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abtl REPORT

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Cost of Proof Sanctions: The New Attorney's Fees

Win, lose or draw, the Code of Civil Procedure provides an effective means for recovering a portion of your client's fees when you have successfully proved a fact denied by your opponent in requests for admission discovery. A case strategy that includes a well-thought-out plan for drafting requests for admission can use this powerful and effective tool to shift attorney's fees even in the absence of a contractual attorney's fee provision or applicable fee-shifting statute. The responding party needs to pay careful attention to the language in the response to avoid a substantial fee bill at the end of the case.

Hon. Beth L. Freeman

What Are Cost of Proof Sanctions?

Cost of proof sanctions are attorney's fees and costs expended proving the truth of certain matters denied in response to requests for admission ("RFAs"). Code of Civil Procedure section 2033.420 provides "if a party fails to admit…the truth of any matter when requested to do so,…and if the party requesting that admission thereafter proves…the truth of that matter, the party requesting the

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Cross-Examinations in Securities Arbitrations

Securities arbitrations, particularly securities arbitrations conducted under the Code of Arbitration Procedure of the Financial Regulatory Authority ("FINRA," formerly the National Association of Securities Dealers or "NASD"), are remarkably different than litigating in court. For one thing, FINRA arbitrators are not even required to follow the law. Instead, as The Arbitrator's Manual makes clear, "they are guided in their analysis by the underlying policies of the law and are given wide latitude in their interpretation of legal concepts." Procedural defenses like the statute of limitations, even on facts that would be a slam dunk in court, are often ignored. Meanwhile, most of the decision-makers are not even lawyers. Typically, the chair of a three-person FINRA panel has a law degree, but the other two panel members often do not. These two differences, in themselves, make securities arbitrations uniquely unpredictable and uncertain. The phenomenon of non-lawyers applying non-law to facts that are often quite intricate is not something to which most litigators are accustomed.

Robert Stumpf

To make things even more interesting add in one more thing: unlike most litigation, there is almost never an opportunity to take depositions of lay witnesses or even experts in a FINRA arbitration. Anything is possible, of course, by stipulation. But depositions by stipulation are, in my experience, few and far between. The FINRA rules do not provide for depositions and, absent extraordinary circumstances, such as the need to perpetuate testimony from a witness who is seriously ill, FINRA arbitration panels almost never permit pre-hearing depositions.

On this tilted but crucial playing field, what can be

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admission may move the court for an order requiring the party to whom the request was directed to pay the reasonable expenses incurred in making that proof, including reasonable attorney's fees." The Discovery Act compels judges to award these sanctions unless they find any of the following: (1) an objection to the request was sustained or a response to it was waived by failing to move for an order compelling further response; (2) the admission sought was of no substantial importance; (3) the party failing to make an admission had a reasonable ground to believe that that party would prevail on the matter; or (4) there was other good reason for the failure to admit. Code Civ. Proc. § 2033.420(b).

Simply put, attorney's fees are back on the table even where your contract is silent on the issue or your claim does not provide attorney's fees as an element of damages. The Discovery Act imposes a far greater monetary sanction for denying a fact later proved at trial than it does for other discovery abuses. Indeed, attorney's fees are even available to the party that lost the jury verdict, if it incurred costs in proving facts about which there was no reasonable ground for dispute (for example, authenticity of photographs). *Smith v. Circle P. Ranch Co., Inc.*, 87 Cal. App. 3d 267, 276 (1978) (affirming $30,500 award to party that lost the lawsuit).

In *Cembrook v. Superior Court*, 56 Cal. 2d 423, 429 (1961), decided along with the five other seminal cases interpreting the 1957 Discovery Act from which section 2033.420 descends, the Supreme Court distinguished RFAs from other forms of discovery under the Discovery Act. The Supreme Court explained that whereas most other discovery procedures are aimed primarily at assisting counsel to prepare for trial, requests for admission are primarily aimed at setting to rest a triable issue so that it will not have to be tried — the purpose is to expedite the trial. The basis for imposing sanctions is thus directly related to this purpose. *See Brooks v. American Broadcasting Co.*, 179 Cal. App. 3d 500, 509 (1986).

How Broad Can RFAs Be?

The Discovery Act places no limit on the scope of RFAs. In the *Cembrook* case, the Supreme Court approved a broad scope including requests for admission of controversial matters, complex facts, and matters of opinion. *Cembrook*, 56 Cal. 2d at 429. In addition to establishing the genuineness of documents, truth of specific facts, opinions related to facts, application of law to fact or matters in controversy, all of which are expressly covered in section 2033.010, RFAs can be used to seek admissions on ultimate issues in a case. In fact, it is proper to ask a party to admit that he cannot establish causation, that defendant is not liable for the harm alleged in the complaint, or that plaintiff suffered no damages. *See Demyer v. Costa Mesa Mobile Home Estates*, 36 Cal. App. 4th 393, 396 n.8 (1995). Additionally, RFAs are not limited to matters within the personal knowledge of the responding party. The Discovery Act requires that a reasonable investigation be conducted before answering the RFA, using available sources of information. *See Wimberly v. Derby Cycle Corp.*, 56 Cal. App. 4th 618, 634 (1997); *Brooks*, 179 Cal. App. 3d at 510.

Strategy in Propounding and Responding to RFAs

As the propounding party, you are virtually unfettered in your creation of the RFAs. It is proper to seek admission of small points, and ultimate issues in the case.

Serving RFAs early in the case can catch your opponent off guard. It is not enough for a denial that discovery has not been completed or that experts have not been retained. Early RFAs may, however, cause a party to respond with blanket objections in order to either buy time or to divert attention away from the obligation to admit or deny the matter. It is important to recognize that if your motion to compel further responses is not timely filed within 45 days of the response, you will have waived your right to a further response and the opportunity to seek sanctions for the cost of proof.

Strategy in responding to RFAs is complex. First, it is imperative that you make a timely response. As one court commented, "The law governing the consequences for failing to respond to requests for admission may be the most unforgiving in civil procedure." *See Demyer,* 36 Cal. App. 4th at 394. If no responses are served, the propounding party may file a motion to deem the matters admitted, which will be granted unless a response is served by the time of that hearing. *See Courtesy Claims Service, Inc. v. Superior Court*, 219 Cal. App. 3d 52 (1990). The *Demyer* court articulates in grim detail the consequences of failing to respond to the RFAs by the time of the hearing on a motion to deem admissions. Stating "But woe betide the party who fails to serve responses before the hearing" (*id.* at 395), the Court of Appeal held that the trial court must, without discretion, grant the motion, which often has fatal consequences for the defaulting party. There is no relief available for failure to respond by the time of the hearing to deem admissions. Calling it the "two strikes and you're out" rule of civil procedure, the *Demyer* court cautions that a malpractice case is certain to follow. *Id.* at 396. The only tidbit of relief that the *Demyer* court offered was to hold that a motion to deem admissions may not be heard on shortened time. *Id.* at 399.

Second, you have an affirmative duty to conduct a reasonable investigation so that you can respond. Moreover, if you give anything other than an unequivocal admission, you are obligated to state the facts upon which you base your denial. It is not enough to say that the matter is hotly contested or to rely on the pleadings to support your denial. *Brooks*, 179 Cal. App. 3d at 510.

Third, you are advised to consider admitting matters that you know you cannot refute at trial, even if it means abandoning a portion of your claim. Sometimes it is best to let go of grandiose claims to avoid the inevitable loss and payment of attorney's fees.

Obtaining Cost of Proof Sanctions

After summary judgment or trial where you have

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proved the truth of matters denied in response to your RFAs, you can seek sanctions in the amount of the fees and costs expended to prove the matters. There is no statutory time limit for filing such a motion. Trial courts have discretion to consider the motion at any time and the Court of Appeal will uphold that decision absent abuse of discretion. *London v. Dri-Honing Corp.*, 117 Cal. App. 4th 999, 1002 (2004). (In an unpublished opinion, the Court of Appeal recently upheld a discovery sanctions motion brought more than one year after trial, deferring to the trial court's exercise of discretion. *See McNamee v. Stewart*, 2007 Cal. App. Unpub. LEXIS 7787.)

When you file your motion, be careful to articulate the tasks required to prove the matters denied. It is not helpful to the court for you to submit your time sheets for the entire trial and expect the judge to sift through your entries. Best practice would dictate that you submit an affidavit outlining the tasks performed to prove each matter and the time associated with those tasks. For example, you might state that you were required to take three depositions, hire an expert witness, prepare for trial and devote two trial days to proof that your client was not liable. In the rare case, you might properly request all costs associated with the case. *See Abdullah v. United Savings Bank*, 43 Cal. App. 4th 1101, 1111 (1996) (apportionment pursuant to Civil Code section 1717 was not required upon proof that the compensable claims were "inextricably intertwined" with non-compensable claims). As one court stated in an unpublished opinion, "the requests were so thoroughly related to the essence of the case that all fees and expenses incurred through the time of trial were necessarily costs of proof within the meaning of Code of Civil Procedure section 2033.420." *See Manhattan Banker Corp. v. Retamco Operating Co.*, 2008 Cal. App. Unpub. LEXIS 4535.

In cases where you are entitled to only a portion of your fees and expenses, the trial court is required to make the apportionment and to use its discretion to assign a reasonable percentage to the compensable time even if you submit an undifferentiated request. *See Bell v. Vista Unified School District*, 82 Cal. App. 4th 672, 689 (2000). If you choose not to quantify the time expended on tasks devoted to proof of the matters denied in the RFA, you will be subject to the determination of the trial judge whose apportionment will be granted great deference by the Court of Appeal. In *Track Mortgage Group, Inc. v. Crusader Ins. Co.*, 98 Cal. App. 4th 857, 868 (2002), the Court of Appeal upheld the trial court's apportionment of fees noting that "the trial court is the best judge of the value of professional services rendered in its court. The only proper basis for reversal of a fee award is an award so large or so small that it shocks the conscience and suggests that passion or prejudice influenced the result." (citation omitted).

And again, consider serving RFAs early. Fees and expenses are compensable only for the time expended after

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Court-Sponsored ADR Programs

Resolution of a business dispute through the litigation process is generally an unpleasant experience for clients. Litigation is time-consuming, expensive and often has a negative impact on important business relationships. Alternative Dispute Resolution ("ADR") procedures often provide faster, less expensive, and more effective settlements. As a result, ADR has become an increasingly popular method for resolution of business disputes. Although many cases go to private mediation or arbitration, business litigators should also be aware of court-sponsored ADR programs, many of which can provide significant cost-savings to clients in an appropriate case. This article will explore the court-sponsored ADR programs of three Bay Area Superior Courts: San Francisco, San Mateo and Santa Clara.

Jeniffer Alcantara

San Francisco

The San Francisco Superior Court commenced ADR services in the early 1980s. Almost 30 years later, the court continues to serve the needs of the business community by offering three primary forms of ADR: judicial arbitration, mediation, and settlement conferences. The most popular method of court-sponsored ADR in San Francisco for business disputes is mediation, followed by participation in the Early Settlement Program.

Mediation is an attractive alternative to litigation because of the numerous advantages it provides. Mediation is often more cost effective because it offers parties the opportunity to engage in resolution before substantial funds are expended. A successful mediation can minimize the disruption to business, decrease the potential for future conflict and preserve important business relationships. Additionally, the parties have greater control over the timing of mediation than in litigation as overloaded dockets can often lead to delays in a trial. Finally, mediation allows the parties to create a settlement that includes types of relief that may not be possible to obtain through the traditional litigation process. In this sense, mediation participants can achieve a "win-win" settlement of their dispute that may not otherwise be available.

San Francisco maintains three mediation programs for general civil cases: Judicial Mediation, the Voluntary Civil Mediation Panel, and Mediation Services at the Bar Association of San Francisco. The three programs vary in that they offer different types of mediators, distinct options of coordination, and contrasting fee arrangements.

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The *Judicial Mediation Program* offers mediation with a San Francisco Superior Court judge familiar with the area of law that is the subject of the controversy. Cases that are considered for participation in the program include, but are not limited to, professional malpractice, construction, employment, insurance coverage disputes, mass torts and complex commercial litigation. The ADR Administrator reviews stipulations to judicial mediation and coordinates the assignment to a judicial officer. Significantly, this program may be utilized at any time throughout the litigation process and is offered at no cost to the parties.

If the parties prefer a professional mediator, the court offers litigants the option of utilizing its *Voluntary Civil Mediation Panel*, which consists of 70 court-approved mediators with various areas of expertise. Parties can be assured that they are receiving quality mediation services since the court has pre-screened the 70 mediators who make up the panel. The court reviews each panel applicant's training, experience and qualifications before approving the applicant for inclusion on the list. To utilize the panel, parties must mutually agree to a mediator and then coordinate the scheduling arrangements themselves. Mediators on the panel are paid at their regular market rates.

Valerie Berland

A third mediation option, *Mediation Services* at the Bar Association of San Francisco ("BASF"), offers an experienced mediator at a reduced rate. Mediation Services was created through a coordinated effort between the court and BASF. A pre-screened mediator provides three free hours of service; thereafter parties may agree to continue with the mediator at the listed hourly market rate. Experienced BASF staff can help parties select a mediator who best meets the needs of their case and can offer suggestions of mediators who specialize in a particular type of business dispute. BASF charges an administrative fee for each party participating in the program.

If mediation is not the preferred choice, business litigants often will opt to participate in the *Early Settlement Program* ("ESP"). ESP was created through a partnership between the court and BASF as part of the court's settlement conference calendar. Matters are heard before a two-member volunteer attorney panel, balanced with plaintiff and defense attorneys with a minimum of 10 years of trial experience. BASF staff handles the administration of the program and will notify the parties of the details of assignment and scheduling. Although the services of the ESP panelists are provided at no cost to the parties, there is an administrative fee payable to BASF for coordination of the program.

The San Francisco Superior Court's ADR Program settlement rate has remained fairly steady throughout the last few decades. More than half (67%) of the cases participating in ADR reach a settlement. With the variety of ADR programs offered, and the clear advantages to litigants involved in a business dispute, the only question that remains is which ADR alternative best fulfills the needs of a particular case.

San Mateo

Established in 1996, the San Mateo Superior Court's Civil ADR Program acts as an ADR resource, giving litigants an early opportunity to resolve their dispute before making a substantial financial and emotional commitment to the litigation process. This voluntary, market-rate program provides counsel and litigants with panels of mediators, arbitrators and neutral evaluators who have been pre-screened for specialized training and experience. For litigants who may have difficulty affording ADR services, fee waivers or reduced fees can be arranged after an income-based screening is conducted.

Similar to San Francisco, mediation is by far the ADR process most often utilized in San Mateo Superior Court cases (96%). Parties are welcome to choose one of the 125 panelists affiliated with the court's program or someone not affiliated with the program, as long as all parties are in agreement. Attorneys can view panelists' *curricula vitae* on the court's website and can run computer searches using different criteria to find a mediator who might work well for their case. (All Civil ADR Program materials are posted on the court's website at: www.sanmateocourt.org/adr/civil.) ADR staff encourages parties to mediate early; however, the specific timing of the mediation session is left up to the parties, because they best know when they are fully prepared for serious settlement negotiations.

The program receives approximately 700 cases per year, one-quarter to one-third of which are business-related disputes. There has been a noted up-tick in attachment efforts recently, with attorneys being very conscious of potential business failures and wanting to secure assets for their clients pending trial. Mediation continues to be the preferred ADR approach for these cases as well.

One of the unique aspects of San Mateo's program is that a member of the court's ADR staff meets with counsel immediately following their case management conference hearing ("CMC"). During the "ADR referral" meeting, counsel not only receive instruction on getting their case to mediation, but are also afforded the opportunity for face-to-face discussions regarding how the case is likely to proceed with respect to the timing of the mediation, scheduling of key depositions and other discovery to be completed. The court's active role in steering parties to mediation can take the pressure off any one party who might be concerned that suggesting mediation at such an early juncture will be misinterpreted as a sign of weakness or doubt about their case.

Once the parties stipulate to mediation at their CMC hearing, the court then orders the case to mediation and works to ensure that parties follow through with their commitment. Some observers attribute both an increase in settlement rates and compliance with program proto-

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cols to recent new rules that empower court ADR staff to set order to show cause hearings. However, because the Civil ADR Program is a voluntary program, it relies more on education and encouragement than on actual sanctions and enforcement.

The San Mateo Superior Court is unique among other Bay Area trial courts in that its complex litigation judges directly refer complex litigation cases to the court's ADR program. Unlike in general civil matters, the complex litigation judges often wait until the issues in a case have been clarified and certain motion work completed before formally referring the case to the program. The ADR referral is often timed in conjunction with certain watershed events in a case (*e.g.*, class certification motions, key discovery rulings, summary judgment motions, etc.). These extended time frames require more direct communication between court ADR staff and the assigned judge regarding the timing of the referral and the parties' willingness to participate.

Over the years, program settlement rates have been remarkably consistent and have remained high (67%), as have satisfaction rates, both with the court's program (86%) and with individual ADR providers (78%).

Santa Clara

The expansion of the Santa Clara County Superior Court ADR program was initiated in 1998. The new program was created through a partnership of the bench, bar and other members of the local community. There is also a Court ADR Committee, which periodically reviews the program's improvements and revisions. The Committee is composed of litigators and neutrals, partners from small and large law firms, community ADR staff, court staff and judges, providing broad-based cooperation, support and input. Similar to other Bay Area superior courts, Santa Clara offers a range of ADR options to litigants in general civil cases, including judicial arbitration, mediation, neutral evaluation, and early settlement conferences. The majority of cases that participate in the civil ADR program elect mediation (61%).

The *Civil Division ADR Panel* lists mediators, private arbitrators and neutral evaluators, both attorneys and non-attorneys, who provide services at market rates. The court screens the panelists for training, experience and skills. Parties may stipulate to ADR and select a neutral from the court's list, or may choose a neutral from any other mutually agreeable source. Each court-screened neutral's listing on the court's website includes a one-page *curriculum vitae*, which outlines the neutral's training, experience, and process style. Like San Mateo County's list, this web-based resource is a searchable database that allows parties to select a neutral to fit their particular requirements. Mediation has always been a good choice for cases where parties may have strong motivations or principles underlying a particular viewpoint. In such cases, a strong neutral negotiator can help elicit information that might be driving a party away from settlement, and allow each party to come to a better understanding of the results of their choices. This type of intervention is helpful in many business and contract-based disputes.

The *Civil Early Settlement Conference* ("CESC") panel was launched in spring 2008. This panel provides attorney neutrals who host settlement conferences held outside the courthouse, usually at the neutral's office. The court pays neutrals from the same fund and at the same rate as judicial arbitrators. CESC is a good choice for cases where each party has a fairly good grasp of the facts and values in the case, and is prepared to begin negotiations.

The *Judges ADR* ("JADR") Program is a revamped service that was originally started in early 2001. The rules were amended and the program was re-launched as Judges ADR in early 2008. Civil judges are available to host settlement conferences or mediations, depending on the stipulation of the parties. Sessions are held at the courthouse. There is no charge for this service, which provides direct intervention time with a judge early in the life of a case. Parties must complete a special stipulation form and be approved for the program by the Civil Supervising Judge. Cases ideally suited to this program are those that would, if taken to trial, consume significant court resources, or cases wherein a judge's expertise and neutral viewpoint may help parties better understand the strengths and weaknesses of their case.

Elizabeth Strickland

In Santa Clara County Superior Court, an ADR referral is initiated when an ADR Information Sheet is given to a plaintiff in a new case. The plaintiff must serve the form on the defendant. During the first CMC appearance 120 days after filing, the judge will ask parties to select an ADR option. A new court date will then be set for an ADR review hearing. If parties are able to choose an ADR process, a neutral and an ADR session date at least five court days before their first CMC, the court will continue the CMC for 90 days to allow parties time to complete ADR.

Referral to any type of ADR other than judicial arbitration is completely voluntary; parties also may stipulate to judicial arbitration. In some circumstances judges may order parties to judicial arbitration, but that practice is slowly changing and may discontinue at some point.

Over the last three fiscal years, the ADR program results have been promising in Santa Clara. Seventy-two percent of the cases participating in mediation fully settle. Of the participants who elect to mediate, 96% were willing to use mediation again. Eighty-seven percent of parties give the process a score of four or five (with five being the highest rating). Although it is still too early to meaningfully analyze the results in the CESC and JADR Programs, early feedback has been very positive. It is anticipated

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that both CESC and JADR will continue to grow as each program in its own way serves the needs of both litigants and counsel.

The advantages of ADR, regardless of the process, are fully recognized when ADR is implemented as early as possible in the life of a dispute. ADR is often most useful after some, but not all, of the discovery has been conducted and parties have explored their respective positions. Because a vast majority of cases settle before trial, it is sensible to try to resolve the case part way through the litigation process rather than on the eve of trial. With the number of ADR options available within and between Bay Area superior courts, business litigators should be able to find an ADR process that will assist them in achieving a final resolution to their case more quickly and inexpensively for their clients than if they had proceeded to trial.

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Cost of Proof Sanctions

the denial is served. *Garcia v. Hyster Co.*, 28 Cal.App. 4th 724, 736 (1994).

Defending Against Cost of Proof Sanctions

Not all matters denied will engender fee awards. First, the matter must be "proved." If you stipulate that the matter is true before trial then no cost of proof fees are allowed. Although your opponent has expended time to be ready to prove the matter, the court will not award fees. *See Stull v. Sparrow*, 92 Cal. App. 4th 860 (2001). Additionally, fees are not appropriate for trial preparation where the case settles before trial. *See Wagy v. Brown*, 24 Cal. App. 4th 1, 6 (1994). But fees are proper when a matter is proved by summary judgment. *See Barnett v. Penske Truck Leasing Co.*, 90 Cal. App. 4th 494 (2001).

Second, you may be able to defeat a fee motion if, after an initial denial, you file a supplemental response containing information that you were unable to obtain through a reasonable investigation at the time of the denial. This approach is somewhat controversial because under the Discovery Act there is no obligation or necessarily any right to file supplemental responses. It is not clear whether a supplemental response that provides an admission or evidence to support a reasonable belief that you will prevail on the matter will suffice. At least one Court of Appeal has urged trial courts to consider this factor in assessing whether there were good reasons for the denial. *See Brooks*, 179 Cal. App. 3d at 510-11.

Finally, and most often, the grounds for opposing cost of proof sanctions are the grounds set forth in section 2033.420. Sanctions are allowed only if the matter is of substantial importance. In *Brooks*, the court held that the matter must have some direct relationship to one of the central issues of the case, *i.e.*, an issue which, if not proven, would have altered the outcome of the case. *Brooks*, 179 Cal.App. 3d at 509.

You can defeat sanctions if you can persuade the court that you had reasonable ground to believe you would prevail at trial. This can be tricky, however. In order to prevail, you must demonstrate that you conducted a reasonable investigation of the facts at the time of your denial and that your investigation pointed to success. Moreover, you must put on evidence to prove that matter at trial. Compare the outcomes in *Wimberly* and *Brooks*. In the *Wimberly* case, defendant denied an RFA seeking an admission that the defect in defendant's product was the proximate cause of plaintiff's injury. Defendant relied upon the opinion of an expert who he later failed to produce at trial. Absent any evidence tending to disprove causation, the Court of Appeal held that cost of proof sanctions were required and it reversed a trial court ruling denying fees under section 2033.420. In contrast, in the *Brooks* case the defendant denied an RFA regarding the location of a bus vis-a-vis the center line of the highway. At trial defendant produced a witness who testified that the bus was over the center line. Although the jury found otherwise, the Court of Appeal upheld a denial of sanctions where the party had a good reason for denying the request for admission and produced a witness at trial to support his denial. Failure to prevail on the matter was not relevant to the award of sanctions. *Id.* at 513.

You may also be able to defeat a sanctions motion where the matter you denied called for a binding admission on the basis of hearsay. *See Weil and Brown, Civil Procedure Before Trial*, ¶ 8:1345 (2006). In such a case, the best response would be that the party is unable to admit or deny the matter and therefore denies the matter. It is recommended that upon such a denial, an explanation be given that the RFA calls for an admission based upon hearsay. (Additionally, sanctions have been rejected in an unpublished case where the responding party denied RFAs that asked a party to admit that another party testified truthfully about his intentions and motivations. In affirming the denial of sanctions, the Court of Appeal reasoned that one party cannot make a binding admission about the state of mind of another party. *Law Offices of Bruce E. Krell v. Ross*, 2007 Cal. App. Unpub. LEXIS 10110.)

Word to the Wise

Use requests for admission as a fee-shifting mechanism. The benefit to the court is an increase in efficiency. Send them out early in the case and do not be afraid to seek admission of ultimate facts. Ask the defendant to admit that he is liable. Ask the plaintiff to admit that she suffered no damages or that there were no trade secrets. Often these broadly worded RFAs will produce a single

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HOWARD M. ULLMAN

On ANTITRUST

The question of the Sherman Act's application to bundled product discounts has vexed courts for some time. In a recent decision, the Ninth Circuit has limited defendants' antitrust liability in this situation, but in doing so has also complicated the analysis.

Manufacturers of two or more products sometimes offer bundled discounts. Rivals — particularly rivals that offer only one of the competing products — may complain that the bundled discounts foreclose competition and violate Section 2 of the Sherman Act.

Courts have struggled with the question of whether such bundled discounting should be analyzed under an exclusive dealing analysis, a tying analysis, or a predatory pricing analysis. Under the exclusive dealing rubric, the question is whether the manufacturer essentially gives purchasers no choice but to buy its products. Under a tying analysis, the primary questions are whether the manufacturer conditions purchase of one product upon purchase of the other, and whether it has market power in the "tying" product market. Under a predatory pricing analysis, the main questions are whether the manufacturer is selling its product below some measure of incremental cost, and whether it has a dangerous probability of recouping its losses after its rival is driven from the market. Defendants generally prefer the predatory pricing analysis because its use of a cost/price screen is thought to be clear and to result in fewer "false positives."

In a heavily-criticized opinion, the Third Circuit in *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (*en banc*), *cert. denied*, 542 U.S. 953 (2004), condemned bundled discounts even when they were above any measure of the defendant's cost. 3M had above a 90% market share in the transparent tape market and was a conceded monopolist. LePage's offered cheaper, "second brand" and private label transparent tape. LePage's challenged 3M's multi-tiered bundled rebate structure, which offered higher rebates when customers purchased products in a number of 3M's different product lines. LePage's asserted claims under Section 2. It did not, however, bring a predatory pricing claim. *See id.* at 151.

The *en banc* court, upholding the jury's Section 2 verdict against 3M, analogized the bundled discounts, not to predatory pricing, but to tying or exclusive dealing. "The principal anticompetitive effect of bundled rebates as offered by 3M is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer." *Id.* at 155. The court did not require LePage's to prove that it or a hypothetical equally efficient competitor could not meet the discounts without pricing below cost. Rather, the court endorsed the trial court's jury instruction that conduct that "has made it very difficult or impossible for competitors to engage in fair competition" is actionable under Section 2. *Id.* at 168.

In *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008), the Ninth Circuit declined to follow *LePage's*, and applied a cost-based test to bundled discounts. In that case, plaintiff and defendant each provided primary and secondary acute-care hospital services. Defendant also provided tertiary-care services, and had a high market share in that market (approaching 90% in some sub-specialties). Plaintiff did not compete in the tertiary-care market. The plaintiff brought a Section 2 claim against defendant, alleging that it offered bundled-service packages to some customers (such as insurance companies). The bundled discounts applied to all services if the insurance companies made defendant their sole preferred provider for primary, secondary, and tertiary care services. *See id.* at 892.

In the Ninth Circuit's view, the fundamental problem with *LePage's* is that it "concludes that all bundled discounts offered by a monopolist are anticompetitive with respect to its competitors who do not manufacture an equally diverse product line" and that it fails to consider whether such discounts may be pro-competitive. *See id.* at 899. The Ninth Circuit refused to adopt the *LePage's* approach, holding that bundled discounts may not be considered exclusionary conduct under Section 2 unless the discounts resemble predatory pricing behavior. *See id.* at 903.

Howard M. Ullman

The Ninth Circuit specifically adopted a discount attribution standard where, when the full amount of the defendant's discount on the bundled offering is allocated to the competitive product, and if the resulting price is above defendant's incremental cost to produce the competitive product, the arrangement is not exclusionary. *See id.* at 906-10. This refinement, although arguably less demanding than the amorphous Third Circuit test, still requires defendants to clear a higher hurdle than merely proving that all sales on average were above cost.

However, the Ninth Circuit also muddied the waters because it reversed a grant of summary judgment to the defendant on a Section 1 tying claim. The evidence presented genuine factual disputes about whether PeaceHealth forced customers (insurers) "either as an implied condition of dealing or as a matter of economic imperative through its bundling discounting" to take some of its services if the insurers wanted other services. *Id.* at 914. The Ninth Circuit did not resolve the question of whether a "no economic option" tying claim would require proof of below-cost pricing. (The Ninth Circuit also did not address bundled discounts involving contractual obligations not to buy from competitors.) As a result, blanket statements to the effect that the legality of price discounting always turns on a cost/price analysis should be considered with caution.

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Cost of Proof Sanctions

word response of "Denied" without any evidence of a reasonable investigation.

By the same token, do not fall prey to those broad RFAs. Provide denials and a response that shows that you made a reasonable investigation. Remember that if you do not have any evidence to submit on the matter at trial, consider stipulating to the facts so that you can avoid fees when the matter is proved against your client.

The Honorable Beth L. Freeman is on the Superior Court for San Mateo County, and is a member of the Board of Governors for the Northern California chapter of ABTL.

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Cross-Examinations in Securities Arbitrations

done to maximize your effectiveness in cross-examining expert and non-expert witnesses? Here are a few ideas that may help you get started.

Experts

(1) Investigate the expert in advance. Under Rule 10321(c) of the NASD (now FINRA) Code of Arbitration procedure, all parties are required to serve upon each other, 20 days before the hearing, copies of "documents in their possession that they intend to present at the hearing and…identify witnesses they intend to present at the hearing." You will thus at least know the witness's name and may even receive a written report (though usually not). The community of experts is still small enough that calling around can usually produce results, and sometimes even yield deposition transcripts from previous arbitrations or court cases.

(2) Make a list of "must admits." In other words, identify points that the expert *must* concede to maintain his or her credibility. For example, in representing a brokerage firm accused of engaging in unsuitable transactions, you might ask the claimant's expert to agree that:

- There is no single "right" investment strategy;
- There is no single "right" investment objective;
- No investment strategy is guaranteed to make money;
- Each investor's situation is different and must be evaluated on its own merits;
- Even "suitable" investments can lose money; and
- The fact that an account lost money does not necessarily mean that someone did something wrong.

In addition to beginning cross-examination in a low-risk fashion, questions like these (or similar questions tailored to fit your particular case), have the benefit of allowing you to restate your key "themes" yet another time.

(3) Have a "market trend" analysis available as a positive alternative explanation for investment losses. Trends in the stock, bond, or real estate markets are readily available from the internet or other public sources and are usually admissible under the relaxed evidentiary rules in arbitration.

(4) Have the other side's expert say good things about your expert. Again, the community is small, and the usual suspects are often in attendance (and often have good things to say about each other). Your expert, in turn, can often predict what his counterpart will say and can help you prepare your counterattack.

(5) Make a list of hypothetical "would it matter ifs," that is, facts or circumstances which, assuming the Panel believes them to be true, could change the expert's opinion, particularly on disputed issues of fact. Phrased appropriately, these become one more form of "must admits." For example, "would it matter to your opinion if the Panel concludes that":

- There was frequent telephone communication between the claimant and the broker?
- The claimant received and reviewed his or her account statements?
- The claimant sometimes said no to the broker's recommendations?
- The claimant loved the strategy when the market was going up?
- The claimant had previous investment experience and/or accounts at other brokerage firms?

Once again, this approach, like the "must admits," gives you a chance to remind the Panel of the good things about your case. And, if the expert rejects them out of hand, or refuses to budge even an inch, his or her credibility may suffer.

(6) Extract admissions or concessions that other theories or explanations may (or may not) apply. For example, in a churning case, that the usual metrics may not make sense in measuring the frequency of trading in an options account; or that all of the expert's turnover ratios are beside the point if the customer "controlled" the trading; or that the expert's conclusions necessarily presume a sophisticated (or unsophisticated) investor; or that even the safest investments lost value during the NASDAQ meltdown beginning in April 2000.

(7) In attempting to limit (or augment) damages, have statistics available showing returns from differing types of investments, *e.g.*, equities, bonds, real estate. Also, consider possible offsets in terms of lost income, lost alternative investments, and so forth.

(8) If you are representing a respondent, invite the expert to agree that "reasonable advisors/investors could differ" on the wisdom or suitability of the investments at issue. If the expert agrees, the case may be over.

(9) Consider asking whether the expert has ever recommended the investments at issue for his own clients. Many experts have or had a book of brokerage business

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JAMES YOON

On PATENTS

"Does it make sense to file a patent case?" Increasingly, the answer to this question is "no." Recent Supreme Court and Federal Circuit decisions have greatly diluted the strength of patents. This dilution combined with long delays in the judicial process and skyrocketing legal costs has dramatically reduced the desirability of filing patent cases for many companies. As a result, it is more critical than ever for patent litigators to perform broad and comprehensive pre-lawsuit diligence whenever they investigate a potential patent case. The failure to perform such diligence can lead to disaster.

Prior to filing a lawsuit, patent litigators must do more than the traditional diligence to confirm that there is a "good faith" legal basis for filing a patent suit. Prudent litigators should also determine whether there is solid, reasonable evidence to believe that the patent suit will advance the financial and strategic goals of a company. Litigators must further identify the potential downside risks to the company prior to filing a lawsuit. An ill-advised patent lawsuit can have catastrophic consequences for a company. In difficult economic times, the millions in legal fees and costs of a patent lawsuit can push a company into financial distress. A patent lawsuit can wake a sleeping giant by causing a defendant with a powerful patent portfolio to file patent counterclaims against a company, threatening sales of key products. Moreover, a patent suit can be very demanding on a company. During discovery and trial, a patent lawsuit consumes the time and energy of company management and employees. And, finally, for litigators, an ill-advised patent lawsuit is likely to destroy the trust and working relationship between the litigator and company officials.

As part of due diligence, patent litigators must make a realistic assessment of the potential upside for each case. This type of assessment requires establishing a set of realistic assumptions and creating a matrix of potential results. For example, in my practice, I typically assume that a patent case will take two years to litigate from the filing date of the lawsuit and create a budget (including fees and costs) for the litigation. Using these assumptions, I confirm with the client that it can afford to wait two years for a decision in the case and that the company is willing (and able) to pay for the legal fees and costs set forth in the budget. Next, it is important that the assessment estimate potential payouts in a range of scenarios. One approach to such an assessment is to create a 3x3 matrix to determine whether the lawsuit makes sense from a financial standpoint. In the rows of the matrix, the approach would include a low, medium and high royalty rate (*e.g.*, 1%, 3% and 5%). In the columns of the matrix, the approach would analyze the case from the perspective of a 25%, 50% and 75% chance of winning. In each of the nine boxes, the approach would enter the expected payout at the intersection of royalty rate and likelihood of success (*e.g.*, revenue related to the accused products x royalty rate x likelihood of success x discounted to take into account two years of litigation). If all nine estimates in the matrix exceed the projected legal budget, it clearly makes financial sense to file the patent lawsuit. If one or more estimates are less than the projected budget, I discuss the estimates with the client to confirm that it is comfortable with the risk profile of the case. If the vast majority of estimates are less than the projected budget, the case does not make financial sense and should only be brought if the client has solid non-financial reasons for filing the lawsuit.

James Yoon

It is also important to examine the potential negative consequences of filing the patent case. Patent litigators should examine a series of questions such as: (1) "Does the potential defendant have patents that can be filed against the company as part of a counterclaim?"; (2) "If the potential defendant does file patent counterclaims against the company, which company will have greater financial exposure, the company or the potential defendant?"; (3) "Will the filing of the lawsuit alienate any customers or potential customers?"; and (4) "How will the stock market react to the filing of the lawsuit and/or potential negative results?" The answers to these questions (and many others) are important factors in the cost-benefit analysis surrounding the filing of a patent case. The answers to the above questions can demonstrate a company should not file a contemplated patent lawsuit even if the potential financial upside of the litigation is substantial.

It is important to recognize that it is often difficult for patent litigators to perform the above described due diligence prior to filing a patent case. Companies often give outside patent litigators little or no notice of their intention to file a patent lawsuit. Instead, at the time they contact a litigator, the only question a company asks a patent litigator is "how soon can you get the patent case on file?" In such situations, patent litigators naturally want to demonstrate to the company (who may be a new client) that they are responsive and can move quickly. While difficult, patent litigators should fight this urge and work with the client to perform the necessary diligence.

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Cross-Examinations in Securities Arbitrations

themselves and may have had accounts where similar trading took place. Many such experts will acknowledge that they, too, lost money in certain markets.

(10) Know when to quit! The best approach is usually a focused search-and-destroy mission, not protracted combat allowing the opposing expert to say it all again. If possible, save at least one "zinger" to end on a high point.

An alternative approach to cross-examining the other side's expert is to delegate that task to your expert's testimony. In other words, rather than trying to hammer away at a possible weakness in cross-examination — and perhaps giving the expert a way of rehabilitating himself — merely ask *your* expert to critique and expand upon these weaknesses in the other side's expert's testimony. With any luck you will have the last word.

Lay Witnesses

Cross-examining non-expert witnesses without first taking their depositions, while perhaps not as nerve-wracking as blindly taking on experts, nonetheless presents its own challenges. The admonition about not asking a question when you do not know the answer remains valid but often difficult to heed. And there is a fine line between getting the full story by, in effect, taking the witness's "deposition" at the hearing (which could conceivably be helpful), and simply boring the Panel (which, of course, emphatically is not).

So, what to do? One approach is to try mediation. If the case resolves, fine. If not, you have probably gotten at least some sense of the key witnesses. (So has your opponent, though.) Mediation aside, here are a few thoughts about cross-examining lay witnesses without benefit of depositions:

(1) Start out with a few of your favorite "must admits" as well. Nothing like getting off to a good start.

(2) Check the web. It really is amazing what you can find out about people these days — even people who are just ordinary folks — by checking the publicly-available internet sources.

(3) Stick with the documents. Although depositions are rare, almost all arbitration tribunals, including FINRA, allow parties to request documents from the other side. Indeed, FINRA has its own lists of documents (including tax returns and resumes) that parties are required to provide automatically, without being asked, relatively early in the case. So, using "cross-examination" simply as a way to emphasize certain documents, *e.g.*, the key language from the compliance manual or the email message warning of risk, is an effective and low-risk way to proceed.

(4) Although the rules require parties to exchange their exhibits 20 days before the hearing, this does not apply to exhibits used for cross-examination or impeachment. So, if you are lucky enough to have a smoking gun, you may be able to keep it a secret until you use it on cross.

(5) The same rule applies to lay witnesses as experts: quit while you are ahead (or not too far behind). Generally speaking, the amount of time to spend on cross is inversely proportional to the effectiveness of the other side's witness. Getting "admissions" from a good witness is hard, but making a weak witness stumble or look evasive is possible. You need to make this call on the fly; no rule can substitute for using good judgment in the moment. In the typical case, though, less is definitely more.

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MICHAEL W. SOBOL

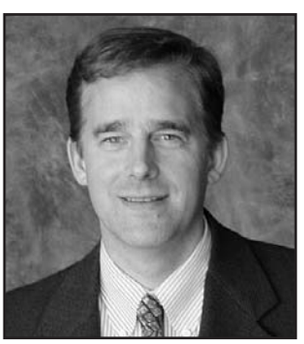
On CLASS ACTIONS

The proportionality of punitive damage awards to actual damages is an issue that has received considerable attention recently. *See, e.g., Exxon Shipping Co. v. Baker*, 128 S. Ct. 2605 (2008). Far less attention has been paid to statutory damages, though the availability of such damages raises similar concerns regarding proportionality and fairness in the class action context. A number of class action lawsuits brought under the Fair Credit Reporting Act, 15 U.S.C. § 1681, *et seq.* ("FCRA") — which provides for statutory damages ranging from $100 to $1,000 for willful violations — illustrate the issue, which has prompted a number of courts in California and elsewhere to consider whether, and under what circumstances, it is appropriate to certify a class when doing so could expose a defendant to large statutory damages liability.

Several California courts have denied certification, on "superiority" grounds, where plaintiffs alleged only a technical violation of the FCRA and the potential statutory damages were very large. *See, e.g., Soualian v. Int'l Coffee & Tea LLC*, 2007 U.S. Dist. LEXIS 96339 (C.D. Cal. 2007); *Bateman v. American Multi-Cinema, Inc.*, 2008 WL 4684146 (C.D. Cal. 2008); *Hile v. Frederick's of Hollywood Stores, Inc.*, 2007 U.S. Dist. LEXIS 81105 (N.D. Cal. 2007). For example, in *Soualian*, plaintiffs alleged that defendant improperly included customers' credit card expiration dates on their credit card receipts, a direct violation of the FCRA. Given the size of the class, defendant faced paying up to $43 million in statutory damages if the class was certified. Finding that it was "virtually impossible" that any of the putative class members could have been harmed by this technical violation, thereby rendering the potential damages were grossly disproportionate to the actual harm suffered by plaintiffs, the Court denied class certification on the ground that a class action was not the superior method of adjudicating the issues raised by plaintiffs. The Ninth Circuit granted plaintiffs leave to appeal the district court's decision, and a number of other cases venued in the district courts were stayed pending that appeal, but the case settled earlier this year before the Ninth Circuit had a chance to rule. Subsequently, Congress passed the Credit and Debit Card Receipt Clarification Act, which barred claims for statutory damages based on the specific FCRA violation alleged in *Soualian*.

Other courts have rejected the use of Rule 23(b)'s superiority requirement to protect FCRA defendants from large statutory damages liability. *See, e.g., Murray v. GMAC Mortg. Corp.*, 434 F.3d 948 (7th Cir. 2006); *Troy v. Red Lantern Inn, Inc.*, 2007 WL 4293014 (N.D. Ill. 2007); *Klingensmith v. Max & Erma's Restaurants, Inc.*, 2007 WL 3118505 (W.D. Pa. 2007). In *Murray*, plaintiffs alleged that the defendant violated the FCRA by gaining access to more than a million individuals' credit reports for illegal purposes. The district court denied certification because, among other things, the statutory damages would have exceeded $1 billion. The court of appeals rejected the district court's reasoning, holding that the size of the damages were the result of a "legislative decision," and that it was "not appropriate to use procedural devices to undermine laws of which a judge disapproves." *Murray*, 434 F.3d at 953-54.

Why did these courts reach different results? Factual differences account for some of the variation. Thus, for example, courts are more likely to want to find a way to deny certification where the alleged breach is merely a technical violation, as in *Soualian*, than they are when the violation is more substantive, as in *Murray*. *See Serna v. Big A Drug Stores, Inc.*, 2007 U.S. Dist. LEXIS 82023, at * 15-16 (making this distinction). But some of the variation is also attributable to philosophical differences regarding, among other things, the purpose of class actions and the relationship between the judiciary and legislature. For example, the district court in *Soualian* focused on the potential results of class litigation which it viewed as unfair, while voicing no concern about the possibility that it might be frustrating the intent of the legislature. By contrast, the court of appeals in *Murray* applied Rule 23 more strictly according to its terms, believing it to be improper to supplant legislative choice with its own notions of a fair result.



Michael W. Sobol

One thing that is striking about these cases is their "all or nothing" nature. Either a class is certified — in which case the plaintiffs can pursue statutory damages on a class-wide basis — or plaintiffs are required to seek relief one plaintiff at a time, with the likely result being that the defendant will face nearly no consequences as a result of its violation of law, even where those violations are willful. One possible compromise is for the legislature to impose a cap on statutory damages in the class action context. Another possibility is for courts certifying these claims to invoke their equitable powers, which are the original basis for class action jurisprudence, and place limits on the amount of the overall recovery. Whatever approach is taken, it will likely focus, just as in the punitive damages context, on the concerns of proportionality to the aggregate harm.

The issues raised in the FCRA cases have implications for class action lawsuits brought under a number of statutes that provide for statutory damages with no aggregate cap on such damages. Companies should be aware of the potential liability risks under these statutes. Conversely, plaintiffs' attorneys should be concerned with undermining class certification by seeking large statutory damages awards which are disproportional to the harm suffered. Companies and lawyers alike should pay close attention to how courts treat this issue going forward.

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Letter from the President

2008 will long be remembered as a remarkable and momentous year. Barack Obama was elected and will become the first African-American President of the United States. The California Supreme Court ruled "that the California legislative and initiative measures limiting marriage to opposite-sex couples violate the state constitutional rights of same-sex couples and may not be used to preclude same-sex couples from marrying." Voters in California then passed Proposition 8, a ballot proposition that amended the state Constitution to restrict the definition of marriage to a union between a man and a woman, thereby reversing the Supreme Court's decision. Stock markets around the world suffered some of the worst losses since the Great Depression and major financial institutions failed at an astonishing pace. Closer to home, two of San Francisco's oldest and most respected law firms voted to dissolve.

Steve Lowenthal

With those events as a backdrop, celebrating the conclusion of another successful year for the Northern California Chapter of ABTL must be placed in the proper perspective. But we're proud to say that we had a very good year. Our membership reached a record level of almost 2,000 lawyers and judges, the highest of all the ABTL Chapters around the State. We had a wonderful year of programming; we've published three outstanding editions of the ABTL Report; we've held an East Bay Lunch Program geared to the more junior attorneys among our members; we've held six outstanding dinner programs throughout the year; and our newest branch, the Leadership Development Committee, held four successful programs for the newest attorneys among our members.

We started the year with an innovative "Ask the Judge" panel, where our members submitted a wide range of questions both before and during the program to our distinguished panel: Judges Susan Illston, Jon Tigar, Katherine Feinstein and James Warren (Ret.). Our next program focused on the important implications from the *Qualcomm* decision on discovery and the relationships between co-counsel and between inside and outside counsel. The spirited discussion included panelists Magistrate Judge Joseph Spero, Professors Deborah Rhode and Steve Bundy, and attorneys John Steele and Denis Salmon. We then held our annual South Bay/Peninsula program entitled "Inside Guantanamo," an insider's perspective on the legal issues arising out of the Guantanamo Bay detention facility, by Major Tom Fleener (Ret.).

The fourth program of the year provided an insightful review of the 2007-08 term of the United States Supreme Court, with Professors Pam Karlan of Stanford and Vik Amar of the University of California — Davis. In October, we watched the Presidential Debate together followed by our own "debate" — a mock Appellate Argument arising out of last years' trade secret case fact pattern. Therese Stewart and Jeff Bleich represented the parties in front of an all-star judicial panel: Justices Mark Simons, Sandra Margulies and Henry Needham. Our final program this year was on December 2 and focused on a powerful study of "subconscious bias." The program was presented by Professor Brian Nosek of the University of Virginia.

Beyond the outstanding programs and publications, ABTL continued its historic function of providing opportunities for friendship, camaraderie and professional development as a break from the adversarial system in which we usually spend our time. Lawyers on all sides of business issues come together with numerous members of the Judiciary to attend programs, watch a Presidential Debate, socialize and discuss issues of concern to all. We develop professional relationships that should and do carry over to our roles in the adversarial process, and facilitate a more civil profession and system of justice.

The work of the ABTL could not be done without a great team of dedicated officers, committee chairs and board members. Special thanks go to our 2008 Officers: Stephen Hibbard (Vice-President), Sarah Flanagan (Treasurer) and Robert Bunzel (Secretary), and to our hard-working committee chairs: MaryJo Shartsis (Membership), Daralyn Durie and Darryl Woo (Programs), Tom Mayhew and Howard Ullman (ABTL Report), Rick Seabolt, Morgan Tovey and Krystal Bowen (Annual Seminar), Drew Bassak and Hon. Mark Simons (East Bay Program) and Lucas Huizar (Leadership Development Committee).

Looking forward to 2009, we hope that the Obama Administration will lead us on a path toward peace and prosperity, that the economy will stabilize and grow, that surviving financial institutions will regain their footing, that jobs and homes will be safe, and that the courts will continue to protect the rights of all. As for our organization, ABTL remains well-positioned for another great year in 2009 with Stephen Hibbard as President and with both continuing and new officers, committee chairs and board members, all working hard to continue the ABTL success and tradition. We'll see you at the next dinner program on February 3, 2009.

Happy Holidays and best wishes to all for a healthy and prosperous 2009.

Steve Lowenthal is a partner in the San Francisco office of Farella Braun & Martel LLP and is the President of the Northern California chapter of ABTL for 2008.