speech Marketing Decision*, WALL ST. J., Jan. 23, 2009. In fact, in a panel presentation at the 2013 ABA White Collar Conference, the head of the FDA's Office of Criminal Investigation stated that in the wake of the Caronia decision, his office had reviewed its investigations from previous years and concluded that all of them involved conduct that would still be actionable after Caronia. *See* Nate Raymond, *Lawyers Debate Impact of 2nd Circuit Off-Label Ruling*, Legal Monitor Worldwide (March 12, 2013), 2013 WLNR 6142345.

the FDA draws its authority to regulate the sale and marketing of pharmaceutical drugs. Instead, the FDA's authority to regulate off-label promotion is drawn from the FDCA's prohibitions against introducing an "unapproved new drug" or a "misbranded" drug into interstate commerce.[13] In this regard, the FDCA grants the FDA wide latitude in regulating a drug's "labeling" to ensure that it is not false or misleading.[14] The term "labeling" is defined broadly to include "all labels and other written, printed, or graphic matter . . . accompanying such article."[15] If a manufacturer promotes a drug for a use not contained in the FDA-approved labeling, the FDA considers the drug a "new drug" insofar as it has not been deemed safe and effective "for use under the conditions prescribed, recommended, or suggested in the labeling."[16] In this regard, even though the FDCA's definition of "labeling" is broad, the FDCA's implementing regulations define "labeling" even further to include virtually any tangible material created or disseminated by a manufacturer discussing a particular drug.[17] As one commentator has noted, therefore, "the Act's prohibition of false or misleading labeling is transformed by the agency into an effective prohibition on any advertisement, promotional message, or discussion that is not consistent with the approved product labeling, or otherwise concerns any use that has not been approved expressly by the FDA, regardless of whether it is truthful or accurately reflects good medical practice."[18]

In addition to proscribing the introduction of an unapproved new drug into interstate commerce, the FDCA also makes it a crime to introduce a "misbranded" drug. A drug is misbranded if, *inter alia*, its labeling fails to bear "adequate directions for use."[19] FDA regulations define "adequate directions for use" as "directions under which the layman can use a drug safely and for the *purpose for which it is intended*."[20] Accordingly, the FDA regulations transform the statutory term "use" into "intended use" which is determined by reference to "the objective intent of the persons legally responsible for the labeling of drugs."[21] Intended use may be demonstrated by "oral or written statements by such persons or their representatives" and "the circumstances that the article is, with the knowledge of such persons or their representatives, offered and used for a purpose for which it is neither labeled nor advertised."[22] The FDA requires, therefore, that each intended use be approved by the agency, and if the intended use has not been approved, then it takes the position that the manufacturer has introduced a misbranded drug into interstate commerce.

The FDCA contains no private right of action, and as a result, only the federal government can bring actions for violations of the Act. Off-label promotion investigations often go hand-in-hand, however, with actions under the federal False Claims Act (FCA), which contains a *qui tam* provision allowing private individuals to file actions on behalf of the United States. Enacted during the Civil War, the FCA subjects to civil liability "[a]ny person who knowingly presents or causes to be presented, to . . . the United States Government . . . a false or fraudulent claim for payment or approval," as well as "[a]ny person who knowingly makes, uses, or causes to be made or used a false record or statement to get a false or fraudulent claim paid or approved by the Government."[23] As one court has noted, the *qui tam* provision of the Act served to "unleash[ ] a posse of *ad hoc* deputies to uncover and prosecute frauds against the government."[24]

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13 *See* 21 U.S.C. §§ 331(a), (d).
14 *See id.* § 352(a).
15 *Id.* § 321(m).
16 *Id.* § 321(p).
17 *See* 21 C.F.R. § 202.1.
18 Osborn, *supra* note 6, at 308-09 (internal quotations and citations omitted).
19 21 U.S.C. § 352(f).
20 21 C.F.R. § 201.5 (emphasis added).
21 *Id.* § 201.128.
22 *Id.*
23 31 U.S.C. §§ 3729(a)(1)-(2).
24 United States ex rel. Wilson v. Graham County Soil & Water Conservation Dist., 528 F.3d 292, 298 (4th Cir. 2008).

In the context of off-label promotion, many (if not most) investigations have been fueled by whistleblowers who file suit under the *qui tam* provisions of the FCA and who hope to receive a substantial share of any subsequent government recovery.[25] These suits rely on an underlying violation of the FDCA, and typically allege that: (1) the manufacturer engaged in an illegal scheme to market off-label uses of a drug or device in violation of the FDCA; and (2) as a result of the off-label promotional campaign, false claims for payment were submitted to federal healthcare programs such as Medicare and Medicaid, which did not provide coverage for the off-label use in question.[26] As noted, 2012 was a record year for recoveries under the FCA, and health care fraud recoveries accounted for over $3 billion.[27] Use of the FCA in prosecuting off-label promotion in particular has been a cornerstone of the government's health care fraud initiative, and the number of off-label enforcement actions have increased concomitantly with the expansion of the FCA generally.[28]

Given the government's expansive formulation of its prohibition against off-label promotion, and the various tools at its disposal to combat it, manufacturers are very aware of the risks of promoting drugs off-label and have implemented comprehensive compliance programs, yet nonetheless continue to find themselves in the government's cross-hairs. This begs the question of why? Briefly, beyond a few narrow exceptions allowing for the exchange of certain off-label scientific information,[29] there are no clear rules governing what information a manufacturer may legally disseminate.[30] Not only are there many uncertainties under the regulatory scheme, there is a general dearth of case law interpreting, and providing a check to, the government's position. This is partly the result of the fact that because most manufacturers are publicly-traded companies, they cannot afford, because of risk of the business loss and reputational damage, to litigate a criminal case to disposition. Moreover, manufacturers criminally convicted of off-label promotion face exclusion from federally-funded health care programs. For these reasons, therefore, nearly all enforcement actions levied against manufacturers end in settlement without a check on the enforcement agencies' interpretations of the rules through adversarial process and without a court decision regarding the agencies' views. This lack of open process also has meant that manufacturers seeking to learn from recent enforcement actions have not been privy to the underlying settlement negotiations, and only have been able to glean relevant information regarding the rules from the few available public materials. As one commentator recently noted, the lack of judicial review in these cases has caused "a cyclical loosening of the kinds of facts that get introduced during these cases as evidence of promotion," as a result of the fact that "prosecutors have grown accustomed to the fact that they are unlikely to face court challenges in these cases."[31]

Because of aggressive enforcement and the tremendous costs and risks stemming from even facing a government investigation, manufacturers have instituted rigorous compliance programs designed to prevent and deter illegal off-label promotional activities. This has necessarily reduced the number of glaring infractions available to the government

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25 *See, e.g.*, David J. Ryan, *False Claims Act: An Old Weapon with New Firepower is Aimed at Health Care Fraud*, Annals of Healthcare Law 4 (1995).
26 *See* Edward P. Lansdale, *Used As Directed? How Prosecutors Are Expanding the False Claims Act to Police Pharmaceutical Off-Label Marketing*, 41 New Eng. L. Rev. 159, 187-89 (2006).
27 *See supra* note 3.
28 *See* Osborn, *supra* note 6, at 312.
29 *See* discussion *infra* at Section III.
30 *See* Osborn, *supra* note 6, at 317.
31 Scott Gottlieb, M.D., *The U.S. Department of Justice's Targeting of Medical Speech and its Public Health Impacts*, AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH, HEALTH POLICY OUTLOOK 4-5 (Dec. 2012), *available at* http://www.aei.org/files/2012/12/06/-the-us-department-of-justices-targeting-of-medical-speech-and-its-public-health-impacts_084900709055.pdf.

to investigate. In response, the government has expanded further their areas of scrutiny and taken more aggressive positions regarding the scope of the FCA and the FDCA's prohibition against off-label marketing. In particular, as the next Section details, prosecutors are increasingly branching out from the traditional sales and marketing aspects of off-label promotion and are now peeking under the hood of clinical research and other aspects of the scientific exchange process.

II. The Trend Towards Scrutiny of Clinical Data and the Scientific Exchange Process

In announcing the $3 billion settlement reached between DOJ and GlaxoSmithKline resolving allegations of off-label promotion of the drugs Paxil and Welbutrin, Deputy Attorney General James Cole announced that in the three years prior, DOJ had "recovered a total of more than $10.2 billion in settlements, judgments, fines, restitution and forfeiture in health care fraud matters."[32] Earlier in 2012, Attorney General Eric Holder testified that for every dollar spent combating health care fraud, the government recoups an average of seven dollars.[33] This return on investment is a key driver of the government's focus on health care fraud, and the government understandably enjoys touting its recoveries. As much of the low-hanging fruit has already been picked, however, and in order to maintain its high return on investment, DOJ has been forced to adopt more aggressive enforcement efforts and theories. In particular, recent settlement agreements and corporate integrity agreements show that prosecutors have begun to focus beyond the actions of sales representatives to manufacturers' medical affairs and clinical research activities.

Several manufacturers are now under investigation for allegedly misrepresenting or failing to disclose clinical trial data. In this regard, prosecutors and plaintiffs' attorneys allege that the sale of an FDA-approved drug based on a misrepresented clinical study, is, by definition, a false claim. For example, in May 2012, DOJ announced a $1.5 billion settlement with Abbott Laboratories over the illegal off-label promotion of the drug Depakote.[34] Abbott pleaded guilty to misbranding Depakote to treat schizophrenia, an indication that was not approved by the FDA. Summarizing one section of the agreed statement of facts contained in the guilty plea, the DOJ press release noted the following:

> Abbott funded two studies of the use of Depakote to treat schizophrenia, and both failed to meet the main goals established for the study. When the second study failed to show a statistically significant treatment difference between antipsychotic drugs used in combination with Depakote and antipsychotic drugs alone, Abbott waited nearly two years to notify its own sales force about the study results and another two years to publish those results.[35]

The delay in the disclosure of clinical study data served as one basis on which DOJ based its off-label promotion claims. Moreover, even after Abbott revised presentation materials to include slides containing information on the disappointing study, the agreed statement of facts from the company's guilty plea states that Abbott also "included approximately a dozen slides about other [positive] studies . . . and slides about when healthcare providers

32 DOJ Press Release, Deputy Attorney General James M. Cole Speaks at the GSK Press Conference (July 2, 2012), *available at* http://www.justice.gov/iso/opa/dag/speeches/2012/dag-speech-1207021.html.
33 DOJ Press Release, Attorney General Eric Holder Testifies Before the U.S. House of Representatives Committee on Appropriations Subcommittee on Commerce, Justice, Science, and Related Agencies (Feb. 28, 2012), *available at* http://www.justice.gov/iso/opa/ag/speeches/2012/ag-speech-1202281.html.
34 DOJ Press Release, Abbott Labs to Pay $1.5 Billion to Resolve Criminal & Civil Investigations of Off-Label Promotion of Depakote (May 7, 2012), *available at* http://www.justice.gov/opa/pr/2012/May/12-civ-585.html.
35 *Id.*

should use Depakote to treat agitation and aggression in elderly dementia patients and how to dose Depakote for this off-label use."[36] Accordingly, the Abbott settlement indicates that, aside from the more overt off-label promotional tactics that have been the cornerstone of DOJ's enforcement efforts, DOJ will now consider the presentation of positive, without available negative, clinical data evidence of off-label marketing – more to the point, and as will be discussed *infra*, at least in the Abbott case, the dissemination of positive without negative data was considered "misleading" by DOJ.

Similarly, the criminal information filed against GlaxoSmithKline (GSK) relating to the off-label investigation of Paxil further illustrates DOJ's new scrutiny of manufacturers' failures to disclose clinical study design and data.[37] In this case, DOJ alleged that GSK hired a contractor to write an article analyzing the results of a clinical study. According to DOJ, the article, which was published in a peer reviewed publication, was false and misleading because "the article's text identified the two primary endpoints . . . [but] the article never explicitly stated that [the clinical study] failed to demonstrate efficacy on either of its primary endpoints."[38] Furthermore, GSK sent the offending article to its sales representatives with an attached cover memorandum. According to DOJ, the cover memorandum misrepresented that the clinical trial of Paxil demonstrated efficacy insofar as it did not explicitly state that the study failed to meet its protocol-defined primary and secondary endpoints, and in addition, failed to notify the sales team that GSK had conducted to other studies that also failed to demonstrate Paxil's efficacy.[39]

As evidenced by DOJ's allegations against Abbott and GSK, it is clear that off-label investigations have delved far beyond more traditional off-label promotional activities, and that the government is now analyzing the actual clinical study protocols and intended primary endpoints of post-market clinical studies. Moreover, law enforcement's clinical focus can now be routinely found in corporate integrity agreements ("CIAs") entered into between settling companies and the Office of the Inspector General ("OIG") of the Department of Health and Human Services. Like DOJ's increased focus on clinical and research activities, OIG has expanded related obligations in recent CIAs, including clinical research-related provisions even in cases in which allegations relating to clinical research are not included in the underlying settlement documents.

More specifically, recent CIAs contain provisions imposing obligations related to clinical studies and research including *inter alia*: (1) designation of personnel involved in post-market clinical studies as "Relevant Covered Persons;" (2) management certifications by senior management responsible for clinical research; (3) adoption of clinical study policies and procedures; (4) the imposition of research and publication controls; (5) monitoring of researchers; and (6) various transparency requirements.[40] Recent CIAs also typically require

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36 Agreed Statement of Facts at 17, United States v. Abbott Laboratories, No. 12-cr-00026-SGW (W.D. Va. May 7, 2012).
37 Criminal Information, United States v. GlaxoSmithKline, LLC, (D. Mass. June 2012) *available at* www.justice.gov/opa/documents/gsk/gsk-criminal-info.pdf (hereinafter, "GSK Criminal Information"); *see also* DOJ Press Release, GlaxoSmithKline to Plead Guilty and Pay $3 Billion to Resolve Fraud Allegations and Failure to Report Safety Data (July 2, 2012), *available at* http://www.justice.gov/opa/pr/2012/July/12-civ-842.html.
38 GSK Criminal Information at ¶ 34, *surpa* note 37.
39 *Id.* at ¶¶ 38-40.
40 *See, e.g.*, Corporate Integrity Agreement Between the Office of Inspector General of the Department of Health and Human Services and Amgen, Inc., U.S. Dep't Health & Hum. Servs. Off. Inspector Gen. (Dec. 14, 2012), https://oig.hhs.gov/fraud/cia/agreements/Amgen_12142012.pdf; Corporate Integrity Agreement Between the Office of Inspector General of the Department of Health and Human Services and Boehringer Ingelheim Pharmaceuticals, Inc., U.S. Dep't Health & Hum. Servs. Off. Inspector Gen. (Oct. 22, 2012), https://oig.hhs.gov/fraud/cia/agreements/Boehringer_Ingelheim_Pharmaceuticals_10222012.pdf; Corporate Integrity Agreement Between the Office of Inspector General of the Department of Health and Human Services and GlaxoSmithKline, LLC., U.S. Dep't Health & Hum. Servs. Off. Inspector Gen. (June 28, 2012), https://oig.hhs.gov/fraud/cia/agreements/GlaxoSmithKline_LLC_06282012.pdf; Corporate Integrity Agreement Between the Office of Inspector General of the Department of Health and Human Services and Abbott Laboratories, U.S. Dep't Health & Hum. Servs. Off. Inspector Gen. (May 7, 2012), https://oig.hhs.gov/fraud/cia/agreements/Abbott_Laboratories_05072012.pdf.

the engagement of a Independent Review Organization ("IRO") to perform various systems and transaction reviews, including reviews of clinical research and publication activities[41] – an onerous requirement that further indicates the trend towards extensive oversight and intervention in the medical affairs and clinical research functions of manufacturers.

By way of example, the recent Amgen, Inc. CIA contains all of the above-mentioned provisions – and further evidences DOJ's scrutiny of post-market clinical research.[42] Moreover, the Criminal Information filed against Amgen and the DOJ Press Release announcing the settlement introduce a new enforcement theory related to clinical research – "reactive marketing." According to the Amgen Criminal Information, Amgen sales representatives were provided with clinical research articles supporting the off-label use of the drug in question, Aranesp.[43] The sales representatives were trained to elicit questions from doctors relating to off-label use of Aranesp, which would provide the reps the "necessary cover" to then give the doctors the off-label studies.[44] According to DOJ, those off-label studies had been rejected by FDA as "insufficient to support the safety and efficacy of those off-label uses."[45]

Taken together, these trends show that DOJ and OIG are seeking ever more tools in CIAs in their quest to root out what they see as off-label promotion. These trends also evidence the growing distrust the government has of manufacturers' post-market clinical research and publication, particularly scrutiny of clinical study design, primary and secondary endpoint analysis, and disclosure (or lack of such) of clinical study results. As discussed in the next section, however, manufacturers now may have a First Amendment argument that can auger the rise of a safe harbor for truthful off-label promotion, or at the very least provide manufacturers with greater leverage in future settlement negotiations.

III. The Intersection of the First Amendment and Truthful Off-Label Promotion

A. The Legal Framework

It is well recognized that the FDCA's misbranding provisions, and the FDA's accompanying regulations impose substantial limitations on manufacturer's ability to speak about off-label uses of their products. What is less clear, however, is precisely the type of speech proscribed by the misbranding provisions, current FDA regulations and the agency's interpretation of those regulations. In this regard, there is no clear line between illegal off-label promotion and the legitimate exchange of scientific information – and manufacturers have been forced to grapple with regulators who have broad authority to condemn off-label promotion, but who have never clearly defined what constitutes "promotion."

While FDA has broad authority to regulate the dissemination of information about prescription drugs, it is not empowered to regulate the practice of medicine, and physicians are free to prescribe drugs for off-label uses.[46] Indeed, as the FDA itself has

41 *See, e.g.*, Amgen CIA, *supra* note 40, at pp. 12-13, 25-26; Abbott Laboratories CIA, *supra* note 40, at pp. 15-16. In most recent CIAs OIG had the authority to select up to three specified areas of review, but in the Amgen and Abbott CIAs, OIG included "Research and Publications Activities" as stand-alone areas for required transaction testing (in addition to the three additional areas of review).

42 *See* Amgen CIA, *supra* note 40; DOJ Press Release, Amgen, Inc. Pleads Guilty to Federal Charge in Brooklyn, NY.; Pays $762 Million to Resolve Criminal Liability and False Claims Act Allegations (Dec. 19, 2012), *available at* http://www.justice.gov/opa/pr/2012/December/12-civ-1523.html; Criminal Information, United States v. Amgen, Inc., No. 12-cr-00760-SJ (E.D.N.Y. Dec. 18, 2012)

43 Amgen Criminal Information, *supra* note 42.

44 *Id.*

45 Amgen DOJ Press Release, *supra* note 42.

46 *See* 21 U.S.C. § 396 (providing that the FDCA does not "limit or interfere with the authority of a health care practitioner to prescribe or administer any legally marketed device to a patient for any condition or disease within a legitimate health care practitioner-patient relationship").

acknowledged, in certain situations off-label use of drugs "may even constitute a medically recognized standard of care."[47] Moreover, in light of the fact that off-label use is a common and often necessary practice, Congress and the Centers for Medicare & Medicaid Services ("CMS") actually mandate federal reimbursement for off-label uses of drugs listed in medical compendia.[48]

Against this backdrop, and in apparent recognition of the legitimate off-label uses of drugs and devices, the FDA has recognized that because physicians require "objective, balanced, and accurate information of important unapproved uses of approved products," the public interest is best served with the "earlier dissemination" of truthful, accurate, and non-misleading off-label information.[49] In that regard, the FDA has promulgated a few limited exceptions to its general proscription against sharing off-label information with health care providers. The few "exceptions" allowing limited scientific exchange of off-label information, however, are often too vague, too narrow, and are promulgated in the form of "non-binding" guidance documents – leaving manufacturers either overly cautious and gun-shy of actually utilizing the available exceptions for fear that their actions could be used as evidence of off-label promotion or potentially raise the risk of enforcement action.[50]

By way of example, non-binding[51] FDA guidance allows manufacturers to disseminate copies of peer-reviewed journal articles discussing clinical trial results for off-label uses,[52] but the manufacturer could be subject to investigation or prosecution if the underlying research contained in the article is summarized – even truthfully – by the manufacturer. Moreover, although it has never clearly stated its position on the matter, FDA policy appears to allow manufacturers to discuss off-label information in response to unsolicited requests,[53] and would appear to allow manufacturers to disseminate "safety warnings" that do not promote, but rather discourage, off-label use of their products.[54] In other words, the FDA has never clearly articulated its position regarding what constitutes permissible "scientific exchange" and what constitutes impermissible "promotion," – and the only thing manufacturers can be certain of, is that statements concerning the efficacy of their products will only be deemed truthful and not misleading if the FDA has specifically included those claims in the approved labeling of the product at issue.

This regulatory uncertainty is complicated by the significant First Amendment free speech concerns attendant to any prohibition on the dissemination of truthful non-misleading scientific information. FDA's authority to regulate off-label promotional speech was constitutionally circumscribed to some degree by the Washington Legal Foundation (WLF) cases of the late 1990s.[55] In those cases, the WLF, a public interest group that

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47 Good Reprint Practices, *supra* note 6.

48 *See* 42 U.S.C. § 1396r-8(k)(6) (Medicaid); Medicare Benefit Policy Manual, Ch. 15, § 50.1.2 (Medicare); *see also* Dep't of Health & Hum. Servs., Charter: Medicare Evidence Development & Coverage Advisory Committee (Nov. 12, 2008), *available at* http://www.cms.hhs.gov/FACA/Downloads/medcaccharter.pdf (discussing CMS authorization of federal reimbursement of products for off-label uses after manufacturer submission of medical information regarding such use).

49 *See* Dissemination of Information on Unapproved/New Uses for Marketed Drugs, Biologics and Devices, 63 Fed. Reg. 64,556, at 64,579 (Nov. 20, 1998).

50 *See* Gottlieb, *supra* note 31.

51 *See* 21 C.F.R. § 10.115(d)(1) (2009) ("Guidance documents do not establish legally enforceable rights or responsibilities.").

52 *See* Good Reprint Practices, *supra* note 6.

53 *See* Citizen Petition Regarding the Food and Drug Administration's Policy on Promotion of Unapproved Uses of Approved Drugs and Devices, 59 Fed. Reg. 59,820, 59,823 (Nov. 18, 1994); *United States v. Stevens*, No. 10-cr-0694 (D. Md. 2011), Tr. 90:10-22 (Apr. 27, 2011) (testimony of FDA official Sandeep Saini). The authors' law firm represented the defendant in the Stevens case.

54 *See Allergan v. United States*, No. 09-cv-1879-JDB (D.D.C.), United States' Reply in Support of Motion to Dismiss, Dkt. No. 37, at 7 (Mar. 29, 2010).

55 *See Wash. Legal Found. v. Friedman*, 13 F. Supp. 2d 51 (D.D.C. 1998), amended by 36 F. Supp. 2d 16 (D.D.C. 1999), dismissed and vacated in part sub. nom. *Wash. Legal Found. v. Henney*, 202 F.3d 331 (D.C. Cir. 2000); *see also* Erin E. Bennett, Comment, Central Hudson-Plus: Why Off-Label Pharmaceutical Speech Will Find Its Voice, 49 Hous. L. Rev. 459, 470-72 (2012) (discussing the history of the WLF litigation); John Kamp, *FDA Marketing v. First Amendment*: Washington Legal Foundation Legal Challenges to Off-Label Policies May Force Unprecedented Changes at FDA, 54 Food & Drug L. J. 555 (1999).

advocates for, among other things, limited government and free enterprise, challenged the FDA's restrictions on the distribution of certain truthful and non-misleading scientific and medical information. In these cases, FDA guidance curtailing the distribution of scientific publications distributed to medical professionals was deemed an unconstitutional infringement of commercial speech under the rubric of the Supreme Court's Central Hudson four-part commercial speech test.[56] While it is beyond the scope of this Article to discuss the WLF litigation in any great detail, it is sufficient to note that the FDA avoided a permanent injunction curtailing enforcement of its guidance by stipulating to certain "safe harbors" established by the WLF ruling.[57]

Notwithstanding the fact that the First Amendment concerns surrounding the FDA's policies have received extensive critique and commentary by academics and other interested parties,[58] many manufacturers have been unwilling to advance First Amendment arguments regarding truthful off-label commercial speech for fear of prejudicing their position in their negotiations with DOJ and FDA. Manufacturers' unwillingness, however, has receded a bit. In recent years, at least two manufacturers have taken the "extraordinary"[59] step of filing declaratory judgment actions against FDA seeking a determination that the First Amendment protects truthful off-label speech.[60] Neither of those actions, however, have been litigated by the manufacturers to a point that yielded a judicial decision.

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56 *Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557 (1980). Under the test articulated in Central Hudson, first, the speech in question must concern lawful activity and must not be misleading in order to garner First Amendment protection. Second, the governmental interest asserted to justify the restriction on speech must be substantial. Third, the restriction must directly advance the governmental interest "to a material degree," and fourth, the restriction must be "narrowly drawn" and not more extensive than necessary to serve the government interest. *United States v. Caronia*, __ F.3d __, 2012 WL 5992141, at *11 (2d Cir. Dec. 3, 2012) (describing the Central Hudson test in the context of off-label promotion and scientific exchange).

57 *See* Osborn, *supra* note 6, at 312; Bennett, *supra* note 55, at 471-72.

58 *See, e.g., id.*; Briana R. Barron, Comment, Silent Warning: the FDA's Ban on Off-Label Speech; Is It Protecting Our Safety?, 94 Marq. L. Rev. 983 (2011); Aaron S. Kesselheim, Off-Label Drug Use and Promotion: Balancing Public Health Goals and Commercial Speech, 37 Am. J. L. & Med. 225 (2011); Jacob Rogers, Freedom of Speech and the FDA's Regulation of Off-Label Drug Uses, 76 Geo. Wash. L. Rev. 1429 (2008); Ralph F. Hall, Inconsistent Government Policies: Why FDA Off-Label Regulation Cannot Survive First Amendment Review Under Greater New Orleans, 62 Food & Drug. L. J. 1 (2007); David M. Fritch, Speak No Evil, Hear No Evil, Harm the Patient? Why the FDA Needs to Seek More, Rather Than Less, Speech From Drug Manufacturers on Off-Label Drug Treatments, 9 Mich. St. U. J. Med. & L. 315 (2005); A. Elizabeth Blackwell, Drug Manufacturers First Amendment Right to Advertise and Promote Products for Off-Label Use; Avoiding a Pyrrhic Victory, 58 Food & Drug L. J. 439 (2003).

59 *See* Osborn, *supra* note 6, at 329.

60 *See* Allergan v. United States, No. 09-cv-1879-JDB (D.D.C.); Johnathan D. Rockoff, *Allergan Suit Seeks to Lift Botox Curbs*, WALL ST. J., Oct. 2, 2009, at B4; Natasha Singer, *Botox Maker's Suit Cites Free Speech*, N.Y. TIMES, Oct. 2, 2009, at B3. In September, 2010, as part of a criminal and civil investigation, Allergan dismissed its lawsuit and stated:

> To resolve [a] criminal and civil investigation, Allergan was required by the Government to dismiss Allergan's First Amendment lawsuit pending in Washington, D.C., in which Allergan sought a ruling that it could proactively share truthful scientific and medical information with the medical community to assist physicians in evaluating the risks and benefits if they choose to use [Allergan's drug] off-label. . . . Allergan is disappointed that the court was not afforded an opportunity to hear and rule on these important First Amendment issues, as Allergan believes that physicians, patients, manufacturers, payers, and ultimately the quality of evidence-based medicine itself would have benefited from a ruling clarifying the law.

Allergan, News Release: Allergan Resolves United States Government Investigation of Past Sales and Marketing Practices Relating to Certain Therapeutic Uses of Botox (Sept. 1, 2010). The authors' law firm represented Allergan in its declaratory judgment action.

See also Par Pharmaceutical, Inc. v. United States, No. 11-cv-1820-RWR (D.D.C.). Echoing the First Amendment suit filed by Allergan, Par Pharmaceutical, Inc. sued FDA seeking declaratory judgment and injunctive relief against FDA's criminalization of truthful and non-misleading off-label speech as a violation of the First Amendment. The company argued that the "threat of prosecution for alleged off-label promotion based on Par's truthful and non-misleading speech to healthcare professionals concerning the FDA-approved use of Par's FDA-approved prescription drug currently chills Par's speech." Par asserted that the government is maintaining an inconsistent approach to off-label uses: criminalizing the manufacturers' discussion of off-label uses while often acknowledging the uses' clinical importance and reimbursing for them under Medicare and Medicaid. Recently, on March 5, 2013, Par pleaded guilty to a single criminal misdemeanor for misbranding Megace ES in violation of the FDCA and agreed to pay $45 million to resolve its criminal and civil liability. Importantly, Par's plea agreement required it to dismiss with prejudice its declaratory judgment action – thereby eliminating the prospect of a judicial ruling on the merits of the First Amendment question. *See* DOJ Press Release, Par Pharmaceuticals Pleads Guilty and Agrees to Pay $45 Million to Resolve Civil and Criminal Allegations Related to Off-Label Marketing (Mar. 5, 2013), *available at* http://www.justice.gov/opa/pr/2013/March/13-civ-270.html; *see also* King & Spalding Client Alert, *Two New Developments in First Amendment Challenges to Off-Label Promotion: What's Next* (March 13, 2013), *available at* http://www.kslaw.com/imageserver/KSPublic/library/publication/ca031313.pdf.

Instead, it has taken the litigating of the issue in a criminal case against a manufacturer's employee to gain a written decision regarding the First Amendment. On December 3, 2012, the United States Court of Appeals for the Second Circuit issued a decision in the case of *United States v. Caronia* finally addressing First Amendment arguments on the merits. The court concluded that "the government cannot prosecute pharmaceutical manufacturers and their representatives under the FDCA for speech promoting the lawful, off-label use of an FDA-approved drug."[61] Hailed by some as a landmark decision, the *Caronia* decision potentially ushers in a new era of FDA off-label enforcement. Before discussing the implications of the opinion, however, a brief background on the case is in order.

B. United States v. Caronia

On December 3, 2012, a majority panel of the Second Circuit overturned the November 2009 misdemeanor conviction of Alfred Caronia for conspiracy to introduce misbranded drugs into interstate commerce by promoting the drug Xyrem for off-label use in violation of the FDCA. Xyrem, a central nervous system depressant, was approved in 2002 for the treatment of a subset of narcolepsy patients. The drug's label contained a boxed warning stating that safety and efficacy had not been established in patients under sixteen years of age.

Caronia's conviction was premised on verbal off-label promotional statements he made while working as a Specialty Sales Consultant for Orphan Medical, Inc. ("Orphan").[62] More specifically, Caronia promoted Xyrem for a variety of unapproved indications and subpopulations, including insomnia, muscle disorders, chronic pain, fibromyalgia, Parkinson's, and in patients under sixteen years of age. The government initiated the investigation in 2005 after a former salesperson filed a *qui tam* suit against the company. During the course of the investigation, Caronia was tape-recorded on two occasions discussing off-label uses of Xyrem with Dr. Peter Gleason, a paid physician speaker. Dr. Gleason and Caronia were recorded discussing off-label uses of the drug with Dr. Jeffrey Charo, an undercover government informant, and in 2006, the government filed charges against Caronia, Dr. Gleason, Orphan, and David Tucker, a former Orphan sales manager. In March 2007, Tucker pleaded guilty to a single felony misbranding charge. In July 2007, Orphan pleaded guilty to felony charges, and its parent company, Jazz Pharmaceuticals, Inc. agreed to pay $20 million and enter into a Corporate Integrity Agreement to resolve both criminal and civil charges.[63] Dr. Gleason pleaded guilty to criminal misbranding charges in August 2008.

Caronia did not plead guilty, and prior to trial moved to dismiss the charges against him on First Amendment grounds. The trial court denied Caronia's motion. While recognizing that Caronia raised issues "very much unsettled, not only in this circuit but nationwide," the court ultimately concluded that the FDCA's criminalization of off-label promotional speech was constitutional insofar as it was not more extensive than necessary to achieve FDA's objective.[64]

61 *United States v. Caronia*, __ F.3d __, 2012 WL 5992141, at *15 (2d Cir. Dec. 3, 2012).
62 Orphan Medical, Inc. was purchased by Jazz Pharmaceuticals, Inc. in 2005. The authors' law firm represented Jazz Pharmaceuticals/Orphan Medical throughout the course of the government's investigation, as well as during the prosecution of Alfred Caronia. King & Spalding continues to represent the Company.
63 *See* DOJ Press Release, Jazz Pharmaceuticals, Inc. Agrees to Pay $20 Million to Resolve Criminal and Civil Allegations in "Off-Label" Marketing Investigation (July 13, 2007), *available at* http://www.justice.gov/usao/nye/pr/2007/2007jul13a.html.
64 *See United States v. Caronia*, 576 F. Supp. 2d 385 (E.D.N.Y. 2008).

Caronia was tried to a jury in October 2008, and was subsequently found guilty of one count of conspiracy to introduce a misbranded drug into interstate commerce. Caronia appealed his conviction to the Second Circuit, arguing that the First Amendment protects truthful and non-misleading promotional speech of an FDA-approved drug for off-label indications. The Second Circuit agreed.

The majority opinion, authored by Judge Denny Chin, first questioned whether Caronia's off-label promotional statements were used as evidence of Xyrem's intended use, as argued by the government, or whether Caronia was prosecuted "only for promoting an FDA-approved drug for off-label use."[65] Citing the Supreme Court's Wisconsin v. Mitchell decision,[66] the court assumed without deciding that off-label promotion could evidence a drug's intended use. After thoroughly examining the prosecutors' trial statements as well as the jury instructions, however, the court concluded that the trial record "confirms overwhelmingly that Caronia was, in fact, prosecuted and convicted for promoting Xyrem off-label."[67] The court noted that "[t]he government never argued in summation or rebuttal that the promotion was evidence of intent," and "never suggested that Caronia engaged in any form of misbranding other than [off-label] promotion."[68] In that regard, the court concluded that the government "clearly prosecuted Caronia for his words – for his speech" and that the trial court's jury instructions "led the jury to believe that Caronia's promotional speech was, by itself, determinative of his guilt."[69] Citing the Supreme Court's 2011 Sorrell v. IMS Health, Inc. decision for the proposition that "[s]peech in aid of pharmaceutical marketing . . . is a form of expression protected by the Free Speech Clause of the First Amendment,"[70] the Second Circuit concluded that heightened scrutiny should apply to the government's interpretation of the FDCA's criminalization of off-label promotional speech.

The court then determined that the government's position was both content and speaker based: content based because the government's interpretation of the misbranding provisions permits "speech about the government-approved use of drugs" while prohibiting "certain speech about the off-label use of drugs," and speaker based because the provisions "target[ ] one kind of speaker – pharmaceutical manufacturers – while allowing others to speak without restriction."[71] Accordingly, the government's interpretation of the FDCA's misbranding provisions could not pass constitutional muster, and Caronia's prosecution failed the strict scrutiny test.

Next, the court concluded that even if off-label promotional speech triggered only intermediate scrutiny, Caronia's prosecution nevertheless failed this lower threshold. Under the four-part Central Hudson test for commercial speech,[72] the court found the first two prongs to be "easily satisfied" insofar as the off-label speech in question concerned lawful activity and off-label speech is "not in and of itself false or misleading."[73] Moreover, the court determined that the government's interest in "preserving the effectiveness and integrity of the FDCA's drug approval process, and [its] interest in reducing patient exposure to unsafe and ineffective drugs" was substantial.[74]

65 Caronia, 2012 WL 5992141, at *8.
66 508 U.S. 476, 489 (1993) (holding that the First Amendment does not prohibit the use of speech to establish intent).
67 Caronia, 2012 WL 5992141, at *9.
68 *Id.*
69 *Id.*
70 131 S. Ct. 2653, 2659 (2011).
71 Caronia, 2012 WL 5992141, at *12.
72 *See supra* note 56.
73 Caronia, 2012 WL 5992141, at *13.
74 *Id.*

Turning to the third and fourth prongs of the Central Hudson test, the court determined that because physicians can legally prescribe, and patients can legally receive, drugs off-label, "it does not follow that prohibiting the truthful promotion of off-label drug usage by a particular class of speakers would directly further the government's goals."[75] Describing the government's position as "paternalistic," the court held that "the government's prohibition of off-label promotion by pharmaceutical manufacturers 'provides only ineffective or remote support for the government's purpose'" and, therefore, failed the third prong of the Central Hudson analysis.[76] Finally, with respect to the last prong of the test, the court held that the government's imposition of a "complete and criminal ban on off-label promotion by pharmaceutical manufacturers" was not narrowly tailored to protect the government's interests. Citing several less-restrictive methods of restricting off-label promotional speech, the court concluded "that the government cannot prosecute pharmaceutical manufacturers and their representatives under the FDCA for speech promoting the lawful, off-label use of an FDA-approved drug."[77]

In a vigorous dissenting opinion, Judge Debra Ann Livingston argued that the majority's decision "calls into question the very foundations of our century-old system of drug regulation."[78] Judge Livingston would have upheld Caronia's conviction on the ground that his off-label promotional speech served only as evidence of the drug's intended use – which the First Amendment does not prohibit – thereby avoiding the constitutional conundrum. In making this determination, however, the dissent never addressed the central point of the majority's opinion – that in this case, Caronia was prosecuted and convicted for "mere off-label promotion."[79] Next, even assuming Caronia was entitled to some level of First Amendment protection, Judge Livingston would have upheld his conviction under the Central Hudson test for commercial speech.[80] Aligning with the majority, the dissent concluded that, the prohibition of off-label speech directly advanced a substantial government interest – ensuring that drugs regulated by the FDA are safe and effective.[81] Then, with little analysis, the dissent summarily concluded that the ban on truthful off-label promotion – only applicable to drug manufacturers – "directly advances" this interest because only drug manufacturers could "undermine the [FDA] approval process by not participating in it."[82] Finally, the dissent would have concluded that the prohibition on off-label promotion was narrowly tailored because drug manufacturers "are the precise group that the government must encourage to participate in the [FDA] approval process."[83] In that regard, Judge Livingston concluded that "[t]he prohibition of off-label promotion is thus not simply a 'paternalistic' attempt to shield physicians and patients from truthful information," and would have found it constitutional because, even if the regulation directly regulates speech, it is narrowly tailored to advance a substantial government interest.[84]

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75 *Id.*
76 *Id.* at *13, 14.
77 *Id.* at *15. The less restrictive alternatives of restricting off-label speech cited by the court include, *inter alia*, developing warning or disclaimer systems or safety tiers for the off-label market, capping off-label prescriptions, imposing non-criminal penalties, or banning off-label use of drugs in certain circumstances. *See id.*
78 *Id.* at *15 (Livingston, J., dissenting).
79 *Id.* at *8.
80 Importantly, Judge Livingston's dissent failed to address "heightened scrutiny" under *Sorrell v. IMS Health, Inc.*, 131 S. Ct. 2653 (2011), which was a separate and independent basis for the majority's decision. *See* Caronia, 2012 WL 5992141, at *12-13.
81 *Id.* at *23 (Livingston, J., dissenting); *id.* at *13 (Chin, J.) (noting that "preserving the effectiveness and integrity of the FDCA's drug approval process" satisfied the fist prong of the Central Hudson analysis).
82 *Id.* at *24 (Livingston, J., dissenting).
83 *Id.*
84 *Id.* at *25.

C. Caronia – Potential Next Steps

Before addressing the potential implications of the *Caronia* decision, it is important to note that the decision does not all of a sudden permit manufacturers to engage in truthful off-label promotion. First, the opinion is only binding law in the Second Circuit, encompassing New York, Connecticut, and Vermont. In that vein, the *Caronia* case was not a declaratory judgment action, and neither the FDA nor DOJ is enjoined from pursuing similar prosecutorial theories in other circuits – or even in the Second Circuit for that matter. Importantly, however, the government has decided not to appeal *Caronia*,[85] which was likely a calculated decision by the government to avoid a Supreme Court ruling embracing the *Caronia* First Amendment reasoning.[86] In that regard, even if the government does not fully embrace the opinion, it is likely to shift its focus to enforcement of only false or misleading promotional statements – or to situations where the off-label promotion at issue demonstrably caused patient harm.[87]

IV. *Caronia's* Implications – First Amendment Safe Harbor or Mere Leverage in Settlement Negotiations

In the wake of *Caronia*, can manufacturers expect a sea change in FDA enforcement activity surrounding off-label promotion? Reading the tea leaves in the immediate aftermath of *Caronia*, the tide does appear to be turning, but perhaps not to the extent manufacturers would like. First, given the high return on investment and the large settlements routinely announced by DOJ, it would be naïve to presume the government would simply abandon these high-profile and profitable cases. Similarly, manufacturers should not expect the *Caronia* decision to stem the tide of whistleblowers bringing off-label allegations to the attention of the government. Nevertheless, while the full impact of the Second Circuit's decision remains to be seen, it clearly represents a check to the government's current off-label enforcement theory. In addition, two recent events shed light on the ways government may approach enforcement in the wake of *Caronia*.

First, only two weeks after the *Caronia* decision was handed down, DOJ announced a $762 million settlement with Amgen, Inc. involving off-label promotion of

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85 *See supra* note 12.

86 Had the government appealed, and the Caronia decision reached the Supreme Court, the authors believe the Court would affirm the decision for a variety of reasons. First, the six Justice Sorrell v. IMS majority spoke clearly on this issue in 2011 when the Court held that restrictions on commercial speech that are both content and speaker-based are subject to "heightened judicial scrutiny." *Sorrell v. IMS Health, Inc.*, 131 S. Ct. 2653, 2664 (2011). The Court's opinion, which dealt with a Vermont statute regulating a pharmaceutical marketing practice known as "detailing," attributed special value to commercial speech relating to public health issues, "where information can save lives." *Id.* Moreover, in Sorrell, the State of Vermont did not argue that detailing was false or misleading or would "prevent false or misleading speech . . . within the meaning of this Court's First Amendment precedents." *Id.* at 2672. While the FDA has, at times, defended its restrictions on off-label promotion on the ground that such promotion is often biased or misleading, given manufacturers' financial interests in making a sale, the cases are legion holding that off-label promotion is not inherently false or misleading. Second, regarding the truthfulness of the speech at issue in Caronia, the trial record establishes that Alfred Caronia was prosecuted for off-label promotion – not false or misleading off-label promotion – and the government never even attempted to establish falsity. *See* Caronia, 2012 WL 5992141, at *6-7. Third, in the Caronia prosecution, it does not appear as though the government took the First Amendment challenge seriously either before or during trial. In this regard, neither the majority opinion nor the dissent discuss any evidence in the record that could be used to support the proposition that banning truthful speech is essential to achieving the government's objectives. Finally, as far as criminal defendants go, Alfred Caronia is fairly sympathetic – essentially the victim of a sting operation, his off-label promotional statements caught on tape by the government never led to actual prescriptions being written, and nobody was injured as a result. After the seemingly more culpable defendants pleaded guilty, Mr. Caronia was sentenced to probation, fined a grand total of $25, and ordered to do community service. All in all, and in light of the Supreme Court's 2011 Sorrell decision, the Caronia case would appear to be strong vehicle in which to have the Court rule on the constitutionality of the government's prohibition on truthful off-label promotion.

87 *See* Brenda Sandburg, Off-Label Prosecutions Hinge On Patient Benefit, Government Attorneys Say, THE PINK SHEET (Mar. 11, 2013) (quoting two Assistant United States Attorneys for the proposition that federal prosecutors will not pursue off-label enforcement actions where the off-label use is the standard of care and where patient harm is not present) (available by subscription; copy on file with the authors).

the drug Aranesp.[88] Not only did the government secure the largest False Claims Act settlement by any biotechnology company to date, it also obtained from Amgen a guilty plea to a criminal charge of illegally introducing a misbranded drug into interstate commerce. Given the temporal proximity to the *Caronia* decision, the press release announcing the Amgen settlement is notable for how forcefully government regulators condemned the practice of off-label promotion, and for how forcefully the government indicated it would continue to police such activity. For example, DOJ Civil Division's Principal Deputy Assistant Attorney General stated that the Amgen settlement "reinforces the Department of Justice's commitment to cracking down on unlawful conduct by pharmaceutical companies."[89] The Acting U.S. Attorney in Brooklyn commented: "Today's settlement demonstrates our vigilance in protecting America's healthcare consumers and pursuing any corporation that seeks to profit by violating U.S. law. ... To all who might consider introducing misbranded drugs into the marketplace, you are on notice: we remain steadfastly committed to prosecuting such violations of law."[90] A representative from the FBI added that "[p]romoting drugs for unapproved purposes is beyond wrong; it jeopardizes the health and safety of the public." Finally, New York's Attorney General continued with the "clear" message that "[t]here are no excuses for illegally marketing off-label drugs ... biotechnology giants are not above the law, and [his] office will continue to ensure that prescriptions be written based on medical judgment – not profit motive."[91] Moreover, and apparently taking cues from the *Caronia* dissent, several regulators echoed statements made in Judge Livingston's dissent when they commented that "[w]hen drug companies improperly misbrand their products, they . . . undermine the federal health care system that protects all of us," and "[p]reserving the integrity of the pharmaceutical industry is important work."[92] Accordingly, with the record Amgen settlement coming close on the heels of the *Caronia* decision, regulators seem to be signaling that the decision will not put a brake on their efforts to police off-label promotion by manufacturers. Indeed, the day before DOJ announced the Amgen settlement, the Acting U.S. Attorney for the Eastern District of New York essentially dismissed the *Caronia* decision out of hand. Noting that the Amgen settlement involved a concerted plan by the company to promote its drug off-label, and that *Caronia* involved mere speech by a sales representative, the prosecutor concluded that "[i]t's a very different type of prosecution."[93]

Second, and on the opposite end of the spectrum, the recent Par Pharmaceutical settlement may presage the shifting balance of power between the government and drug manufacturers. As previously noted, Par sued the FDA seeking declaratory judgment and injunctive relief against FDA's criminalization of truthful and non-misleading off-label speech as a violation of the First Amendment.[94] In its complaint, Par disclosed that it has been under investigation for its promotion of the drug Megace ES since 2009, and on March 5, 2013 Par pleaded guilty to a criminal misdemeanor for misbranding the drug and agreed to pay $45 million to resolve its civil and criminal liability. The global resolution settled three whistleblower suits brought under the False Claims Act.[95] Par's plea agreement, however, required it to dismiss with prejudice its declaratory judgment action – thereby eliminating the prospect of a judicial ruling on the merits of the First Amendment

88 *See* Amgen Press Release, *supra* note 42.
89 *Id.*
90 *Id.*
91 *Id.*
92 *Id.*
93 Andrew Pollack and Mosi Secret, *Amgen Agrees to Pay $762 Million for Marketing Anemia Drug for Off-Label Use*, N.Y. TIMES, Dec. 18, 2012.
94 *See supra* note 60.
95 *See* DOJ Press Release, Par Pharmaceuticals Pleads Guilty and Agrees to Pay $45 Million to Resolve Civil and Criminal Allegations Related to Off-Label Marketing (Mar. 5, 2013), *available at* http://www.justice.gov/opa/pr/2013/March/13-civ-270.html.

question. Much like the Allergan settlement, it would appear as though Par's First Amendment arguments – especially in light of the *Caronia* decision – may have provided additional leverage in the company's settlement discussions with the government.

Of course, too much can be read into the Amgen and Par settlements, but at a minimum the dichotomy between the two cases is illustrative of the potential impact of the *Caronia* decision. Par's complaint requested a declaration that the regulations implementing the misbranding provisions of the FDCA be declared unconstitutional insofar as the FDA's interpretation of those regulations bars truthful and non-misleading speech concerning off-label use of FDA-approved drugs.[96] On the other hand, in its settlement with the government, Amgen pled guilty to a misbranding charge, in which the government alleged that "in order to increase sales of [its] drug and reap the resulting profits, Amgen illegally sold the drug with the intention that it be used at off-label doses *that the FDA had specifically considered and rejected*."[97] Moreover, the civil settlement resolved allegations that Amgen paid illegal kickbacks to spur prescriptions, and that Amgen engaged in "*false* price reporting practices."[98] In this regard, because *Caronia* applies only to *truthful*, *non-misleading* off-label promotion, cases like Amgen – which apparently involved some false and misleading conduct (not to mention allegations of kickbacks) – will likely continue to be prosecuted aggressively. On the other hand, in situations such as the one Par Pharmaceutical finds itself – where arguably only truthful information is at issue – the government's position is significantly weakened, and manufacturers may find the *Caronia* case provides significant leverage in negotiations involving ongoing investigations by the government.

Thus, while *Caronia* may not significantly deter the government from investigating and prosecuting manufacturers for off-label promotion, the case will almost certainly serve to alter the government's strategy and tactics with respect to the way it chooses cases to bring, and with respect to the way it presents those cases in the event they are litigated. First, the *Caronia* decision did not declare the FDCA's misbranding provisions unconstitutional: instead, the Second Circuit held that "the government cannot prosecute pharmaceutical manufacturers and their representatives under the FDCA for speech promoting the lawful, off-label use of an FDA-approved drug."[99] In so ruling, the *Caronia* court distinguished between truthful and untruthful speech in order to avoid declaring the misbranding provisions unconstitutional:

> [E]ven if speech can be used as evidence of a drug's intended use, we decline to adopt the government's construction of the FDCA's misbranding provisions to prohibit manufacturer promotion alone as it would unconstitutionally restrict free speech. *We construe the misbranding provisions of the FDCA as not prohibiting and criminalizing the truthful off-label promotion of FDA-approved prescription drugs.*[100]

By construing the FDCA narrowly in order to avoid a ruling on the constitutionality of the FDCA itself, the Second Circuit essentially held that the FDCA's misbranding provisions exempt "truthful off-label promotion," which in turn would indicate that the Second Circuit considers falsity to be an element of the criminal misbranding provisions. If the *Caronia* reasoning is adopted by other courts, and truthful off-label promotion is exempted

96 *See Par Pharmaceutical, Inc. v. United States,* No. 11-cv-1820-RWR, Dkt. No. 1 at pp. 32-33 (D.D.C. Oct. 14, 2011).
97 Amgen Press Release, *supra* note 42 (emphasis added).
98 *Id.* (emphasis added).
99 Caronia, 2012 WL 5992141, at *15.
100 *Id.* (emphasis added).

from the FDCA's misbranding prohibitions, then in future criminal off-label prosecutions the burden would fall to the government to show that the promotional statements at issue were intentionally false or misleading.[101]

In that regard, one should expect to see increased scrutiny by the government of off-label promotion charges. Before bringing a case, the government will ensure there existed strong evidence that a company or its representative made knowing statements about the safety or efficacy of their products that were false, misleading, or omitted critical information. In other words, in future off-label promotion cases, the government is likely to focus on instances where off-label promotional statements are demonstrably false. Manufacturers can expect to see, therefore, the development of a meaningful First Amendment safe harbor for truthful and non-misleading promotional speech. As a corollary, it is unlikely that prosecutors will bring criminal charges against companies for off-label promotion when there is strong scientific support for the off-label promotional statements at issue.[102] Of course, what precisely constitutes strong scientific support, or truthful and non-misleading information, will still be subject to debate.

As previously discussed, prosecutors have been branching out from the traditional sales representative-initiated speech for evidence of off-label promotion. More specifically, there has been a greater focus on the underlying scientific studies and data used to support promotional speech. In the wake of *Caronia*, manufacturers should expect to see even greater focus in these areas. Indeed, in light of *Caronia*, the government will often be required to delve into the clinical data supporting off-label promotional statements in order to determine whether those statements are truthful and non-misleading.

Manufacturers should expect to see continued scrutiny of post-market clinical study design, primary and secondary endpoint analysis, and disclosure (or lack of such) of clinical study results. The science undergirding promotional statements will be carefully evaluated before prosecutors decide to initiate investigations, and will be further evaluated if and when prosecutors levy charges against a manufacturer. In addition, and in light of *Caronia*, the FDA and prosecutors will be forced to articulate more directly what they consider valid and truthful scientific information.

If other courts begin to embrace *Caronia*'s First Amendment reasoning in more cases, the FDA may be forced to issue guidance that would serve to delineate a safe harbor – the type of off-label information the Agency considers truthful and non-misleading. In this regard, a Citizen Petition filed by seven pharmaceutical manufacturers in 2011 could serve as a framework for such guidance. The Citizen Petition notes the uncertainty surrounding the current FDA position on off-label promotion and asks FDA to

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101 *Cf. United States v. Harkonen*, No. 11-10209 (9th Cir. Mar. 4, 2013), *available at* http://cdn.ca9.uscourts.gov/datastore/memoranda/2013/03/04/11-10209.pdf. In 2009, a jury convicted Scott Harkonen, the former CEO of InterMune, Inc., of wire fraud based on a press release that fraudulently described clinical trial results about the drug Actimune. The district court in the northern district of California sentenced Harkonen to 3 years probation, 6 months home detention, community service, and a $20,000 fine. Both parties appealed to the Ninth Circuit. In a short unpublished opinion, the Ninth Circuit affirmed the district court. Harkonen challenged the conviction arguing that the First Amendment barred his prosecution. The Ninth Circuit applied a two-part analysis: (1) whether sufficient evidence supports the verdict; and (2) if so, whether the facts as found by the jury establish the core constitutional facts. The Ninth Circuit emphasized that the First Amendment does not protect fraudulent speech. Therefore, the court identified the core constitutional issue in Harkonen's case as whether there was sufficient evidence to support the jury's finding that the press release was fraudulent. Deferring to the jury's findings on the elements of the wire fraud charge, the Ninth Circuit affirmed the wire fraud conviction. Importantly, Harkonen was convicted of wire fraud which required a finding that the statements he made were fraudulent. The jury acquitted Harkonen of the misbranding charge, so unlike *Caronia*, the Harkonen case did not present a First Amendment defense based on truthful and non-misleading statements about an unapproved use of a drug. In other words, the jury's finding that Harkonen knowingly participated fraudulent activity distinguishes the Harkonen case from the *Caronia* case and other off-label enforcement actions where there have not been formal findings of fraudulent off-label statements.

102 *See* Sandburg *supra*, note 87.

clarify its position with respect to the following: (1) manufacturer responses to unsolicited requests for off-label information; (2) the meaning of "scientific exchange" and activities that would constitute scientific exchange; (3) interactions with formulary committees, payors, and similar entities; and (4) the dissemination of third-party clinical practice guidelines.[103]

Given the fact that the Supreme Court spoke clearly on the contours of the commercial speech doctrine only two years ago in Sorrell v. IMS Health, Inc., and in light of the FDA's recent setback in *Caronia*, the government may take the opportunity to develop a sensible policy to guide manufacturer conduct regarding off-label promotion. Such a policy would be welcomed by the industry and could ultimately ensure that more relevant and timely scientific information reaches physicians and prescribers.

V. Conclusion

The Second Circuit's *Caronia* decision represents an unmistakable setback to the government's current theory underlying its enforcement of off-label promotion. As confirmed by the *Caronia* court, truthful and non-misleading off-label promotional speech is entitled to First Amendment protection. Manufacturers should seek, and FDA should recognize, a First Amendment safe harbor as the framework surrounding off-label promotion enforcement continues to develop. As discussed above, however, *Caronia* only alters the playing field to some degree. As seen by the government's increased scrutiny of clinical data and the scientific exchange process, the government has many tools and theories still available to combat what it considers to be misleading and untruthful promotional speech. In the wake of *Caronia*, therefore, manufacturers will still need to continue to carefully screen and control their promotional materials.

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103 *See* FDA Citizen Petition (Jul. 5, 2011), *available at* www.regulations.gov, Docket No. FDA-2011-P-0512. The Citizen Petition was submitted on behalf of the following companies: Allergan, Inc.; Eli Lilly and Co.; Johnson & Johnson; Novartis Pharmaceuticals Corp.; Novo Nordisk, Inc.; Pfizer, Inc.; and Sanofi-Aventis U.S. LLC.

THE ATTORNEY-CLIENT PRIVILEGE AND DISCOVERY OF AN INFRINGER'S INTENT IN PATENT CASES

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INTRODUCTION

The Federal Circuit has increased the relevance of an infringer's mental state over the last six years. During that time, the Federal Circuit changed the willfulness standard from a negligence-based duty-of-care standard to an objective-recklessness standard, which includes a subjective recognition of the objective risk. The Federal Circuit also made clear that an infringer only induces infringement if the infringer has the specific intent to cause another to infringe. A patent holder, thus, must prove the appropriate *mens rea* to succeed on any claim of willful or induced infringement. Discovery of this necessary element, however, is often thwarted by assertions of attorney-client privilege because companies involve and so heavily rely on attorneys for patent-related issues these days. Courts are primed, therefore, to address the fundamental tension between requiring a patent holder to prove an infringer's mental state while also protecting the sanctity of the infringer's attorney-client privilege. This tension is particularly difficult to fairly address when an infringer attempts to rely on some non-privileged information to rebut a charge of willful infringement or inducement while maintaining privileged information on the same subject. This article addresses the "at-issue" doctrine in this context.

BACKGROUND

I. The Attorney-Client Privilege

The attorney-client privilege is the oldest privilege known to the common law.[1] The existence of the privilege dates back to Roman law through "[t]he notion that the loyalty owed by the lawyer to his client's case disables him from being a witness in his

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The content of this article should not be taken as legal advice or as an expression of the views of the firm, its attorneys, or any of its clients. We hope the article spurs discussion in the legal community with insight into the experience of the authors.

1 *See Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

client's case."[2] Similarly, the first trace of the privilege in the English common law dates back to Queen Elizabeth's time, in which "the oath and honor of the barrister and the attorney protect them from being required to disclose, upon examination in court, the secrets of the client."[3] This code-of-honor justification later shifted to the current basis: A client cannot be expected to put forth all necessary facts without the assurance that the lawyer will not be compelled to reveal those confidences over the client's objection.[4] The United States adopted the privilege and this justification from the common law,[5] and the United States Supreme Court lucidly defined the policy behind the privilege in *Upjohn Co. v. United States* as encouraging "full and frank communications between attorneys and their clients and thereby promot[ing] broader public interests in the observance of law and administration of justice."[6] The sanctity of the privilege is a bedrock principle of our system of justice.

The fundamental element of the privilege is that communications are confidential. Attorneys are ethically bound to keep client communications in confidence, save specific exceptions.[7] And in order to be effective, the United States Supreme Court explained that "if the purpose of the attorney-client privilege is to be served, the attorney and client must be able to predict with some degree of certainty whether particular discussions will be protected. An uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all."[8]

United States courts, thus, generally exclude privileged information from discovery, even when those communications are highly relevant. But there are exceptions. Parties are not permitted, for instance, to selectively disclose privileged information, using the privilege as both a "sword and a shield." And as set forth further below, parties can waive privilege by injecting an issue into litigation that necessarily places the privileged information at issue.

II. Willful Infringement

The standard for willful infringement has evolved dramatically since the Federal Circuit's inception. In 1983, for instance, the Federal Circuit explained in *Underwater Devices v. Morrison-Knudsen Co.* that an infringer with knowledge of the asserted patent had "an affirmative duty to exercise due care to determine whether or not he is infringing. Such an affirmative duty includes, *inter alia*, the duty to seek and obtain competent legal advice from counsel before the initiation of any possible infringing activity."[9] The court developed this duty-of-care standard further in *Kloster Speedsteel AB v. Crucible Inc.*, in which the Federal Circuit introduced the notion that an adverse inference may be appropriate when infringers do not offer an opinion of counsel at trial.[10] Specifically, the court reversed a finding of no willful infringement, explaining that the infringer "has not even asserted that it sought advice of counsel when notified of the allowed claims and [the patentee's] warning, or at any time before it began this litigation," and held that the infringer's "silence on the subject, in alleged reliance on the attorney-client privilege, would warrant the conclusion that it either obtained no advice of counsel or did so and was advised that its importation and sale of the accused products would be an infringement of valid U.S.

2 John W. Strong, MCCORMICK ON EVIDENCE, § 87 at pg. 134 (5th Ed. 1999).
3 *Id.*
4 *See id.*
5 In 1776, Delaware was the first colony to codify the attorney-client privilege in its Constitution.
6 *Upjohn*, 449 U.S. at 389.
7 ABA Model Rule of Processional Conduct § 1.6. An attorney does not violate his ethical obligations by disclosing confidential information pursuant to a court order. *See id.* § 1.6(6).
8 *Upjohn*, 449 U.S. at 393.
9 *Underwater Devices v. Morrison-Knudsen Co.*, 717 F.2d 1380, 1389-90 (Fed. Cir. 1983).
10 *Kloster Speedsteel AB v. Crucible Inc.*, 793 F.2d 1565 (Fed. Cir. 1986).

patents."[11] The court then reinforced this adverse-inference standard in *Fromson v. Western Litho Plate & Supply Co.*, which determined as a general rule that "a court must be free to infer that either no opinion was obtained or, if an opinion were obtained, it was contrary to the infringer's desire to initiate or continue its use of the patentee's invention."[12]

But the Federal Circuit reevaluated its willful infringement precedent starting in 2004. In *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp.*, 383 F.3d 1337 (Fed. Cir. 2004), the *en banc* court determined two issues of law. First, the court held that a jury may not infer that an opinion of counsel, not disclosed by an infringer, would have contained negative information for the infringer.

> There should be no risk of liability in disclosures to and from counsel in patent matters; such risk can intrude upon full communication and ultimately the public interest in encouraging open and confident relationships between client and attorney. As Professor McCormick has explained, the attorney-client privilege protects 'interests and relationships which ... are regarded as of sufficient social importance to justify some sacrifice of availability of evidence relevant to the administration of justice.'[13]

Second, while the court upheld the duty-of-care standard, the Federal Circuit held that there was no duty to obtain an opinion of counsel. So the patent holder was not entitled to an adverse inference instruction based on a defendant's failure to obtain an opinion of counsel. "[T]he failure to obtain an exculpatory opinion of counsel shall no longer provide an adverse inference or evidentiary presumption that such an opinion would have been unfavorable."[14]

Three years later, the *en banc* court overruled the duty-of-care standard promulgated in *Underwater Devices*. In *In re Seagate*, the court elevated the standard for willful infringement from a negligence-based standard to an "objectively reckless" standard.[15] Thus, "to establish willful infringement, a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent."[16] While the infringer's state of mind is not relevant to the objective prong of the inquiry, the patent holder must prove that the infringer knew or should have known of the risk if it establishes the objective risk.[17] The Federal Circuit, therefore, elevated the importance of the infringer's "state of mind" into the willfulness standard.

III. Indirect Infringement – Inducement

The Federal Circuit's precedent on induced infringement under 35 U.S.C. § 271(b) also evolved and heightened the standard for the infringer's mental state as an element of the claim. While inducement always required some mental state, by 2006 the law was unclear "whether the required intent must be merely to induce the specific acts [of

11 *Id.* at 1580.
12 *Fromson v. Western Litho Plate & Supply Co.*, 853 F.2d 1568, 1572-73 (Fed. Cir. 1988).
13 *Id.* at 1344.
14 *Id.* at 1346.
15 *In re Seagate Tech., LLC*, 497 F.3d 1360 (Fed. Cir. 2007).
16 *See id.* at 1371.
17 *See id.*

infringement] or additionally to cause an infringement."[18] The Federal Circuit resolved this dispute in *DSU Med. Corp. v. JMS Co.*, when the court held that inducement requires "'that the alleged infringer knowingly induced infringement and possessed *specific intent to encourage another's infringement*.' Accordingly, inducement requires evidence of culpable conduct, directed to encouraging another's infringement, not merely that the inducer had knowledge of the direct infringer's activities."[19]

The Federal Circuit determined that an exception to this "specific intent" standard existed if an infringer exercised "deliberate indifference" to the existence of the asserted patent.[20] The United States Supreme Court reviewed this standard in *Global-Tech Appliances, Inc. v. SEB S.A.* In the Court's view, "deliberate indifference" was not a high enough standard; instead, the Court determined that an infringer is liable for induced infringement, even without knowledge of a patent, if it acted with "willful blindness."[21] Willfully blind defendants "deliberately shield[s] themselves from clear evidence of critical facts that are strongly suggested by the circumstances." In other words, "(1) the defendant must subjectively believe that there is a high probability that a fact exists and (2) the defendant must take deliberate actions to avoid learning of that fact."[22] An infringer's mental state, thus, is directly relevant and necessary to a patent holder's inducement claim.

ISSUE AND ANALYSIS

An infringer's mental state is now as important and relevant as ever. As set forth above, a patent holder must prove a specific, heightened mental state to succeed on claims of willfulness and inducement. Proving a mental state in patent litigation, however, is more difficult than in other areas of law. Whether a party infringes a patent often involves claim construction. And claim construction often involves attorney analysis. More generally, companies routinely route any and all patent issues through attorneys, thus increasing the cloak of privilege in patent litigation. In light of this complexity, patent holders face an increased challenge during discovery to obtain necessary information to support its claims. There are three broad scenarios that a patent holder may now find itself in during discovery of the infringer's mental state.

First, there is information about the infringer's mental state and it is not privileged. An engineer, for instance, may write an incriminating email or memorandum to another engineer. This category is increasingly rare to find, particularly among sophisticated companies. In any event, in this scenario, the question is only whether the evidence is sufficient to meet the appropriate *mens rea* standard, which is for the trier of fact to assess and decide.

Second, there is information about the infringer's mental state and it is all privileged. A company may learn of a patent through counsel, and then obtain an opinion from counsel about the patent. Assuming no other information exists (and no other circumstantial facts giving rise to "willful blindness"), this scenario will likely result in a directed verdict against the patent holder for willful or induced infringement because the

18 *MercExchange, L.L.C. v. eBay, Inc.*, 401 F.3d 1323, 1332 (Fed. Cir. 2005) (citing *Insituform Techs., Inc. v. CAT Contracting, Inc.*, 385 F.3d 1360, 1378 (Fed. Cir. 2004)), cert. granted in part, 126 S. Ct. 733, 163 L. Ed. 2d 567 (2005); *see Manville Sales Corp. v. Paramount Sys.*, 917 F.2d 544, 553 (Fed. Cir. 1990) ("The plaintiff has the burden of showing that the alleged infringer's actions induced infringing acts and that he knew or should have known his actions would induce actual infringements."). *But see Hewlett-Packard Co. v. Bausch & Lomb,* 909 F.2d 1464, 1469 (Fed. Cir. 1990) ("Proof of actual intent to cause the acts which constitute the infringement is a necessary prerequisite to finding active inducement.").

19 *DSU Med. Corp. v. JMS Co.*, 471 F.3d 1293 (Fed. Cir. 2006) (citing *MGM Studios Inc. v. Grokster, Ltd.,* 125 S. Ct. 2764, 2780 (2005); *Manville*, 917 F.2d at 553) (emphasis added)).

20 *SEB S. A. v. Montgomery Ward & Co.*, 594 F.3d 1360 (Fed. Cir. 2010).

21 *Global-Tech Appliances, Inc. v. SEB S.A*, 131 S. Ct. 2060 (2011).

22 *See id.*

infringer will remain silent, and the patent holder will not have evidence to offer to meet its burden of proof. So, even if the infringer received an opinion of counsel that the infringer in fact infringed a valid patent and thus had a specific intent to infringe or cause infringement, the patent holder may still lose because the infringer's mental state is cloaked in privilege.

The third possible scenario is that there is information about the infringer's mental state, and some of it is privileged and some of it is not. This scenario presents the most difficult issues to deal with. First, it is always challenging for both patent holders and infringers to carefully navigate between privileged and non-privileged information. Second, the law is not clear at what point an infringer places its privileged information "at-issue" by producing and relying on non-privileged information on the same subject – i.e., its mental state about infringement. The following discussion will address this scenario in more detail.

I. The at-issue doctrine precludes parties from maintaining privilege on subjects that it places at issue in the litigation.

One well-established exception to the attorney-client privilege is the "at-issue" doctrine (also referred to as the implied waiver doctrine). The Fifth Circuit, for instance, explained the doctrine in *Conkling v. Turner*: "The great weight of authority holds that the attorney-client privilege is waived when a litigant places information protected by it in issue through some affirmative act for his own benefit, and to allow the privilege to protect against disclosure of such information would be manifestly unfair to the opposing party."[23] Other circuits are in accord.[24]

In *Conkling*, the plaintiff had sued for fraud, based in part on a defendant's false representation of complete ownership of a company.[25] The plaintiff sought to overcome a statute of limitations based on a tolling theory because he had not known of the fraud within four years of filing suit.[26] The defendants sought discovery of when the plaintiff knew or should have known of the misrepresentation.[27] The plaintiff originally opposed this discovery because the subject involved attorney-client privileged communications.[28] The Fifth Circuit, nonetheless, found waiver on this subject because the plaintiff had put his mental state at issue in the litigation through its opposition to the statute of limitation defense.[29]

District courts have addressed this at-issue doctrine in patent cases, most frequently in the context of an equitable estoppel defense which requires reasonable and actual reliance by the infringer on the patent holder's misleading conduct. But district courts have not been uniform on this issue.

23 *Conkling v. Turner*, 883 F.2d 431, 434 (5th Cir. 1989).
24 *See, e.g., Doe v. United States*, 350 F.3d 299, 302 (2d Cir. 2003) ("It is well established doctrine that in certain circumstances a party's assertion of factual claims can, out of considerations of fairness to the party's adversary, result in the involuntary forfeiture of privileges for matters pertinent to the claims asserted."); *Home Indem. Co. v. Lane Powell Moss & Miller,* 43 F.3d 1322, 1326 (9th Cir. 1995) (adopting *Hearn v. Rhay*, 68 F.R.D. 574, 581 (E.D. Wash. 1975); *XYZ Corp. v. United States*, 348 F.3d 16 (1st Cir. 2003); *U.S. Fire Insurance Co. v. Asbestospray, Inc.*, 182 F.3d 201, 212 (3d Cir. 1999); *Garcia v. Zenith Electronics Corp.*, 58 F.3d 1171, 1175 (7th Cir. 1995).
25 *Conkling*, 883 F.2d at 433.
26 *See id.*
27 *See id.*
28 *See id.* at 434-35.
29 *See id.* at 435.

A. Some courts have broadly interpreted the at-issue doctrine when an infringer asserts a defense of equitable estoppel.

In *THK America v. NSK Co.*, the Northern District of Illinois adopted a broad approach to the at-issue doctrine.[30] In that case, the defendant asserted equitable estoppel as a defense, and the patent holder sought discovery broadly on the issue of reliance. The court rejected the defendant's assertion that its evidence of reliance only came from non-privileged information and that it should not be compelled to disclose its privileged analysis on the same subject.

> If a defense of estoppel may be defeated by showing that the party asserting the defense actually relied not on plaintiff's conduct but on its lawyers' advice, the party claiming estoppel has put attorney-client communications in issue, and fundamental fairness dictates that the plaintiff be permitted to examine communications relevant to the estoppel question.[31]

The same court reached a similar conclusion in *Southwire Co. v. Essex Group, Inc.*[32] The court ordered the defendant to produce privileged communications, so the plaintiff could assess and rebut the defendant's claims of reliance for its equitable estoppel defense. By way of background, the defendant had alleged that it relied on the plaintiff's delay in bringing suit to build a new building. The plaintiff contended that the defendant did not rely on the plaintiff's inaction, but rather its attorney's advice about the patent. The court concluded that the defendant had put its opinions of counsel at issue through its equitable estoppel defense, and fairness required discovery on the opinions to rebut the defendant's allegations of reliance on the plaintiff's delay.

> If Southwire has evidence that Essex actually relied on something other than Southwire's actions or silence, that serves to undercut the inference that Essex seeks to have drawn from its 'objective' evidence. In short, Essex asserts that it relied on Southwire's delay in building the four plants; Southwire says that Essex relied on something else. What Essex is arguing here is that Southwire is not entitled to prove what Essex actually relied on, even though the court should be entitled to infer actual reliance from Essex's own proof. The unfairness of Essex' position is manifest.[33]

The Southern District of New York undertook a similar approach in a copyright case. In *Lombardi v. Whitehall XI/Hubert Street, LLC*, the defendant pled an equitable estoppel defense, requiring it to prove "that it was 'ignorant of the true facts.'"[34] Before that litigation, the defendant had received legal advice about the architectural plans that later became the subject of the copyright claim. The court determined that the privileged communications "may bear on [the defendant's] knowledge or lack thereof regarding the copyright-protected status of the [plaintiff's architectural] plans."[35] The court allowed

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30 *THK Am., Inc. v. NSK Co.*, 157 F.R.D. 637, 650 (N.D. Ill. 1993).
31 *See id.*
32 *Southwire Co. v. Essex Group, Inc.* 570 F. Supp. 643, 649-50 (N.D. Ill. 1983).
33 *Id.* at 649-50; *see also Douglas Press Inc. v. Universal Mfg. Co.*, No. 01-CV-2565, 2003 U.S. Dist. LEXIS 9860, at *11-12 (N.D. Ill. June 10, 2003) ("the Court agrees that [the plaintiff] is entitled to try to defeat the defense by demonstrating that [the defendant] relied on its attorneys' advice, and not [the plaintiff's] alleged inaction and delay in filing suit."); *Liberty Mut. Ins. Co. v. Tedford*, 644 F. Supp. 2d 753, 763-65 (N.D. Miss. 2009) (finding waiver based on equitable estoppel counterclaim and allowing discovery into privileged communications).
34 *Lombardi v. Whitehall XI/Hubert Street, LLC*, 2008 U.S. Dist. LEXIS 49167, at *3 (S.D.N.Y. June 26, 2008).
35 *See id.*

discovery "regarding the rights to [the plaintiff's architectural] plans, the terms in the purchase agreement related to the Plans, and the risks of a copyright lawsuit," including therefore privileged communications.[36]

B. Other courts have adopted a more restrictive application of the at-issue doctrine, even when an infringer asserts an equitable estoppel defense.

Other courts, as well as the Northern District of Illinois, have adopted a narrower, more restrictive approach than that set forth in *THK*, *Southwire*, and *Lombardi*. In *Chamberlain Group v. Interlogix Inc.*, the court rejected a broad interpretation of the at-issue doctrine and found no waiver based on the defendant's equitable estoppel defense. The court explained that, for the at-issue doctrine to apply, "[a] party must affirmatively use privileged communications to defend itself or attack its opponent in the action before the implicit waiver rule is applicable."[37] The Southern District of California adopted a similar approach in *Sorensen v. Black & Decker Corp.*, rejecting a theory "that by asserting equitable estoppel, [the accused infringer] necessarily waived the attorney-client privilege because [the patentee] is entitled to investigate whether [the accused infringer's] actions were the result of an independent decision based on advice of counsel and not in reliance on the conduct of the patentee."[38]

C. The Federal Circuit has addressed this issue only once, and the scope of its analysis is unclear.

The Federal Circuit has not directly weighed in on this issue. It has, however, denied the argument that "any assertion of estoppel and laches 'inherently places at issue . . . communications with counsel."[39] The court, as a result, reversed summary judgment of no laches and equitable estoppel where the defendant refused to disclose privileged communications.[40] While the opinion has little analysis or background on this issue, the court noted that the disputed privileged communications in this case were not relevant to the topics of laches and equitable estoppel. So, the decision is not controlling as to situations when the non-privileged and privileged information involves the very same subject.

II. How the at-issue doctrine may affect discovery and proof of an infringer's intent.

Returning to the third scenario set forth in section I, the question becomes how much, if any, discovery is a patent holder entitled to of the infringer's mental state when willfulness or inducement is at issue, and the infringer has both non-privileged and privileged information relating to its mental state.

For example, assume Engineer Smith at Acme Corp. learns of Innovation Corp.'s '123 patent. He then emails Engineer Johns that Acme Corp's products do not induce infringement based on his reading and interpretation of the claims in the '123 patent. Engineer Smith then seeks to confirm his understanding by conferring with his outside counsel, who explains that Engineer Smith's interpretation is fundamentally wrong, and that Acme Corp's actions infringe a valid patent. Innovation Corp. then sues Acme for willfully inducing infringement. Engineer Smith's email to Engineer Johns is produced during

36 *See id.*
37 *Chamberlain Group v. Interlogix Inc.*, No. 01-C-6157, 2002 U.S. Dist. LEXIS 5468, at *8 (N.D. Ill. Mar. 27, 2002); *see also Genentech, Inc. v. Insmed Inc.*, 236 F.R.D. 466, 469 (N.D. Cal. 2006) (holding that attorney client privilege was not waived by testimony that did not do anything more than deny intent and did not put any attorney client communication in issue).
38 *Sorenson v. Black & Decker Corp.*, 2007 WL 1976652, at *2 (S.D. Cal. Apr. 9, 2007).
39 *Int'l Rectifier Corp. v. IXYS Corp.*, 361 F.3d 1363, 1376 (Fed. Cir. 2004).
40 *See id.*

discovery, but Engineer Smith's communications with his counsel are withheld on the grounds of privilege.

In general, there are three broad possibilities in this scenario.

1. No waiver. Courts could apply the at-issue doctrine narrowly, and hold that waiver only occurs if Acme Corp. actually relies on any privileged information to support its defense of Innovation Corp.'s willfulness or inducement claims. The advantage of this approach is that it robustly protects the attorney-client privilege. The disadvantage, however, is that it allows and risks inequitable, if not fraudulent, results. If Engineer Smith takes the stand, for instance, and testifies that neither Acme nor he subjectively intended to infringe the '123 patent, that testimony is dishonest and untrue. Alternatively, Engineer Johns could testify about relying on Smith's email – even without knowledge of the privileged communications – which would be true, but still unfair to Innovation Corp. if it does not receive full discovery on the issue.

2. Broad waiver. Courts could apply the at-issue doctrine more broadly, and determine that Acme Corp.'s mental state is at-issue in the case and therefore Innovation Corp. gets full discovery of non-privileged and privileged information regarding Acme's mental state. This result seems unlikely. The more recent case law on at-issue waiver in equitable estoppel cases has declined this broader approach. Such a broad waiver, moreover, is at odds with the fundamental policy protection of the attorney-client privilege and the *Knorr-Bremse* holding. This broad waiver would also be difficult to reconcile with a similarly-situated defendant that has no non-privileged information (i.e., its mental state is wholly dependent on privileged information) and is allowed to maintain its privileged information – a proposition that is seemingly uncontroversial. But such a broad approach would allow the infringer's state of mind to be decided fully on the merits.

3. Case-by-Case waiver. Courts could apply a hybrid analysis, and determine whether privileged information is genuinely at-issue based on a case-by-case analysis and fundamental fairness. In this situation, courts could review the privileged information *in camera*, and determine if Acme Corp. has placed its privileged analysis at issue in the case based on the totality of circumstances. One downside to this approach is that it further taxes the Court with additional, time-intensive work, some of which is difficult to assess (i.e., oral communications). This approach is also problematic because privilege is best dealt with through bright-line rules, so that parties know in advance when privilege may be waived. But this case-by-case approach is valuable in that it would likely prevent the inequitable and unjust possibilities set forth in scenario 1.

Quite clearly, none of these possibilities is a silver bullet. And the issue only becomes more difficult as fact patterns blur more to grey: i.e., when the privileged information does not so directly contradict the non-privileged information, or when an infringer attempts to draw a distinction between simply holding the patent holder to its burden of proof versus affirmatively offering evidence to rebut a patent holder's proof of its mental state (and whether that difference should matter for this inquiry), among various other situations.

CONCLUSION

The Federal Circuit has increased the relevance of an infringer's mental state in patent litigation. This increase has raised the potential for a patent holder to have a meritorious claim, but at the same time, be unable to discover and prove that claim because the necessary proof may be withheld under claims of privilege. While this scenario may not be wholly *sui generic* in the law, it is at least unusual. So courts will need to decide when and to what extent an infringer puts its privileged information at issue in litigation by rebutting a claim of willfulness or inducement. The line between what is fair for a patent holder attempting to prove its claim versus what is fair for an infringer to withhold as privileged is unlikely to be easy to draw.

RETOOLING PATENT DAMAGES LAW FOR NPE CASES*

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I. INTRODUCTION

Since creation of the Federal Circuit in 1982, patent litigation has become increasingly more common. The bulk of reported cases in the 1980s and 1990s were between competitors; that is, the plaintiff practiced its own patented invention and sued a defendant whose accused product competed with the plaintiff's. (We will refer to these plaintiffs as "practicing entities" or "PEs".) The remedy of choice for PEs was lost profits damages, which were considered more lucrative than reasonable royalty damages. Non-practicing entities ("NPEs") – plaintiffs that do not practice the patent – also sued for infringement during the 1980s and 1990s, but an NPE cannot recover lost profits damages because it does not compete with the defendant and thus does not lose profits due to infringement. NPEs are relegated to reasonable royalty damages. A recent patent litigation study found during the period from 1995 to 2000 that PE cases yielded 23% higher damages awards than NPE cases.[1]

The turn of the century ushered in a striking increase in NPE litigation. NPEs focused on ways to maximize reasonable royalty damages, but their focus was not singular since they also wielded the remedy of a permanent injunction. However, in 2006, the Supreme Court handed down its *eBay* decision, making it more difficult to obtain a permanent injunction, especially for NPEs.[2] Lacking the threat of injunction, NPEs constructed more creative and lucrative reasonable royalty theories, resulting in handsome payoffs in many cases. Juries handed NPEs verdicts of eight, nine, and even ten figures.

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* The purpose of this paper is to serve as a starting point for academic discussion at the 2012 Sedona Conference concerning the future of the law surrounding patent damages. The discussion herein does not necessarily reflect the views of the authors, or of Fish & Richardson P.C., as to what the law currently is or should be in the future.

1 PricewaterhouseCoopers, 2012 Patent Litigation Study: Patent Litigation Continues to Rise Amid Growing Awareness of Patent Value, at page 7 (September 2012) (finding from 1995 to 2000 that the median award for PEs was $5.5M versus $4.5M for NPEs).

2 *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006). Justice Kennedy filed a concurring opinion in which he commented on the problem with giving NPEs the power of injunctive relief: "In cases now arising trial courts should bear in mind that in many instances the nature of the patent being enforced and the economic function of the patent holder present considerations quite unlike earlier cases. An industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees. For these firms, an injunction, and the potentially serious sanctions arising from its violation, can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent. When the patented invention is but a small component of the product the companies seek to produce and the threat of an injunction is employed simply for undue leverage in negotiations, legal damages may well be sufficient to compensate for the infringement and an injunction may not serve the public interest." *Id.* at 396-97 (citations omitted).

The data on recoveries for PEs versus NPEs swung to the other side – the same patent study determined from 2006 to 2011 that NPE median damages awards were nearly double that of PEs.[3]

This trend has continued into the current decade. Juries have awarded enormous sums in patent cases, including to NPEs. Many of these verdicts have been overturned, however, on post-trial motions or appeal. Some examples are:

- *LaserDynamics v. Quanta Computer* (E.D. Tex. 2010, 2011; Fed. Cir. 2012): \$52M verdict in first trial overturned on motion for new trial; \$8.5M verdict in second trial vacated on appeal by the Federal Circuit.[4]
- *Lucent v. Microsoft* (Fed. Cir. 2009; S.D. Cal. 2011): Original \$358M verdict vacated by Federal Circuit and remanded for new trial on damages. Lucent awarded \$70M verdict in second trial, but district court vacated on JMOL. Final judgment of \$26M in reasonable royalty damages.[5]
- *Mirror Worlds v. Apple* (E.D. Tex. 2011; Fed. Cir. 2012): \$625M verdict vacated on JMOL; affirmed on other grounds by the Federal Circuit.[6]
- *Cornell v. HP* (N.D.N.Y. 2009) (Rader, J., sitting by designation): \$184M verdict overturned on JMOL; remittitur of \$53.5M offered to Cornell.[7]
- *Mformation v. RIM* (N.D. Cal. 2012): \$147M verdict vacated on JMOL (currently on appeal to the Federal Circuit).[8]

The problem of excessive NPE verdicts stems at least in part from the lack of guidance in the damages statute and the relatively unbridled nature of the *Georgia-Pacific* reasonable royalty methodology.[9] The patent statute (35 U.S.C. § 284) provides only that courts must award damages adequate to compensate for infringement, "but in no event less than a reasonable royalty." *Georgia-Pacific* lays the groundwork for computing reasonable royalties, envisioning a hypothetical negotiation between a willing licensor (patentee) and a willing licensee (defendant) occurring at the time infringement began, including a list of 15 factors that influence this negotiation. *Georgia-Pacific* has given NPEs enormous leeway in crafting damages theories and opens the door to nearly limitless supporting evidence, resulting in many damages awards that have far exceeded the value of the patented invention. While the Federal Circuit and district courts have made a strong effort in recent years to rein-in NPE damages awards, perhaps more drastic measures are warranted.

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3 2012 Patent Litigation Study, *supra* note 1, at page 7 (finding from 2006 to 2011 that the median award for NPEs was \$6.9M versus \$3.7M for PEs; finding between 2001 and 2005 that the median award for NPEs was \$10.9M versus \$5.6M for PEs).

4 *LaserDynamics, Inc. v. Quanta Computer, Inc.*, No. 2:06-CV-348-TJW (E.D. Tex., June 9, 2010) (vacating award of \$52M because there was "no basis" for application of the entire market value rule), *subsequent opinion*, 2011 WL 7563818 (E.D. Tex., Jan. 7, 2011) (before second trial, ruling on defendant's *Daubert* motion and excluding expert testimony on entire market value rule and royalty rates, but allowing plaintiff's expert to testify on remaining damages theory), *aff'd in part on other grounds, rev'd in part on damages issues, and remanded*, Nos. 2011-1440, -1470, 2012 WL 3758093 (Fed. Cir., Aug. 30, 2012) (holding that LaserDynamics' theory of damages was legally unsupportable).

5 *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009) (vacating \$358M damages verdict), *after remand*, 837 F. Supp. 2d 1107 (S.D. Cal. 2011) (granting JMOL regarding \$70M damages verdict and entering judgment of \$26.3M in reasonable royalty damages and \$14M in prejudgment interest).

6 *Mirror Worlds, LLC v. Apple, Inc.*, 784 F. Supp. 2d 703 (E.D. Tex. 2011) (granting JMOL and vacating damages verdict because Mirror Worlds had failed to provide substantial evidence to support the damages verdict), *aff'd on other grounds*, 692 F.3d 1351 (Fed. Cir. 2012).

7 *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279 (N.D.N.Y. 2009).

8 *Mformation Techs., Inc. v. Research in Motion Ltd.*, Case No. C 08-04990 JW (N.D. Cal., Aug. 8, 2012) (granting RIM's JMOL on grounds of no infringement; not reaching damages issue).

9 *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970), *modified*, 446 F.2d 295 (2d Cir.), *cert. denied*, 404 U.S. 870 (1971).

II. THE PROPOSAL

This article proposes a specific reform of damages law applied in NPE cases. The proposal would modify the current approach to reasonable royalties as follows:

1) Abolish the *Georgia-Pacific* hypothetical negotiation in NPE cases.

   - A limited exception would permit NPEs to prove an established royalty.

   - The established royalty could be a running royalty or fully paid-up lump sum, depending on the circumstances.

2) If an NPE cannot demonstrate an established royalty, the NPE is relegated to a fully paid-up lump sum award of reasonable royalty damages.

   - This award is based on the value of the patented invention over the next best noninfringing alternative (NBNA) at the time the defendant adopted the patented invention.

     - Value = incremental profit due to the patented invention.

   - The NPE and defendant split the value/incremental profit.

     - This is what they would have done at the time the defendant adopted the patented invention if they had negotiated at arms-length.

     - The split may be determined, for example, using negotiation theory.

     - The NPE and defendant each offers its own proposed value/profit split, and the jury decides which is correct.

   - The fully paid-up lump sum award precludes an injunction or ongoing (post-verdict) royalties. The NPE receives full value for its patented technology from the lump sum award.

   - The only exception – if the NPE can prove an absence of acceptable and available noninfringing substitutes (similar to *Panduit* lost profits approach), and the defendant is unable to prove otherwise.

     - In such cases, the NPE can seek damages under a different approach – i.e., the NPE is not relegated to a fully paid-up lump sum award.

- This exception will arise only in very limited situations.

3) If the NPE believes the fully paid-up lump sum award is insufficient, it may argue that damages should be enhanced under 35 U.S.C. § 284, which does not recite preconditions for the judge to enhance damages and thus could be utilized in this new damages model.

Although this proposal is a major departure from existing reasonable royalty law, it is not without relevant precedent in congressional patent reform. Prior to enactment of the America Invents Act ("AIA"), both the Senate and House considered various options for reforming the patent damages statute in 35 U.S.C. § 284. Congressional damages reform sprung largely from the soaring damages verdicts in NPE cases. The effort began in 2007 and would have modified the damages statute to recite a gatekeeping function for district courts. Indeed, one of the proposed amendments would have included specific language codifying apportionment. The apportionment language provided that the royalty rate would apply "only to the portion of the economic value of the infringing products or process properly attributable to the claimed invention's specific contribution over the prior art." In other words, the royalty award would reflect the incremental value of the patented technology over the NBNA. Damages reform became one of the most controversial aspects of the Congressional effort – specifically inclusion of apportionment – and ultimately, when the AIA became law, Section 284 remained unchanged in this key respect.[10] Thus, even though Congress did not adopt apportionment, a central component of this article's proposal has previously gained traction in Congress.

In addition, numerous commentators have advocated aspects of this proposal, though it does not appear that anyone has assembled all the pieces articulated here. For example, some commentators have criticized the *Georgia-Pacific* methodology and have proposed its elimination or a modification.[11] Some have advocated using the incremental value of the patented technology over the NBNA as a valid measure of damages.[12] According to one commentator, NPEs ignore this kind of apportionment and rely instead

10 Senator Leahy stated that damages reform was a compromise and that he would have done more, opting for inclusion of apportionment: "It is true that I would have gone farther. One of the problems with patent litigation today is the lack of guidance given to juries. But another is that courts simply are not focusing on the essence of the invention. … I hope [the new cases] move the law toward compensation for what the actual invention is." Statement by Senator Leahy introducing April 2, 2009 Manager's Amendment to S.515 (amendment deleting entire market value rule and apportionment provisions).

11 *See, e.g.,* Christopher B. Seaman, *Reconsidering the* Georgia-Pacific *Standard for Reasonable Royalty Patent Awards*, 2010 BYU L. Rev. 1661 (2010); Daralyn J. Durie & Mark J. Lemley, *A Structured Approach to Calculating Reasonable Royalties*, 14 Lewis & Clark L. Rev. 627 (2010) (criticizing *Georgia-Pacific*); Mark A. Lemley, *Distinguishing Lost Profits from Reasonable Royalties*, 51 Wm. & Mary L. Rev. 655 (2009) (concluding that *Georgia-Pacific* has resulted in a systematic overcompensation of patent owners in some industries); Brian J. Love, *The Misuse of Reasonable Royalty Damages as a Patent Infringement Deterrent*, 74 Mo. L. Rev. 909 (2009).

12 *See, e.g.,* Brian J. Love, *Patentee Overcompensation and the Entire Market Value Rule*, 60 Stan. L. Rev. 263 (2007) (stating that when calculating reasonable royalty damages the rate should be applied to the incremental value added by the patented invention); Seaman *supra* note 11 at 1711 ("In lieu of *Georgia-Pacific*, this Article proposes that courts should adopt an alternative standard for imposing a reasonable royalty: when an acceptable noninfringing substitute for the patented technology exists, the cost of that substitute should serve as a 'ceiling' on a reasonable royalty."); Roger D. Blair & Thomas F. Cotter, *Rethinking Patent Damages*, 10 Tex. Intell. Prop. L.J. 1, 59 (2001) (stating that an infringer in a real negotiation "would have agreed to a royalty equal to or no more than the amount he could have expected to earn from using a non-infringing alternative"); Elizabeth M. Bailey, *et al.*, *Making Sense of Apportionment*, 12 Colum. Sci. & Tech. L. Rev. 255 (2011) (advocating an economic approach to patent damages, but recognizing that in the absence of synergies between the patented technology and other technologies in the accused product, one may consider the incremental value of the patented technology over a noninfringing alternative); Eric E. Bensen & Danielle M. White, *Using Apportionment to Rein in the* Georgia-Pacific *Factors*, 9 Colum. Sci & Tech. L. Rev. 1 (2008) (arguing that "(i) apportionment should be the *threshold* question in every reasonable royalty analysis, and (ii) only factors relevant to approximating a fair *market* price for the patent should be used to determine the 'reasonable' royalty.") (emphasis in original). Judge Posner, sitting by designation, recently espoused this approach in a *Daubert* ruling: "[Defendant] Keebler would not have paid a royalty higher than the cost to it of switching to a noninfringing substitute for the plaintiffs' margarine in its cookies or otherwise reworking its manufacturing process to avoid making the infringing margarine." *Brandeis Univ. v. Keebler Co.*, Case No. 1:12-cv-01508, slip op. at 9 (N.D. Ill. January 18, 2013).

on allegedly comparable licenses because they are "easy to obtain and summarize," resulting in damages that better reflect the "hold up" value of patent litigation rather than the negotiation of a reasonable license.[13] Courts and at least one commentator have recognized that, in the right circumstances, and with the proper jury instructions, a fully paid-up lump sum royalty can completely compensate a patentee and obviate the need for considering injunctive relief or ongoing royalties.[14] In addition, even the *Georgia-Pacific* case recognized the concept of profit splitting – factor 15 states that the amount awarded should allow the licensee "to make a reasonable profit."[15]

III. Advantages of the Proposal

This article's proposal has several advantages over the existing reasonable royalty framework, and in particular *Georgia-Pacific*.

- **The proposal leaves intact the remedy of established royalty**

The proposal allows an NPE to prove that an established royalty – either running royalty or lump sum – is the proper remedy, rather than a fully paid-up lump sum award based on incremental profit over the NBNA. Thus, in the right circumstances, an NPE with an established licensing program may be able to obtain a damages award consistent with its program. If the NPE believes it should receive its established rate plus an additional kicker for being forced to litigate (or for some other reason), the NPE can seek enhanced treble damages under 35 U.S.C. § 284.

Unlike the *Georgia-Pacific* methodology, the requirements for proving an established royalty are structured and predictable. The Supreme Court in *Rude v. Westcott*[16] articulated a five-part test that a patentee must satisfy to prove an established royalty:

> (1) prior royalties must have been paid or set before commencement of the infringement at issue;
> (2) prior royalties paid (i.e., prior licenses) must be sufficient in number to demonstrate acquiescence in the industry that the allegedly "established" rate is reasonable;
> (3) the allegedly "established" rate must have been substantially uniform;
> (4) prior licensees must have agreed to the rate while they were not under a threat of suit or in settlement of pending litigation; and
> (5) the infringing activity at issue must be commensurate with the activity contemplated under the prior licenses.

This test will only be satisfied in rare cases, and in those circumstances the NPE will be entitled to its established royalty rate and its established license structure.

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13 Paul H. Roeder, *Challenging Inflated Damages Claims by NPEs*, Law360 (Sept. 4, 2012).

14 Barbara A. Parvis, *Does a Lump Sum Payment Cover All Future Patent Use?*, Law360 (June 6, 2012); *Personal Audio LLC v. Apple Inc.*, No. 9:09CV111, 2011 WL 3269330 (E.D. Tex. July 29, 2011); *Lighting Ballast Control LLC v. Philips Elecs. North Am. Corp.*, 814 F. Supp. 2d 655, 693 (N.D. Tex. 2011), *rev'd on other grounds*, 498 Fed. Appx. 985 (Fed. Cir. Jan. 2, 2013) (unpublished opinion), *pet. en banc granted*, 2013 WL 1035092 (Fed. Cir. March 15, 2013) (issue concerning deference to district courts on claim construction). *But see DataTreasury Corp. v. Wells Fargo & Co.*, No. 2:06-cv-72, Docket No. 2463 (E.D. Tex., Jan. 12, 2011) (holding that based on jury instructions, the verdict form's reference to lump sum paid-up royalty was not sufficient to foreclose an ongoing royalty on post-verdict sales).

15 318 F. Supp. at 1120. In the appeal of *Georgia-Pacific*, the Second Circuit actually held the district court had erred because the awarded royalty "gobbled up" all the defendant's expected profit and stated that the "reasonable 'royalty must be fixed so as to leave the infringer, or suppositious licensee, a reasonable profit.'" 446 F.2d 295, 299 (2d Cir. 1971) (quoting district court, 318 F. Supp. at 1122).

16 130 U.S. 152 (1889).

- **The proposal eliminates the unrealistic, unstructured approach of *Georgia-Pacific* and its potential for mischief**

The *Georgia-Pacific* approach to reasonable royalty damages assumes a hypothetical negotiation between a willing licensor and willing licensee. It also assumes the parties are bargaining over a patent they both agree is valid and infringed. But a plaintiff and defendant in litigation are anything but willing negotiators. Moreover, even the most seasoned licensing professional would be hard pressed to recall an actual negotiation in which the parties agreed the patent was valid and infringed – quite the contrary, in an actual negotiation the parties will take opposite views on the patent's merits. However, *Georgia-Pacific* asks a lay jury, with little to no experience in the patent licensing world, to indulge this fiction and thereby derive an award of damages.

Another issue undermining the *Georgia-Pacific* approach is its timing. The hypothetical negotiation takes place when the defendant begins infringement, but then *Georgia-Pacific* allows consideration of evidence that arises after this date[17] – and the courts have condoned this practice.[18] Indeed, in many NPE cases, the most important evidence presented to the jury is license or settlement agreements that were entered into *after* the hypothetical negotiation date. Depending on which party urges their relevance, either the NPE or defendant will assert that these agreements are "comparable" to the hypothetical license and attempt to convince the jury that it should base the hypothetical license on them, even though they *did not exist* when the supposed negotiation occurred. The paradox is evident – how could a licensor and licensee conduct a negotiation on facts that did not exist at the time of the negotiation?

Furthermore, as stated above, the *Georgia-Pacific* case itself propounds a laundry list of factors that may be used in computing a reasonable royalty. These factors are so malleable they create an open season on damages theories and supporting evidence. One may argue they give litigants, especially NPEs, too much leeway in concocting damages theories and are susceptible to abuse. And now that NPEs can no longer obtain an injunction, they are motivated to exaggerate their damages and seek reasonable royalty awards that far exceed the value of their inventions. Once the jury hands down its verdict, the defendant is left with only one expensive and relatively unpredictable course of action – post-trial motions followed by appeal. If the verdict is affirmed, the defendant faces the likelihood that the NPE will receive an award of ongoing royalties that are even greater than the royalty rate awarded at trial.

The current proposal would eliminate *Georgia-Pacific* and its potential for mischief. There would be no need to assume a willing licensor-willing license or a patent that is valid and infringed. License agreements dated after infringement began would be irrelevant. The bulk of the *Georgia-Pacific* factors would be eliminated.[19] Instead, assuming the NPE cannot prove an established royalty – and this will hold true in nearly every case – the NPE will be relegated to an award of damages based on the actual value of the patented invention over the NBNA. This approach more closely approximates a *real* negotiation the parties would have conducted outside of litigation.

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17 *See, e.g., Georgia-Pacific* factor #11: "The extent to which the infringer has made use of the invention; and any evidence probative of the value of that use."

18 *See, e.g., Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1333 (Fed. Cir. 2009) ("[F]actual developments occurring after the date of the hypothetical negotiation can inform the damages calculation.").

19 Two factors would remain in play in connection with determining incremental value over the NBNA: Factor #9 – "The utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results"; Factor #13 – "The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer." 318 F. Supp. at 1120.

- **The proposal ties damages to the value of the NPE's patented invention**

In *ResQNet*, the Federal Circuit cautioned that "the trial court must carefully tie proof of damages to the claimed inventions' footprint in the marketplace."[20] The Federal Circuit has spent considerable effort over the past few years clarifying and refining damages law to help trial courts realize this goal. It has published opinions addressing the entire market value rule, apportionment, and comparable licenses. A focus in many of these cases has been tying damages to the actual value of the invention.

But the pace of excessive NPE awards does not appear to be slowing. The cases cited in the introduction are only a few examples of enormous verdicts in NPE cases that were overturned on JMOL or appeal. It seems likely, however, that many such verdicts are not undone – post-trial motions are denied, appeal is not pursued, the parties settle. It would not be a stretch to conclude that many of these problem verdicts, at least in part, suffer from a failure to identify the actual value of the patented invention relative to the state of the prior art and in particular the NBNA.

The proposal in this article would do just that – tie the damages to the claimed invention's actual footprint. An NPE would be required to prove the incremental value of its patented invention over the NBNA. This inquiry inherently incorporates apportionment, which is arguably the most problematic issue in damages law today.[21] Perhaps more important, this aspect of the proposal is closer to a real-world license negotiation in which the potential licensee would not pay more for the patented invention than its incremental value over the NBNA.[22] Instead, the potential licensee would simply reject the proposed license and use the NBNA rather than the patented invention.[23] In other words, it would trade the loss in profits from *not* licensing the patented invention for the decrease in costs it would have incurred by taking a license – assuming those costs exceed the profits.[24] Of course, this also assumes the NBNA would have been acceptable and available to the potential licensee (i.e., defendant).

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20 *ResQNet.com, Inc. v. Lansa, Inc.*, 594 F.3d 860, 869 (Fed. Cir. 2010).

21 *See LaserDynamics*, 2012 WL 3758093, at *13 (Fed. Cir. Aug. 30, 2012) (rejecting plaintiff's expert's one-third apportionment because it appeared "to have been plucked out of thin air"; "This complete lack of economic analysis to quantitatively support the one-third apportionment echoes the kind of arbitrariness of the '25% Rule' that we recently and emphatically rejected from damages experts, and would alone justify excluding Mr. Murtha's opinions in the first trial."); *Mirror Worlds*, 784 F. Supp. 2d 703, 727 (E.D. Tex. 2011) (vacating $625M damages award and stating that "Mirror Worlds cannot simply apply 'haircuts' adjusting the royalty rate to apportion damages" where entire market value rule not satisfied), *aff'd on other grounds*, 692 F.3d 1351 (Fed. Cir. 2012). Apportionment has its origins in the Supreme Court. *See Garretson v. Clark*, 111 U.S. 120, 121 (1884) (stating that the patentee must "give evidence tending to separate or apportion the defendant's profits and the patentee's damages between the patented feature and the unpatented features, and such evidence must be reliable and tangible, and not conjectural or speculative, or he must show by equally reliable and satisfactory evidence that the profits and damages are to be calculated on the whole machine, for the reason that the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature.").

22 *See Brandeis Univ. v. Keebler Co.*, Case No. 1:12-cv-01508, slip op. at 9 (N.D. Ill. January 18, 2013) (Posner, J., sitting by designation) ("Keebler would not have paid a royalty higher than the cost to it of switching to a noninfringing substitute for the plaintiffs' margarine in its cookies or otherwise reworking its manufacturing process to avoid making the infringing margarine.").

23 In some cases the surplus value created by the patented invention may be zero when compared to the NBNA. For example, envision a situation where the accused infringer has no prior knowledge of the patent, has two or more equally good alternatives at the time it designs its product, and adopts the patented technology, which is a relatively minor feature in a complex product. In this case, the value of the NBNA equals the value of the patented feature – i.e., there is no incremental difference. If the accused infringer had known of the patent, it would have simply chosen the NBNA because the patented feature provides no additional advantages and simply increases the cost of the product. In a real world negotiation, after having unwittingly adopted the patented feature, the accused infringer would be willing to pay the patentee for a license to avoid the cost of implementing the NBNA, but nothing more. Here, the only advantage of the patented feature is the avoidance of all the costs associated with a redesign (e.g., labor costs, manufacturing costs, downtime costs).

24 These costs would include the royalties (or lump sum) payable under the license and the costs to switch to and implement the patented invention. This concept is probably easier to visualize with a real-world example. Imagine purchasing a new car, with an option to purchase an in-dash navigation system that is easy to see, convenient to use, and highly functional. This option will add $1500 to the cost of the car. But there are alternatives: use navigation features on your smartphone and mount the phone to your dash, or revert to a paper map or directions printed from the Internet. As much as the in-dash system would be nice to have, the price tag may simply be too steep considering that alternatives exist, and some may decide against the option based on the cost. In this case, the "profit" (or increased convenience value) does not exceed the "cost" (the $1500 option fee). For others, the profit may outweigh the cost, and the car's new owner will drive off the lot with the $1500 navigation system. The same calculus, through likely more complex, may be undertaken when deciding to license a patented technology.

Surveys are becoming more common in patent damages and could be used to establish the incremental value of the patented invention. In *i4i v. Microsoft*, the Federal Circuit accepted the use of surveys to estimate the amount of infringing use by consumers and hence, in part, the value of the patented invention.[25] Judge Posner in *Apple v. Motorola*[26] recognized the utility of surveys to apportion the value of a patented invention over the NBNA, despite holding that the actual surveys used in the case were flawed for the purpose of valuing the patented features: "[C]onsumer surveys designed to determine the value of a particular feature or property of a consumer product are a common and acceptable form of evidence in patent cases."[27] For purposes of this article's proposal, either the patentee or defendant could use surveys to establish their respective positions on incremental value of the patented invention.

- **The proposal avoids complex, expensive litigation over injunctions and ongoing royalties**

Under the current proposal, an NPE may only obtain a fully paid-up lump sum award. In other words, the jury's verdict would provide the NPE with complete compensation from the infringement. As a consequence, there would be no complex and costly litigation over whether an injunction should be awarded,[28] or the amount of ongoing royalties in lieu of an injunction. The verdict would make the NPE whole. This is consistent with most real-world licensing negotiations involving NPEs, in which an accused infringer will insist on buying peace with the NPE for the remaining life of the asserted patent. Contrary to this reality, imposition of an ongoing royalty creates two hypothetical negotiations between the NPE and defendant – one when the infringement begins, and one after the verdict in which the court sets the ongoing royalty rate.

- **The proposal eliminates the risk of prejudicial license agreements reaching the jury**

NPEs frequently rely on license and settlement agreements to drive up the royalty rate. The Federal Circuit has cracked down on this practice in recent cases, requiring that such agreements be "comparable" to the hypothetical license.[29] Despite this tightening of the law, license agreements that are arguably *not* comparable, and that ultimately may sway a jury to hand down an unjustified damages verdict, continue to be admitted into evidence.

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25 *i4i Ltd. Partnership v. Microsoft Corp.*, 598 F.3d 831, 855-56 (Fed. Cir. 2010). The Supreme Court recognized that the use made of a patented feature may aid appraisal of the patent's value. *Sinclair Refining Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689, 697 (1933); *see also Lucent*, 580 F.3d at 1333-34 (citing *Sinclair* for this proposition).

26 *Apple, Inc. v. Motorola, Inc.*, No. 1:11-cv-08450, 2012 WL 1959560 (N.D. Ill., May 22, 2012) (Posner, J., sitting by designation).

27 *Id.* at *5 (citing *i4i* and *Lucent*). *See also id.* at *7: "The value of [the patented] feature to the consumer is again a question the answer to which could be elicited, within a permissible (because unavoidable) range of uncertainty, by a properly designed and executed consumer survey."

28 Where the alleged NPE argues that it does compete with the defendant, parties have litigated over the propriety of an injunction, and in some post-*eBay* cases the NPE has won. *See, e.g., Harris Corp. v. Federal Express Corp.*, No. 6:07-cv-1819 (M.D. Fla., Feb. 28, 2011) (imposing a permanent injunction where NPE (Harris) did not compete with FedEx, because Harris had licensed the patent to companies that did compete with FedEx and continuing to permit FedEx's infringing systems to remain in the market created a risk of irreparable harm to Harris' licensing opportunities), *aff'd in part, rev'd in part, vacated in part, and remanded, all on other grounds*, 2013 WL 174185 (Fed. Cir. January 17, 2013) (unpublished opinion); *Commonwealth Scientific & Indus. Research Organization v. Buffalo Tech. (USA), Inc.*, No. 6:06-CV-324, 2007 U.S. Dist. LEXIS 43832 (E.D. Tex., June 15, 2007) (granting injunction to NPE (CSIRO) essentially because CSIRO is a research institution whose revenues are based on its reputation and because the patented technology was the "core technology" embodied in the accused products; distinguishing Justice Kennedy's *eBay* concurrence quoted above in footnote 2), *aff'd in part, vacated in part, and remanded, all on other grounds*, 542 F.3d 1363 (Fed. Cir. 2008).

29 *See, e.g., Lucent*, 580 F.3d at 1325, 1327-28; *ResQNet*, 594 F.3d at 870; *LaserDynamics*, Nos. 2011-1440, -1470, slip op. at 42-45.

Under the current proposal, comparable license agreements would only be relevant if the NPE attempts to prove an established royalty. They would be excluded from the calculus in determining the incremental value of the patented technology over the NBNA.

IV. CRITICISMS OF THE PROPOSAL

This proposal is vulnerable in several aspects. This section identifies a number of criticisms and attempts to rebut them.

- **How do we define NPE?**

It is a safe bet that litigation will ensue over the definition of "NPE." Paradigm examples are, of course, easily identified: patent holding companies that make no products; limited liability companies that are established solely to assert patents; an inventor enforcing her own patent. Similar to Justice Potter's observation about obscenity in *Jacobellis v. Ohio*[30] – "I know it when I see it" – we see these companies or individuals and know they are NPEs. The lines become more blurred, however, when we step away from the paradigm:

- Universities
- Spin-outs from PEs
- Former PEs that no longer make products
- Companies that are PEs for some products but an NPE in the market for the patented technology

These types of entities will test the limits of "NPE." Any patentee who falls into one of these categories will likely litigate the question of whether it should be considered an NPE for purposes of damages, attempting to avoid the damages methodology set out in this article. This could lead to significant litigation costs and uncertainty and could place a burden on the judicial system.

In response, it is the clear-cut NPEs who arguably place the greatest burden on the patent system and who are the beneficiaries of some of the most astonishing and unjustified damages verdicts. Moreover, just like any issue in litigation, the gray areas may be navigated via statutory guidelines and judicial precedent.

- **Courts are ill-equipped to determine the value of the patented invention over the NBNA**

Two criticisms stem from this point. First, how do you identify the NBNA when the universe of prior art may be vast? It is difficult enough to identify noninfringing substitutes, let alone the best of those, i.e., the NBNA. Second, how do you quantify the differential value between the NBNA (e.g., the best prior art) and the patented invention?

These points were raised by former Chief Judge Michel of the Federal Circuit in connection with Congressional patent reform. On May 3, 2007, Judge Michel wrote an open letter to Congress imploring it not to codify apportionment:

> [T]he provision on apportioning damages would require courts to adjudicate the economic value of the entire prior art, the asserted patent

30 378 U.S. 184 (1964).

> claims, and also all other features of the accused product or process whether or not patented. This is a massive undertaking for which courts are ill-prepared. For one thing, generalist judges lack experience and expertise in making such extensive, complex economic valuations, as do lay jurors. For another, courts would be inundated with massive amounts of data, requiring extra weeks of trial in nearly every case. Resolving the meaning of this novel language could take years, as could the mandating of proper methods. The provision also invites an unseemly battle of "hired-gun" experts opining on the basis of indigestible quantities of economic data. Such an exercise might be successfully executed by an economic institution with massive resources and unlimited time, but hardly seems within the capability of already overburdened district courts.[31]

The response to this criticism is that much of apportionment is already part of patent litigation. In lost profits, the patentee must prove an absence of acceptable noninfringing substitutes. The NBNA would be one of these substitutes. A defendant arguing for invalidity will almost certainly assert the patent is obvious under 35 U.S.C. § 103. The Supreme Court's decision in *Graham v. John Deere*[32] states guidelines for the obviousness inquiry: The scope and content of the prior art must be determined, and any differences between the patented invention and the prior art must be ascertained. The Supreme Court recognized that there would be difficulties in applying the nonobviousness test, but that they would be "comparable to those encountered daily by the courts in such frames of reference as negligence and scienter, and should be amenable to a case-by-case development."[33] The same is true for this damages proposal. Finally, damages experts are routinely called upon to determine the incremental value of a patented invention over alleged substitutes. Thus, while this criticism is not unfounded, this article's proposal is well within the capabilities of the judicial system.

- **The use of surveys to establish incremental value would simply replace inflated *Georgia-Pacific* theories with inflated survey estimates**

The section above on advantages identifies surveys as a mechanism for apportioning the value of the patented invention over the NBNA. One could argue, however, that surveys are fraught with imprecision and susceptible to same type of mischief as *Georgia-Pacific* theories. That is, NPEs could manipulate surveys to inflate the value of their patents, and defendants could do the same to drive down value. Accordingly, the criticism is that the proposal in this article, to the extent it relies on surveys, is no better than *Georgia-Pacific*.

Though not perfect, surveys do not offer the same potential for abuse inherent in the *Georgia-Pacific* framework. Surveys can be effectively designed to answer the precise question of a patented feature's value over the NBNA – consumers can be asked questions that isolate the feature and its value. For example, in *Apple v. Motorola*, Judge Posner posited that competently designed and administered surveys could have been used to determine, "within the limits of tolerable uncertainty," just how much consumers would have paid for the patented smartphone features at issue.[34]

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31 *See* http://www.fr.com/files/uploads/attachments/patentdamages/05-03-07Michelletter.pdf.
32 383 U.S. 1 (1966).
33 *Id.* at 18.
34 *Apple v. Motorola*, 2012 WL 1959560, at *10.

One remaining criticism of using surveys to isolate and estimate value is that *isolation* fails to account for the synergistic value of a patented feature working together with or enabling other features. For example, if the patent were directed to improving the display on a smartphone (e.g., by making it brighter and more brilliant and/or less power hungry), the patented feature may contribute value to consumers by allowing *other features* to be implemented on the smartphone that could not be achieved with prior art displays (e.g., allowing consumers to play games that require a brighter and finer display). If the survey isolated the value of the patented display over the NBNA display, the survey would fail to account for the combined value of the improved display and its enablement of desirable games for consumers.[35] Surveys can be designed, however, to focus not only on the isolated value of the patented feature, but also on the synergistic value achieved by combining the patented feature with other unpatented features.[36]

- **The profit split leads to Nash Bargaining, game theory, and other damages theories that have no place in a patent trial**

As part of this proposal, once the incremental value of the patented invention is determined, that value must be split between the NPE and defendant. Many profit splitting approaches have been developed through negotiation theory, but they are relatively new to patent law and not without controversy. Perhaps the most famous negotiation theory was developed by Princeton Professor John Nash – he won a Nobel Prize for his work and was the subject of the feature film, "A Beautiful Mind," starring Russell Crowe. In its essence, Nash's theory (known as the Nash Bargaining Solution, or "NBS") holds that two negotiating parties would in most cases settle for an *equal split* of the surplus created by their cooperation in reaching a deal. In other words, if a purchaser wanted to spend $X for a product, and the seller wanted to receive $X+Y for the product, the parties would agree to a selling price of $X+1/2Y (assuming $1/2Y is within the range of compromise for each party).[37]

At least one court has criticized the NBS for use in determining patent damages. Judge Alsup of the Northern District of California, presiding over the litigation between Oracle and Google, was faced with the NBS. At least on the facts in that case, Judge Alsup concluded that the NBS was unacceptable: "It is no wonder that a patent plaintiff would love the [NBS] because it awards fully half of the surplus to the patent owner, which in most cases will amount to half of the infringer's profit, which will be many times the amount of real-world royalty rates. There is no anchor for this fifty-percent assumption in the record of actual transactions."[38] Judge Alsup also criticized the mathematical complexity

35 *See* Elizabeth M. Bailey, *et al.*, *supra* note 12 (referring to synergistic features as "complementaries"; "When there are complementaries between assets, such that the combined use of two or more assets is worth more than their individual use, no unique way exists to apportion the overall value of the product among the assets (including the patented technology at issue)."). *Cf. Oracle America, Inc. v. Google Inc.*, No. C 10-03561 WHA, 2012 WL 850705, at *10 (N.D. Cal., March 13, 2012) ("Google argues that [the expert's] conjoint survey results are unreliable because the features selected to be surveyed, only seven in total, were purposely few in number and omitted important features that would have played an important role in real-world consumers' preferences. Google argues that this inappropriately focused consumers on artificially-selected features and did not reliably determine real-world behavior. This order agrees – on this record for this application.").

36 *Cf. Oracle v. Google*, 2012 WL 850705, at *11-12 ("The above-described flaw, however, is not fatal to the conjoint analysis' calculation of the relative preference between 'application startup time' and 'availability of applications.' The study participants were unlikely to infer implicit attributes onto these two features. The calculated relative preference between these two features is sufficiently reliable for the purposes of *Daubert*. Thus, [the expert's] use of this relative preference for his apportionment calculation is not stricken.").

37 The NBS does not compel a 50/50 profit split. If one party has more bargaining power – for example, if the patentee-licensor could produce the patented technology or the defendant-licensee could turn to reasonable noninfringing alternatives – the result of the NBS could be something other than 50/50. *See VirnetX Inc. v. Cisco Sys., Inc.*, Case No. 6:10-cv-00417-LED (E.D. Tex. March 1, 2013) (Doc. No. 745) (denying motion to exclude expert's use of NBS with 45/55 split because the expert proffered some explanation for deviation from the traditional 50/50 split).

38 *Oracle America, Inc. v. Google Inc.*, 798 F. Supp. 2d 1111, 1119 (N.D. Cal. 2011). *See also id.* (observing that NBS "has never been approved by a judge to calculate reasonable royalties in litigation, at least in the face of an objection. This is despite the fact that for decades it has been lurking in the field of economics.").

of the NBS, observing that it "would invite a miscarriage of justice by clothing a fifty-percent assumption in an impenetrable façade of mathematics."[39] One could also argue that the NBS – or any profit splitting model – contradicts Congress' elimination in 1946 of patent damages based on the defendant's profits.[40] A patentee can seek its *lost* profits, but not the defendant's profits.

In response, the NBS and negotiation game theory are well-accepted economic models for calculating the outcome of a negotiation.[41] They are recognized as a scientific method in determining patent licensing royalty rates.[42] Moreover, despite the critical language from Judge Alsup, other courts have been more charitable when faced with profit splitting theories.[43] For years, courts and juries have heard experts testify on economic concepts such as supply and demand, demand elasticity, and fixed and variable costs. Assuming a trial court properly exercises its gatekeeping authority, there is no reason to believe a jury cannot process a damages theory in which the profit split is reliably based on the NBS or other negotiation game theory.

- **This proposal is at odds with Federal Circuit precedent holding that design-around costs cannot cap reasonable royalty damages**

In *Mars v. Coinco*,[44] the Federal Circuit was faced with the defendant's argument that its cost to design-around the patented invention should *cap* its liability for reasonable royalty damages. In other words, it was the defendant's position that an infringer could not be forced to pay more than it would have paid for the cheapest noninfringing substitute at the time infringement began (i.e., the date of the hypothetical negotiation). The Federal Circuit flatly rejected this argument: "[E]ven if [the defendant] had shown that it had an acceptable noninfringing alternative at the time of the hypothetical negotiation, [it] is wrong as a matter of law to claim that reasonable royalty damages are capped at the cost of implementing the cheapest available, acceptable, noninfringing alternative. … To the contrary, an infringer may be liable for damages, including reasonable royalty damages, that exceed the amount that the infringer could have paid to avoid infringement."[45]

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39 *Id.* at 1120.

40 The 1946 Patent Act abolished the infringer's profits as a remedy for utility patents, Patent Act of August 1, 1946, though the remedy remains intact for design patents, 35 U.S.C.§ 284.

41 *See, e.g.*, Ken Binmore, *et al.*, *An Outside Option Experiment*, The Quarterly Journal of Economics (Nov. 1989) ("The Nash bargaining solution has been widely used as a modeling tool for wage negotiations in applied economics.").

42 *See, e.g.*, Toshihiro Matsumura & Noriaki Matsushima, *Patent Licensing, Bargaining, and Product Positioning*, Institute of Social and Economic Research Osaka Univ., Discussion Paper No. 775 (May 2010); Roy Weinstein, *et al.*, *Taming Complex Intellectual Property Compensation Problems*, TTI Vanguard Conference (Washington, D.C. October 4, 5, 2011) ("The Nash Bargaining Solution ("NBS") provides a generally accepted framework for identifying and evaluating factors that influence negotiation outcomes between parties."). *Cf. Sanofi-Aventis Deutschland GmbH v. Glenmark Pharmaceuticals Inc.*, Civil Action No. 07-CV-5855 (DMC-JAD), 2011 WL 383861, at *12-13 (D.N.J., Feb. 3, 2011) (denying defendant's MIL against plaintiffs' expert's 50/50 profit split, and apparently accepting plaintiffs arguments (1) that "game theory, which is what [the expert] used in determining his reasonable royalty rate, is the standard model in economics for calculating the outcome of a negotiation, is recognized as a scientific method in determining reasonable royalty rates, and is unrelated to the 25 percent rule rejected in *Uniloc*," and (2) "that [the expert] did not arbitrarily apply a 50/50 profit split, but rather reached that result after considering the facts of the case, specifically the relationship between the parties and their relative bargaining power, the relationship between the patent and the accused product, the standard profit margins in the industry, and the presumed validity of the patent. ").

43 *VirnetX Inc. v. Cisco Sys., Inc.*, Case No. 6:10-cv-00417-LED (E.D. Tex. March 1, 2013) (Doc. No. 745) (denying motion to exclude expert's use of NBS); *Gen-Probe Inc. v. Becton Dickinson & Co.*, Case No. 09-CV-2319 BEN NLS and 10-CV-0602 BEN NLS (S.D. Cal. Nov. 26, 2012) (noting that NBS has been "criticized as impenetrable," citing *Oracle Am., Inc. v. Google Inc.*, 798 F. Supp. 2d 1111, 1120 (N.D. Cal. 2011), but nevertheless allowing plaintiff's expert to testify on profit splitting approach that used "combination of real world observation and the Nash bargaining solution"); *Lucent v. Gateway*, No. 07-CV-2000 H(CAB), 2011 WL 2728317 (S.D. Cal., July 13, 2011) (denying Microsoft's motion in limine regarding Lucent's expert's opinion that the alleged value of the patented technology ($138M) would be split roughly 50/50); *Sanofi-Aventis*, 2011 WL 383861, at *12-13 (denying defendant's MIL against plaintiffs' expert's 50/50 profit split that was ostensibly based on "game theory"); *Inventio Ag v. Otis Elevator Co.*, No. 06 Civ. 5377 (CM), 2011 WL 3359705, *3 (S.D.N.Y., June 23, 2011) (allowing patentee's expert to use an approach applying the *Georgia-Pacific* factors to "the midpoint" between the rate in a license and the defendant's presumed profit), *rev'd in part, vacated in part, and remanded, all on other grounds*, 497 Fed. Appx. 37 (Fed. Cir. Nov. 27, 2012) (unpublished opinion).

44 *Mars, Inc. v. Coin Acceptors, Inc.*, 527 F.3d 1359 (Fed. Cir. 2008).

45 *Id.* at 1373.

This article's proposal does not, however, violate *Coinco*. In that case, the defendant urged that damages should not exceed the *cost* to implement the *cheapest* noninfringing alternative. Here, in contrast, damages are based on the incremental *difference in value* between the patented invention and the *next best* noninfringing alternative, not the cost of the cheapest alternative. The flaw in the *Coinco* defendant's theory is that it was trying to limit its damages to the cost of a cheap design-around without accounting for the value of the patented invention. Indeed, Judge Lifland in his decision explicitly stated that he believed the availability of noninfringing alternatives to be "highly relevant to hypothetical reasonable royalty negotiations, and this is not a very difficult conclusion to reach."[46] Judge Lifland stated he had "no doubt that [defendant] had the ability and the resources to develop noninfringing technology," but also found that "the particular noninfringing technology didn't perform as well" as the patented technology.[47] So the district court's analysis in *Coinco* was arguably consistent with this proposal – Judge Lifland recognized the defendant had alternatives, but also found those alternatives to be less valuable than the infringing technology, and used that data as a key piece of his royalty analysis.

- **What happens when there is no NBNA?**

Critics will argue that *Georgia-Pacific* will still be required in cases where no NBNA exists, and that this exception will swallow the new proposal. This is a valid concern, but far from insurmountable. First, it should be noted that an NBNA will likely exist in a large majority of NPE cases. Most NPE patents are directed to a single feature in a multicomponent product, and there are nearly always alternatives – either a noninfringing design that could be substituted for the patented feature (even an imperfect substitute),[48] or the option to omit the patented feature entirely. In fact, the cases where *Georgia-Pacific* has caused the most concern – patents directed to features in computer hardware, computer software, smartphones, etc. – will mostly, if not *always*, have an identifiable NBNA. Even in cases where the patent is directed to an overall product, an NBNA will almost certainly exist. We live in a world of explosive technological advancements, and nearly every product, product feature, or process is built upon preexisting technology – meaning prior art, noninfringing alternatives will exist in nearly every field.

Accordingly, there will be little need to deviate from this proposal. If the need does arise, courts can exercise their role as gatekeeper to ensure the NPE's fallback damages theory is reliable and tethered to the facts of the case.

- **Willfulness will be back to the jury in every case**

The Federal Circuit recently stiffened the standard for proving willful infringement in *Bard Peripheral Vascular v. W.L. Gore* (en banc).[49] Prior to *Bard*, the Federal Circuit handed down *In re Seagate* (en banc) in which it held that a negligent defendant could not be found liable of willful infringement.[50] Instead, the patentee must prove by clear and

46 *Mars, Inc. v. Coin Acceptors, Inc.*, Case 2:90-cv-00049-JCL-ES, at page 27 (D.N.J., May 11, 2007) (transcript of proceedings). Judge Lifland added: "It just seems to me self evident [sic] that if the accused infringer who is negotiating for a royalty and is of course seeking a lower royalty, will find it very relevant that he can present alternatives that don't infringe, and that will be acceptable to customers and likewise the patentee that is seeking a high royalty will be very interested in showing during the negotiations that such alternatives do not exist." *Id.*

47 *Id.* at 29.

48 *See Brandeis Univ. v. Keebler Co.*, Case No. 1:12-cv-01508, slip op. at 10 (N.D. Ill. January 18, 2013) (Posner, J. sitting by designation) ("For [a reasonable] royalty would depend on the cost, in higher production costs and loss of business to competitors, of the best ***imperfect*** substitute …..") (emphasis added).

49 *Bard Peripheral Vascular, Inc. v. W.L. Gore & Assoc., Inc.*, 682 F.3d 1003 (Fed. Cir. 2012) (en banc).

50 *In re Seagate Tech., LLC*, 497 F.3d 1360, 1371 (Fed. Cir. 2007) (en banc).

convincing evidence that the defendant acted in an objectively reckless manner.[51] In *Bard*, the Federal Circuit further refined willful infringement, taking objective recklessness out of jurors' hands and placing it into the judge's to determine as a matter of law.[52]

Under the current proposal, an NPE would be permitted to seek enhanced damages if it believes the fully paid-up lump sum award is insufficient. Consequently, one could argue that nearly every NPE will drum-up some form of alleged misconduct by the patentee that requires an enhancement, or contend that under principles of fairness and equity the damages award should be enhanced, in order to have these issues decided by the jury as part of the damages inquiry. The proposal would thus return patent litigation to its pre-*Bard* state.

The response to this criticism is that courts are well equipped to address willfulness-type arguments. Willfulness arises in many kinds of litigation and has long been a part of patent cases. Moreover, enhancement of damages would be guided by the strict *Seagate* standard; not just any conduct by the defendant would result in increased damages under Section 284. In any event, even with the *Seagate* standard in place, NPEs will assert willful infringement in nearly every case to gain settlement leverage. Thus, allowing for enhancement of the fully paid-up lump sum damage award proposed here would not make a significant change to the existing state of patent litigation. Alternatively, the enhancement provision of this article's proposal could be jettisoned, leaving the remaining components in place.

V. CONCLUSION

This article's proposal would significantly reduce runaway damages awards in NPE cases. It would cut off any argument by an NPE for injunctive relief and would eliminate ongoing royalties that complicate NPE cases and may result in a windfall. Moreover, the proposal would bring patent damages more in line with licensing realities, tying an NPE's damages award to the contribution of its patented invention over the prior art and/or noninfringing alternatives. Finally, eliminating the *Georgia-Pacific* approach to reasonable royalty damages would avoid the unrealistic assumptions and unbridled framework that plague the approach.

51 *Id.* ("Accordingly, to establish willful infringement, a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its action constituted infringement of a valid patent. … The state of mind of the accused infringer is not relevant to this objective inquiry. If this threshold objective standard is satisfied, the patentee must also demonstrate this objectively-defined risk … was either known or so obvious that it should have been known to the accused infringer.").

52 682 F.3d at 1007, 1008 ("When a defense or noninfringement theory asserted by an infringer is purely legal (e.g., claim construction), the objective recklessness of such a theory is a purely legal question to be determined by the judge. When the objective prong turns on fact questions, as related, for example, to anticipation, or on legal questions dependent on the underlying facts, as related, for example, to questions of obviousness, the judge remains the final arbiter of whether the defense was reasonable, even when the underlying fact question is sent to a jury."; "[T]he ultimate legal question of whether a reasonable person would have considered there to be a high likelihood of infringement of a valid patent should always be decided as a matter of law by the judge.") (citations omitted).

COUNSEL COURTS KEEP: JUDICIAL RELIANCE ON SPECIAL MASTERS, COURT-APPOINTED EXPERTS, AND TECHNICAL ADVISORS IN PATENT CASES

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I. INTRODUCTION

> *No one will deny that the law should in some way effectively use expert knowledge wherever it will aid in settling disputes. The only question is as to how it can do so best.*
>
> Learned Hand, *Historical and Practical Considerations Regarding Expert Testimony*, 15 HARV. L. REV. 40 (May 1901).

Patent cases are among the most complex matters that a federal district court must supervise. Typically, the court will be forced to grapple with an arcane, specialized vocabulary, opaque prior art references, and intricate products. The court will also likely endure battles of the experts featuring sharply divergent viewpoints regarding mysterious technologies. In effect, hearing a patent case can be as conceptually difficult as asking it to resolve a dispute between two parties speaking different languages. Moreover, since patent litigation has nearly tripled over the past twenty years, this appears to be a problem that is not going away. *See* Chris Barry et al., *2012 Patent Litigation Study: Litigation continues to rise amid growing awareness of patent value*, PricewaterhouseCoopers 6 (Sept. 2012), *available at* http://www.pwc.com/us/en/forensic-services/publications/2012-patent-litigation-study.jhtml.

Many suggestions have been proposed for lightening the burden that patent litigation places on the judiciary. For example, some commentators have called for specialized patent courts. *See*, *e.g.*, Richard A. Posner, *Why There Are Too Many Patents in America*, TheAtlantic.com (July 12, 2012), *available at http://www.theatlantic.com/business/archive/2012/07/why-there-are-too-many-patents-in-america/259725/*. Congress has provided a number of solutions as well, such as the Patent Pilot Program in which district court judges may request to hear patent cases, enabling disinterested judges to decline them, thereby building greater, albeit concentrated, experience with patent litigation in the federal judiciary. Omnibus Trade Act of 2010, Pub. L. No. 111-344, 124 Stat. 3674 (2011).

One approach that district courts presiding over patent cases may take to manage this technical complexity is to seek help from an expert on patent law or on the technology at issue – a "neutral expert." Courts have inherent authority to engage special masters, court-appointed expert witnesses, and technical advisors who may help explain the technology, translate esoteric language, answer difficult legal and factual questions, and provide a view of the evidence untainted by party affiliation.

While such neutral experts can be of considerable help to courts in presiding over patent cases, they give rise to significant risks, from increased costs to violations of fundamental due process rights. Accordingly, courts wading into the neutral expert waters must do so carefully. Below, we provide an overview of the legal framework for each species of neutral expert, discuss the potential benefits and risks inherent to each, and recommend steps a district court should take when considering whether to appoint a neutral expert.

II. THE LAW GOVERNING APPOINTMENT OF NEUTRAL EXPERTS

Courts have the inherent power to engage third parties to assist them in performing their judicial duties. *In re Peterson*, 253 U.S. 300, 312-13 (1920) ("Courts have . . . inherent power to provide themselves with appropriate instruments required for the performance of their duties. This power includes authority to appoint persons unconnected with the court to aid judges in the performance of specific judicial duties, as they may arise in the progress of a cause."). Courts must balance this power, however, with their duty under Article III "to determine by [their] own judgment the controversy presented." *Stauble v. Warrob, Inc.*, 977 F.2d 690, 695 (1st Cir. 1992) (quoting another source).

The law provides some guidelines for courts to follow in striking this balance. At least superficially, the legal requirements for courts' appointment of third-party aids vary in number and precision according to the extent of the delegation of judicial authority. At one end of the spectrum, the Federal Rules of Civil Procedure provide specific conditions and procedures for courts to follow when appointing special masters, who may decide issues pursuant to overt delegations of authority. At the opposite end, no Federal Rules govern courts' use of technical advisors, who provide no on-the-record decisions or testimony. *See Reilly v. United States*, 863 F.2d 149, 156 (1st Cir. 1988) (holding Federal Rule of Evidence 706 does not govern technical advisors). We discuss the law relevant to special masters, court-appointed experts, and technical advisors below.

A. Special Masters

1. Courts may refer any issue to a special master with the parties' consent. Without consent, courts may refer *almost* any issue to a special master.

Rule 53 of the Federal Rules of Civil Procedure governs special masters. *See* Fed. R. Civ. P. 53; *Constant v. Advanced Micro-Devices, Inc.*, 848 F.2d 1560, 1566 (Fed. Cir. 1988) ("The powers and conduct of special masters are generally governed by Fed. R. Civ. P. 53, and the specific powers of the master are defined by the order of reference in each particular case."). In 2003, Rule 53 was "revised extensively to reflect changing practices." Fed. R. Civ. P. 53 advisory committee notes (2003 amendments). In its current form, Rule 53 provides that courts may appoint special masters for three purposes:

- To perform any duties to which the parties consent;
- To hold trial proceedings and make or recommend factual findings on issues decided without a jury, provided "some exceptional condition" exists or there is a "need to perform an accounting or resolve a difficult computation of damages"; or

- To handle pre- and post-trial matters "that cannot be effectively and timely addressed by an available district judge or magistrate judge of the district."

Fed. R. Civ. P. 53(a)(1).

Pursuant to Rule 53, courts are not required to obtain the parties' consent before referring to a special master any pre- or post-trial matter or trial of any damages question implicating "complex quantitative issues." *Stauble*, 977 F.2d at 694. The parties' consent is needed only when courts wish to appoint special masters to preside over trial of non-jury issues and make or recommend findings of fact, absent "some exceptional condition" existing. Fed. R. Civ. P. 53(a)(1)(B)(i); *cf. Constant*, 848 F.2d at 1566 ("[T]he court has the power to appoint masters without the consent of the parties.").

One might interpret "exceptional condition" broadly enough to encompass matters dealing with unusual factual complexity – for example, patent cases dealing with especially complicated technology. Courts have rejected such a broad reading.

In *Los Angeles Brush Manufacturing Corp. v. James*, 272 U.S. 701 (1927), the Supreme Court declined to issue a writ of mandamus regarding a district court's referral of patent cases to a special master, but stated that a per se referral of all special cases to a special master would fall afoul of the Equity Rules then in effect. The Court observed that, apart from certain issues such as validity, "[t]here is no reason why a patent litigant should be subjected to any greater expense than any other litigant." *Id.* at 707.

The Court again considered whether complexity amounted to an "exceptional condition" in *La Buy v. Howes Leather Co.*, 352 U.S. 249 (1957). In that case, the Supreme Court affirmed the Seventh Circuit's issuance of a writ of mandamus vacating a district court's referral of antitrust cases to a special master for trial on the merits. The Court agreed that the lower court's bases for the referral – a congested docket and "unusual complexity of issues of both fact and law" – were not "exceptional circumstance[s]." *Id.* at 258-59. Regarding the latter basis, the Court explained that "most litigation in the antitrust field is complex. It does not follow that antitrust litigants are not entitled to a trial before a court." *Id.* at 259. The Court added that complexity of issues "is an impelling reason for trial before a regular, experienced trial judge rather than before a temporary substitute appointed on an ad hoc basis and ordinarily not experienced in judicial work." *Id.*

In *Stauble v. Constant*, the First Circuit applied *La Buy* and held that "[n]onconsensual reference of fundamental issues of liability to a master for adjudication is not consonant with either Rule 53 or Article III." 977 F.2d at 696. In a case reminiscent of *Bleak House*, a shareholder and director brought claims for breach of fiduciary duty, diversion of corporate assets, and misappropriation of corporate opportunities against fellow directors and the corporation. The district court referred the case to a special master for trial of both liability and damages, asserting that the damages issues were complex and that "the interweaving of liability and damages constitute[d] the requisite 'exceptional condition.'" *Id.* at 694. The First Circuit rejected the reference and observed that "the perceived imbrication seems to be the same old whine in a different bottle. Saying that liability and damages are inextricably intertwined is just an alliterative way of saying that a given case suffers from a particular strain of complexity." *Id.* at 694-95. The appeals court then held that referring the trial of liability to a special master violated Article III. It explained:

> [T]he Constitution prohibits us from allowing the nonconsensual reference of a fundamental issue of liability to an adjudicator who does not possess the attributes that Article II demands. Because Rule 53 cannot retreat from what Article III requires, a master cannot supplant the district judge. Determining bottom-line legal questions is the responsibility of the court itself.

Id. at 695.

Finally, in *United States v. Microsoft Corp.*, 147 F.3d 935 (D.C. Cir. 1998), the D.C. Circuit granted mandamus relief vacating the district court's referral to a special master of the DOJ's motion to permanently enjoin Microsoft from requiring licensees of its operating system software to license Internet Explorer as well. The DOJ defended the reference in part based on the technological complexity of the software at issue in its motion. The court of appeals rejected this argument. Citing *La Buy*, the court observed that "it is very doubtful that complexity tends to legitimate references to a master at all." *Id.* at 955 (citing *La Buy*, 352 U.S. at 259). Interestingly, the court of appeals noted its preference that courts deal with difficult technologies by enlisting neutral experts rather than referring matters to employing special masters:

> To the extent that adjudication may lead the court into deep technological mysteries, we note the court's power under Rule of Evidence 706 to appoint expert witnesses. Whether such an expert is appointed by agreement of the parties or not, the expert's exposure to cross-examination by both sides makes the device a far more apt way of drawing on expert resources than the district court's unilateral, unnoticed deputization of a vice-judge.

Id. at 955 n.22 (citation omitted).

Notwithstanding the foregoing, the parties of course may consent to referral of decisions of liability on the merits to special masters. *Phillips Petroleum Co. v. Huntsman Polymers Corp.*, 157 F.3d 866, 870 (Fed. Cir. 1998) (parties stipulated to appointment of special master to decide summary judgment motions concerning infringement and noninfringement).

2. Rule 53 and the appointing order define the special master's role

Rule 53 directs courts to issue an appointing order when referring matters to a special master. Fed. R. Civ. P. 53(b)(2). "The appointing order must direct the master to proceed with all reasonable diligence." *Id.* In addition, the appointing order must identify:

- The master's duties and limits on its authority;
- Conditions applicable to any ex parte communications between the master and the court or a party;
- What materials the master should preserve and file as the record of its activities;

- The mechanics for reviewing the master's orders, findings, and recommendations, including time limits, method of filing the record, and standards for review; and

- The "basis, terms, and procedure for fixing the master's compensation."

Id.

Courts may issue the appointing order only after the master files an affidavit disclosing any grounds for disqualification under 28 U.S.C. § 455 and, if any ground is disclosed, only after the parties waive the disqualification, with the court's approval. Fed. R. Civ. P. 53(b)(3).

Courts must give the parties notice and an opportunity to be heard both before initially appointing a special master, Fed. R. Civ. P. 53(b)(1), and before amending the appointing order, Fed. R. Civ. P. 53(b)(4).

Apart from any responsibilities conferred through the appointing order, Rule 53 contains default provisions relevant to a special master's role. A master may "(A) regulate all proceedings; (B) take all appropriate measures to perform the assigned duties fairly and efficiently; and (C) if conducting an evidentiary hearing, exercise the appointing court's power to compel, take, and record evidence." Fed. R. Civ. P. 53(c)(1). A master may also issue sanctions, including non-contempt sanctions under Rules 37 and 45 of the Federal Rules of Civil Procedure. Fed. R. Civ. P. 53(c)(2).

Rule 53 contemplates that special masters will issue orders to the parties and, pursuant to the appointing order, reports and recommendations to the Court. The master must file and serve each on the parties. *See* Fed. R. Civ. P. 53(d), (e). Before acting on the special master's report or recommendations, district courts must give the parties notice and an opportunity to be heard. Fed. R. Civ. P. 53(f)(1). Parties may object or move to adopt or modify a master's order, report, or recommendation. Fed. R. Civ. P. 53(f)(2). Parties risk waiving positions by failing to do so. *Schaefer Fan Co. v. J&D Mfg.*, 265 F.3d 1282, 1289 (Fed. Cir. 2001) (finding party waived claim construction argument by failing to object to master's rulings); *Constant*, 848 F.2d at 1566 ("A party cannot wait to see whether he likes a master's findings before challenging the use of a master. Failure to object in a timely fashion constitutes a waiver."). With three exceptions, courts must evaluate objections to a master's findings of fact and conclusions of law under de novo review. Fed. R. Civ. P. 53(f)(3), (4). The exceptions are (1) the parties may stipulate to review of a master's factual findings for clear error; (2) the parties may stipulate that factual findings of a master appointed with the parties' consent or to oversee a pre- or post-trial matter are final; and (3) unless the appointing order establishes a different standard of review, a master's rulings on a procedural matter are reviewed for abuse of discretion. Fed. R. Civ. P. 53(f).

3. Use of special masters in patent cases

In patent cases, special masters are most frequently appointed to preside over claim construction. A 2009 study commissioned by the Federal Judicial Center found that special masters addressed claim construction issues in nearly 41% of patent cases in which courts appointed a master. *See* Jay P. Kesan and Gwendolyn G. Ball, A STUDY OF THE ROLE AND IMPACT OF SPECIAL MASTERS IN PATENT CASES 17, Federal Judicial Center (2009) (hereafter, "FJC Study"), *available at http://www.fjc.gov/public/pdf.nsf/lookup/specmapa.pdf/$file/specmapa.pdf.* This frequency makes sense given the Rules Advisory Committee specifically recommended use of special masters in claim construction in their notes to the 2003 amendments to Rule 53: "The court's responsibility to interpret patent claims as a matter of law . . . may be greatly assisted by appointing a master who has expert knowledge of the field in which the patent operates." Fed. R. Civ. P. 53 advisory committee notes (2003 amendments). The Federal Circuit has also approved use of a special master to oversee claim construction. *See Absolute Software, Inc. v. Stealth Signal, Inc.*, 659 F.3d 1121, 1131 (Fed. Cir. 2011) ("A primary purpose of appointing a special master is to narrow the issues before the district court judge to facilitate an efficient and timely resolution of complex or highly-technical issues, such as patent claim construction.").

Apart from claim construction, the next four most common issues over which special masters have presided in patent cases are discovery (35.53%), infringement (12.05%), invalidity (8.43%), and enforceability/inequitable conduct (4.82%). *See* FJC Study at 17. This distribution of issues suggests that courts typically appoint special masters to preside over pre-trial aspects of patent cases (e.g. claim construction and discovery) rather than merits issues normally resolved through summary judgment or trial (e.g. infringement and validity). Nevertheless, the Federal Circuit has approved of special masters' handling of infringement and validity. *See Riverwood Int'l Corp. v. Mead Corp.*, 212 F.3d 1365, 1366 (Fed. Cir. 2000) (special master appointed to make factual findings regarding infringement and validity); *Constant*, 848 F.2d at 1566 ("Masters can properly aid the court in evaluating issues of patent validity and infringement in the context of motions for summary judgment, and have often done so.").

Notwithstanding the Advisory Committee's statement that courts may benefit by appointing "a master who has expert knowledge of the field in which the patent operates," Fed. R. Civ. P. 53 advisory committee notes (2003 amendments), special masters are typically attorneys. FJC Study at 4. And while many may have technical degrees, the Federal Judicial Center study found that special masters' technical training is often limited to a bachelor's degree. *Id.* The Federal Circuit has rejected challenges to appointment of a special master based on a lack of technical training. *Constant*, 848 F.2d at 1567 ("Appellant Constant is wrong in presuming that a master need have the same expertise in the technology as the inventor. Where complicated issues of patent law are involved, the appointment of an experienced patent attorney is quite appropriate.").

4. The parties compensate special masters

Finally, Rule 53 provides that special masters are compensated by the parties. Fed. R. Civ. P. 53(g)(4). As such, courts "must consider the fairness of imposing the likely expenses on the parties and must protect against unreasonable expense or delay" when appointing special masters. Fed. R. Civ. P. 53(a)(3).

B. Court-Appointed Experts

As many authorities have recognized, courts' inherent authority to appoint their own experts "is virtually unquestioned." Fed. R. Evid. 706 advisory committee notes (1972 proposed rules); *see also United States v. Green*, 544 F.2d 138, 145 (3d Cir. 1976) ("[T]he inherent power of a trial judge to appoint an expert of his own choosing is clear.").

Apart from this inherent authority, courts derive authority to appoint neutral experts from Rule 706 of the Federal Rules of Evidence. *Daubert v. Merrell Dow Pharms.,* *Inc.*, 509 U.S. 579, 595 (1993) ("Rule 706 allows the court at its discretion to procure the assistance of an expert of its own choosing."). Under Rule 706, "[o]n a party's motion or on its own, the court may order the parties to show cause why expert witnesses should not be appointed and may ask the parties to submit nominations." Fed. R. Evid. 706(a). Courts may appoint any expert on which the parties agree and "any of its own choosing." *Id.*

In contrast with the extensive rules applicable to special masters, Rule 706 contains only a handful of requirements relevant to court-appointed experts, some of which are not even mandatory. The court's obligations are twofold:

- The court *must* inform the expert of his or her duties, either in writing or orally before the parties, Fed. R. Evid. 706(b); and

- The court *may* allow the fact that the expert is appointed by the court to be disclosed to the jury, Fed. R. Evid. 706(d).

The expert's duties are also limited. The expert:

- must advise the parties of any findings he or she makes;

- may be deposed by any party;

- may be called to testify by the court or any party; and

- may be cross-examined by any party, including a party that called the expert to testify.

Fed. R. Evid. 706(b).

Court-appointed experts are "entitled to a reasonable compensation, as set by the court." Fed. R. Evid. 706(c). Like special masters, that compensation is paid by the parties, although Rule 706 grants courts the authority to set the proportions paid by the parties, as well as the time of payment. Fed. R. Evid. 706(c)(2).

In *Monolithic Power Systems, Inc. v. O2 Micro Int'l Ltd.*, 558 F.3d 1341 (Fed. Cir. 2009), the Federal Circuit affirmed the district court's appointment of an expert under Rule 706. It held that the district court properly applied Rule 706 by (1) allowing the parties to show cause why it should not appoint an expert witness; (2) providing detailed written instructions setting forth the expert's duties; (3) ordering the expert to make himself available for depositions and trial; (4) instructing the parties to share the expert's reasonable fees and expenses; and (5) informing the jury that the court appointed the expert and instructing the jury not to assign the expert's opinion "greater inherent weight on accord of his independent status." *Id.* at 1347-48.

The appeals court rejected the appellant's arguments that using a court-appointed expert is unfair because it departs from the advocacy and jury systems and that court-appointed experts "'tend to become in the eyes of the jury anointed, not appointed,'" *id.* at 1348 (quoting Hearings on Proposed Rules of Evidence Before the Subcomm. on Criminal Justice of the H. Comm. on the Judiciary (Supp.), 93d Cong., 1st Sess., 238 (1973)), calling these arguments "policy arguments" that Congress rejected when framing Rule 706.

Finally, while the Federal Circuit admitted some discomfort with court-appointed experts, *see id.* ("The predicaments inherent in court appointment of an independent expert and revelations to the jury about the expert's neutral status trouble this court to some extent."), it noted that the prevailing standards permitted courts "wide latitude" to appoint neutral experts and that the case at issue was "unusually complex" and featured "starkly conflicting expert testimony." *Id.*

C. Technical Advisors

Unlike special masters and court-appointed experts, technical advisors do not come within the purview of any Federal Rules. In *Reilly*, the First Circuit rejected the Government's argument that the Rule of Evidence 706 governs technical advisors as well as court-appointed experts. Looking to the text of Rule 706, the Advisory Committee Notes, and cases applying it, the appeals court held that the rule does not apply to courts' appointment of technical advisors. The court explained that the procedures set forth in Rule 706 "have marginal, if any, relevance to the functioning of technical advisors. Since an advisor, by definition, is called upon to make no findings and to supply no evidence, provisions for depositions, cross-questioning, and the like are inapposite." *Reilly*, 863 F.2d at 156 (internal citations omitted).

Given this lack of coverage under the Federal Rules, several courts of appeals have provided guidance to courts when considering the appointment of a technical advisor. *Reilly* itself states that technical advisors

> [a]re not witnesses, and may not contribute evidence. Similarly, they are not judges, so they may not be allowed to usurp the judicial function. A judge may not, for example, appoint a legal advisor to brief him on legal issues, since determination of purely legal questions is the responsibility of the court itself. Neither may a court employ a technical advisor to undertake an independent mission of finding facts outside the record of the case. In fine, the advisor's role is to act as a sounding board for the judge – helping the jurist to educate himself in the jargon and theory disclosed by the testimony and to think through the critical technical problems.

Id. at 157-58 (internal citations and quotations omitted). *Reilly* also warned that use of a technical advisor "is, if not a last, a near-to-last resort, to be engaged only where the trial court is faced with problems of unusual difficulty, sophistication, and complexity, involving something well beyond the regular questions of fact and law with which judges must routinely grapple." *Id.* at 156-57.

More specific guidelines were provided by Judge Tashima in his dissenting opinion in *Association of Mexican-American Educators v. State of Cal.*, 231 F.3d 572 (9th Cir. 2000). The majority held that the district court did not abuse its discretion in appointing a technical advisor originally disclosed as a court-appointed expert, but who did not testify as such, absent any evidence suggesting impropriety on the court's behalf. *Id.* at 591. In dissent, Judge Tashima stated that the district court failed to explain the technical advisor's role and to address a party's objection based on evidence of potential bias. *Id.* at 612 (Tashima, J., dissenting). Judge Tashima first observed that, in exercising its inherent authority to appoint technical advisors, district courts "must observe certain, minimal, procedural safeguards in order to insure that the advisor is unbiased and impartial, and that his participation is properly confined." *Id.* at 609. Judge Tashima then identified two risks of using technical advisors:

> First, whenever a court appoints a technical advisor, there is a danger that the court will rely too heavily on the expert's advice, thus compromising its role as an independent decisionmaker and the requirement that its findings be based only on evidence in the record. This risk is especially salient if the contents of the communications between the trial judge and the advisor is hidden from the parties (and appellate review), and where the parties have no opportunity to respond to the advisor's statements. Second, experts in the relevant field, particularly if it is a narrow and highly-specialized one, may be aligned with one of the parties; therefore, the district court must make every effort to ensure the technical advisor's neutrality, lest the advisor develop into, or give the appearance of being, an advocate for one side.

Id. at 610-11. With this backdrop, Judge Tashima proposed the following rules for district courts to follow when appointing technical advisors:

> (1) utilize a fair and open procedure for appointing a neutral technical advisor;
>
> (2) address any allegations of bias, partiality, or lack of qualification;
>
> (3) clearly define and limit the technical advisor's duties;
>
> (4) make clear to the technical advisor that any advice he gives to the court cannot be based on any extra-record information; and
>
> (5) make explicit, either through an expert's report or a record of *ex parte* communications, the nature and content of the technical advisor's advice.

Id. at 611; *see also Federal Trade Comm'n v. Enforma Natural Prods., Inc.*, 362 F.3d 1204, 1215 (9th Cir. 2004) (adopting standards for technical advisors enumerated by Judge Tashima).

The Federal Circuits formally adopted Judge Tashima's recommendations for appointing technical advisors in *TechSearch L.L.C. v. Intel Corp.*, 286 F.3d 1360 (Fed. Cir. 2002). In that case, the appellant argued that a district court abused its discretion by appointing a technical advisor because the technical advisor conducted an independent investigation and did not certify compliance with the court's order conferring his duties. The Federal Circuit held that the district court did not abuse its discretion.

The appeals court first observed that the lower court found "evaluation of the prior art required it to consider and understand complex technical concepts beyond normal technical and scientific facts regularly addressed by the district court." *Id.* at 1377. It then explained that district courts "must have the authority to appoint a technical advisor in such instances so that the[y] . . . can better understand scientific and technical evidence in order to properly discharge [their] gatekeeper role of determining the admissibility of such evidence." *Id.* The court stated, "[I]n those limited cases where the scientific complexity of the technology is such that the district court may require the assistance of a technical advisor to aid in understanding the complex technology underlying the patent, it has the inherent authority to appoint such an advisor." *Id.* at 1378.

Turning to the particular appointment at issue, the Federal Circuit noted that the district court adopted guidelines similar to those set forth by Judge Tashima, including "recogniz[ing] that the technical advisor's role is limited to explaining the terminology and theory underlying the evidence offered by the parties[,]" determining that the advisor was a neutral third party and explaining the reasons for that determination, assuring the parties that the advisor would not engage in independent investigation, identifying material relied on by the advisor, and requiring the advisor to execute an affidavit affirming his understanding of these rules before beginning his engagement and to certify compliance at its conclusion. *Id.* at 1380. The appeals court rejected the argument that purchasing computer equipment and billing time for research showed that the technical advisor engaged in independent research as well as the argument that the advisor failed to certify compliance. *Id.* at 1380-81.

III. THE BENEFITS AND RISKS OF APPOINTING NEUTRAL EXPERTS

Just as each species of neutral expert has its own procedural regime, each species has its own set of associated benefits and risks. We discuss each set of benefits and risks below.

A. Special Masters

1. Potential benefits

The most significant reason to employ any type of neutral expert is the expertise that he or she may bring. In this regard, special masters may accelerate adjudication of claim construction, infringement, or validity issues implicating complex technology, for example, if they are well-versed in the relevant technology or highly experienced in the intricacies of claim construction. With respect to special masters' participation in claim construction, the Rules Advisory Committee noted that "the advantages of initial determination by a master may make the process more effective and timely than disposition by the judge acting alone," even though the court must review that initial determination *de novo*. Fed. R. Civ. P. 53 advisory committee notes (2003 amendments). In addition, Rule 53 contemplates that special masters may communicate *ex parte* with appointing courts, which may enable courts to obtain answers to questions regarding the technology at issue more quickly than putting the issues to the parties for briefing or argument.

Some evidence suggests that harnessing special masters' expertise leads to better decisions. The Federal Judicial Center study discussed above concluded that cases in which special masters participated may have lower rates of reversal than cases in which the court does not appoint a master. FJC Study at 10-11. The study compared reversal rates in "long-duration patent cases," defined as cases lasting 1,000 days or more. *Id.* at 11. It found that the reversal rate in such cases in which the court did not appoint a special master was 11.7%. *Id.* By contrast, the reversal rate in long-duration patent cases in which the court appointed a master was only 3.6%. *Id.* The authors concluded that "[t]hese results would suggest that the average case with a special master is both less likely to have a ruling appealed and less likely to have a ruling reversed than the 'average' complex patent case." *Id.*

This evidence may not be so clear-cut, however, given the small sample-size used by the authors (only eight appeals involving special masters were considered) and contradictory findings – once the authors expanded their data set beyond "long-duration patent cases" to all patent cases, the rates of appeal and reversal for cases involving special masters paralleled cases that did not. *Id.* at 10.

2. Risks

As the reader may have surmised, we view the above benefits of special masters in patent cases as muted, especially when measured against several significant risks.

First, while courts utilize neutral experts primarily to avail themselves of greater expertise, it is not clear that special masters actually provide it. Unlike court-appointed experts and technical advisors, special masters are almost always lawyers, and thus lack the same level of immersion in the relevant technology that one would expect from a university professor or industry veteran. Significantly, even where special masters have some technical training, such training is frequently limited to a bachelor's degree. FJC Study at 4; *see also* Dolly Wu, *Patent Litigation: What About Qualification Standards for Court Appointed Experts*, Boston College Intellectual Property & Technology Forum 5 (2010), *available at* http://bciptf.org/wp-content/uploads/2011/07/5-PATENT-LITIGATION.pdf (arguing that most special masters would not qualify as persons of ordinary skill in the art). Accordingly, special masters are unlikely to provide the same level of technological expertise as court-appointed expert witnesses or technical advisors.

A related risk arises where courts appoint attorneys who are primarily patent prosecutors. Considering that, in patent cases, courts most often appoint special masters to assist with claim construction, prosecutors may be ill-equipped based on their lack of experience with *Markman* proceedings compared to experienced litigators or retired judges. Prosecutors are accustomed to broad construction approaches used by the PTO that differ from the standard applicable to litigation. Ironically, prosecutors may have *less* experience with claim construction than many district courts. Moreover, prosecutors may tend to rely more heavily on the specification than on other forms of intrinsic evidence, or even extrinsic evidence, than experienced litigators or judges, and thus may bring certain interpretive biases to the *Markman* table.

Second, contrary to the Rules Advisory Committee's suggestion that special masters may make claim construction "more effective and timely," there are reasons to believe that appointing masters leads to delay and increases costs to the parties. Apart from the obvious fact that the parties pay special masters, using special masters increases costs because, instead of the court deciding issues in the first instance, the parties must walk the additional steps of arguing the issue to the master, waiting for the report and recommendation to issue, and objecting to the court, which must then engage in *de novo* review, potentially leading to a new round of submissions, evidence, and argument. Moreover, delegating the decision in the first instance may decrease the time the district court spends acquainting itself with the record and the parties' positions, which could lead the court to be less familiar with the claims and relevant technology during later parts of the proceedings – e.g., summary judgment, motions *in limine*, and trial. As the Federal Judicial Center's Patent Case Management Guide notes:

> [T]he use of a special master runs an even greater risk of distancing the court from the details of claim construction. This limits the court's involvement in some of the most critical aspects of many patent cases

> and can create problems should claim construction require adjustment later in the case. It may limit the court's ability to gain command over the background science and technology, which could be important later in the case (for example, in addressing non-obviousness).

Peter S. Menell et al., Patent Case Management Judicial Guide 5-21 to -22 (2nd ed. 2012), available at http://ssrn.com/abstract=2114398.

In addition, empirical evidence suggests that patent cases in which the court appointed a special master lasted longer, settled less frequently, and went to trial more often than cases in which the court did not appoint a master. FJC Study at 8-9. In particular, the Federal Judicial Center study found that patent cases in which the court employed a special master lasted nearly three times longer on average than patent cases without a special master's participation. *Id.* at 8. Although statistics showing that cases involving special masters lasted longer could simply reflect that courts are more likely to appoint special masters in complex cases, the Federal Judicial Center study also suggests that special masters have not been demonstrably successful in inducing the parties to settle. *Id.* at 9. And, notably, the studies' authors could not "say with any statistical certainty that the presence of a special master in a case reduced resource expenditures below what they would have been without a master." *Id.*

Finally, delegating issues to special masters may impinge the parties' due process rights to resolution before an Article III judge. As explained above, considerable jurisprudence exists on precluding nonconsensual reference of "fundamental issue[s] of liability" to special masters. *Stauble*, 977 F.2d at 695. In the context of patent litigation, there is a disconnect between such jurisprudence and the fact that courts most frequently employ special masters to participate in claim construction. As the Federal Circuit has noted, claim construction is "often dispositive." *ATD Corp. v. Lydall, Inc.*, 159 F.3d 534, 540 (Fed. Cir. 1998) (quoting *Markman v. Westview Instruments, Inc.*, 52 F.3d 967, 976 (Fed. Cir. 1995) (en banc), *aff'd*, 517 U.S. 370 (1996) ("In this case, as often occurs, the question of literal infringement was resolved upon the court's construction of the claims."). Indeed, one commentator has noted that "Federal district court judges estimate that claim construction was central to the resolution of their patent cases in upwards of 94% of such cases." Neil A. Smith, *Complex Patent Suits: The Use of Special Masters for Claim Construction*, 2 LANDSLIDE 37 (Sept./Oct. 2009). Although the Rules Advisory Committee implied that claim construction "blur[s] the divide between pretrial and trial functions," Fed. R. Civ. P. 53, advisory committee notes (2003 amendments), the text of Rule 53 provides that courts may appoint special masters to oversee claim construction over a party's objection. And while Rule 53 requires that district courts review special masters' reports and recommendations *de novo*, a risk remains that courts will not provide the intensive oversight that due process requires. This risk is all the more apparent when one considers that the court's lack of familiarity with the law or technology led them to appoint a master in the first place.

B. Court-Appointed Experts

1. Potential benefits

Court-appointed experts are designed to provide an unaffiliated, unbiased voice that can explain and translate the technology. Implicit in this is the assumption that courts distrust party experts, who are paid to provide an opinion that aligns with the arguments crafted by counsel, and thus are susceptible to questions regarding their credibility. While our system presumes that the fact-finder, whether judge or jury, is ordinarily capable of making credibility determinations, doing so proves far harder when the parties' experts are using an esoteric vocabulary bearing a striking resemblance to gibberish to the ears of an average juror. In essence, when listening to a dispute between two people arguing in a foreign language, how can a fact-finder tell which one of them is giving the more truthful and better-reasoned opinion? Court-appointed expert witnesses may help resolve this problem by translating complex, technological evidence for the fact-finder and providing a neutral perspective on the evidence and on the parties' positions.

In addition, court-appointed expert witnesses have advantages over the other species of neutral experts. Unlike special masters, courts do not delegate decision-making authority to court-appointed experts, so any due process considerations are comparatively attenuated. As the Federal Circuit's opinion in *Monolithic Power Systems* shows, the parties remain able to persuade the fact-finder to conclude differently than the court-appointed expert. *See* 558 F.3d at 1348 (noting that "the jury's verdict did not entirely track" the court-appointed expert's opinion). Unlike technical advisors whose opinions are provided *sub rosa*, court-appointed experts must "advise the parties of any findings" reached and must answer questions during deposition and trial, including through cross-examination. Fed. R. Evid. 706(b).

2. Risks

One risk of court-appointed experts reflected in the case law is that juries view them as "anointed, not appointed." *Monolithic Power Sys.*, 558 F.3d at 1348 (internal citation omitted). In short, the concern is that informing the jury of the Rule 706 expert's status as a court appointee will signify that the expert is unbiased and thus more credible, such that the party with whom the independent expert sides enjoys an unfair advantage over the other party.

Rule 706, however, provides courts several ways of overcoming this concern. First, under Rule 706(d), the court has discretion not to authorize disclosure to the jury that the expert has been appointed by the court. Keeping this information from the jury diminishes the risk that the Rule 706 expert will be seen as "anointed." Instead, the jury may perceive the court-appointed expert as just another expert, and thus may be more likely to make credibility determinations on the same bases as the ones applying to the parties' experts. Second, Rule 706 states that parties may cross-examine court-appointed experts. Subjecting such experts to cross-examination helps to ensure that juries will actually deliberate on the merits of their opinions, rather than simply rubberstamp them as truth based on the experts' perceived independence. *See Microsoft*, 147 F.3d at 955 n.22 ("Whether . . . a[n] [Rule 706] expert is appointed by agreement of the parties or not, the expert's exposure to cross-examination by both sides makes the device a far more apt way of drawing on expert resources than the district court's unilateral, unnoticed deputization of a vice-judge.").

A second significant risk associated with court-appointed experts relates to how they are vetted. Seasoned patent litigators undertake extensive efforts to vet their testifying experts to ensure that they have the appropriate background, education, lack of bias, familiarity with the technology, and presentation skills. By contrast, courts may have neither the time nor resources to properly vet experts before appointment. Moreover, while patent litigators go through the expert vetting process in every case, courts rarely appoint independent experts and thus may be less equipped to do so. The fear is that, in a case involving semiconductors, the court's law clerk will simply place a call to a professor in the local university's electrical engineering department, regardless of whether that person has the skill set and familiarity with the specific technology at issue that are necessary to explain that technology to the fact-finder in a manner that is both constructive and coherent.

Finally, using court-appointed experts will impose additional costs on the parties. As a threshold matter, Rule 706 obligates the parties to compensate the expert in the proportion set by the court. Fed. R. Evid. 706(c)(2). In addition, the time devoted to selecting the expert, researching and writing the expert report, sitting for depositions, and appearing at trial can lead to lengthy and costly delays.

C. Technical Advisors

1. Potential benefits

Like court-appointed experts, technical advisors provide the benefit of a person unconnected with either party who has sufficient expertise to explain difficult technical concepts and translate specialized vocabulary. Unlike Rule 706 expert witnesses, however, a technical advisor's role is to convey guidance directly to the court, not to provide evidence to the fact-finder. Thus, in addition to contributing the benefit of an unbiased explanation of the relevant technology, technical advisors also potentially increase efficiency by enabling courts to have questions answered when they arise, without having to submit issues to the parties for briefing or waiting until oral argument.

Relatedly, because technical advisors do not submit reports, offer testimony, or provide factual findings, the risk of increased delay and cost are not as significant for technical advisors as for other types of neutral experts. Moreover, unlike special masters and court-appointed experts, no Rule requires the parties to compensate technical advisors.

2. Risks

Of course, the tradeoff of this superior efficiency is that technical advisors reside within the figurative black box – because all communications occur *ex parte*, the parties have no way to respond to the advice provided to the court by the technical advisor if they disagree with it. Further, because interactions between courts and technical advisors occur off the record, parties are disadvantaged when appealing court decisions that may be premised on input received from technical advisors.

Moreover, this lack of transparency acts as an incubator for several additional risks. First, a court may become too dependent on the technical advisor and thus may forfeit its role as independent decision-maker. *See Assoc. of Mexican-American Educators*, 231 F.3d at 610. For example, in contrast with law clerks, another kind of *ex parte* advisor, with whom judges share similar training but enjoy greater experience, judges have less training and experience in the relevant technology than technical advisors, and thus are less able to "filter out" bad technical advice. *Id.* at 613-14. That the technical advisors are never cross-examined deprives the court of another means of filtering out such bad advice.

Second, even though one of the key purposes of neutral experts is to provide an unbiased opinion, where the relevant technical field is highly specialized, technical advisors may bring with them pre-existing alignments with the parties – or with the parties' experts. Once again, the absence of transparency prevents the parties from guarding against this latent bias or challenging it on appeal.

Finally, there is a risk that the technical advisor's guidance to the court will not be based on record evidence but on extra-record information obtained through independent investigation. That such information is conveyed through *ex parte* communications deprives the parties of the opportunity to respond, thus undermining their due process rights.

IV. CONCLUSION

As we have demonstrated, special masters, court-appointed experts, and technical advisors provide courts with some significant benefits in adjudicating patent cases; however, each species of neutral expert presents an equally significant series of risks. Courts must carefully weigh these pros and cons when deciding whether to engage a neutral expert and, if so, what kind of neutral to engage. To assist courts in conducting that balancing, we offer the following recommendations:

Special Masters

- Refrain from appointing special masters to oversee claim construction over the parties' objections.
- When selecting a special master for purposes of claim construction, consider experienced litigators and retired judges in addition to or instead of patent prosecutors.
- Consider whether engaging an independent expert under Rule of Evidence 706, rather than a special master, would provide adequate assistance in understanding the technology at issue.

Court-Appointed Experts

- Exercise discretion to withhold from the jury the fact that the expert is appointed by the court.
- Solicit recommendations and, potentially, briefing from the parties on candidate experts. Conduct a *voir dire* hearing to allow the parties to vet candidates before selecting one for appointment.

Technical Advisors

- Use a transparent process for identifying, selecting, and appointing a technical advisor. Solicit suggestions from the parties and entertain any objections relevant to bias, partiality, or lack of qualifications.
- Define the technical advisor's duties in a written order. Provide the parties an opportunity to object or respond. Order the technical advisor to identify all materials considered. Clearly instruct the technical advisor not to undertake any independent investigations.
- Provide a report to the parties of *ex parte* communications with the advisor. Consider communicating with the advisor through written correspondence rather than informal conversations.

DISTRICT COURT PATENT CASE MANAGEMENT POST-AIA

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Patent cases present unique challenges to the judicial system due to their technical complexity and the many legal issues typically presented. Compounding the management challenge is the fact that patent litigation often involves enormous amounts of money and sometimes the very survival of the parties.

In the late 1990's some judicial districts began to adopt local rules for the management of patent cases. Adoption of such rules became more widespread over the next few years, and typically provided for early infringement and invalidity contentions, a schedule for briefing of claim construction issues, and sometimes disclosures of contentions relating to willfulness and other issues.

By the early 2000's, pressure grew for legislative reform of the patent system. Inevitably, industries divided into camps of influence, some lobbying for dramatic changes in the prosecution of patents, others for reform of patent litigation. After several attempts at reform stalled, Senate leaders in the spring of 2011 eliminated controversial litigation reforms, paving the way for House passage of H.R. 1249. Following President Obama's characterization of the legislation as a "jobs bill," the Senate quickly passed the House version, which was signed into law in September 2011.[2]

The Smith-Leahy America Invents Act promises to be the most radical revision of American patent law in the last half-century. This paper deals with case management issues flowing from enactment of the AIA, together with other ongoing management issues often encountered in patent cases.

I. PARALLEL PROCEEDINGS

The AIA introduces a new scheme for post-grant review[3] of patent validity by the Patent and Trademark Office.[4] Pendency of PTO proceedings parallel to cases in District Courts will present new challenges in case management.

A. Stays of District Court Cases Pending Post-Grant Review

The availability of the new post-grant review procedures will exacerbate the existing issue of the propriety of a stay of a District Court proceeding pending the

1 The ideas in this paper were prompted by my co-faculty for this panel: Ray Chen, Hon. Faith Hochberg, Karen Keller, Ron Shutz, Robert Sterne and Hon. Ronald Whyte. Opinions and errors are mine alone.
2 A complete copy of the AIA as enacted can be found at: http://www.govtrack.us/congress/bills/112/hr1249/text.
3 In this paper, "post-grant review" refers generically to inter partes review, supplemental examination, post grant review and Section 18 proceedings under the AIA, as well as to ex parte reexaminations that survive the AIA.
4 The details of this new approach to PTO post-grant review of validity will be discussed in depth by other panels.

completion of parallel validity proceedings before the PTO. For years District Courts have struggled with the issue of stays during reexamination or reissue proceedings before the PTO. Predictably, different courts have demonstrated varying inclinations to stay their proceedings pending completion of a reexam or reissue. Some districts have appeared skeptical of the utility of stays,[5] while others have adopted guidelines more likely to result in stays during the pendency of reexams.[6] Still others have crafted stay orders that effectively imposed estoppels on litigants who unsuccessfully urged invalidity in reexaminations.[7] Judicial approaches to this issue lack uniformity, with most courts adopting a case-by-case approach.

Although the AIA revolutionized the scheme of post-grant review by the PTO, the Act provides scant guidance about stays of parallel District Court litigation. The history of Congressional debate of the AIA provides little insight.[8] During debate Senator Charles Schumer noted that business method patents are "the bane of the patent world,"[9] and introduced an amendment providing specific guidelines for the grant of stays pending post-grant proceedings dealing with business method patents relating to the financial industry. Specifically, Senator Schumer indicated that his amendment (which became the basis for Section 18 of the Act) was modeled on a single unpublished 2006 decision of a District Court in Colorado.[10] Notably, Senator Schumer and others elected to rely on this unpublished decision and to ignore substantial other authority evaluating the issue of stays pending reexam, presumably because only the *Broadcast Innovation* case included a factor directing the court to evaluate whether a stay would reduce the burden of litigation on the parties and on the court.[11]

The result of Senator Schumer's amendment was the inclusion in the AIA of specific statutory guidance for the grant of a stay in proceedings under Section 18 of the Act involving the transitional program for covered business method patents. (In simplified terms, this section is a special post-grant review provision for business method patents applicable to the financial industry.) The stay provision provides:

> (b) REQUEST FOR STAY. –
>
> (1) In General. – If a party seeks a stay of a civil action alleging infringement of a patent under section 281 of title 35, United States Code, relating to a transitional proceeding for that patent, the court shall decide whether to enter a stay based on –
>
> > (A) whether to stay, or the denial thereof, will simplify the issues in question and streamline the trial;
> >
> > (B) whether discovery is complete and whether a trial date has been set;
> >
> > (C) whether a stay, or the denial thereof, will reduce the burden of litigation on the parties and on the court.

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5 *Soverain Software LLC v. Amazon.com, Inc.*, 356 F.Supp. 2d 600, 662 (E.D. Tex. 2005).
6 *Ricoh Co., Ltd. v. Aeroflex, Inc.*, 2006, U.S. Dist. LEXIS 93756 at *13 (N.D. Cal. 2006).
7 *Premier Int'l Associates LLC v. Hewlett-Packard Co.*, 554 F.Supp.2d 717 (E.D. Tex. 2008).
8 A complete guide to the legislative history of the AIA can be found at: http://www.uspto.gov/aia_implementation/guide-to-aia-p1.pdf.
9 Congressional Record (March 8, 2011).
10 *Broadcast Innovation v. Charter Communications*, 2006, W.L. 1897165 (Colo. 2006).
11 Congressional Record (March 8, 2011).

While this statutory language appears only to guide the discretion of the court (directing consideration of whether the case will be simplified; the stage of the litigation; the presence or absence of prejudice), the legislative history reveals that the final factor (whether the stay will reduce the burden of litigation on the parties and the court) was intended by the Congressional drafters to result in a denial of a stay of litigation only "in extremely rare circumstances."[12]

Further emphasizing Congressional intent that the PTO have first crack at determining invalidity of financial business method patents, Section 18 also provides for an interlocutory appeal from grant or denial of the stay; directs the Federal Circuit to review District Court decisions to ensure consistent application of established precedent; and provides that the review may be *de novo.*

Section 18, however, is only one of several new post-grant procedures which will present to the District Courts the issue of the propriety of stay during the pendency of post-grant actions before the PTO. In contrast to the detailed guidance for District Court stays provided by Section 18, none of the other post-grant procedures created by the AIA make any mention of the factors guiding a District Court in considering a stay, nor does anything in the AIA address the preexisting issue of stays during reexams or reissue proceedings. The entirely new scheme of post-grant review created by the AIA, coupled with the absence of Congressional guidance as to the posture of the District Courts during such proceedings, have created conflicting views of the appropriate treatment of requests for stays in the District Courts pending PTO action on post-grant review.

One view is that the creation of new vehicles for post-grant review in the AIA is an indication of Congressional intent that the first post-grant review of validity should be within the PTO. This view is buttressed by the statute's admonition that post-grant review should be completed with dispatch,[13] and by the assumption that the new post-grant review procedures will be less expensive than proceedings before the District Court.

A competing view is that the failure of Congress to provide guidance for the issuance of a District Court stay during post-grant proceedings (other than the transitional program for covered business method patents) indicates that the AIA left the previous law intact. Adherents of this view urge that District Courts should apply traditional factors (speed, efficiency, status of the case) in considering a stay of their proceedings in the face of post-grant review, but that courts should not be more inclined than previously to grant stays pending post-grant evaluation.

However District Courts approach the propriety of a stay during post-grant review by the PTO, a number of issues are likely to arise to complicate matters. Multi-party cases create the possibility that different parties may institute post-grant review based on different prior art in an effort to partially escape the estoppel effects of post-grant review (described in more detail below). Similarly, multiple parties, or even a single party, may seek serial post-grant reviews. Repetitive reviews may compromise the equity of a stay which potentially could be extended throughout multiple PTO proceedings.

12 Congressional Record (March 8, 2011).
13 The AIA directs that the PTO conclude most post-grant proceedings within one year, except that they may be extended for six months for good cause. Section 6(a).

B. Estoppel based on post-grant review

The scope of the estoppel suffered by an unsuccessful petitioner in post-grant review under the AIA will play a significant role in both the District Courts' evaluation of a request for a stay and in the continuing litigation. Although the effect of the AIA on estoppel will be covered in detail by another panel at this conference, at a high level the AIA provides that, following a final written decision by the PTO, an unsuccessful petitioner will be estopped from alleging invalidity in the District Court based on any ground raised or that reasonably could have been raised during the post-grant review.[14]

While the possibility of estoppel would seem to weigh heavily in favor of staying the District Court proceeding pending the outcome of post-grant review (based on the assumption that the patent will either be found invalid or the petitioner will be estopped from re-asserting art in the District Court), the reality is likely to be more nuanced. First, a petitioner is not obligated to present all allegedly invalidating art to the PTO. Indeed, because the post-grant proceedings will relate only to patents or printed publications, any allegedly invalidating prior art which does not fit within those categories will almost certainly survive an unfavorable post-grant review.

Second, multi-party cases and post-grant proceedings also create issues about the efficacy of the new estoppel provisions. Only a defendant who petitions the PTO for post-grant review will be subject to a potential estoppel, thus undermining the basis for a stay in favor of non-petitioner defendants who will not be estopped.

C. Other Issues Raised By Parallel Proceedings

The availability of new parallel proceedings under the AIA promises to enhance the importance of other issues previously considered by the District Courts.

If a stay is granted, the courts have little guidance as to what point in the post-grant procedure it would be appropriate to lift the stay (final determination by the reexaminers/appeal to the Board of Patent Appeals/appeal to the Federal Circuit). The AIA's provision that estoppel applies upon final written action of the PTO[15] suggests that it would be appropriate to lift a stay at that stage, and before appeal to the Board or the Circuit.

Lifting a stay upon finality of post-grant review (or at least sufficient progress in the review to justify going forward in the District Court) will seem to warrant consideration of preferential settings of Markman hearings, summary judgments and trial. If courts believe that an equitable *quid pro quo* for a stay during post-grant proceedings is preferential disposition after the stay is lifted, achieving this objective obviously creates issues for already crowded District Court dockets.

The new post-grant review procedures will also present issues concerning the admissibility into evidence in the District Court of those proceedings. Pre-AIA treatment of admissibility of reexaminations may provide some guidance as to the admissibility of the new procedures. Most District Courts have excluded from evidence before juries information about pending reexams on the grounds that evidence of interim actions by the PTO (typically a grant of the reexam and frequently an initial rejection) is unduly

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14 Section 315(e).
15 Section 315(e)(1).

prejudicial because such actions are preliminary and frequently changed on final action by the Office. On the other hand, final office actions confirming the validity of a patent following reexam are typically allowed into evidence on the grounds that such actions are part of the prosecution history of the patent.

II. JOINDER OF PARTIES UNDER SECTION 299

The AIA creates new law governing joinder of parties in patent litigation. Congress reached into the management of District Court litigation, legislating matters previously left to the Federal Rules of Civil Procedure and the discretion of the District Courts.

A. Background of the New Joinder Rules

Prior to enactment of the AIA, joinder was governed by Federal Rules of Civil Procedure 19-21. Rule 20 provides that parties can be joined permissively when relief is sought with respect to the same transaction or occurrence. District Courts exercised broad discretion with respect to joinder under the Rules, some courts finding that the assertion of infringement of the same patent satisfied the same transaction or occurrence requirement,[16] and others reaching the opposite conclusion.[17] After adoption of the AIA, the Federal Circuit sided with the latter approach, holding that for pre-AIA cases mere infringement of the same patent is insufficient to justify joinder under Rule 20.[18]

In Congress, throughout five years of searching debate over Patent Reform, there was no suggestion that the Federal joinder rules needed reform specific to patent cases. Late in House debate over HR 1249, however, an amendment was adopted with little discussion and no debate. That amendment eventually became Section 299 of the AIA.

The new joinder provisions provide:

> **§299. Joinder of parties**
>
> "(a) JOINDER OF ACCUSED INFRINGERS. With respect to any civil action arising under any Act of Congress relating to patents, other than an action or trial in which an act of infringement under section 271(e)(2) has been pled, parties that are accused infringers may be joined in one action as defendants or counterclaim defendants, or have their actions consolidated for trial, or counterclaim defendants only if;
>
> "(1) any right to relief is asserted against the parties jointly, severally, or in the alternative with respect to or arising out of the same transaction, occurrence, or series of transactions or occurrences relating to the making, using, importing into the United States, offering for sale, or selling of the same accused product or process; and

16 *MyMail, Ltd. v. America Online, Inc.*, 223 F.R.D. 455 (E.D. Tex. 2004).
17 *WiAV Networks, LLC v. 3Com Corp.*, No. 1003448, 2010 WL 3895047 (N.D. Cal. 2010).
18 *In re EMC Corp.*, 2012 U.S. App. LEXIS 9159 (Fed. Cir. 2012).

> "(2) Questions of fact common to all defendants or counterclaim defendants will arise in the action.
>
> "(b) ALLEGATIONS INSUFFICIENT FOR JOINDER. For purposes of this subsection, accused infringers may not be joined in one action as defendants or counterclaim defendants, or have their actions consolidated for trial, based solely on allegations that they each have infringed the patent or patents in suit.
>
> "(c) WAIVER. A party that is an accused infringer may waive the limitations set forth in this section with respect to that party.".

Section 299(a) provides that accused infringers may be joined only in enumerated circumstances. Subsection (a)(1) essentially tracks the existing language of Rule 20, but adds to the existing requirement of "the same transaction, occurrence or series of transactions of occurrences" the new requirement that those transactions or occurrences must relate to "the same accused product or process."

Subsection (b) makes explicit that mere allegation of infringement of the same patent is insufficient to satisfy the requirement for joinder.

B. Textual Issues in Section 299

Although the new language of Section 299 is brief, it will present challenging issues in its application by the District Courts. At the outset, there will likely be substantial argument over what is the "same product" for purposes of joinder. In the context of vertical relationships between co-defendants (e.g., manufacturer/distributor/retailer of the same product), confirming the presence of the "same product" should be straightforward, although these procedural settings may implicate the tendency of some courts to stay simultaneous claims against downstream parties pending the outcome of allegations against the manufacturer of the accused product.

The situation presented by horizontally oriented co-defendants (e.g., multiple sellers of identical products) is likely to be more challenging. Of course, co-defendants selling identical devices would surely satisfy Section 299 and could be joined in a single case. In many instances, however, it may be unclear what constitutes a "product" within the meaning of the statute. For example, in a case alleging infringing sales by retailers of mobile phone handsets, is the "product" that must be the same a particular handset? Or the same chip that is accused of infringement within different handsets? Or the same circuit within different chips?

Issues will also arise when co-defendants' allegedly infringing activities overlap but are not identical. Multiple retailers may offer the same accused product for sale, but may offer additional products accused of infringement that are not sold by other co-defendants. Federal Rule of Civil Procedure 18 provides that any claim may be brought against a properly joined party, whether or not that claim implicates other parties, but it is unclear whether Section 299's requirement of the "same product" alters the traditional rule.

There also may be issues under Section 299 as to the meaning of the "same process." Is the same process limited to the same factory? Could similar but non-identical fabrication equipment carry out the same process? Is the "sameness" of the process defined by the steps of a method claim, in which case any party accused of practicing the steps could be considered to be carrying out the same process?

C. Joinder for Pre-Trial Case Management

Although Section 299 provides that co-defendants may be joined in one action "or have their actions consolidated for trial"[19] only if they are accused of infringing via the same product or process, the statute is notably silent on pre-trial consolidation or joint case management. Omission from the Act of any prohibition against pre-trial consolidation suggests that District Courts continue to be free to manage related cases jointly pre-trial. Because passage of Section 299 already has resulted in the filing of scores of separate cases alleging infringement of the same patents by different defendants, it seems vital that courts be able to jointly resolve discovery disputes, construe claims and rule on summary judgment motions. But pre-trial consolidation or joint management of separate patent cases will present new issues.

One that has been the subject of creative judicial attention post-AIA is the timing of transfers for convenience under 28 U.S.C. § 1404(a). Much of the pre-AIA controversy surrounding Rule 20 joinder in patent cases related to the joinder of local and remote defendants in a single action. The presence of a defendant local to the forum, coupled with the judicial economy achieved by avoiding duplicative litigation, often made it impossible for a remote co-defendant to demonstrate that the case was clearly more convenient in another jurisdiction as required by § 1404(a).

Prohibitions against joinder of defendants not accused of infringing via the same product or process will make opposition to transfer more difficult, because the remote defendant must be sued in a separate case and will urge that its convenience facts must stand alone.[20] Recently, Chief Judge Leonard Davis of the Eastern District of Texas issued an order attempting to reconcile the interests of judicial economy achieved by joint pre-trial management of multiple cases with entitlement to transfer for convenience under §1404(a).[21] After finding that more than twenty defendants were improperly joined, Chief Judge Davis indicated that he would manage the resulting severed cases jointly for all pre-trial purposes with the exception of ruling on motions to transfer for convenience. In the event the court determined that a particular case merited transfer under §1404(a), however, Chief Judge Davis indicated that such transfers would be effective only after the issuance of his Markman order. This approach was justified by the judicial economy of a single court making claim construction determinations. Although Chief Judge Davis recognized that his claim constructions would not be binding on a transferee court, his Order expressed the hope that reasoned claim constructions by a judge familiar with the patents at least would be useful after transfer.[22]

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19 The haste with which Section 299 was enacted is evident from what appears to be a textual error in the statute: Subsection (a) provides that "parties that are accused infringers may be joined in one action as defendants or counterclaim defendants, or have their actions consolidated for trial, *or counterclaim defendants* only if..." (Italics added) The italicized language appears to be an artifact of an earlier draft of the subsection. When the language prohibiting consolidation for trial was added, it appears that Congress lacked the time to eliminate the surplus "or counterclaim defendants."

20 Although in cases where venue is maintained for any defendant, plaintiffs in related cases can be expected to argue that considerations of judicial economy weigh in favor of hearing other actions in the same jurisdiction.

21 *Norman IP Holdings, LLC v. Lexmark International, Inc.*, 6:11cv495 (E.D. Tex. 2012).

22 Predictably, commentators on Chief Judge Davis' Order have complained that it deprives defendants of the convenience of conducting pre-Markman matters in a local forum. Others have expressed the view that judicial economy trumps minimal inconvenience, particularly given the judicial resources expended in duplicative claim constructions.

Joinder issues presented by the AIA are not limited to consolidation and joint management of cases pre-trial. The language of Section 299 purporting to require separate trials for defendants not implicated by the same product or process creates an interesting interplay with Federal Rule of Civil Procedure 42 governing consolidation and separate trials. This issue will be of particular interest to plaintiffs in patent litigation who are required by Section 299 to file separate suits against multiple defendants, but who wish to avoid repetitive trials, potentially involving identical prior art, of the validity of the asserted patents. Rule 42 allows a District Court to consolidate actions that involve a common question of law or fact, or to "join for hearing or trial any or all matters at issue in the actions." A joint trial of defendants in different unconsolidated cases limited to the issue of invalidity arguably might avoid the prohibition against defendants being "*consolidated* for trial" under Section 299. Undoubtedly, defendants wishing to preserve multiple bites at the invalidity apple will argue that such a joint trial amounts to a consolidation prohibited by the new statute.

Another interesting question relating to pre-trial management of separate cases involving the same patents is the relationship between Section 299 and Multi-District Litigation proceedings. In a recent case, an MDL panel held that the AIA does not alter the ability of a multi-district panel to consolidate and reassign cases for MDL pre-trial management.[23] Furthermore, the Federal Circuit recently observed (albeit in a pre-AIA case) that an MDL panel might be able to decide the common issue of invalidity in multiple cases involving the same asserted patent.[24] Since the role of an MDL forum has typically been to conduct pre-trial management of cases and then to return each case to its originating district for trial, it is unclear whether a final disposition of invalidity issues would constitute a "trial" that must be held in the originating district, or presents a common issue which could be finally resolved at the MDL forum.

III. OTHER CASE MANAGEMENT ISSUES

In addition to case management issues engendered by the passage of the AIA, District Courts continue to evaluate procedures which may promote efficient management of patent cases.

A. Limits on Asserted Patents and Claims

Courts often are confronted with patent owners seeking to enforce scores, or even hundreds, of patent claims. Large numbers of claims greatly increase the burden of claim construction, as well as rulings on summary judgment and the length of trial. To some extent, the problem of excessive claim assertion is self-policing, since most patent holders are motivated to reduce the number of claims in order to simplify presentation at trial. On the other hand, patent owners may have little motivation to drop asserted claims until late in the litigation, so defendants and the courts may still be faced with numerous claims in the pre-trial phase.

Although most courts have relied on the self-interest of patent owners to eventually reduce the number of claims (together with hearty admonishment from the court to do so), in some instances District Courts have found it necessary to order a

23 *In re Bear Creek Technologies Inc. ('722 Patent Litigation)*, MDL No. 12-2344 (GMS) (D. Del. July 25, 2012).
24 *In re EMC Corp.*, 2012 U.S. App. LEXIS 9159 (Fed. Cir. 2012).

plaintiff to reduce the number of its asserted claims. Although the Federal Circuit has approved this procedure,[25] the circumstances of that case were extraordinary: The plaintiff was required to reduce 1,975 asserted claims to 64, and was allowed to substitute previously dropped claims for any of the 64 at a later stage in the litigation. The Federal Circuit's reliance on these safeguards of the patent holder's rights in *Katz* counsels caution in case management procedures designed to encourage a litigant to limit its claims.

Even if courts are cautious about procedures that require a patent holder to relinquish its property rights, there seems to be no impediment to a court severing claims or patents into separate cases under Rule 42 so that the original case may move forward on a reasonable number of issues.

B. Management of Claim Construction

Another panel at this conference will discuss claim construction issues in detail, but a few case management considerations deserve note.

Many District Courts have expressed frustration at the amount of judicial resources which must be devoted to construing large numbers of claims. In response, some District Courts have either limited the number of claims to be construed, or have required the parties to identify the most important claims for construction. For example, Rule 4.1(b) of the Local Patent Rules for the Northern District of California now provides that "[t]he parties shall also jointly identify the ten terms likely to be most significant to resolving the parties' disputes, including those terms for which construction may be case or claim dispositive."

Since District Courts are obligated to construe claims placed in issue (or at least to decide explicitly whether such claims need construction),[26] a hard limit on the number of claims for construction may be problematic. This dilemma should be avoided by the Northern District's approach which requires identification of the ten most important terms, but places no limit on the number of terms which may eventually be construed.

Another case management technique involving claim construction is early limited constructions designed to resolve potentially dispositive issues. This approach has been used in the Eastern District of Texas when dealing with patent cases involving large numbers of defendants (in some cases more than 100).[27] In such cases, courts have experimented with allowing defendants to propose construction of a maximum of three claim terms at an early stage of the litigation. These terms are briefed, argued and construed on an expedited basis. In at least one case, that early construction resulted in a summary judgment in favor of 90 percent of the defendants, thus reducing the case to manageable proportions. In other instances, the same courts have refused to follow this procedure if defendants are unable to demonstrate that expedited claim constructions will be dispositive.

C. Provisional Orders

Several District Courts use provisional claim construction orders to allow the parties to comment on proposed constructions before they are finally adopted.

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25 *In re Katz Interactive Call Processing Patent Litigation*, 639 F. 3d 1303 (Fed. Cir. 2011).
26 *O2 Micro International Ltd. v. Beyond Innovation Technology Co.*, 521 F.3d 1351 (Fed. Cir. 2008).
27 *Parallel Networks LLC v. Abercrombie & Fitch*, No. 6:10cv111, slip op. at 5 (E.D. Tex. Mar. 15, 2011).

Occasionally, District Courts have even issued such provisional orders in advance of the Markman hearing. Of course, prudence dictates that limits be placed on responses to such provisional orders to avoid an additional round of briefing on claim construction issues.

A related management technique is the prompt issuance following the completion of a Markman hearing of a provisional order which sets forth without reasoning the claim constructions to be adopted by the Court. Receipt of these constructions allows the parties to proceed with informed discovery, expert reports and summary judgment, and allows the court to issue a reasoned claim construction opinion at a later time without impairing the ability of the parties to move forward meanwhile.

Some courts also have begun to question the utility of Markman hearings in all patent cases. While not all District Courts have conducted hearings on claim construction issues, the great majority have elected to do so. At least a few have now begun to question the utility of a hearing in every case, and have begun to decide some or all claim construction issues on the briefs.

Finally, the new post-grant procedures of the AIA will result in claims being construed in litigation before the PTO. Because claim construction is a matter of law, such Markman rulings will not be binding on the courts but, in District Court litigation involving the same parties as in the post-grant review, there could be issues of judicial estoppel and arguments that claim construction conducted in the PTO should be given weight by courts in the interest of judicial economy.

D. Bifurcation of Discovery or Trial

Attempts to manage the complexity of patent litigation through bifurcation have met with mixed success. At least some courts have experimented with bifurcating discovery into an initial damages phase followed by a liability phase. The theory behind this approach is that it potentially allows the parties to evaluate the importance of the case and may foster early opportunities for settlement. The difficulty is that the scope of damages usually will be impacted by liability considerations, so this approach to bifurcation seems to have engendered little enthusiasm.

At trial, some courts routinely bifurcate liability and damages. A number of courts have also bifurcated issues of willfulness.

E. Accelerated Issue Adjudication

Section 273 of the AIA creates a new defense prior commercial use. Under this section, an infringer has a complete defense if it used a patented process at least one year before the filing of the patent.

Since all facts pertinent to this defense should be in the possession of the accused infringer, it may present opportunities for early adjudication through summary judgment or an early jury trial limited to that issue.

F. Damages Disclosures

While local rules governing patent cases invariably contain requirements of initial disclosures of infringement and invalidity contentions, almost none require the patent holder to disclose its damages theories. Since this issue is present in virtually every case, a standard order requiring disclosure of damages theories may clarify the expectations of the court and save the parties unnecessary discovery practice. In light of the rapidly developing law concerning proof of patent damages, careful consideration would have to be given to the timing of such disclosures and their relation to the conduct of other discovery in the case.

AN OUTSIDER LOOKS AT A CRIMINAL ANTITRUST TRIAL

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I. INTRODUCTION

This article is about an antitrust criminal trial, which the author followed as an outsider, and the author's perspective on some of the issues that arose.

From January 9 through March 13, 2012, Judge Susan Illston presided at the criminal antitrust trial in *United States v. AU Optronics Corporation* et al., NO. CR. 09-00110 SI in the United States District Court for the Northern District of California. AU Optronics Corporation ("AUO"), a Taiwanese corporation; its American subsidiary, AU Optronics Corporation America ("AUOA"); and five of its executives were charged with conspiring with other Taiwanese and Korean manufacturers to fix prices of TFT-LCD panels from 2001 to 2006. TFT-LCD panels are the flat screens used in laptop computers, desktop computer monitors, and televisions, as well as a host of other electronic products, such as cell phones and iPods.

AUO's alleged co-conspirators included three other Taiwanese companies (CPT Corporation, Chi Mei, and Hannstar) and two Korean companies (Samsung and LG Display). From the fall of 2001 to the fall of 2006, these six companies met as a group in Taiwan, generally on a monthly basis, to exchange production and pricing information and to agree on TFT-LCD prices. They referred to their meetings as "Crystal Meetings." In the period of the alleged conspiracy, there were approximately 50 such Crystal Meetings, all of which were well documented by one or more of the attending companies. The reports of the Crystal Meetings prepared by various participants, including AUO, LG Display, and Chunghwa, recorded express price-fixing and price-stabilization agreements reached at the meetings. The conspirators, including AUO, also entered into price-fixing agreements in one-on-one bilateral meetings and email and telephone communications throughout the period of the conspiracy.

Although most sales of the panels by the conspirators were originally made to makers of finished products outside the United States, substantial sales were made to United States buyers for delivery both inside and outside the United States (e.g., Dell, HP/Compaq, IBM, Apple); and roughly 30 percent of laptops, monitors, and flat screen TVs containing TFT-LCDs made by the conspirators were ultimately sold to consumers and other end users in the United States, which was the largest market for products containing TFT-LCD. During the period of the conspiracy, the conspirators manufactured in excess of 80 percent of TFT-LCD's world-wide. The conspirators also engaged in considerable price-fixing activity in the United States in connection with serving their major American customers, such as Dell in Texas. At the Crystal Meetings, the conspirators specifically discussed these major American customers and the prices they would be charged.

Four of the conspirators pleaded guilty to felony violations of Section 1 of the Sherman Act before Judge Illston and paid fines: LG Display, $400 million; Chi Mei, $220 million; CPT, $65 million; and Hannstar, $30 million.[1] A number of their individual executives entered guilty pleas, were sentenced, and served time in federal prison, although largely minimum security. Another conspirator, Samsung, applied for leniency under the Antitrust Criminal Penalty Enhancement and Reform Act of 2004, by being the first conspirator to report the conspiracy to the Antitrust Division of the United States Department of Justice and essentially ratting out the other conspirators, even though Samsung was apparently one of the initiators of the conspiracy.

Only AUO withstood the Department of Justice and insisted on going to trial. The result of its intransigence was that AUO, AUOA, and AUO's two top executives were found guilty as charged; the jury acquitted two lower level executives; and the jury failed to reach a verdict on a mid-level executive, whom the DOJ has said it plans to retry. The jury also determined that the price-fixing conspiracy affected more the $500 million of United States commerce, a finding exposing AUO to a criminal fine of $1 billion.

II. THE DEFENSE: "MEET TO COMPETE"

AUO's defense at trial was the absence of any agreement by AUO to fix or stabilize TFT-LCD prices. According to defense counsel, AUO went to the Crystal Meetings only to obtain information from its competitors so that it could better compete in a highly competitive market, which it in fact did. It never really entered into any agreement on TFT-LCD prices with any of its competitors. It simply collected information on their future pricing intentions, which it then used to its own advantage by undercutting its competitors' prices to gain market share. When AUO's words and actions manifested agreement on prices at Crystal Meetings, AUO was really just bluffing, as in a poker game. The others at the meetings also understood that they were not really agreeing on prices, because prices were in fact being set by the market and not the manufacturers of TFT-LCD, as evidenced by steadily declining prices, rampant cheating or deviation from allegedly agreed-to prices, numerous large buyers with oligopsony power, and other dynamics of the marketplace. The essence of the defense, as phrased by counsel for one of the individual defendants, was "meet to compete," which was what AUO was allegedly doing in exchanging pricing and production information with competitors and in attending Crystal Meetings.[2]

AUO presented its defense without calling as witnesses any of the individual defendants or other employees of the corporate defendants. Instead, AUO relied on cross-examination of the prosecution's witnesses, who were employees of other conspirators that

1 Two Japanese companies, Sharp ($120 million) and Hitachi ($31 million), pleaded guilty to more limited, but related conspiracies to fix prices for TFT-LCD sold to particular United States customers (Dell, Motorola, Apple).

2 Clever as this coinage might have been, it fell far short of "If the glove doesn't fit, you must acquit." This particular defendant, whose counsel crafted the phrase, was convicted. Indeed, the Government nicely turned the tables on the defense in closing argument: Once again, "Meet to compete" — you've heard that phrase said by some of the lawyers here; some of the defense counsel. It's a catchy phrase, but it's completely an empty one. I think "Meet to cheat" is a more appropriate phrase there. Meet to cheat your customers. Meet to cheat your consumers of your products. [Trial Transcript, Rough, 4806:12-17.]

had pleaded guilty and agreed to cooperate with the Government, and testimony of an expert economist, Bruce Deal, who relied on a plethora of industry data and statistics for opinions that the actions not only of AUO, but also of the other admitted conspirators, were inconsistent with a conspiracy to fix and stabilize TFT-LCD prices; and that, even if such a conspiracy existed, it had no actual effect on TFT-LCD prices.

The Government's case consisted of: (1) testimony of several customers victimized by the conspiracy (Dell and HP/Compaq); (2) testimony of employees of other conspirators who admitted and described the conspiracy and their role in its implementation – extremely strong direct evidence, although subjected at times to skillful and effective cross-examination; (3) reports of Crystal Meetings prepared by AUO and other conspirators, which expressly admitted and detailed price-fixing agreements reached at the meetings – in essence irrefutable evidence very difficult to rebut; (4) summaries of the documentary evidence providing an overview of the history and number of Crystal Meetings; and (5) the testimony of expert economist Dr. Keith Leffler, who calculated the effect of the conspiracy on United States commerce and rebutted the testimony of Mr. Deal, apparently quite effectively.

III. An Outsider's Observations

During the proceedings, which this observer followed by reading daily transcripts and actually attending one day of trial, there were three quite interesting legal issues that arose. These involved: (1) what the jury was to be told about the exchange of competitive pricing and production of information as evidence of conspiracy; (2) how the jury was to evaluate the claim that AUO did not conspire because its executives harbored unexpressed intentions not to agree on prices, and to use the information received at Crystal Meetings to undercut competitors' prices; and (3) the extent to which the jury was free to draw adverse inferences from AUO's failure to call any employee as a witness to deny AUO's participation in the conspiracy.[3]

Following the jury's verdict, a final question presented itself: Given the overwhelming direct evidence of the conspiracy, including the testimony of actual participants and first-hand contemporaneous written reports of the Crystal Meetings, did the "Meet to Compete" defense ever really stand a chance? This observer's conclusion is that it did, as shown by the acquittal of the two lower-level AUO executives, one of whom attended Crystal Meetings, while the other knew about the meetings, and the failure to reach a verdict with respect to the mid-level executive, who both attended and wrote reports of the Crystal Meetings for his superiors, in which he admitted and described price-fixing agreements.

The reason the "Meet to Compete" defense proved as effective as it did, however, in the view of this observer, is the treatment the other three issues received from the Government and the Court during the trial. It is these three issues that will now be addressed.

A. The Exchange of Competitive Information

A linchpin of the "Meet to Compete" defense was the premise that under Section 1 of the Sherman Act, the exchange of pricing and production information with

3 Full disclosure requires the author to state that during the AUO criminal trial he filed amicus briefs on the first two issues on behalf of the Indirect Purchaser Plaintiff Classes in *In Re TFT-LCD (Flat Panel) Antitrust Litigation*, 3:07-md-01827-SI in the United States District Court for the Northern District of California. Much of the discussion to follow relies on those briefs.

competitors is permissible and even pro-competitive. The defense asked for and received both a preliminary and final jury instruction on this issue. The instruction said:

> Evidence has been introduced concerning the exchange of information about prices between the defendants and employees of other companies manufacturing TFT-LCDs alleged to be co-conspirators. The Government claims that such exchanges are part of the evidence establishing that the defendants entered into an agreement or future mutual understanding to fix prices, as alleged in the indictment.
>
> It is not unlawful for a person to obtain information about a competitor's prices, or even to exchange information about prices, unless done pursuant to an agreement or mutual understanding between two or more persons, as charged in the indictment. Nevertheless, you may consider such facts and circumstances, along with other evidence, in determining whether there was an agreement or mutual understanding between two or more persons, as alleged in the indictment. [Trial Transcript, Rough ("Tr."), 1395:24-1396:13; 4718:24-4719:9.]

Although clearly a correct statement of the law, on the record in the case, this was arguably a much more favorable instruction than the defense was entitled to receive. The reason is that the undisputed evidence of record was that AUO and its competitors were exchanging information about ***future prices*** and their ***intentions regarding future prices*** at the Crystal Meetings, not information about historical past prices.

The seminal cases dealing with information exchanges are *Eastern States Lumber Ass'n v. United States*, 234 US 600 (1914) (price-fixing conspiracy found from information exchange combined with other factors); *American Column & Lumber Co. v. United States,* 257 U.S. 377 (1921) (same); *United States v. American Linseed Oil Co*., 262 US 371 (1923) (same); *Maple Flooring Ass'n v. United States*, 268 US 563 (1925) (no conspiracy from information exchange without more); *Cement Mfrs. Ass'n v. United States*, 268 US 588 (1925) (same result as *Maple Flooring*); and *United States v. Container Corp. of America*, 393 US 333 (1969) (price-fixing conspiracy found from information exchange combined with other factors). The bottom line from these cases is that an information exchange among competitors is legally neutral standing alone and not sufficient by itself to establish a price-fixing conspiracy. In more modern parlance, one or more "plus factors" will be necessary to support a finding of a conspiracy to fix prices. Chief among such plus factors, however, is exchanging information about future prices, as occurred in the Crystal Meetings.

Numerous authorities have held that exchanges of information about future prices stand on an entirely different footing from exchanges of information about past prices, and are more than sufficient to establish an unlawful agreement to fix prices. *In re Coordinated Pretrial Proceedings in Petroleum Products Antitrust Litigation*, 906 F.2d 432, 461-62 (C.A.9 (Cal.), 1990):

> In response to this evidence, the appellees raise two arguments. First, they contend that these exchanges of information were "innocuous" and that no inference of conspiracy can be drawn

from them. This argument cannot be squared with the Supreme Court's holding that, under certain circumstances, the exchange of production and supply information may supply "an attractive basis for cooperative, even if unexpressed, 'harmony' with respect to future prices." *American Column & Lumber Co. v. United States,* 257 U.S. 377, 398, 42 S.Ct. 114, 116, 66 L.Ed. 284 (1921); see also Sullivan, Antitrust Sec. 97 (1977) (Data as to production figures "can be used to police production quotas imposed by a cartel or, in an oligopolistic structure, can facilitate interdependent action in reducing output.").

American Column Lumber Co. v. United States, 257 U.S. 377 (1921):

This elaborate plan for the interchange of reports does not simply supply to each member the amount of stock held, the sales made and the prices received, by every other member of the group, thereby furnishing the data for judging the market, on the basis of supply and demand and current prices. It goes much farther. It not only furnishes such information, with respect to stock, sales and prices, but also reports, giving the views of each member as to 'market conditions for the next few months'; what the production of each will be for the next 'two months'; frequent analyses of the reports by an expert, with, we shall see, significant suggestions as to both ***future prices*** and production; and opportunities for future meetings for the interchange of views, which the record shows were very important. It is plain that the only element lacking in this scheme to make it a familiar type of the competition suppressing organization is a definite agreement as to production and prices. But this is supplied: By the disposition of men 'to follow their most intelligent competitors,' especially when powerful; by the inherent disposition to make all the money possible, joined with the steady cultivation of the value of 'harmony' of action; and by the system of reports, which makes the discovery of price reductions inevitable and immediate. The sanctions of the plan obviously are financial interest, intimate personal contact, and business honor, all operating under the restraint of exposure of what would be deemed bad faith and of trade punishment by powerful rivals. [Emphasis added.]

Todd v. Exxon Corp., 275 F.3d 191, 211 (2nd Cir., 2001):

Alongside the "structure of the industry involved," the other major factor for courts to consider in a data exchange case is the "nature of the information exchanged." *Gypsum*, 438 U.S. at 441 n.16. There are certain well-established criteria used to help ascertain the anticompetitive potential of information exchanges. As part of the analysis, a court should consider, "broadly speaking, whether it was of the sort in *American Column & Lumber Co. v. United States* ... or of that in *Maple*

> *Flooring Manufacturers Ass'n v. United States." Battipaglia*, 745 F.2d at 175 (citations omitted). Applying the relevant criteria reveals anticompetitive potential in this case.
>
> The first factor to consider is the time frame of the data. The Supreme Court has made clear that "[e]xchanges of current price information, of course, have the greatest potential for generating anti-competitive effects and although not per se unlawful have consistently been held to violate the Sherman Act." *Gypsum*, 438 U.S. at 441 n.16 (citing *Am. Column & Lumber; Am. Linseed Oil Co.*; and *Container Corp*.). The exchange of past price data is greatly preferred because current data have greater potential to affect future prices and facilitate price conspiracies. ***By the same reasoning, exchanges of future price information are considered especially anticompetitive.*** [Emphasis added.]

United States v. Serta Associates, Inc., 296 F. Supp. 1121, 1127 (N.D. Ill., 1969):

> Similarly, circulation of a price list among competitors was forbidden in *Interstate Circuit, Inc. v. United States,* 306 U.S. 208, 59 S.Ct. 467, 83 L.Ed. 610 (1939), because the list prices were likely to be the prices ***for the future***, thus allowing the competitors to price their merchandise accordingly; the instant local restrictions on advertising, when combined with the "suggested retail prices," result in an even more accurate prophecy of retailers' future prices. [Emphasis added.]

See, *Fleischman v. Albany Med. Ctr.*, 728 F.Supp.2d 130, 153 (N.D. N.Y., 2010):

> Information exchanges that involve future terms of competition (e.g., prices or wages) can allow firms to communicate their plans for future prices or wages to their rivals and create a means by which rivals can communicate back how they will respond. Thus, information exchanges involving future or planned terms of competition can provide a means by which rivals can reach agreement.
>
> *See* Expert Report of Gregory S. Vistnes, at 4. In forming this opinions, Vistnes relied on economic theories published in various economic journals.

On the basis of the foregoing authorities, the Court could have refused to give the instruction on information exchanges, or it could have added language that the exchange of information about future prices is different and sufficient to establish an unlawful agreement to fix prices. In any event AUO should have no complaint or issue for appeal based on the instruction given. It got far more than it should have from the Court on this point.

B. The Undisclosed Intention Not to Agree

Throughout the trial, defense counsel attempted to lay the groundwork for an argument that defendants could not be found guilty if they ostensibly agreed to price-fixing at Crystal Meetings, but secretly intended not to abide by the agreements reached. For example, the following questioning occurred during the cross-examination of Brian Lee, a CPT employee who attended Crystal Meetings and prepared meticulous reports of the meetings and agreements reached:

Q Well, you don't know what was in anybody else's mind at those meetings, do you?
A It is true that we can't read other people's mind. However, the figures that we were discussing were written on the whiteboards. One is one, two is two, everything is very clear. It's not possible to miscomprehend. [Tr., p. 1561:12-17.]

* * *

Q Even back then, you didn't know what anybody was thinking, did you?
A You're right.
Q Except yourself. You knew what you were thinking.
A Yes.
Q As for anybody else, all you had was what they said, right?
A Yes. [Tr., p.1567:4-11.]

* * *

Q Well, you had no idea what Dr. Hsiung was thinking at the time about that, do you?
A I do not know what he was thinking, but we had understanding as to whether the price had rebate. [Tr., p. 1690:16-19.]

* * *

Q You would agree with me that an agreement requires people to be thinking the same things (Indicating) as the words they're saying. Right?
A Yes.
Q Requires both people, if we're just talking about two people, to have all their cards on the table. Right?
THE COURT: Mr. Berson, –
MS. PATCHEN: Objection –
THE COURT: – the colloquialisms are very complicated in this case, so perhaps you could just try to avoid them.
MR. BERSON: All right.
BY MR. BERSON:
Q It requires people to say what they mean, and mean what they said, doesn't it?
MS. PATCHEN: Objection. That's vague, Your Honor.
THE COURT: Overruled.
You can answer that.
THE WITNESS: Yes. [Tr., pp. 1730:9-1731:2.]

Such questioning, which generally proceeded without objection from the Government, and hence without comment or ruling by the Court, was particularly troubling. To this observer, such questioning, as well as the argument for acquittal it was intended to support, seriously and fundamentally misconceived both the law of contracts or agreement and the law of antitrust criminal intent.

First, the idea that there can be no agreement if a party has an undisclosed intention not to agree, but provides an objective manifestation of assent, appears flatly contrary to basic contract law. If defendants at the Crystal Meetings objectively manifested their assent to price-fixing agreements, then they in fact agreed, regardless of any undisclosed intent not to agree or not to abide by the price-fixing agreements. *Gooding v. Shearson Lehman Bros., Inc.*, 878 F.2d 281, 284 (9th Cir., 1989) ("[T]he undisclosed intentions of the parties are ... immaterial ... the outward manifestation or expression of assent is controlling."); *Bretz v. Portland General Elec. Co.*, 882 F.2d 411, 413 (9th Cir. 1989) ("In Montana, as in most other jurisdictions, '[t]he mutual assent essential to the formation of a contract ... must be gathered from the outward objective manifestations of the parties and not by the subjective undisclosed intent of one of the parties.'"); *Bolander v. Godsill*, 116 F.2d 437, 439 (9th Cir., 1940):

> Considered from a standpoint as to manifestation of assent to deceased's offer, it is clear that whatever may have been Godsil's secret intention, her acts in looking after [the] deceased manifested an acceptance of the offer. The secret intention of Godsil was, therefore, immaterial. 1 Restatement of the Law, Contracts, p. 25, § 20; 17 C.J. S., Contracts, p. 361, § 32.

Franklin Life Ins. Co. v. Mast, 435 F.2d 1038, 1045 (9th Cir., 1970); *Associated Milk Producers, Inc. v. Meadow Gold Dairies, Inc.*, 27 F.3d 268, 273 (7th Cir., 1994); *Goldberg v. Bear, Stearns & Co., Inc.*, 912 F.2d 1418, 1420 n.1 (11th Cir., 1990); *Industrial Products Mfg. Co. v. Jewett Lumber Co.*, 185 F.2d 866, 869 (8th Cir., 1950) ("Though there must be a meeting of the minds of the parties to constitute a contract, such meeting of the minds is to be determined by the expressed, and not by the secret, intention of the parties."); *EBC Inc. v. Clark Bldg. Sys. Inc.*, 618 F.3d 253, 263 (3d Cir., 2010) ("It is well established in Pennsylvania that '[i]n ascertaining the intent of the parties to a contract, it is their outward and objective manifestations of assent, as opposed to their undisclosed and subjective intentions, that matter.'").

Thus, where the evidence established that defendants clearly and objectively manifested their assent to price-fixing agreements, as it overwhelmingly did here, the defendants should not have been allowed to claim that no agreement was formed by reason of their unexpressed intention not to agree. The Government could have objected to these questions and suggestions; and, if it did, the Court should have sustained the objection and instructed the jury that such an unexpressed intent not to agree is irrelevant and must be disregarded.

Nor would such a ruling and instruction run afoul of the law of the criminal antitrust intent required for a conviction of felonious price-fixing. The Supreme Court treated the issue of intent definitively in *United States v. United States Gypsum Company*, 438 U.S. 422 (1978). First, the Court held "that the criminal offenses defined by the Sherman Act should be construed as including intent as an element." 438 U.S. at 443. In defining the requisite intent, however, the Supreme Court made clear that the prohibited intent exists when a defendant knows that a price-fixing agreement "is practically certain to follow from his conduct, whatever his desire may be as to that result." *Id.*, at 445. "Where carefully planned and calculated conduct is being scrutinized in the context of a criminal prosecution, ***the perpetrator's knowledge of the anticipated consequences is a sufficient predicate for a finding of criminal intent***." *Id.*, at 445-46; [Emphasis added.] Thus, according to the Supreme Court, "action undertaken with knowledge of its probable consequences and having the requisite anticompetitive effects can be a sufficient predicate for a finding of criminal liability under the antitrust laws." *Id.*, at 444. *Accord*: *United States v. Brown*, 936 F.2d 1042, 1046 (9th Cir., 1991).

Thus, regardless of any alleged unexpressed intent not to agree, if defendants objectively manifested their assent to price-fixing agreements at the Crystal Meetings, all that need be shown for a conviction is defendants' knowledge that the probable consequences of their conduct would be "a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce." *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940). The Government was entitled to exclude this evidence and to have the jury instructed that AUO's alleged undisclosed intention not to agree could not be considered as a defense once the jury found that AUO had objectively manifested its assent to price-fixing agreements and understood the probable consequences of doing so.

C. Adverse Inferences from AUO's Failure to Call Witnesses

On this issue, the rules of evidence run into the Fifth Amendment. At trial, AUO and AUOA called no witnesses other than the expert economist. They called no current employee to deny their participation in the conspiracy, although there clearly were employees other than the individual defendants who could have given such testimony. The individual defendants, as was their Fifth Amendment right, did not testify.

The law is clear that as corporations AUO and AUOA have no Fifth Amendment right against self-incrimination. *United States v. White*, 322 U.S. 694, 699 (1944):

> Since the privilege against self-incrimination is a purely personal one, it cannot be utilized by or on behalf of any organization, such as a corporation. *Hale v. Henkel*, 201 U.S. 43, 26 S.Ct. 370, 50 L.Ed. 652; *Wilson v. United States*, 221 U.S. 361, 31 S.Ct. 538, 55 L.Ed. 771, Ann.Cas.1912D, 558; *Essgee Co. v. United States*, 262 U.S. 151, 43 S.Ct. 514, 67 L.Ed. 917.

The law is also clear that the introduction of weak evidence when strong is available permits an adverse inference against the proponent of the evidence. *Interstate Circuit, Inc. v. United States*, 306 US 208, 226 (1939):

> The production of weak evidence when strong is available can lead only to the conclusion that the strong would have been adverse. *Clifton v. United States,* 4 How. 242, 247. Silence then becomes evidence of the most convincing character. *Runkle v. Burnham,* 153 U.S. 216, 225; *Kirby v. Tallmadge,* 160 U.S. 379, 383; *Bilokumsky v. Tod,* 263 U.S. 149, 153, 154; *Vajtauer v. Commissioner of Immigration,* 273 U.S. 103, 111, 112; *Mammoth Oil Co. v. United States,* 275 U.S. 13, 52; *Local 167 v. United States,* 291 U.S. 293, 298.

Thus, had AUO and AUOA been the only defendants in the criminal trial, the Government surely could have commented on their failure to call witnesses and their silence in the face of the incriminating evidence against them, and could have requested and perhaps received an *Interstate Circuit* instruction. In the criminal trial, the Government in fact did neither.

This presents the interesting question of whether the presence of the individual defendants, who did have Fifth Amendment rights, changed the calculus, prevented the Government from commenting on the failure of the corporate defendants to call witnesses, and thereby somehow imparted to the corporate defendants Fifth Amendment protection they would not otherwise have enjoyed. There appears to be no authority on point. Conceivably, the argument would be that commenting on the silence of the corporate defendants would impermissibly call attention to the failure to testify of the individual defendants, so as to violate their Fifth Amendment rights and infect the proceedings sufficiently to warrant reversal of any conviction of the individual defendants. Under the circumstances, the Government could justifiably have chosen not to comment on the corporate silence, as a tactical matter, in order not to risk reversal of individual convictions. It also could reasonably have concluded that the evidence was sufficiently strong to convict the corporate defendants without a need to comment on their failure to call witnesses.

Nonetheless, there can be no basis for thinking that commenting on the silence of the corporate defendants posed a risk of reversal of their convictions, unless the Government feared an ultimate overruling of *United States v. White* by the Supreme Court – not so farfetched a possibility in light of *Citizens United v. Federal Election Commission*, 558 U.S. 1 (2010), and the propensity of five current Supreme Court Justices to view corporations as giant persons walking the earth.

One other aspect of this issue is intriguing. In *Griffin v. California*, 380 U.S. 609 (1965), the Supreme Court held that it was error to instruct a jury that it could ***not*** draw an adverse inference from a criminal defendant's exercise of his Fifth Amendment right not to testify, because such an instruction drew undue attention to the defendant's silence. In *Carter v. Kentucky*, 450 U.S. 288 (1981), however, the Supreme Court held that it was error to refuse to give an instruction, if requested by the defense, that the jury could not draw an adverse inference from the defendant's exercise of his Fifth Amendment right not to testify. Thus, the Supreme Court conferred on defendants the choice of whether or not to instruct on the exercise of Fifth Amendment rights.

In the AUO criminal trial, counsel for the individual defendants elected the *Carter v. Kentucky* alternative. They requested and received the following instruction:

> A defendant is presumed to be innocent, unless and until the Government proves the defendant guilty beyond a reasonable doubt. In addition, a defendant does not have to testify or present any evidence to prove innocence. The Government has the burden of proving every element of the charge beyond a reasonable doubt. The defendant – a defendant in a criminal case has a constitutional right not to testify. You may not draw any inference of any kind from the fact that a defendant did not testify. [Tr., 4709:24-4710:9.]

In addition, defense counsel stressed the right of the individual defendants to remain silent free of adverse inferences both in voir dire/opening statements and closing arguments. *E.g.*:

> The Judge is going to instruct at the end of this case that you can't consider whether someone else – whether a defendant testifies, or not. It's a choice they have. And if they don't testify, you can't hold it against them. Would you be able to

> ignore whether someone testified or not, and judge the case entirely on what happens here in court from that witness stand? Would you be able to do that? [Tr., 182:23-183:5.]

Inasmuch as the individual defendants so clearly chose the path of *Carter v. Kentucky*, one could argue that, with the jury expressly instructed about the right of the individual defendants to remain silent, and receiving repeated reminders from defense counsel, there could be no possibility of undue prejudice to the individual defendants from the Government's commenting on the failure of the corporate defendants to call witnesses.

IV. CONCLUSION

This author does not claim to be even close to being an expert or aficionado of criminal law, but merely an interested, if not fascinated, observer of an interesting and fascinating criminal trial, a very major and important one, in which the Government, defense counsel, the Court, and finally the jury all did a masterful job. The result was an exemplary proceeding and a truly just and significant result. Price fixers were held to account, as they should have been; and the importance and wisdom of the antitrust laws were reconfirmed. The foregoing thoughts and comments are those of a kibitzer, who found the entire process an absorbing intellectual challenge. The issues discussed were chosen because of their knottiness and the likelihood of their recurrence in future trials, and in the hope that their explication may provide guidance in shaping the development of antitrust law in a positive and productive direction that will preserve and protect the competitive process, as the antitrust laws were meant to do.

ADMINISTRATIVE TRIALS AT THE FEDERAL TRADE COMMISSION IN COMPETITION CASES

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Unlike the Department of Justice ("DOJ"), which can seek relief only in federal court, the Federal Trade Commission ("FTC") has its own internal administrative hearing process as an alternative. Cases are heard by an administrative law judge ("ALJ") in a trial setting that is more comprehensive and thorough than one might see in an antitrust case brought in a federal or state court. The FTC's Rules of Practice for these adjudicative proceedings, commonly called "Part 3" proceedings,[1] detail most of the applicable rules. Counsel on both sides can easily be disadvantaged if they are not thoroughly familiar with these rules and the FTC's and the ALJ's interpretations of them.[2]

Compared to a typical federal court case, the FTC's adjudicative procedure is cumbersome and tedious. Yet, with recent rule changes at the FTC, the pre-trial proceedings move rapidly – often in tandem with parallel federal court proceedings. Both sides must be prepared to move at a high speed beginning with the first status hearing, held within ten days of the answer, which is due fourteen days after the complaint is issued.[3] Often, at that first status hearing, the parties give abbreviated opening statements to the ALJ, discuss discovery, and within a few days, the ALJ will issue a protective order and scheduling order, and the race will have begun. Within five months from the complaint (eight months in conduct cases), the trial of often two-to-three months commences. This may seem like a long time to prepare for trial. But considering that a mere ten weeks after that initial conference with the ALJ, fact discovery is usually concluded – often including dozens of depositions and millions of documents produced in discovery – one has to be prepared for battle very early in the game.

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1 The term arises from the placement of the Rules in the third part of Title 16 of the Code of Federal Regulations, at 16 C.F.R. § 3.1 *et seq.* ("Rules").

2 It is difficult for a respondent to find ALJ opinions related to procedure or evidence. The FTC Staff usually has its own precedent file with such rulings. The best way is to do a targeted search in the ftc.gov web site in the folder for adjudicative proceedings.

3 Rule § 3.21.

In the past, the Part 3 procedure was extraordinarily slow. Cases often dragged on for years.[4] These delays harmed the FTC's ability to persuade federal courts to enjoin mergers to maintain the status quo pending the Commission's decision on the merger. Parties often argued (and still do) that it made no business sense to allow a merger to languish pending the FTC's slow process to a decision.[5] To most merging companies and many courts, it appeared unreasonable to allow the FTC to take a case through an injunction proceeding, potentially obtain an inconsistent ruling from the ALJ, and then, potentially, years later, for the Commission itself to rule to allow or decide against the merger.[6]

To help resolve the timing problem, the Commission revised its Rules of Practice in 2009 to guarantee a fast proceeding (from complaint to initial ALJ decision) in every case.[7] The abbreviated schedule has worked in the few cases that have gone through the process. The schedule is still much longer than schedules typically used by federal courts in similar cases,[8] but the discovery phase follows nearly the same timing as a parallel federal proceeding. The result of the change usually requires parties to combine the discovery in Part 3 with a parallel federal proceeding. The intended effect of the change was to put pressure on federal courts not to dig too deep into the FTC's complaint, especially in merger challenges, but the courts still have not bought into that concept.[9] The main reason for that reluctance is that the FTC process still has the added layer of an FTC appeal and decision that seems to add 6-12 months to a final decision.

The FTC still has not solved this issue and may never do so. The only two apparent solutions to the problem are (i) that the FTC trim back the time it takes to render a final Commission decision or (ii) create a formal policy, similar to the one that it uses for federal preliminary injunction decisions, to decide quickly that it will not proceed forward on a case that FTC complaint counsel lost before the ALJ, except when it is the public

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4 FTC has had a rule limiting its own time for decisions since at least 1994 (currently 45 days); however, it has often not followed its own timing constraints in antitrust cases. *See, e.g.,* Federal Trade Commission, *Notice of Federal Trade Commission Approval of Procedures to Govern the Preparation of Final Orders and Opinions in Adjudicative Proceedings* (Apr. 7, 1994), *available at* http://ftc.gov/os/adjpro/adjprepprocedures.pdf; *cf. In re Rambus*, FTC Docket No. 9302, docket *available at* http://ftc.gov/os/adjpro/d9302/index.shtm (first opinion issued twenty-three months after oral argument; final opinion issued eight months later); *In re Chicago Bridge*, FTC Docket No. 9300 ("*Chicago Bridge*"), docket *available at* http://ftc.gov/os/adjpro/d9300/index.shtm (first opinion issued fourteen months after oral argument; final opinion with divestiture issued five years after oral argument); *In re Polypore*, FTC Docket No. 9327 ("*Polypore*"), docket *available at* http://ftc.gov/os/adjpro/d9327/index.shtm (complaint was filed on September 10, 2008 and a final Opinion issued on December 10, 2010), *aff'd,* 686 F.3d 1208 (11th Cir. July 11, 2012). Prior to the amendment to the Rules, cases often took longer than a year just to get through the discovery process. *See Chicago Bridge* (discovery lasted two years).

5 Delays at the FTC are not always caused by the Commission or its Staff. For example, in pre-merger challenges, merging parties have an incentive to give the federal court schedule priority if they believe they have a better chance at winning before the court rather than the ALJ. In post-merger cases, the merged party is often reaping the rewards of the merger and a delay in a potential divestiture may be in its interest. In both *Chicago Bridge* and in *Polypore*, most of the delays were at the request of the respondent, not complaint counsel. In both cases, the respondent moved repeatedly to reopen the record.

6 The *Donnelley* case is the best example of how the system worked before 2009. *R.R. Donnelley & Sons Co. v. FTC,* 931 F.2d 430, 431, 433–34 (7th Cir. 1991). The Commission lost the preliminary injunction case in federal court; the case was then tried in Part 3, where the ALJ ordered divestiture; yet, on appeal, the Commission reversed the ALJ and ruled in favor of Donnelley— four years after the proceedings began. *See In re R.R. Donnelley & Sons Co.*, FTC Docket No. 9243, 1995 WL 17012641, 120 F.T.C. 36 (1995).

7 *See* Federal Trade Commission, *FTC Issues Final Rules Amending Parts 3 and 4 of the Agency's Rules of Practice* (Apr. 27, 2009), http://www.ftc.gov/opa/2009/04/part3.shtm. FTC Rules of Practice, §§ 3.41 (allowing a hearing of 210 hours in a merger case, typically lasting between six and nine weeks), 3.46 (post-hearing briefing – 31 total days), 3.51 (initial 70-day decision and 30-day extension), 3.52 (appeal to FTC – minimum of 55 days), and 3.54 (FTC decision – 45 days). More recently, *In re Promedica Health System*, FTC Docket No. 9346, the case began on January 6, 2011 and reached a Commission decision on June 25, 2012. *See* docket *available at* http://www.ftc.gov/os/adjpro/d9346/index.shtm. Similarly, *In re North Carolina Bd. of Dental Examiners*, FTC Docket No. 9343, the FTC took the case from a complaint to a Commission decision in about 18 months. Docket *available at* http://www.ftc.gov/os/adjpro/d9343/index.shtm.

8 In *United States v. H&R Block, et al.*, for example, the case went from the complaint through a trial on the merits and a final opinion in less than six months. 833 F. Supp. 2d 36 (D.D.C. 2011).

9 In *FTC v. Lab. Corp. of Am.,* No. SACV 10-1873 AG (MLGx), 2011 WL 3100372 (C.D. Cal. 2011), the court said that the time to a final decision was still too far off for it to ignore the need for it to decide the case; in *FTC v. Graco,* No. 12-CV-307 (D. Minn. 2012), the court likewise set a full schedule and hearing to hear the matter, although it would have taken place after the scheduled Part 3 trial. *But see FTC v. ProMedica Health Sys., Inc.*, No. 3:11-CV-47, 2011 U.S. Dist. LEXIS 33434, at *3, *164 (N.D. Ohio Mar. 29, 2011) (making a decision based on summaries of testimony and no live witnesses and recognizing that an administrative trial was scheduled to begin in two months with an initial decision expected in seven months).

interest to continue the challenge.[10] Such a rule would put Part 3 proceedings on nearly an equal footing with parallel federal proceedings.

The Advantages and Disadvantages of Part 3 Versus Federal Court.

It is important to understand why the FTC uses Part 3 proceedings rather than federal court in certain cases. The choice between these two forums appears to be driven more often by statute than by strategy. Under both Section 5 of the FTC Act and Section 7 of the Clayton Act (in a merger case), the FTC has "wide discretion in its choice of a remedy."[11] Yet neither of these statutes expressly authorizes the FTC to seek anything but equitable relief (e.g., an injunction, divestiture, or prohibition) in a Part 3 case. In a post-acquisition case, the FTC also may ask a federal court to order a preliminary injunction requiring an immediate divestiture,[12] but typically the FTC has used federal courts in merger cases only for pre-acquisition injunctive relief to maintain the status quo, with the threat of a Part 3 proceeding to hear the actual merits of the case.

Under Section 13(b) (usually in merger cases), the FTC may seek injunctive relief in court only "pending the issuance of a complaint" in Part 3 for a hearing on the merits.[13] When the FTC seeks preliminary relief from a federal court under Section 13(b) for a pending merger, it has advantages that the DOJ lacks.

First, unlike the DOJ, the FTC can attempt to obtain preliminary relief in court and then – win or lose – can try the case again in a Part 3 proceeding. Second, in an FTC merger case brought under Section 13(b), a federal court is authorized only to grant preliminary relief rather than combine a preliminary injunction with a permanent injunction hearing and decide the merits of the case, as courts often do in DOJ cases.[14] Thus, the FTC can almost always argue for a lesser standard – especially in "sliding-scale" jurisdictions[15] – at a preliminary hearing; whereas, the DOJ must be prepared to argue the case on the merits much earlier in the process.

In a post-acquisition case, however, the FTC gains little advantage by filing in federal court, unless it can convince the court to order divestiture as preliminary relief, which may be extremely rare but not impossible. In non-merger cases, it may be a closer call for the FTC whether to go to federal court or to stay within its own adjudicative forum. On the one hand, in Part 3, the FTC has the advantage that appellate courts must, in most cases, defer to the Commission's fact-finding and policy decisions. This can be helpful if the FTC is trying to articulate and apply Section 5 in a novel way.[16] On the other

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10 *Policy Statement on Administrative Litigation Following the Denial of a Preliminary Injunction* and accompanying statement of the Commission (June 21, 1995), reprinted at 60 Fed. Reg. 39741 (Aug. 3, 1995), *available at* http://www.ftc.gov/os/fedreg/1995/august/950803administrativelitigation.pdf.

11 *See, e.g., North Texas Specialty Physicians*, FTC Docket No. 9312, Commission Opinion 37 (Nov. 29, 2004), *available at* http://www.ftc.gov/os/adjpro/d9312/051201opinion.pdf (*citing, inter alia, FTC v. National Lead Co.*, 352 U.S. 419, 428 (1957)).

12 *See FTC v. Elders Grain, Inc.*, 868 F.2d 901, 907 (7th Cir. 1989) (Posner, J.) (affirming an order of rescission of an acquisition as a form of preliminary injunctive relief).

13 15 U.S.C. § 53(b) (Commission may seek an injunction if it has "reason to believe" that any person is "violating, or about to violate, any provision of law enforced by the Federal Trade Commission, and . . . that the enjoining thereof pending the issuance of a complaint by the Commission . . . would be in the interest of the public").

14 *See, e.g., United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36 (D.D.C. 2011); *United States v. SunGard Data Sys., Inc., et al.,* 172 F. Supp. 2d 172, 179 (D. D.C. 2001) (relying on Fed. R. Civ. P. 65(a)(2)).

15 Some circuits allow for a lesser showing of the likelihood of success on the merits, in all cases, for a preliminary injunction when there is a higher showing of either irreparable harm or the equities. *See, e.g., FTC v. Whole Foods Market*, 548 F. 3d 1028, 1035 (D.C. Cir. 2008).

16 *See, e.g., N. Tex. Specialty Physicians v. FTC*, 528 F.3d 346, 360–63 (5th Cir. 2008) (adopting an "inherently suspect" standard fashioned by the Commission in Part 3), *cert. denied*, 129 S. Ct. 1313 (2009); *Polygram Holding, Inc. v. FTC*, 416 F.3d 29, 36–37 (D.C. Cir. 2005) (same).

hand, a losing respondent can appeal to any appellate court in which the respondent does business. This can put the FTC at a disadvantage in circuits that have already expressed opposition to the FTC's legal position.[17] In short, there are many reasons why the FTC might choose to go to federal court for some kinds of cases and to Part 3 for others. But for post-acquisition cases and cases in which the FTC is trying to clarify the law (*e.g.,* to clarify the law of *Noerr-Pennington* in the *Unocal* case), Part 3 is likely the most suitable forum under the statutory scheme.

From a trial lawyer's perspective, witness examination and general trial strategy is often the same whether the case is tried in federal court or in Part 3. But there is one significant difference that drives trial strategy: in federal court, a trial attorney must simplify the case to focus the judge on core issues; in a Part 3 hearing, the trial attorney and the ALJ have the additional burden of creating an administrative record for the FTC to hear the case *de novo* and to support an administrative decision.[18] In a perfect world, these two strategies should lead to identical results, but in the real world, they do not. Over the last twenty years, a typical merger trial in federal court has lasted approximately 5-9 days – even on the merits. At the FTC, even under the new Rules of Practice, a hearing on a merger case is likely to last as long as 30 trial days, stretched over two months. In a conduct case, a federal court is likely to try a civil antitrust case in a matter of weeks; whereas, an FTC conduct case can last as long as 3-4 months (*i.e., Rambus* and *Unocal*), even under the new Rules.[19]

Due to the nature of the administrative proceeding, each Part 3 case tends to require enormous resources and time to present, during which time counsel must persuade initially one of the ALJs, who have been extremely independent. An outsider to the Commission might think that the ALJs simply report to the Commission and do what they are told. While the FTC Staff often wishes that were the case, it simply is not so. In the past, the Commission has reversed ALJs both when they have ruled against *and* even for the Staff.[20] This divide between the Commission and the ALJs creates one benefit: a potential for a fairer hearing for respondents. Under the Administrative Procedures Act, 5 U.S.C. § 500, *et seq.*, an ALJ is an independent Article I judge and while he or she is employed by the Commission, he or she does not work for or report to the Commissioners.[21] The ALJs at the FTC[22] have made their independence extraordinarily clear. Indeed, respondent or complaint counsel would make a serious mistake if either believes that the ALJ speaks for the Commission. My own experience is that the ALJs more often turn to their own decisions, the Federal Rules of Evidence, federal court opinions, and other APA decisions

17 *See, e.g.*, *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1065–66 (11th Cir. 2005) (rejecting the Commission's rule-of-reason approach to "pay-for-delay," pharmaceutical settlement agreements, enunciated in a Part 3 case, based on prior precedent in *Valley Drug Co. v. Geneva Pharms.*, 344 F.3d 1294, 1312 (11th Cir. 2003)). But the FTC finally defeated the 11th Circuit's position in *FTC v. Actavis, Inc., et al.* (U.S., dkt. 12-416, June 17, 2013).

18 5 U.S.C. §§ 556(e), 557(c); Rule § 3.54(a).

19 The *Intel* case, FTC Docket No. 9341, was scheduled to take as many as 322 hours (45-50 trial days, or nearly three months with scheduled holidays and other hearings). *See* Complaint, *available at* http://www.ftc.gov/os/adjpro/d9341/091216intelcmpt.pdf. In the last year, multiple cases were scheduled for the same time period and were set for 2-3 days per week, which would have further extended the length of the trial. The trial in the recent case of *Matter of McWane, Inc.*, et al., Dkt. 9351 (Comm'n appeal pending), began on September 4, 2012 and concluded on November 2, 2012. It included over 2,000 exhibits, 53 witnesses, 6,045 pages of trial transcript, and 3,052 pages of post-trial briefs. Initial Decision (May 8, 2013) *available at* http://www.ftc.gov/os/adjpro/d9351/130509mcwanechappelldecision.pdf.

20 The Commission reversed the ALJ in *Schering* and in *Rambus*, but has also reversed ALJ decisions that were in favor of the Staff. The best example is the *Donnelley* case, *infra* note 17. *See also Beltone Elecs. Corp*., FTC Docket No. 8928, 1982 WL 608293, 100 F.T.C. 68 (July 6, 1982) (Reversing ALJ and dismissing its original complaint); *Int'l Ass'n of Conf. Interpreters*, FTC Docket No. 9270, 1997 WL 33483304, 123 F.T.C. 465, 660–61 (Feb. 19, 1997) (reversed in part). But this strategy can backfire when a regional circuit does not defer to the Commission's judgment. *See, e.g.*, *Schering Plough Corp. v. FTC*, 402 F.3d 1056 (11th Cir. 2005) (court of appeals choosing the fact finding of the ALJ over that of the Commission); *see also McWane*, *supra,* n. 19 (After trial, the ALJ rejected three of the seven counts, including the conspiracy and invitation to collude counts).

21 5 U.S.C. § 3105; Rule § 3.42(f).

22 There is currently only one ALJ appointed. *See About the Office of Administrative Law Judges*, FEDERAL TRADE COMMISSION, http://www.ftc.gov/ftc/alj.shtm (last visited Sept. 27, 2012).

for procedural and sometimes even substantive precedent before considering the Commission's views on the matter – unless the issue is clearly decided by the Rules of Practice or the law of the case.

During this entire process, in addition to following an order of proof, examining witnesses, and arguing the case, the parties typically create a huge record of thousands of exhibits, dozens of witness examinations, and thousands of pages of post-trial findings of fact, attachments, and other briefing that are better measured in pounds, rather than pages. So how does one get from day one to the end? Without going over each and every Rule and interpretation, the following should give the uninitiated a broad overview of the Part 3 process.

Pre-Complaint.

Every Part 3 case begins with an initial pre-complaint investigation called "Part 2" proceedings.[23] Typically, during this period, potential respondents present their own arguments informally, not only to the FTC Staff but also, in some cases, to each Commissioner in the hope of preventing the issuance of a complaint. During this initial time period, the Staff will seek documents and conduct numerous investigational hearings, which are similar to depositions. It is often critical at this stage for litigation counsel for respondents to be involved in preparing the case for possible litigation for three reasons: First, testimony from investigational hearings will likely be admitted at a Part 3 trial,[24] and it is therefore foolish to ignore case preparation at this stage of an investigation. Second, once a complaint is filed, discovery moves so quickly that a potential respondent who does not prepare a case for potential litigation during the commencement of investigational hearings will likely never catch up. Finally, those final discussions with Commissioners will likely be the last time the potential respondents will be allowed to discuss the case with them until the Part 3 proceeding is completed or suspended.[25] Once a complaint is issued, even the FTC's complaint counsel and staff cannot communicate with the Commission until the end or withdrawal of the proceeding, except by written motion.[26]

At the conclusion of this investigation process, the Staff then recommends to the Commission, with additional recommendations from the Bureaus of Competition and Economics, a proposed disposition of the matter.[27] If the Commission decides to issue a litigation complaint,[28] under the Part 3 rules, the Commission could hear the case on its own, assign one commissioner to hear the case, or assign the case to an ALJ, which is almost always the case.[29]

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23 As their name suggests, these investigative proceedings are governed by a set of rules that can be found in the second part of Title 16 of the Code of Federal Regulations.

24 Rule § 3.43(b). Recently, one respondent unsuccessfully attempted to keep investigational hearings out of evidence. *See In re McWane, Inc., et al,* Dkt. No. 9351, *available at* http://www.ftc.gov/os/adjpro/d9351/120815aljorddenyrespmoprecludecc.pdf.

25 *See* 5 U.S.C. § 557(d)(1).

26 *See* 5 U.S.C. § 554(d); *cf. William Jefferson & Co. v. Bd. of Appeals & Assessment No. 3*, No. 11-55223, 2012 U.S. App. LEXIS 18323, at *17 (9th Cir. Aug. 29, 2012) (approving use of an ethical wall between attorneys representing the county assessor and attorneys advising the board of appeals).

27 For example, after a ten-month extensive inquiry by the Staff, the Commission decided not to issue a complaint in *Royal Caribbean Cruises, Ltd.*, FTC File No. 021 0041 (Statement of the Commission) (Oct. 4, 2002), *available at* http://www.ftc.gov/os/2002/10/cruisestatement.htm. Some have been critical of the fact that a Commissioner may be approached by both the Staff and a potential respondent before the complaint and then later become the final adjudicator after a trial. But the alternative, a lack of access to the Commissioners prior to a complaint being issued, would be far more troublesome.

28 Even in cases that involve a consent order that the Staff has already negotiated with the respondent, the Commission still issues a complaint.

29 Rule § 3.42(a).

Commencement of the Case.

In normal practice, the Commission will vote for a complaint but then wait until the next morning to tell the respondents of the decision.[30] Once that notice has been given, if the case requires a federal complaint, the FTC Staff, through the Counsel Supporting the Complaint (commonly referred to as Complaint Counsel) will file a federal complaint in court. Often that complaint is filed with a motion to file it under seal.[31] Typically, that motion to seal is decided by a judge before the complaint is accepted for filing. Then, the assigned federal judge often will call the parties in for a scheduling conference, and the federal case begins.

While the federal case is beginning, the Part 3 case clock starts once the respondent has been served with the administrative complaint, which is filed in the FTC Secretary's office and is typically posted on the FTC website. An answer is then due within 14 days.[32] Unlike federal procedure, a respondent cannot just move to dismiss and ignore the duty to answer. Any "motion to dismiss, … motions to strike, and motions for summary decision" will be referred to the Commission for decision and usually will not delay the schedule.[33] In most cases, unless a party is willing to have the Commission decide a case on the pleadings, such early motions are usually a complete waste of effort.

Within five days of the answer, the parties must have their first discovery conference, exchange initial disclosures (Rule § 3.31(b)) and be prepared to offer the ALJ their comments on a proposed schedule.[34] During these initial few days, appearances should be filed, which will allow the ALJ to know the counsels' email and other contact information.

Generally, the ALJ will then send the parties a proposed scheduling order, which includes the Judge's own rules for discovery and procedure that may not be found in the Rules of Practice. Then, within 10 days of the filing of the answer, the ALJ will hold a scheduling conference (usually in the Commission Hearing Room, where the trial will also occur) to discuss the schedule, pending motions and other topics set forth in Rule § 3.21.

At the end of the scheduling conference, the ALJ then allows the parties to make a brief opening statement about the case. This presentation is critical because it is likely that this will be the last time either party will actually see the ALJ before the final pre-trial conference, and it is always important for the parties to make sure that the ALJ understands the parties' positions in the case in order to decide the dozens of motions that usually follow.

Within two days of the scheduling conference, the ALJ will have delivered to the parties a scheduling order and a standard protective order (that is set forth in Rule § 3.31). No discovery can commence until the scheduling order has been issued. It is critical for the parties to follow the ALJ's rules in the Scheduling Order, especially in how to file pleadings. The Secretary of the FTC's office is like the clerk of court for almost all filings, but the ALJ usually has his own preference on how pleadings should be copied or filed with his chambers.

30 This notice is most often given by the Bureau Director by phone to counsel of record.
31 In some jurisdictions, as is the case in the District of D.C., the FTC must file the complaint with its motion and supporting evidence as well. *See* D.D.C. Local Rule 65.1(c).
32 Rule § 3.12.
33 Rule § 3.22.
34 Rule § 3.21.

As one can see, moving through the first two weeks of a Part 3 case is like racing through a maze; and I have not gone through all the details of each and every one of the Rules of Practice. A case becomes even more complicated if it involves a preliminary injunction proceeding.

Coordinating Parallel Proceedings.

In many FTC competition cases, especially pre-merger challenge cases, the agency files a request for a preliminary injunction in federal court and a complaint in Part 3 simultaneously. Federal courts have historically been willing and interested in hearing the facts of the case with live testimony at a preliminary injunction hearing. Discovery is often truncated, but allowed. But even that process still may take 2-3 months to get to such a hearing. During that period, the Part 3 process will not only start, but fact discovery will nearly be completed.

Thus, it is common for the parties to coordinate the discovery between these two proceedings, so that one does not have to do everything twice. To help accommodate this necessary coordination, the FTC amended its Rules to allow for the admission of "[r]elevant, material, and reliable" testimony and expert reports (and other hearsay) from related proceedings where "the Commission and at least one respondent did participate."[35] Such evidence includes depositions and testimony from a federal case in which the FTC and one party participated and even investigational hearings in Part 2 investigations. This is meant to include proceedings like a related preliminary injunction case, but not a civil case in which the FTC did not participate.

Venue of Part 3 and Federal Proceedings.

Under the Rules, the ALJ can order that the trial occur in "more than one place."[36] The reality is that this almost never happens.[37] The apparent reason is that it is difficult for an ALJ at the FTC to hold hearings outside of DC when the same judge is managing other matters simultaneously. There is no ability for a respondent to ask for a different location due to convenience or expense.

Nevertheless, federal courts have often been willing to transfer preliminary injunction cases for forum non conveniens reasons.[38] Thus, in the appropriate case and even when the FTC refuses to file a case in a location that is convenient to the respondents and third parties, a respondent may be able to persuade a court to transfer the federal case to a more convenient location. Often a more convenient forum is also where the merging parties will find a court more sympathetic to their positions because it is more familiar with the local issues that may be relevant to the case. Transfer of venue may also help clarify that most of the actual discovery (*i.e.,* depositions) will occur locally and not in Washington, D.C.

Pre-Trial Discovery.

Part 3 discovery is fairly similar to that found in any complex federal court case, except that the ALJs typically allow for more motion practice and argument than most

35 Rule § 3.43(b).
36 Rule § 3.41(b)(1).
37 The current ALJ typically denies any such request unless both parties agree. *See, e.g., Polypore, available at* http://www.ftc.gov/os/adjpro/d9327/090324aljorddentrespmochangehearing.pdf.
38 A recent example is the *FTC v. Graco Inc.,* FTC Docket No. 9350, decision *available at* http://www.ftc.gov/os/adjpro/d9350/2120126gracomemo.pdf*; see also FTC v. Cephalon,* 551 F. Supp. 2d 21, 25 (D.D.C. 2008); *FTC v. Lab. Corp. of Am.*, No. 10-2053-RWR, 2010 U.S. Dist. LEXIS 141320 (D.D.C. Dec. 3, 2010).

federal judges would tolerate. Nevertheless, the ALJs have recently become quite responsive to motions and will rule quickly on every pending motion. In some rare cases, the ALJs will hear an emergency motion by phone but are not known to hear any motions in person or in the courtroom, except during the scheduled pre-trial conferences.

Depositions, requests to admit, interrogatories, depositions of company representatives and other standard discovery tools are quite typical.[39] Often depositions are videotaped, and much of the deposition record will be designated for the record at trial.[40] Depositions are often treated as evidence depositions (usually as admissions of an adverse party or of "unavailable" witnesses) that may be used extensively throughout the proceedings. As in federal court, counsel may sign subpoenas for witnesses (forms are provided by the Secretary's office). Document discovery is fairly normal, with a recent emphasis on imaging exhibits, which is also becoming more common in federal court.

Due to the fast pace of discovery, one must be careful not to wait until all documents are produced to begin depositions. The discovery period is just too abbreviated to stage each kind of discovery in that way. Moreover, one must be diligent to push for discovery responses, and if responses are not forthcoming, meet/confer and if necessary move to compel quickly. It is common for parties to find themselves at the end of discovery and find that the Rules and the ALJ will simply not allow them any more time.

The ALJ can limit the scope of discovery, upon motion, but, in general, discovery in Part 3 is far more expansive than one would typically see in federal court.[41] Third parties are often surprised by the difficulties they encounter in attempting to quash or limit discovery in response to a Part 3 subpoena. It would probably be more sensible for discovery not to be as broad as it is in most Part 3 proceedings, but the parties' and the ALJ's desire to create a record for the Commission and for an eventual appeal tends to expand the record and hence the discovery that creates it.

One note about expert discovery: It usually occurs after fact discovery and is also very quick. If a party is not preparing for expert discovery throughout the case, it will be caught short at the end. The ALJs are very diligent about excluding expert opinions that were not properly disclosed during the discovery period.

Other Pre-Trial Procedures.

Due to the bureaucratic nature of Part 3, it has become common for parties and third parties to file numerous motions during the discovery phase. Most of these motions are, frankly, useless and most are denied. The ALJs usually do not hear any argument on motions but are very quick to decide them (although they have 14 days to do so) and typically write multi-page opinions explaining the reasons for the decision.[42] Non-dispositive motions that go to the substance of the case (e.g., excluding experts or limiting evidence) are usually treated as motions in limine and are often decided at the final pre-trial conference or deferred until the issue arises at trial.[43]

39 *See* Rules §§ 3.31-3.39.
40 My own view is that videotaped depositions in Part 3 are usually a waste of money. Depositions are not read or played at trial, except in impeachment or perhaps at closing argument.
41 *See* Rule § 3.31(c)(2).
42 *See* Rule § 3.22, especially the page limits and timing for motions.
43 The current view of what motions in limine are in the Part 3 context is best described in a recent ALJ order in *McWane*, *available at* http://www.ftc.gov/os/adjpro/d9351/120814aljordgrantanddenyinpart.pdf.

Dispositive motions are generally referred to the Commission for decision. Due to the time limits for filing and for the Commission's response, it is almost impossible for either party to file and receive a decision on such a motion before the commencement of trial.[44]

Motions to settle the case through consent are also referred to the Commission for decision. If complaint counsel does not agree to the proposed settlement, a respondent may still file a motion to the ALJ who then will forward it to the Commission if the ALJ believes there is a reasonable possibility of settlement.[45] Then, only the Commission can decide to withdraw the case from Part 3 in order to discuss a potential consent order. If both complaint and respondent's counsel agree to the motion, and the motion complies with Rule 3.25, the Secretary will issue an order that withdraws the case from Part 3, usually for a set period of time so that the Commission and its staff can discuss the proposed consent order with the parties.[46]

There are some critical motions that one might need to make regarding exclusions of evidence or motions to compel (which are usually granted), but the bottom line is that the Rules of Practice were written in a way that makes it difficult, if not impossible, for the parties to use motion practice to avoid or delay a trial.[47] Thus, in my view, the parties should use motion practice sparingly and spend their time preparing for trial.

After fact discovery is concluded, the ALJ will hold a final pre-trial conference.[48] Those conferences have usually been quite lengthy, mostly because the ALJ is supposed to resolve evidentiary issues at that conference. Parties usually show up with their final witness lists and exhibits, along with hundreds of objections, and motions in limine. The ALJs have been quite diligent in moving through each and every issue. But one litany of discourse seems to occur in almost every pre-trial conference: parties often believe they can argue for the admission of each and every one of the thousands of exhibits on the proposed exhibit list. This is a foolish exercise. For good cause, the ALJ will exclude a category of evidence, but this is rare. Instead, after the parties argue for a few hours, the ALJ will undoubtedly tell the parties to work it out and come back with 2-3 narrow categories of argument, which will be heard and usually denied.

In the majority of cases, most relevant evidence will come in – even reliable hearsay. Under the current Rules of Practice § 3.43(b), ***all:***

> Relevant, material, and reliable evidence shall be admitted. Irrelevant, immaterial, and unreliable evidence shall be excluded. Evidence, even if relevant, may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or if the evidence would be misleading, or based on considerations of undue delay, waste of time, or needless presentation of cumulative evidence. Evidence that constitutes hearsay may be admitted if it is relevant, material, and bears satisfactory indicia of reliability so that its use is fair.

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44 *See* Rule § 3.22(a). In *McWane*, however, the Commission did provide its decision within the 45-day deadline set by Rule 3.22(a), and before the scheduled trial. *See* Commission Order, *available at* http://www.ftc.gov/os/adjpro/d9351/120809mcwaneorder.pdf.

45 Rule § 3.25(c).

46 *Id.*

47 As Rule 3.1 makes clear, the Commission's stated policy is to conduct Part 3 proceedings expeditiously and make every effort to avoid delay at any stage of the proceedings.

48 *See* Rule § 3.21(e).

> … If otherwise meeting the standards for admissibility described in this paragraph, depositions, investigational hearings, prior testimony in Commission or other proceedings, expert reports, and any other form of hearsay, shall be admissible and shall not be excluded solely on the ground that they are or contain hearsay.

In other words, unless there is a good reason to keep evidence out,[49] the ALJ is likely to allow for its admission. Documents from the parties are likely to be admitted (as admissions or business records), and third-party documents can easily be admitted with an appropriate declaration.[50]

The Trial and Aftermath.

Trials in Part 3 are often long and, with some exceptions, similar to bench trials in federal court. Most trials are held in the Commission's large hearing room, which looks like an older court room, but which has good video (LCD and plasma screens) and audio equipment and is supported by an excellent staff. The acoustics however are poor, and the large room is so packed with seating (usually empty chairs) that it has little space for any visual exhibit displays. But the electronic trial presentation system works well with trial presentation software.

The trial begins with opening statements of no more than 2 hours for each side, after which complaint counsel calls the first witness.[51]

Witnesses testify from a chair stuck in the far side of the front of the room, and counsel must question the witness from a large podium about thirty-five feet away. The witness, the ALJ, and each counsel table have LCD screens to see documents. But it is still common to give the witness a binder of hard copies of exhibits.

The day-to-day procedure in the hearing room is much like any bench trial. Nevertheless, trial in a Part 3 proceeding is generally a slow process. Trial days usually begin at 9:00 or 9:30 and end at 5:00-5:30, unless the ALJ agrees to continue the hearing to finish a witness's testimony. The ALJ will usually allow for a break in the morning, a lunch break, and one break in the afternoon. It is uncommon for counsel to put on more than two witnesses in a day. Counsel (against their own interest, in my view) often make numerous objections, which the ALJs often deal with in detail, allowing sometimes unnecessary and lengthy argument by counsel.

Witnesses are usually called just once, meaning that adverse witnesses called by complaint counsel are typically put on as witnesses on direct by respondent's counsel in the same session. Experts are usually not allowed to pretend they are fact witnesses (giving a second closing argument, as one might see in a jury case). Experts are usually confined to what work they actually did. Counsel are allowed to cross-examine any adverse party or witness.[52]

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49 *See, e.g., Intel Corp.*, Dkt. No. 9341, 2010 FTC LEXIS 45 (F.T.C. May 6, 2010) (ALJ order denying motion to admit the European Commission's decision on grounds of unfair prejudice, undue delay, and cumulativeness).
50 *See* Rule § 3.43(c).
51 Rule § 3.41(b)(5).
52 *See* Rule § 3.41(d).

As for the rules of evidence, the Commission's Rules of Practice give little guidance except to explain in Rule § 3.43(b) that "relevant, material, and reliable evidence shall be admitted. Irrelevant, immaterial, and unreliable evidence shall be excluded." One simply has to accept that the hearing is an administrative hearing under the APA, under which even reliable, relevant hearsay can be admitted.[53]

In the absence of a Rule or precedent, however, the ALJ will defer to the Federal Rules of Evidence and relevant case law from the federal courts or similar administrative tribunals. However, the purpose of Part 3 proceedings is to create the record for the Commission and thus it is more likely that evidence will be admitted.[54]

There are other reasons for voluminous records. For example, both complaint counsel and respondents know that the Commission will hear the case de novo, regardless of what the ALJ does, and also understand that even evidence that is rejected by the ALJ can still be used by the Commission.[55] It is also usually unclear which circuit court of appeals may have jurisdiction over an appeal, because under Section 11(c) of the Clayton Act[56] and Section 5(c) of the FTC Act,[57] a respondent may appeal to any circuit where the "violation occurred" (Clayton Act), where the "method of competition or the act or practice in question was used" (FTC Act), or where it "resides or carries on business." Moreover, in typical cases, that could include many, if not all, of the regional circuits. Thus, it is common for complaint counsel to attempt to put on evidence to support different theories of the case to ensure that the case will be affirmed on appeal.[58]

Despite the length of a typical trial, one must remember that it is a timed trial of approximately 30 trial days, unless extended by the Commission itself.[59] In the initial complaint, and in the Rules, the parties are given a limit of hours for the trial and are allowed an equal amount of time for asking questions, arguing motions, etc. A rebuttal case is almost always not allowed. Closings are generally scheduled for 2 hours per side no more than 5 days after the last filed proposed findings after trial.

Post-Trial Procedures.

At the conclusion of the trial (within 21 days of the closing of the hearing record), the parties must file proposed findings of fact and conclusions of law as well as a brief.[60] These are typically huge sets of documents that collectively number in the thousands of pages. It is critical for counsel to work with the court reporter to get daily transcripts and prepare the post-trial filings during the trial. There is simply not enough time to prepare such voluminous pleadings after closing argument.

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53 *FTC v. Cement Inst.*, 333 U.S. 683, 706 (1948) ("[A]dministrative agencies like the Federal Trade Commission have never been restricted by the rigid rules of evidence."); *In re Am. Home Prods. Corp.*, 1981 WL 389401, 98 F.T.C. 136 (Sept. 9, 1981) (Initial Decision) ("[U]nder the Commission's Rules of Practice, all relevant and material evidence – whether it is hearsay or not – is admissible, as long as it is reliable.").

54 The need for a record has also driven the ALJs to demand briefing on nearly every issue, even on small evidentiary issues that might be ruled on by a district judge during trial without even an argument. The lengthy findings of fact and conclusions of law are often several hundred pages long for each side. For example, the Proposed Findings of Fact and Conclusions of Law in *Chicago Bridge* (not including the briefs) were 214 pages (Complaint Counsel), *available at* http://www.ftc.gov/os/adjpro/d9300/030225cc findfactandconoflaw.pdf and 335 (Respondents), *available at* http://www.ftc.gov/os/adjpro/d9300/030327respcorrectfindoffact.pdf. Even recent cases, such as *Polypore* and *North Carolina Bd. of Dental Examiners*, FTC Docket No. 9343 (a less fact-intensive case), yielded post-trial briefing of 2,350 and 1,501 pages respectively.

55 *See* Rule § 3.43(i) (Offers of Proof).

56 15 U.S.C. § 21(c).

57 15 U.S.C. § 45(c).

58 *See, e.g., Realcomp II, Ltd. v. FTC*, 635 F.3d 815, 826-27 (6th Cir. 2011) (affirming the Commission's opinion based on the alternative full rule-of-reason analysis, rather than the principal quick-look analysis).

59 The general hearing rules are found in Rule § 3.41.

60 *See* Rule § 3.46, which contains numerous requirements for the filing.

Within 70 days (with some exceptions) of the filing of the last reply findings,[61] the ALJ issues what is called an Initial Decision, which because of the typically voluminous underlying record is usually lengthy as well.

Commission Appeal.

Once the trial has finished and an Initial Decision has issued, the process has only just begun. The Initial Decision is not binding on the Commission, which hears all cases de novo after briefing and oral argument.[62] The rules for appeal are quite detailed and must be followed strictly.[63] If the respondent loses the appeal, it may then appeal to any circuit court of appeals in which the "violation occurred" or in which they "reside or conduct business."[64] Factual findings by the Commission, "if supported by evidence, shall be conclusive."[65] Moreover, courts will generally defer to the Commission's choice of a remedy.[66]

Conclusion.

This brief overview should give the reader a hint that Part 3 procedures are complex, and the process begins with a rapid discovery process and ends with a lengthy trial and potentially, a lengthy process for appeal. But the process can be quite fair if one understands the rules well and prepares for trial early in the case – optimally, before the complaint is even issued.

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61 Rule § 3.51(a).
62 Rule § 3.54(b) (Commission "will adopt, modify, or set aside the findings, conclusions and rule or order contained in the initial decision").
63 *See* Rule § 3.52.
64 15 U.S.C. § 21(c). *See also* 15 U.S.C. § 45(c).
65 *Id.*; *FTC v. Algoma Lumber Co.*, 291 U.S. 67, 73 (1934). *Cf. Schering Plough Corp. v. FTC*, 402 F.3d 1056 (11th Cir. 2005) (court choosing the fact finding of the ALJ over that of the Commission).
66 *Jacob Siegel Co. v. FTC*, 327 U.S. 608, 611 (1946); *Polypore Int'l, Inc. v. FTC,* 686 F.3d 1208, 1218-19 (11th Cir. 2011).

ANTITRUST JUDGMENTS IN BENCH TRIALS AS EVIDENCE: THE UNINTENDED CONSEQUENCES OF SECTION 5(A)

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I. INTRODUCTION

When the Antitrust Division of the Department of Justice files a civil lawsuit challenging the conduct of a defendant, the government has the authority under Section 4 of the Sherman Act[2] to obtain an injunction against the challenged conduct but not to seek damages unless the conduct has injured the government as a purchaser itself.[3] It is inevitable that, after the government files such a case, private parties will file follow-on treble damages litigation.

It is the rare government case that goes to trial, but when a defendant does take that risk, the result of the trial has an important effect on the follow-on treble damages litigation. Private plaintiffs can use a government judgment against the defendant as prima facie evidence of liability under Section 5(a) of the Clayton Act[4], as long (1) the judgment is one "under the antitrust laws"[5] and (2) the judgment is entered after testimony is taken, i.e., either after trial or after trial has started. Private plaintiffs naturally prefer to await the result of the government case before prosecuting their own so that they can take advantage of this provision. Also contributing to the primacy of the government case is the difficulty, if not impossibility, of consolidating the government and private suits for trial even if all parties agree that it is a good idea to do so. "Congress has articulated a strong public policy against combining antitrust complaints brought by the government with private antitrust damages suits." *United States v. Dentsply, Int'l Inc.*, 190 F.R.D. 140 (D. Del. 1999) (denying motion to consolidate private suits with government antitrust case on the basis of the explicit preclusion of such consolidation in the statute authorizing pretrial multidistrict consolidation, 28 U.S. C. § 1407(g)). And, under the current version of Section 5(a), plaintiffs also can use collateral estoppel to preclude a defendant from re-litigating any issue necessarily and finally decided in the government case.

Since the government's case is equitable in nature, it is tried to the bench, without a jury. But the follow-on treble damages case, if tried, would be presented to a jury. If a

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2 15 U.S.C. § 4.
3 The government may, however, seek damages on its own behalf if the defendants' conduct has injured the government in its business or property.
4 15 U.S.C. § 16(a).
5 The limitation on the use of judgments to those obtained "under the antitrust laws" means that plaintiffs cannot use judgments that the Federal Trade Commission obtains, whether in a district court or administratively, as prima facie evidence of the defendant's liability. *See, e.g.*, *Y & Y Popcorn Supply Co. v. ABC Vending Corp.*, 263 F. Supp. 709, 713 (E.D. Pa. 1967) (concluding that a plaintiff could not invoke § 5(a)'s rebuttable presumption following entry of a judgment under Section 5 of the FTC Act because Section 5 is not an antitrust law); *Minnesota Mining & Manufacturing v. New Jersey Wood Finishing*, 332 F.2d 346 (3d Cir. 1964) (same).

defendant loses its case to the government after a bench trial, the private plaintiffs can invoke Section 5(a) as conclusive proof of issues decided in the prior case, and as prima facie evidence of liability on any other liability issues in the subsequent jury trial. That means that, in the follow-on jury trial, the defendant cannot contest most issues, and, on those that it can contest, the burden shifts to the defendant to rebut the plaintiffs' prima facie case. This circumstance seems to limit a defendant's constitutional right to a trial by jury since the burden of proof is dictated by the findings of a judge in a bench trial.

This paper explores the interrelationship between a verdict in the government's case and the use of that verdict in follow-on treble damages litigation. We first look for guidance in the origins of Section 5(a), and in the evolution of the jury trial right in cases with mixed legal and equitable claims. We then establish that Section 5(a)'s unintended consequences outweigh the benefits that informed Congress' view of the advisability of the provision in the first place. Finally, we offer some concluding thoughts.

II. THE GOVERNING PRINCIPLES

A. The Origin of Section 5(a)

Congress enacted Section 5(a) in 1914 as part of the Clayton Act. At that time, under the principle of "mutuality," a plaintiff could not use the doctrine of collateral estoppel to prevent a defendant from re-litigating an issue that it had lost in a previous trial, unless the plaintiff was a party in the previous action against the defendant. Private plaintiffs that brought follow-on civil treble damages claims therefore could not benefit from a finding of liability in a preceding government action because they had not been parties to the government suit. In addition, the federal rules did not permit collective actions in the same way that they do today; Congress did not adopt a form of the present Rule 23 until 1938.[6] Without an established class action framework, private plaintiffs were left to take on large corporate defendants on their own. They faced the prospect of lengthy trials regardless of whether the defendants had previously been found liable for the same conduct in an action brought by the government. And, even if the defendant had been found liable in the government action, the plaintiff had to prove up every element of its antitrust claim.

To address these perceived problems, Congress enacted Section 5 of the Clayton Act to increase the effectiveness of the Clayton Act's treble damages provision in two ways. First, under Section 5(a), "a final judgment or decree" from "any suit or proceeding in equity" brought by or for the United States for a violation of the antitrust laws would be "prima facie evidence" against the defendant in a subsequent, private treble damage suit. Second, pursuant to Section 5(b), the statute of limitations would be tolled or suspended during the pendency of the government litigation. Together, Congress intended for these elements to provide incentives to private parties to pursue punitive treble damages claims in follow-on civil actions.

B. The Evolution of the Right To A Jury Trial In Cases With Mixed Legal and Equitable Claims

There is no indication in Section 5(a)'s legislative history that Congress considered the question of how the new statute might affect a defendant's right to a jury trial in a

6 See Advisory Committee Notes to Subdivision A of former Rule 23 (1937).

subsequent private damages suit. But, at that time, despite the perceived importance of the right to a jury trial, there were circumstances in which that right could be compromised without running afoul of the Seventh Amendment. For many years, for example, courts struggled with the role of a jury trial in the resolution of cases that included both legal and equitable claims. Three competing rules emerged regarding the sequence of trials in cases with both legal and equitable issues. One line held that the determination of the sequence of trial should be left to the absolute discretion of the trial judge. *See Orenstein v. United States,* 191 F.2d 184, 190 (1st Cir. 1951). A second held that the nature of the "basic issue" should control, so if the "basic issue" was equitable, the bench trial preceded the jury trial. *See Reliance Ins. Co. v. Everglades Discount Co.*, 204 F.2d 937 (5th Cir. 1953). A third held that in the absence of special circumstances, factual issues common to both legal and equitable claims must be tried to a jury. *See Leimer v. Woods*, 196 F.2d 828 (8th Cir. 1952).

In *Beacon Theaters v. Westover*,[7] the Supreme Court began to tackle the application of the Seventh Amendment jury right to cases that raised both legal and equitable claims. In *Beacon,* the defendant in a declaratory judgment action asserted a counterclaim and cross-claim under the Sherman Act, requested treble damages, and demanded a jury trial to resolve the factual issues. The district court, however, denied the defendant's jury trial demand because the issues raised by the complaint were "essentially equitable"[8] and should be tried to a judge first. The defendant petitioned the Ninth Circuit for a writ of mandamus to require the district court to set aside its ruling, but the Ninth Circuit affirmed.[9]

The Supreme Court reversed the Ninth Circuit and granted the defendant's petition for a writ of mandamus to order the district court to try the legal claim first. The Court reasoned that a plaintiff could not eliminate a defendant's jury trial right by "blending" a "claim, properly cognizable at law" with a "demand for equitable relief in aid of the legal action."[10] Such a practice, the Court explained, would allow a plaintiff to effectively use the Declaratory Judgment Act to displace the "substantive right" to a jury trial afforded by the Seventh Amendment, which was precisely the opposite of what Congress intended.[11] Thus, where legal and equitable claims are joined in the same action, the Court held that the trial court has only limited discretion in determining the sequence of trial, and "that discretion . . . must, wherever possible, be exercised to preserve jury trial."[12]

Three years later, in *Dairy Queen, Inc. v. Wood*, the Supreme Court expanded on the jury trial principles announced in *Beacon Theatres*.[13] Dairy Queen sought an injunction against a defendant which continued to operate his business in violation of the Dairy Queen trademark. Dairy Queen also sought an accounting to determine the exact amount of money that the defendant owed it. The defendant demanded trial by jury, which the district court denied and the Court of Appeals affirmed.

The Supreme Court reversed and held that *Beacon Theatres* applied whether or not the trial judge chose to characterize the legal issues presented as "incidental" to equitable issues. Further, the Court held, under *Beacon Theatres*, any legal issues for which a trial by jury was timely, and properly demanded, must be submitted to a jury.[14] Construing the sole

7 *Beacon Theaters v. Westover*, 359 U.S. 500 (1959).
8 *Id.* at 503.
9 *Beacon Theaters v. Westover*, 252 F.2d 864 (9th Cir. 1958).
10 359 U.S. at 510.
11 *Id.* at 508-509 ("Our decision is consistent with the plan of the Federal Rules and the Declaratory Judgment Act to effect substantial procedural reform while retaining a distinction between jury and nonjury issues and leaving substantive rights unchanged.").
12 *Id.* at 510.
13 369 U.S. 469, 479 (1962).
14 *Id.* at 473.

question presented to be whether the action contained any legal issues, the Court concluded that the request for a money judgment was a claim that is "unquestionably legal."[15] Thus, the Court held, the Seventh Amendment entitled the defendant to a trial by jury on the factual issues relating to whether the defendant breached the trademark licensing agreement.

Beacon Theaters and *Dairy Queen* hold that if the *same case* raises both legal and equitable claims, the defendant has the right to have the jury claims tried first. Those cases, however, did not address the circumstances presented when a government judgment precedes a civil damages trial. In this context, there are *two different cases* with *two different plaintiffs*. And, the government's case is typically tried first to the bench. Thus, *Beacon Theaters'* directive on sequencing the trial of legal and equitable claims did not apply to preserve the jury trial right in the subsequent private case.

Several lower federal court cases explored this issue in some detail after *Beacon Theatres*. In *Rachal v. Hill*,[16] the Securities Exchange Commission obtained injunctive relief against the defendant for violations of federal securities laws. The plaintiff then brought a follow-on civil class action against the defendant to recover damages based on the same legal theory. The defendant claimed it had a right to have the damages claims tried to a jury. The district court, however, concluded that the defendants had had a full and fair opportunity to litigate the liability issue. The court held that the defendants were collaterally estopped from denying liability and granted the plaintiff's summary judgment motion. The Fifth Circuit reversed. The court observed that *Beacon Theatres* stood for the principle that a litigant has a right to have legal claims tried first to a jury in an action where legal and equitable claims are joined. As such, the court reasoned, it would be "anomalous" after *Beacon Theatres* to hold that a litigant could lose his constitutional right to a jury trial because of a prior adverse determination in an equitable, nonjury proceeding.

In *McCook v. Standard Oil Co. of California*,[17] a court confronted similar facts, but in an antitrust context. Following a successful government litigation against Standard Oil,[18] the plaintiff argued that the liability finding should collaterally estop the defendant from denying that it had violated the antitrust laws. The court disagreed. It identified three obstacles to applying collateral estoppel in this context: (1) the elimination of Standard Oil's jury trial right; (2) the *Rachal* holding, which held that collateral estoppel could not deprive a defendant of its jury trial right; and (3) the presence of Section 5(a), which, in the court's view, defined the use of the government judgment in a private case as prima facie evidence. The court held that, as a matter of judicial policy, it would be inappropriate to permit a plaintiff to collaterally estop a defendant from contesting liability where (1) Congress had expressed a preference for the Section 5(a) prima facie standard instead and (2) doing so would prevent the defendant from exercising its jury right, through no procedural fault of its own. "Therefore, the court conclude [d] that the strong public policy favoring jury trials preclude[d] the court from applying the doctrine of collateral estoppel . . . because Standard Oil did not have a right to try its case before a jury in the prior government action."[19]

15 *Id.* at 476.
16 435 F.2d 59 (5th Cir. 1970).
17 393 F. Supp. 256 (C.D. Cal. 1975).
18 *United States v. Standard Oil Co. of California*, 362 F. Supp. 1331 (N.D. Cal. 1972).
19 393 F. Supp. at 258; *id.* at 259 (noting because of the "public policy in favor of jury trials growing out of the Seventh Amendment," *Rachal* could be read as creating a "judicial policy exception to the general doctrine of collateral estoppel," not mandated by the Seventh Amendment, but by notions of basic fairness).

C. *Parklane Hosiery*: The Jury Trial Right and the Principle of Collateral Estoppel On A Collision Course

These cases, essentially limiting the application of collateral estoppel, were inconsistent with developing law that was extending it. In *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation*, 402 U.S. 313 (1971), for example, the Supreme Court held that a plaintiff could take advantage of collateral estoppel even if it had not participated in a prior litigation against the defendant, eliminating the requirement of "mutuality." Without the requirement that a private plaintiff must have participated in a government suit in order to use collateral estoppel against a defendant, the issue of whether it was constitutionally permissible to eliminate a defendant's right to a jury trial on issues litigated in the government case was presented squarely.

Similarly, the Supreme Court granted certiorari in *Parklane Hosiery Co. v. Shore*,[20] to resolve whether the jury trial right precluded a plaintiff from using collateral estoppel to prevent a defendant from re-litigating issues that it had lost in a prior government suit. In *Parklane*, a stockholder's class action sued a corporation on allegations that the corporation issued a false and misleading proxy statement. Soon thereafter, the SEC sued the same corporation based on substantially similar factual allegations. Although the two cases were filed in the same district, they were assigned to different judges. A bench trial was held in the SEC suit, and the district court found the defendants liable. In the private litigation, the plaintiffs then filed for summary judgment on the ground that the corporation was precluded from re-litigating the same issue in that suit.

On appeal, the Second Circuit held, and the Supreme Court affirmed, that the Seventh Amendment did not bar the application of collateral estoppel in a follow-on case for damages, where the defendant's prior liability finding arose in a bench trial. As to *Beacon* Theaters and *Dairy Queen*, the court noted that those cases established "a general prudential rule" in favor of a jury trial but not an absolute one.[21]

D. Moving Forward: Section 5(a)'s Application post-*Parklane*

In the antitrust context, two issues existed after *Parklane*. First, since Congress had provided in Section 5(a) that a government judgment is prima facie evidence of liability in a subsequent damages case, could a plaintiff also collaterally estop a defendant from re-litigating issues that it had lost in the government case, using the decree as conclusive proof instead of just prima facie evidence? Prior to 1980, Section 5(a) was silent as to the collateral estoppel effect of a government judgment. Some courts held that Congress intended that Section 5(a) supplant the common law principles of collateral estoppel under which a court could give not only prima facie but conclusive effect to government judgment. *Illinois v. General Paving Co*., 590 F.2d 680, 682-832 (7th Cir. 1979). Congress amended Section 5(a) in 1980 to make clear that a plaintiffs' ability to use a government judgment as prima facie evidence of liability was in addition to any collateral estoppel rights that it may have.

Second, *Parklane* arose under the securities laws, so it did not address the jury trial right in connection with Section 5(a)'s provision that a government judgment is prima facie evidence of liability. While *Parklane* permits a private plaintiff to collaterally estop a defendant from re-litigating issues "necessarily and finally" decided in the previous

20 439 U.S. 322 (1979).
21 *Id*. at 334 (quoting *Beacon Theatres*, 359 U.S. at 510).

government case, that does not mean that the private antitrust plaintiff only has to prove up its damages to win the subsequent case. To prevail in an antitrust case, a private plaintiff, in addition to proving up the antitrust violation, must also establish that the violation injured it in its business or property. *See Story Parchment v. Paterson Parchment Paper Co.*, 282 U.S. 555, 563 (1931). "[T]he issue of liability in antitrust cases includes not only the question of violation, but also the question of fact of injury, or impact." *Alabama v. Blue Bird Body Co., Inc.* 573 F.2d 309, 320 (5th Cir. 1978). The government need not prove that issue in order to win its case. *See Howard Hess Dental Laboratories, et. al. v. Dentsply Int'l Inc.*, 602 F. 3d 237, 248 (3d Cir. 2010) (affirming that the issue of injury to private plaintiffs was not necessary to the judgment in favor of the government in previous case).

Thus, a plaintiff's ability to introduce a government judgment as prima facie evidence of liability is broader than its collateral estoppel right, and thus directly impacts a defendant's right to a jury trial on its claims. The private plaintiff may also be pursuing theories or causes of action not determined in the government case, and the presence of a government decree in such a trial may affect the fairness of the second proceeding.

III. AN ARGUMENT FOR RETIRING THE "PRIMA FACIE EVIDENCE" STANDARD OF SECTION 5(A)

As the evolution of the law from *Beacon Theaters* through *Parklane Hosiery* suggests, Section 5(a) as it now stands exists in a completely different enforcement and common law framework from when Congress enacted it. Specifically, in 1914:

- The Antitrust Division of the Department of Justice was the only active enforcement agency. The Federal Trade Commission existed on paper only.

- The federal rules of procedure did not contain a provision that permitted plaintiffs to bring class actions. Private plaintiffs injured by antitrust violations had to pursue their damages claims against corporate defendants independently.

- Perhaps most importantly, mutuality was a central element of collateral estoppel. In other words, Congress arguably enacted Section 5(a) to fill a void that no longer exists.

Given these changes, it is not clear that the "prima facie" evidence standard in Section 5(a) continues to make sense. To the contrary, rather than providing a counter-balance to a decidedly pro-defendant legal system as Congress intended in 1914, the evolution of collateral estoppel law combined with Section 5(a) now means that the thumb sits doubly on the plaintiff's side of the scale when it comes to follow-on cases. The plaintiff can collaterally estop a defendant from re-litigating issues finally decided in the government case, and can introduce the judgment as prima facie evidence of injury (or any other issues not decided in the government case), shifting the burden to the defendant to rebut that issue. This result gives the plaintiff far more advantage than the application of collateral estoppel does, and eliminates the defendant's right to have the plaintiff prove its own injury to a jury.

There are three arguments for amending Section 5(a) to eliminate the "prima facie evidence" standard and leave use of the judgment to collateral estoppel principles. We address each below.

A. Section 5(a) Creates Confusion for Judges and Juries

Section 5(a) does not specify the evidentiary treatment of a prior government judgment in an antitrust case. In 1915, the Supreme Court summarized Section 5(a)'s operation as follows:

> [Section 5] establishes a rebuttable presumption. It cuts off no defense, interposes no obstacle to a full contestation of all the issues, and takes no question of fact from either court or jury. At most, therefore, it is merely a rule of evidence. It does not abridge the right of trial by jury or take away any of its incidents. Nor does it in anywise work a denial of due process of law.[22]

That application sounds straightforward enough. The problem, however, is the application of a rebuttable presumption in a jury trial where the only issues are injury and damages because the defendant is collaterally estopped from contesting the substantive violation. There are no assurances that a jury will not accord a liability finding undue weight in the follow-on litigation therefore effectively diluting the defendant's right to present a defense on the impact issue, or any other issue not decided in the government case. Indeed, courts frequently rely on Rule 403 of the Federal Rules of Evidence[23] to exclude otherwise admissible evidence (including related judgments) in civil contexts on the basis that the evidence, though relevant (1) would tend to confuse the jury[24] or (2) would permit the jury to decide a case based on a prior finding instead of basing its verdict on the evidence presented in the subsequent case.[25] A handful of courts applying Section 5(a)'s prima facie standard have expressed similar concerns.[26]

The risk of juror confusion that predominates these Rule 403 decisions exists every time Section 5(a) is applied. To be sure, a judge may attempt to limit the weight a jury accords to a prior finding by including a limiting instruction.[27] But it is not at all clear that the burden this places on the jury in the first instance leads to any salient benefit.

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22 *Meeker & Co. v. Lehigh Valley R.R.*, 236 U.S. 412, 430 (1915).

23 Rule 403 states:

> The court may exclude relevant evidence if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence.

FED. R. EVID. 403.

24 *See, e.g.*, *United States Football League v. National Football League*, 842 F.2d 1335, 1372-73 (2d Cir. 1988) (court was "wary of allowing a trier of fact to draw inferences of intent from the outcome of prior lawsuits in an area so fraught with uncertainty and doubt"); *Diaz v. Cianci*, 737 F.2d 138, 139 (1st Cir. 1984) (upholding trial court's exclusion of prior adjudications under Rule 403); *Brownko Int'l, Inc. v. Ogden Steel Co.*, 585 F. Supp. 1432, 1436 (S.D.N.Y. 1983) (ambiguous arbitration award excluded by trial court because "confusion of issues could clearly arise, the jury being led into the inappropriate function of relitigating the arbitration").

25 *See, e.g., Roche Diagnostics Operations, Inc. v. Abbott Diabetes Care*, 756 F. Supp. 2d 598, 605 (D. Del. 2010) ("The admission of a prior verdict creates the possibility that the jury will defer to the earlier result and thus, will not effectively, decide a case on evidence not before it"); *St. Clair Intellectual Prop. Consultants v. Fuji Photo Film Com., Ltd.*, 674 F. Supp. 2d 555, 2009 U.S. Dist. LEXIS 108679, *7 (D. Del. Nov. 19, 2009) (same); *see also Porous Media Corp. v. Pall Corp.*, 173 F.3d 1109, 1117-18 (8th Cir. 1999) (same); *Coleman Motor Co. v. Chrysler Corp.*, 525 F.2d 1338, 1351 (3d Cir. 1975) ("A jury is likely to give a prior verdict against the same defendant more weight than it warrants."); *City of New York v. Pullman, Inc.*, 662 F.2d 910, 915 (2d Cir. 1981) (administrative report properly excluded under Rule 403 because "the report would have been presented to the jury in 'an aura of special reliability and trustworthiness' which would not have been commensurate with its actual reliability").

26 *See, e.g.*, *Buckhead Theatre Co. v. Atlanta Enters.*, 327 F.2d 365, 368 (5th Cir. 1964) ("This is a circumstance that must be taken into consideration by any court if it is to have any discretion as to the admission of evidence, which, while having some probative value, may also have extremely prejudicial effect by reason of non-relevant matters that would inevitably be presented to the jury if the evidence were to be admitted.").

27 *Emich Motors Corp. v. General Motors Corp.*, 340 U.S. 558, 571 (1951) (noting in a Section 5(a) case that "[i]t is the task of the trial judge to make clear to the jury the issues that were determined against the defendant in the prior suit, and to limit to those issues the effect of that judgment as evidence in the present action").

B. Taking Testimony and the *Microsoft* Consent

Second, while there has been little substantive law developed in conjunction with Section 5(a), one issue that has been the subject of some debate is the fact that Section 5(a) does not "apply to consent judgments or decrees entered before *any testimony has been taken*." Although the reasoning behind this rule makes sense insofar it seeks to prevent prima facie liability or collateral estoppel from attaching where evidence was not presented, there is not complete agreement as to what this phrase means. On the one hand, reading this phrase literally, some courts have read it to mean that once a trial begins and the defendant settles, the ensuing settlement agreement is admissible under Section 5(a).[28]

Conversely, however, in the *Microsoft* litigation, the district court concluded that a settlement entered into between the DOJ and Microsoft was a "consent decree" within the meaning of the Tunney Act and Section 5(a), notwithstanding the fact that it followed a trial.[29] As one article has since noted, "characterizing the proposed settlement of a case after litigation has taken place as a Tunney Act proceeding may deprive subsequent treble damage action plaintiffs of the use of the 'final judgment or decree' in subsequent litigation, in violation of the express language of 5(a) of the Clayton Act."[30]

Given the government's increasing desire to challenge anticompetitive conduct and the extent to which a settlement after testimony will cost the defendant a finding of collateral estoppel or, at least, prima facie liability, the ambiguity surrounding this phrase could benefit from statutory clarification. Otherwise, a defendant will have no choice but to settle sooner than it might otherwise need to or want to in order to limit its financial exposure.

C. Section 5(a) Reinforces the "Two-Antitrust Agency" Problem

The best illustration of why Section 5(a) reflects bad policy is its differing application to FTC and DOJ proceedings. The statute treats FTC and DOJ findings differently in two respects. First, the prima facie standard only applies to government actions brought "under the antitrust laws."[31] This was of no moment when Congress enacted Section 5(a) in 1914 because Congress had yet to create the FTC let alone enact Section 5 of the FTC Act, which is the agency's principle statute for challenging anticompetitive conduct. When Congress enacted Section 5 in 1914, it elected not to amend the definition of "antitrust law" provided in Section 1 of the Clayton Act.[32] As a result, courts have uniformly held that FTC orders based on Section 5 of the FTC Act are not brought "under the antitrust laws" and are therefore outside of Section 5(a)'s scope.[33] This carve out proves significant because the FTC's principle authority for challenging anticompetitive conduct is *Section 5 of the FTC Act*. Section 5(a)'s prima facie standard essentially has no effect when it comes to FTC's challenges to anticompetitive conduct.[34]

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28 *See, e.g., Ambook Enters. v. Time Inc.*, 612 F.2d 604, 612-13 (2d Cir. 1979); *Sablosky v. Paramount Film Distrib. Corp.*, 137 F. Supp. 929, 935 (E.D. Pa. 1955). *See also Michigan v. Morton Salt Co.*, 259 F. Supp. 35, 65 (D. Minn. 1966) (admitting a civil consent decree against one of several defendants after concluding that the consent decree had been "entered after testimony was taken" for purposes of Section 5(a) based on the plaintiff's submission of testimony previously taken from the defendant in a related criminal case in which the defendant and others had been acquitted).

29 *Microsoft II: Final Judgment*, 231 F. Supp. 2d 144, 150 (D.D.C. 2002).

30 J. Flynn & D. Bush, *The Misuse and Abuse of the Tunney Act: The Adverse Consequences of the "Microsoft Fallacies,"* 34 LOY. U. CHI. L.J. 749, 800 (2003).

31 15 U.S.C. § 16(a).

32 15 U.S.C. § 12 (defining "antitrust laws" and not including the Federal Trade Commission Act, which promulgated Section 5).

33 *See, e.g.*, *Y & Y Popcorn Supply Co. v. ABC Vending Corp.*, 263 F. Supp. 709, 713 (E.D. Pa. 1967) (concluding that a plaintiff could not invoke § 5(a)'s rebuttable presumption following entry of a judgment under Section 5 of the FTC Act because Section 5 is not an antitrust law); *Minnesota Mining & Manufacturing v. New Jersey Wood Finishing*, 332 F.2d 346 (3d Cir. 1964) (same).

34 A few courts have held that the prima facie presumption applies to FTC orders in proceedings brought under the Clayton Act which is "an antitrust law." *See Purex Corp. v. Proctor & Gamble Co.*, 453 F.2d 288 (9th Cir. 1971) (private litigation related to FTC merger challenge).

Second, as a result of amendments made by the Antitrust Procedural Improvements Act of 1980, Section 5(a) states that collateral estoppel will not apply to any finding made by the FTC "under the antitrust laws or under section 5 of the Federal Trade Commission Act which could give rise to a claim for relief under the antitrust laws." In short, Congress determined that defendants in a private antitrust suit should not be subject to liability without the evidence first being tested through the discovery, evidentiary, and trial procedures applicable in the federal courts.

In isolation, both of these FTC carve outs make sense. Their cumulative practical effect, however, is that Section 5(a)'s prima facie and collateral protections apply only to judgments rendered in litigations brought by the DOJ. Given the active nature of *both* the FTC and the DOJ when it comes to conduct investigations, such a one-sided rule is hard to justify. If the DOJ obtains a finding that Company A is liable under Section 2 of the Sherman Act for monopolization, a private plaintiff can then use that finding to claim that Company A is collaterally estopped in follow-on private litigation and to argue that the defendant is prima facie liable. If, however, the FTC successfully obtains a finding that Company B is liable under Section 5 of the FTC Act *based on the very same conduct*, a private plaintiff cannot use that finding for collateral estoppel or prima facie effect against Company B. Company A and Company B effectively stand in very significantly different situations in private litigation.

Moreover, and just as significantly, the disparate application of collateral estoppel under Section 5(a) arguably changes the incentives for a defendant to settle the government litigation depending on which agency obtains clearance: whereas Company B (the FTC defendant) need only think about all of the standard risks in settling versus litigation, Company A (the DOJ defendant) must weigh heavily the risk that it will be collaterally estopped from contesting a liability finding in private treble damages litigation.

In short, Section 5(a) situates two defendants that end up at different agencies in substantively different positions. Indeed, as to the follow-on private litigation, their rights to put on a defense are not remotely the same. Whether or not that rises to a due process violation, we believe it is, at a minimum, bad antitrust policy.

IV. CONCLUSION

It is unfortunate that the Supreme Court's decisions in *Beacon Theaters*, *Dairy Queen*, and *Parklane*, have been read not as protecting a judge's discretion to provide a jury trial where possible, but as holding that a plaintiff's entitlement to collateral estoppel is a trump card. Rightly or wrongly, that outcome means that private plaintiffs are not without a means to obtain an expeditious judgment on liability following a related bench trial if they meet the elements of common law collateral estoppel. In 1914, that was not the case. In short, the entire problem that Section 5(a) was designed to cure – the need to provide incentives to plaintiffs to bring antitrust treble damage cases – no longer exists. It is hard to identify any benefits that the prima facie standard aspect of Section 5(a) adds that outweigh the challenges that we have identified here.

A step in the right direction would be to give judges back the discretion to hold jury trials that litigants have construed *Parklane* and its progeny as taking away. Rather than stating that a finding of liability will be prima facie evidence of liability, Congress could suggest in Section 5(a) that it is within the judge's discretion to decide whether the competing objectives of expediency (which plaintiffs desire) and due process (which defendants desire) are better served by a bench trial or a jury trial. At a minimum, this would give those defendants that are not subject to collateral estoppel an opportunity to argue for the full hearing to which, but for the government suing first, they would otherwise be entitled to have.

CHANGING THE WAY WE TRY MERGER CASES

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I was sworn in as a FTC Commissioner at the beginning of 2006. Just before that time the Antitrust Division had lost a number of merger cases that it felt it should have won.[1] Similarly, the Commission had lost a number of merger cases it thought it should have won.[2] Moreover, the Agencies had not won a single hospital merger case in nearly a decade.[3] Not surprisingly, then, the staffs of both Agencies were somewhat dazed and gun shy about trying merger cases.

As a career trial lawyer, I had faced some of the best plaintiffs' lawyers in the country. For example, they include Mike Khourie in *England v. Chrysler Corp.*,[4] *Jenkins v. Gray Line*, and *Polara Enterprises, Inc. v. United States Golf Association*,[5] a non-merger case; Joe Alioto, Jr. in *Ringsby v. Trucking Employers, Inc.*,[6] who was joined by Dan Shulman in *Reilly v. Hearst Corp.*, a merger case involving the *San Francisco Chronicle* and the *San Francisco Examiner*;[7] and Fred Furth in numerous cartel cases against Continental Can in the 1980s. I figured we at the Commission could learn a lot from them. On the other hand, I had faced a number of plaintiffs' lawyers who weren't so skilled. I think, for example, of the plaintiffs' lawyers in the *Brand Name Prescription Drugs* case, which we tried to a Chicago jury for eight weeks in the late 1990s;[8] and of most (not all) of the Justice Department team in the *Oracle* case, which we tried to Judge Walker in 2004.[9] I figured I could learn from their mistakes how *not* to try an antitrust case.[10]

* The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisor, Henry Su, for his invaluable assistance in preparing this paper. (I served as FTC Commissioner from 2006 - 2013.)

1 *See* United States v. Oracle Corp., 331 F. Supp. 2d 1098 (N.D. Cal. 2004); United States v. SunGard Data Sys., Inc., 172 F. Supp. 2d 172 (D.D.C. 2001); United States v. Engelhard Corp., 970 F. Supp. 1463 (M.D. Ga.), *aff'd*, 126 F.3d 1302 (11th Cir. 1997).

2 *See* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109 (D.D.C. 2004); FTC v. H.J. Heinz Co., 116 F. Supp. 2d 190 (D.D.C. 2000), *rev'd*, 246 F.3d 708 (D.C. Cir. 2001).

3 *See* FTC v. Tenet Healthcare Corp., 186 F.3d 1045 (8th Cir. 1999), *rev'g* 17 F. Supp. 2d 937 (E.D. Mo. 1998); United States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121 (E.D.N.Y. 1997); FTC v. Butterworth Health Corp., 946 F. Supp. 1285 (W.D. Mich. 1996), *aff'd*, 121 F.3d 708 (6th Cir. 1997) (unpublished per curiam decision *at* No. 96-2440, 1997 U.S. App. LEXIS 17422); United States v. Mercy Health Servs., 902 F. Supp. 968 (N.D. Iowa 1995), *vacated as moot*, 107 F.3d 632 (8th Cir. 1997); FTC v. Freeman Hosp., 911 F. Supp. 1213 (W.D. Mo.), *aff'd*, 69 F.3d 260 (8th Cir. 1995); FTC v. Univ. Health, Inc., No. CV-191-052, 1991 U.S. Dist. LEXIS 19299 (S.D. Ga. Apr. 11, 1991).

4 493 F.2d 269 (9th Cir. 1974).

5 No. C-78-1320-RHS, 1984 U.S. Dist. LEXIS 21475 (N.D. Cal. Dec. 5, 1984).

6 760 F.2d 276 (9th Cir. 1985).

7 107 F. Supp. 2d 1192 (N.D. Cal. 2000).

8 *In re* Brand Name Prescription Drugs Antitrust Litig., No. 94-C-897, 1999 U.S. Dist. LEXIS 550 (N.D. Ill.), *aff'd in part & rev'd in part*, 186 F.3d 781 (7th Cir. 1999).

9 United States v. Oracle Corp., 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

10 *See generally* J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, Lessons Learned from *United States v. Oracle Corp.*, Remarks Before the Antitrust in the High Tech Sector: Mergers, Enforcement and Standardization Conference (Jan. 31, 2012), http://www.ftc.gov/speeches/rosch/120131oraclelessons.pdf; J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, Can Antitrust Trial Skills Really Be "Mastered"? Tales out of School About How to Try (or Not to Try) an Antitrust Case, Remarks Before the ABA Section of Antitrust Law Antitrust Masters Course (Sept. 30, 2010), http://www.ftc.gov/speeches/rosch/100930roschmasterscourseremarks.pdf.

So I tried to rectify things once I joined the Commission as a Commissioner. At first, I ran into some resistance from the staff. I was told, for example, that they'd "outlast" me. Maybe so, but that did not mean they were trying merger cases the right way. And they weren't. They were relying for the most part on customer and competitor testimony to make their cases. That was understandable. That is what they had been taught to do, and old habits die hard.[11]

But that wasn't what I had learned from the A-plus plaintiffs' trial lawyers. In fact, when the lead lawyer for the Antitrust Division in the *Oracle* case told Judge Walker that his best witnesses were the customer witnesses,[12] I was pretty sure we had that case won because that wasn't how the A-plus lawyers tried their cases. Judge Walker has subsequently confirmed my litigation instincts in his post-mortem discussions of the customer testimony.[13]

I.

The best plaintiffs' lawyers try their cases by describing succinctly but distinctly how the transaction or practice they were challenging was anticompetitive. I call that "describing the story line" of the case.[14] There are numerous advantages to doing that. Most importantly, it focuses the court or jury on something they could understand,[15] instead of on esoteric, econometric formulae that lay judges and juries (including me) are not so likely to comprehend,[16] or on the speculation by third-party witnesses about whether the transaction would lead to a small but significant, non-transitory increase in price (SSNIP).[17] Beyond that, if the merger had already been consummated, it means that

11 *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 2.2.2 (2010) (continuing to describe customers as a potential source of "highly relevant" and "valuable" information), *available at* http://www.ftc.gov/os/2010/08/100819hmg.pdf [hereinafter MERGER GUIDELINES].

12 *See Oracle Corp.*, 331 F. Supp. 2d at 1125–33.

13 *See* Vaughn R. Walker, *Merger Trials: Looking for the Third Dimension*, COMPETITION POL'Y INT'L, Spring 2009, at 35, 45 ("Apart from the rehearsed character and monotony of these witnesses' testimony, the most striking feature or image the testimony conveyed was that it was at odds with the basic premise of the government's case.") [hereinafter *Merger Trials*]; Vaughn R. Walker, *Search for a Competition Metric: The Role of Testimony from Customers, Competitors and Economists*, 2 COMPETITION L. INT'L 3, 3–5 (2006) (describing several shortcomings of customer testimony, including litigation-inspired perspective, selection bias, and competency issues) [hereinafter *Competition Metric*]. *See also Oracle Corp.*, 331 F. Supp. 2d at 1131, 1158–59.

14 Mike Tigar refers to this as the "primacy of story." MICHAEL E. TIGAR, PERSUASION: THE LITIGATOR'S ART 6–8 (1999).

15 *See* John D. Bates, *Customer Testimony of Anticompetitive Effects in Merger Litigation*, 2005 COLUM. BUS. L. REV. 279, 289 (2005) ("[T]he challenge of the advocate is to take the complicated issues and explain or present them in a clear fashion to someone who, in all probability, is not an expert in the field."); *Interview: Judge William W. Schwarzer, Northern District of California*, 2 ANTITRUST, Fall 1987, at 32, 32 ("The burden is on the lawyers to teach the trier of fact and to present the case so that it can be understood.").

16 *See* Richard A. Posner, *The Law and Economics of the Economic Expert Witness*, 13 J. ECON. PERSPECTIVES 91, 96 (1999) ("Econometrics is such a difficult subject that it is unrealistic to expect the average judge or juror to be able to understand all the criticisms of an econometric study, no matter how skillful the econometrician is in explaining a study to a lay audience." (citing Daniel L. Rubinfeld, *Econometrics in the Courtroom*, 85 COLUM. L. REV. 1048 (1985))).

17 *See Oracle Corp.*, 331 F. Supp. 2d at 1131 ("Although these witnesses speculated on that subject, their speculation was not backed up by serious analysis that they had themselves performed or evidence they presented. There was little, if any, testimony by these witnesses about what they would or could do or not do to avoid a price increase from a post-merger Oracle."); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 145-46 (D.D.C. 2004) ("Furthermore, while the court does not doubt the sincerity of the anxiety expressed by SPRB customers, the substance of the concern articulated by the customers is little more than a truism of economics: a decrease in the number of suppliers may lead to a decrease in the level of competition in the market. Customers do not, of course, have the expertise to state what will happen in the SPRB market, and none have attempted to do so."). *See also* Bates, *supra* note 15, at 286 (pointing out that the fundamental problem with customer testimony is not that the testimony is subjective, or being used to prove anticompetitive effects, but that customers are not competent to testify about something of which they have no personal knowledge–namely, a prediction or projection of the likely effects of a merger that they have never had an occasion (outside of litigation) to make); Walker, *Competition Metric*, *supra* note 13, at 3-4 (explaining that customer testimony about their likely reactions to a post-merger price increase amounts to "unsubstantiated conjecture" because customers are really testifying about their "preferences established in the premerger landscape" rather than what they could do in response to anticompetitive price increase).

the trier of fact doesn't have to speculate about what would have happened because it has already happened.[18]

Additionally, the story line approach means that we can more flexibly consider a broad range of effects to be anticompetitive effects. For example, we are used to being told by economists that if pricing is opaque, then we cannot consider higher prices to be a coordinated effect of the transaction or practice.[19] For one thing, this isn't even accurate because there are many practices short of price-fixing (as, for example, the allocation of customers or territories) that have the same effect as monitoring and coordinating prices.[20] In any event, economists tend to focus on elevated prices both because neoclassical economics focuses largely on prices,[21] and because prices are more easily measurable than non-price dimensions of competition like quality, variety, and consumer choice.[22] If we analyze the transaction or practice by reference to the transaction's or practice's anticompetitive effects, whatever they may be, we are not so apt to be imprisoned by price theory.

Finally, we can consider both coordinated effects and unilateral effects to be anticompetitive effects of the transaction or practice. Traditionally, merger analysis has tended to treat the two as entirely separate theories of liability.[23] A unilateral effects theory more often than not involves proof that the products (or services) of the acquired and acquiring firms are each other's closest substitutes such that a diversion of sales from the B side to the A side is likely to make a post-merger price increase profitable.[24] A coordinated effects theory more often than not involves proof that the transaction is likely to further concentrate an already concentrated market that is vulnerable to coordinated conduct.[25] But, as we have learned from bitter experience, there are cases in which our proof of unilateral effects may be found wanting so that we must rely, in the alternative, on proof of coordinated effects.[26] So I have suggested that almost every merger case be pleaded as both a unilateral effects and a coordinated effects case (since most unilateral effects cases involve highly concentrated markets too).

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18 *See* Polypore Int'l, Inc., No. 9327, 2010 FTC LEXIS 96, at *9 (Dec. 13, 2010) (Rosch, Comm'r, concurring) ("Evidence about what actually happened following the transaction may, in other words, reduce the need to employ economic theories in order to predict the relevant market or what is likely to happen–in particular, the SSNIP test described in the Horizontal Merger Guidelines. Put differently, economic theory is not a substitute for, or superior to, the empirical evidence about whether the transaction has actually resulted in anticompetitive effects."), *available at* http://www.ftc.gov/os/adjpro/d9327/101213polyporeconcurringopinion.pdf; Evanston Nw. Healthcare Corp., No. 9315, 2007 FTC LEXIS 210, at *255-56 (Aug. 7, 2007) (Rosch, Comm'r, concurring) ("We can look to see if there is any probative post-merger evidence that demonstrates whether or not the merger has been anticompetitive. We do not need to try to predict the future as would be necessary to analyze an unconsummated merger proposal."), *available at* http://www.ftc.gov/os/adjpro/d9315/070806rosch.pdf.

19 *See, e.g.,* David T. Scheffman & Mary Coleman, *Quantitative Analyses of Potential Competitive Effects from a Merger*, 12 GEO. MASON L. REV. 319, 337 (2003) ("While negotiated pricing does not mean that coordination of pricing (or customer allocation) is impossible, if prices are not transparent reaching an agreement is more difficult. In addition, if prices are opaque, detection of cheating (at least with respect to price) will not be possible.").

20 MERGER GUIDELINES, *supra* note 11, § 7.2 ("Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation."); *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 64-66 (D.D.C. 2005) (noting that pricing is not the only type of "key information" that can be used to facilitate coordination, and that a mature market with "little room for growth" may supply conditions that "can lead to even greater stabilization of market share and greater segmentation of the market, thus increasing the incentives and lowering the impediments to tacit coordination").

21 *See, e.g.,* Robert G. Harris & Thomas M. Jorde, *Antitrust Market Definition: An Integrated Approach*, 72 CALIF. L. REV. 3, 27 (1984); Herbert Hovenkamp, *Rationality in Law & Economics*, 60 GEO. WASH. L. REV. 293, 330 (1992); Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 932 (1979).

22 *See generally* J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, The Next Challenges for Antitrust Economists, Remarks at the NERA 2010 Antitrust & Trade Regulation Seminar (July 8, 2010), http://www.ftc.gov/speeches/rosch/100708neraspeech.pdf. Professor Thomas Sullivan has suggested, however, that nonprice factors can be taken into account through their impact on output, which is measurable. E. Thomas Sullivan, *On Nonprice Competition: An Economic and Marketing Analysis*, 45 U. PITT. L. REV. 771, 800 (1984).

23 *See, e.g.,* Thomas O. Barnett, *Substantial Lessening of Competition – The Section 7 Standard*, 2005 COLUM. BUS. L. REV. 293, 298 (2005) ("In the taxonomy of the antitrust kingdom, we divide the genus of anticompetitive effects into two basic species: unilateral effects and coordinated effects.").

24 MERGER GUIDELINES, *supra* note 11, § 6.1.

25 *Id.* § 7.1.

26 *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 60–67, 67–72 (D.D.C. 2009).

The sources of a story line are too numerous to mention, but the staff has looked chiefly to the following possible sources. First, it may be based on the parties' 4(c) submissions. (For the uninitiated, "4(c) documents" are supposed to be provided to the Agencies as part of the materials that the merging parties submit pursuant to the Hart-Scott-Rodino Act,[27] and they are supposed to include all documents authored by, or submitted to, any director or officer of the parties describing any purpose of the transaction or the market in which the parties' goods or services compete.)[28]

Second, the story line may be based on the writings of representatives of the parties, including their email,[29] whether or not the writing is sworn or is a 4(c) document.[30] Third, it may be based on the admissions or statements against interest[31] made by a representative of a party during a deposition (we call it an investigational hearing).[32] Again, for those not familiar with an investigational hearing, it is like a deposition except there may be a second Commission attorney present who keeps the deponent on the "straight and narrow" and who, not surprisingly, generally sides with the Commission attorney who is asking the questions.[33] Fourth, the story line may be based on the conduct of the parties such as the payment of a seemingly exorbitant amount to make the acquisition, or the payment of a high breakup fee, or the implementation of a "fix" before the transaction that evidences a concern about the antitrust merits of the transaction.[34]

Sometimes, of course, the "story line" just falls out of the sky or out of the mouth of a CEO or Chairman of a party during trial. I once had that happen to me. My chairman witness (unnecessarily) confessed to perjury when he was being cross-examined by Joe Alioto Jr. But that doesn't happen very often, which is why football coaches generally "script" their opening plays ahead of time. Or sometimes, a "story line" gets pre-empted. The best at that was Mike Khourie. He once told a jury during opening statements that when I got up I'd say "such and such," and a juror nodded disapprovingly. Sure enough, when I gave my opening statement, I said "such and such" almost word for word.

II.

The best plaintiffs' antitrust lawyers are adept at telling the anticompetitive story from the get-go out of the mouths of the Chairman, CEO or Chief Marketing Officer of the parties instead of relying solely on customer or competitor witnesses.[35] The advantages to doing it this way are threefold. To begin with, it generally prevents these party officers from giving "canned" testimony to justify the transaction.[36] Instead, the trier of fact will

27 15 U.S.C. § 18a (2011).

28 16 C.F.R. § 803.1(a) & pt. 803, App. (item 4(c)) (2012).

29 *See, e.g., FTC v. ProMedica Health Sys., Inc.*, No. 3:11-cv-00047, 2011 U.S. Dist. LEXIS 33434, at *45-46 (N.D. Ohio Mar. 29, 2011) (concluding from an internal email that "St. Luke's anticipated that the transaction with ProMedica, and its potential for higher prices, would undergo antitrust scrutiny").

30 *See* PREMERGER NOTIFICATION OFFICE, FED. TRADE COMM'N, ITEM 4(C) TIP SHEET (Apr. 26, 2012) (describing scope of search for responsive 4(c) documents), *available at* http://www.ftc.gov/bc/hsr/4cTipSheet.pdf.

31 *See* 16 C.F.R. § 3.43(b) (2012) (statements or testimony by a party-opponent are admissible).

32 *See* 16 C.F.R. § 3.43(e) (2012) (allowing information obtained during investigation to be offered into evidence). *See also* 16 C.F.R. § 2.8 (2012) (setting forth the basic procedure for investigational hearings).

33 *See* 16 C.F.R. § 2.9 (2012) (setting forth the rights of witnesses in investigational hearings).

34 MERGER GUIDELINES, *supra* note 11, § 2.2.1 ("The financial terms of the transaction may also be informative regarding competitive effects."); *see, e.g., FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34, 46 (D.D.C. 2002) ("The FTC's argument that defendants have in some manner sought to evade FTC and judicial review by proposing the amended agreement is without merit. Rather, the Court construes defendants' position to be that they have attempted to address the concerns expressed by the FTC by amending the proposed merger agreement.").

35 *See* Walker, *Merger Trials*, *supra* note 13, at 46 & n.58 (recalling that plaintiff's counsel in *Reilly v. Hearst Corp.* called Timothy White, the publisher of the *Examiner*, as the first witness to talk about he tried to secure San Francisco Mayor Willie Brown's support for Hearst's acquisition of the *Chronicle* with the promise of favorable political coverage; also commenting that "[c]alling a defendant as the first witness is almost always a good idea for plaintiffs").

36 *See* DAVID BERG, THE TRIAL LAWYER: WHAT IT TAKES TO WIN 246 (2006) ("Being called adverse can put defense witnesses at a huge disadvantage. They don't get a chance to get comfortable on the stand or to warm up the jury, by answering friendly questions from a friendly lawyer. Instead, they get cross-examined immediately about the worst facts in the case.").

hear their story for the first time via cross-examination since they are considered hostile witnesses who can be led.[37] Indeed, Dan Wall, who was lead counsel for Oracle, used to welcome efforts by such a witness to disown the documents that he or she authored because it gave him a chance to flash the witnesses' document up on the screen for all the world to see.[38]

Second, because customer or competitor witnesses (like any third party witness) are not generally considered hostile witnesses, one generally cannot interview them, much less prepare them to testify, ahead of time. It takes an amazing amount of talent (or guts) to put a third-party witness on the stand without knowing what he or she will say. Additionally, it is very difficult to "thread the needle" – that is to say, to assure a trier of fact that a third-party witness is "representative" of all other similarly situated witnesses (like customers),[39] and at the same time not to bore the trier of fact to tears because the testimony is repetitive of other third-party witnesses that have testified.[40]

III.

So as time went on, I and the other Commission members took to asking the staff to describe the "story line" of each antitrust case and to tell us how they would tell the story (that is to say, try the case) before we would vote out a complaint. Then I at least would ask for assurance from the staff that that is indeed how the case would be handled. If it was not, then I might conclude that I lacked the requisite "reason to believe" that Section 5 requires in order to vote out a complaint.[41]

It was critically important that the Commission staff "learn how to lose" as well. As a trial lawyer, I knew full well that if you tried cases you were going to lose some of them. I did and even the best plaintiffs' lawyers did. Of course, I did not want the staff to get used to losing. But at the same time I realized that if the Commission tried as many cases as I hoped we would (and we have), we were going to lose some of them.[42] I wanted the staff to understand that that just goes with the territory.[43]

37 *See* 16 C.F.R. § 3.41(c) & (d) (2012). For example, Judge Walker found Mr. White's testimony in *Reilly* to be "explosive and entertaining." Walker, *Merger Trials*, *supra* note 13, at 46.

38 Indeed, regarding the admissibility of documents generated by the respondents and produced from their own files, there is a Commission rule that puts the burden of proof on the respondents "to introduce evidence to rebut a presumption that such documents are authentic and kept in the regular course of business." 16 C.F.R. § 3.43(d)(3) (2012).

39 *United States v. Engelhard Corp.*, 126 F.3d 1302, 1306 (11th Cir. 1997) ("No matter how many customers in each end-use industry the Government may have interviewed, those results cannot be predictive of the entire market if those customers are not representative of the market."); Feesers, Inc. v. Michael Foods, Inc., 632 F. Supp. 2d 414, 445 (M.D. Pa. 2009) (holding that "testimony presented by Defendants from a few customers who did not find price significant" should not be given "the same weight, particularly where as here, there is other evidence suggesting that price is quite important to other customers in the same industry"); United States v. SunGard Data Sys., Inc., 172 F. Supp. 2d 172, 192 (D.D.C. 2001) ("Without more information, the Court simply cannot determine whether these 50 declarations are representative of the shared hotsite client base."). *See also* John Harkrider, *Moving Anticompetitive Impact: Moving Past* Merger Guidelines *Presumptions*, 2005 COLUM. BUS. L. REV. 317, 340–42 (2005) (reviewing a number of problems with reliance on customer testimony, including selection bias); Walker, *Competition Metric*, *supra* note 13, at 3 ("Even when this testimony is given by live witnesses in the courtroom, the choice of customers is almost always a product of selection bias. Seldom does it appear that the customers' views represent the general customer population.").

40 FED. R. EVID. 403 ("The court may exclude relevant evidence if its probative value is substantially outweighed by a danger of one or more of the following: … undue delay, wasting time, or needlessly presenting cumulative evidence."); FED. R. EVID. 611(a)(2) ("The court should exercise reasonable control over the mode and order of examining witnesses and presenting evidence so as to: … avoid wasting time.") M.T. Bonk Co. v. Milton Bradley Co., 945 F.2d 1404, 1408 (7th Cir. 1991) ("Trial courts have discretion to place reasonable limits on the presentation of evidence to prevent undue delay, waste of time, or needless presentation of cumulative evidence.") (citing Rules 403 and 611).

41 *See* Dissenting Statement of Comm'r J. Thomas Rosch at 2, Lab. Corp. of Am., No. 9345 (Nov. 30, 2010), *available at* http://www.ftc.gov/os/adjpro/d9345/101201lapcorpdisstatement.pdf.

42 *See, e.g.,* FTC v. Lundbeck, Inc., Nos. 08-cv-6379 & 08-cv-6381, 2010 U.S. Dist. LEXIS 95365 (D. Minn. Aug. 31, 2010), *aff'd*, 650 F.3d 1236 (8th Cir. 2011); Rambus Inc. v. FTC, 522 F.3d 456 (D.C. Cir. 2008), *setting aside* No. 9302, 2007 FTC LEXIS 13 (Feb. 2, 2007) & 2007 FTC LEXIS 212 (Apr. 27, 2007); FTC v. Foster, No. Civ-07-352 JB/ACT, 2007 U.S. Dist. LEXIS 47606 (D.N.M. May 29, 2007); Schering-Plough Corp. v. FTC, 402 F.3d 1056 (11th Cir. 2005), *setting aside* No. 9297, 2003 FTC LEXIS 187 (Dec. 8, 2003).

43 *See* Stephen Calkins, *In Praise of Antitrust Litigation: The Second Annual Bernstein Lecture*, 72 ST. JOHN'S L. REV. 1, 6 (1998) ("One advantage of regularly litigating is that the government can afford to lose.").

Finally, I wanted the staff to understand the importance of publicity during a trial. No trier of fact likes to be taken for granted that either the case is a dead-bang winner or a sure loser. All of the best plaintiffs' antitrust lawyers understood that. That is why they took care to let the media know at all times what was happening.[44] Dan Wall understood that too. He would stroll out of the *Oracle* trial at the end of each day to "brief" the press on what they had just seen. You have no idea how little even experienced media mavens understand our craft. We have an excellent public relations staff at the Commission.[45] The staff should learn to use it.

There were a number of other reforms that the Commission adopted in the merger arena. We had long been criticized (justly I think) by the ABA Section of Antitrust Law and *FTC:Watch* (among other bodies) for how long it took for the Commission to issue a decision on an appeal to the Commission.[46] It was contended that it sometimes took so long that the parties lacked an incentive to consummate the deal. So we changed our so-called Part 3 rules to put a time limit on ourselves.[47] That time limit begins to run when oral argument is held.[48] So far it seems to be working. We have adhered to that time limit in every appeal that we have considered since the *Polypore* decision was issued.[49] I would like to see our so-called Part 2 rules include a similar governor on the time it takes the staff to complete its investigation in order to eliminate the "one-way" discovery and the "turn over every rock" type of investigation they can conduct whenever the Hart-Scott-Rodino time limits do not apply.[50]

I would also like to see the 2010 Merger Guidelines amended to make clearer the procedures that we follow in analyzing a merger complaint (that is to say, that we focus as a Commission on the story line and how the case is to be tried before we vote out a complaint). The Guidelines purport to describe how a merger is analyzed at the Commission. But they were written mostly by economists for economists. They may describe how economists look at things.[51] But that is not how we, as Commissioners, decide a case.[52] This not to say that the Commission should ignore econometrics (or customer testimony) in trying its cases. But they should be "frosting on the cake" instead of the cake itself.

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44 Mike Tigar has suggested prefacing brief informative statements to the media about the issues in the case with the following words of respect to the trier of fact, which serve to show that he or she is not to be taken for granted:
We intend to do our talking in court. We have faith in the jury system. We think that the jurors who will be selected deserve our respect, and we respect them by letting them hear first, in court and from the witness stand, what the evidence will be. We are not going to try our case in the media. Our position, though, is clear. ... Tigar, *supra* note 14, at 148.

45 *See About the Office of Public Affairs*, FED. TRADE COMM'N, http://www.ftc.gov/opa/about.shtm.

46 *See Report of the American Bar Association Section of Antitrust Law Special Committee to Study the Role of the Federal Trade Commission*, 58 ANTITRUST L.J. 43, 116 n.168 (1989) ("Particularly troubling is the length of time between oral argument and issuance of an opinion. . . . . There is no excuse for taking more than a year to write an opinion.") (calculating an average time of 15.1 months from oral argument to final decision).

47 *See* 16 C.F.R. § 3.52 (2012); 16 C.F.R. Parts 3 and 4: Rules of Practice, 74 Fed. Reg. 1804 (Jan. 13, 2009) (announcing interim final rules).

48 16 C.F.R. § 3.52(a)(1) (45 days after oral argument is held, or if there is no oral argument, then 45 days after the deadline for the filing of any reply briefs).

49 Polypore Int'l, Inc., No. 9327, 2010 FTC LEXIS 97 (Dec. 13, 2010) (oral argument was held on July 28, 2010).

50 *See* J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, Reflections on Procedure at the Federal Trade Commission, Remarks Before the ABA Section of Antitrust Law Antitrust Masters Course 10 (Sept. 25, 2008), http://www.ftc.gov/speeches/rosch/080925roschreflections.pdf.

51 *See Schwarzer*, *supra* note 15, at 36 (viewing the then DOJ merger and vertical restraint guidelines as the work of some economists, to be regarded as a form of expert economist opinion).

52 *See* J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, Concurring Statement on the Release of the 2010 Horizontal Merger Guidelines 3 (Aug. 19, 2010) ("These Guidelines do not describe the way that the Bureau of Competition and enforcement staff at the Commission proceed today. They also do not reflect the way that the courts proceed."), http://www.ftc.gov/speeches/rosch/100819horizontalmergerstatement.pdf. *See also* Thomas Penfield Jackson, *Merger Analysis in the '90s: The Guidelines and Beyond – Judicial Perspective*, 61 ANTITRUST L.J. 165, 169 (1992) ("And, [a federal judge] will be generally unimpressed with authorities which do not actually control the decision in the case, including anyone's Guidelines on any subject.").

LEGISLATING FOR LITIGATION: REFORMS TO INTERNATIONAL ANTITRUST LITIGATION GATHER PACE

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For some time, the European Union and a number of its Member States have tried to encourage private litigation of antitrust claims. This has culminated in significant proposed legislation, and related policy recommendations, squarely aimed at a manageable expansion in litigation. The proposed EU legislation marks a decisive step in a continuing move away from a purely administrative model of antitrust law towards a more mixed system involving greater private enforcement, a trend arguably at its clearest in England and Wales. In that jurisdiction the government has published draft legislation to establish an opt-out scheme for collective redress, i.e., something akin to a U.S. class action. How close the American parallel will be remains to be seen, but it is clear that the administrative model of antitrust enforcement with which Europe is so associated will not escape unscathed, with significant implications for all those active in European markets. Indeed, the Competition Appeal Tribunal ("CAT"), the specialist court for UK competition law claims, recently awarded punitive damages for the first time,[2] although the scope for punitive damages following pending reforms remains to be seen.[3]

This article will consider the recent proposals to reform antitrust litigation, the context of EU and national attempts to reform private actions, and their relation of increased private litigation to existing public enforcement mechanisms. It will also consider potential international issues posed by the reforms, notably jurisdictional aspects and tensions that may be emerging between national and European reforms.

I. REFORMS TO EUROPEAN ANTITRUST LITIGATION

The European model of antitrust enforcement is distinguished by a considerable role for administrative discretion and enforcement. Broadly speaking, the EU system first set up by Regulation 17,[4] and since broadly copied, empowers antitrust agencies to take action to protect and promote competition through potentially far reaching prohibitions on anticompetitive conduct. Since 2004, however, the European Commission has shared

1 Respectively Partners and Associate, Sidley Austin LLP, Brussels and New York. All views expressed in this article are exclusively those of the authors and do not necessarily reflect those of Sidley Austin LLP or its clients. This article has been prepared for informational purposes only and does not constitute legal advice.
2 *2 Travel Group PLC (in liquidation) v Cardiff City Transport Services Limited* [2012] CAT 1.
3 *Albion Water Ltd. v Dwr Cymru Cyfyngedig* [2013] CAT 6 cited the punitive damages analysis in *Cardiff's* case, but did not award punitive damages on the particular facts before it.
4 Regulation (EEC) No 17/62.

increasing authority with the National Competition Authorities ("NCAs") on the one hand, and national courts in Member States on the other.[5] At the same time, the EU courts have upheld a free-standing right to claim damages for a competition law infringement, and required Member State courts to ensure that redress is available in such cases on at least as favorable a basis as it is for similar domestic claims.[6]

The original institutional set up continues to cast a long shadow over the pattern that this litigation tends to take. The significant advantages of public enforcers in terms of resources and legal empowerments creates a strong incentive to bring follow-on damages actions, which rely on findings of facts established in administrative decisions, rather than to bring a stand-alone action in which the infringement must be proven. Thus the standard model of a European competition law claim tends to involve waiting for the agency to take an adverse decision, and then filing a claim that the facts and infringement thereby established caused a loss to the relevant undertaking.[7]

Commission Proposals

The EU has taken an active role in encouraging such follow-on claims. For several years, the Directorate General for Competition (DG Competition) has commissioned research and authored studies to increase the role of the limited amount of antitrust litigation that has occurred.[8] Strange as it may seem to those working in jurisdictions arguably defined by an excess of litigation, the European Commission has thereby sought to encourage the role of private litigation, not least to provide an element of redress to individual consumers (rather than a fine paid into the general coffers of the EU) and perhaps also to decrease the burden on public enforcers.

The stated overarching aim of the Commission is "to create an effective system of private enforcement by means of damages actions that complements, but does not replace or jeopardize, public enforcement."[9] In other words, the Commission seeks to encourage litigation alongside public enforcement, rather than as a substitute to it. This approach was echoed by Joaquin Almunia, the EU's Commissioner for Competition, who stated in September 2011:

> *Our legislative action must make possible that every victim of the companies that breach competition law should exercise their right to be compensated for damages regardless of where they are in the EU and regardless of whether they bring individual or collective actions.*[10]

5 Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty OJ 2003 L/1/1.
6 Case C-453/99, *Courage v Crehan* [2001] ECR I-6297; Joined Cases C-295/04 to C-298/04, *Manfredi* [2006] ECR I-6619.
7 For a summary of recent research into the typical litigation pattern, *see* M. Danov and S. Dnes, "Cross-Border EU Competition Litigation: New Evidence from England and Wales" in M. Danov, F. Becker and P. Beaumont eds., *Cross-Border EU Competition Law Actions* (Oxford: Hart, 2013).
8 Key consultations include DG Competition, "White Paper on Damages Actions for Breach of the EC antitrust rules," COM(2008) 165, 2.4.2008; "Green Paper - Damages actions for breach of the EC antitrust rules" COM(2005) 672, 19.12.2005; and Oxera Consulting, "Quantifying antitrust damages: Towards non-binding guidance for courts," Study prepared for the European Commission. The move towards more private litigation has led to the comment that EU and U.S. litigation models are converging, at least in terms of evaluating damages: see C. Korenblit, "Quantifying Antitrust Damages – Convergence of Methods Recognized by U.S. Courts and the European Commission," [2012] *CPI Antitrust Chronicle* 1.
9 European Commission, *White Paper on Damages*, op. cit., final paragraph.
10 Joaquin Almunia, "Public enforcement and private damages actions in antitrust," Speech to the Economic Committee of the European Parliament, Brussels, 22 September 2011.

The Commission thus expressed the intention to take action on the procedural issues that seemed to stand in the way of the competition law claims it seeks to encourage, notably issues surrounding access to evidence, the effect of private litigation on the leniency program, and the scope for delays in follow-on litigation to time bar follow-on damages claims.

In June 2013, the European Commission tabled the draft EU legislation that was the product of this lengthy process, as well as a policy Recommendation on collective redress. Both seek to encourage private antitrust litigation. Briefly, the proposed legislation requires Member States to ensure that certain stumbling blocks for the would-be litigant are removed, subject to certain safeguards.[11] If the legislation passes, key features will require Member States to:

- ensure minimum standards so as to allow document disclosure, subject to protections designed to prevent disclosure of sensitive documents such as leniency applications and settlement documents;
- require cartel liability to be joint and several, except in the case of a leniency recipient;
- set down minimum limitation periods and provisions on how these are to run;
- follow a uniform approach to the "passing on" defense where a cartel overcharge affects numerous parties in a distribution chain;
- enact a rebuttable presumption that cartels cause overcharges, and
- enable courts to grant a stay of proceedings while discussions on consensual resolutions take place.

Alongside the Directive, the Commission has also released a Recommendation on class actions that, although not binding, puts the Member States on notice to comply with its aims (on pain of possible future legislation should they fail to do so).[12] The Commission therefore now officially recommends that Member States should adopt collective redress mechanisms, although notably it recommends an "opt-in," rather than "opt-out," model, and that collective actions may be taken by pre-authorized representative entities meeting certain criteria. To prevent the perceived scope for abuse, however, the Commission recommends against punitive damages and contingency fees in representative actions. It also advocates ensuring that third party litigation funding is carefully reviewed, and calls for restrictions on the standing of parties who can bring representative actions so as to exclude profit-making entities.

11 *See* European Commission, "Proposal for a Directive of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union," COM(2013) 404 final. A Directive is binding as to its aims but leaves Member States free to decide the means by which they will fulfil those aims.

12 *See* European Commission, "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, "Towards a European Horizontal Framework for Collective Redress," COM (2013) 401/2; *see also* "Commission Recommendation on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law" C(2013) 3539/3.

On the same day, the Commission also released official guidance on the methods that can be used by courts to estimate damages in competition law cases. As with the collective actions Recommendation, the guidance is not binding, but is likely to be highly influential.[13]

The legislative proposal and the Recommendation represent a compromise between a number of stakeholders. The Directorate General for Health and Consumers has an interest in the potential impact of these reforms on consumers, and the Directorate General for Justice has a stake in the outcome of any reform to civil justice measures as part of its brief to ensure the smooth functioning of cross-border legal issues between Member States. Indeed, any move to expand the role of litigation is highly controversial in many quarters. The legislative proposal was significantly overdue, having been expected in draft form for several months, and previous attempts to adopt a legislative proposal failed.

For its part, the European Parliament has also been extremely vocal and active in this area, and has at times sought to limit the scope for reforms aimed at encouraging litigation, for example in its response to a consultation by DG Justice on the future of collective redress in Europe.[14] Although the Parliament has recently softened its stance on an increased role for class actions, the choice of a Recommendation on class actions (which the Commission can adopt on its own), rather than legislation (which would require Parliament's agreement), may be interpreted as an attempt to bypass the European Parliament.

Member State reforms to litigation

The Commission reform process drew wide attention, especially with Member State governments, not least because of the increased profile of competition law and policy as a means to achieve growth during a period of global stagnation. The lead taken by the European Commission may have been instrumental in encouraging these steps.

The day after the European Commission published the proposed legislation and Recommendation, the UK government published a draft Consumer Rights Bill ("the Bill") that proposes amendments to UK competition law designed to assist litigants.[15] The Bill represents the latest step in a controversial consultation process[16] and provides an insight into the form that national steps designed to encourage litigation might take.

Drawing on the results of the consultation, the Bill proposes to expand the scope for litigation in several ways:

- **Stand alone court access:** The Bill expands the jurisdiction of the specialist Competition Appeal Tribunal ("CAT") to be able to hear stand-alone damages claims, i.e., removing the requirement for there to be a prior regulatory finding of infringement before litigation can be brought at the CAT. The CAT will also be able to grant injunctions and a fast-track procedure to assist plaintiffs would be made available.

13 Communication from the Commission on quantifying harm in actions for damages based on breaches of Article 101 or 102 of the Treaty on the Functioning of the European Union.
14 European Parliament Committee on Legal Affairs, "Draft Report on 'Towards a Coherent European Approach to Collective Redress'," 15.7.2011.
15 UK Department for Business, Innovation and Skills, Draft Consumer Rights Bill, June 2013 (TSO: Cm 8657).
16 UK Department for Business, Innovation and Skills, "Private Actions in Competition Law: A Consultation on Options for Reform," available at http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/p/12-742-private-actions-in-competition-law-consultation.pdf.

- **Class actions:** the Bill would allow "collective proceedings" to be brought at the CAT on an opt-out basis, subject to significant discretion on the part of the CAT whether to allow the collective action to proceed.

- **Collective settlements:** Where such a "collective proceedings order" has been made, the Bill provides for means for collective settlement of the action. However, the Bill would not permit punitive damages to be awarded in collective actions.

- The Bill also provides for **voluntary redress schemes** to be entered into before the regulator takes an infringement decision, i.e. through administrative negotiations, perhaps in an attempt to balance the controversial proposals on collective actions contained in the Bill.

The Bill and the draft EU legislation, if both pass in their present forms, may not be fully consistent as they differ on several important points. By way of example, the EU legislation requires a presumption of overcharge, whereas the Bill dropped exactly this requirement even though it was present in earlier stages of the consultation that led to the Bill. There are also inconsistencies between the Bill and the stated policy preferences of the European Commission in its Recommendation, most glaringly where the Bill provides for opt-out procedures contrary to the Commission's stated preference for opt-in.

Differences between the Bill and the Recommendation may not be as immediately pressing as differences with any directive that emerges, the Recommendation not being immediately binding, but should the opt-out procedure attract litigants the Commission may be prompted to legislate when it next reviews the development of private litigation. So although the policy position of the EU, for the next few years at least, appears to have been articulated, there seems to be substantial scope for continuing disagreements on this perennially controversial topic and the scope for collective redress of the claims will fluctuate for some time to come.

Indeed, this result seems likely as the English courts are already an attractive venue for private antitrust litigation, not least because of their permissive discovery rules compared with the practice (if not always the letter of the law) in civilian jurisdictions, and a relatively expansive approach to jurisdiction.[17] For some years, the English courts have been moving slowly but steadily in the direction of a more American model of enforcement, in which courts would play a greater enforcement role, and the provisions on class actions would seem to accelerate that trend.[18]

The Bill fits into a wider picture of reform to the institutional framework of the UK antitrust agencies, and can be seen as part of a wider rebalancing of competition enforcement in the UK.[19] A wholesale shift towards an American model in which agencies would be required to litigate remains unlikely; indeed, a prominent commentator has noted that:

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17 *See e.g. Toshiba Carrier UK Ltd v. KME Yorkshire Ltd* [2012] EWCA Civ 1190 (allowing use of "anchor defendants" for jurisdictional purposes), discussed further below.

18 For a comparative approach to institutional aspects of antitrust enforcement, please see D. Crane, *The Institutional Structure of Antitrust Enforcement* (Oxford: OUP, 2011).

19 The Lawyer, "Merger of Competition Commission and OFT meets with muted response," 16.3.2011.

> *It is inconceivable that a European system would totally privatize all enforcement on an American model or that the existing regulatory or punishment functions of public authorities would be removed or restricted.*[20]

Yet if a wholesale shift away from administrative enforcement seems relatively unlikely, the preference for rebalancing towards greater litigation is apparent in several jurisdictions. Some of the most prominent plaintiff-friendly reforms in a civil law jurisdiction have come from the Netherlands, where it is possible for a representative body to enter into collective settlements on behalf of consumers, much as the UK Bill would allow.[21] Indeed, the plaintiff-friendly approach adopted by certain jurisdictions arguably involves the removal of safeguards in an attempt to attract litigants. It is an open question whether the emerging differences represent a rent-seeking race to the bottom, or merely healthy regulatory competition, but it is certainly the case that some jurisdictions have made it significantly easier to fund a case. For example, collective settlement representatives in the Netherlands can be funded by third party litigation funders, or law firms, and although the UK Bill stops short of allowing damage-based agreements and restricts third party funding of class actions, the UK did consider whether to remove these safeguards at the consultation stage.[22]

As these changes continue to gather pace, the shifting balance towards private enforcement across Europe will markedly impact the appropriate strategy in antitrust counseling and litigation with a European element. A clear pattern encouraging private litigation can be seen from the EU reforms, filtering down to Member State reforms, albeit with some variation in focus and scope.

II. IMPLICATIONS FOR INTERNATIONAL LITIGANTS

Tensions between national and EU approaches

The contrast between the UK Bill and the EU proposals and Recommendations demonstrates the potential for increasing tension between litigation in Member State courts and the more unified approach to reform now actively sought at the EU level. There may even be incentives for some Member States to take a plaintiff-friendly approach in order to attract, and export, litigation, especially because there is a significant jurisdictional overlap between Member State jurisdictions in competition law claims. Although the EU has now articulated its policy position for the coming years, tensions between this position and divergent national approaches seem very likely.

The potential tension is particularly noticeable in some follow-on litigation in the UK that took place as the reform process gathered pace. In *Cardiff Bus*, the UK's specialist Competition Appeal Tribunal ("CAT") went so far as to make its first ever award of punitive damages on the basis that the incumbent operator in the case willingly disregarded a new entrant's rights under competition law not to be impeded by the abuse of dominance established by an earlier administrative decision. The scope for future awards of punitive damages remains to be seen (they may not be available in follow on cases where there has

20 C. Hodges, "European Competition Enforcement Policy: Integrating Restitution and Behaviour Control," 34 *W. Comp* 3

21 See, for example, Stichting Investor Claims Against Fortis, which is funded by a consortium of law firms representing investors for whom it seeks to obtain compensation (*see* http://www.investorclaimsagainstfortis.com/frequently_question.php).

22 BIS Consultation, op. cit., q. 23.

been a fine,[23] and legislation may block them in class actions). Yet the case has been followed in more recent litigation,[24] suggesting that litigants may well come to seek punitive damages, at least in stand alone actions or follow on cases in which no fine has been applied. The result is surprising because punitive damages awards fly squarely in the face of the Commission's stated policy preferences, squarely underlining the scope for continuing tension between national litigation and attempts at reform, whether at the national or European level.

Jurisdictional considerations

The international tensions that result are particularly pressing because of the jurisdictional rules that apply to these cases. Consider, for example, the expansive approach to jurisdiction taken by the English courts as recently confirmed by the Court of Appeal in *Toshiba Carrier UK Ltd v. KME Yorkshire Ltd.*[25] There, the Court upheld its jurisdiction in a follow-on claim against several defendants even though none of the infringing parties named in the fining decision itself was domiciled in the UK: it sufficed that one of the defendants was a subsidiary of one of the named parties in the fining decision. As this subsidiary was involved in the implementation of the conduct, it provided the necessary "anchor defendant" to bring the case in the UK against all five defendants.

This expansive approach to jurisdiction at the national level, which is by no means unique to England and Wales, is mirrored at the EU level in the private international law framework governing European litigation, which creates significant scope for overlaps in jurisdiction where parties are based in several countries. Specifically, the European legislation governing the private international law to be applied between Member States of the European Union, the Brussels Regulation, contains scope for defendants and claimants to assert jurisdiction in several locations.[26] Contrary to expectations in some quarters, the draft Directive and Recommendation did not carve out a special jurisdictional rule for cross-border collective actions, meaning that this overlapping jurisdiction will persist and with it strong incentives to make the best possible use of divergences between procedural rules such as those apparent from comparing the UK Bill and the EU Recommendation and draft Directive.

III . CONCLUSION

Competition litigation in Europe will continue to be in a state of flux for some time as the precise scope of reforms is finalized, and ultimately their implications realized. The decisions of the CAT referred to above, although for the time being confined to follow-on litigation under somewhat unusual circumstances, provide practical examples how future litigation might develop. Increased tensions between litigation and administrative enforcement may simply be the logical result of the recent moves to increase the role for litigation through sweeping reforms, without a commensurate decrease in the role for administrative enforcement as a quid pro quo.

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23 *Devenish Nutrition Ltd. v. Sanofi-Aventis and others* [2008] EWCA (Civ) 1086. The decision has already been criticised by two leading commentators: See O. Odudu and G. Virgo, "Inadequacy of Compensatory Damages," 17 *Restitution Law Review* 117 (2009).

24 *Albion Water*, op cit.

25 [2012] EWCA Civ 1190. *See e.g.* Sidley Austin LLP, "Court of Appeal Judgment May Encourage Cartel Damages Claimants to Drop Anchor in England and Wales" for further details, available at http://www.sidley.com/Court-of-Appeal-Judgment-May-Encourage-Cartel-Damages-Claimants-To-Drop-Anchor-in-England – Wales-10-10-2012/.

26 Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters OJ L 12, 16.1.2001, as amended. See more: Danov, *Jurisdictions and Judgments*, op. cit.

The role of litigation in the reforming European model of antitrust enforcement remains to be seen, and European antitrust litigation is still very much finding its feet. It is, however, predictable that recent reforms will pile further pressure onto fault lines already identified in the interplay between administrative and judicial enforcement to the extent that they do not perfectly reconcile the two, which lofty goal seems relatively unlikely. Jurisdictional issues with the Brussels Regulation, the relative roles of damages and fines, and issues in choosing a settlement and leniency strategy will all become more pressing as the incentives to litigate increase. The pace of developments in European antitrust litigation therefore looks set to increase, and will continue to require careful monitoring by all those who must consider the appropriate strategy in international cartel and abuse cases.

NAVIGATING THE GAUNTLET: A SURVEY OF DATA PRIVACY LAWS IN THREE KEY LATIN AMERICAN COUNTRIES

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In October 2000, Argentina enacted Latin America's first comprehensive legislation on personal data protection. Since that time, the region has seen an explosion in laws protecting personally identifiable information, focused primarily on electronic data. While these data protection efforts are, by and large, modeled after similar laws in Europe (in particular, Spain), unlike the European Union ("EU") member states, the laws are not based on a common directive, which has resulted in significant variation in implementation and focus.

At the same time these laws have been enacted, more and more multi-national companies and governments have started using cloud computing and other methods of sharing electronic information across borders, including countries in Latin America. With foreign direct investment in Latin America and the Caribbean topping $173 billion in 2012, the protection of personal data has rapidly become a critical issue for companies operating in the region.[2] Complicating matters, as social networks expand and become more popular in Latin America, more employees are using mobile devices for both business and personal purposes, entwining personal data with business data.

All of these developments challenge traditionally held legal principles of privacy, jurisdiction, and discovery in commercial litigation contexts. This paper examines the laws currently in place in three representative Latin American countries - Argentina, Mexico, and Uruguay - and proposes best practices in alignment with *The Sedona Conference® International Principles on Discovery, Disclosure & Data Protection* ("*Int'l Principles*") for companies, governments, and even individuals involved in litigation in the United States that implicates electronic data originating in each of these three countries. Indeed, the relative dearth of case law or other analyses addressing how U.S. litigation may be impacted by the data privacy and protection laws in place in Argentina, Mexico, and Uruguay highlights the importance of careful application of the practical aspects of the *Int'l Principles*.

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2 U. N. Econ. Comm. for Latin Am. and the Caribbean ("ECLAC"), *Foreign Direct Investment in Latin Am. and the Caribbean 2012. Briefing paper*, at 7, LC0000 (May 2013).

These countries are representative of the region in several ways. First, their respective populations vary from small (Uruguay), to medium (Argentina), to large (Mexico). Second, they have varying degrees of commitment to free market principles. Argentina is currently focused on central controls and anti-free market reforms. Mexico and Uruguay seem to be moving in the other direction. Third, these countries present varying levels of corruption risks, with Argentina and Mexico representing higher risk locales and Uruguay on the lower end of the spectrum.[3] Finally, while more than 200 American companies with annual revenues exceeding $10 billion operate in Argentina, Uruguay, and Mexico, these countries demonstrate varying levels of integration with the United States market.[4] Mexico, a member of the North Atlantic Free Trade Agreement ("NAFTA"), has an economy highly entwined with the United States, while the economies of Argentina and Uruguay are more linked to other countries in Latin America and Europe.

Argentina – Leading the Charge

Argentina enacted the *Personal Data Protection Act* ("PDPA") in October 2000.[5] Closely modeled after Spain's *Law on the Protection of Personal Data*, the PDPA provides the regulatory framework for Argentina's data protection regime. Following the PDPA's passage, Argentina issued regulations pursuant to the statute in December 2001.[6] The PDPA, along with these implementing regulations, seeks the comprehensive protection of personal data in Argentina in accordance with the privacy provisions in the country's Constitution, which include a right to privacy and a right to habeas data.[7]

The PDPA, with limited exception, governs the ability of entities and individuals (or "data users") to "process" (i.e., collect, preserve, organize, store, use, evaluate, block, destroy, treat, communicate, or transfer) the "personal data" of others - broadly defined to include any information concerning identified or identifiable individuals or legal entities.[8] Argentina's definitions of "data user" and "processing" are similar to the definitions used by the EU for "data controller" and "processing," respectively.

Additionally, much like the EU, the PDPA affords a higher level of protection to what it terms "sensitive data," which means personal data revealing racial or ethnic origin, political views, religious, philosophical or moral beliefs, union affiliations and any information concerning health status or sexual habits or behavior.[9] No person can be compelled to provide sensitive data, and it may only be collected and processed in cases of public interest authorized by law or for statistical or scientific purposes, provided that the data owners are no longer identifiable (i.e., rendered anonymous).[10]

The PDPA's jurisdictional scope is less clear than the data privacy laws of other countries. By its terms, however, the PDPA applies to individuals and legal entities, public or private, having a legal domicile or local offices or branches in Argentina, whose data are subject to processing ("data owners").[11] This would appear to include multi-national American companies with offices, subsidiaries, affiliates, or employees operating in Argentina.

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3 *See* Transparency International Corruption Perception Index (2012), www.transparency.org/cpi2012/results/.
4 *See* Uniworld Business Publications, Inc. (searches conducted 5/7/2013 and 5/28/2013).
5 *Personal Data Protection Act*, Law No. 25,326 (Oct. 2000).
6 Decree No. 1.558/2001, Regulations of Law No. 25,326 ("PDPA Regulations").
7 Arts. 18, 19, 43 of the Constitution of the Argentine Nation (Aug. 22, 1994). Article 43 states as follows: "Any person shall file [a prompt and summary proceeding] to obtain information on the data about himself and their purpose, registered in public records or data bases, or in private ones intended to supply information; and in case of false data or discrimination, this action may be filed to request the suppression, rectification, confidentiality or updating of said data."
8 Arts. 1-3, PDPA.
9 Art. 2, PDPA.
10 Art. 7, PDPA.
11 Art. 2, PDPA.

Entities and individuals wishing to collect and process personal data in Argentina must, except in limited circumstances, obtain express consent from the data owners in writing or through similar means, depending on the circumstances. To obtain such consent, which, as in the EU, may be revoked at any time, data users must notify data owners in advance and in an express and clear manner of: (1) the purpose for which the personal data will be processed; (2) who the personal data may be provided to; (3) the existence of the relevant database and the identity and location of the person responsible for it; (4) the compulsory or discretionary character of any questions being asked; (5) the consequences of providing the data, of refusing to do so, or of providing inaccurate data; and (6) their right to data access, rectification, and suppression.[12]

As with the Spanish data protection regime, the PDPA also requires all public and private databases to register with Argentina's data protection authority, unless otherwise exempted, before they begin to process personal data.[13] The filing of these registrations is accomplished by submitting a hard copy to Argentina's data protection authority that includes, at a minimum, the following information: (1) the name and address of the data user; (2) characteristics and purpose of the database; (3) nature of the personal data contained in the database; (4) method of collecting and updating the personal data; (5) destination of the personal data and individuals or entities to whom the data may be transferred; (6) manner in which the registered information can be interrelated; (7) means used to ensure data security, including details on the individuals with access to information processing resources; (8) duration for which the data will be stored; and (9) conditions under which third parties can access their personal data, and the procedures to rectify or update such data.[14]

As Argentina's law was passed in 2000, it understandably does not fully anticipate the current use of cloud or internet-based networks that are physically located outside of Argentina but reach into the country for electronic personal data. For this reason, it is unclear how far Argentina's requirement that data users register all "public and private databases" with its data protection agency actually reaches. While it seems clear that a company setting up a server in Argentina for use by employees working in the country would fall within this requirement, there is no guidance on how the requirement may apply to a cloud system that extends into the country.[15]

In terms of the relationship between data users and data owners, the PDPA identifies a limited number of circumstances in which consent for the processing of personal data is not required, including, among others, situations where the data: (1) are secured from a publicly available source; (2) are collected in connection with the exercise of duties inherent in the powers of the state; (3) are limited to certain basic information, including name, national identity card number, tax or social security identification number, occupation, birth date, address, and telephone number; or (4) arise from a scientific or professional contractual relationship and are necessary for its development or fulfillment.[16]

12 Arts. 5-6, PDPA. Argentina has not formally decided whether consent obtained from a data owner checking a box on an internet site would be sufficient under these Articles.

13 Art. 21, PDPA. Exemptions include public databases not created for the purpose of providing reports and private databases created exclusively for personal use. This would not exempt databases created and used by multi-national companies for business communication purposes, which would necessarily include employees' personal data (i.e., identifying information and other personal information).

14 *Id.*

15 If the PDPA works similarly to Spain's data protection law, the data user established in Argentina would register its database and identify its cloud services provider (i.e., data processor). In turn, that provider would be subject to the PDPA even if it (and its subcontractors) is actually located outside Argentina.

16 Art. 5, PDPA.

Unlike in Mexico and certain other Latin American countries, Argentina does not provide an exception to obtaining consent when gathering and producing personal data is necessary in connection with a judicial proceeding. Accordingly, in order to comply with the PDPA, companies involved in U.S. litigation must obtain express, revocable consent from data owners in Argentina before treating processing personal data.

Personal data collected for processing must be: (1) truthful, adequate, pertinent, and proportionate; (2) used only for the limited purpose for which it was legally obtained; (3) collected using fair and honest means; and (4) stored such that data owners can exercise their rights of access. Personal data that is inaccurate or incomplete, in whole or part, must be immediately updated, amended or suppressed. Any personal data collected must be destroyed once the purposes of the collection have been met.[17]

Unlike the data privacy laws of many other countries, the PDPA does not require entities to appoint a personal data officer to oversee compliance and manage requests from data owners.

Personal data can generally only be communicated or transferred with the data owner's prior consent upon being informed of both the purpose of the proposed transfer and the identity of any and all prospective recipients.[18] Where personal data is transferred, the recipient is subject to the same regulatory and legal obligations as the data user.[19]

Cross-border transfers of personal data out of Argentina likewise require the data owner's express consent[20] and may only include countries that provide data protection comparable to the PDPA.[21] Exceptions to this latter requirement include, among others: (1) where the data owner consents to an international transfer without such protection; (2) where adequate protection levels are secured by agreement; and (3) cases of international judicial collaboration or intelligence sharing.[22]

Despite the text of these seemingly onerous regulations, it is not clear how strictly the PDPA prohibitions on cross-border transfers are interpreted or enforced in Argentina. The United States does not have a data protection scheme comparable to the PDPA, which suggests that litigants in U.S. courts would have to obtain the express consent of the data owner for the international transfer of personal data and, if at all possible, secure an agreement with other parties involved in the litigation (or move for an order of court) providing for heightened protection of all personal data culled from Argentine data owners, as called for in the PDPA

Regardless, the PDPA requires the data user to take such technical and organizational measures as are necessary to guarantee the security, integrity and confidentiality of personal data in order to avoid their alteration, loss, or unauthorized access or processing. Such measures must allow the data user to detect any intentional or

17 Art. 4, PDPA.
18 Art. 11, PDPA. Such consent is not required where, among other reasons: (1) a law so provides; (2) the transfer is made directly between government agencies; or (3) the personal data has been disassociated from the data owner.
19 *Id.* This would appear to include cloud services providers processing data from Argentina but operating outside Argentina. *See supra*, n.14.
20 Art. 12, PDPA Regulations. Consent is not required for transfers of personal data from a register that is legally constituted to provide information to the public and which is open to consultation either by: (1) the public in general; or (2) any person who can demonstrate legitimate interest, provided that the legal and regulatory conditions for the particular query are fulfilled.
21 Art. 12, PDPA.
22 *Id.* Additional statutory exceptions apply in the following circumstances: (1) the exchange of certain medical data; (2) bank transfers or exchanges; and (3) transfers arranged within the framework of international treaties to which Argentina is a party.

unintentional distortion or breach of such information.[23] The PDPA does not require data security breaches or losses to be reported to Argentina's data protection authority or to data owners. Pursuant to applicable security regulations, however, all data incidents must be recorded in a security ledger that Argentina's data protection directorate is entitled to inspect upon request.[24] This regulation stresses the importance of the fifth of the six *Int'l Principles* - keeping a detailed, accurate log of all efforts to address data protection obligations.

The *Dirección Nacional de Protección de Datos Personales* ("DNPDP") is the national directorate charged with overseeing Argentina's data protection regime. The DNPDP, while characterized as "independent" in the exercise of its duties, is housed within Argentina's Ministry of Justice and Human Rights, from which it receives its operating budget.[25] The DNPDP is responsible for educating parties on the terms of the PDPA, issuing rules and regulations, maintaining the registry of existing databases, monitoring compliance, conducting inspections, and imposing sanctions.[26] To fulfill these responsibilities, the DNPDP has authority to conduct investigations, either upon request of a data owner or data user, or on its own initiative.[27]

Where violations of the law are identified, the DNPDP has the power to impose administrative sanctions, including warnings, suspension, or cancellation of a data user's right to maintain a database, as well as monetary penalties ranging from AR$1,000 to AR$100,000 (approximately $200 to $20,000 USD), depending on the scope and severity of misconduct. Data owners whose rights have been violated may seek a separate recovery for damages arising from the violation of their data protection rights.[28] Beyond monetary sanctions, criminal charges may be brought against violators which carry terms of imprisonment ranging from one month up to three years, depending upon the violator's position of trust and the severity of the violations.[29]

On June 30, 2003, the European Commission formally recognized Argentina as providing an "adequate" level of protection for personal data that comports with the European Union's Directive on the Protection of Personal Data.[30] The European Commission's recognition notwithstanding, critics have questioned Argentina's commitment to enforcing the law. From 2005 to mid-2012, the DNPDP imposed only nineteen sanctions, most of which were in the form of written warnings.[31] Possible explanations for Argentina's failure to adequately enforce the law include insufficient resources and a lack of political will. Indeed, the EU has questioned the independence of the DNPDP Director because he is both nominated and subject to dismissal by Argentina's Minister of Justice and Human Rights.[32] The EU has also expressed concern about the effectiveness of the DNPDP because it possesses only federal jurisdiction and lacks power when a matter falls within the jurisdiction of an Argentine province.[33]

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23 Art. 9, PDPA. The DNPDP provides additional information on its security expectations in resolutions N° 11/2006 and N° 9/2008, which, among other things, detail basic, intermediate, and critical levels of security to be implemented, depending on risk factors such as the nature and sensitivity of the data.
24 Resolution N° 11/2006 and Resolution N° 9/2008.
25 Resolution N° 1558/01, Art. 29.
26 Art. 29, PDPA.
27 Arts. 29, 31-32, PDPA.
28 Arts. 33-44, PDPA.
29 Arts. 29, 31-32, PDPA.
30 Commission of the European Communities, Commission Decision C (2003) 1731 (June 30, 2003).
31 Enrique M. Stile, *The Current Importance of Implementing Data Protection in Argentina*, Employment Law Alliance (Apr. 10, 2012), www.employmentlawalliance.com/firms/marvalar/articles/the-current-importantce-of-implementing-data-protection-in-argentina.
32 A Journal of Law and Policy for the Information Society 2005–2006, *Argentina's Protection of Personal Data: Initiation and Response*, at 799-800, www.moritzlaw.osu.edu/students/groups/is/files/2012/02/gakh.pdf.
33 *Id.*

Despite the apparent lax enforcement of Argentina's data privacy laws, companies operating in Argentina should tread carefully given the scope of the protections outlined in the PDPA. The *Int'l Principles* appear useful in the Argentine context, particularly their focus on transparency, communication, and recordation of an entity's efforts to comply with the law. Specifically, individuals and multi-national companies operating in Argentina and participating in U.S. litigation should consider the following:

- **According due Respect:** Both litigants and courts should show respect for the Argentine data privacy law and regulations. With recognition from the European Commission, Argentina's law carries some strict requirements with respect to express consent, registration of databases, and restrictions on international transfers of information. While Argentina's enforcement agency, the DNPDP, does not appear to use its powers as often or as consistently as similar agencies in Europe (or Mexico), data users in Argentina should still make litigants and courts aware of the PDPA and the potential consequences they may suffer for violating it.

- **Acting in Good Faith:** Given the limits on international transfers of personal data and the need for express consent, data users should bring the PDPA to the attention of the court and litigants at the very beginning of litigation. Indeed, data users should set the table for acting reasonably and in good faith by providing internal policies for obtaining express consent from employees to gather business and personal data, preserving potentially relevant data, and determining whether a database needs to be registered under the PDPA. However, obtaining express consent from other data owners (i.e., clients, individuals, or legal entities) may prove difficult.

- **Limiting the Scope of Discovery:** With Argentina striving to bring its data privacy and protection laws in line with those in Europe, the *Int'l Principle* counseling a litigant to limit the scope of electronic discovery to only that data relevant and necessary to support a party's claim or defense should be applied as it is in Europe. If identical or substantially similar data may be obtained domestically or from a country with less stringent data privacy laws, such as Brazil,[34] then a data controller should seek to prevent disclosure of data originating in Argentina (at least initially). Whether gathering and producing data via Fed. R. Civ. P. 26(a)(1) or 34, data users should seek to narrow the focus of production through agreement.[35]

- **Negotiating a Stipulation/Protective Order:** Because of the PDPA's restrictions on cross-border transfers of personal data, parties involved in U.S. litigation should act quickly and invite collaboration with other parties to provide a framework for protecting personal data originating in Argentina in a manner consistent with the PDPA. This

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34 Brazil has no law that specifically addresses data protection. Instead, similar to the United States, Brazil has a patchwork of laws and regulations that extend varying degrees of data protection to particular types of relationships, industry sectors, and professions. *See* Luiz Costa, *A Brief Analysis of Data Protection Law in Brazil*, Consultative Committee of the Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data (June 2012).

35 Data users should also use their judgment to limit the scope of data preservation, acting in good faith and consistent with a reasonable interpretation of what data may be relevant to the case.

process could involve the DNPDP if the data user has questions about the applicability of the PDPA to certain types of data or electronic information systems.[36] Under the PDPA, data users need to ensure via agreement or court order that personal data gathered in Argentina and transferred to the United States is protected in line with the terms of the PDPA and that sensitive personal data is not transferred at all.

- **Demonstrating Adequate Process:** The PDPA specifically notes that Argentina's data protection directorate is entitled to inspect documents which set forth the steps that the data user has taken to act in good faith and avoid violating the PDPA when gathering, using, and transferring personal data. Accordingly, all data users should ensure careful recordation of all steps taken and considered in order to comply with the PDPA while also meeting their preservation and discovery obligations in U.S. litigation.

- **Responsibly Disposing of Protected Data:** Data users also must implement policies that facilitate the destruction or return of personal data once the litigation has ended (or the data is no longer necessary or relevant). Ideally, this process should be incorporated into the agreement or court order sought through the fourth *Int'l Principle*.

In sum, Argentina's data privacy and protection regime strives to be as restrictive as those in Europe (and particularly Spain), but falls short in several areas. First, the agency tasked with enforcing the PDPA lacks effective enforcement capabilities compared to European data protection agencies. Second, while the law applies to both individuals and legal entities, the language of the law, drafted in 2000, has not kept pace with technological advancement and therefore remains vague and difficult to apply to cloud or internet-based networks, databases and mobile devices located outside of Argentina. Third, Argentina's law, even if enforced, does not have fines and criminal sanctions on par with those utilized in Europe and other Latin American countries.

Mexico – A More Nuanced Approach

Mexico features one of the most recently passed data protection laws in Latin America. Enacted in July 2010, the *Federal Law on the Protection of Personal Data Held by Private Parties* ("LPPD") provides the regulatory framework for data protection by private parties in Mexico.[37] Since passage of the LPPD, Mexico has taken several steps to fully implement the law, including issuing: (a) regulations pursuant to the LPPD which entered into force in December 2011;[38] (b) "Parameters for Self-Regulation" which entered into force in January 2013;[39] and (c) "Privacy Notice Guidelines," which became effective in April 2013.[40]

36 One complication with this approach is the possibility that a data user has not registered a database with the DNPDP because the server or system is located outside of Argentina. In this case, the data user should seek counsel and interpretation of the PDPA from an expert in the law.

37 Data protection by public entities in Mexico is governed by the *Federal Law on Transparency and Access to Public Government Information* ("FLTA"), enacted in 2002.

38 Regulations of the Federal Law on the Protection of Personal Data Held by Private Parties (or "LPPD Regulations") (Dec. 22, 2011).

39 Parameters for Adequate Application of the Self-Regulatory Scheme Commitments Referred to in Article 44 of the Federal Law for the Protection of Personal Data in Possession of Individuals, Official Gazette of the Federation (Jan. 17, 2013).

40 Privacy Notice Guidelines (Apr. 17, 2013).

The LPPD, passed shortly after the 2009 Madrid Resolution outlining International Standards on the Protection of Personal Data and Privacy, seeks to ensure that personal data in Mexico are only processed for legitimate purposes with informed consent, in line with the rights of privacy and self-determination enshrined in Mexico's constitution.[41] In mid-January 2013, the APEC ("Asia-Pacific Economic Cooperation") announced that Mexico had become the second formal participant in the APEC's Cross-Border Privacy Rules ("CBPR") framework, following the United States, which became the first formal participant in July 2012.[42]

The LPPD, with limited exception, governs the ability of private entities and individuals (or "data controllers") to "process" (or access, collect, use, manage, disclose, transfer, or store) the "personal data" of others – broadly defined to include any information concerning an identified or identifiable individual.[43] For instance, personal data include an individual's name, address, telephone number, e-mail address, etc. Additionally, the LPPD affords a higher level of protection to what it terms "sensitive personal data," which are personal data touching on the most private areas of an individual's life, the misuse of which might lead to discrimination or involve a serious risk.[44] These definitions of "personal data" and "sensitive personal data," while similar to those used by EU countries, include nuances that distinguish Mexico's data privacy law from most other countries' laws.

According to the LPPD Regulations, it applies to personal data: (a) processed by an establishment (i.e., individual, company or subsidiary of a company) of a data controller in Mexico; (b) processed anywhere in the world on behalf of a data controller established in Mexico; (c) where Mexican law is applicable by virtue of a contract or international law; or (d) where the data controller, while not established in Mexico, uses means located in Mexico to process personal data located abroad (which must be more than the mere transit of personal data through Mexico).[45]

Given the language of these Regulations, the LPPD would reach all electronic personal data held by a Mexican subsidiary of a multi-national company, even if the data may be accessed from an office in the United States. Clearly, the Mexican law was drafted with the concept of cloud computing firmly in mind, as it reaches outside of Mexico to data "processed anywhere in the world" on behalf of an entity or individual in Mexico. Under this framework, it appears that a Mexican employee using a mobile device while working in Canada would be creating potentially protectable data.

In instances where private entities or individuals seek to process personal data without violating Mexican law, the LPPD advises adhering to the following eight key principles: (1) Legality: The processing of personal data must adhere to Mexican and international law; (2) Consent: To process personal data, data controllers must generally obtain informed consent from the individuals to whom the data relates (or "data owners"); (3) Notice/Information: Data controllers must issue a privacy notice that communicates to

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41 Arts. 6, 7, 16, 20 of the Political Constitution of the United Mexican States. Article 16 amended in June 2009 to include the following language (unofficial translation): "All people have the right to enjoy protection on his personal data, and to access, correct and cancel such data. All people have the right to oppose disclosure of his data, according to the law. The law shall establish exceptions to the criteria that rule the handling of data, due to national security reasons, law and order, public security, public health, or protection of third party's rights."

42 Cedric Laurant, Mexico Implements APEC's Cross-Border Privacy Rules, Cedric's Privacy Blog, (Feb. 26, 2013), www.blog.cedriclaurant.org/2013/02/26/mexico_implements_apec_cross-border_privacy_rules/.

43 Arts. 2-3, LPPD.

44 Art. 3, LPPD. In particular, this encompasses data related to racial or ethnic origin, current or future health status, genetic information, religion, philosophical or moral beliefs, union membership, political views, or sexual preference. The LPPD also has higher level requirements for data controllers seeking to create databases of "sensitive data." Art. 9, LPPD.

45 Art. 3, LPPD Regulations.

data owners the type of personal data involved and the purposes for which it will be processed; (4) Quality: Personal data that are processed must be pertinent, correct, exact, complete, and up to date; (5) Purpose: Personal data may only be processed for the explicit purposes outlined in the associated privacy notice provided to data owners; (6) Fidelity/Loyalty: Data controllers must protect the interests of the data owners when processing personal data; (7) Proportionality: Data controllers may only process the personal data necessary to fulfill the purposes for which they were obtained; (8) Accountability/Responsibility: Data controllers bear responsibility for the personal data in their custody.[46]

In accordance with the principles above, companies and individuals wishing to process personal data must, except in limited circumstances, obtain consent from the data owners. To obtain such consent, data controllers must provide data owners with a privacy notice in advance (either electronically, orally, or in writing) that plainly identifies, among other things, the following: the data controller; the personal data at issue and the purpose for which it is being sought; whether the personal data will be transferred; and the data controller's rights, including the right to withhold consent or revoke it prospectively at a later time. Data controllers must also designate a personal data officer to manage requests from data owners seeking to exercise these rights.[47]

For personal data that is neither "sensitive" nor financial in nature, consent may be implied from the lack of any objection by the data owner to the privacy notice (notice and opt out). For financial data, however, consent must be express, and for sensitive personal data, consent must be express *and* written (with notice and an "opt in"). If the purpose for processing the personal data ever changes from the justification originally set out in the privacy notice, consent must be re-obtained.[48]

The LPPD also identifies a limited number of circumstances in which consent for the processing of personal data is not required, including where: (1) a law or resolution from a competent authority so provides; (2) the personal data are publicly available; (3) the personal data is dissociated (i.e., can no longer be used – either by itself or jointly with other information – to identify the individual); (4) the processing of personal data is to comply with the obligations of a legal relationship with the data owner; (5) an emergency exists that could potentially harm an individual or her property; or (6) it is necessary for medical reasons and the data owner is unable to grant consent.[49]

Data controllers may transfer personal data to third parties, either domestically or abroad, if they have obtained consent for such transfers by adequately providing for them in the governing privacy notice. Where personal data is transferred to a third party, the data controller must take sufficient steps to ensure that the third party complies with Mexican law and the applicable privacy notice. The LPPD exempts several types of transfer from the consent requirements, including, among others, transfers: (a) made to a holding company, parent, subsidiary, or affiliate of the data controller; (b) necessary to comply a legal relationship that is with or for the benefit of the data owner; or (c) necessary in connection with a judicial proceeding or are otherwise required by law or authority.[50]

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46 Art. 6, LPPD; Arts. 10-40, LPPD Regulations.

47 Art. 15-18, LPPD; Arts. 22-29, LPPD Regulations. Under the LPPD, data owners enjoy what are known as an "ARCO" right, including the right to: (a) access their personal data; (b) rectify erroneous or incomplete personal data; (c) cancel the processing of their personal data; and (d) object to the processing of their personal data. *See* Arts. 16-35, LPPD; Arts. 71-85, LPPD Regulations.

48 Arts. 8-10, LPPD; Arts. 11-19, LPPD Regulations.

49 Arts. 10, LPPD.

50 Arts. 36-37 LPPD; Arts. 60-63, LPPD Regulations.

Given the infancy of the Mexican law, it is not yet clear whether the reference to a "judicial proceeding" in the LPPD means that a data controller in civil litigation in the United States would not need to obtain the consent of a data owner before gathering, processing, and producing his or her personal data in discovery.[51] Not surprisingly, American courts often interpret a foreign law's reference to "judicial proceedings" to include civil litigation in the United States.[52]

The LPPD imposes additional obligations on a data controller once the data has been gathered. Data controllers must establish and maintain adequate physical, technical and administrative security measures designed to protect personal data from unauthorized damage, alteration, loss, or use. Third parties hired to secure personal data on behalf of a data controller assume the obligations as the data controller. Where there has been a breach of personal data, data controllers must promptly notify data owners upon assessing the nature and extent of the breach.[53]

The *Instituto Federal de Acceso a la Información* ("IFAI") is the federal agency that oversees Mexico's data protection regime, with assistance from other agencies, including the Ministry of Economy. IFAI, which has operational, budgetary, and decision-making autonomy, is responsible for, among other things, proactively monitoring and enforcing compliance with the LPPD and LPPD Regulations, responding to complaints from data owners, and imposing sanctions for non-compliance.[54] To fulfill these responsibilities, IFAI has authority to conduct investigations, either upon request of a data owner or data controller or on its own initiative.[55]

Where violations of the law are identified, IFAI can impose monetary penalties from 100 to 320,000 times the daily minimum wage in Mexico City (which amounts to approximately $500 to $1.5 million USD),[56] depending on the scope of misconduct, with fines potentially doubling for repeat offenses. Where the misconduct involves the processing of sensitive personal data, fines can be increased up to double these amounts. Beyond monetary sanctions, criminal charges can be brought against violators carrying terms of imprisonment ranging from three months to five years, depending upon the severity of the violations.[57]

While Mexico's data protection laws are the most recently implemented, they are not as stringent as others in the region (e.g., Argentina and Uruguay) and they have not yet been deemed adequate by the European Union. However, Mexico's data protection regime nevertheless appears well-positioned to be among the most effective in Latin America in

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51 Spain's data privacy law includes a similar reference to "judicial proceeding," with the nationality of the proceeding unspecified. In Spain, foreign judicial proceedings are generally included within the definition of the phrase so long as the data controller is the individual or party involved in the proceeding.

52 For example, in a recent decision in the United States District Court for the Southern District of New York concerning a subpoena served on Banco De La Nacion Argentina ("BNA"), *NML Capital, Ltd. v. Republic of Argentina*, 03 Civ. 8845 (TPG) *et al.*, 2013 U.S. Dist. LEXIS 17572, at *42 (S.D.N.Y. Feb. 8, 2013), the court noted that the text of many countries' data privacy laws "provide no basis for holding that the [consent] exception applies only to a court order from a country's own court." Accordingly, the court found that the laws "do not prohibit BNA from complying with this court's orders to produce responsive documents." *Id.*

53 Arts. 19-21, LPPD; and Arts. 49-59, LPPD Regulations.

54 Arts. 38-44, LPPD; and Monika Kuschewsky, *Data Protection & Privacy*, at 357-58 (2012). Earlier this year, a bill was introduced in the Mexican Congress that would amend the Mexican Constitution by, among other things, creating an independent federal agency, separate and apart from IFAI, to protect private sector data. Transitory Art. 5, Proposed Amendments to the Mexican Constitution, at 109 (April 2013). The proposed amendment's ultimate fate is unclear, but it is not expected to pass this year.

55 Arts. 45-60, LPPD; and Arts. 113-122, LPPD Regulations.

56 The Council of Representatives of Mexico's National Minimum Wage Commission set the minimum wage for Geographic Area "A," an area which includes Mexico City, at 64.76MXN a day. Cuesta Campos Abogados, *General Minimum Wage 2013* (Jan. 13, 2013), www.cuestacampos.com/site/library/general_minimum_wage.html.

57 Arts. 63-65, LPPD.

terms of protecting personal data. Reasons for this include IFAI's budgetary independence and administrative autonomy, which serve to embolden the agency and leave it free to enforce the law in ways that may be politically unpopular.

IFAI, which is also responsible for overseeing FLTA, the law governing public data protection in Mexico, has not shied away from challenging prominent public institutions in Mexico. Just this year, IFAI has issued prominent directives against the following institutions: Instituto Mexicano del Seguro Social ("IMSS"), the government agency that administers public health, pension and social security programs in Mexico;[58] Secretariado Ejecutivo del Sistema Nacional de Seguridad Pública ("SESNSP"), the government agency for public security;[59] and Petróleos Mexicanos ("PEMEX"), Mexico's state-owned oil company.[60]

IFAI has also exercised its enforcement authority in the private sector, imposing several significant sanctions since the LPPD went into effect. For instance, in December 2012, the IFAI imposed sanctions of over two million Mexican pesos (over $162,000 USD) on Pharma Plus S.A. de C.V., a company which operates pharmacies in Mexico, for failing to provide a sufficient privacy notice to patients whose information regarding filling prescriptions for psychotropic medications was systematically collected.[61]

Though Mexico's data protection law contains nuances distinguishing it from those in Europe and other Latin American countries, the *Int'l Principles* provide a framework for successfully navigating the new law and regulations. Data controllers litigating in the United States should focus on transparency, communication, and reasonable limits on the scope of data collected. Specifically, individuals and multi-national companies operating in Mexico and participating in U.S. litigation should consider the following:

- **According due Respect:** Both litigants and courts should show respect for the new Mexican law and regulations. With an independent agency, IFAI, proving willing to enforce Mexico's data privacy and protection schema, data controllers appear to be at risk of fines and even criminal prosecution if they process personal data without consent or misuse any such data.

- **Acting in Good Faith:** Ultimately, data controllers involved in U.S. litigation will be judged both by a U.S. court and Mexico's IFAI by their reasonableness and good faith. That is why they must identify custodians and categories of potentially relevant protected data as early as possible. Communication between a data controller and the individuals whose data may be relevant to a U.S. legal action is crucial, and should include consent forms and explanations about the need for the data and the individuals' privacy rights. Data controllers have an opportunity in Mexico to obtain "implied consent" of data owners through, for example, a section of an employee handbook. This may be sufficient to allow data controllers to gather, process, and

58 Uniradioinforma.com, *Deberá el IMSS información de servicio de traslado colectivo: IFAI* (May 11, 2013), www.uniradioinforma.com/noticias/mexico/articulo192248.html.
59 Cronica.com.mx, *Instruye IFAI informar sobre órdenes de aprehensión pendientes* (May 27, 2013), www.cronica.com.mx/notas/2013/756337.html.
60 Vanguardia, *Ordena IFAI a Pemex estregar copia de contratos* (May 15, 2013), www.vanguardia.com.mx/ordenaifaiapemexestregarcopiadecontratos-1741784.html.
61 Computerworld Mexico, *Farmacias San Pablo, primera compañía multada por violar la LFPDPPP* (Dec. 5, 2012), /www.computerworldmexico.mx/Articulos/26557.htm.

produce employees' personal data that is neither financial nor sensitive in nature (as defined in the Mexican law). Communication between a litigant and adversary is similarly crucial, as a litigant must voice proportionality concerns early to avoid "going down the rabbit hole."

- **Limiting the Scope of Discovery:** Litigants should attempt to limit the scope of electronic discovery to non-sensitive, non-financial personal data that is relevant and necessary to support a party's claim or defense. If identical or substantially similar data may be obtained domestically or from a country with a less protective data privacy law, then a data controller should seek to prevent disclosure of personal data originating in Mexico (at least initially). Whether gathering and producing data via Fed. R. Civ. P. 26(a)(1) or 34 (or, in certain cases, Fed. R. Civ. P. 45), data controllers should seek to narrow the focus of production through agreement.

- **Negotiating a Stipulation/Protective Order:** While this concept is certainly not unique to Mexico, parties should act cooperatively when a case involves personal data originating in Mexico. One way to approach this would be to draft a protective order: (a) defining "personal data" in line with Mexico's law; (b) extending special confidentiality protection to any such data produced in the case; (c) defining "sensitive personal data" in line with Mexico's law and excluding such materials from preservation and production or, if such data are relevant and necessary in the case, allowing a party to redact the individuals' names and identifying information so that relevant data may be produced anonymously; (d) seeking an order phasing discovery so that non-personal data may be produced and reviewed before a party processes personal data; and (e) agreeing on a protocol or legitimization plan that maximizes simultaneous compliance with Mexico's data privacy law and a data controller's preservation and discovery obligations.

- **Demonstrating Adequate Process:** If a data controller adheres to the first four *Int'l Principles* when dealing with electronic data in Mexico, the fifth should be achievable with one additional step – the data controller should prepare documentation of all efforts taken to comply with Mexico's data privacy law and to comply with its preservation and discovery obligations.

- **Responsibly Disposing of Protected Data:** The data controller should ensure that it has implemented sufficient policies such that the attorneys and individuals handling protected data are both capable of protecting the data from unwanted disclosure and disposing of the data when no longer necessary.

Overall, Mexico's LPPD provides a clearer, more current construct for protecting personal data, but it is not as restrictive on its face as the laws in place in Argentina or Uruguay. For example, the LPPD allows data controllers to obtain "implied consent" from data owners for transfer of non-sensitive, non-financial personal data. The LPPD also allows more exceptions to consent for transfers to subsidiaries, affiliated companies, and even across borders.

However, data controllers in Mexico should not view the more limited restrictions as an invitation to ignore the LPPD. The law includes substantially larger fines and criminal penalties than Argentina's and Uruguay's law, and the IFAI has demonstrated the autonomy and will to investigate and enforce the LPPD. All of these factors counsel taking the same type of nuanced approach to Mexico's data privacy law that Mexico took in drafting and implementing it.

Uruguay – Leaning Toward Spain

Uruguay enacted the *Protection of Personal Data and Habeas Data Action* ("PDHDA") in August 2008.[62] The PDHDA shares much in common with Argentina's PDPA, as Spain's data protection regime served an influential role in the drafting of both privacy statutes. Since the passage of the PDHDA, Uruguay has issued several directives implementing the statute, the most comprehensive of which came in August 2009.[63]

The PDHDA states at the outset that the right to the protection of personal data "is inherent in the human person," and therefore enshrined in the country's Constitution. Furthermore, according to the PDHDA, the protection of personal data can apply by extension to legal persons, as appropriate.[64]

The PDHDA, with limited exception, governs the ability of any person (or "data user") to "process" (or treat, collect, use, form, store, organize, transfer, or communicate) the "personal data" of others - broadly defined to include any information concerning identified or identifiable natural or legal persons.[65]

Additionally, the PDHDA affords a higher level of protection to what it terms "sensitive data," or personal data revealing racial or ethnic origin, political views, religious, philosophical or moral beliefs, union affiliations and any information concerning health status or sexual habits or behavior.[66] No person can be compelled to provide sensitive data, and it may only be collected and treated in cases of public interest authorized by law and for statistical or scientific purposes, provided that the data owners are no longer identifiable.[67]

The processing of personal data is subject to the PDHDA when it is conducted by a data user or processor whose activities are carried out in Uruguayan territory or where the processing is carried out by a means located in the country.[68] Where private entities or individuals seek to process personal data without violating Uruguayan law, they must adhere to seven key principles: (1) legality; (2) truthfulness; (3) purpose/finality; (4) prior informed consent; (5) data security; (6) confidentiality; and (7) responsibility.[69]

Data users who wish to process personal data under the PDHDA must, except in limited circumstances, obtain the express and informed consent of the data owners, which must be freely given and documented.[70] To obtain such consent, which may be revoked at

62 Law No. 18.331 (Aug. 11, 2008).
63 Decree No. 414/009, Regulations on Law No. 18, 331 (August 31, 2009) ("PDHDA Regulations").
64 Arts. 1-2, PDHDA. While the Constitution of the Eastern Republic of Uruguay does not expressly acknowledge rights to privacy and the protection of personal data, Article 72 states that "[t]he listing of rights, obligations and guarantees made by the Constitution does not exclude others that are inherent to the human personality or that derive from the republican form of government."
65 Arts. 1-10, PDHDA. Statutory exceptions include databases: (1) held by individuals for personal or household use; (2) used by public safety, defense, state security and law enforcement; (3) created and regulated by special laws.
66 Art. 3, PDHDA.
67 Art. 18, PDHDA.
68 Art. 3, PDHDA Regulations.
69 Art. 5, PDHDA.
70 Art. 9, PDHDA; Arts. 5-6, PDHDA Regulations.

any time, data users must notify data owners in advance of: (1) the purpose for which the personal data will be treated; (2) who the personal data may be provided to; (3) the existence of the relevant database and the identity and location of the person responsible for it; (4) the compulsory or discretionary character of any questions being asked; (5) the consequences of providing the data, of refusing to do so, or of providing inaccurate data; and (6) their right to data access, rectification, and deletion of data.[71] Once the reasons for processing the personal data are no longer present, the personal data must be deleted.

The additional requirement of "informed" consent, which is not expressly mentioned in the Argentine or Mexican laws (even if it may be easily inferred), again makes communication between data users and data owners absolutely crucial. The remaining regulations in this portion of the PDHDA emphasize the need for involving data owner custodians in the data collection process, in addition to providing them with regular updates about the processing and production of any personal data in U.S. litigation.

The PDHDA also identifies a limited number of circumstances in which consent for the processing of personal data is not required, including, among others, situations where the data: (1) are secured from a publicly available source; (2) are collected in connection with the exercise of duties inherent in the powers of the state; (3) are limited to certain basic information, including name, national identity card number, tax or social security identification number, occupation, birth date, address, and telephone number; (4) arise from a scientific or professional contractual relationship and are necessary for its development or fulfillment; or (5) are used for personal or domestic purposes only.[72] This portion of the PDHDA largely mirrors the Argentine PDPA and the Spanish data protection regulations.

Also similar to Argentina's PDPA and the Spanish data protection regulations, Uruguay's PDHDA requires all public and private databases to register with the Uruguay's data protection authority, unless otherwise exempted, before they begin to process personal data.[73] The filing of these registrations is accomplished by submitting a hard copy to Argentina's data protection authority that includes, at a minimum, the following information: (1) the database and the data user; (2) nature of the personal data contained in the database; (3) procedures for obtaining and processing the personal data; (4) means used to ensure data security, including details on the individuals with access to the information treatment process; (5) protection of personal data and the exercise of privacy rights; (6) destination of the personal data and individuals or entities to whom the data may be transferred; (7) duration for which the data will be stored; and (8) conditions under which third parties can access their personal data, and the procedures to rectify or update such data.[74]

Unlike the data privacy laws of many other countries, the PDHDA does not require entities to appoint a personal data officer to oversee compliance and manage requests from data owners.

Personal data can generally only be communicated to another individual or entity: (a) for purposes directly related to the legitimate interests of both the data user and the recipient;[75] and (b) with the data owner's prior consent upon being informed of both the

71 Arts. 13-17, PDHDA; Arts. 9-16, PDHDA Regulations.
72 Art. 9, PDHDA; Arts. 5-6, PDHDA Regulations.
73 Arts. 28-29, PDHDA; Arts. 15-16, PDHDA Regulations.
74 *Id.*
75 Article 7(f) of the EU Directive features a similar reference to "legitimate interests," which means that the processing of non-sensitive data may be based on a data controller's (or assignee's) legitimate commercial interest when data owners' fundamental rights are not overridden.

purpose of the proposed transfer and the identity of the prospective recipient.[76] Where personal data is transferred, the recipient is subject to the same regulatory and legal obligations as the data user.[77] It is not yet clear whether the "legitimate interests of both the data user and the recipient" would include disclosure of personal data in the context of civil litigation in the United States. However, it should be noted that litigation could potentially be used as legitimate grounds for processing and producing non-sensitive data, provided that adequate safeguards of data owners' rights are adopted (e.g., through a stipulation or protective order). This concept has been accepted by the Spanish Data Protection Supervisory Authority.

The PDHDA generally prohibits the transfer of personal data to countries or international organizations that do not provide adequate levels of data protection.[78] Exceptions to this prohibition can include, among others, situations in which the transfer is: (1) pursuant to international judicial cooperation or intelligence sharing; (2) related to certain bank transfers or exchanges; (3) allowed under an international treaty to which Uruguay is a party; (4) unambiguously consented to by the data owner; (5) necessary for contractual reasons; or (6) necessary or legally required for the safeguarding of vital interests.[79]

Cross-border transfers of personal data between or within a group of companies is permitted without any additional authorization in situations where the parent, subsidiary, affiliate or branch receiving the personal data has adopted a code of conduct duly registered with the *Unidad Reguladora y de Control de Datos Personales* ("URCDP").[80]

The PDHDA also requires the data user to adopt technical and organizational measures as necessary to ensure the security, integrity and confidentiality of personal data in order to avoid their alteration, loss, unauthorized access, or treatment.[81] Where a data user (or person responsible for processing) detects a security breach that is likely to substantially affect the rights of the data owner or other stakeholders, the data user must inform the persons involved.[82]

The URCDP, a decentralized and autonomous arm of Uruguay's Agency for the Development of Electronic Government and Information Society and Knowledge ("AGESIC"), is the government authority charged with overseeing the country's data protection regime.[83] The URCDP is responsible for, among other things, advising parties on the terms of the PDHDA, issuing rules and regulations, maintaining the registry of existing databases, monitoring compliance, conducting inspections, and imposing sanctions.[84] To fulfill these responsibilities, the PDHDA provides the URCDP with broad investigative powers, including audit and inspection rights, and subpoena, search and seizure authority.[85]

Where violations of the law are identified, the URCDP may impose administrative sanctions, including warnings, suspension or cancellation of the respective database, and

76 Art. 17, PDHDA; Art. 14, PDHDA Regulations. Such consent is not required where, among other reasons: (1) it is a law of general interest; (2) the personal data relates to health and sharing it is necessary for reason of public health and safety; or (3) the personal data has been disassociated from the data owner.
77 *Id.*
78 Art. 23, PDHDA; Art. 34, PDHDA Regulations.
79 *Id.*
80 Art. 35, PDHDA Regulations.
81 Art. 10, PDHDA; Arts. 7-8, PDHDA Regulations.
82 *Id.*
83 Arts. 31-36, PDHDA Regulations.
84 *Id.*
85 *Id.*

monetary penalties of up to UYU500,000 (approximately $25,000 USD), depending on the scope and severity of misconduct. PDHDA does not provide grounds for criminal enforcement or imprisonment.[86]

On August 21, 2012, the European Commission formally recognized Uruguay as providing an "adequate" level of protection for personal data that comports with the European Union's Directive on the Protection of Personal Data.[87] In addition, on April 10, 2013, Uruguay acceded to Convention 108, the Council of Europe's data standards treaty.[88]

Uruguay's data protection legislation is very similar to Argentina's, though its specific requirements concerning "informed" consent and emphasis on the rights of data owners to maintain access to their personal data counsel full application of those *Int'l Principles* which provide for constant communication between data users and data owners. Individuals and multi-national companies operating in Uruguay and participating in U.S. litigation should consider the following:

- **According due Respect:** Both litigants and courts should show respect for the Uruguay law and regulations, which has been judged adequate by the European Commission. Uruguay's push to accede to Convention 108 also bolsters the credibility of the PDHDA. While Uruguay's data protection agency, the URCDP, does not have a long history of enforcing the PDHDA or imposing fines and penalties, Uruguay's recent push for full European recognition may portend robust enforcement efforts in the future.

- **Acting in Good Faith:** The need for data users to act reasonably and in good faith, particularly with respect to communicating with and obtaining express consent from data owners, is emphasized in the PDHDA. Entities operating in Uruguay need to implement and adhere to policies that both educate data owners and provide a framework for obtaining their informed consent when data users need to preserve potentially relevant data and determine whether a database needs to be registered under the PDHDA.

- **Limiting the Scope of Discovery:** Even more important than in Mexico or Argentina, companies operating in Uruguay and litigating in the United States need to limit the scope of discovery into the personal data of data owners located in Uruguay. Given that data users must obtain the informed consent of data owners, and because that consent may be revoked at any time for any reason, data users continually risk violating the PDHDA when processing and producing personal data. Accordingly, parties should hew closely to this *Int'l Principle*, which counsels working with opposing parties and the court to limit the scope of electronic discovery to only that data relevant and necessary to support a party's claim or defense.

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86 Art. 35, PDHDA.
87 Commission of the European Communities, Commission Decision C (2012) 5704 (Aug. 21, 2012).
88 Stanislava Gaydazhieva, *Uruguay Joins European Data Protection Convention*, New Europe Online, (Apr. 12, 2013), www.neurope.eu/article/uruguay-joins-european-data-protection-convention.

- **Negotiating a Stipulation/Protective Order:** The PDHDA's restrictions on transfers to countries with lesser levels of data protection, which includes the United States, means that a data user in Uruguay involved in U.S. litigation should proactively seek a stipulation or protective order providing confidentiality and other safeguards for any personal data gathered, processed, and potentially produced in the case. Under the PDHDA, in order to transfer personal data from Uruguay to the U.S. in a civil litigation context, it appears that a data user must provide comparable safeguards as discussed above or obtain the unambiguous (and revocable) consent of each data owner.

- **Demonstrating Adequate Process:** As in Argentina, Uruguay's data privacy law empowers its data agency to monitor compliance with the law. Accordingly, all data users should keep track of steps taken and considered in order to comply with the PDHDA while meeting their preservation and discovery obligations in U.S. litigation.

- **Responsibly Disposing of Protected Data:** As in both Argentina and Mexico, data users in Uruguay must implement policies that require the disposal of personal data as soon as practicable. Once again, this process would be best incorporated into the agreement or court order sought through the fourth *Int'l Principle*.

Uruguay's data protection structure has the potential to become the most restrictive in Latin America, provided the URCDP diligently enforces the PDHDA. The URCDP does not appear to suffer from the criticized lack of effective autonomy of the DNPDP in Argentina, but it does lack the history of enforcement demonstrated by Mexico's IFAI. Only time will tell whether Uruguay will implement and enforce its European-style data privacy and protection laws.

The data protection regimes currently in place in these three representative Latin American countries share a great deal in common, as evidenced by our survey. However, the variation that does exist, particularly in key areas such as cross-border transfers and actual enforcement of the statutes, represents a significant challenge for companies seeking to do business across Latin American borders.

THE SEDONA CONFERENCE® COMMENTARY ON PROPORTIONALITY IN ELECTRONIC DISCOVERY*

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PREFACE

Welcome to another major publication in The Sedona Conference® Working Group Series (WGS℠). This is the "post-public comment" version of *The Sedona Conference® Commentary on Proportionality in Electronic Discovery*, a project of our Working Group on Electronic Document Retention & Production (WG1). The public comment version of this Commentary was first published in October 2010 and gained immediate recognition for providing a practical analytical framework to assist lawyers, judges, and parties realize the goals of Rule 1 of the federal and most state Rules of Civil Procedure – achieving the "just, speedy, and inexpensive determination of every action."

As a testament to its value and timeliness, the public comment version of this Commentary has been cited in eight federal court decisions (including one Federal Circuit Court of Appeals decision), 15 law review articles, seven legal treatises, and at least 166 legal blogs or websites. While all the citations have been favorable, they have also included some constructive critique and useful suggestions for revision. In addition, since the Commentary was first published, the concept of "proportionality" has explicitly been included in several local rules and court pilot projects, and has found its way into the federal rulemaking process through proposed revisions to Federal Rules of Civil Procedure 26 and 37, currently before the Civil Rules Advisory Committee and the Standing Committee on Rules of Practice and Procedure of the Judicial Conference of the United States.

This "post-public comment" version incorporates many of the suggestions and updates received by the original drafting team, which drew on the collective expertise of a diverse group of lawyers and representatives of firms providing consulting and legal services to both requesting and responding parties in civil litigation. And in addition to the comment by the courts and in the legal press, the Commentary was the subject of dialogue at four meetings of WG1, and numerous WG1 members contributed individual comments and edits. On behalf of The Sedona Conference®, I want to thank the editorial team and all the WG1 members whose dialogue and comments contributed to this Commentary. We hope our efforts will assist lawyers, judges, and others involved in the legal system work with the concept of proportionality in discovery.

We hesitate to call this a "final" version, as the ongoing dialogue on proportionality and its practical application to civil litigation will doubtless continue. If you wish to submit any further comments, please visit our website at www.thesedonaconference.org and join the online discussion forums, or email us at info@sedonaconference.org.

Kenneth J. Withers
Director of Judicial Education
The Sedona Conference®
January 2013

THE SEDONA CONFERENCE® PRINCIPLES OF PROPORTIONALITY

1. The burdens and costs of preserving potentially relevant information should be weighed against the potential value and uniqueness of the information when determining the appropriate scope of preservation.

2. Discovery should generally be obtained from the most convenient, least burdensome and least expensive sources.

3. Undue burden, expense, or delay resulting from a party's action or inaction should be weighed against that party.

4. Extrinsic information and sampling may assist in the analysis of whether requested discovery is sufficiently important to warrant the potential burden or expense of its production.

5. Nonmonetary factors should be considered when evaluating the burdens and benefits of discovery.

6. Technologies to reduce cost and burden should be considered in the proportionality analysis.

INTRODUCTION

This Commentary discusses the origins of the doctrine of proportionality, provides examples of its application, and proposes principles to guide courts, attorneys, and parties. The principles do not merely recite existing rules and case-law but rather provide a framework for applying the doctrine of proportionality to all aspects of electronic discovery. Although the Commentary cites primarily federal case-law and rules, the principles apply equally to electronic discovery in state courts.

In 1938, the Federal Rules of Civil Procedure ("Federal Rules") were adopted, providing for "the just, speedy, and inexpensive determination of every action." FED. R. CIV. P. 1 (1938). Over the years, the Federal Rules have witnessed various technological revolutions, such as the "modern miracle of photographic reproduction,"[1] which one court noted "lessen[s] what might otherwise be burdensome transportation of records and documents."[2]

Since their enactment in 1938, the Federal Rules have been amended several times to keep pace with the changing demands of courts and parties. In 1983, Rule 26(b)(1) was amended to grant courts the authority to limit excessive discovery. The Advisory Committee noted that the amendments were intended to "guard against redundant or disproportionate discovery by giving the court authority to reduce the amount of discovery that may be directed to matters that are otherwise proper subjects of inquiry."[3] This addition was important because "[e]xcessive discovery and evasion or resistance to reasonable discovery requests pose significant problems."[4] As explained by the Advisory Committee, the amendments address the problem of disproportionate discovery (without expressly mentioning "proportionality"). The Committee sets out the general proportionality test: determining whether "the burden or expense of the proposed discovery outweighs its likely benefits" and lists a number of factors bearing on proportionality. These include the nature and complexity of the lawsuit, the importance of the issues at stake, the parties' resources, the significance of the substantive issues, and public policy concerns.[5]

The Federal Rules were amended again in 1993 when a new paragraph was added, Rule 26(b)(2). This Rule adds further judicial flexibility to address the tremendous increase in the amount of potentially discoverable information caused by the "information explosion of recent decades" and the corresponding increase in discovery costs.[6] The Advisory Committee Notes explain that "[t]he revisions in Rule 26(b)(2) are intended to provide the court with broader discretion to impose additional restrictions on the scope and extent of discovery. ..."[7]

In the late 1990s, the Committee acknowledged that amended Rule 26(b)(2) was having little effect. It suspected that the location of the proportionality provision, buried among other discovery provisions, hindered its effectiveness. It responded by amending Rule 26(b)(1) in 2000 to include the proportionality provision in the same subdivision that contains the general discovery duty. "This otherwise redundant cross-reference has been added to emphasize the need for active judicial use of subdivision (b)(2) [proportionality factors] to control excessive discovery."

1 *Herbst v. Able*, 278 F. Supp. 664, 667 (S.D.N.Y. 1967).
2 *Goldberg v. Taylor Wine Co.*, No. 77-1548, 1978 U.S. Dist. LEXIS 19891, at *14 (E.D.N.Y. Jan. 27, 1978).
3 *See* Advisory Committee Notes to 1983 Amendments to FED. R. CIV. P. 26(b).
4 *See* Advisory Committee Notes to 1983 Amendments to FED. R. CIV. P. 26.
5 *See* Advisory Committee Notes to 1983 Amendments to FED. R. CIV. P. 26(b).
6 *See* Advisory Committee Notes to 1993 Amendments to FED. R. CIV. P. 26(b).
7 *Id.*

In 2006, Rule 26(b)(2) was amended to limit the discovery of electronically stored information ("ESI") deemed not reasonably accessible because of the costs and burdens of retrieving it. The Advisory Committee Notes to this amendment state that the costs and burdens of retrieving information that is not reasonably accessible can properly be considered as part of the proportionality analysis, and that discovery of such information may be limited or the costs of such discovery shifted from the responding to the requesting party.[8]

Notwithstanding the foregoing amendments, courts have not always insisted on proportionality when it was warranted.[9] And, even when courts have applied proportionality concepts, they have not always described them as such.[10] In the electronic era, it has become increasingly important for courts and parties to apply the proportionality doctrine to manage the large volume of ESI and associated expenses now typical in litigation. The discussion below addresses the key issues both parties and courts confront when they conduct a proportionality analysis pursuant to Rule 26(b)(2)(C). A list of recommended principles follows the general discussion.

The Availability of the Information from Other Sources

Rule 26(b)(2)(C)(i) directs courts to impose limitations where "the discovery sought is unreasonably cumulative or duplicative, or can be obtained from some other source that is more convenient, less burdensome, or less expensive." FED. R. CIV. P. 26(b)(2)(c)(i). Where relevant information is available from multiple sources, this rule allows courts to limit discovery to the least expensive source.[11]

Waiver and Undue Delay

Rule 26(b)(2)(C)(ii) also directs courts to limit discovery where "the party seeking discovery has had ample opportunity to obtain the information by discovery in the action." FED. R. CIV. P. 26(b)(2)(C)(ii). Pursuant to this provision, both discovery requests and objections to discovery must be reasonably prompt, or they may be deemed waived.[12]

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8 *See* Committee Notes to 2006 Amendments to FED. R. CIV. P. 26(b)(2).

9 *See* Committee Notes to 2000 Amendments to FED. R. CIV. P. 26(b)(1) ("The Committee has been told repeatedly that courts have not implemented these limitations with the vigor that was contemplated."); CHARLES A. WRIGHT & ARTHUR R. MILLER, *Federal Practice & Procedure* § 2008.1, at 121 (2d ed. 1994) (describing the "paucity of reported cases" applying the proportionality rule and concluding "that no radical shift has occurred").

10 *See, e.g.*, *Waldron v. Cities Serv. Co.*, 361 F.2d 671, 673 (2d Cir. 1966), *aff'd*, 391 U.S. 253 (1968) ("The plaintiff … may not seek indefinitely … to use the [discovery] process to find evidence in support of a mere 'hunch' or 'suspicion' of a cause of action."); *Jones v. Metzger Dairies, Inc.*, 334 F.2d 919, 925 (5th Cir. 1964) ("Full and complete discovery should be practiced and allowed, but its processes must be kept within workable bounds on a proper and logical basis for the determination of the relevancy of that which is sought to be discovered."); *Dolgow v. Anderson*, 53 F.R.D. 661, 664 (E.D.N.Y. 1971) ("A trial court has a duty, of special significance in lengthy and complex cases where the possibility of abuse is always present, to supervise and limit discovery to protect parties and witnesses from annoyance and excessive expense."); *Welty v. Clute*, 1 F.R.D. 446 (W.D.N.Y. 1940) (finding a second deposition of a plaintiff unnecessary given the availability of other discovery).

11 For example, in *Young v. Pleasant Valley School District*, the court rejected the plaintiffs' request for production of emails located on back-up tapes, citing Rule 26(b)(2)(C)(i), and noting that "[t]he burden and expense of rebuilding the district's email system in order to provide the discovery requested by the plaintiffs, along with the additional and less expensive means available for plaintiffs to get this material[,] makes the plaintiffs' discovery request impractical." *Young v. Pleasant Valley Sch. Dist.*, No. 07-854, 2008 WL 2857912, at *3 (M.D. Pa. July 21, 2008).

12 *Ford Motor Co. v. Edgewood Props.*, 257 F.R.D. 418, 426 (D.N.J. 2009) ("One may reasonably expect that if document production is proceeding on a rolling basis where the temporal gap in production is almost half a year apart, a receiving party will have reviewed the first production for adequacy and compliance issues for a reason as obvious as to ensure that the next production of documents will be in conformity with the first production or need to be altered. It was incumbent on Edgewood to review the adequacy of the first production so as to preserve any objections. The Court is not dictating a rigid formulation as to when a party must object to a document production. Reasonableness is the touchstone principle, as it is with most discovery obligations. The simple holding here is that it was unreasonable to wait eight months after which production was virtually complete.").

Burden Versus Benefit

In assessing whether to limit discovery, courts consider whether "the burden or expense of the proposed discovery outweighs its likely benefit, considering the needs of the case, the amount in controversy, the parties' resources, the importance of the issues at stake in the action, and the importance of the discovery in resolving the issues." FED. R. CIV. P. 26(b)(2)(C)(iii). When they analyze these factors, courts weigh the burdens of discovery against the potential benefit of the information to be produced in light of the specific circumstances of the case. For example, a court may order a party to engage in a burdensome and costly production if the information sought is extremely pertinent to the case and is unavailable elsewhere. But what if the cost of producing the information exceeds the total value of the case? Or what if expensive production is warranted based solely on the value of the case, but the producing party lacks the resources to pay for the production? Or what if the amount in controversy is low, but the case raises important societal issues? These are the kinds of questions a court and parties may consider when they decide whether to limit discovery.[13]

Although Rule 26(b)(2)(C)(iii) discusses a number of monetary considerations, courts considering a limitation on discovery may likewise take nonmonetary factors into account, such as the societal benefit of resolving the case on its merits or the nonmonetary burden on the producing party. Fed. R. Civ. P. 26(b)(2)(C)(iii) expressly provides that "the importance of the issues at stake in the action" is one of the proportionality factors. The "metrics" set forth in Rule 26(b)(2)(C)(iii) provide courts with significant flexibility and discretion to assess the circumstances of the case and to make sure the scope and duration of discovery are reasonably proportional to the value of the requested information, the needs of the case, and the parties' resources.

Most courts that have addressed proportionality focus on Rules 26(b) and (c). However, Rule 26(g) also requires that the parties propounding or responding to discovery requests conduct their own proportionality analysis. Described by one court as "[o]ne of the most important, but apparently least understood or followed, of the discovery rules,"[14] Rule 26(g)(1) provides that:

> [e]very discovery request, response, or objection must be signed by at least one attorney of record in the attorney's own name. … By signing, an attorney or party certifies that to the best of the person's knowledge, information, and belief formed after a reasonable inquiry: ... with respect to a discovery request, response, or objection, it is: ... neither unreasonable nor unduly burdensome or expensive,

13 *See, e.g.*, *Young v. Pleasant Valley Sch. Dist.*, 2008 WL 2857912, at *2; *see also Spieker v. Quest Cherokee, LLC*, No. 07-1225, 2008 WL 4758604, at *3 (D. Kan. Oct. 30, 2008) (assessing a request to limit discovery in a class action, rejecting "defendant's argument that the 'amount in controversy' is limited to the named plaintiffs' claims" and stating that "defendant's simplistic formula for comparing the named plaintiffs' claims with the cost of production is rejected"); *Southern Capitol Enters., Inc. v. Conseco Servs., L.L.C.*, No. 04-705, 2008 WL 4724427, at *2 (M.D. La. Oct. 24, 2008) ("Perfection in document production is not required. . . . In these circumstances Rule 26(b)(2)(C)(iii) comes into play. At this point in the litigation, the likely benefit that could be obtained from [further discovery] is outweighed by the burden and expense of requiring the defendants to renew their attempts to retrieve the electronic data."); *Metavante Corp. v. Emigrant Sav. Bank*, No. 05-1221, 2008 WL 4722336, at *4 (E.D. Wis. Oct. 24, 2008) ("In viewing the totality of the circumstances, including the amount in controversy in this case, the parties' resources, and the issues at stake, the court concludes that the burden [of production] does not outweigh the value of the material sought."); *Mancia v. Mayflower Textile Servs. Co.*, 253 F.R.D. 354, 364 (D. Md. 2008) ("I noted during the hearing that I had concerns that the discovery sought by the Plaintiffs might be excessive or overly burdensome, given the nature of this FLSA and wage and hour case, the few number of named Plaintiffs and the relatively modest amounts of wages claimed for each."); *Cenveo Corp. v. Slater*, No. 06-2632, 2007 WL 442387, at *2 (E.D. Pa. Jan. 31, 2007) ("The dispute before the Court requires a weighing of defendants' burden in producing the information sought against plaintiff's interest in access to that information. Because of the close relationship between plaintiff's claims and defendants' computer equipment, the Court will allow plaintiff to select an expert to oversee the imaging of all of defendants' computer equipment.").

14 *Mancia v. Mayflower Textile Servs. Co.*, 253 F.R.D. 354, 357 (D. Md. 2008).

> considering the needs of the case, prior discovery in the case, the amount in controversy, and the importance of the issues at stake in the action.

FED. R. CIV. P. 26(g)(1). The Advisory Committee announced that this rule is intended to impose "an affirmative duty to engage in pretrial discovery in a responsible manner that is consistent with the spirit and purposes of Rules 26 through 37."[15] To that end, the rule "provides a deterrent to both excessive discovery and evasion by imposing a certification requirement that obliges each attorney to stop and think about the legitimacy of a discovery request, a response thereto, or an objection."[16] Indeed, the Advisory Committee noted that "the premise of Rule 26(g) is that imposing sanctions on attorneys who fail to meet the rule's standards will significantly reduce abuse by imposing disadvantages therefor."[17]

In sum, courts applying the doctrine of proportionality may consider a variety of factors, including the benefit of the proposed discovery (including nonmonetary benefits), the burden or expense of the proposed discovery, the availability of the information from other sources, and undue delay on the part of the party seeking or resisting discovery.

We recognize that some parties may inappropriately raise proportionality arguments, either as a sword to increase the burden on the producing party[18] or as a shield to avoid legitimate discovery obligations.[19] Courts must be wary of such abuses. In any event, the burden or expense of discovery is simply one factor in a proportionality analysis and may not be dispositive or even determinative in specific cases.

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15 Advisory Committee Notes to 1983 Amendments to FED. R. CIV. P. 26(g).

16 *Id.*

17 *Id.*

18 *See, e.g.*, *Kay Beer Distrib., Inc. v. Energy Brands, Inc.*, No. 07-1068, 2009 WL 1649592 (E.D. Wis. June 10, 2009). In this matter involving the terms of a distribution agreement, the plaintiff moved to compel a native production of five DVDs containing the defendant's emails and other ESI for a five-year period. The court denied the motion, holding that "[Defendant] has no obligation to turn over to an opposing party in a lawsuit non-discoverable and privileged information. ... The mere possibility of locating some needle in the haystack of ESI ... does not warrant the expense [defendant] would incur in reviewing it." *Id.* at *4.

19 *See Kipperman v. Onex Corp.,* 260 F.R.D. 682 (N.D. Ga. 2009). The court noted that "rather than seeking a protective order [the defendants] determined themselves that it would be overly burdensome" to produce the discovery in the court-ordered format. *Id.* at 693. The court sanctioned the defendants under Rules 26 and 37, for their failure to follow discovery orders, their lack of diligence in discovery, and "making blatant misrepresentations about the value of email discovery in this case in an effort to influence the court's ruling." *Id.* at 692.

THE SEDONA CONFERENCE® PRINCIPLES OF PROPORTIONALITY

Principle 1: The burdens and costs of preserving potentially relevant information should be weighed against the potential value and uniqueness of the information when determining the appropriate scope of preservation.

The Federal Rules do not apply until litigation has commenced. However, courts can invoke their inherent authority to sanction parties for pre-litigation preservation failures. The proportionality principles set forth in the Federal Rules, while not directly applicable, may guide those considering their pre-litigation preservation obligations.[20]

Thus, a party, for whom an obligation to preserve potentially relevant information has arisen, should weigh the burdens and costs of preservation against the potential value and uniqueness of such information before deciding on the appropriate scope and manner of any preservation.[21]

Courts conducting a *post hoc* analysis of a party's pre-litigation preservation decisions should evaluate those decisions in light of both the proportionality factors set forth in Rule 26(b)(2)(C) and the preserving party's good faith and reasonableness. The analysis will, in turn, depend on the knowledge available when the information was, or could have been, preserved.[22] Although there is no case-law applying the proportionality factors set forth in the Federal Rules in the pre-litigation context, parties who demonstrate that they acted thoughtfully, reasonably, and in good faith in preserving, or attempting to preserve, information prior to litigation should generally be entitled to a presumption of adequate preservation. However, parties must be prepared to make this demonstration and cannot rely on a "pure heart, empty head." Courts should not allow hindsight bias to color their analysis of a party's deliberate, reasonable, and good faith preservation efforts.[23]

Principle 2: Discovery should generally be obtained from the most convenient, least burdensome and least expensive sources.

Rule 26(b)(2)(C)(i) provides that courts must limit discovery when the requested material can be obtained from sources that are "more convenient, less burdensome, or less expensive." FED. R. CIV. P. 26(b)(2)(C)(i). In other words, if relevant information is available from multiple sources, a court can limit discovery to the least burdensome source, and thus control litigation costs and promote efficiency in accordance with Rule 1. *See* FED. R. CIV. P. 1. Likewise, this provision enables courts to protect parties from abusive discovery

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20 See, e.g., The Sedona Principles (2d ed. 2007), *available at* https://thesedonaconference.org/download-pub/78 Principle 5 ("The obligation to preserve electronically stored information requires reasonable and good faith efforts to retain information that may be relevant to pending or threatened litigation. However, it is unreasonable to expect parties to take every conceivable step to preserve all potentially relevant electronically stored information."); The Sedona Conference® Commentary on Preservation, Management and Identification of Sources of Information That Are Not Reasonably Accessible 14 (July 2008), *available at* https://thesedonaconference.org/download-pub/1703 ("If the burdens and costs of preservation are disproportionate to the potential value of the source of data at issue, it is reasonable to decline to preserve the source."); The Sedona Conference® Commentary on Inactive Information Sources 11 (July 2009), *available at* https://thesedonaconference.org/download-pub/64 ("A reasonableness/proportionality analysis should be conducted to determine whether it would be reasonable under the circumstances to take steps to preserve a specific inactive information store. …"); see also The Hon. Paul W. Grimm, et al., Proportionality in the Post-Hoc Analysis of Pre-Litigation Preservation Decisions, 37 U. BALT. L. REV. 381 (2008) (urging for "the application, by analogy, of Federal Rules of Civil Procedure 26(b)(2)(C) and 37(e) to the pre-litigation duty to preserve").

21 The determination of whether a preservation obligation has arisen is addressed in *The Sedona Conference® Commentary on Legal Holds: The Trigger & The Process* (2007) *available at* https://thesedonaconference.org/download-pub/470. This Commentary also addresses the appropriate scope and manner of preservation after the determination has been made that a preservation obligation exists.

22 *Rimkus Consulting Group, Inc. v. Cammarata*, 688 F. Supp. 2d 598, 613 (S.D. Tex. 2010) ("Whether preservation or discovery conduct is acceptable in a case depends on what is *reasonable*, and that in turn depends on whether what was done – or not done – was *proportional* to that case and consistent with clearly established applicable standards.").

23 *Cf. Rhoads Indus., Inc. v. Bldg. Materials Corp. of Am.*, 254 F.R.D. 216, 226 (E.D. Pa. 2008) ("[H]indsight . . . should not carry much weight, if any, because no matter what methods an attorney employed, an after-the-fact critique can always conclude that a better job could have been done.").

requests. Although any one source is unlikely to meet all three criteria by being the most convenient, least burdensome, and least expensive; parties should carefully weigh each of these factors when determining which source is optimal.

For example, a court may consider limiting discovery of backup tapes that are not reasonably accessible[24] if the relevant information stored on the tapes can be obtained from other, more accessible, sources, such as hard-copy records, testimony, or nonparty discovery. If, for example, the producing party can easily produce hard copies of its requested emails, that party probably should not incur the costs of restoring backup tapes containing the same emails.[25]

In determining whether to limit purportedly burdensome or expensive discovery pursuant to Rule 26(b)(2)(C)(i), a court should consider the specific situation of the parties, taking into account the various sources in which the requested information can be found, the burden and expense of production from those sources, and whether limiting discovery to less burdensome or expensive sources will reduce the utility of the information sought. For example, the producing party may find that large numbers of emails may be more accessible and more easily produced as hard copies; but, because they will not be in electronic form, the requesting party will have to incur the costs of scanning and loading them onto a search platform or conducting a costly manual search. In this situation, it may be appropriate for a court, when it considers a request to limit production, to consider the totality of litigation costs and who should bear certain of those costs.

In the early stages of litigation, the parties and the court may be unable to assess whether limiting discovery is appropriate. The parties, for example, may not yet be fully aware of all of the viable claims and defenses or the factual or legal issues, which will ultimately be critical in the litigation. Similarly, if a requesting party seeks production of ESI archived several years earlier, the responding party may not have a full understanding of the content of the ESI or its potential value to the litigation.[26]

Under these circumstances, the court, or the parties on their own initiative, may find it appropriate to conduct discovery in phases, starting with discovery of clearly relevant information located in the most accessible and least expensive sources. Phasing discovery in this manner may allow the parties to develop the facts of the case sufficiently to determine whether, at a later date, further discovery that is more burdensome and expensive is, nevertheless, warranted. In addition, given that the vast majority of cases settle, phasing discovery may allow the parties to develop a factual record sufficient for settlement negotiations without incurring the costs of more burdensome discovery that may only be necessary if the case goes to trial.

Parties who wish to conduct phased discovery must communicate with one another about the issues relevant to the litigation and the repositories – both accessible and

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24 Rule 26(b)(2)(B) provides that "[a] party need not provide discovery of electronically stored information from sources that the party identifies as not reasonably accessible because of undue burden or cost. On motion to compel discovery or for a protective order, the party from whom discovery is sought must show that the information is not reasonably accessible because of undue burden or cost. If that showing is made, the court may nonetheless order discovery from such sources if the requesting party shows good cause, considering the limitations of Rule 26(b)(2)(C). The court may specify conditions for the discovery." FED. R. CIV. P. 26(b)(2)(B).

25 *Cf. U.S. v. O'Keefe*, 537 F.Supp.2d 14, 21 (D.D.C. Feb. 18, 2008).

26 *See* Committee Notes to 2006 Amendments to Rule 26(b)(2) (noting that, "because the court and parties may know little about what information the sources identified as not reasonably accessible might contain, whether it is relevant, or how valuable it may be to the litigation," it may be appropriate for the parties to engage in "focused discovery . . . to learn more about what burdens and costs are involved in accessing the information, what the information consists of, and how valuable it is for the litigation in light of information that can be obtained by exhausting other opportunities for discovery.").

inaccessible – that may contain relevant information. Moreover, the parties must cooperate with one another to prepare and propose to the court a phased discovery plan.[27]

Principle 3: Undue burden, expense, or delay resulting from a party's action or inaction should be weighed against that party.

Although the Federal Rules do not set forth specific deadlines by which parties must propound or otherwise sequence discovery, courts will often set discovery deadlines in accordance with their own scheduling orders or local rules. Courts may also sequence fact and expert discovery, set specific dates for completion of document production, or limit the time period in which parties can raise discovery disputes. From a proportionality perspective, propounding discovery requests at the early stages of the litigation allows parties sufficient time to explore compliance with the discovery requests and bring any disputes before the court for resolution. Accordingly, parties should raise any discovery disputes as soon as is reasonably possible but only after engaging in good faith attempts to resolve the dispute without the court's involvement.

If a dispute cannot be resolved, it should be raised with the court promptly. In determining whether the requested relief is appropriate, the court may consider the time at which the issue arose and whether the moving party could have raised the issue earlier. The resolution of such disputes can be fact-intensive, requiring the court to assess whether the producing party complied with its discovery obligations, the degree of culpability involved, and the prejudice to the requesting party.

Traditionally, parties must bear their own costs when they respond to discovery requests, including the costs of production. In assessing whether a particular discovery request or requirement is unduly burdensome or expensive, a court should consider the extent to which the claimed burden and expense grow out of the responding party's own action or inaction. In practice, this principle typically focuses on actions taken, or not taken, by the responding party with regard to the duties to preserve, search, and produce relevant information.[28] But, it can also occasionally arise when a requesting party delays filing a motion to compel production of ESI or production of ESI in a particular format.

A failure to preserve relevant information in an accessible format at the outset of litigation should be weighed against any party seeking to avoid the resultant burden of restoring the information. The Advisory Committee noted that an "appropriate consideration" in assessing burden and expense in the context of claims that information is not reasonably accessible is "the failure to produce relevant information that seems likely to have existed but is no longer available on more easily accessed sources."[29]

This proportionality principle also applies when a party fails to engage in early, meaningful discussions designed to develop a discovery plan and avoid potential disputes.

27 These issues may be considered at the Rule 26(f) conference, at which the parties must "discuss any issues about preserving discoverable information; and develop a proposed discovery plan." FED. R. CIV. P. 26(f)(2).

28 *Quinby v. WestLB AG*, 245 F.R.D. 94, 104-05 (S.D.N.Y. 2006) ("[I]f a party creates its own burden or expense by converting into an inaccessible format data that it should have reasonably foreseen would be discoverable material at a time when it should have anticipated litigation, then it should not be entitled to shift the costs of restoring and searching the data. This would permit parties to maintain data in whatever format they choose, but discourage them from converting evidence to inaccessible formats because the party responsible for the conversion will bear the cost of restoring the data. Furthermore, it would prevent parties from taking unfair advantage of a self-inflicted burden by shifting part of the costs of undoing the burden to an adversary. If, on the other hand, it is not reasonably foreseeable that the particular evidence in issue will have to be produced, the responding party who converts the evidence into an inaccessible format after the duty to preserve evidence arose may still seek to shift the costs associated with restoring and searching for relevant evidence.").

29 Committee Notes to 2006 Amendments to Rule 26(b)(2).

Application of the principle in this context is appropriate because a party can be sanctioned for failing "to participate in good faith in developing and submitting a proposed discovery plan as required by Rule 26(f)."[30] A party's failure to engage in an early and meaningful meet-and-confer may shape a subsequent proportionality analysis when, for example, a party refuses to consult with an opponent about a keyword search protocol and a second search with better keywords proves necessary or when a duplicative production of material becomes necessary after ESI is produced in a form that is not reasonably usable.

Principle 4: Extrinsic information and sampling may assist in the analysis of whether requested discovery is sufficiently important to warrant the potential burden or expense of its production.

Rule 26(b)(2)(C)(iii) provides that in considering whether to limit potentially burdensome or expensive discovery, courts should consider "the importance of the discovery in resolving the issues." FED. R. CIV. P. 26(b)(2)(C)(iii). In other words, the court may limit discovery if the information sought, while relevant, is not sufficiently important to warrant the burden and expense of its production.[31] This issue often arises when discovery requests seek information that is duplicative, cumulative, or not reasonably accessible.[32] *See* FED. R. CIV. P. 26(b)(2)(B) (incorporating factors set forth in Federal Rule 26(b)(2)(C)).

When asked to limit discovery on the basis of burden or expense, courts should consider the likely benefits of the information sought to resolving factual issues in dispute. Discovery must be limited if the burden or expense of producing the requested information is disproportionate to its likely benefits, considering the discovery's importance to the litigation. Performing this kind of assessment can be particularly challenging since it may be impossible to evaluate the requested information until it is actually produced.[33]

In some cases, it may be clear that the information requested is important or perhaps even outcome-determinative.[34] In other cases, courts can order sampling of the requested information, consider extrinsic evidence, or both, to determine whether the requested information is sufficiently important to warrant potentially burdensome or expensive discovery.[35]

In Kipperman v. Onex Corporation, the court required the defendants to produce two "sample" backup tapes so the court could compare the volume and importance of the information located on the tapes with the costs of their restoration and production.[36] After

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30 FED. R. CIV. P. 37(f).

31 An alternative to limiting burdensome or expensive discovery is to shift its cost to the requesting party. *See* FED. R. CIV. P. 26(c); *see also Rowe Entm't, Inc. v. William Morris Agency, Inc.*, 205 F.R.D. 421, 428 (S.D.N.Y. 2002) ("[T]here is no justification for a blanket order precluding discovery of the defendants' e-mails on the ground that such discovery is unlikely to provide relevant information… The more difficult issue is the extent to which each party should pay the costs of production."); *McPeek v. Ashcroft*, 202 F.R.D. 31, 34 (D.D.C. 2001) ("The converse solution is to make the party seeking the restoration of the backup tapes pay for them, so that the requesting party literally gets what it pays for.").

32 Courts may also employ sampling for the purpose of evaluating a request to shift costs. *See Zubulake v. UBS Warburg LLC*, 217 F.R.D. 309, 324 (S.D.N.Y. 2003) ("Requiring the responding party to restore and produce responsive documents from a small sample of backup tapes will inform the cost-shifting analysis.").

33 *See* Committee Notes to 2006 Amendments to Rule 26(b)(2) ("The good-cause determination, however, may be complicated because the court and parties may know little about what information the sources identified as not reasonably accessible might contain, whether it is relevant, or how valuable it may be to the litigation."); *see also Peskoff v. Faber*, 244 F.R.D. 54, 59 (D.D.C. 2007) ("Application of this factor can be challenging because the importance of the results of the forensic examination can only be assessed after it is done.").

34 *See Covad Communs. Co. v. Revonet, Inc.*, 258 F.R.D. 5, 13 (D.D.C. 2009) (permitting discovery that "should establish once and for all" a key issue in the case).

35 *See* Committee Notes to 2006 Amendments to Rule 26(b)(2) ("[T]he parties may need some focused discovery, which may include sampling of the sources, to learn more about what burdens and costs are involved in accessing the information, what the information consists of, and how valuable it is for the litigation in light of information that can be obtained by exhausting other opportunities for discovery.").

36 *Kipperman v. Onex Corp.*, 260 F.R.D. 682 (N.D. Ga. 2009).

reviewing the results of the sample, the court determined that the information contained on the backup tapes was sufficiently important to warrant further discovery: "I don't ... declare these to be smoking guns but they certainly are hot and they certainly do smell like they have been discharged lately."[37]

In addition to sampling, courts generally consider extrinsic information submitted by the parties to determine whether requested discovery is sufficiently important to warrant potentially burdensome or expensive discovery. Such evidence may include the parties' opinions regarding the likely importance of the requested information,[38] whether the requested information was created by "key players,"[39] whether prior discovery permits an inference that the requested information is likely to be important,[40] whether the creation of the information requested was contemporaneous with key facts in the case,[41] and whether the information requested is unique.[42] Any attempt to evaluate the importance of requested information will be fact-specific and thus will vary from case to case.

The party opposing discovery, of course, may put forth evidence that the burden or expense of producing the requested information outweighs its potential importance.

Principle 5: Nonmonetary factors should be considered when evaluating the burdens and benefits of discovery.

The Federal Rules recognize that proportionality encompasses nonmonetary considerations. Rule 26(g)(1)(B)(iii) requires that an attorney (or *pro se* party) who promulgates discovery must consider "the needs of the case, prior discovery in the case, the amount in controversy, and the importance of the issues at stake in the action." Rule 26(b)(2)(C)(iii) similarly requires that a court consider "the importance of the issues at stake in the action" when it considers whether to limit discovery. FED. R. CIV. P. 26(b)(2)(C)(iii).

The Committee Notes to Section 26(b)(2)(C)(iii) state:

> The elements of Rule 26(b)(1)(iii) address the problem of discovery that is disproportionate to the individual lawsuit as measured by such matters as its nature and complexity, the importance of the issues at stake in a case seeking damages, the limitations on a financially weak litigant to withstand extensive opposition to a discovery program or to respond to discovery requests, and the significance of the substantive issues, as measured in philosophic, social, or institutional terms. Thus the rule recognizes that many cases in public policy spheres, such as employment practices, free speech, and other matters, may have importance far beyond the monetary amount involved.[43]

What role should nonmonetary factors such as "the importance of the issues at stake" play in a proportionality analysis? In civil actions that are essentially private disputes

37 *Id.* at 691 ("The court believes that some of the most interesting evidence in this matter has come from e-mail production.").
38 *Id. at* 689 ("Defendants argued that … the value of the information on the tapes was dubious at best.").
39 *Zubulake*, 217 F.R.D. at 317 ("[E]mail constituted a substantial means of communication among UBS employees.").
40 *Peskoff*, 244 F.R.D. at 60 ("[I]t can be said that the information that has been produced thus far in this case permits the court to infer the possible existence of additional similar information that warrants further judicial action."); *Ameriwood Indus., Inc. v. Liberman*, No. 06-524, 2006 WL 3825291, at *3 (E.D. Mo. Dec. 27, 2006) ("In light of the Samsung email, the Court finds that other deleted or active versions of emails may yet exist on defendants' computers.").
41 *Ameriwood Indus., Inc.*, 2006 WL 3825291, at *5 ("In the instant action, defendants are alleged to have used the computers, which are the subject of the discovery request, to secrete and distribute plaintiff's confidential information.").
42 *See* FED. R. CIV. P. 26(b)(2)(C)(i) (providing that courts must limit discovery that is "unreasonably cumulative or duplicative").
43 *See* Committee Notes to 1983 Amendments to Rule 26(b).

(such as most breach of contract or traditional tort actions), nonmonetary factors are usually irrelevant. However, in civil actions deriving from constitutional or statutorily created rights (such as those brought under 42 U.S.C. § 1983 or Title VII), nonmonetary factors may favor broader discovery. Any proportionality analysis should consider the nature of the right at issue and any other relevant public interest or public policy considerations, and whether, under the particular circumstances of the case, discovery should be restricted.

For example, in *Disability Rights Council of Greater Washington v. Washington Metropolitan Transit Authority,* an action for injunctive relief under the Americans with Disabilities Act, the court denied the defendant's request to limit discovery of backup tapes because of "the importance of the issue at stake and the parties' resources."[44] Other courts have considered nonmonetary issues such as "the strong public policy in favor of disclosure of relevant materials,"[45] and even the health concerns and family obligations of the producing party.[46]

Principle 6: Technologies to reduce cost and burden should be considered in the proportionality analysis.

It is well documented that the volume of ESI is exploding in every corner of the digital world, increasing the volume of potentially discoverable information. Where appropriate, the application of technology to quickly isolate essential information serves the goal of proportionality by creating efficiencies and cost savings. Parties should meet and confer regarding technological approaches to preservation, selection, review, and disclosure that reduce overall costs, better target discovery, protect privacy and confidentiality, and reduce burdens.

Parties or their counsel should have a general understanding of the technology available to reduce the cost and burden of electronic discovery in accordance with the proportionality doctrine.[47] These tools and techniques change rapidly, and keeping abreast of changes can present a challenge. Counsel should remain current in the advancements or engage experts as needed to ensure they take advantage of best practices. The Sedona Conference® has published a number of commentaries recently that discuss the application of technology to contain costs and reduce expense and burden.[48]

When they consider arguments related to cost and burden, courts may ask the parties to provide detailed information about the retrieval of electronic information, the use

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44 *Disability Rights Council of Greater Washington v. Washington Metro. Transit Auth.*, 242 F.R.D. 139, 148 (D.D.C. 2007). The court noted that: "Plaintiffs are physically challenged citizens of this community who need the access to public transportation that WMATA is supposed to provide. That persons who suffer from physical disabilities have equal transportation resources to work and to enjoy their lives with their fellow citizens is a crucial concern of this community. Plaintiffs have no substantial financial resources of which I am aware and the law firm representing them is proceeding pro bono ... I will therefore order the search of the backup tapes Plaintiffs seek." *Id.* at 148.

45 *Patterson v. Avery Dennison Corp.*, 281 F.3d 676, 681 (7th Cir. 2002).

46 *Hunter v. Ohio Indem. Co.*, No. 06-3524, 2007 WL 2769805, at *1 (N.D. Cal. Sept. 21, 2007) ("[T]he burden of a deposition on Ms. Jansen, who has virtually no knowledge of any [relevant] issues … and is caring for a spouse with a life-threatening illness, would be inhumane as well as unproductive.").

47 Principle 11 of The Sedona Principles notes that parties may use technological tools for preservation and production: "A responding party may satisfy its good faith obligation to preserve and produce relevant electronically stored information by using electronic tools and processes, such as data sampling, searching, or the use of selection criteria, to identify data reasonably likely to contain relevant information." *The Sedona Principles* (2d ed. 2007), *available at* https://thesedonaconference.org/download-pub/81 Principle 11.

48 *See The Sedona Conference® Commentary on Achieving Quality in the E-Discovery Process* (May 2009) *available at* https://thesedonaconference.org/download-pub/65; *The Sedona Conference® Commentary on Preservation, Management and Identification of Sources of Information that are Not Reasonably Accessible* (Aug. 2008) *available at* https://thesedonaconference.org/download-pub/66; *The Sedona Conference® Best Practices Commentary on Search & Retrieval Methods* (Aug. 2007) *available at* https://thesedonaconference.org/download-pub/76 and others available on the Publications page at https://thesedonaconference.org/search_and_retrieval. In addition, the ongoing TREC Legal Track has yielded insights into best practices. *See* Douglas W. Oard, Jason R. Baron, and David D. Lewis, *Some Lessons Learned To Date from the TREC Legal Track* (2006-2009), Feb. 24, 2010, http://trec-legal.umiacs.umd.edu/LessonsLearned.pdf.

of review tools, and key word searches.[49] Parties familiar with the available technological tools and their costs will have an edge in asserting, or responding to, arguments concerning cost and burden.

Parties and law firms involved in a significant amount of electronic discovery may choose one or more standard tools that meet their overall needs. The fact that a standard tool is not the ideal fit for a particular case should not be held against the firm or the party unless the tool is conspicuously inadequate, as might happen where the volume of information is unusually high. Parties and law firms may have to consider other tools for cases that exceed the capacity of their standard tool or tools.

While technology may create efficiencies and cost savings, it is not a panacea and there may be circumstances when the costs of technological tools outweigh the benefits of their use.

49 *Apsley v. Boeing Co.*, No. 05-1368, 2007 WL 163201, at *4 (D. Kan. Jan. 18, 2007) (scheduling a hearing to consider arguments related to the burden of producing emails, including technological issues).

THE SEDONA CONFERENCE® COMMENTARY ON ETHICS & METADATA*

A Project of The Sedona Conference® Working Group on Electronic Document Retention & Production (WG1)

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PREFACE

> "The enhanced possibility of inadvertent production of privileged or work product information, the stakes in the management of privilege reviews, and careless handling of client communications raise serious ethical issues. Similarly, the disparate views on how lawyers should treat metadata (e.g., when to delete, when to send, when to review) create additional risks for lawyers, especially in cases across different jurisdictions."[1]

The Sedona Conference® Commentary on Ethics and Metadata focuses on the ethical considerations[2] surrounding the inclusion and review of metadata in the non-discovery and discovery contexts. This Commentary is intended to provide practical guidance for lawyers in protecting confidential metadata and to assist the judiciary in fashioning appropriate discovery orders.

The *Sedona Principles Second Edition*[3] contains more detailed information about the ability to access and produce metadata. This Commentary does not presume to duplicate that work. Rather, this Commentary explores significant ethical duties of attorneys in handling metadata, which may constitute client confidences to be protected or evidence to be produced, depending on the circumstances.[4]

These duties must be explored within two very different contexts: the non-discovery context and the discovery context. It is critical throughout this Commentary and in understanding a lawyer's ethical obligations with respect to metadata to always *first* consider whether you are operating within the discovery or nondiscovery context.[5]

1. ***The Non-discovery Context:*** when lawyers send or receive information (i.e., "communications") containing metadata.[6]

2. ***The Discovery Context:*** when lawyers send, produce or receive electronically stored information (ESI) containing metadata in response to a discovery request or subpoena.

In general, the ethical duties of a lawyer relating to metadata follow the same principles of the ethical duties relating to any other type of information. An exception is

1] *The Sedona Principles, Second Edition: Best Practices Recommendations & Principles for Addressing Electronic Document Production* (2007), https://thesedonaconference.org/download-pub/81. ("Sedona Principles Second Edition") at 41.

2] This is the first Sedona Commentary devoted to ethics and electronic information. It is also the first Commentary to move beyond WG1's previously exclusive focus on aspects of discovery or records management/preservation.

3] The Commentary drafting team uses the definitions of metadata currently found in the *Sedona Principles* (2d Edition) and the *Sedona Glossary* (3d Edition), https://thesedonaconference.org/download-pub/471. There are a number of nuances associated with the various definitions of metadata used in the ethics opinions, in the case law, and by The Sedona Conference®, and the definition of metadata is likely to evolve. However, attempting to harmonize these definitions or proposing an alternative definition of "metadata" is beyond the scope of the Commentary.

4] This Commentary addresses a lawyer's ethical duty established by a jurisdiction's rules of professional conduct (and, in some contexts, more broadly to include any duty imposed on a lawyer by any statute, rule, or case law). The duties discussed apply to a lawyer and not to a client, party, or other nonlawyer. For example, discovery is between parties, but lawyers are the responsible gatekeepers. Hence, we often refer to what a lawyer produces or receives.

5] "In assessing the ethical obligations of both the sending and receiving lawyer with respect to metadata, we find it useful to distinguish between electronic documents provided in discovery or pursuant to a subpoena from those electronic documents voluntarily provided by opposing counsel. Although the Florida and Alabama Bars have recognized a similar distinction, *see* Florida Bar Op. 06-2; Alabama State Bar, Office of Gen. Counsel Op. No. R0-2007-02, the distinction has not been universally recognized in other ethics opinions addressing metadata. *See* ABA Formal Op. 06-442; Maryland Bar Ass'n Ethics Docket No. 2007-09." District of Columbia Bar Opinion 341 (Sept. 2007).

6] Metadata outside the context of discovery may include information – often lawyer-created – *about* discovery obligations, such as circulating a draft Case Management Order for comment by the opposing party.

found in a few jurisdictions that make some presumptions about metadata and, essentially, equate *metadata* with *confidential information* and may not recognize the distinctions between the different types of metadata. For the receiving lawyer in the non-discovery context, as discussed below, there is wide disparity among the state bar associations relating to both (a) the review (potentially mislabeled "mining") of metadata and (b) the "notification" to the sending lawyer of receipt of metadata. Resolving the different approaches of such jurisdictions may present difficulties for a lawyer with a multijurisdictional practice and are also addressed.

Otherwise, for each jurisdiction, the action required of a lawyer who receives confidential metadata through inadvertence is the same action required of a lawyer who receives any other confidential information through inadvertence. For example, if a rule prohibits a lawyer from continuing to read a file once he or she has ascertained it is privileged, a lawyer may not continue to read metadata once he or she has ascertained it is privileged.[7]

And it is critical to also note that these *anti-mining* opinions do not generally apply to a lawyer's ethical obligations relating to documents sent or received pursuant to a request for production;[8] but only relate to metadata (and arguably only certain types of metadata) received in the non-discovery context.

The Commentary was first published for public comment in March 2012. In the year following there were several significant developments in the law, most notably the adoption by the American Bar Association House of Delegates in August 2012 of recommendations by the ABA Commission on Ethics 20/20 to extend a lawyer's duty of competence beyond simply competence in the law to competence in technology relevant to advising and representing clients. The editors have also considered and incorporated several dozen comments from members of The Sedona Conference® Working Group 1 on Electronic Document Retention and Production and from the public at large.

We hope our efforts will be of immediate and practical assistance to practicing lawyers, judges, those who advise lawyers on professional responsibility issues, and those who regulate professional conduct. As with all of our WGS℠ publications, we anticipate that developments in the law and technology will necessitate revisions and updates of this Commentary. Your comments and suggestions for future editions are welcome, and we urge you to visit The Sedona Conference® website at www.thesedonaconference.org to offer your comments on the public forum pages. You may also submit feedback by emailing us at info@sedonaconference.org.

Kenneth J. Withers
Director of Judicial Education
The Sedona Conference®
June 2013

7] *See, e.g., Rico v. Mitsubishi Motors Corp.*, 42 Cal. 4th 807, 68 Cal. Rptr. 3d 758 (Dec. 2007): "[A]n attorney who receives privileged documents through inadvertence ... may not read a document any more closely than is necessary to ascertain that it is privileged. Once it becomes apparent that the content is privileged, counsel must immediately notify opposing counsel and try to resolve the situation."

8] *See* n.4 above; *But also see* D.C. Bar Opinion 341 (Sept. 2007) ("[E]ven in the context of discovery or other judicial process, if a receiving lawyer has actual knowledge that metadata containing protected information was inadvertently sent by the sending lawyer, the receiving lawyer, under Rule 8.4(c), should advise the sending lawyer and determine whether such protected information was disclosed inadvertently. *See* D.C. Ethics Op. 256 ('The line we have drawn between an ethical and an unethical use of inadvertently disclosed information is based on the receiving lawyer's knowledge of the inadvertence of the disclosure.').

I. ETHICS AND METADATA – BASIC CONCEPTS

A. What is Metadata?

Quite simply, metadata is often described as *data about data*.

Although a generally accurate description of metadata (i.e., *data about data*), the *Sedona Principles Second Edition* goes further and specifically notes the importance, in the discovery context, of distinguishing between the different types of metadata. "An electronic document or file usually includes not only the visible text but also hidden text, formatting codes, formulae, and other information associated with the file. These many types of ancillary information are often lumped together as 'metadata,' although some distinctions between different types of metadata should be recognized."[1]

These multiple types of metadata are identified and defined in the *Sedona Glossary*.[2] The *Sedona Glossary* contains a general definition for the term *metadata*. But the drafters of the *Sedona Glossary* moved well beyond this general definition and further identified seven different types of metadata and also referred to the more thorough discussion of metadata contained in the *Sedona Principles Second Edition* discussed above.[3] Also relying upon the *Sedona Principles Second Edition*, the court in *Aguilar*[4] recognized this idea that not all metadata is created equally in the discovery context and when resolving questions concerning the evidentiary value, relevance, or usefulness of metadata.[5]

The discussion in *Aguilar* begins with a general definition of metadata: "Metadata, frequently referred to as 'data about data,' is electronically-stored evidence that describes the 'history, tracking, or management of an electronic document.'"[6]

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1 *The Sedona Principles, Second Edition: Best Practices Recommendations & Principles for Addressing Electronic Document Production* (2007), https://thesedonaconference.org/download-pub/81. ("Sedona Principles Second Edition") at 60.

2 *The Sedona Conference Glossary, Third Edition: E-Discovery & Digital Information Management* (2010), https://thesedonaconference.org/download-pub/471. ("*Sedona Glossary*").

3 *Id* at 33 citing the *Sedona Principles Second Edition* at 60 and citing the *Sedona Glossary Third Edition* at 3 17, 19, 22, 34, 52, 53. The *Sedona Glossary* includes, among others, the following types of metadata:
Application Metadata: Data created by the application specific to the ESI being addressed, embedded in the file and moved with the file when copied; copying may alter application metadata.
Document Metadata: Properties about the file stored in the file, as opposed to document content. Often this data is not immediately viewable in the software application used to create/edit the document but often can be accessed via a "Properties" view. Examples include document author and company, and create and revision dates.
Email Metadata: Data stored in the email about the email. Often this data is not even viewable in the email client application used to create the email, e.g., blind copy addresses, received date. The amount of email metadata available for a particular email varies greatly depending on the email system. Contrast with File System Metadata and Document Metadata.
Embedded Metadata: Generally hidden, but an integral part of ESI, such as "track changes" or "comments" in a word processing file or "notes" in a presentation file. While some metadata is routinely extracted during processing and conversion for e-discovery, embedded data may not be. Therefore, it may only be available in the original, native file.
File System Metadata: Metadata generated by the system to track the demographics (name, size, location, usage, etc.) of the ESI and, not embedded within, but stored externally from the ESI.
Metadata: Data typically stored electronically that describes characteristics of ESI, found in different places in different forms. [Metadata] [c]an be supplied by applications, users or the file system. Metadata can describe how, when and by whom ESI was collected, created, accessed, modified and how it is formatted. [Metadata] [c]an be altered intentionally or inadvertently. Certain metadata can be extracted when native files are processed for litigation. Some metadata, such as file dates and sizes, can easily be seen by users; other metadata can be hidden or embedded and unavailable to computer users who are not technically adept. Metadata is generally not reproduced in full form when a document is printed to paper or electronic image. *See also* Application Metadata, Document Metadata, Email Metadata, Embedded Metadata, File System Metadata, User-Added Metadata and Vendor-Added Metadata. For a more thorough discussion, *see* The Sedona Guidelines: Best Practice Guidelines & Commentary for Managing Information & Records in the Electronic Age (Second Edition).
User-Added Metadata: Data, possibly work product, created by a user while copying, reviewing, or working with a file, including annotations and subjective coding information.
Vendor-Added Metadata: Data created and maintained by the electronic discovery vendor as a result of processing the document. While some vendor-added metadata has direct value to customers, much of it is used for process reporting, chain of custody, and data accountability. Contract with User-Added Metadata.

4 *Aguilar v. Immigration & Customs Enforcement Div. of U.S. Dep't of Homeland Sec.*, 255 F.R.D. 350 (S.D.N.Y. 2008).

5 *Id* at 354 ("To understand why the importance of metadata varies, it is first necessary to explain what it is and distinguish among its principal forms.")

6 *Aguilar* at 354 citing *Williams v. Sprint/United Mgmt. Co.*, 230 F.R.D. 640, 646 (D.Kan 2005).

However, just as the *Sedona Principles Second Edition* and the *Sedona Glossary Third Edition,* the *Aguilar* court goes on to explain that "[a]lthough metadata often is lumped into one generic category, there are at least several distinct types, including substantive (or application) metadata, system metadata, and embedded metadata."[7]

- **Application Metadata**[8]

  "Substantive metadata, also known as *application metadata*, is 'created as a function of the application software used to create the document or file' and reflects substantive changes made by the user ... and includes data that instructs the computer how to display the fonts and spacing in a document. ... Substantive metadata is embedded in the document it describes and remains with the document when it is moved or copied."[9]

- **System Metadata (File System Metadata)**

  "System metadata 'reflects information created by the user or by the organization's information management system.'[10] ... This data ... can usually be easily retrieved from whatever operating system is in use. ... Examples of system metadata include data concerning 'the author, date and time of creation, and the date a document was modified.'"[11]

- **Embedded Metadata**

  "Embedded metadata consists of 'text, numbers, content, data, or other information that is directly or indirectly inputted into a [n]ative [f]ile by a user and which is not typically visible to the user viewing the output display' of the native file. …'[12] Examples include spreadsheet formulas, hidden columns, externally or internally linked files (such as sound files), hyperlinks, references and fields, and database information."[13]

As noted above and as expected, the discussions and significance of the different types of metadata in *Aguilar* and in the *Sedona Principles Second Edition* concern the production of metadata in the *discovery context.*

The *role* or importance of metadata for a lawyer in the *non-discovery context* is generally limited to the ethical obligations as interpreted by the ethics opinions discussed below. And there is no obvious discussion of the different types of metadata by the state bar

7 *Aguilar* at 354 citing *Sedona Principles Second Edition* at 60 and citing as supporting authority United States District Court for the District of Maryland, *Suggested Protocol for Discovery of Electronically Stored Information* 25-28 ("*Maryland Protocol*"). *See also* the *Sedona Glossary* at 3, 17, 19, 22, 34, 52, 53. Although the *Sedona Glossary* identifies seven different types of metadata, the court in *Aguilar* identifies the three primary types of metadata and does seem to collapse some of the seven distinct types defined in the Sedona Glossary into one of its three categories (e.g., what is defined in the *Sedona Glossary* as Email Metadata appears to be subsumed within the definition of substantive (or application) metadata in *Aguilar*).

8 Although the court in *Aguilar* uses the terminology "substantive metadata" (and expressly equates it with "application metadata"), throughout this Commentary, the more commonly used and understood terminology of "application metadata" will be used.

9 *Id* (emphasis added).

10 *Aguilar* at 354 citing *Sedona Principles Second Edition* at 60.

11 *Aguilar* at 354 citing the *Maryland Protocol* at 26.

12 *Aguilar* at 354, 355 citing the *Maryland Protocol* at 27.

13 *Id.*

associations and, specifically, the types of metadata for which *mining* is prohibited.[14] Instead, the general term *metadata* is most often used by the drafters of the *anti-mining* opinions with the unintentional consequences of arguably prohibiting the receiving party of viewing even the author (application metadata) when visible on the face of an email.[15]

A lack of precision in defining or identifying the different types of metadata may result in misunderstandings in both the analysis of a legal question and its resolution. Recognizing these distinctions in types of metadata may assist in understanding (a) the bar associations' ethical opinions in the non-discovery context, (b) how to prevent the inadvertent disclosure of confidential information in both the discovery and nondiscovery contexts, and (c) the parties' obligations to preserve and produce metadata in the discovery context.

B. Lawyer's Primary Ethical Duties Regarding Metadata

A lawyer's primary ethical duties regarding metadata may be said to fall into four subject areas: confidentiality, competence, supervision, and preservation. These duties must be considered in each of the discovery and non-discovery contexts. Of course, these duties apply in more than just the context of metadata, but they are of particular significance in that context.

1. The Duty of Confidentiality

The injunction on a lawyer's disclosure of confidential information[16] draws from the first cases protecting attorney-client communications in 16th century England to the modern right of privacy found in many constitutions,[17] with everything in between from Rule 5.2(a) of the Federal Rules of Civil Procedure ("Fed. R. Civ. P.") to the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"). The rule may be stated thus:

> A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly

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14 Although, the Arizona State Bar in its "anti-mining" opinion states: "Except in the specific circumstances described in this opinion, a lawyer who receives an electronic communication may not examine it for the purpose of discovering the metadata *embedded in it*." Arizona State Bar Opinion 07-03: Confidentiality; Electronic Communications; Inadvertent Disclosure (Nov. 2007). It is unclear if the drafters' use of the term "embedded" is intended as a limitation on "anti-mining" to this *type* of metadata most likely to contain confidential information. Or, more likely, the use of the phrase "metadata embedded in [the electronic communication]" was considered akin to the phrase "metadata associated with [the electronic communication]" and not used as a term of art. *See also* Alabama Ethics Opinion RO-2007-02 at 2 ("The act of deliberately seeking out and viewing metadata embedded in a document is most often referred to as 'mining' the document.").

15 Metadata is generally thought to be hidden information which is not always the case, especially for certain types of metadata (e.g., application metadata for an email including author, recipients, and date), and reinforces the concept of not lumping all metadata into a single generic category. *See* Pennsylvania Bar Ass'n Comm'n on Legal Ethics and Professional Responsibility, Formal Op. 2007-500 at 2 (2007), *reconsidered* Pennsylvania Formal Op. 2009-100 (2009) ("Metadata, which means 'information about data,' is data contained within electronic materials that is not ordinarily visible to those viewing the information."); *see also* North Carolina State Bar, 2009 Formal Ethics Opinion 1, at fn. 1 (Jan. 15, 2009) (adopting Penn. Formal Op. 2007-500 definition); *but see* Barbara J. Rothstein, Ronald J. Hedges, & Elizabeth C. Wiggins, Managing Discovery of Electronic Information: A Pocket Guide for Judges 24-25 (Federal Judicial Center 2007) ("Information about a particular data set or document which describes how, when, and by whom the data set or document was collected, created, accessed, or modified; its size; and how it is formatted. Some metadata, such as file dates and sizes, *can easily be seen by users*; other metadata can be hidden from users but are still available to the operating system or the program used to process the data set or document.") (emphasis added).

16 "Confidential Information" as used here means information subject to a legally recognized or mandated exemption from disclosure or use. Generally, "confidential information" consists of a client confidence or secret or other information that a lawyer generally must not disclose absent authorization from the person possessing the right to withhold the information, including lawyer-client communications and information protected as work product. A lawyer may also possess other, private information from a third party protected from disclosure.

17 *See, e.g.,* California Constitution, Art 1, § 1 "All people are by nature free and independent and have inalienable rights. Among these are enjoying and defending life and liberty, acquiring, possessing, and protecting property, and pursuing and obtaining safety, happiness, and privacy."

> authorized in order to carry out the representation or the disclosure is permitted by [certain specific exceptions, e.g., to prevent death or substantial bodily harm].[18]

The basic rules prohibiting the disclosure of confidential information apply equally to confidential information in metadata. A lawyer must exercise reasonable care to prevent the disclosure of confidences and secrets contained in metadata transmitted to another.[19] A lawyer's duty "includes taking care ... to employ reasonably available technical means to remove [confidential] metadata before sending the file."[20]

2. The Duty of Competence

By the very nature of being a member of the bar, a lawyer must act competently in any matter the lawyer undertakes.[21]

"A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."[22] The duty of competence requires a lawyer to avoid disclosure of confidential information in metadata.[23] As Minnesota Lawyers Professional Responsibility Board said, "Competence requires that lawyers understand that:

- metadata is created in the generation of electronic files,
- transmission of electronic files will include transmission of metadata,
- recipients of the files can access metadata, and
- actions can be taken to prevent or minimize the transmission of metadata."[24]

The duty of competence means a lawyer must understand metadata (and the different types of metadata), including having sufficient knowledge for the lawyer to adhere to the lawyer's duties of confidentiality and preservation as applied to metadata.[25]

3. The Duty of Supervision

A lawyer must become knowledgeable about metadata, and a firm must provide for the acquisition of such knowledge. *ABA Model Rules of Prof'l Conduct R. 5.1*

18 ABA Model Rules of Prof'l Conduct R. 1.6 *Confidentiality of Information* (2009) (virtually all states have the same or similar rules regarding a lawyer's duty of confidentiality). *See also, e.g.,* California Bus. & Prof. Code § 6068(e)(1) (A lawyer has a duty "To maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.")

19 *See, e.g.,* North Carolina State Bar 2009 Formal Ethics Opinion 1 (Jan. 15, 2010) ("[A] lawyer must use reasonable care to prevent the disclosure of confidential client information hidden in metadata when transmitting an electronic communication. ..."); New York State Bar Association Opinion 782 (Dec. 8, 2004) ("Lawyers must exercise reasonable care to prevent the disclosure of confidences and secrets contained in 'metadata' in documents they transmit electronically to opposing counsel or other third parties.").

20 D.C. Bar Opinion 341 (Sept. 2007). Again, appreciating the various types of metadata can aide in preventing the disclosure of confidential information—for instance, a drafter-created file title in a law firm's information management system ("system metadata") can contain confidential information (e.g., "Draft settlement agmt w/ client reqs for para 2") that may need to be "scrubbed" prior to transmission in the non-discovery context.

21 Although set forth as a separate rule by the ABA, the duty of diligence is inherent in competent representation. ABA Model Rules of Prof'l Conduct R. 1.3 Diligence (2009) ("A lawyer shall act with reasonable diligence. ...").

22 ABA Model Rules of Prof'l Conduct R. 1.1 Competence (2009).

23 *See, e.g.,* Minnesota Lawyers Professional Responsibility Board Opinion No. 22 (Mar. 26, 2010) ("[A] lawyer is ethically required to act competently to avoid improper disclosure of confidential and privileged information in metadata in electronic documents.").

24 *Id.*

25 The ABA Commission on Ethics 20/20 is proposing that the comments for the rule on competence be amended to include that "[a] lawyer should keep abreast of changes in the law and its practice, *including the benefits and risks associated with technology*. ..." ABA Commission on Ethics 20/20 Initial Draft Proposals – Technology and Confidentiality (May 2, 2011) at www.abanow.org (emphasis added).

Responsibilities of Partners, Managers, and Supervisory Lawyers (2009) require those with managerial authority to make reasonable efforts to ensure that the firm and its lawyers follow the Rules of Professional Conduct.[26] Also, the duty of supervision as articulated, for example, R. 5.1(a) may require the implementation of a firm-wide application to scrub certain outgoing email to remove metadata.[27] "[L]awyers must either acquire sufficient understanding of the software that they use or ensure that their office employs safeguards to minimize the risk of inadvertent disclosures."[28]

4. The Duty of Preservation

In contrast to the oft-required removal of metadata before transmission to another, the duty of preservation of evidence may include the obligation <u>not</u> to *scrub* certain *transactional* metadata.[29] A lawyer must not unlawfully alter, destroy, or conceal a file or other material having potential evidentiary value.[30] If one reasonably anticipates litigation, one must take care to prevent the routine deletion of certain metadata, especially embedded metadata in potentially relevant ESI. For example, one must not delete metadata such as tracked changes if the changes show the contract negotiations between business people if the contract is the subject of likely litigation. Such deletion may constitute spoliation. Removing metadata from certain evidentiary files may even be illegal.[31]

Preservation obligations and practices outside the context of *reasonably anticipated* litigation, however, differ considerably. "Absent a legal requirement to the contrary, organizations are not required to retain metadata. ..."[32] In fact, an earlier Sedona Commentary reminds us that to maintain the security of certain files mandated for retention, particularly those of certain regulated entities, a party may properly decide to remove some metadata.[33]

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26 *See also* Rule 5.3(a) Responsibilities Regarding Nonlawyer Assistants: "A lawyer has a duty to supervise a law firm or department's junior members, paralegals, support staff, and any third-parties for whose work the lawyer is responsible."

27 *See also* Professional Ethics of the Florida Bar Opinion 10-2 (Sept. 24, 2010) ("A lawyer who chooses to use [d]evices that contain [s]torage [m]edia such as printers, copiers, scanners, and facsimile machines must take reasonable steps to ensure that client confidentiality is maintained and that the [d]evice is sanitized before disposition, including ... (3) supervision of nonlawyers to obtain adequate assurances that confidentiality will be maintained; and (4) responsibility for sanitization of the [d]evice by requiring meaningful assurances from the vendor at the intake of the [d]evice and confirmation or certification of the sanitization at the disposition of the [d]evice.").

28 D.C. Bar Opinion 341 (Sept. 2007).

29 *See, e.g., The Ad Hoc Committee for Electronic Discovery of the United States District Court for the District Of Delaware, Default Standard for Discovery of Electronic Documents ("E-Discovery")* (revised March 2, 2007) ("[T]he producing party must preserve the integrity of the electronic document's contents, i.e., the original formatting of the document, its metadata and, where applicable, its revision history.").

30 *See, e.g.,* ABA Model Rules of Professional Conduct, Rule 3.4(a), Fairness to Opposing Party and Counsel ("A lawyer shall not: (a) unlawfully obstruct another party' s access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value. A lawyer shall not counsel or assist another person to do any such act. ...") "In a discovery or subpoena context ... a lawyer must be careful in situations where electronic documents constitute tangible evidence. Rule 3.4(a) prohibits altering, destroying or concealing material having potential evidentiary value. … [R]emoval of metadata may be prohibited. ..." West Virginia State Bar Ethics Opinion L.E.O. 2009-01 (June 10, 2009).

31 Minnesota Lawyers Professional Responsibility Board Opinion No. 22 (Mar. 26, 2010) ("Removing metadata from evidentiary documents in the context of litigation or in certain other circumstances may be impermissible or illegal.").

32 *The Sedona Guidelines: Best Practice Guidelines & Commentary for Managing Information & Records in the Electronic Age* (November 2007) at 28, *available at* https://thesedonaconference.org/download-pub/74. *See also, e.g.,* the *Minnesota Recordkeeping Metadata Standard* as an example of guidelines regarding use and preservation of metadata, including metatags.

33 "Federal law requires a variety of regulated entities to adopt policies and procedures to ensure the security of information, to protect against unauthorized access or use, and to destroy the information through special, secure methods." *The Sedona Conference® Commentary on Preservation, Management and Identification of Sources of Information that are Not Reasonably Accessible* (July 2008) at 19, *available at* https://thesedonaconference.org/download-pub/66. One business practice appropriate to some circumstances may be "[r]emoving some metadata from documents in retaining them as records or when transmitting them to others." *Id.*

II. A LAWYER'S ETHICAL OBLIGATIONS IN THE NON-DISCOVERY CONTEXT

A. Ethical Duties of a Lawyer *Sending* Metadata

A lawyer who sends metadata has the same duties of confidentiality and competence as with the sending of any other information. [34] A lawyer must use reasonable care to prevent disclosure of confidential (including *privileged*) metadata.[35]

Part of the lawyer's duty is to remove others' confidential metadata. Although the typical breach is the lawyer's failure to remove information regarding a client before transmitting it, a file may contain metadata relating to confidential information of a third party. As noted above, a lawyer's duty "includes taking care ... to employ reasonably available technical means to remove [confidential] metadata before sending the [file]. ... Accordingly, lawyers must either acquire sufficient understanding of the software that they use or ensure that their office employs safeguards to minimize the risk of inadvertent disclosures."[36]

Just as with the inadvertent disclosure of any confidential information, if a lawyer discovers he or she has inadvertently sent confidential metadata to another, the lawyer must diligently notify all those who may have received the metadata and obtain its return or destruction. Electronic information may leave the lawyer via a BlackBerry, instant messaging, etc. Due care must be taken in all circumstances.

B. Ethical Duties, Generally, of a Lawyer *Receiving* Metadata

Most jurisdictions require a lawyer who receives a file from another lawyer through inadvertence to notify the sending lawyer. The typical bar association rule mandating such notification derives from ABA Model Rules of Professional Conduct ("MRPC") Rule 4.4(b): "A lawyer who receives a document relating to the representation of the lawyer's client and knows or reasonably should know that the document was inadvertently sent shall promptly notify the sender." *A fortiori*, "[i]f a lawyer receives a document which the lawyer knows or

34 To the extent one has access to a public record in electronic form, one should have access to the metadata in that record. By making the file public, the metadata perforce is made public. This was the holding in 2009 by the Arizona Supreme Court. *Lake v. City of Phoenix*, 218 P.3d 1004 (Ariz. 2009) (a "public record" in electronic format, if preserved and requested under the Arizona Public Records Act, includes the metadata). Although the State Bar of Arizona had earlier opined that a recipient may not examine a file for the purpose of discovering the metadata embedded in it. Arizona State Bar Opinion 07-03: Confidentiality; Electronic Communications; Inadvertent Disclosure (Nov. 2007) ("Except in the specific circumstances described in this opinion, a lawyer who receives an electronic communication may not examine it for the purpose of discovering the metadata embedded in it.") Presumably the principle enunciated by the Arizona Supreme Court should apply generally to metadata in public records subject to sunshine laws, the Freedom of Information Act (FOIA), and all other public-records statutes. A lawyer's duty of confidentiality means that if a lawyer submits information in electronic form to a government entity, the lawyer must ensure that any information to be redacted is done correctly and completely, again requiring the lawyer to possess a basic level of competence.

35 *See, e.g.,* North Carolina State Bar 2009 Formal Ethics Opinion 1 (Jan. 15, 2010) ("[A] lawyer must use reasonable care to prevent the disclosure of confidential client information hidden in metadata when transmitting an electronic communication . ..."); New York State Bar Association Opinion 782 (Dec. 8, 2004) ("Lawyers must exercise reasonable care to prevent the disclosure of confidences and secrets contained in 'metadata' in documents they transmit electronically to opposing counsel or other third parties.").

36 D.C. Bar Opinion 341 (Sept. 2007).

reasonably should know inadvertently contains confidential or privileged metadata; the lawyer shall promptly notify the document's sender. ..."[37]

In addition, regardless of a Rule 4.4(b), some jurisdictions require a lawyer who has received confidential materials through inadvertence not to read any more than is essential to ascertain if the materials are protected confidential information. At that point, the lawyer must notify the sending lawyer to resolve the matter.[38]

C. But see, Certain Bar Opinions Prohibit *Mining* by a Lawyer Receiving Metadata

Depending on the jurisdiction governing the receiving lawyer's conduct, different duties may apply to a lawyer who receives a file containing metadata sent by another.[39] Several bar associations' ethics opinions prohibit the receiving lawyer's viewing of any of the file's metadata (referred to as *data mining* in some of these opinions).[40] Such state ethics opinions appear to presume that metadata is *per se* confidential to its lawyer-author.[41]

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37 Minnesota Lawyers Professional Responsibility Board Opinion No. 22 (March 2010). The receiving lawyer may also be prohibited from using or further distributing an inadvertently sent document/file until the matter is resolved. *See, e.g.,* ABA Model Rules of Prof'l Conduct R. 4.4(b) (2009): "A lawyer who receives a document relating to the representation of the lawyer's client and knows or reasonably should know that the document was inadvertently sent shall promptly notify the sender." Like Minnesota, most states have a similar rule. But, notably, California, which has been adapting its Rules of Professional conduct to be more like the ABA Model Rules of Prof'l Conduct, specifically rejected 4.4(b): "The Commission also recommends against adoption of paragraph (b) of Model Rule 4.4 and the related comments, in part, because a lawyer's duties concerning inadvertently transmitted writings often are fact-bound inquiries and therefore are difficult to specify in rule that will have disciplinary consequences. In addition, case law may continue to evolve in this area of lawyer conduct in response to variations in factual situations." State Bar Commission for the Revision of the Rules of Professional Conduct at 19 (June 26, 2010).
In its Comment to ABA Model Rule of Prof'l Conduct R. 4.4(b) (2009), the ABA notes, "Whether the lawyer is required to take additional steps, such as returning the original document, is a matter of law beyond the scope of these Rules. …" ABA Model Rules of Prof'l Conduct Comments to R. 4.4(b) (2009):

> [2] Paragraph (b) recognizes that lawyers sometimes receive documents that were mistakenly sent or produced by opposing parties or their lawyers. If a lawyer knows or reasonably should know that such a document was sent inadvertently, then this Rule requires the lawyer to promptly notify the sender in order to permit that person to take protective measures. Whether the lawyer is required to take additional steps, such as returning the original document, is a matter of law beyond the scope of these Rules, as is the question of whether the privileged status of a document has been waived. Similarly, this Rule does not address the legal duties of a lawyer who receives a document that the lawyer knows or reasonably should know may have been wrongfully obtained by the sending person. For purposes of this Rule, "document" includes e-mail or other electronic modes of transmission subject to being read or put into readable form.
>
> [3] Some lawyers may choose to return a document unread, for example, when the lawyer learns before receiving the document that it was inadvertently sent to the wrong address. *Where a lawyer is not required by applicable law to do so, the decision to voluntarily return such a document is a matter of professional judgment* ordinarily reserved to the lawyer. See R. 1.2 and 1.4. (emphasis added).

If a lawyer is inclined to return a document in these circumstances, the lawyer first must consider if the lawyer's duty of diligent representation would mandate the opposite action.

38 *See, e.g., Rico v. Mitsubishi Motors Corp.,* 42 Cal. 4th 807, 68 Cal. Rptr. 3d 758 (Dec. 12, 2007) ("When a lawyer who receives materials that obviously appear to be subject to an attorney-client privilege or otherwise clearly appear to be confidential and privileged and where it is reasonably apparent that the materials were provided or made available through inadvertence, the lawyer receiving such materials should refrain from examining the materials any more than is essential to ascertain if the materials are privileged, and shall immediately notify the sender that he or she possesses material that appears to be privileged. The parties may then proceed to resolve the situation by agreement or may resort to the court for guidance with the benefit of protective orders and other judicial intervention as may be justified." (quoting *State Comp. Ins. Fund v. WPS, Inc.* (1999) 70 Cal. App. 4th 644, 656-67, 82 Cal. Rptr. 2d 799 (1999))).

39 Some ethics opinions may be binding on members of a state bar (and lawyers who practice in the state) but others are merely advisory. *See, e.g., Arizona State Bar Opinion 07-03: Confidentiality; Electronic Communications; Inadvertent Disclosure* (Nov. 2007) ("Formal opinions of the Committee on the Rules of Professional Conduct are advisory in nature only and are not binding in any disciplinary or other legal proceedings."); Ethics Opinions, State Bar of California ("These advisory opinions regarding the ethical propriety of hypothetical attorney conduct, although not binding, are often cited in the decisions of the Supreme Court, the State Bar Court Review Department and the Court of Appeal.") http://ethics.calbar.ca.gov/Ethics/Opinions.aspx (last visited Jan. 4, 2011).

40 *See, e.g.,* Alabama Ethics Opinion RO-2007-02 at 2 ("The act of deliberately seeking out and viewing metadata embedded in a document is most often referred to as 'mining' the document."). *See also* discussion above concerning the use of phrases similar to "metadata embedded in a document."

41 *See, e.g.,* New York State Bar Association, Committee on Professional Ethics, Opinion 749, *Use of Computer Software to Surreptitiously Examine and Trace E-Mail and Other Electronic Documents* (December 14, 2001) (concluding that, "[a] lawyer may not make use of computer software applications to surreptitiously 'get behind' visible documents or to trace e-mail."). *See also* Alabama State Bar Ethics Opinion RO-2007-02, *Disclosure and Mining of Metadata* (March 14, 2007) ("Mining of metadata constitutes a knowing and deliberate attempt by the recipient attorney to acquire confidential and privileged information in order to obtain an unfair advantage against an opposing party."). *Id.* Of course, not all metadata is, in fact, confidential. These presumptions concerning "confidentiality *per se*" may arise from this misunderstanding of the different types of metadata and intend to only prohibit the examination of embedded metadata. The fact that all metadata is not confidential is further supported by The ABA Commission on Ethics 20/20. The Commission is proposing that the rule on inadvertent disclosure be amended to make clear that "[r]eceipt of information containing 'metadata' does not, standing alone, create a duty under this Rule." ABA Commission on Ethics 20/20 Initial Draft Proposals – Technology and Confidentiality (May 2, 2011) at www.abanow.org.

1. Few Reported Decisions

There are few reported decisions discussing whether it is ethical for a lawyer to examine the metadata in a received file. This is likely because courts do not usually deal with rules of professional conduct. (In contrast, in the context of litigation, there is a growing body of case law regarding metadata, although a court usually deals with a lawyer's conduct pursuant to the Fed. R. Civ. P., the Federal Rules of Evidence ["F.R.E."], and the inherent power of the court to govern the proceeding before it.) *In re Jessica L. Cutler, Steinbuch v. Cutler* does explicitly discuss the New York State Bar Association's ethics opinion prohibiting "data mining" of a received file's metadata.[42] *Cutler*, however, a bankruptcy matter, has a set of uncommon facts such that any comments on the New York ethics opinion are *dicta* at best.

2. Bar Associations' Ethics Opinions[43]

a) *Prohibited*

The following jurisdictions generally prohibit a lawyer from examining a received file for metadata:

- Alabama[44]
- Arizona[45]
- Florida[46]
- Maine[47]
- New Hampshire[48]
- New York[49]
- North Carolina[50]

In an early "anti-mining" opinion, the New York State Bar Association held, "A lawyer may not make use of computer software applications to surreptitiously 'get behind' visible documents or to trace e-mail."[51] An awareness of the different types of metadata (e.g., *application metadata* that instructs the computer how to display fonts) may cure this presumption of confidentiality for all metadata and could be limited to metadata more likely to contain confidential information (e.g., *embedded metadata* containing presentation notes).

b) *No Prohibition Unless the Lawyer has Actual Knowledge*

The following jurisdictions generally allow a lawyer to examine a received file for metadata *unless the receiving lawyer has actual*

42 *In re Jessica L. Cutler, Steinbuch v. Cutler*, No. 07-31459, Adv. No. 07-50064, 2009 WL 2370624 (Bankr. N.D.N.Y. June 5, 2009).
43 *See also* the ABA chart Metadata Ethics Opinions Around the U.S., www.abanet.org/tech/ltrc/fyidocs/metadatachart.html (last visited May 3, 2010).
44 Alabama State Bar Ethics Opinion RO-2007-02, *Disclosure and Mining of Metadata* (March 14, 2007).
45 Arizona State Bar Ethics Opinion 07-03, *Confidentiality; Electronic Communications; Inadvertent Disclosure* (November 2007).
46 Florida State Bar Ethics Opinion 06-2 (September 15, 2006).
47 Maine State Bar Ethics Opinion 196 (October 21, 2008).
48 New Hampshire State Bar Association Ethics Opinion 2008-2009/4, *Disclosure, Review, and Use of Metadata in Electronic Materials* (April 16, 2009).
49 New York State Bar Ethics Opinion 782, *E-mailing Documents that May Contain Hidden Data Reflecting Client Confidences and Secrets* (December 8, 2004); New York State Bar Association, Committee on Professional Ethics, Opinion 749, *Use of Computer Software to Surreptitiously Examine and Trace E-Mail and Other Electronic Documents* (December 14, 2001).
50 North Carolina State Bar 2009 Formal Ethics Opinion 1, *Review and Use of Metadata* (January 15, 2010).
51 Conclusion, New York State Bar Association Opinion 749 (Dec. 14, 2001).

knowledge that the file contains confidential metadata and should assume that the information was transmitted inadvertently.

- Colorado[52]
- District of Columbia[53]
- West Virginia[54]

The West Virginia State Bar opinion typifies many of the bar association opinions on metadata in that it appears to set inconsistent guidelines. At one point, it speaks of "actual knowledge" that "metadata was inadvertently sent." Yet, at another point, it seems to require the receiving lawyer to presume that the sending was inadvertent.

"[I]f a lawyer has received electronic documents and *has actual knowledge* that metadata was inadvertently sent, the receiving lawyer should not review the metadata before consulting with the sending lawyer to determine whether the metadata includes work-product or confidences."[55]

But ...

"The Board finds ... there is a burden on a lawyer receiving inadvertently provided metadata to consult with the sender and abide by the sender's instructions before reviewing such metadata."[56]

But again ...

The federal court for the Southern District of West Virginia, sitting in diversity, held:

"[N]o West Virginia Rule or Standard of Professional Conduct requires notification to the producing party by the receiving party of the inadvertent disclosure of a privileged document."[57]

c) *No Prohibition*

The following jurisdictions generally have no prohibition on reading metadata received from another:

- Maryland[58]

52 Colorado State Bar Ethics Opinion No. 119, *Disclosure, Review, and Use of Metadata* (May 17, 2008).
53 District of Columbia Bar Ethics Opinion 341, *Review and Use of Metadata in Electronic Documents* (September 2007).
54 West Virginia State Bar Ethics Opinion LEO 200-01, *What is Metadata and Why Should Lawyers Be Cautious?* (June 10, 2009).
55 West Virginia State Bar Ethics Opinion L.E.O. 2009-01 (June 10, 2009) (emphasis added).
56 *Id.*
57 *Mt. Hawley Ins. Co. v. Felman Prod., Inc.*, No. 3:09-CV-00481, 2010 WL 1990555 (S.D. W.Va. May 5, 2010), No. CIV.A. 3:09-0481, 2010 WL 2944777 (S.D. W.Va. July 23, 2010); and *id.* at *7 ("This court has jurisdiction over this case based on diversity of citizenship. [Complaint, # 1, 7, at 2.] Pursuant to Federal Rule of Evidence 501, the privilege 'shall be determined in accordance with State law.'").
58 "Subject to any legal standards or requirements (case law, statutes, rules of procedure, administrative rules, etc.), this Committee believes that there is no ethical violation if the recipient attorney (or those working under the attorney's direction) reviews or makes use of the metadata without first ascertaining whether the sender intended to include such metadata." Maryland State Bar Association - Committee on Ethics, Ethics Docket No. 2007-09.

- Vermont[59]
- Minnesota (but it's a fact-specific question)[60]

This is also the position of the American Bar Association.[61]

d) *Case-by-Case Basis*

According to the following bar association, a lawyer must determine whether to use metadata on a case-by-case basis.

- Pennsylvania[62]

e) *Other Jurisdictions*

Even though other jurisdictions may not have weighed in on the specific question concerning metadata inadvertently sent, one should look for guidance to that jurisdiction's rules regarding a lawyer's duty on receipt of any inadvertently sent ESI. A lawyer should treat those rules as establishing a minimum duty because no jurisdiction has a more lenient rule for confidential metadata than it does for other confidential ESI.

f) *Wrinkles Throughout the Different Bar Association Opinions*

There are wrinkles in all of the opinions. One must carefully read them for the particular application to one's immediate circumstances. Consider the different takes above on what a West Virginia lawyer should do.

As noted, some opinions presume that searching for metadata is, *per se*, searching for confidential information. It is this misunderstanding of the different types of metadata that leads to the blanket prohibition on viewing any metadata, even metadata that would have no claim to confidentiality.

Other opinions appear to share this broad injunction against a lawyer who receives a file from another from searching metadata, yet a closer look at some of them reveals a possibly narrower rule: They may more precisely prohibit the lawyer from *searching for*

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59 Vermont Bar Association Professional Responsibility Section Opinion 2009-1 (August 27, 2009). ("[T]here is a clear basis for an inference that thorough review of documents received from opposing counsel, including a search for and review of metadata included in electronically transmitted documents, is required by [Vermont Rules of Professional Conduct] VRPC 1.1 Competence, and VRPC 1.3 Diligence. ... Vermont lawyers are subject to the obligation to notify opposing counsel if they receive documents that they know or reasonably should know were inadvertently disclosed. Whether inadvertent disclosure results in waiver, ... and whether the receiving lawyer can review and use the inadvertently disclosed information, remain issues of substantive law."). *Id.* at 6.

60 "Opinion 22 is not meant to suggest there is an ethical obligation on a receiving lawyer to look or not to look for metadata in an electronic document. Whether and when a lawyer may be advised to look or not to look for such metadata is a fact specific question beyond the scope of this Opinion." Minnesota Lawyers Professional Responsibility Board Opinion No. 22 (Mar. 26, 2010).

61 American Bar Association Formal Ethics Opinion 06-442 (August 5, 2006).

62 Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility Formal Opinion 2009-100, *Ethical Obligations on the Transmission and Receipt of Metadata* (June 17, 2009) *superseding* Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility Formal Opinion 2007-500, *Mining Metadata* (March 13, 2008) ("The Committee ... determined that the prior opinion provided insufficient guidance to recipients of documents containing metadata and did not provide correlative guidance to attorneys who send such documents.").

> *confidential information* in the metadata. Consider North Carolina: A "lawyer who receives an electronic communication from another party or another party's lawyer *must refrain from searching for* and using *confidential information* found in the metadata embedded in the document."[63]
>
> For most jurisdictions, the minimum rule of thumb is: **A lawyer may not go looking for metadata with a bad intent, i.e., to discover another's confidences.**

D. A Receiving Lawyer may have a Good Reason – or Even an Obligation – to Search for Metadata

At least one bar association has suggested that a lawyer's duties of competence and diligence *require* a search for and review of metadata included in electronically transmitted documents.[64] In addition, among other reasons, a lawyer and a law firm have a duty to protect their electronic information systems from attack by security threats such as a computer virus. By necessity, an anti-virus software application scans the metadata of all incoming (and often outgoing) messages and their attachments. A lawyer may also need to check an email's full header or a file's properties to determine the authenticity of the email or file.

III. A LAWYER'S ETHICAL DUTIES REGARDING METADATA IN THE DISCOVERY CONTEXT

A. Discovery is Different – Usually

For the sending lawyer, just as the situation in the non-discovery context, the lawyer sending/producing files containing metadata must ensure that no confidential information is disclosed to another not entitled to see it. In discovery, however, a lawyer cannot withhold whatever the lawyer chooses. In addition, privileged information withheld – if otherwise responsive – usually must be accounted for on a privilege log.

For the receiving lawyer in the context of discovery, however, the lawyer generally is allowed (and possibly mandated) to search for and examine any produced metadata. This search and examination is conducted without the presumption that such search and examination have a wrongful intent, as held in some jurisdictions' ethics opinions on metadata discussed above in the non-discovery context.

Particularly in litigation, a lawyer may be subject to obligations regarding metadata other than the Rules of Professional Conduct. Certain rules govern a matter before a tribunal regarding the right to withhold confidential information from disclosure and

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63 The North Carolina State Bar, 2009 Formal Ethics Opinion 1 (Jan. 15, 2009) (emphasis added). "In summary, a lawyer may not search for and use confidential information embedded in the metadata of an electronic communication sent to him or her by another lawyer or party unless the lawyer is authorized to do so by law, rule, court order or procedure, or the consent of the other lawyer or party. If a lawyer unintentionally views metadata, the lawyer must notify the sender and may not subsequently use the information revealed without the consent of the other lawyer or party." *Id.*

64 Vermont Bar Association Professional Responsibility Section Opinion 2009-1 at 5 (August 27, 2009) ("[T]here is a clear basis for an inference that thorough review of documents received from opposing counsel, including a search for and review of metadata included in electronically transmitted documents, is required by VRPC 1.1 Competence, and VRPC 1.3 Diligence."). *But see* District of Columbia Bar Ethics Opinion 341, *Review and Use of Metadata in Electronic Documents* (September 2007) at fn. 9 ("In concluding that a lawyer *may* review metadata in documents produced in discovery (that is, unless and until the lawyer has actual knowledge that the metadata contains protected information), we do not intend to suggest that a lawyer *must* undertake such a review. Whether as a matter of courtesy, reciprocity, or efficiency, 'a lawyer may decline to retain or use documents that the lawyer might otherwise be entitled to use, although (depending on the significance of the documents) this might be a matter on which consultation with the client may be necessary.'") (citations omitted).

providing direction regarding a lawyer's duty to protect such information from disclosure. They also direct a lawyer's conduct if such confidential information is subsequently disclosed without authorization from the holder of the right.

B. Ethical Duties of a Lawyer for a Party *Producing* Metadata

The ethical duties of a lawyer for a party producing metadata in response to discovery or a subpoena are generally the same ethical duties of a lawyer for a party producing any other ESI. A party must produce all responsive information not subject to withholding on the basis of privilege or another consideration.[65] This includes metadata. "[M]etadata ... must be produced when requested and not objected to. However, any metadata that is privileged can still be protected and exempt from discovery, upon proper assertion of a privilege."[66] For responsive information in metadata withheld on the basis of privilege, the withholding party must provide a privilege log, i.e., the party must (i) expressly make the claim; and (ii) describe the nature of the information to the extent necessary for another to assess the claim.[67] For practical purposes, other than certain types of *embedded metadata* (e.g., tracked changes, presentation notes, or comments), there will be very little metadata for which a claim of privilege is asserted.

1. A Lawyer Must Review Metadata for Confidential Information

A lawyer has a duty to review metadata for confidential information, including information protected by the attorney-client privilege, in an otherwise nonconfidential responsive file. Whether a diligent review has occurred affects whether confidentiality or privilege claims have been waived on any inadvertently produced information.[68] Again, an understanding of the different types of metadata will assist in identifying the very limited types of metadata that could possibly contain confidential or privileged information and expediting any necessary review.[69]

When conducting this review of files and the appropriate metadata, if, by way of example, responsive yet privileged embedded metadata is part of a file, it must not be removed from the original file; but it must be redacted on a copy of the file. And, as discussed above, the producing lawyer must sufficiently detail the basis for the redaction, such as pursuant to the attorney-client privilege.

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65 Fed. R. Civ. P. Rule 26(b)(1) Scope in General: "Unless otherwise limited by court order, the scope of discovery is as follows: Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense – including the existence, description, nature, custody, condition, and location of any documents or other tangible things and the identity and location of persons who know of any discoverable matter. For good cause, the court may order discovery of any matter relevant to the subject matter involved in the action. Relevant information need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence. All discovery is subject to the limitations imposed by Rule 26(b)(2)(C)."

66 West Virginia State Bar Ethics Opinion L.E.O. 2009-01 (June 10, 2009).

67 Fed. R. Civ. P. Rule 26(b)(5) Claiming Privilege or Protecting Trial-Preparation Materials. (A*) Information Withheld.* When a party withholds information otherwise discoverable by claiming that the information is privileged or subject to protection as trial-preparation material, the party must: (i) expressly make the claim; and (ii) describe the nature of the documents, communications, or tangible things not produced or disclosed – and do so in a manner that, without revealing information itself privileged or protected, will enable other parties to assess the claim.

68 *See, e.g., Mt. Hawley* 2010 WL 1990555 (court found defendant did not take reasonable steps to prevent inadvertent disclosure of an email and thus waived protection for it, applying Federal Rule of Evidence 502(b), considering *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 250 F.R.D. 251 (D. Md. 2008) and similar cases as to reasonableness).

69 The format of production and, specifically, what fields of metadata are produced will obviously impact what metadata is reviewed for confidentiality and privilege.

2. Additional Duties of a Sending Lawyer who has Inadvertently Produced Confidential (including privileged) Metadata

If a lawyer discovers that the lawyer (party) has inadvertently produced privileged or otherwise confidential metadata to another, certain additional duties attach depending on the applicable discovery rules and rules of professional conduct. At a minimum, as part of the lawyer's duty to protect confidential information, the lawyer must request the return or destruction of the inadvertently produced confidential metadata (which usually means the return or destruction of the inadvertently produced file of which the metadata is a part).

For inadvertently produced, privileged information, this information needs to be identified on a privilege log as noted above. For inadvertently produced confidential (not privileged) information, again, depending upon the terms or existence of a protective order, the information may need to be redacted or reproduced with the appropriate legend or other *mark* identifying the information as confidential and restricted in its use.

The burden of retrieving any inadvertently-produced metadata lies squarely on the back of the producing party and its lawyer. Although not a rule of professional conduct, Federal Rule of Civil Procedure 26(b)(5)(B), "clearly places the burden of claiming privilege and notifying other parties on the party who produced the information. This burden is of course consistent with the well-settled rule that the party claiming a privilege or protection has the burden of establishing its entitlement thereto." [70]

C. Ethical Duties of a Lawyer for a Party *Receiving* Metadata

1. General

The ethical duties of a lawyer receiving metadata in response to discovery follow the same principles of the ethical duties of a lawyer who receives any other type of ESI produced in discovery or pursuant to a subpoena.

A lawyer should specify in the discovery request the form(s) in which ESI is to be produced.[71] The request is often for responsive files to be produced in native format with all metadata intact or in a reasonably useable form, which may include specified fields of metadata.[72] Thus, just as the producing party is aware of which metadata fields must be reviewed for possible future production, the receiving party should have an expectation of the types or fields of metadata that will be produced with the responsive files.

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70 *See Mt. Hawley* 2010 WL 1990555 at *3, *citing United States v. Jones*, 696 F.2d 1069, 1072 (4th Cir. 1982).

71 The Sedona Conference® also recommends the topic, among others, be resolved at a meet and confer between the parties and their attorneys: "The anticipated form or forms of production to be sought, the need for metadata, and the form of preservation of information pending discovery." *The Sedona Conference® Commentary on Preservation, Management and Identification of Sources of Information that are Not Reasonably Accessible* (July 2008) at 17, *available at* https://thesedonaconference.org/download-pub/66.

72 In *Covad Commc'n Co. v. Revonet, Inc. 267 F.R.D. 14* (D.D.C. 2010), Judge Facciola held that, because Rule 34(b)(2)(E)(ii) itself also permits production in another, usable format, the Rule contradicted plaintiff's claim that native, electronic format is absolutely obligatory. The court also relied on *The Sedona Conference, Best Practices, Recommendations, & Principles for Addressing Electronic Document Production* (2004) at i, *available at* https://thesedonaconference.org/download-pub/99. ("Unless it is material to resolving the dispute, there is no obligation to preserve and produce metadata absent agreement of the parties or order of the court.") *See also Sedona Principles Second Edition*: "Absent party agreement or court order specifying the form or forms of production, production should be made in the form or forms in which the information is ordinarily maintained or in a reasonably usable form, *taking into account the need to produce reasonably accessible metadata that will enable the receiving party to have the same ability to access, search, and display the information as the producing party* where appropriate or necessary in light of the nature of the information and the needs of the case. ... [T]he Committee Note to Rule 34(b) explicitly states that '[i]f the responding party ordinarily maintains the information it is producing in a way that makes it searchable by electronic means, the information should not be produced in a form that removes or significantly degrades this feature.' Accordingly, a party should produce electronically stored information in 'reasonably usable' forms, though not necessarily 'native format.'" *Sedona Principles Second Edition* at 60 and 63.

A lawyer must not then overlook the review of metadata requested and received in discovery. A lawyer must also have sufficient knowledge and employ the proper diligence to make sure that the received metadata is complete (unless redacted for privilege and subsequently logged) and not altered or deleted from the original in the possession, custody, or control of the producing party.

2. Duties if a Lawyer Discovers or is Notified that Metadata has Been Inadvertently Produced

Unlike a lawyer who receives metadata in the non-discovery context, a lawyer who receives metadata in response to a discovery request or pursuant to a subpoena is generally justified in assuming that the metadata was provided intentionally.

If a lawyer, however, discovers that metadata has been inadvertently produced in discovery, certain duties may attach, particularly if the lawyer is bound by a professional rule of conduct similar to ABA MRPC Rule 4.4(b) (2009), which requires notification to the sending lawyer. Similarly, of those bar associations that have opined on the issue, at least one has held that if a receiving lawyer has *actual knowledge* that metadata containing protected information was *inadvertently* sent by the sending lawyer, the receiving lawyer should advise the sending lawyer.[73] In addition, a jurisdiction may require the cessation of any further examination and notification of the sending lawyer if the received metadata is ascertained to contain confidential information.[74] Typically, rules of procedure do not impose any obligation on the receiving lawyer. For example, the Federal Rules of Civil Procedure "impose[ ] no duty on a party receiving privileged information to do anything unless and until it is notified of the claim."[75] But, "[o]nce notified of an inadvertent production of a privileged document, Rule 26(b)(5)(B) explicitly requires return, sequestration, or destruction of the document and any copies of it. ... The Rule prohibits defendants from using or disclosing the information until the claim is resolved and requires defendants to take reasonable steps to retrieve the information if defendants disclosed it before being notified of the attempted claw-back."[76]

3. Discovery is Different

Unlike metadata received outside the context of discovery, even those jurisdictions that prohibit the examination of metadata ("data mining") do not apply the prohibition generally to metadata produced in discovery. Some of the opinions use overbroad language, but a careful reading suggests the broad injunction against searching for metadata does not apply to metadata received in discovery. For example, compare the broad language of the Alabama State Bar ethics opinion prohibiting all "data mining" with its statement that, in discovery, "the mining of an email may be vital."

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73 District of Columbia Bar Ethics Opinion 341, *Review and Use of Metadata in Electronic Documents* (September 2007) ("Notwithstanding all this, even in the context of discovery or other judicial process, if a receiving lawyer has actual knowledge that metadata containing protected information was inadvertently sent by the sending lawyer, the receiving lawyer, under Rule 8.4(c) [the analogue to ABA MRPC 4.4(c)], should advise the sending lawyer and determine whether such protected information was disclosed inadvertently. See D.C. Ethics Op. 256 ['the line we have drawn between an ethical and an unethical use of inadvertently disclosed information is based on the receiving lawyer's knowledge of the inadvertence of the disclosure'].").

74 *See, e.g.,* [at current footnote 8] *Rico v. Mitsubishi Motors Corp.*, 42 Cal. 4th 807, 68 Cal. Rptr. 3d 758 (Dec. 13, 2007): "[A]n attorney who receives privileged documents through inadvertence ... may not read a document any more closely than is necessary to ascertain that it is privileged. Once it becomes apparent that the content is privileged, counsel must immediately notify opposing counsel and try to resolve the situation."

75 *Mt. Hawley* 2010 WL 1990555 at *3.

76 *Id.*

> "Absent express authorization from a court, it is ethically impermissible for an attorney to mine metadata from an electronic document he or she inadvertently or improperly receives from another party."[77]
>
> *But ...*
>
> One possible exception to the prohibition against the mining of metadata involves electronic discovery. ... [P]arties may be sanctioned for failing to provide metadata along with electronic discovery submissions. ... [T]he mining of an email may be vital in determining the original author, who all received a copy of the email, and when the email was viewed by the recipient. In Enron-type litigation, the mining of metadata may be a valuable tool in tracking the history of accounting decisions and financial transactions.[78]

IV. MULTIJURISDICTIONAL ISSUES

Jurisdictional conflicts have been a significant issue since the founding of these United States. This Commentary addresses only jurisdictional conflicts regarding metadata. Furthermore, those conflicts can be narrowed to those in which a lawyer receives metadata in the *non-discovery context*. As discussed above, this last circumstance is the one in which a conflict may arise because some jurisdictions limit accessing metadata by the receiving lawyer's.

Most jurisdictions' rules of professional conduct have a choice-of-law rule similar to ABA MRPC Rule 8.5:

> b) Choice of Law. In any exercise of the disciplinary authority of this jurisdiction, the rules of professional conduct to be applied shall be as follows:
>
> (1) For conduct in connection with a matter pending before a tribunal, the rules of the jurisdiction in which the tribunal sits, unless the rules of the tribunal provide otherwise; and
>
> (2) For any other conduct, the rules of the jurisdiction in which the lawyer's conduct occurred; or, if the predominant effect of the conduct is in a different jurisdiction, the rules of that jurisdiction shall be applied to the conduct. A lawyer shall not be subject to discipline if the lawyer's conduct conforms to the rules of a jurisdiction in which the lawyer reasonably believes the predominant effect of the lawyer's conduct will occur.

Multijurisdictional practice, and, hence, jurisdictional conflicts, may be more common in the context of litigation. For litigated matters, the choice-of-law rule in most jurisdictions is direct: The applicable rules "for conduct in connection with a matter pending before a tribunal" are the rules of the jurisdiction in which the tribunal sits. Regarding metadata produced and received in the discovery context, even the restrictive bar association opinions generally presume a lawyer may examine all such metadata.[79] Indeed, the applicable rules of professional conduct may mandate such an examination.

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77 Alabama State Bar Ethics Opinion RO-2007-02 (March 14, 2007).
78 *Id.*
79 *But also see* n.7 above.

But even for metadata transmitted in the non-discovery context in a matter before a tribunal, determining which jurisdiction's rule applies to a lawyer who is a member of another bar association is simple: the rules of the jurisdiction in which the tribunal sits. To the extent a jurisdiction limits the examination of metadata by the receiving party, the rule that counts is the one in which the tribunal sits. Hence, if Arizona would prohibit such examination and Colorado would otherwise permit it, if the matter is being heard in Phoenix, both Arizona and Colorado lawyers must follow Arizona Ethics Rules in such a matter.

The restrictive *anti-mining* opinions, however, are written primarily with *non-litigation* (i.e., a matter that is not before a tribunal) in mind.

A. The Ethical Dilemma in the *Non-litigation Context*[80]

Lawyers subject to the ethical rules of different jurisdictions may be subject to different ethical obligations concerning the receipt of metadata in the *non-discovery and the non-litigation contexts*. For instance, when a lawyer is admitted to practice law in multiple jurisdictions, his or her ethical obligations may conflict, as they do in Arizona and Colorado. In Arizona, a lawyer is prohibited from examining an electronic communication in the non-discovery context for the purpose of discovering its metadata.[81] In Colorado, a lawyer "generally may ethically search for and review metadata embedded in an electronic document that the receiving lawyer receives from opposing counsel or other third party."[82] If a lawyer is licensed in both Arizona and Colorado, the question arises as to which ethical obligation the lawyer must follow when involved in a matter that is not before a tribunal (i.e., non-litigation context). MRPC Rule 8.5(b) requires the lawyer to follow the ethical rule of the jurisdiction in which the lawyer is conducting business, or the jurisdiction which receives the "predominant effect" of the conduct.

B. Are Other Ethical Duties Implicated?

In instances when it is not particularly clear which jurisdiction receives the "predominant effect" of the conduct, one approach in trying to reconcile this conflict is to follow the ethical requirements of the most restrictive state (that is, the lawyer essentially contracts away his or her "right to mine" in a particular state). In other words, the lawyer is guided by the most restrictive ethics of the two states - e.g., Arizona where mining is prohibited. The lawyer would be assured he or she is not violating state bar ethical requirements concerning "mining" of metadata.

But if there is no prohibition on accessing and reviewing metadata in a jurisdiction in which the lawyer practices, there is a question as to whether the lawyer would be obligated to review metadata to fulfill the lawyer's duty of competency.

C. Best Practices

Best practices suggest that a lawyer anticipate any potential problems or conflicts with jurisdictional rules concerning metadata and resolve them before an issue arises. This can be accomplished by mutual agreements (protective orders or non-waiver agreements) as

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80 Discussed throughout this Commentary is the distinction between the discovery (information produced in response to a discovery request or subpoena) and non-discovery contexts. This is the only instance in which it is necessary to draw an even further distinction, e.g. (a) in front of a tribunal or (b) in a "non-litigation context."
81 State Bar of Arizona Ethics Committee Opinion, 07-03.
82 Colorado Bar Association Ethics Committee Opinion 119.

to metadata – namely, agree that breach of the agreement (which should be embodied in a court order) would violate MPRC R. 8.4. An agreement on how metadata will be handled reduces the potential for allegations that the way in which a lawyer handled metadata was surreptitious and is less likely to be objectionable on an ethical level. However, in any conflict situation, the court should be notified of the conflict, its nature, and the lawyers' proposed solution.

V. MITIGATION

A. Metadata: Out of Sight, Out of Mind

Too often awareness of metadata follows the old saying: Out of sight, out of mind. And therein lies the risk of malpractice and sanctions.

Certain types of metadata (e.g., embedded metadata) may migrate to new files because of the frequent reuse of prior work-product, potentially carrying with it certain confidential information without any cognizance by the new user. For example; Kate creates a licensing agreement for What-Zit, and Cleo copies it to use as a template for licensing Hot-Now. Embedded in Kate's file are tracked changes containing confidential information, of which Cleo may not be aware when she sends her draft to a different client.[83] Although, as in our example, a lawyer who sends or produces a file may be oblivious to the embedded metadata, the recipient may easily be able to access and view it. It may even appear as the recipient opens the file. Sometimes this is fine, and other times it is unfortunate. In any event, a lawyer should always be aware of all the information he or she sends to another.[84]

B. Practical Tips

Please note that these tips relate only to the sending of information containing metadata in the non-discovery context and are certainly not exhaustive as technology continues to evolve and the quantity of metadata continues to increase.

1. Scrubbing

The easiest way to prevent disclosure of confidential information in metadata is the installation and implementation of metadata scrubbing software.[85] However, scrubbing <u>may</u> constitute spoliation if a legal duty exists to preserve the data that is being scrubbed.[86]

Another practical tip for preventing the disclosure of confidential information in metadata is to scrub the metadata during the conversion to .pdf. A .pdf will have its own metadata, but it is limited to the author who created the .pdf and the date/time the document was converted to .pdf. The .pdf will not contain the original word processing software metadata.

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83 In addition, the "profile" of the user attached to the "new" document may be that of the creator of the "original." For example, certain metadata fields in Cleo's document may have information from the same metadata fields in Kate's document, for example, Kate may still appear as the author.

84 Businessman Derrick Max, reacting to Democrats' outrage when his e-mailed Congressional testimony revealed input from the Republican Social Security Administration, vented that, "The real scandal here is that after 15 years of using Microsoft Word, I don't know how to turn off 'track changes.'" Zeller, Tom, Jr., *Beware Your Trail of Digital Fingerprints*, N.Y. Times (Nov. 7, 2005).

85 *See also* n.34 above.

86 An alternative is to copy the document to a new file and scrub the new file before transmitting to a third party (which will, most likely, create a new document that also must be preserved).

Scanning a document is another way to avoid inadvertent disclosure of confidential metadata. Scanning a document to .pdf or .tiff eliminates metadata as well unless the metadata is displayed when the document is scanned. However, users often find that converting to .pdf from their desktop is faster and easier, so the safest solution may be some form of scrubbing.[87]

2. Track Changes

If using *Track Changes* in documents, proper acceptance and rejection will eliminate disclosure of confidential metadata, which the recipient could otherwise view. The user should always check to ensure that there are no tracked changes that need to be accepted or rejected.[88]

Another practical tip when using Track Changes is to avoid hiding the *Track Changes* from view by choosing: Review tab from the Ribbon, select the Tracking group; select the pull-down menu that begins with Final: Show Markup; choose Final. (Microsoft Office's Word 2010).

Again, scanning a document to .pdf or .tiff eliminates tracked changes unless tracked changes are displayed when the document is scanned.

3. Electronic Redactions

Also, beware of electronic redactions because electronic redactions may simply be overlays, exposing the *hidden* to search, copy, and paste.

Although some word processing software has electronic redaction tools, it is typically safest to print the document containing the confidential text, black out the confidential text and scan the document before sending it electronically.

4. Agreements and Orders

Other practical tips for avoiding the disclosure of metadata include agreements – confidentiality or non-disclosure agreements, stipulated protective orders, and non-waiver agreements. Such agreements are applicable to document productions in the discovery context and could also be used in the non-discovery context if specified.

VI. CONCLUSION

Electronic communications between lawyers are now standard practice, and the duty of a lawyer to maintain confidences in the transmission of ESI requires consideration of technical and legal questions. What is metadata? What metadata is or should be included in these communications? What are the ethical constraints imposed on the lawyer by the jurisdiction that licensed the lawyer and, for that matter, other jurisdictions where he or she may practice? This Commentary introduces metadata in the context of the duties and obligations lawyers now face on a daily basis and opens the dialogue on ethics and metadata.

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87 Some useful scrubbing information is available at http://blogs.adobe.com/acrobat/2010/08/scrubbing-metadata-%E2%80%93-practice-and-policy-2.html and http://www.workshare.com.

88 Documents should also be checked for comments, hidden columns, or other information that the user could embed within the document.

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PREFACE

Welcome to *The Sedona Conference® Primer on Social Media*, a publication in The Sedona Conference Working Group Series℠ ("WGS℠").

On behalf of The Sedona Conference®, I want to thank the drafting team and all WG1 members whose comments contributed to this Primer and for all of their efforts to make this work product as helpful as possible. I especially want to acknowledge the contributions made by Ronni Solomon and Alitia Faccone, who assumed the leading roles in editing the Primer, and WG1 Steering Committee Liaison Jonathan Redgrave, who brought the Primer over the finish line. And on behalf of the Drafting Committee, I'd like to thank 2012-13 WG1 Steering Committee Chair Conor Crowley for his special contributions, guidance, and commentary on this Primer.

Unlike many of the previous publications in this Series, this is not entitled a "Commentary," nor does it present any formal "Principles," although it contains plenty of practical guidance for attorneys, judges, and parties. This is called a "Primer" because the goal is to provide primary instruction to the bar and bench in the basics of social media and the law, from definitions, to the use of social media in business, to the discovery of social media in litigation, to professional responsibilities lawyers have in relation to their own use of social media. This is a fast-developing and fast-changing area of technical, social, and legal development, and any consensus-based commentary or set of principles that claims to advance the law in this area may be doomed to obsolescence as soon as it is announced on Twitter. However, we hope that this Primer represents a positive first step in grounding the dialogue leading to consensus on moving the law forward in the reasoned and just way.

We hope our efforts will be of immediate and practical assistance to lawyers, judges, database management professionals, and others involved in the legal system. As with all of our WGS℠ publications, we anticipate that developments in the law and technology will necessitate revisions and updates of this Primer. Your comments and suggestions for future editions are welcome. If you wish to submit any further comments, please visit our website at www.thesedonaconference.org and join the online discussion forums, or email us at info@sedonaconference.org.

Kenneth J. Withers
Director of Judicial Education
The Sedona Conference®
October 2012

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INTRODUCTION

Hundreds of millions of individuals now use social media to communicate and to build online communities.[1] And these users are not only the young. A Pew Research paper issued in August 2010 notes that "[s]ocial networking use among Internet users ages 50 and older has nearly doubled – from 22% to 42% over the past year," and "[h]alf (47%) of Internet users ages 50-64 and one in four (26%) users ages 65 and older now use social networking sites."[2]

Social media is also increasingly important for business organizations and the legal community – the former largely because of their marketing potential, and the latter as yet another source of information to be regulated, managed, and ultimately preserved and produced during investigations or litigation. Twenty-two percent of Fortune 500 companies now have a public-facing blog that has received at least one post in the last 12 months.[3] And in a sign of the times, Pepsi dropped a long-running Super Bowl TV advertising campaign in favor of a $20 million expenditure on a social media campaign.[4]

Despite, or perhaps because of, the ubiquity of social media, the term defies easy definition. Given the variety and fluidity of forms and formats, it may be more helpful to focus on the most common features of social media content. Social media typically features content that is:

Shared (the content is made available to others)
Interactive (participants are often both suppliers and users of related content)
Internet-based (the content is accessed via the World Wide Web)
Personal (the content usually represents personal commentary or art, or solicits such input)
Informal (the content is typically conversational, candid, unstructured, and unedited)

Social media formats may include text, graphics, audio, or video, with a range exemplified by such familiar social media sites such as LinkedIn, Twitter, Wikipedia, Myspace, Facebook, Flickr, BlogTalkRadio, and YouTube.

Organizations should be sensitive to the inherent risks and rewards of social media and should develop a clearly defined strategy that takes into account the four typical ways in which they can be used:

- A company may use social media to shape a formal business presence based on a clear corporate objective;

- Employees may use social media to pursue legitimate business goals that may or may not be officially authorized;

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1 Alyse Speyer, 12 Amazing Social Media Statistics, January 28, 2011, http://www.blogher.com/12-amazing-social-media-statistics (last visited Apr. 3, 2012).
2 Mary Madden, Older Adults and Social Media, August 27, 2010, http://www.pewinternet.org/Reports/2010/Older-Adults-and-Social-Media.aspx (last visited Apr. 3, 2012).
3 Nora Ganim Barnes, Ph.D. & Eric Mattson, *The Fortune 500 and Social Media: A Longitudinal Study of Blogging and Twitter Usage by America's Largest Companies*, February, 2010, http://www.umassd.edu/cmr/studiesandresearch/thefortune500andsocialmedia2010study (last visited Apr. 3, 2012).
4 Jennifer Preston, Pepsi Bets on Local Grants, Not the Super Bowl, January 30, 2011, http://www.nytimes.com/2011/01/31/business/media/31pepsi.html (last visited Apr. 3, 2012).

- Employees may engage in personal use of social media on company property, perhaps on their own time; and

- Third parties may use social media to comment on a particular company, product, or service.

Identifying the ways in which social media is used, and understanding the typical rights or obligations related to their content, are essential steps in shaping a sensible social media policy.

Electronic discovery issues in litigation are a particular concern for organizations as the volume of data continues to grow and the costs of preservation, collection, review, and production remain high even as they decrease on a per-unit basis. Lawyers are now counseling clients in many cases to take the same preservation steps for various social media data as for other electronically stored information. Because of the complex data management and ownership issues inherent in social media, its preservation presents some of the most significant challenges in the e-discovery space.

To address these challenges, organizations should consider taking a practical approach to meeting their legal obligations by identifying overall objectives, setting clear policies, training employees, and monitoring the impact of social networking on their operations.

Toward that end, this Primer provides best practice guidance on the corporate use and management of social media, as well as their preservation, collection, and production in the form of electronically stored information (ESI). There are, of course, references to various types of social media in other publications by The Sedona Conference®, and, while some overlap may be inevitable, the goal here has been to limit this Primer to issues unique to social media.

PART ONE – ORGANIZATIONAL ISSUES

I. Use of Social Media in Business: Benefits and Risks

Social media allows businesses to extend their reach and enhance their collaborative efforts by connecting large communities with related interests. And because social media deliver nearly real-time communications from a virtually unlimited number of individuals scattered across the Internet, businesses can use social media for diverse purposes. For example, product forums can facilitate communication among customers to help them resolve their own issues. Customer complaints and other threats to corporate brands can be quickly identified and mitigated. Productivity can be enhanced by allowing employees to access time-sensitive or topical information created by experts.

Social media can also present risks, if, for example, employees spend company time accessing social media sites unrelated to the business or if they disclose confidential or proprietary data.

Before organizations adopt and use social media, they should balance the business benefits with the inherent risks of this powerful communication tool.

A. Benefits

1. Enhanced Collaboration

Social media tools provide organizations with a flexible environment in which informal interactions among a broad group of customers and business partners can be quickly and cost-effectively facilitated. These tools can foster collaboration and innovation by connecting individuals with similar interests and by connecting subject matter experts with a large, distributed network of potential collaborators. The resulting communities can then network further and share knowledge in real time and across organizational and geographical boundaries.

Social media allow organizations to communicate simultaneously with large groups of stakeholders, harnessing product, process and service innovations by inviting ideas from across the company's ecosystem. The speed and diversity of group feedback can accelerate problem solving, which in turn can lead to better and more timely solutions. Social media can also enhance the ability of organizations to capture and share institutional knowledge and to rapidly deliver information to the people who need it.

2. Improved Business Relationship

Social media can foster partner and customer relationships by improving lines of communication, engaging key partners, and providing more opportunities for greater feedback from customers. By drawing on the collective talents, knowledge, and experiences of employees, customers, suppliers, and partners, an organization can improve its performance.

Organizations that engage the broader public on topics of interest to their business using social media enjoy additional opportunities to understand customer needs and may gain new insights, particularly concerning demographics and purchasing or product usage behaviors. Social media-powered customer service options such as peer support networks and user-generated knowledge bases allow organizations to empower their customers to help themselves.

3. Increased Productivity

Social media can increase employee productivity by enabling pervasive, time-sensitive access to information; by leveraging a community of experts or technical advances to prioritize information based on relevance, usability or ease of incorporation; and by creating communities of common interest/expertise or specific centers of excellence within an organization or business environment.

B. Risks

1. Loss of Productivity

While social media can benefit organizational users, they also create significant inherent risks. The same technology that enhances employee productivity by connecting communities of interest and experts can also sap productivity when used for purposes not directly related to core business activities. Allowing access to external social networking sites increases the likelihood that employees will engage in non-work activities on company time.

2. Lack of Security

In addition to potential loss of productivity, organizations relying on social media risk disclosure of confidential data, misuse of personal data, and damage to brand and reputation. Social media often lacks certain real security controls common in more formal corporate technical environments. Even where data privacy protection exists, it is often left to the judgment of individual users to engage that protection. Such fragmented decision making can result in an inconsistent approach to the risks and rewards of social media, and can make a coherent organizational strategy difficult, if not impossible, to achieve.

3. Disclosure of Information

The casual manner in which social media users communicate can sometimes lead to sharing too much information about projects, products, or clients – either intentionally or inadvertently. Once such information is disclosed, it may be difficult or impossible to prevent further dissemination.

The advent of social media technology has transformed organizations and some employees into "publishers." Thus, organizations should now consider whether to take advantage of the coverage afforded by media liability insurance products. Traditionally, these insurance products have been utilized by publishers of content found in books, magazines, newspapers, and also by radio and television broadcasters. However, the "publication" of content on social media sites and blogs may leave organizations vulnerable to potential liabilities arising from defamation, invasion of privacy, copyright infringement, false advertising, and trade libel. Even if an organization has an insurance policy it believes may already cover such publishing, it should verify that the policy does not contain exclusions for publication of social media content.

4. Preservation of Social Media

Additionally, organizations face the risk that social media will impact litigation and e-discovery by leaving a trail of information, documents, and records that may need to be maintained for legal or regulatory purposes. However, organizations must also remain sensitive to the role third parties play in creating or maintaining social media. Because of the complex data management and ownership issues inherent in social networking, preservation of social media presents significant challenges. *See infra* Part II, §I.A. and B. With the exception of internally hosted sites, an organization may not have access to relevant content or be in privity with the social media site, which instead has a direct relationship with an employee. Finally, organizations should consider what, if any, potential liability it may face as a result of social media activity by its employees.

II. Development of a Social Media Policy

A. Exploring the Potential Benefits of Social Media Policies for Organizations

The first question any company considering a social media policy may ask is, "Do we even need a social media policy?" As the global workforce increasingly becomes a society of content producers rather than content consumers,[5] and as momentum and control of such content continues to shift from the centralized voice of an organization to the disparate voices of numerous individuals, the need for a social media policy has become increasingly clear.[6] Indeed, a quick Internet search of the phrase "social media policy" yields over 226,000,000 results. Interestingly, however, in 2009, less than 20% of organizations had social media policies in place to monitor and mitigate the potential risks associated with the use of social media.[7] And two years later – despite rapid proliferation of social media – a Poneman Institute study reported that only 35% of organizations (national and international) had a social media policy.[8] And of the 35% with such a policy, only 35% actually enforced that policy.[9] Instead, many organizations continue to address issues related to social media reactively, rather than proactively, without giving employees clear guidelines to align their social media usage with the organization's strategy, policies, and values. Or, in some cases, the issues posed by social media are mingled with general policies and guidelines involving digital communication generally without regard to unique considerations attendant to social media.

The real question is not whether an organization should have a social media policy, but rather the extent to which such a policy can (or perhaps should) effectively

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5 Art Shaw, *The Promise of Advertising Through Social Media,* Epic Media Group, June 8, 2010, http://blogs.imediaconnection.com/blog/2010/06/08/the-promise-of-advertising-through-social-media (last visited Apr. 4, 2012) (Social media "supports the democratization of knowledge and information, and transforms people from content consumers to content producers.").

6 Sharlyn Lauby, *Should Your Company Have a Social Media Policy?* Mashable on Facebook, April 27, 2009, http://mashable.com/2009/04/27/social-media-policy/ (last visited Apr. 4, 2012).

7 Matt Leonard, *Lawsuits & PR Nightmares: Why Employees Need Social Media Guidelines,* Search Engine Journal, August 19, 2009, http://www.searchenginejournal.com/why-employees-need-social-media-guidelines/12588/ (last visited April 18, 2012). Based on a recent survey, 58% of respondents expected to manage social media e-discovery in 2011 – more than double the 27% in 2010. Dean Gonsowski, *Two Surveys Confirm Social Media eDiscovery Has Reached Tipping Point,* eDiscovery 2.0, August 2, 2011, http://www.clearwellsystems.com/e-discovery-blog/2011/08/02/two-surveys-confirm-social-media-in-ediscovery-has-reached-tipping-point/ (last visited Apr. 3, 2012). The lack of a policy will likely have implications for social media data in litigation.

8 *Social Medial Use Could Cause Security Problems for Companies,* Bitefinder Resource Center, September 30, 2011, http//www.bitdefender.com/security/social-media-use-could-cause-security-problems-for-companies.html (last visited Apr. 3, 2012).

9 *Id.* According to Larry Poneman, with respect to "the companies with the policies in place, they are not 'vigorously enforced.'"

control social media behavior or the content it generates. A rational policy should not focus on managing the use of a particular social media site, but rather on managing the people who generate or use the content. Once an organization decides how to approach the use of social media by its employees, it must then consider whether and how the policy regarding such use will regulate the business use and/or the personal use of social media by its employees.

Understandably, employers can be skeptical about granting employees unrestricted access to social media because they are concerned about lack of control. In the business-use context, permitting employees to publicly voice their unedited opinions about the organization can be risky. When people are "posting" or "tweeting," they tend to express themselves more colloquially, making statements they would not necessarily include in a more formally prepared and edited business document. In truth, organizations have always faced the risk that their employees might disparage others, release proprietary information, or expose the organization to community disapproval. However, the explosion of social media has dramatically facilitated rapid communication to a broad audience; and the freedom from responsibility that comes with anonymity, if not anticipated and properly regulated, can transform isolated errors in judgment into incidents with potentially dire organizational consequences.

For these and other reasons, many notable organizations have banned the use of some or all forms of social media in the workplace. For example, the White House, the Marine Corps, and the Green Bay Packers have all imposed prohibitions against tweeting.[10] Recent statistics reveal that 54% of companies still do not allow employees to visit social networking sites for any reason while at work.[11] However, most employers – supported by many industry experts – agree that attempting to block access to social media sites to prevent employees from talking, texting, and now tweeting, is ineffective. Further, such a policy may actually decrease productivity.[12] Any employee with an iPhone, BlackBerry, or other personal device has unfettered access to social media portals and the ability to create content at his or her fingertips.[13] Furthermore, as a recent technology white paper found, access to social media sites does not require any special hardware or software; employees can easily bypass the security guidelines and safeguards set up by the Information Technology ("IT"), human resources ("HR"), and legal departments.[14]

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10 Jay Shepard, *Five Reasons Twitterers Make Better Employees*, Gruntled Employees, August 20, 2009, http://www.gruntledemployees.com/gruntled_employees/2009/08/five-reasons-twitterers-make-better-employees.html (last visited Apr. 3, 2012). Although the White House communications team is denied access to the government's Facebook postings and Twitter feeds, the "White House New Media" team has been exempted from this policy. Michael Scherer, *Obama and Twitter: White House Social Networking,* Time, http://www.time.com/time/printout/0,8816,1896482,00.html (last visited Apr. 3, 2012). In the case of the Marine Corps, the original ban put in place in April 2009 (excluding private use by Marines on personal computers outside their jobs) was revoked one year later in April 2010 when those covered by the policy were authorized to use social networking sites, user-generated content, social software, instant messaging, and discussion forums on the Marine Corps Enterprise Network. However, access remains limited to "reasonable durations and frequency" as determined by a supervisor. Cpl. Scott Schmidt, Headquarters Marine Corps, *Social media: Changing How the Marine Corps Operates,* http://www.marines.mil/unit/hqmc/Pages/SocialmediachanginghowtheMarineCorpsoperates.aspx (last visited Apr. 3, 2012).

11 J.D.Rucker, *Social Media Use at Work Yields Higher Productivity,* Soshable, Jan. 19, 2011, http://soshable.com/social-media-use-at-work-yields-higher-productivity (last visited Apr. 4, 2012). Additional statistics reveal that 19% of companies allow use for business purposes only, 16% allow for limited personal use and 10% allow unlimited personal use. *Id.*

12 *Id.*

13 This ability and access to technology has led to the phenomenon referred to as the "consumerization of IT," a trend where new information technology emerges first in the consumer market and then spreads into business organizations, resulting in the convergence of the IT and consumer electronics industries, and a shift in IT innovation from large businesses to the home. Consumerization, *from Wikipedia the Free Encyclopedia*, http://en.wikipedia.org/wiki/Consumerization (last visited Apr. 3, 2012).

14 *Social Media: Business Benefits and Security, Governance and Assurance Perspectives*, ISACA 2010. The Information Systems Audit and Control Association ("ISACA") is a global organization focused on the security of information systems. Specifically, a representative of the ISACA has recognized, "[h]istorically, organizations tried to control risk by denying access to cyberspace, but that won't work with social media. . . . Companies should embrace it, not block it. But they also need to empower their employees with knowledge to implement sound social media governance." Lance Whitney, *Study: Social-Media Use Puts Companies at Risk,* CNet News, June 8, 2010, http://news.cnet.com/8301-1023_3-20007071-93.html (last visited Apr. 3, 2012).

Given the pronounced and increasing bias in favor of social media as a means of personal communication, organizations probably cannot completely prevent its workplace usage. Conversely, while the collective wisdom is that efforts to block or deny all access to social media are unworkable, a failure to impose any restrictions at all will lead to unpalatable risks. The challenge is thus figuring out where on this continuum from toleration to restriction the organization should land.

The answer probably lies in encouraging social media use, but limiting the number and types of social networks employees can access. Indeed, a policy that discourages social media entirely may represent a risk-averse, traditional approach to communications that could easily send the wrong signal both inside and outside the organization. However, if an organization has a positive relationship with its employees, the risks are minimized and the potential benefits are great.

No matter where an organization fits along the continuum, a written policy that sets boundaries and guidelines is sound business practice. With rapid changes in technology and constant emergence of new social media outlets and other opportunities for individuals to produce and share content, structure in the form of guidelines and policies can remove some of the uncertainty employees may have regarding acceptable conduct.

Whether the policy focuses on business use, individual use, or both, or whether it authorizes multiple spokespersons or restricts access to a select few, the most significant reason for an organization to implement a written social media policy is that in this age of democratization, a well-constructed policy ensures that the organization is speaking with a unified voice.

B. Organizational Goals of a Policy

When possible, all affected stakeholders, including business heads, risk management professionals, and representatives from human resource and legal departments, should be involved in setting goals and crafting the policy, and they should all be committed to its enforcement. As with any organization-wide initiative, there will likely be varying levels of participation and disagreements about the best final product; but compliance is more likely when all stakeholders have a voice. An inclusive approach will also help to reduce the risks of fragmented decision making and the adoption by different business units within an organization of different approaches.

In order to establish the goals and purpose of a specific social media policy, a threshold decision is whether the policy's primary goal will be to regulate usage for business purposes or usage by employees for their own purposes. To decide whether business purposes should be the focus, an organization must realistically assess its organizational and work culture. For example, is the organization a start-up online retailer looking to improve its visibility and to generate sales and a following with social media marketing? Is it an established brand looking to both promote and protect its hallmark in the global, electronic marketplace? Is it an organization in a heavily regulated industry requiring rigid compliance by its employees with applicable rules and regulations?

Whatever the organization's strategic goals and whatever the intended scope of its social media policy, the policy itself should establish clear ground rules. Educating employees should also be a primary purpose, including explaining how a posting, whether on an organization-sponsored site or an employee's personal Facebook page, could breach organizational and informational security, damage the organization's image or reputation, or even expose the organization to malware.[15]

Another fundamental goal of any social media policy should be to address the fine line between personal and professional communications involving different forms of social media. Employees need to understand where employers draw this line; but, at the same time, organizations also need to determine how the goals and purposes of its policy will intersect and affect the privacy rights of its employees,[16] i.e., how and in what manner the employer will reserve the right to monitor employee usage. Any good policy will help establish boundaries, but the policy also needs to be flexible and it should acknowledge that the personal/business demarcation will rarely support a bright-line rule.

Social media can leverage the power of the individual and harness the collective voices of an organization. A specific policy crafted to achieve that leverage can become one of the centerpieces of an organization's strategic plan.

C. Issues to Consider in Drafting a Policy

Organizations should strive to make their policies as straightforward as possible in order to facilitate understanding and compliance. In fact, some of the more workable policies are expressed as a short list of guiding principles, often with only 5-to-10 major points. In contrast, consider the school board sued by a teachers' union for an unclear and overly restrictive policy that included a 21-point bullet list of the "Liability Risks of Using Social Media."[17]

1. Style and Structure

An organization's culture should influence the form, format, and tone of its social media policy. For example, what works in an advertising agency will likely differ from what works in a large law firm. Among the issues that should be considered are the following:

- How social media have been used in the past by the organization, and the organization's plans to expand or reduce that usage;

- Whether any specific types of social media could pose a particular concern for the organization;

15 "Malware, short for malicious software, consists of programming (code, scripts, active content, and other software) that is designed to disrupt or deny operation, gather information that leads to loss of privacy or exploitation, or gain unauthorized access to system resources, or that otherwise exhibits abusive behavior." *Wikipedia the Free Encyclopedia*, http://en.wikipedia.org/wiki/Malware (last visited Apr. 3, 2012).

16 For example, in the state of New Jersey, the right to privacy has been more broadly interpreted than under federal law. Under the New Jersey Constitution, the right of privacy takes the form of a fundamental right to personal integrity. Although the word "privacy" does not appear in the state constitution, the New Jersey Supreme Court has explicitly articulated and broadly defined a right of privacy that protects individuals from state interference on illegitimate grounds. *See* N.J. Const. art. I; Grayson Barber, *Privacy and the New Jersey Constitution,* New Jersey Lawyer Magazine, February 2002. In the 2008 decision of *State v. Reid*, the defendant was charged with computer theft and moved to suppress evidence that her Internet Service Provider (ISP) provided in response to a subpoena. The New Jersey Supreme Court "[held] that citizens have a reasonable expectation of privacy, protected by Article I, Paragraph 7, of the New Jersey Constitution, in the subscriber information they provide to Internet service providers – just as New Jersey citizens have a privacy interest in their bank records stored by banks and telephone billing records kept by phone companies." 194 N.J. 386, 389 (2008). The Court stated that while there might not have been a violation under the United States Constitution, the New Jersey Constitution provides for enhanced privacy rights that were violated in that case. *Id.* at 396-97.

17 Mathew Pellegrino, *SRPE, teacher 'de-friending' district media policy*, August 31, 2010, http://www.srpressgazette.com/articles/policy-11089-educators-new.html (last visited Apr. 3, 2012).

- How social media usage affects employee productivity;
- Whether the organization is drafting a policy in response to an incident or questionable use of social media, or instead, is proactively outlining best practices;
- Whether the organization should address industry-specific or organization-specific concerns; and
- Who will serve as the gatekeeper for adopting new social media technologies.

A short, conversational policy encouraging employee participation in certain forms of social media may be most appropriate for some organizations. Alternatively, others may benefit from a more formal, structured policy that places significant restrictions on the use of social media in the work setting. A tightly restrictive policy may be especially appropriate in regulated industries or government agencies. Soliciting input from more than one source, including legal (inside or outside counsel), information technology, records management, and business functions, will facilitate a more effective policy and a more coherent approach.

Certain elements can transform a policy from a negative, restrictive code of conduct to one that fosters a collaborative relationship while still achieving the goal of regulating behavior. These elements may include:

- Demonstrating the benefits of engaging in social media to employees;
- Focusing on what employees have the freedom to do as opposed to the restrictions being placed on them;
- Promoting responsibility and the exercise of good judgment with respect to what is published; and
- Requiring employees to take ownership of their social media communications by always stating who they are and whom they represent and by promptly correcting their mistakes.

Organizations that encourage, or even sponsor, social media use by employees when acting on behalf of the corporation for marketing or other business purposes may wish to consider separating policy language from more general guidance regarding internal protocols or permissions. In fact, an argument may be made that every social media policy should include accompanying guidelines to frame and implement the policy language. Such guidelines might address:

- The process to be followed to gain approval for use;
- The scope of topics or information that can or cannot be disseminated through social media;
- A referral process for customer issues;

- The permissibility or form of comments regarding competitors; and
- A description of specifically disallowed activities.

Another distinction may be drawn between policies designed to guide employees in their business use of social media and their personal use of social media that may impact their employer.

In all cases, clarity is essential. The policy should incorporate specific examples and should ensure high visibility by using multiple forms of publication. Publication might take the form of a notice attached to each computer log-on, a broadly disseminated written policy, employee orientation and training, or all of the above.

2. Content

An effective social media policy should address at least three key content areas: (1) employee rights and obligations; (2) monitoring guidelines; and (3) engagement processes and roles.

Two basic life lessons should drive social media policy content: *play nice* and *don't take things that don't belong to you*. Although common sense should rule, some degree of explicit instruction should still be part of any organization's social media policy. However, the longer and more verbose the policy, the less likely it is to be effective. The goal should be to include the purpose and relevant guidelines, providing employees with the necessary structure so that they are on notice regarding the rules and the reasons for them.

As with all policies that implicate the rights of employees, a sound social media policy should promote fair, even-handed treatment. Organizations would be well served, if practical, to go beyond the initial group of stakeholders and work with the employees to determine what policies would be fair and realistic given the corporate culture. This practice would also permit the organization to gain valuable information and insight regarding the current social media behavior of its employees.

3. Legal and Ethical Considerations

Policy language should first cover basic legal and ethical considerations and provide required commentary on any specific regulatory restrictions or requirements unique to a particular industry, along with a general statement requiring adherence to all federal, state, and local laws. A second policy category may cover employees' responsibility for any content they post. This category might include language about ensuring the authenticity of posted content (*e.g.,* not knowingly publishing false information); eschewing defamatory or inappropriate content; and avoiding disclosure of personal information regarding other employees, competitors, or other persons outside the organization.

An often-overlooked twist with social media concerns is its use in research, sometimes called "scraping" or "social listening." When social media content is routinely "scraped" by company employees or by third parties ("listening vendors"), guidance should be provided to them regarding ethical obligations associated with the use of such content, such as whether the terms of service of sites have been observed.

An increasing number of organizations recommend that employees who are neither company executives nor designated spokespersons utilize a disclaimer when using social media for private purposes.[18] Disclaimers, if utilized properly, can facilitate freedom of speech while at the same time providing protection for both the employer and the employee.

4. Protecting Intellectual Property

Employees may benefit from detailed instructions that define which uses of an organization's intellectual property are acceptable and which are not. For example, employees may be told whether or when they can use logos or disclose proprietary or confidential information. By informing employees about specific, potential risks to the organization created by inadvertent disclosures, an organization can help them make better decisions and think through the consequences of their actions before they act. A well-drafted policy will also help to protect third parties' intellectual property – and to mitigate the organization's risk – by requiring attribution for all quotations or references to copyrighted works used in social media communications.

5. Definitions and Relationships

Social media use by employees may be viewed as a subset of all e-communications within an organization, and therefore will share some characteristics with email, collaborative workspaces, and other internal messaging systems. Consequently, smaller organizations or those that do not actively support the use of social media may choose to include social media policy language as a component of their other policies, highlighting any unique aspects. Under this approach, a blanket statement regarding the application of the policy to all forms of online communication and conduct may be appropriate.

Alternatively, and particularly when the organization uses social media proactively, the social media policy may stand alone but should contain references to, and complement, existing policies. These references acknowledge that there will be linkages with other organizational policies, such as those regarding codes of conduct, harassment, ethics, confidentiality, e-communications, and conflicts of interest. For example, a written policy should clearly inform employees that social media will not provide them with a refuge from confidentiality and "code of conduct" obligations they owe to their employers.[19] Maintaining and even highlighting ties and links to other policies can help place a social media policy in context and reinforce the importance of compliance. In any case, however, unless the written policies are quite short, it is generally not advisable for an organization to combine all of its rules in one master policy. Employees are far less likely to read a lengthy, comprehensive code of conduct document than concise statements of specific rules. Finally, an organization's other policies should be reviewed before setting a social media policy to ensure that the policies are consistent.

D. Compliance and Enforcement

It is an obvious corollary to any policy that there should be a way to ensure its compliance. Organizations need to communicate clearly and frequently with employees

18 Best.Buy.PR, *Best Buy Social Media Policy*, Best Buy, April 13, 2011, http://forums.bestbuy.com/t5/Welcome-News/Best-Buy-Social-Media-Policy/td-p/20492 (last visited Apr. 3, 2012) ("State that it's YOUR opinion: When commenting on the business. Unless authorized to speak on behalf of Best Buy, you must state that the views expressed are your own.").

19 Kevin H. Nalty, *Moving Beyond Compliant Social Media*, PharmExec.com, March 1, 2010, http://pharmexec.findpharma.com/pharmexec/article/articleDetail.jsp?id=661648 (last visited Apr.3, 2012).

regarding policies and procedures; and in particular, they need to establish and communicate the consequences flowing from policy violations. Training is recommended and, depending on the organization, will likely require collaboration with representatives from the IT, HR, and legal departments. Because it is impossible to anticipate or highlight every potential scenario, training should stress a common sense approach and should help employees understand the implications of conduct, especially in the realm of personal use that might not otherwise be obvious.

A more complicated issue regarding compliance and enforcement in the social media context is monitoring. For organizations that choose not to rely on the honor system, monitoring is the only way to confirm efficacy and compliance. Further, some organizations may be explicitly or effectively required to monitor by a regulatory scheme. Establishing a monitoring practice is necessary in order to review communications and content for consistency, clarity and compliance with guidelines, especially if an organization encourages employees to contribute to its social media presence through a business-use based policy. An organization that attempts to regulate the personal use of social media in the workplace may face a more onerous task, which at its most extreme would require knowledge of its employees' social media site affiliations and then the time and access to examine each of the sites individually. While monitoring is not necessarily an all-or-nothing proposition, there are several monitoring issues to consider:

- How and in what manner will monitoring take place;
- What is the breadth and the scope of the content that will be monitored;
- Who will be tasked with the responsibility to monitor;
- What are the costs associated with monitoring;
- What privacy rights of employees are implicated;[20] and
- What, if any, less intrusive means can the organization employ to regulate compliance?

Many organizations monitor compliance with "message compliance specialists" whose specific duties include ensuring that employees neither inadvertently nor intentionally violate the organization's social media policy.[21] Another option, and one that continues to become more viable and more sophisticated, is software geared specifically to monitor, control, and record posted content, at least if it passes through the corporate

20 Consider the case of *Pietrylo v. Hillstone Restaurant Group*, 2009 WL 3128420 (D.N.J. Sept. 25, 2009) wherein two restaurant employees sued their former employer following their termination for posting comments critical of the company on a private, employee-only Myspace page. According to plaintiffs, the restaurant's managers gained access to the page only after they "strongarmed and threatened" a fellow employee and member of the private group to provide them with the member's email address and password. Although the jury found in favor of the defendants on common law claims for invasion of privacy, finding that the plaintiffs had no reasonable expectation of privacy in the Myspace group, the case was still decided in favor of plaintiffs finding the managers had violated the Stored Communications Act and the New Jersey Wire Tapping & Electronic Surveillance Act by intentionally accessing the Myspace page without authorization. However, the *Pietrylo* case warns organizations that in the absence of reliable evidence that an employee is engaged in malfeasance causing serious damage to the employer's interest or violating substantial company policies, any kind of policy that allows employers to access password-protected social media sites is ill-advised.

21 Marisa Peacock, *GRC Roll-up: The Impact of Social Media and Governance,* CMS Wire, March 10, 2010, http://www.cmswire.com/cms/enterprise-cms/grc-rollup-the-impact-of-social-media-and-governance-006919.php (last visited Apr. 3, 2012).

network.[22] Other options include using Google alerts and subscribing to employee Twitter feeds. Focusing on social media as simply another communication medium, rather than as part of an organizational marketing strategy, may help an organization crystallize the scope of measurement and monitoring.

No matter what level of monitoring or other means to ensure compliance it uses, an organization should establish and communicate consequences for policy violations; and then follow through when violations occur. Here again, cultural considerations will influence the tone and severity of any policy language. Clear communication is helpful, and the policy may explain what employees should do if they have questions, how they should report a violation, and what the consequences will be for failing to follow the policy.

In some cases, organizations may consider specifying that violations of social media policies, whether as a result of business or personal use, will be considered grounds for termination of employment. Consider, however, that employees must be placed on notice about such severe remedies. Best Buy uses a compliance provision that is particularly blunt:

> **Just in case you are forgetful or ignore the guidelines above, here's what could happen. You could:**
>
> - Get fired (and it's embarrassing to lose your job for something that's so easily avoided)
> - Get Best Buy in legal trouble with customers or investors
> - Cost us the ability to get and keep customers
>
> "Remember: protect the brand, protect yourself."[23]

As varied as social media tools and opportunities are, so too are the reasons an employer may have to discipline an employee. Some primary concerns include illegal web-based conduct; unsatisfactory job performance as a result of using social media while on the job; or disparaging or harassing a fellow employee, supervisor, client, or customer. Before imposing any specific discipline, organizations would be wise to consider the possible legal consequences of such disciplinary action.[24] This is particularly true when they discipline employees for what may have been protected concerted activity, or when the policy

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22 *See, e.g.*, www.nextpoint.com.

23 Best.Buy.PR, *Best Buy Social Media Policy*, Best Buy, April 13, 2011, http://forums.bestbuy.com/t5/Welcome-News/Best-Buy-Social-Media-Policy/td-p/20492 (last visited Apr. 3, 2012).

24 *Social Media in the Workplace: Managing the Risks,* Jackson Lewis, March 9, 2010, http://www.jacksonlewis.com/resources.php?NewsID=3235 (last visited Apr. 3, 2012). Some of these constraints may include: The National Labor Relations Act; protection under a whistleblower statute; or whether the employee was engaging legal off-duty activity.

language alone might interfere with employees' perceived rights.[25] Particularly in the case of public employees, the issue of restricting free speech comes into play.

Monitoring need not be limited to employee use. Certain organizations would be well advised to employ some type of monitoring protocol to protect their brands by detecting brand theft and defamatory material that might harm the brand's reputation. This monitoring can be done internally or externally through use of services and software tools developed for such purposes. For each organization considering this type of monitoring, a cost-benefit analysis is advisable.

E. Updating the Policy

Unlike many corporate policies grounded in long-standing law, regulation, or tradition, a social media policy can quickly become outdated. Consequently, attention should be paid to updating the policy on at least an annual basis.

A number of factors may influence whether policy language should be revised:

- Attention to internal social media issues as they arise. Policies are in some part reactive responses to events as they occur in an organization. Keeping track of any significant events (such as breaches of existing policy) will help inform whether an update is in order.

- Metrics/logs. If an organization is concerned with potential excessive use of social media by employees (particularly non-business uses), then a review of Internet usage logs may provide useful metrics.

- Changes in organizational use and implementation. Any strategic, tactical, or technical change to an organization's use of social media or the enforcement of an applicable policy may require a policy update. Such changes may include, for example, a new and proactive use of social media for marketing or a move to allow greater employee involvement on behalf of the organization.

- Case law survey and regulatory changes. A growing body of case law addresses social media issues. An annual review of key rulings should be

25 In *In re American Medical Response of Connecticut, Inc.*, NLRB Case No. 34-CA-12576 (October 27, 2010), employee Dawnmarie Souza was fired for posting derogatory comments on Facebook about her supervisor. After being denied her request for union representation, Souza posted her comments on Facebook, which resulted in supportive comments from co-workers. She was fired shortly thereafter. The NLRB, pursuant to its authority to safeguard employee rights and prevent unfair employer practices, filed a complaint against AMR in October 2010, alleging the company's overly broad policies violated Section 7 of the National Labor Relations Act ("NLRA"). Under Section 7, which gives employees the right "to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection," employees must be permitted to discuss the terms and conditions of their employment with co-workers and others. By terminating Souza for posting comments that drew support from co-workers, AMR had violated the NLRA. Notwithstanding the NLRB's position in the lawsuit – which settled – the NLRB's general position remains that employers are permitted to regulate employee behavior, including speech on social media web sites. In this case, the NLRB simply clarified that these generally permissible policies regulating free speech are not permissible if they interfere with employees' rights to organize labor unions and engage in concerted activities. Jessica Martinez, *NLRB v. American Medical Response: A Rare Case of Protected Employee Speech on Facebook*, Berkeley Technology Law Journal, http://btlj.org/2011/03/07/nlrb-v-american-medical-response-a-rare-case-of-protected-employee-speech-on-facebook (last visited Apr. 3, 2012). In the more recent case of *Hispanics United of Buffalo, Inc. v. Ortiz*, and the NLRB's first written decision involving social media, an administrative law judge ruled that HUB violated the NLRA when it terminated five employees for posting complaints after-hours on Facebook about their jobs, one of their managers, and some of their more challenging social service clients. According to the ALJ, "employees have a protected right to discuss matters affecting their employment amongst themselves." The judge clarified that it did not matter that the gripes were not directed at forming a union or otherwise changing employee working conditions at HUB. Applying previous decisions, he found that activity does not need to have the goal of changing working conditions to be protected.

part of every policy analysis. Similarly, for those in regulated industries, updated regulations or new interpretations of existing ones are an important consideration.

- Changes in the complexion of social media. New forms or uses for social media will inevitably evolve that will necessitate adjustments of the social media policy.

F. Examples of Specific Policies in Action

1. The Blended Approach

The social media policy promulgated by the Coca Cola Company ("CCC") provides a good illustration of an effective policy that on its face successfully incorporates the principles stated above by clearly setting forth its purpose, establishing guidelines, providing structure, and focusing on the positive aspects of the policy and the regulation of employee conduct. Consider its stated purpose, which is printed in bold in the first paragraph:

> These Online Social Media Principles have been developed to help empower our associates to participate in this new frontier of marketing and communications, represent our Company, and share the optimistic and positive spirits of our brands.[26]

Immediately thereafter, CCC lists its core values, including leadership, collaboration, integrity, accountability, passion, diversity, and quality, and then explains how these values relate to and are incorporated into the policy:

> These Online Social Media Principles are intended to outline how these values should be demonstrated in the online social media space and to guide your participation in this area, both when you are participating personally, as well as when you are acting on behalf of the Company.[27]

CCC also recognizes the relationship between traditional media and social media and makes reference to its rules for other types of communications:

> The same rules that apply to our messaging and communications in traditional media still apply in the online social media space; simply because the development and implementation of an online social media program can be fast, easy, and inexpensive doesn't mean that different rules apply.[28]

As CCC's Online Social Media Principles serve a dual function for business and individual uses, the policy provides a list of specific principles relating to each type of use in sections entitled "Our Expectations for Associates' Personal Behavior in Online Social Media," and "Our Expectations for Online Spokespeople."[29] Moreover, the policy recognizes the interplay and tension between business and personal postings:[30]

26 *Online Social Media Principles,* The Coca Cola Company, 2006-2009, http://www.thecoca-colacompany.com/socialmedia (last visited Apr. 3, 2012).
27 *Id.*
28 *Id.*
29 *Id.*
30 *Id.*

> Online, your personal and business personas are likely to intersect. The Company respects the free speech rights of all of its associates, but you must remember that customers, colleagues, and supervisors often have access to the online content you post. Keep this in mind when publishing information online that can be seen by more than friends and family, and know that information originally intended just for friends and family can be forwarded on. Remember NEVER to disclose non-public information of the Company (including confidential information), and be aware that taking public positions online that are counter to the Company's interests might cause conflict.

Notably, CCC's Online Social Media Principles are less than three pages long.

2. Regulations and Restricted Access

At the other end of the spectrum, the "Guide to the Internet for Registered Representatives" (the "Guide") by Financial Industry Regulatory Authority ("FINRA") is tied specifically to regulatory requirements and provides employees with far less freedom. The stated purpose focuses on restriction as opposed to empowerment as follows:

> FINRA has developed this page to make registered representatives (RRs) aware of the compliance requirements and potential liabilities when using the Web and electronic communications for business purposes.[31]

And the scope of the communication the Guide encompasses is broad:

> All communications with the public are subject to compliance with FINRA rules and related interpretative materials.[32]

The Guide also makes clear that Registered Representatives are not exempt from the rules and regulations when the use is personal rather than business related. Further, the Guide specifically ties certain types of information and messages found in social networking to National Association of Securities Dealers Rule 2210, which delineates the different types of electronic communications for purposes of how they are regulated:[33]

> Social networking sites such as Facebook, Twitter and LinkedIn usually have static and interactive content. Static content like a profile, background or wall information is usually considered an "advertisement." Static content is generally accessible to all visitors and usually remains posted until it is removed. As with all advertisements and sales literature as defined, a registered principal for the firm must approve all static content. Interactive content includes real-time extemporaneous online discussions with unrelated third parties, such as in a chat room. Chat room content is considered a public appearance. Similar to extemporaneous discussions by an RR at a public appearance, interactive content does not require prior principal approval but must be supervised.

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31 *Guide to the Internet for Registered Representatives,* FINRA, July 12, 2010, http://www.finra.org/Industry/Issues/Advertising/p006118 (last visited Apr. 3, 2012).

32 *Id.*

33 *Id.*

For a regulatory body, the Guide does for FINRA what the Online Social Media Principles does for CCC by providing covered employees of regulated entities with unambiguous guidelines on acceptable conduct.

3. Embracing Social Media

The Zappos model can probably be characterized by a single word – participation – and it has been recognized as one of the best established, aggressive, and successful uses of social media from a marketing perspective.[34] Although its "all-employee social media free love policy"[35] is unworkable for the vast majority of organizations, certain basic tenets of the model can be applied to any organization considering how to approach a social media policy. In particular, it provides that the company culture should support employee engagement with social media, and that the company leadership should understand and support the model. The Zappos participation model specifically conforms to the company's core values:

> As we grow as a company, it has become more and more important to explicitly define the core values from which we develop our culture, our brand, and our business strategies. These are the ten core values that we live by:
>
> 1. Deliver WOW Through Service
> 2. Embrace and Drive Change
> 3. Create Fun and A Little Weirdness
> 4. Be Adventurous, Creative, and Open-Minded
> 5. Pursue Growth and Learning
> 6. Build Open and Honest Relationships With Communication
> 7. Build a Positive Team and Family Spirit
> 8. Do More With Less
> 9. Be Passionate and Determined
> 10. Be Humble[36]

The examples of CCC, FINRA and Zappos demonstrate the wide range of social media policies used by organizations. There is no single policy that will be appropriate in all situations because policies will vary based on an organization's goals and values.

III. Privacy and User Expectations

A. A Privacy Overview

At first blush, the concept of privacy in connection with an organization's use of social media may appear contradictory since social media exist precisely to distribute information among many people. Some may even view social media as a form of public broadcasting.[37] For example, celebrity users of Twitter can have millions of followers. *See*

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34 Brian Chappell, *Zappos: Social Media Marketing Example #26,* Ignite Social Media, February 4, 2010, http://www.ignitesocialmedia.com/social-media-examples/zappos-social-media-example (last visited Apr. 3, 2012).

35 *Grow Practical Marketing Solutions*, January 24, 2010, http://www.businessesgrow.com/2010/01/24/it-worked-for-zappos-it-probably-wont-work-for-you (last visited Apr. 5, 2012).

36 *Zappos Family Core Values*, Part of the Zappos Family, 1999-2010, http://about.zappos.com/our-unique-culture/zappos-core-values (last visited Apr. 3, 2012).

37 A natural question that flows from this phenomenon is whether social media is legally transforming private citizens into public figures for purposes of privacy laws, but such a concept is not within the scope of this Primer.

infra IV.A.2. However, many users of social media utilize the applications for communicating among select groups of friends or individuals both in and out of the workplace. It is in this context that users of social media may have, or believe they are entitled to, an expectation of privacy in their personal communications even if they are initiated in the workplace. *See supra* II.B. It is this dichotomy between the personal and public nature of these communications that makes privacy a difficult issue for many organizations, not only for employees but also for third parties communicating with employees. *See infra* Part II, V. It is from this blurred vantage point that courts are now carefully considering the issues and beginning to provide some guidance.

1. *City of Ontario v. Quon*

In 2010, the Supreme Court commented on the challenges of applying the law of privacy to the broader context of electronic communications in *City of Ontario v. Quon*.[38] *Quon* involved the privacy interest of a government employee in text messages he sent through his government-issued pager. Declining to set precedent on broader employee privacy rights issues, the Court observed that "[t]he judiciary risks error by elaborating too fully on the Fourth Amendment implications of emerging technology before its role in society has become clear."[39] Of concern are rapid changes in the technology itself as well as the impact of technology on societal norms.[40] For example:

> Cell phone and text message communications are so pervasive that some persons may consider them to be essential means or necessary instruments for self-expression, even self-identification. That might strengthen the case for an expectation of privacy. On the other hand, the ubiquity of those devices has made them generally affordable, so one could counter that employees who need cell phones or similar devices for personal matters can purchase and pay for their own. And employer policies concerning communications will of course shape the reasonable expectations of their employees, especially to the extent that such policies are clearly communicated.[41]

The Court's comments here are directed towards hardware; nevertheless, they could be applied as well to software applications such as social media. Applications such as Facebook are so widespread that they could well be considered "pervasive" under the Court's analysis above, and therefore "necessary instruments for self-expression," that increase the expectation of privacy.[42] On the other hand, the increasing popularity of economical mobile devices that access the Internet may reduce the expectation of privacy, as employees might reasonably be expected to buy their own personal devices.

Quon involved Fourth Amendment issues of governmental searches. Furthermore, the plaintiff's status as a law enforcement official clearly impacted his privacy expectations. However, the Court's comments about the employer's desire to ensure that the employee was using the company-provided equipment for work rather than for personal use has relevance to privacy expectations.

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38 130 S. Ct. 2619, 177 L. Ed. 2d 216 (2010).
39 177 L.Ed. 2d at 227.
40 *Id.*
41 *Id.*
42 As of March 5, 2012, Facebook had 812,145,160 users, 155,701,780 of them in the United States. http://www.checkfacebook.com.

2. Employee Privacy Interests in Social Media Usage from Email Cases

Several courts have ruled on the privacy interest of employees who use company equipment for personal email communications. In *Stengart v. Loving Care Agency, Inc.*,[43] a company's retrieval of messages from a workplace laptop computer used by an employee to access her private, password-protected web-based email account was found to violate the employee's expectation of privacy. Although the company argued that its policy permitted it to review email retrieved from company equipment,[44] the court found that the policy permitted occasional personal use and did not address use of personal, web-based accounts.[45] Under these circumstances, the court found that the steps taken by the plaintiff to secure her account created a reasonable expectation of privacy when communicating with her attorney and that these communications were privileged.[46]

In contrast, other courts have found that employees did not have a privacy interest in personal email exchanged using company equipment. In *Holmes v. Petrovich Development Co., LLC,*[47] the California Court of Appeal found that the plaintiff had no expectation of privacy when sending emails to her attorney using her employer's business email system.[48] Significantly, the court based its holding on the policy the employer had in place and the plaintiff's knowledge of that policy. The court distinguished cases like *Stengart* and *Quon*, which were cited by plaintiff. Specifically, the court found that no expectation of privacy existed here because:

> Holmes used a computer of defendant company to send the emails even though: (1) she had been told of the company's policy that its computers were to be used only for company business and that employees were prohibited from using them to send or receive personal email, (2) she had been warned that the company would monitor its computers for compliance with this company policy and thus might "inspect all files and messages ... at any time," and (3) she had been explicitly advised that employees using company computers to create or maintain personal information or messages "have no right of privacy with respect to that information or message."[49]

The court clearly enunciated its rationale:

> [T]he emails sent via company computer under the circumstances of this case were akin to consulting her lawyer in her employer's conference room, in a loud voice, with the door open, so that any reasonable person would expect that their discussion of her complaints about her employer would be overheard by him.[50]

43 201 N.J. 300, 990 A.2d 650 (2010).
44 The policy provided that the company could review "all matters on the company's media systems and services at any time," and "all e-mails, Internet communications and computer files were property of the company."
45 201 N.J. at 314-15, 990 A.2d at 659.
46 The court cited a combination of the facts in finding that she had a reasonable expectation of privacy, including that she did not store the password on her computer, and the confidential nature of the content of the e-mails, involving privileged communications with her attorney regarding her employment discrimination lawsuit against the company. 201 N.J. at 321-22, 990 A.2d at 663.
47 191 Cal.App.4th 1047 (Jan. 13, 2011).
48 *Id.* at 48-49; *accord Scott v. Beth Israel Med. Ctr., Inc.*, 2007 WL 3053351 (N.Y.Supp. Oct. 17, 2007); *see also, e.g., In re The Reserve Fund Sec. and Derivative Litig.*, 2011 WL 2039758 (S.D.N.Y. May 23, 2011) (applying four-point test from *In re Asia Global Crossing. Ltd.*, 322 B.R. 247 (Bankr. S.D.N.Y. 2005) and holding that because there was no reasonable expectation of privacy the marital communications privilege did not apply to e-mail sent using company email system).
49 *Id.* at 2.
50 *Id.* at 3.

The court concluded that because the plaintiff did not communicate in confidence, the communications were not privileged. One distinction between the cases appears to be that in *Stengart*, the employee took steps to maintain the privilege by sending the communications via her own personal email account even though she used her employer's equipment. However, in both cases, the employers argued that the policy in question permitted the use of the emails at trial. While it is unclear how the *Holmes* court would have ruled had the employee sent the communication through a personal email account, it is apparent from *Holmes* that the cloak of potential privilege may not be enough to protect communications in the face of a clearly delineated, specific corporate policy.

B. Privacy and Social Media: Expectation is Becoming Unreasonable

As the case law continues to develop in the area of social media and privacy, the trend appears to be that courts will not recognize or protect privacy interests of those who voluntarily engage in social media communications. Although initial cases addressing this issue arise in the context of labor and employment, family law, and personal injury matters, where unique considerations broadly implicate the sort of information found on social media sites, the opinions indicate that, in the future, social media and privacy could likely become mutually exclusive concepts in the law.

As the cases below indicate, courts appear to be more willing to allow discovery not only of publicly available profiles and wall postings but also of information that the user has attempted to protect using a site's privacy options.[51] Such decisions will ultimately have repercussions in the organizational context as well.

1. *EEOC v. Simply Storage Management, LLC*

In *EEOC v. Simply Storage Management, LLC,*[52] defendants sought discovery of the plaintiffs' Facebook and Myspace content to assess plaintiffs' claims of emotional distress resulting from alleged sexual harassment. The court permitted defendants to obtain content reflecting the plaintiffs' emotional states,[53] over the EEOC's objections of relevance and that such disclosures would embarrass the plaintiffs. The court noted that the privacy settings on the social media sites were not a basis for shielding the content from discovery, "[a]lthough privacy concerns may be germane to the question of whether requested discovery is burdensome or oppressive and whether it has been sought for a proper purpose in the litigation."[54] The court observed that an appropriate protective order would address plaintiffs' privacy concerns.

2. *Romano v. Steelcase, Inc.*

In *Romano v. Steelcase, Inc.*,[55] a personal injury action, defendants sought access to the plaintiff's current and historical Facebook and Myspace accounts, including all deleted pages and related information, which may have contained information inconsistent with

51 *McMillen v. Hummingbird Speedway, Inc.,* No. 113-2010 CD (Pa. C.P. Jefferson Sept. 29, 2010) (requiring plaintiff to provide user name and password of his Facebook and Myspace accounts to opponent's attorneys over objection that the private portions of the sites were confidential); *Largent v. Reed*, No. 2009-1823, 2011 WL 5632688 (Pa. C.P. Franklin Nov. 8, 2011) (same re Facebook account credentials).
52 Case No. 1:09-cv-1223-WTL-DML, 270 F.R.D. 430 (S.D. Ind., May 11, 2010).
53 The content included "status updates, wall comments, causes joined, groups joined, activity streams, blog entries" and could also include photographs and videos, but tagged photos of the plaintiffs on the sites of third parties was less likely to be relevant. Simply Storage, supra note 41, at *14-*16.
54 *Id.* at *8.
55 Misc.3d 426 (Sup. Ct. Suffolk Co. Sept. 21, 2010).

claims she made concerning the extent and nature of her injuries. The court found that the public portions of the plaintiff's social networking sites included content that was material and necessary to the litigation, and concluded that a reasonable likelihood existed that the same would also hold true of the private portions.

The opinion was premised on two grounds: The defendant needed the information as a matter of civil procedure, and releasing the information would not violate the plaintiff's right to privacy under the Fourth Amendment.

As to discovery, the court focused on the liberal nature of the disclosure rules in New York:

> The information sought by defendant regarding Plaintiff's Facebook and Myspace accounts is both material and necessary to the defense of this action and/or could lead to admissible evidence. . . . In light of the fact that the public portions of Plaintiff's social networking sites contain material that is contrary to her claims and deposition testimony, there is a reasonable likelihood that the private portions of her sites may contain further evidence such as information with regard to her activities and enjoyment of life, all of which are material and relevant to the defense of this action. Preventing Defendant from accessing Plaintiff's private postings on Facebook and Myspace would be in direct contravention to the liberal disclosure policy in New York State.[56]

As to the right of privacy claimed by plaintiff, the court found that both the sites themselves and plaintiff's conduct respecting the sites precluded the existence of such a right:

> Indeed, as neither Facebook nor Myspace guarantee complete privacy, Plaintiff has no legitimate reasonable expectation of privacy. . . . Thus, when Plaintiff created her Facebook and Myspace accounts, she consented to the fact that her personal information would be shared with others, notwithstanding her privacy settings. Indeed, that is the very nature and purpose of these social networking sites else they would cease to exist. Since Plaintiff knew that her information may become publicly available, she cannot now claim that she had a reasonable expectation of privacy. As recently set forth by commentators regarding privacy and social networking sites, given the millions of users, "[i]n this environment, privacy is no longer grounded in reasonable expectations, but rather in some theoretical protocol better known as "wishful" thinking.[57]

Even before *EEOC* and *Romano* were decided, a plaintiff was ordered to produce a complete Facebook profile in *Bass v. Miss Porter's School*.[58] Defendants had sought

56 *Id.* at *7-8.

57 *Id.* at *15-*16. In the same month *Romano* was decided in New York, the Court of Common Pleas in Pennsylvania rendered a similar decision in a personal injury action. In *McMillen v. Hummingbird Speedway, Inc.*, No. 113-2010 CD (Pa. C.P. Jefferson Sept. 29, 2010), *supra* n.50, the court also held that non-public portions of the plaintiff's Facebook and Myspace accounts were discoverable. However, rather than focus on expectation of privacy, or lack thereof, the court in *McMillen* based its holding on declining to adopt a "social network site privilege" in response to plaintiff's argument that his communications were "confidential" and "protected against disclosure." Since then several courts in Pennsylvania have granted discovery of social media data; *see, e.g., Zimmerman v. Weis Mkts., Inc.*, No. CV-09-1535, 2011 WL 2065410 (Pa. C.P. Northumberland May 19, 2011); *Offenback v. L.M. Bowman, Inc.*, 2011 WL 2491371 (M.D. P. June 22, 2011); *Largent v. Reed*, No. 2009-1823, 2011 WL 5632688 (Pa. C.P. Franklin Nov. 8, 2011).

58 Civil No. 3:08cv1807 (JBA), 2009 WL 3724968 (D.Conn. Oct. 27, 2009).

documents related to plaintiff's alleged teasing and taunting in text messages and on Facebook. While the plaintiff had sought to restrict the amount of material produced, the court ordered the entire profile produced, holding that:

> Facebook usage depicts a snapshot of the user's relationships and state of mind at the time of the content's posting. Therefore, relevance of the content of Plaintiff's Facebook usage as to both liability and damages in this case is more in the eye of the beholder than subject to strict legal demarcations, and production should not be limited to Plaintiff's own determination of what may be "reasonably calculated to lead to the discovery of admissible evidence."[59]

The courts' treatment of the expectation of privacy is understandably different when minors are concerned.[60] Nevertheless, when central to the allegations, as demonstrated in the *EEOC*, *Romano*, and *Bass* opinions, courts have ordered the production of social media materials.

Courts have generally not allowed employers to use confidential user name and password information to access employee activity on social media sites outside of the discovery process. In *Pietrylo v. Hillstone Restaurant Group*,[61] two restaurant employees sued their former employer following their termination for posting comments critical of the company on a private, employee-only Myspace page. Plaintiffs claimed that the restaurant's managers gained access to the page only after they "strong-armed and threatened" a fellow employee and member of the private group to provide them with the member's email address and password. A jury found that the managers had violated the Stored Communications Act ("SCA") (*see infra* Part II, §III) and the New Jersey Wire Tapping & Electronic Surveillance Act by intentionally accessing the Myspace page without authorization. Interestingly, the jury found in favor of the defendants on common law claims for invasion of privacy, finding that the plaintiffs had no reasonable expectation of privacy in the Myspace group.[62] The *Pietrylo* case instructs that in the absence of reliable evidence that an employee is engaged in malfeasance causing serious damage to the employer's interest or violating substantial company policies, any attempt to obtain access to password-protected social media sites may be ill advised.

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59 *Id.* at *3-*4. The court reviewed the material in camera before ordering the entire Facebook profile produced.

60 Cases highlighting these issues are *Beye v. Horizon*, 06-Civ.-5337, and *Foley v. Horizon*, 06-Civ.-6219, 568 F. Supp. 2d 556 (D.N.J. 2008). Parents sued on behalf of minor children over insurer's refusal to pay health benefits for anorexia or bulimia. Under then existing New Jersey law, mental illness was covered only if biologically based. Horizon Blue Cross Blue Shield sought the minor's online postings arguing that these were relevant to understanding the causes of the eating disorders, biological or emotional. The court ordered the plaintiffs to turn over the minors' writings about the eating disorders, including entries on Facebook or Myspace. *See* Mary Pat Gallagher, *Myspace, Facebook Pages Called Key to Dispute Over Insurance Coverage for Eating Disorders* (Feb 1, 2008) (cases consolidated for discovery: *Beye v. Blue Cross Blue Shield of NJ,* 06 Civ. 5337 (D.N.J. 2008) and *Foley v. Horizon,* 06 Civ. 6219), available at http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=900005559933 (last visited Apr. 3, 2012).

61 2009 WL 3128420 (D.N.J. Sept. 25, 2009).

62 More recently the American Civil Liberties Union requested that the Maryland Department of Public Safety and Corrections cease and desist enforcing a policy requiring that applicants for employment with the Division, as well as current employees undergoing recertification, provide the Division with all social media account user names and passwords for use in employee background checks. In a letter dated January 25, 2011, the ACLU alleged that this policy was violative, *inter alia*, of the SCA and the Maryland state equivalent (Md. Courts & Jud. Proc. Art., § 10-4A-01 *et seq.*) and also constituted an invasion of privacy "and arguably chills employee speech and due process rights protected under the First and Fourteenth Amendments to the U.S. Constitution." Letter from Deborah A. Jeon, Legal Director, American Civil Liberties Union of Maryland, to Secretary Gary D. Maynard, Maryland Department of Public Safety and Correctional Services (Jan. 25, 2011). On April 6, 2011, the Department responded by letter to the ACLU partially describing the DOC's revised policy which provided that candidates for jobs and recertification sign a form saying that they understand it is "voluntary" for them to provide access to their social media accounts during interviews. The ACLU was not persuaded, opining that it would be virtually impossible for an applicant to prove that not giving up their password was the reason they were not hired, if that were the case. According to the ACLU, what was also troublesome was that the revised policy did not take into account the interests of the Facebook "friends" whose privacy rights are ostensibly invaded by the government without their consent. Press Release, American Civil Liberties Union of Maryland, *ACLU Says Division Of Corrections' Revised Social Media Policy Remains Coercive And Violates "Friends" Privacy Rights* (Apr. 18, 2011).

C. Privacy and Social Media Policies

As discussed in greater detail in Part II of this Primer, *infra*, courts have recognized that the unique characteristics of social media can present special challenges in discovery. The *EEOC* court noted:

> [d]iscovery of [social networking sites] requires the application of basic discovery principles in a novel context. … At bottom, though, the main challenge in this case is not one unique to electronically stored information generally or to social networking sites in particular. Rather, the challenge is to define appropriately broad limits – but limits nevertheless – on the discoverability of social communications in light of a subject as amorphous as emotional and mental health, and to do so in a way that provides meaningful direction to the parties.[63]

The challenge is similar for organizations drafting social media policies and addressing the privacy considerations such policies may implicate. As an initial matter, regardless of whether the employer sponsors the use of social media by employees, it is a good idea to remind employees of the dangers associated with posting too much personal information. An employer may equally expect that employees' use of social media will not interfere with their work and may wish to include an explicit policy statement to this effect.

More particularly, policy language should contain some statement about the organization's position regarding privacy, whether personal use is permitted and to what extent; whether an employee's social media activity may be monitored and, if so, how that information may be used. This portion of the policy may also cover personal uses of social media that might impact the organization as well as business uses sanctioned for the benefit of the organization. When drafting policies that attempt to regulate employee behavior, employers should also be mindful of the *Stengart* opinion and avoid crafting a policy that may not withstand legal scrutiny. But although an employee may expect some degree of privacy in their social media communications, the nature and degree of that privacy will depend on a variety of factors, including the nature of the communication, the recipient of the communication, and the content of the communication, and, as *Holmes* demonstrates, any policy that may be in place respecting the use of social media. As with other integral parts of any social media policy, those portions dealing with privacy should be revisited regularly to keep pace with the developing law in this area.

IV. Regulatory Considerations

Social media presents a number of challenges for companies falling under the purview of regulators. On the surface, social media might appear to be like any other communication medium utilized by regulated entities; in reality, however, characteristics unique to social media set it apart from other forms of communication in several important ways. With the typical communication media – most often press releases, press interviews, and regulatory filings – there are almost always clearly identified spokespeople, media controls, and processes. With social media, in contrast, the identity of the "speaker" may be difficult to discern or verify by those viewing such commentary or by the regulated entities themselves.

63 *Simply Storage, supra,* 270 F.R.D. 430, at *8; *see also* Magistrate Judge Kristen L. Mix's commentary in "Discovery of Social Media," 2011 Fed. Cts. L. Rev. 5 (November 2011).

Perhaps more significantly, even speakers who are clearly identified may offer little or no information about their relationship (if any) with a regulated entity about which they communicate. Additionally, the proliferation of social media has been so rapid that both regulated entities and regulators themselves either lack well-defined policies, or have only recently issued policies governing how regulated entities should handle social media. Both the lack of well-defined and established policies and the dearth of precedent interpreting newly established policies can lead to increased uncertainty by regulators concerning control of social media, and in turn, can leave regulated entities without proper guidance.

The potential ramifications for inappropriate or illegal social media use by regulated entities are largely congruent with the compliance risks such entities already face. Examples include charges of unfair or deceptive advertising, under the jurisdiction of the U.S. Federal Trade Commission (FTC); charges of incomplete sales and marketing information, under the jurisdiction of the U.S. Food and Drug Administration (FDA); charges of disclosure of non-public information, under the jurisdiction of the U.S. Securities and Exchange Commission (SEC); and charges of making incomplete, exaggerated or misleading claims, under the jurisdiction of the U.S. Financial Industry Regulatory Authority (FINRA).

A. Sample Regulatory Guidelines

Many regulatory agencies have published social media usage guidelines for entities under their regulatory purview, including the Financial Industry Regulatory Authority ("FINRA"), the Securities and Exchange Commission ("SEC") and the Federal Trade Commission ("FTC") as well as myriad other federal, state, and local government entities. Many of these guidelines seek to address the same challenges presented by social media activity regardless of type of entity or the social media vehicle used, such as transparency, training, authorization, and disclosure:

- **Transparency**. Regulators advise employers to specify whether employees are permitted to use social media for business purposes. In theory, this practice allows consumers to better corroborate the veracity of social media communications.

- **Training**. Employers are strongly encouraged to train both authorized and unauthorized employees on the appropriate way to handle social media, the company's policies on external communication (including those using social media), and the potential risks to the entity and individual for inappropriate or illegal social media usage.

- **Authorization**. Regulated entities are encouraged to clearly identify which individuals, teams, or functional areas (if any) are authorized by the entity to utilize social media for the company's benefit. Without such clear authorization, regulated entities cannot easily establish whether inappropriate or illegal social media activity was company-sanctioned or the result of a "rogue" employee – a distinction with a huge impact on any subsequent enforcement activity or penalty.

- **Disclosure**. Social media usage by employees of regulated entities should (and in the case of the FTC must) disclose both their identity and their relationship with the regulated entity. This allows readers of such social media communications to understand the context in which such communication is made.

1. Financial Services

FINRA has issued rules regarding social media use for securities firms in the form of FINRA Regulatory Notices 11-39 and 10-06.[64] As previously noted,[65] these rules are far more restrictive than practices applicable to non-regulated entities. Firms are required to retain records of communications related to the broker-dealer's business, including those made through social media sites. These rules may require securities firms to consider carefully the rules of a given social media site and whether available technology can record and retain content generated on that site. Regulatory requirements should also lead organizations to consider the benefits and risks of external as opposed to internal hosting of social media content.

Not only do the FINRA rules require firms to retain social media information, but the regulations also speak to policies or processes for supervising social media use and the training of employees regarding social media policies.[66]

2. Securities Markets

The SEC has reminded companies that statements made through social media outlets are corporate communications subject to the antifraud provisions of the securities laws.[67] Accordingly, companies should consider taking steps to put into place controls and procedures to monitor statements made by or on behalf of the company on these types of electronic forums.[68]

Applying its interpretation of securities laws to the use of social media, the SEC has taken action to freeze the assets of a Canadian couple who fraudulently touted penny stocks though their website, Facebook and Twitter.[69]

An additional example of the power of Twitter to impact trading was described by Dian Chu, writing in the EconForecast blog. She related how the rapper 50 Cent, who had over 3.8 million Twitter followers, tweeted about the merits of a penny stock. Subsequently, the shares in the stock jumped 290% in one day. Approximately 9.24 million shares of the stock were traded in two days. The New York Post reported that in financial documents filed by the company, its auditor raised questions about its ability as a going concern.

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64 FINRA Notice 11-39 is available at http://www.finra.org/Industry/Regulation/Notices/2010/P124187, and FINRA Notice 10-06 is available at http://www.finra.org/industry/regulation/notices/2010/p120760 (both last visited Apr. 5, 2012). These notices are presented in Q&A format, and specifically delineate between the different topic areas covered by the Notices.

65 *See* Section II(F)(2), *supra*.

66 Seven principal points are addressed by Notice 10-06 in Q&A format: Recordkeeping responsibilities, suitability responsibilities, types of electronic forms, blogs, social networking sites, supervision of social networking, and third-party posts. *See* Spotlight on FINRA Social Media Webinar (February 12, 2010), located at http://everydaytenacity.com/asset-management-marketing/spotlight-finra-social-media-webinar-highlights (last visited Apr. 3, 2012). Notice 11-36 answers some additional questions on some of these topics, and also addresses accessing social media sites from personal devices.

67 Commission Guidance on the Use of Company Web Sites, Release Nos. 34-58288, IC-28351, effective date August 7, 2008, located at http://www.sec.gov/rules/interp/2008/34-58288.pdf (last visited Apr. 3, 2012). Speaking about interactive features of corporate web sites, the Commission noted that interactive "communications can take various forms, ranging from 'blogs' to 'interactive shareholder forums.'"

68 *Id.* at pp. 40-41.

69 *SEC Charges Two Canadians with Fraudulently Touting Penny Stocks on a Web Site*, Facebook and Twitter, Press Release No. 2010-114, June 29, 2010, http://www.sec.gov/news/press/2010/2010-114.htm (last visited Apr. 3, 2012).

Apparently, however, the rapper's attorney intervened, and a subsequent tweet by the rapper stated: "I own [company] stock thoughts on it are my opinion. Talk to financial advisor about it."[70]

3. FTC Regulated Entities

In October 2009, the FTC, the federal government's chief guardian against unfair or deceptive business practices, revised its Guides Concerning the Use of Endorsements and Testimonials in Advertising to include social media.[71] The notice incorporated several changes to the FTC's guidelines, which address endorsements by consumers, experts, organizations, and celebrities, as well as the disclosure of important connections between advertisers and endorsers. Specifically, the revised Guides specify that while the FTC will consider conduct and render decisions on a case-by-case basis, the post of a blogger who receives cash or in-kind payment to review a product is considered an endorsement:

> Thus, bloggers who make an endorsement must disclose the material connections they share with the seller of the product or service. Likewise, if a company refers in an advertisement to the findings of a research organization that conducted research sponsored by the company, the advertisement must disclose the connection between the advertiser and the research organization.[72]

In light of these new guidelines, organizations should be aware that the FTC is keeping a close eye on their interactions with bloggers. In April 2010, six months after the revised Guides were released, the FTC made public its first investigation into a company's relationship with bloggers. The case involved a promotion by Ann Taylor, which had invited bloggers to preview the Loft division's summer 2010 collection, offering a "special gift" and promising that those posting coverage from the event would be entered into a "mystery gift-card drawing," where they could win between $50 and $500. The invitation explained that bloggers must submit posts to the company within 24 hours in order to find out the value of their gift card.[73]

The event, coupled with the unusual request for posts to be submitted for a prize, was noticed and analyzed by the FTC.[74] As explained by Mary Engle, the FTC's Associate Director – Advertising Practices, in a letter dated April 20, 2010, to Ann Taylor's legal representation: "We were concerned that bloggers who attended a preview on January 26, 2010 failed to disclose that they received gifts for posting blog content about that event."[75] Although the agency decided not to take action against Ann Taylor, the decision indicates that the FTC is watching these issues closely; and, in addition, it provided some insight into how it is viewing marketers' relationships with online communities.

70 Dian Chu, *Hip Hop Social Media Meets Wall Street: 50 Cent and His $8.7 Million Penny Stock Tweets,* EconForecast, January 15, 2011, http://dianchu.blogspot.com/2011/01/hip-hop-social-media-meets-wall-street.html (last visited Apr. 3, 2012).
71 Federal Trade Commission, *Guides Concerning the Use of Endorsements and Testimonials in Advertising*, (effective December 1, 2009), http://www.ftc.gov/os/2009/10/091005endorsementguidesfnnotice.pdf (last visited Apr. 3, 2012).
72 FTC Press Release *FTC Publishes Final Guides Governing Endorsements, Testimonials*, October 5, 2009, http://www.ftc.gov/opa/2009/10/endortest.shtm (last visited Apr. 3, 2012).
73 Natalie Zmuda, *Ann Taylor Investigation Shows FTC Keeping Close Eye on Blogging*, April 28, 2010, http://adage.com/article?article_id=143567 (last visited Apr. 3, 2012).
74 *Id.*
75 Closing Letter to Kenneth A. Plevan, Esq., Counsel for Ann Taylor, April 20, 2010, www.ftc.gov/os/closings/100420anntaylorclosingletter.pdf (last visited Apr. 3, 2012).

The revised Guides prompted questions, and in July of 2010, the FTC published answers to questions regarding the revised Guides.[76] The FTC explained that it revised the Guides to show how they apply to today's marketing world, and it answered several of the most frequently asked questions about the revised Guides.[77]

Because social media can be particularly effective at communicating the efficacy or truthfulness of a regulated entity's sales or marketing claims, the FTC has focused on trying to ensure that consumers are fully informed about who is on the other side of any such communication (e.g., identifying "astroturfing" campaigns by regulated entities). The FTC has also been concerned about payments to Internet users who post positive product reviews on websites and the development of "flogs," which are blogs that appear objective and genuine but are designed to covertly promote a product.[78]

4. Health Care Industries

The importance of regulatory compliance in health care necessitates extra care in the formulation and enforcement of social media policies, as well as consideration of technology tools to support them.

a. Food and Drug Administration

Unlike the FTC, which has been active in providing detailed social media guidance, the U.S. Food and Drug Administration ("FDA") was beginning to develop guidelines regarding social media use to promote FDA regulated products as this Primer was drafted. The FDA held public hearings in November 2009 on "Promotion of FDA-Regulated Medical Products Using the Internet and Social Media Tools."[79] The FDA's Division of Drug Marketing, Advertising and Communications indicated that the FDA had been researching the following topics in connection with promotion of FDA-regulated medical products on social media: "Responding to unsolicited requests; fulfilling regulatory requirements when using tools associated with space limitations; fulfilling post-marketing submission requirements; online communications for which manufacturers, packers or distributors are accountable; use of links on the Internet; [and] correcting misinformation."[80]

Despite its previous communications, the FDA has still not published comprehensive social media guidelines. In December 2010, the FDA released a document focused on the FDA's "Strategic Priorities: 2011-2015." The document does provide some insight into the future direction of the FDA and offers certain insights regarding its position on social media. It also offers advice that pharma companies considering marketing or communications for a drug, medical device, healthcare organization, or biomedical research organization should heed. But for those awaiting specific guidance on social media usage there is only one point in the entire 48-page document of strategic priorities where social

76 *See* FTC's Revised Endorsement Guides: What People are Asking, http://business.ftc.gov/documents/bus71-ftcs-revised-endorsement-guideswhat-people-are-asking (last visited Apr. 3, 2012).
77 *Id.*
78 Alan Friel, *Navigating FTC's Guidance on Social Media Marketing*, Adweek, Nov. 30, 2009, http://www.adweek.com/aw/content_display/community/columns/other-columns/e3i5bf1e98f0ce98d79ff2629077ea6b78a (last visited Apr. 3, 2012).
79 Transcripts and additional information can be found at http://www.fda.gov/AboutFDA/CentersOffices/OfficeofMedicalProductsandTobacco/CDER/UCM184250.htm (last visited Apr. 3, 2012).
80 *Three-Month Pushback Frustrates Industry Digging into Social Media and Internet Advertising*, Advertising Age, December 22, 2010, http://adage.com/article?article_id=147857 (last visited Apr. 3, 2012).

media is even mentioned.[81] On December 30, 2011, the FDA released a limited-scope draft guidance addressing off-label usage of pharmaceuticals.[82] The draft left many questions unanswered.[83]

Industry observers believe that, notwithstanding its lack of guidance on how organizations may utilize social media without violating FDA regulations, the FDA itself intends to actively use social media formats to reach patients, healthcare professionals, and other governmental organizations. Indeed, the FDA has already launched several forward-thinking social media initiatives, including tweeting about FDA Recalls and creating a dedicated YouTube Channel.[84]

b. HIPAA

The use of social media in the health care industry creates unique challenges – perhaps more than in any other industry. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) sets forth a variety of rules focused on privacy and security of personal health information.[85] Although HIPAA mandates the confidentiality of personal health information, the use of social media by health professionals has resulted in numerous publicized security breaches. For example, seven hospital staff members were fired or disciplined after taking photos of a dying patient and posting them on Facebook.[86] Another hospital fired five hospital employees who "used social media to post their personal discussions concerning hospital patients" on Facebook.[87] Three years ago, the same hospital fired ten staff members for taking photographs of patients and patient records.[88]

A more complex issue is presented by the creation of "health networks" composed of individuals who use social media to share or collaborate regarding health issues.[89] Within these online networks, individuals share personal health information. Users may fail to review carefully the privacy policies of the social media host regarding privacy, use, ownership, or retention of the information. In addition, users may fail to appreciate that other users may violate the privacy terms and share confidential information. There also may be special concerns where the user's posts disclose or suggest personal health information of others. For example, a user might post information regarding a genetic condition that would then suggest familial health information.[90]

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81 Rohit Bhargava, *The FDA & Social Media: What to Expect in 2011*, December 21, 2010, located at http://www.dailyblogworld.com/post/marketing/the-fda-social-media-what-to-expect-in-2011.aspx (last visited Apr. 5, 2012).

82 U.S. Department of Health and Human Services, Food and Drug Administration, Guidance for Industry Responding to Unsolicited Requests for Off-Label Information About Prescription Drugs and Medical Devices, December 30, 2011, http://www.fda.gov/downloads/drugs/guidancecomplianceregulatoryinformation/guidances/ucm285145.pdf (last visited Apr. 3, 2012).

83 See Arundhati Parmar, *FDA's social media marketing draft guidance: a roundup*, MedCity News, Jan. 12, 2012, http://www.medcitynews.com/2012/01/fdas-social-media-marketing-draft-guidance-a-round-up (last visited March 5, 2012).

84 *Supra* n.80.

85 *See Understanding Health Information Privacy,* http://www.hhs.gov/ocr/privacy/hipaa/understanding/index.html (last visited Apr. 3, 2012).

86 M. Hennessy-Fiske, *When Facebook Goes to the Hospital, Patients May Suffer, L.A. Times*, August 8, 2010, http://articles.latimes.com/2010/aug/08/local/la-me-facebook-20100809 (last visited Apr. 4, 2012).

87 *5 Nurses Fired for Facebook Postings*, June 10, 2010, http://www.10news.com/news/23857090/detail.html (last visited Apr. 4, 2012).

88 *Cell Phone Photos led to Hospital Firings*, May 11, 2007, http://www.10news.com/news/13305945/detail.html (last visited Apr. 4, 2012).

89 *See, e.g.*, Patricia Sanchez Abril and Anita Cava, *Health Privacy in a Techno-Social World: A Cyber-Patient's Bill of Rights*, Northwestern Journal of Technology and Intellectual Property, Summer 2008, http://www.law.northwestern.edu/journals/njtip/v6/n3/1 (last visited Apr. 4, 2012).

90 For example, California law enforcement arrested a man using familial DNA matching. The son's DNA was taken while in custody and led to a familial match (father) in multiple homicides. A. Fantz, *Accused Serial Killer Snared Using Controversial Technique*, July 11, 2010, http://www.cnn.com/2010/CRIME/07/08/familial.dna/index.html (last visited Apr. 4, 2012).

Such self-disclosure may raise issues regarding eligibility for insurance or insurance benefits. Although insurance companies' advertising regulations may govern their postings to social media sites, another issue is whether insurance companies may use an individual's postings to determine insurability or rates.[91]

An additional complexity arises from social media postings related to mental health. A social media posting might disclose explicitly or implicitly a possible mental health issue, or lack thereof. For example, a Canadian woman on disability leave diagnosed with depression had her insurance benefits cancelled after posting vacation pictures on Facebook.[92] United States courts have ordered production of social media postings of minors related to the causes and symptoms of eating disorders and related to alleged extreme emotional distress in harassment cases.[93]

Social media postings related to mental state may also pose ethical issues for "required reporters" such as schools or medical professionals. For example, many therapists search for patient information posted on social media sites.[94] What are their ethical obligations to report a potential patient threat based on a social media posting?

5. Department of Defense

According to Deputy Secretary of Defense William J. Lynn III, the Department of Defense has recognized "the importance of balancing appropriate security measures while maximizing the capabilities afforded by 21st Century Internet tools," and has issued a policy memorandum on the "responsible and effective use of Internet-based capabilities."[95] The policy seeks to balance DOD's national security mission with the recognized benefits of collaboration, both within DOD and with the general public.[96]

B. Regulatory Compliance Advantages of a Social Media Policy

Regulators have made it clear that regulated entities are likely to benefit from a social media usage policy, and they are encouraging or even requiring regulated entities to maintain one. As the purview of regulators varies, so, too, do their guidelines as to whether entities within their oversight must maintain a policy; and, if so, what it should or must include. Examples range from the FTC (which states that the decision to proceed with an enforcement action will be influenced by the presence or absence of a policy) to FINRA (which requires that regulated entities not only have a policy but that its enforcement be supervised and monitored).[97]

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91 Susan Stead, *Social Media Meets Insurance Regulation: Where Are We Headed?* June 7, 2010), http://www.property-casualty.com/Issues/2010/June-7-2010/Pages/Social-Media-Meets-Insurance-Regulation-Where-Are-We-Headed.aspx (last visited Apr. 4, 2012).

92 Ki Mae Heussner, *Woman Loses Benefits After Posting Facebook Pics,* Nov. 23, 2009, http://abcnews.go.com/Technology/AheadoftheCurve/woman-loses-insurance-benefits-facebook-pics/story?id=9154741 (last visited Apr. 4, 2012).

93 *See* Mary Pat Gallagher, *Myspace, Facebook Pages Called Key to Dispute Over Insurance Coverage for Eating Disorders*, Feb. 1, 2008 (cases consolidated for discovery: *Beye v. Blue Cross Blue Shield of NJ*, 06-Civ.-5337 (D.N.J. 2008), and *Foley v. Horizon*, 06-Civ.-6219), http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=900005559933 (last visited Apr. 4, 2012); *EEOC v. Simply Storage Mgmt.*, No. 1:09-cv-1223-WTL-DML (S.D. Ind. May 11, 2010).

94 Dana Scarton*, Google and Facebook Raise New Issues for Therapists and their Clients*, *The Washington Post*, March 30, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/03/29/AR2010032902942_pf.html (last visited Apr. 4, 2012).

95 DOD Releases Policy for Responsible and Effective Use of Internet-Based Capabilities, U.S. Department of Defense News Release No. 154-10, February 26, 2010, http://www.defense.gov/releases/release.aspx?releaseid=13338, (last visited Apr. 4, 2012).

96 *Id.* The policy, as amended, can be found at http://www.dtic.mil/whs/directives/corres/pdf/DTM-09-026.pdf (last visited Apr. 4, 2012).

97 16 C.F.R. Part 255 (2009).

PART TWO – E-DISCOVERY ISSUES

Adequate preservation, collection, review, and production of social media content may require specialized attention and cooperation. The purpose of Part II is to provide guidance and a framework for addressing the unique challenges arising from the discovery of social media. The intent is not to supersede *The Sedona Principles* or *The Sedona Commentary on Legal Holds*, but rather to provide additional guidance with respect to those issues unique to social media content.

I. Threshold Issues

A. Relevance

As is the case with other types of electronically stored information ("ESI"), the threshold issue in deciding how to preserve and collect social media content is determining whether the content is relevant.[98] Various courts have already found that social media content that is relevant to litigation is discoverable.[99] For example, one court found that social media might be relevant to understanding the emotion, feeling, or mental state of claimants in a sexual harassment suit.[100] And sanctions are possible for spoliation of social media content, as with any sort of relevant information.[101] Thus, it is clear that social media content that is relevant to reasonably-anticipated litigation must be preserved.[102]

B. Possession, Custody and Control

Another threshold issue is determining whether social media content is in the party's possession, custody, or control such that a party has a legal obligation to identify and preserve it.[103] This determination is complicated for social media content because of the various ways in which the content is generated and stored. An individual user may generate content by uploading it to his or her site. The user, however, may not have access to all potentially relevant social media content and its associated data once the item is posted.[104] The content is typically stored and hosted by a social media service provider and not by the user. If the user-generated content is posted to someone else's social media site, the user may not have any access to the content once it is posted. Additionally, an organization may store social media content generated by users on the organization's internal servers and infrastructure that the users may not be able to access.

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98 *Zubulake v. Warburg,* 220 F.R.D. 212 (S.D.N.Y. 2003) (*Zubulake IV*) (party is "under a duty to preserve what it knows, or reasonably should know, is relevant in the action, is reasonably calculated to lead to the discovery of admissible evidence, is reasonably likely to be requested during discovery and/or is the subject of a pending discovery request").

99 *Bass v. Miss Porter's School*, 2009 WL 3724968 (D.Conn. Oct. 27, 2009) (ordering the production of "more than 750 pages of wall postings, messages, and pictures" from plaintiff's Facebook account); *Ledbetter v. Wal-Mart Stores, Inc.*, 2009 WL 1067018 (D. Colo. Apr. 21, 2009) (denying plaintiffs' motion for protective order regarding their Facebook, Myspace, and Meetup.Com content); *see also Muniz v. UPS*, 2011 WL 311374 (N.D. Cal. Jan. 28, 2011)(finding plaintiff's counsel's postings on various listservs and social media networks were irrelevant to fee dispute but noting that the type of searching discovery that is typical of issues on the merits is not equivalent to fee litigation).

100 *EEOC v. Simply Storage Mgmt.,* 270 F.R.D. 430 (S.D.Ind. May 11, 2010); *see also Offenback v. Bowman,* 2011 WL 2491371 (M.D. Pa. June 22, 2011).

101 *See Lester v. Allied Concrete Co.,* Nos. CL.08-150, CL09-223 (Va. Cir. Ct. Sept. 1, 2011) (reducing jury award by over $4 million because plaintiff "deliberately delete[d] Facebook photos that were responsive to a pending discovery request" at counsel's direction); *Lester v. Allied Concrete Co.*, Nos. CL08-150, CL09-223 (Va. Cir. Ct. Oct. 21, 2011) (ordering plaintiff and plaintiff's counsel to pay defendants over $700,000 in fees and expenses).

102 "A reasonable anticipation of litigation arises when an organization is on notice of a credible probability that it will become involved in litigation, seriously contemplates initiating litigation, or when it takes specific actions to commence litigation." *The Sedona Conference® Commentary on Legal Holds: The Trigger & The Process*, 11 The Sedona Conference J. 265 at 269 (Fall 2010) *available at* https://thesedonaconference.org/download-pub/470.

103 F.R.C.P. 34(a)(1).

104 There are certain types of data to which the user or subscriber may not have easy access, but to which the service provider does. This can include activity log data showing the date and time the user accessed the site, IP addresses from where the account was accessed, and reports detailing other aspects of the user's social media account.

Whether a user who generated content posted on a social media site has possession, custody, or control of his or her own social media content, thus requiring preservation, is the most straightforward analysis. A user typically has "control" of his or her own social media content – to the extent he or she can still access it – because the user typically has the "legal right, authority, or practical ability to obtain the materials sought on demand."[105] Indeed, some social media sites even specify in their terms of use that users have control of their own content.[106] Thus, a user sued in an individual capacity has a duty to preserve relevant social media content that the individual can obtain on demand.[107]

The determination whether an organization has possession, custody, or control of social media content stored on its internal servers and infrastructure is similarly straightforward. A corporation that has the "ultimate authority to control, to add, to delete, or modify" a website stored on its own servers has possession, custody, or control of the content.[108]

The more difficult analysis is determining whether an organization has possession, custody, or control of relevant social media content posted by an employee on an external social media site, and whether the organization has a duty to identify and preserve social media content stored in this manner. In a similar context, a court held that an individual plaintiff did not have possession, custody, or control of hyperlinks contained in emails wherein the hyperlinks were originally stored on an external remote server but no longer existed and thus the plaintiff did not spoliate evidence by failing to preserve such hyperlinks.[109] This case suggests courts may view social media content posted by an employee on an external site not to be in the possession, custody, or control of the organization, and this view is consistent with the case law relating to an employee's right to privacy. On the other hand, at least one court has ordered a corporation to produce email from personal email accounts from upper-management employees over the corporation's objection that it did not have access to the employees' personal email accounts.[110] Additionally, commentators have suggested that employers that expressly inform their employees that any and all documents and information created, stored, or exchanged from or by the employer's computer and communications systems belong to the employer, or employers that monitor employees' private use of company computers could arguably be held to "control" such information. This may be the case even if the information was created for personal use, and even if physically stored on a third party's servers. The employer thus may have to produce such information if requested in discovery.[111]

C. Ethics

Another issue with the preservation and collection of social media is whether it is even permissible to access social media sites in order to preserve or collect data for use in legal proceedings. Because data posted on social media sites is usually protected by privacy

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105 *Steele Software Sys. Corp. v. DataQuick Info. Sys., Inc.*, 237 F.R.D. 561, 564 (D. Md.2006) (citations and internal quotations omitted).

106 "You own all of the content and information you post on Facebook, and you can control how it is shared. ..." Facebook Statement of Rights and Responsibilities, April 26, 2011, Revision, § 2 (http://www.facebook.com/#!/terms.php, last visited on Apr. 4, 2012). In addition, Facebook has a feature allowing users to download content that they have placed on Facebook. *See* Mark Zuckerberg, "Giving You More Control," Oct. 6, 2010, http://blog.facebook.com/blog.php?post=434691727130 (last visited on Apr. 4, 2012).

107 Arteria Property Pty Ltd. v. Universal Funding, 2008 WL 4513696 (D.N.J. Oct. 1, 2008).

108 *Id.*

109 *Phillips v. Netblue, Inc.*, 2007 WL 174459 (N.D.Cal. Jan. 22, 2007).

110 *Helmert v. Butterball,* 2010 WL 2179180 (E.D.Ark. May 27, 2010).

111 *See* Steven Bennett, *Civil Discovery of Social Networking Information*, 39 Southwestern Law Review 413, 419 (2010), http://www.swlaw.edu/pdfs/lr/39_3bennett.pdf (last visited Apr. 4, 2012).

settings and various degrees of permissions, regular Internet searches yield only the limited user profile information that is made publicly available to everyone. When the site provider does not conduct the collection, the process of collecting a deeper cut of social media data typically requires the collector to access the social media site directly. This can be done either by logging on to the site using a personal account or by using software that accesses websites via automated means. Each of these approaches potentially poses ethical issues when data is collected for use in legal proceedings.

As discussed in detail below, there is clear authority against attorney "pretexting"; it is unethical for an attorney to use deceptive means to "friend" or cause another to "friend" a person in order to gain access to postings with heightened privacy settings for use in litigation. Once logged into the social media site, however, a person need not "friend" a second person in order to access his public-facing information. Yet collecting a fellow site user's public-facing information may raise its own issues. While social media sites exist to facilitate the sharing of data, the act of data preservation or collection may violate the social media site's terms of service. Sites may require account holders to adhere to codes of conduct that include refraining from collecting fellow account holders' information without informed consent; it is unclear if this includes collecting data for use in legal proceedings.[112] Penalties for failing to follow a site's terms of service may include termination of the user's account.

In any event, this method of preservation or collection puts the collector squarely in the chain of custody. Using or producing this data during legal proceedings may result in the collector becoming a witness and being required to testify concerning the collection methodology and process.[113] Casual, incomplete collection of social media data may create problems with authentication if the data, collected for a different purpose, is later used to provide evidence of website changes or to support charges of spoliation. For these reasons, thought should be given to using specialized software and the services of competent vendors for social media site data collection.

II. Preservation and Collection Guidance for Social Media

The preservation and collection of social media data poses significant technical challenges and raises evidentiary issues that at this time are only beginning to play out before courts. To the extent that the underlying data is essentially similar to other types of ESI, the same legal standards apply equally to social media data. Social media data preservation and collection practices should accordingly conform to the principles developed for ESI preservation and collection in general.[114] Because, however, social media data is often hosted remotely, is dynamic and collaborative by nature, can include several data types, and is meant to be accessed through unique interfaces, preservation and collection protocols and standards that have evolved for other ESI are often a poor fit.

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112 *See*, *e.g.*, "Facebook's Privacy Policy," Sept. 23, 2011, http://www.facebook.com/policy.php (last visited Dec. 18, 2011), addressing the sharing of data posted on Facebook, *and* Facebook "Statement of Rights and Responsibilities," Apr. 26, 2011, http://www.facebook.com/terms.php (last visited Apr. 4, 2012), which states in pertinent part:
"This Statement of Rights and Responsibilities ("Statement") derives from the Facebook Principles, and governs our relationship with users and others who interact with Facebook. By using or accessing Facebook, you agree to this Statement. ...
5. Protecting Other People's Rights
7. If you collect information from users, you will: obtain their consent, make it clear you (and not Facebook) are the one collecting their information, and post a privacy policy explaining what information you collect and how you will use it.

113 *See*, *e.g.*, *Toytrackerz LLC v. Koehler*, Civil Action No. 08-2297-GLR, 2009 WL 2591329, at *6 (D.Kan. Aug. 21, 2009) (non-government website printout was inadequately authenticated under FRE 901; to authenticate a website printout, a proponent must present testimony from the person who created the printout to the effect that it "accurately reflects the content of the website and the image of the page on the computer at which the printout was made.").

114 *See*, *e.g.*, *The Sedona Principles*, Principles 5, 6 and 12, https://thesedonaconference.org/download-pub/81.

What is clear is that failing to collect relevant data from social media sites when a preservation need arises or is anticipated is ill advised because social media sites can terminate an account or membership[115] and delete content.[116] Thus, organizations might consider collecting social media content at the early stages of the e-discovery process for preservation purposes in order to avoid spoliation arguments. For these reasons, preservation and collection strategies are discussed together herein.

The best strategy for handling difficult preservation and collection issues is to confer with opposing counsel and agree on reasonable steps.[117] There will be various circumstances, however, where consultation is not possible, such as when there is no identifiable opposing party or opposing counsel when the duty to preserve is triggered.[118] Thus, organizations need to consider various strategies when consultation with opposing counsel is not possible.

Tools for preservation and collection of social media content are still being developed and are constantly evolving.[119] Because each social media site is unique, the tools used to preserve and collect content from one site may not work for others. Furthermore, although social media sites may be accessed using a web browser, the nature of social media sites makes it difficult to preserve the content as one would with other websites.

Some practitioners resort to capturing and preserving static images as a means of preservation. There is extensive precedent for courts permitting the use and introduction into evidence of static images.[120] Once logged in, the data preserver/collector can access the target user's public-facing social media posts. This access may use technology employed by site users rather than technology employed by the site provider. However, simply printing out social media site data could result in an incomplete and inaccurate data capture that is hard to authenticate, except on the basis of the personal knowledge of a witness.[121] Also, social media sites can contain data and information, such as video content, that cannot be properly collected in the form of static images (i.e., screen shots and .pdf images).

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115 For example, "Myspace may terminate your Membership at any time, for any or no reason, with or without prior notice or explanation, and without liability." Myspace Terms of Use Agreement, June 25, 2009, ¶ 2 http://www.myspace.com/index.cfm?fuseaction=misc.terms (last visited Apr. 4, 2012). Similarly, Twitter "reserve[s] the right at all times ... to terminate users or reclaim usernames." Twitter Terms of Service, http://twitter.com/tos (last visited Apr. 4, 2012). And "Foursquare may terminate your access to all or any part of the Service and/or Add-to Link at any time, with or without cause, with or without notice, effective immediately, which may result in the forfeiture and destruction of all information associated with your membership." Foursquare Labs, Inc., Terms of Use, http://foursquare.com/legal/terms (last visited Apr. 4, 2012).

116 For example, "Myspace may reject, refuse to post or delete any Content for any or no reason. ..." Myspace Terms of Use Agreement, June 25, 2009, ¶ 7.1, http://www.myspace.com/index.cfm?fuseaction=misc.terms (last visited Apr. 4, 2012). Similarly, Twitter "reserve[s] the right at all times ... to remove or refuse to distribute any Content on the Services. ..." Twitter Terms of Service, http://twitter.com/tos (last visited Apr. 4, 2012). And Foursquare reserves the right to (i) remove, suspend, edit or modify any Content in its sole discretion, including without limitation any User Submissions at any time, without notice to you and for any reason. ..." Foursquare Labs, Inc., Terms of Use, http://foursquare.com/legal/terms (last visited Apr. 4, 2012).

117 *See The Sedona Conference Cooperation Proclamation* (2008); *In re Facebook PPC Advertising Litig.,* 2011 WL 1324516 (N.D.Cal. Apr. 6, 2011) (ordering parties to meet and confer in order to devise ESI protocols including for Facebook data) *available at* https://thesedonaconference.org/download-pub/173.

118 *See The Sedona Conference® Commentary on Preservation, Management and Identification of Sources of Information that are Not Reasonably Accessible* (July 2008) *available at* https://thesedonaconference.org/download-pub/1703.

119 In October of 2010, for example, Facebook added a feature called "Download Your Information," which allows users to download their profile information, contact information, interests, groups, wall posts, and the photographs, videos, and other content posted to the user's profile. See http://www.facebook.com/blog.php?post=434691727130 (last visited Apr. 4, 2011); https://www.facebook.com/help/?faq=18844 (last visited Apr. 4, 2012).

120 *See, e.g., Michigan v. Liceaga*, 2009 WL 186229 (Mich. App. Jan. 27, 2009) (photograph from defendant's Myspace site depicting him holding the gun used to shoot murder victim and "'throwing' a gang sign" was properly used for the purpose of establishing state of mind and intent and also showed his familiarity with weapons); *U.S. v. Ebersole*, 263 Fed.Appx. 251 (3d Cir. Jan. 13, 2008) (Myspace page admitted at revocation hearing provided context for threatening e-mail sent to stalking victim's sister).

121 *Lorraine v. Markel Am. Ins. Co.,* 241 F.R.D. 534, 538, 542-43 (D.Md.2007); Paul W. Grimm *et al., Back to the Future: Lorraine v. Markel American Insurance Co. and New Findings on the Admissibility of Electronically Stored Information,* 42 Akron L. Rev. 357, 368-69 (2009) (discussing standard for authentication of web site print outs); *see also, e.g., Griffin v. State,* 2011 WL 1586683 (Md. Apr. 28, 2011) (trial court's admission of inadequately authenticated Myspace print out was reversible error); *State vs. Eleck*, 2011 WL 3278663 (Conn. App. Aug. 8, 2011) (affirming trial court's exclusion from evidence based on inadequate authentication of a print out of defendant's Facebook account).

Depending on the specific type of information that needs to be preserved or collected, videoing/interactive demonstration software that creates a record of the experience of navigating a site may more accurately represent the dynamic nature of the information, including capturing dynamic and non-text postings such as audio and video materials.

As with all ESI collections, thorough documentation and verification of the process and results is key to ensuring a cogent product that, if challenged, may be supported with affidavits or testimony. Circumstantial evidence may enhance authentication, including the presence of photographs, email addresses, and posting dates.[122] Related data obtained from other sources, including email notifications of posting activity and computer and account usage logs, may provide additional context to aid authentication.

Any collection of social media content can only represent the social media site data at a fixed point in time. And because of the dynamic nature of social media content, the collector may need to perform completely new collections on a periodic basis, should the circumstances demand. Also, any collection will most likely be a visual representation of what may be complex and interactive data captured without the benefit of metadata and logging data, and without the benefit of the useful data that allows the content to be easily navigated and used.

Third-party providers are developing solutions that go beyond capturing static and single point-in-time images from a specific social media site, and instead allow certain content to be downloaded or collected in a way that better preserves the content and captures the unique metadata fields associated with social media data.[123] Properly captured, these metadata fields can assist with establishing the chain of custody, with authentication, and help to facilitate more accurate and efficient data processing and review. Currently, the full range of metadata associated with social media data can only be collected with specialized e-discovery software designed for that purpose.

Social media sites can, and some do, publish rules and specifications that allow application programming interfaces (APIs) to interact with the social media site in order to capture social media site data by automated means.[124] Because these products integrate with the APIs published by the providers, they are better able to filter data and collect social media data in a more defensible manner, including by collecting all available metadata fields for individual social media items and by generating MD5 hash values for collected social media items. The products are multiplying rapidly and undergoing refinement, spurred on by the need to fill the new regulatory niche, with flow-on effects for e-discovery. When properly developed, these products are registered and approved by the provider and their use is subject to specific terms of service for developers.[125]

However, providers may seek to restrict or ban the use of software designed to automate the collection of website data outside of what is permitted by the APIs and the

122 *See*, *e.g.*, *In re T.T.*, 228 S.W.3d 312, 322-23 (Tex. App.—Houston [14th Dist.] 2007).
123 For example, a "tweet" generated on Twitter or an individual Facebook post contains over 20 specific metadata items. *See* http://blog.x1discovery.com/2011/10/11/key-facebook-metadata-fields-lawyers-and-ediscovery-professionals-need-to-be-aware-of (last visited Apr. 4, 2012).
124 An API generally is a set of rules and instructions that allow a software program to interact with other software. *See* Wikipedia available at http://en.wikipedia.org/wiki/Api. APIs may not be effective to capture content from all social media sites, and each social media site may operate in a unique way and allow different types of interaction.
125 *See, e.g.,* Facebook "Platform Policies" available at http://developers.facebook.com/policy (last visited Apr. 4, 2012).

terms of service for application developers.[126] Some site providers are working aggressively to prevent such unauthorized third-party access, including seeking criminal prosecutions for violations where the application intentionally circumvents the security protocols and API frameworks of the provider.[127]

III. Preservation and Collection Guidance in Light of the Stored Communications Act

As discussed above, an organization whose duty to preserve has been triggered may lack possession, custody, or control over relevant social media content stored on external websites. Under these circumstances, a litigant may turn to the social media service provider. A major obstacle to obtaining content directly from the service provider, however, is the Stored Communications Act of the Electronic Communications Privacy Act ("ECPA"). The SCA has been interpreted broadly enough to encompass social media content, such as private YouTube videos,[128] wall posts on a restricted-access Facebook account, comments on a restricted-access Myspace account, private messaging on Facebook and Myspace,[129] and restricted electronic bulletin boards.[130] Below is a detailed discussion of the SCA and guidance on how requesting parties can navigate through the statutory framework to attempt to accomplish preservation or collection.

A. Restrictions on Electronic Communication Service Providers

The SCA imposes different levels of restrictions and protections, depending on whether the service provider at issue is providing electronic communication services or remote computing services. An "'electronic communication service' means any service which provides to users thereof the ability to send or receive wire or electronic communications. ... "[131] And, with certain exceptions, the SCA prohibits "a person or entity providing an electronic communication service to the public" from "knowingly divulg[ing] to any person or entity the contents of a communication while in electronic storage by that service. ..."[132]

For this restriction to apply, the communication must be in "electronic storage." While this may seem like a common term, for purposes of the SCA, "electronic storage" is limited to the following scenarios:

> (A) any temporary, intermediate storage of a wire or electronic communication incidental to the electronic transmission thereof; and
>
> (B) any storage of such communication by an electronic communication service for purposes of backup protection of such communication.[133]

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126 *See, e.g.*, Facebook "Statement of Rights and Responsibilities" available at http://www.facebook.com/terms.php (last visited Apr. 4, 2012):
3. Safety
2. You will not collect users' content or information, or otherwise access Facebook, using automated means (such as harvesting bots, robots, spiders, or scrapers) without our permission.

127 *See, e.g., Facebook, Inc. v. Power Ventures, Inc.*, N.D.Cal., No. C5:08-CV-05780-JW, Document 89 (July 20, 2010) (Order denying Facebook's motion for judgment on claim that violating web site terms of service violates California's computer crimes law Cal. Penal Code § 502, but finding that admitted, deliberate circumvention of technical measures taken to block access through third party's site may subject a user to criminal liability).

128 *Viacom International Inc. v. YouTube Inc.*, 253 F.R.D. 256, 264-65 (S.D.N.Y. 2008).

129 *Crispin v. Christian Audigier, Inc.*, 717 F.Supp.2d 965 (C.D.Cal. 2010) (reasoning in part that wall postings on Facebook and comments on Myspace "are in electronic storage" and denying access).

130 *Konop v. Hawaiian Airlines, Inc.*, 302 F.3d 868 (9th Cir. 2002).

131 18 U.S.C. § 2510(15).

132 18 U.S.C. § 2702(a)(1). One obvious exception is that the service provider may disclose the communication to the sender or intended recipient. 18 U.S.C. § 2702(b)(3).

133 18 U.S.C. § 2510(17).

Thus, this section of the SCA only prohibits an electronic communication service from divulging the contents of communications that are either in temporary storage (such as messages waiting to be delivered) or kept for purposes of backup protection.

B. Restrictions on Remote Computing Service Providers

The SCA separately prohibits unauthorized disclosure of communications by those providing "remote computing services" to the public. Under the Act, "'remote computing service' means providing the public computer storage or processing services by means of an electronic communications system. ..."[134] With respect to such service providers, the SCA prohibits the following:

> [A] person or entity providing remote computing service to the public shall not knowingly divulge to any person or entity the contents of any communication which is carried or maintained on that service –
>
> (A) on behalf of, and received by means of electronic transmission from (or created by means of computer processing of communications received by means of electronic transmission from), a subscriber or customer of such service;
>
> (B) solely for the purpose of providing storage or computer processing services to such subscriber or customer, if the provider is not authorized to access the contents of any such communications for purposes of providing any services other than storage or computer processing. ...[135]

Compared to the restrictions on "electronic communication service providers," the restrictions on remote computing service providers" are broader and are not limited to communications that are in temporary storage or kept for purposes of backup protection.

C. Determining the Type of Service Involved

Whether a service provider is providing an electronic communication service or a remote computing service depends in large part on the specific type of information or data at issue and its current state. The distinction is not trivial, and can sometimes mean the difference between liability and no liability under the SCA.[136] Also, and adding to the complications of this Act, an entity may qualify as providing both types of service, even for a single type of communication.

For private messages, such as email, that have not yet been delivered or read, the service provider typically is considered an electronic communication service provider, and the messages are subject to the SCA because the communication is in temporary intermediate storage pending delivery.[137]

134 18 U.S.C. § 2711(2).
135 18 U.S.C. § 2702(a)(2).
136 *Quon v. Arch Wireless Operating Co., Inc.*, 529 F.3d 892, 900 (9th Cir. 2008) (agreeing that "if Arch Wireless is an [electronic communication service provider], it is liable as a matter of law, and that if it is [a remote computing service provider], it is not liable"), *rev'd on other grounds*, *Ontario v. Quon*, 130 S.Ct. 2619, 177 L.Ed.2d 216 (2010).
137 *See Crispin v. Christian Audigier, Inc.*, 717 F.Supp.2d at 987 (C.D.Cal. 2010), and cases addressed therein.

For email that has already been delivered and read, however, there is a split of authority. A copy remains on the service provider's server, and a court may decide that the service provider is still an electronic communication service provider and that the communication is still subject to the SCA because it is being kept for backup purposes. For example, the Ninth Circuit has held that:

> An obvious purpose for storing a message on an ISP's server after delivery is to provide a second copy of the message in the event that the user needs to download it again – if, for example, the message is accidentally erased from the user's own computer. The ISP copy of the message functions as a "backup" for the user.[138]

However, other courts may disagree. The Federal District Court for the Eastern District of Pennsylvania, for instance, ruled that retrieved email messages, even if still on the ISP's server, are not kept for backup purposes and therefore "retrieval of a message from post-transmission storage is not covered by the Stored Communications Act."[139]

Courts may also conclude that service providers that retain delivered and read email messages are actually remote computing service providers, thus eliminating the "electronic storage" issue altogether. The Federal District Court, Central District of Illinois, so held in a matter involving web-based email:

> Thus, unless a Hotmail user varies from default use, the remote computing service is the only place he or she stores messages, and Microsoft is not storing that user's opened messages for backup purposes. Instead, Microsoft is maintaining the messages "solely for the purpose of providing storage or computer processing services to such subscriber or customer."[140]

It is not necessary that a service provider fall into a single category. Whether the service provider is providing an electronic communication service or a remote computing service, or both, can change depending on the state of the message at issue. Thus, for Facebook's and Myspace's private messaging features:

> As respects messages that have not yet been opened, those entities operate as [electronic communication service] providers and the messages are in electronic storage because they fall within the definition of "temporary, intermediate storage" under § 2510(17)(A). As respects messages that have been opened and retained by [the user], ... the ... entities operate as [remote computing service] providers providing storage services under § 2702(a)(2).[141]

These categorizations do not have to be mutually exclusive. The Federal District Court for the Central District of California has held that Facebook wall posts and Myspace comments are not subject to protection as forms of temporary intermediate storage.[142] But the prohibition applicable to electronic communication service providers can still apply

138 *Theofel v. Farey-Jones*, 359 F.3d 1066, 1075 (9th Cir. 2004).
139 *Fraser v. Nationwide Mut. Ins. Co.*, 135 F.Supp.2d 623, 636 (E.D.Pa. 2001) (holding that retrieval of stored e-mail after retrieval did not violate the SCA).
140 *United States v. Weaver*, 636 F.Supp.2d 769, 772 (C.D.Ill. 2009).
141 *Crispin v. Christian Audigier, Inc.*, 717 F.Supp.2d at 987 (C.D.Cal. 2010).
142 *Id.* at 988-989.

because Facebook wall posts and Myspace comments are stored for backup as soon as they are made.[143] Additionally, Facebook and Myspace can also be characterized as remote computing service providers with respect to Facebook wall posts and Myspace comments.[144] Thus, Facebook and Myspace are both electronic communication services and remote computing services with respect to wall posts and comments, and the SCA will apply to prohibit the services from divulging the contents of such wall posts and comments.

D. Public vs. Private Issues

The prohibitions in the SCA expressly apply only to those who provide services to the public. They do not apply, for example, to companies that provide email service to their employees.[145]

Additionally, the SCA protections apply only to private communications and not those readily accessible to the general public.[146] For example, if a user's privacy setting for Facebook or Myspace is such that the general public can view Facebook wall posts or Myspace comments, then the SCA will not apply.[147] The SCA will apply, however, to protect Facebook wall posts or Myspace comments if the user's privacy settings limit access.[148] Similarly, the SCA will not apply to an Internet bulletin board where the general public could gain access simply by signing up,[149] but the SCA will apply to Internet bulletin boards that limit access.[150] Similarly, the SCA will apply to protect videos marked as "private" by a user of YouTube.[151]

E. Enforcement of the Prohibition Against Divulging Communications

There are some exceptions that allow service providers to disclose communications.[152] There is no exception, however, under the SCA for civil subpoenas.[153]

143 *Id.*
144 *Id.* at 990.
145 *Andersen Consulting LLP v. UOP*, 991 F.Supp. 1041, 1042-043 (N.D.Ill. 1998).
146 18 U.S.C. § 2511(2)(g).
147 *Crispin v. Christian Audigier, Inc.*, 717 F.Supp.2d at 991 (C.D.Cal. 2010).
148 *Id.*
149 *Snow v. DirecTV, Inc.*, 450 F.3d 1314, 1321-22 (11th Cir. 2006) ("In order to be protected by the SCA, an Internet website must be configured in some way so as to limit ready access by the general public.").
150 *Konop v. Hawaiian Airlines, Inc.*, 302 F.3d 868 (9th Cir. 2002).
151 *Viacom International Inc. v. YouTube Inc.*, 253 F.R.D. 256, 264 (S.D.N.Y. 2008). YouTube is a remote computing service provider, as it provides video storage services to its users.
152 *See* 18 U.S.C. § 2702(b). One important exception is that governmental entities can compel ECS providers to disclose communications, including those stored with social media sites, pursuant to a warrant issued using the procedures described in the Federal Rules of Criminal Procedure by a court of competent jurisdiction for communications that are in electronic storage for less than 180 days. 18 U.S.C. §2703(a). For communications that are in electronic storage for more than 180 days, a governmental entity can require RCS providers to disclose the contents of such communications by obtaining a warrant and showing probable cause just as is required in § 2703(a) and discussed above. 18 U.S.C. § 2703(b)(1). In addition to a warrant, the governmental entity can also compel disclosure of these email communications stored beyond 180 days by obtaining an administrative subpoena under § 2703(b) or a court order under § 2703(d), both of which require a lower reasonableness standard than a probable cause showing under a warrant. *United States v. Ferguson*, 508 F.Supp.2d 7, 9 (D.D.C. 2007). It is important to note that the Sixth Circuit in December 2010 held that the provisions of 18 U.S.C. §§ 2703(b) and (d) that allow for a governmental entity to compel a provider to disclose the contents of email communications stored beyond 180 days without a warrant are a violation of the Fourth Amendment and therefore unconstitutional. *United States v. Warshak*, 631 F.3d 266, 288 (6th Cir. 2010), *reh'g denied*, No. 08-3997, 2011 U.S. App. LEXIS 5007 (6th Cir. Mar. 7, 2011); *In the Matter of an Application of the United States for an Order Authorizing the Release of Historical Cell-Site Information*, 2010 WL 5437209 (E.D.N.Y. Dec. 23, 2010) (relying on *Warshak*, finding that government can only obtain location of individuals under SCA with warrant based on probable cause due to Fourth Amendment). The Sixth Circuit's rationale is based on its finding that users in most cases have a reasonable expectation of privacy in emails stored with providers such as Google even if the provider reserves the right to access the users' email for certain purposes and thus the Fourth Amendment is implicated when governmental entities compel a provider to surrender the contents of such emails. *Warshak*, 631 F.3d at 274; *United States v. Cioffi and Tannin*, 668 F. Supp. at 390 n.7; Orin S. Kerr, *Applying the Fourth Amendment to the Internet: A General Approach*, 62 Stan. L. Rev. 1005, 1029 (April 2010) ("The Fourth Amendment should generally protect the contents of communications stored in 'the cloud' of the Internet, including remotely stored files maintained on a server that is hosted for individual users."); *but see In re United States*, 665 F.Supp.2d at 1224 (stating that users do not have a reasonable expectation of privacy in emails stored with ISPs because the users voluntarily exposed email to ISPs in the ordinary course of business). Thus, in the Sixth Circuit, a governmental entity cannot obtain email communications through an administrative subpoena or a court order under §§ 2703(b) or (d), and is strictly limited to obtaining the communications through a warrant. *Warshak*, 631 F.3d at 274.
153 *Chasten v. Franklin,* 2010 WL 4065606 *2 (N.D. Cal. Oct. 14, 2010); *Crispin v. Christian Audigier, Inc.*, 717 F.Supp.2d at 975(C. D. Cal. 2010); *Viacom International Inc. v. YouTube Inc.*, 253 F.R.D. 256, 264 (S.D.N.Y. 2008); *In re Subpoena Duces Tecum to AOL, LLC*, 550 F.Supp.2d 606, 611 (E. D. Va. 2008).

Courts have quashed subpoenas that would violate the SCA if enforced[154] and denied motions to compel that would result in a violation of the SCA.[155] Moreover, courts have held that the users of the services have standing to seek to quash subpoenas directed to third-party service providers when those subpoenas seek the users' electronic communications.[156]

Additionally, the SCA provides for a civil cause of action against service providers that violate the SCA.[157] The aggrieved party may sue for both equitable relief and damages.[158] The minimum that can be awarded is $1,000; and the damages can include actual damages suffered by the plaintiff, any profits made by the violator as a result of the violation, punitive damages for willful or intentional violations, and attorneys' fees and costs.[159]

F. The Prohibition Against Access by Unauthorized Persons

In addition to barring service providers from divulging the contents of communications, the SCA also bars third parties from improperly accessing an electronic communication maintained by an electronic communication service provider. Specifically, with certain exceptions,[160] the Act prescribes criminal penalties and provides a private right of action against anyone who:

> intentionally accesses without authorization a facility through which an electronic communication service is provided; or intentionally exceeds an authorization to access that facility; and thereby obtains, alters, or prevents authorized access to a wire or electronic communication while it is in electronic storage in such system. ...[161]

This prohibition can apply to attorneys who, through improper means, gain access to protected content. In 2004, the Ninth Circuit Court of Appeals held that, in light of the SCA and the overbreadth of the subpoenas issued (they had no time or subject-matter limitations), the attorneys who issued subpoenas to the adverse parties' ISP seeking the adverse parties' email;

> "transparently and egregiously" violated the Federal Rules, and ... acted in bad faith and with gross negligence in drafting and deploying [the subpoena]. They are charged with knowledge of its invalidity. ... The subpoena power is a substantial delegation of authority to private parties, and those who invoke it have a grave responsibility to ensure it is not abused.[162]

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154 *See, e.g., Chasten v. Franklin,* 2010 WL 4065606 (N.D. Cal. Oct. 14, 2010); *In re Subpoena Duces Tecum to AOL*, 550 F. Supp.2d 606 (E.D. Va. 2008); *O'Grady v. Superior Court*, 139 Cal.App.4th 1423, 44 Cal.Rptr.3d 72 (2006).

155 *See, e.g, Federal Trade Commission v. Netscape Communications Corp.*, 196 F.R.D. 559 (N.D. Cal. 2000) (denying FTC's motion to compel).

156 *Mancuso v. Florida Metropolitan University, Inc.,* 2011 WL 310726 (S.D.Fla. Jan. 28, 2011) (plaintiff has standing to move to quash subpoenas directed to among other non-parties, Facebook and Myspace, regarding his usage); *Chasten v. Franklin,* 2010 WL 4065606 (N.D.Cal. Oct. 14, 2010) (defendant had standing to move to quash subpoena seeking emails sent from his Yahoo! email account); *Crispin v. Christian Audigier, Inc.*, 717 F.Supp.2d at 976 (C.D.Cal. 2010) (plaintiff had standing to seek to quash subpoenas directed to Media Temple, Facebook, and Myspace that sought plaintiff's communications); *J.T. Shannon Lumber Co., Inc. v. Gilco Lumber, Inc.*, Case 07-CV-00119 (N.D. Miss, Delta Div, Aug. 14, 2008) (defendants had standing to seek to quash subpoena seeking defendants' e-mail from ISP).

157 18 U.S.C. § 2707. In *Quon v. Arch Wireless Operating Co., Inc.*, 529 F.3d 892 (9th Cir. 2008), *rev'd on other grounds*, *Ontario v. Quon*, 130 S.Ct. 2619, 177 L.Ed.2d 216 (2010), a provider of text messaging services was held to be liable as a matter of law for violating the SCA by releasing transcripts of text messages.

158 18 U.S.C. § 2707(b).

159 18 U.S.C. § 2707(c).

160 18 U.S.C. § 2701(c).

161 18 U.S.C. § 2701(a) (prohibiting improper access); 18 U.S.C. § 2701(b) (criminal penalties); 18 U.S.C. § 2707(a) (private right of action).

162 *Theofel v. Farey-Jones*, 359 F.3d 1066, 1074 (9th Cir. 2004).

The trial court sanctioned the attorneys.[163] Additionally, because the ISP actually responded to the subpoena by providing some email for the attorneys to review, the Court of Appeals held that the victims could maintain civil claims against the attorneys for violating the SCA. The court stated, "The subpoena's falsity transformed the access from a *bona fide* state-sanctioned inspection into private snooping."[164] Thus, the exception under the SCA for conduct authorized by the entity providing the electronic communications service did not protect the attorneys who issued the subpoenas to the ISP.

G. Seeking to Obtain Information Without Violating the SCA

In light of the prohibitions under, and the potential for criminal and civil liability for violating, the SCA, attorneys must take care when seeking discovery of communications protected by the SCA. One obvious way to obtain communications protected by the SCA would be to subpoena or otherwise obtain them directly from the user or subscriber. Doing so would not implicate the SCA.

If it is deemed necessary to obtain protected communications directly from the service provider, then it should be done with the consent of the user or subscriber of the service. The SCA expressly allows a service provider to divulge the contents of a communication if the service provider has the consent of the originator or recipient of the communication.[165] If voluntary consent is not given, then the requesting party may have to seek a court order compelling the user or subscriber to provide the necessary consent.[166]

Obtaining consent, of course, takes time. And while the parties try to negotiate consent, or while the requesting party seeks a court order, information may be lost. For instance, the founder and administrator of one of the Internet's most popular imageboards[167] testified that threads in the site's most popular board "generally speaking" last "from minutes to hours to a few days at maximum."[168]

If there is a risk that evidence may be lost, a requesting party could place the service provider on notice that the requesting party will be seeking consent, whether voluntary or compelled, to obtain the sought-after information. The requesting party can then further request that the service provider preserve or back up the information, and offer to pay the reasonable costs associated with such preservation. Following such notice, the requesting party could contact the service provider and seek assurances that the requested information is being preserved. Sending a preservation letter to a third party, such as a service provider, however, does not necessarily impose a duty upon the third party to comply.[169] Even jurisdictions that recognize a cause of action for negligent spoliation against third parties typically require a contractual duty to preserve, or a special circumstance or relationship between the requesting party and the third party giving rise to a legal duty to preserve.[170]

163 *Id.* at 1072.
164 *Id.* at 1073.
165 18 U.S.C. § 2702(b)(3).
166 *See* Defendant Wal-Mart Stores, Inc.'s Motion to Compel Production of Content of Social Networking Sites, Case No. 1:06-CV-01958, 2009 WL 3061763 (D. Colo. May 26, 2009) (granted by minute order dated June 8, 2009, directing that "Plaintiffs shall forthwith execute consents allowing the Social Networking Sites to produce the information sought in defendant's subpoenas.").
167 An imageboard is an Internet bulletin board devoted to the posting of pictures and images.
168 Testimony of Christopher Poole, page 10, lines 18-22, *United States v. Kernell*, Case No. 3:08-CR-142 (E.D.Tenn. April 22, 2010).
169 *See The Sedona Conference® Commentary on Non-Party Production & Rule 45 Subpoenas* (2008), Section II.B.2; *Fletcher v. Dorchester Mut. Ins. Co.*, 773 N.E.2d 420, 424-25 (Mass. 2002) *available at* https://thesedonaconference.org/download-pub/69 (addressing a non-party's duty with respect to preservation).
170 *Mazloum v. District of Columbia Metropolitan Police Dept*, 522 F.Supp.2d 24, 55-56 (D.D.C. 2007).

> Absent some special relationship or duty rising by reason of an agreement, contract, statute, or other special circumstance, the general rule is that there is no duty to preserve possible evidence for another party to aid that other party in some future legal action against a third party.[171]

Some courts recognize that the duty to preserve can arise in relation to a third party when "there has been a specific request to the spoliator to preserve the evidence. ..."[172] A preservation request alone may not, however, be sufficient to trigger a third party's duty to preserve.[173]

If the court has jurisdiction over the third party, another approach would be to seek permission to issue a preservation subpoena to the service provider early in the litigation.[174] At least one court has recognized that "[i]t may be necessary to issue a preservation subpoena to a non-party when the non-party does not have actual notice of the litigation or when the non-party is a corporate entity which typically destroys electronic information by 'performing routine backup procedures.'"[175] A preservation subpoena would not compel the service provider to divulge the contents of any stored communications, but merely preserve them. The only mention in the SCA of preservation by a service provider is in the context of certain government subpoenas.[176]

IV. Review and Production

A. Review

Generally, the way in which social media data will be reviewed for discovery purposes is driven by how that data was preserved and collected and what is feasible under the circumstances. There are several possible approaches to review. One is to review the social media data in the application with which it was collected, such as commercially available APIs focused on marketing and business development purposes. Another is to load the data into an early case assessment or review tool. The choice turns on various factors, including the importance to the case of reviewing the data interactively as it appeared on the social media site and of monitoring how the content changed over time; the volume of the data to be reviewed; whether metadata was collected along with the content; and the ability of the collection application to facilitate coding and to support litigation processing and management needs (including, for example, search, sampling, Bates stamping and other endorsements, redaction, and export).

When the data volume is low or it is important to review the social media data interactively as it was originally displayed on the site or over a certain time period, it may be best to review the social media content using the API used for collection.[177] Available

171 *Koplin v. Rosel Well Perforators*, 241 Kan. 206, 208, 734 P.2d 1177, 1179 (1987).

172 *Oliver v. Stimson Lumber Co.*, 297 Mont. 336, 349, 993 P.2d 11, 20 (1999). The *Oliver* opinion relies on the holding of *Johnson v. United Servs. Auto. Ass'n*, 67 Cal.App.4th 626, Cal.Rptr.2d 234 (1998), which was abrogated in *Lueter v. State of California*, 94 Cal.App.4th 1285, 115 Cal.Rptr.2d 68 (2002).

173 *Andersen v. Mack Trucks, Inc.*, 341 Ill.App.3d 212, 217, 276 Ill.Dec. 203, 210, 793 N.E.2d 962, 969 (Ill. App. Ct. 2003) (finding no special circumstance imposing a duty to preserve evidence when a defendant sent a letter to a third party requesting preservation of the truck's hose that was allegedly the cause of the plaintiff's injury).

174 *Johnson v. U.S. Bank Nat. Ass'n*, Case No. 1:09-CV-492, 2009 WL 4682668 (S. D. Ohio, Dec. 3, 2009) (permitting issuance of a preservation subpoena to third parties prior to Rule 26(f) conference).

175 *In re Nat'l Century Fin*, 347 F.Supp.2d 538, 542 (E. D. Ohio 2004).

176 18 U.S.C. § 2704.

177 When an individual party's own social media content on a third-party site is relevant to litigation, it can undertake the review directly in its account on the third-party site to determine whether it contains potentially relevant and responsive information. *Offenback v. Bowman*, 2011 WL 2491371 n.3 (M.D. Pa. June 22, 2011).

social media marketing and brand-monitoring products can collect an entire site or a single page with its associated content, such as links to other sites and multimedia files, making the review experience similar to the experience the user had when uploading or posting content. This functionality could be important in a trademark or trade dress infringement case; for example, where the way the allegedly infringing mark is displayed throughout a site or sites and over time is critical. Similarly, interactive access may be relevant to understanding the emotional or mental state of claimants in a sexual harassment suit.[178]

Several marketing and branding-tool vendors have added review features such as search and tagging functionality to their products to address e-discovery and compliance issues. However, these tools are still evolving; and before proceeding, litigants should test the review and production features to determine if they will provide efficient review and support litigation production needs.

When large volumes of social media data are involved, it may make more sense to use an early case assessment tool to filter the social media content and a review tool to accomplish the review. Review tools, in particular, are specifically designed to facilitate efficient review, management, and production. Selecting a review tool for social media data may be particularly useful when the case team is most concerned with the text from social media sites as opposed to the way data was displayed on the social media site. Reviewing social media content in a review tool is also practical when the content was preserved and collected in a manner that rendered it more like other types of ESI such as email, enabling reviewers to utilize features such as threading and bulk tagging.

Clustering and near de-duping technology may also be helpful in identifying content from social media data that is similar to and can be grouped with other ESI such as email and loose files. This technology provides fuller context and prevents social media data from being reviewed in isolation. This functionality, which can also allow the review to proceed faster and more efficiently, is optimized when social media metadata is available.[179]

If the social media content is loaded into a review platform, it will be important to consider how the content will be organized as “documents” within the platform. For example, is the document a page, a site, a user’s page, an email message, a blog posting, or a photograph? Content may need to be parsed and reconstructed to make it manageable for review as well as to give context.

It is important to remember that most review tools are not currently programmed to mimic the interactive experience of a social media site. The difficulty in collecting metadata associated with the relevant social media content, combined with other issues such as the tendency of social media sites to incorporate content from external sites, can make using a conventional review platform to review social media content inefficient and ineffective.

B. Production

The same analysis that guides the selection of an appropriate review platform also applies to the production of social media data. The issue turns on how important it is to the case for the receiving party to be able to review the social media site data interactively and as it appeared on the social media site. When interactive review is not important, it

178 *EEOC v. Simply Storage Mgmt.,* 270 F.R.D. 430 (S.D.Ind. May 11, 2010).
179 *The Sedona Principles* at 60-66, https://thesedonaconference.org/download-pub/81.

may be sufficient to produce the social media content in a reasonably usable, searchable format with or without metadata. Currently, and especially in cases involving small amounts of social media data, static images or hard-copy print outs are commonly used for review and production.[180]

It will sometimes be important to produce the relevant social media data in an interactive format that imitates the way it appeared on the site. Production in this manner would be consistent with the concept that a reasonably usable production format is typically one that allows the receiving party to make use of data in the same or similar way as the producing party ordinarily maintained the documents.[181]

Some parties are experimenting with producing social media data in a way that enables a requesting party to make similar use of the content within the meaning of Fed. R. Civ. P. 34(b)(2)(E)(ii). One strategy may be to produce static images of the relevant sites so it is clear what the site looked like at a point in time while, at the same time, "friending" the requesting party who can then view the sites interactively; alternatively, the producing party could "friend" the judge who could perform an *in camera* review.[182] Some courts have required parties to provide their social media user names and passwords to their opponents' attorneys so the opposing counsel has direct, read-only access to the accounts.[183] Another strategy may be to give the requesting party access to certain portions of the API used for collection.

Giving the opponent direct access to a database should be a last resort when there is no other way to accomplish production and when it is critical to the litigation that the opponent have interactive and similar use of the content. Several problems arise when a user of a social media site is required to "turn over" the user name and password to the opposing party. First, doing so may violate the social media site's terms of use.[184] Second, many people use the same password for multiple sites.[185] Thus, a litigant turning over a password for a single social media site may, in fact, be handing over the password to other more sensitive websites. Third, at least one social media site has adopted protocols for detecting when users try to access their accounts from a different computer than they normally use, and respond by requiring additional "proof" that the person attempting to login is who they say they are.[186] The additional proof can come in the form of additional security questions, identifying friends in photographs, or entering a birth date.[187] Finally, requiring users to hand over control of their social media accounts presumes that all of the

180 *See, e.g., Bass*, 2009 WL 3724968 (D.Conn. Oct. 27, 2009) (production of relevant pages of Facebook in hard copy).

181 *The Sedona Principles* at 60-66, https://thesedonaconference.org/download-pub/81.

182 *McMillen v. Hummingbird Speedway*, No. 113-2010 CD, 2010 WL 4403285 (Pa. C.P. Jefferson Sept. 9, 2010); *see also Offenback v. Bowman*, 2011 WL 2491371 (M.D.Pa. June 22, 2011) (court obtained plaintiff's log-in information for Facebook and conducted in camera review to determine if the site contained relevant information); *Barnes v. CUS Nashville, LLC*, 2010 WL 2265668 (M.D.Tenn. 2010) (Magistrate Judge offering to set up a Facebook account and to "friend" friends and witnesses of the plaintiff in order to facilitate in camera inspection and expedite discovery).

183 *Largent v. Reed*, No. 2009-1823, 2011 WL 5632688 (Pa. C.P. Franklin Nov. 8, 2011) (ordering plaintiff to "turn over to Defense counsel here Facebook username email and password"); McMillen *v. Hummingbird Speedway, Inc.*, No. 113-2010 CD, 2010 WL 4403285 (Pa. C.P. Jefferson Sept. 9, 2010) (ordering plaintiff to provide Facebook and Myspace user names and passwords to defendant's counsel); *but see Piccolo v. Paterson*, No. 2009-04979, (Pa. C.P. Bucks May 6, 2011) (court denied defendants motion to compel access to plaintiff's private Facebook account postings).

184 For instance, Facebook users agree that they "will not share [their] password, . . . let anyone else access [their] account, or do anything else that might jeopardize the security of [their] account." http://www.facebook.com/legal/terms, Section 4 paragraph 8 (last visited Apr. 4, 2012). Facebook's terms of use also prohibit users from soliciting login information or accessing an account belonging to someone else. *Id.* at Section 3 paragraph 5. Similarly, Reddit's terms of use, as last revised on October 21, 2008, state that users "may not authorize others to use [their] Registration Information." http://www.reddit.com/help/useragreement (last visited Apr. 4, 2012).

185 One online survey revealed that 33% of respondents use the same password for every website that they visit that requires a password. http://nakedsecurity.sophos.com/2009/03/10/password-website (last visited Apr. 4, 2012).

186 Facebook, for instance, will block "suspicious logins," which include attempts to login from "an unusual device." http://www.facebook.com/blog.php?post=389991097130 (last visited Apr. 4, 2012). In order to proceed, the user attempting to login must "answer an additional verification question to prove his or her identity as the real account owner." *Id.*

187 *Id.*

content is discoverable. The focus essentially shifts to the forum of the medium as being relevant and away from the content itself. In addition, turning over user name and passwords also provides the opportunity for spoliation as there will be no audit trail of what was deleted or created.

V. Other Challenges to the Discovery and Use of Social Media

Although the usefulness of social media as evidence is readily apparent, there are many potential limitations on the ability to obtain such information in discovery and to use that information in adversarial proceedings. In this section, we discuss whether the use of social media information may be limited by considerations such as privacy and First Amendment issues (such as anonymous posters), unique social media issues in regulated industries, and international discovery and ethical constraints.

A. Challenges of Third Party Discovery

As discussed above, one of the primary issues may be the amount of third-party discovery needed from individual social media users and third party social media sites. In any adversarial proceeding, one should check the social media sites for information regarding their approach to responding to third party subpoenas.[188] Many include information about service of process, what information will be provided, or even fee schedules for searches. In addition, the "terms and conditions" of use for any such site may be important to gain a preliminary understanding of how the specific site has allocated risks and responsibilities regarding content, ownership, and other considerations.[189]

B. Government Use of Social Media and Social Media Collection

Government agencies are increasingly using social media to communicate.[190] As in other social networking contexts, this is a two-way interaction. Individual users can access the agencies' profiles and postings and government agencies also have access to the profiles and postings of individual users. In many litigations, a government agency is a party or it may store information as a third party. As such, a private party may seek to collect and analyze social media data through a Freedom of Information Act request or through a subpoena.[191]

C. Privacy and Anonymity

Social media sites raise a number of privacy-related issues. As with other Web 2.0 technologies, there is a risk of disclosing personal identifying information that can be used to damage the reputation or the financial or physical security of an individual.

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188 For more general information regarding an Internet Service Provider's perspective on responding to subpoenas, *see* Electronic Evidence Compliance – A Guide for Internet Service Providers (US Internet Service Provider Association 2003) available at http://publicintelligence.net/electronic-evidence-compliance-a-guide-for-internet-service-providers.

189 *See generally The Sedona Conference® Commentary on Non-Third Party Production and Rule 45 Subpoenas, available at* https://thesedonaconference.org/download-pub/78.

190 Transparency and Open Government, 74 Fed. Reg 4685 (Jan. 21, 2009) (executive departments ordered to adopt technologies to enhance public participation); *see also* The White House, http://www.whitehouse.gov, urging the public to connect with the White House using a variety of social media sites.

191 For a discussion of government use of social media and attendant risks *see* Danielle Keats Citron, *Fulfilling Government 2.0's Promise with Robust Privacy Protections*, University of Maryland School of Law No. 2009-41 available at http://ssrn.com/abstract=1493254 (last visited Apr. 4, 2012).

1. User Privacy Settings

Few cases had addressed the distinction between social media communications that the user designates as "private" and those that are publicly accessible until *Crispin v. Christian Audigier*, 2010 WL 2293238 (C.D. Cal. May 26, 2010) and *EEOC v. Simply Storage Mgmt.*, No. 1:09-cv-1223-WTL-DML (S.D. Ind. May 11, 2010), discussed above. The status of communications as "private" or "public" is important in determining whether SCA protection applies as discussed above. Thus, understanding a user's privacy settings may be crucial in conducting discovery.

In disclosing social media in discovery, there is also a consideration of protecting the privacy rights of individuals not parties to the litigation. This issue can arise, for example, when third parties have posted content on a party's social media site, which has then been requested in discovery, and the third party has the expectation that his or her information would be maintained as "private." One court has suggested, based on the user terms of service and privacy policies of popular social media sites that "no person choosing Myspace or Facebook as a communications forum could reasonably expect that his communications would remain confidential, as both sites clearly express the possibility of disclosure."[192] Assuming a court finds that privacy rights are implicated, the question arises about the steps a party must take to protect the third party's privacy rights prior to producing content involving the third party in response to a discovery request. At first blush, it may sound appropriate for the producing party to redact any third-party "private" information that is not relevant to the litigation. This would result in skyrocketing review costs, however, because of the additional review time required to identify the content and make the necessary redactions. The most prudent course of action would be to require the parties to the action to enter into a protective order or confidentiality agreement that protects the confidential nature of the parties' information and also protects the privacy of third-party private information. Additionally, parties may attempt to agree to the production of certain database fields from the social media sites that would intentionally exclude irrelevant "private" third party content.

2. Seeking the Identity of Anonymous Posters

One well-known feature of social media is the ability to post anonymous comments. This practice poses a significant challenge for those seeking to remove defamatory material but who also need to identify the anonymous posters or who seek discovery from them. The Communications Decency Act (CDA) states that "no provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider." 47 U.S.C. §230(c)(1) (2008). This provision has been used to preclude suits against Internet service providers who have been asked to remove defamatory content. Therefore, a party must proceed in a "John Doe" suit against the anonymous poster and then issue subpoenas that seek information concerning the identity of the anonymous poster.[193]

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192 *McMillen v. Hummingbird Speedway*, No. 113-2010 CD, Court of Common Pleas, Jefferson County, PA; s*ee also In re United States,* 665 F.Supp.2d 1224 (stating that users do not have a reasonable expectation of privacy in emails stored with ISPs because the users voluntarily exposed email to ISPs in the ordinary course of business); *but see Piccolo v. Paterson*, No. 2009-04979, Court of Common Pleas, Bucks County, May 5, 2011 (refusing to allow defendants' attorneys access to private Facebook postings).

193 Cases and commentators continue to discuss the scope of the CDA. At least one article has questioned whether it should be applied in the context of social media sites that could be characterized as "gossip sites." Skyler McDonald, *Defamation In The Internet Age: Why Roommates.Com Isn't Enough To Change The Rules For Anonymous Gossip Websites*, 62 Fla. L. Rev. 259 (2010).

The process of uncovering an anonymous poster's identity can be difficult as initial subpoenas may simply produce other IP addresses, requiring additional subpoenas regarding that account holder's identity and account ownership. ISPs or social media sites may notify the account holder or poster, and that person may then seek to quash the subpoena. While procedurally this can be done, a separate set of challenges arise because one cannot utilize the Rule 26 meet-and-confer process to talk to "John Doe's" counsel about the appropriate scope of electronic discovery of social media activities in the case.

Federal courts have applied different standards to determine whether an anonymous poster's identity must be disclosed. For example, the Ninth Circuit denied mandamus when the district court ordered disclosure of posters' identities.[194] In its decision in *In re Anonymous Online Speakers*, the Ninth Circuit discusses a variety of different standards employed by courts regarding protection of anonymous online speech. The Ninth Circuit found that the district court erred in applying a heightened standard requiring that the plaintiff be able to prevail on a hypothetical motion for summary judgment before learning the identity of anonymous posters, but there was no clear error in ordering disclosure of the posters' identities.[195] As stated by the Ninth Circuit:

> [W]e suggest that the nature of the speech should be a driving force in choosing a standard by which to balance the rights of anonymous speakers in discovery disputes. For example, in discovery disputes involving the identity of anonymous speakers, the notion that commercial speech should be afforded less protection than political, religious, or literary speech is hardly a novel principle.[196]

Courts may require plaintiffs to meet a higher standard when they are seeking the identities of third-party witnesses. For example, a federal district court applied a heightened standard to efforts to seek the identity of a third-party anonymous poster. In that case, the court found that the plaintiff's argument that the identity of the bloggers might assist his efforts to impeach defendant's testimony was not sufficiently compelling to outweigh the anonymous bloggers' First Amendment rights.[197]

3. Protective Orders and Sealing

There are strong common law and constitutional presumptions in favor of open courts and public access to court files that extend to the filing of pleadings and other court papers, the evidence presented in adjudication, and the bases for the judgment or verdict. Because all federal cases – and increasingly more state cases – are filed and managed electronically, with public access via the Internet, parties may fear the exposure that litigation involving social media may bring, or may use the threat of such exposure to gain unfair advantage in litigation.

In the discovery context – where there is no presumption in favor of public access – parties with significant relevant social media subject to discovery should negotiate an agreement with the other side to keep confidential any sensitive and private social media, and apply for a protective order under Fed. R. Civ. P. 26(c) that restricts the distribution of

194 *In re Anonymous Online Speakers*, No. 09-71265 (9th Cir. July 12, 2010) (discussing differences between political and commercial speech).
195 *Id.*
196 *Id.* (citations omitted).
197 *McVicker v King,* W.D. Pa., No. 09-436, 3/3/10.

the discovery to specified individuals for specified purposes. The standard for such a protective order is "good cause … to protect a party or person from annoyance, embarrassment [or] oppression."[198] If any of the social media discovery is to be filed with the court or used as evidence, the parties should negotiate, and the court approve, a procedure for lodging such discovery with the clerk subject to a determination by the court as to whether sufficient cause exists for filing the material under seal.[199] If the material has already been filed with the court, the standard for sealing the information is necessarily much higher to overcome given the presumption of public access.[200]

D. Ethical Limitations and Social Media

The use of social media by attorneys implicates various ethics rules and canons. This is true both for an attorney's personal use of social media and for understanding how social media generally affects legal practice, including its potential use as evidence.

1. Attorneys' Own Use of Social Media Through Blogging/Commenting

Attorneys should take care to ensure that their use of social media does not violate ethics rules. For example, they should be careful not to unintentionally create an attorney-client relationship through social media and make sure that any use of social media is consistent with ethics rules regarding solicitation or advertising.

Attorneys' or judges' use of social media to discuss cases or those involved in adversarial proceedings may also create an ethics issue. For example, a Florida attorney was disciplined (with a reprimand and fine) for "numerous derogatory remarks about a judge on a public Internet website."[201] An Illinois assistant public defender lost her job and a disciplinary complaint was filed concerning her blog postings that referred to a judge as "Judge Clueless" and which made reference to pending cases, allegedly revealing confidential information and sufficient information to identify participants.[202] Other attorneys have also been reprimanded or disciplined for blog entries regarding courtroom proceedings.[203] Similarly, attorneys and their employers have been sued for defamation based on anonymous online blogging.[204] Judges using social media have also caught attorneys in misrepresentations.[205] Judges, too, have been admonished for Internet postings.[206] Several states have issued ethics opinions regarding judges' use of social media.[207]

198 Fed. R. Civ. P. 26(c)(1)
199 Fed. R. Civ. P. 26(c)(1)(H).
200 *See generally*, *The Sedona Guidelines on Confidentiality and Public Access* (March 2007), https://thesedonaconference.org/download-pub/478.
201 *See Supreme Court Disciplines 33 Attorneys*, Jan. 22, 2009, http://www.floridabar.org/TFB/TFBPublic.nsf/WNewsReleases/31ecd17b99b806a485257546005a210f!OpenDocument (last visited Apr. 4, 2012) *A Legal Battle for Lawyers-Online Attitude vs. Rules of the Bar* NYTimes.com Page 1 of 3. http://www.nytimes.com/2009/09/13/us/13lawyers.html (referring to judge as "Evil, Unfair Witch").
202 *In the Matter of: Kristine Ann Peshek*, No. 6201779, https://www.iardc.org/09CH0089CM.html.
203 California Bar Journal Discipline Summaries, http://members.calbar.ca.gov/search/member_detail.aspx?x=185591 (attorney suspended and fined for not disclosing that he is an attorney during jury selection and blogging about trial while serving as juror); *Judge Reprimands Temp Prosecutor for Personal Blog*, Apr. 28, 2006 (temporary district attorney reprimanded by Court for blog postings re opposing counsel called "juvenile, obnoxious and unprofessional")(last visited Apr. 4, 2012).
204 *See Ward v. Cisco* (defamation case based on anonymous Patent Troll Tracker blog entry later attributed to in-house Cisco attorney Richard Frenkel).
205 *Facebooking Judge Catches Lawyer in Lie*, Sees Ethical Breaches, ABA Journal, July 31, 2009 (attorney requested continuance based on death of father but Facebook postings showed parties and other activities).
206 *In re Complaint of Judicial Misconduct*, No. J.C. No. 03-08-90050 (Judicial Council of the Third Circuit, June 5, 2009); http://www.upi.com/Top_News/US/2010/04/07/Judge-sues-over-alleged-Internet-remarks/UPI-64921270686534 (last visited Apr. 4, 2012).
207 The Supreme Court of Ohio, Board of Commissioners on Grievances and Discipline, Opinion 2010-7 (Dec. 3, 2010) (judges' social media use is permitted and providing guidelines); Florida Supreme Court Judicial Ethics Advisory Committee, Opinion No. 2009-20, Nov. 17, 2009 (judges may not add lawyers who appear before them as "friends" on a social networking site).

2. Attorney Understanding of Social Media as Potential Evidence

Lawyers should be aware of the potential risks to a client from using social media in legal proceedings. Among their duties are those of competence (ABA MR 1.1) and confidentiality (ABA MR 1.6). The disclosure or use of metadata has been discussed in a variety of publications, usually in the context of documents or email. However, metadata concepts can also appear in the context of social networking. For example, geotagging may permit someone to know where a phone was active or a picture taken.[208] Similarly, metadata may be critical to determining the actual author or poster to a social media site.

As part of the duty of confidentiality, attorneys must also consider the possibility that various proceedings will be posted on social media or networking sites. For example, attorneys may need to make clear that videotaped depositions are "attorney's eyes only" and may not be posted on YouTube.[209]

Finally, as in other areas, counsel must be careful regarding the receipt of confidential or privileged information. For example, ABA Formal Op. 05-437 requires a lawyer who received privileged or confidential documents to "promptly notify the sender in order to permit the sender to take protective measures." This may be more difficult in the context of social media where the origin of the information may be unclear. In the context of litigation, counsel may be able to notify opposing counsel and the court. However, in a pre-litigation context, the "sender" whom the attorney should notify pursuant to the rules may not be obvious, or the attorney may receive materials on an unauthorized basis, such as anonymous documents digitally transmitted through a social media site.[210]

The lawyer's difficulties may be compounded if the attorney learns that the client has improperly gained access to an opposing party's social media content or accounts. Several state bar ethics committees have addressed situations where attorneys learn that a client has access to secret materials of an adversary and they have identified a variety of different courses of action, including advising the client that materials cannot be retained or withdrawing from the representation.[211] Courts have disqualified counsel when they received information under suspect circumstances.[212]

3. Attorney Use of Social Media for Formal and Informal Discovery

Attorneys who use social media sites for investigation must remember that the ethical rules and Rules of Professional Conduct do not change simply because social media sources are involved. When investigating witnesses and even potential jurors, an attorney may wish to view the witnesses' or jurors' social media sites.

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208 *Web Photos That Reveal Secrets, Like Where You Live*, Aug. 11, 2010, http://www.nytimes.com/2010/08/12/technology/personaltech/12basics.html (last visited Apr. 5, 2012).

209 *Judge Orders Counsel to Remove Deposition Excerpt From YouTube*, Dec. 9, 2008, http://www.law.com/jsp/article.jsp?id=1202426579607 (last visited Apr. 4, 2012); *Was That a Yes or a No? Depositions in the YouTube Era*, Latham and Watkins, June 2010, http://www.lw.com/Resources.aspx?page=FirmPublicationDetail&searchText=youtube&publication=3547&globalsearchtype=8191 (last visited Apr. 4, 2012).

210 *See* ABA Formal Op. No. 94-382 (07/05/1994) and Model Rule 4.4(b).

211 Phila. Bar Ass'n., Prof'l Guidance Comm., Phila. Ethics Op. 2008-2, 2008 WL 1849685 (Mar. 2008) (attorney who learns client has access to potentially damaging e-mails between opposing party and opposing lawyer must do more than refuse to discuss (husband's access to his ex-wife's email)); Florida Bar Professional Ethics Comm., Op. 07-01 (Sept. 2007) (lawyer whose client improperly obtains opponent's confidential materials must advise client that the materials cannot be retained or used without informing the opposing party).

212 *See, e.g.*, *Castellano v. Winthop*, 27 So.3d 134 (Fla.Dist.Ct.App. 5th Dist. 2010) (firm disqualified after spending more than 100 hours reviewing attorney-client communications and other confidential information from flash drive that client took from opposing party).

A common feature of many social media sites is the ability of users to limit and control access to the content they post.[213] Thus, a lawyer may know that a social media site exists but not be able to access it. While tempting, it may be a violation of the Rules of Professional Conduct for a lawyer to request greater access to a user's account under pretext, without being forthright about the request and fully disclosing the purpose of the request.[214]

Also, the rules limiting discovery apply equally to requests for social media content. While social media provides additional discovery opportunities, misunderstanding social media can lead to discovery abuses. Social media sites have become a substitute for diaries, letter writing, and photo albums. Sending physical copies of photographs to friends and family is becoming obsolete as people share photographs through their social media sites. Similarly, sending several postcards during a vacation may become a thing of the past as users are able to send and post personalized photographs and messages about their vacations through their social media sites using smart phones and other web-enabled devices.

Attorneys should keep in mind the potential breadth of information that can be contained on a social media site. Discovery requests seeking the entirety of a person's social media site without any date or subject-matter restriction can be akin to asking for every photo album that a person has access to, or asking for copies of every letter that the person has ever sent or received. Thus, discovery requests seeking social media content should be narrowly tailored to seek only relevant information. After all, when signing a request for production, attorneys certify that the discovery sought is "not interposed for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation," and "neither unreasonable nor unduly burdensome or expensive. ..."[215]

4. Juror's Use of Social Media

The use of social media by jurors can also result in old problems in a new context. Jurors' unauthorized use of social media has jeopardized cases and can result in a mistrial. This includes jurors using social media to comment about pending trials,[216] and jurors using social media sites to investigate the litigants and discover information about the case.[217]

In light of this problem, courts have begun tailoring their jury instructions to specifically address the juror's use of social media sites.[218] In fact, in 2010, the Committee

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213 *See Crispin v. Christian Audigier, Inc.*, 717 F. Supp.2d 965 (C.D.Cal. 2010) (addressing limited access to Facebook and Myspace content); *Viacom International Inc. v. YouTube Inc.*, 253 F.R.D. 256, 264 (S.D.N.Y. 2008) (addressing limited access to a user's YouTube content).

214 The Philadelphia Bar Association Professional Guidance Committee, in Opinion 2009-2, opined that sending an anonymous friend request to a witness's Myspace and Facebook accounts for the purpose of gaining access to information that is not available to the general public would violate Rules 4.1 and 8.4(c) of the Rules of Professional Conduct. Model Rule 8.4(c) in particular provides that "i[t] is professional misconduct for a lawyer to ... engage in conduct involving dishonesty, fraud, deceit or misrepresentation. ..." *See also* New York City Bar Formal Opinion 2010-2. ("A lawyer may not attempt to gain access to a social networking website under false pretenses, either directly or through an agent." However, "an attorney or her agent may use her real name and profile to send a 'friend request' to obtain information from an unrepresented person's social networking website without also disclosing the reasons for making the request.").

215 F.R.C.P. 26(g)(1)(B)(ii) & (iii).

216 *See U.S. v. Fumo*, 2009 WL 1688482, *58-67 (E.D.Pa. 2009) (juror posting vague comments on Facebook, Twitter, and blogs tangentially related to his jury duty not grounds for removal of juror).

217 *See United States v. Bristol-Martir*, 570 F.3d 29 (1st Cir. 2009) (juror's Internet research related to the applicable law grounds for setting aside conviction and remanding for new trial); *People v. Wadle*, 77 P.3d 764 (Colo.App. 2003), *aff'd*, 97 P.3d 932 (Colo. 2004) (juror's Internet research about anti-depressant medication taken by defendant was grounds for vacating conviction and a remanding for new trial); *Wilgus v. F/V Sirius, Inc.*, 665 F. Supp.2d 23 (D. Maine 2009) (juror "friending" plaintiff and viewing plaintiff's Facebook page after verdict and judgment entered was sufficient to require investigation into juror misconduct, but not grounds for new trial).

218 *See, e.g., Martin v. Royce*, 2010 WL 2521063 (N.D.Ind. 2010) (jury instructed not to consult "reference materials ... the internet, websites, blogs" and not to communicate with others about the case on their "cell phone, through e-mail, BlackBerry, iPhone, text messaging, or on Twitter, through any blog").

on Court Administration and Case Management of the Judicial Conference published and circulated to United States District Court judges a suggested jury instruction that specifically instructs jurors that they are prohibited from using these technologies in the courtroom, in deliberations, or outside the courthouse to communicate about or research cases on which they currently serve.[219]

219 The proposed instruction is available at http://www.uscourts.gov/newsroom/2010/DIR10-018.pdf (last visited Apr. 4, 2012).

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