The International Association of Defense Counsel is the oldest international association of lawyers representing corporations and insurers. Its activities benefit the approximately 2,500 invitation-only, peer-reviewed members and their clients through networking, educational and professional opportunities as well as benefiting the civil justice system and the legal profession. The IADC takes a leadership role in many areas of legal reform and professional development.

Founded in 1920, the IADC’s membership comprises the world’s leading corporate and insurance lawyers including partners in large and small law firms, senior counsel in corporate law departments and insurance executives. They engage in the practice and management of law involving the defense, prosecution and resolution of claims affecting the interest of corporations and insurers. The Association maintains a comprehensive list of publications and training programs, including the quarterly Defense Counsel Journal. It provides educational offerings including its Midyear and Annual Meetings, Regional Meetings, the Trial Academy, the Corporate Counsel College, International Corporate Counsel College, and the Professional Liability Roundtable. The IADC founded the Defense Research Institute (DRI) and co-founded Lawyers for Civil Justice.
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President’s Page

Preserving Judicial Independence

By James M. Campbell

At the IADC Midyear Meeting in February, the Honorable Sandra Day O’Connor was this year’s Foundation Forum speaker. Central to her presentation, Justice O’Connor stressed the critical importance of preserving the independence of the judiciary. For those of us lucky enough to hear Justice O’Connor speak, we were reminded of the challenges that arise on the state court level of keeping and retaining qualified judges when judges are elected rather than selected.

Justice O’Connor has worked with the Judicial Selection Initiative encouraging states to transition to selection committees, rather than direct elections, for the appointment of state and local judges. Her work reminds all of us that the nation’s founders recognized the importance that federal judges retain the freedom to make unpopular decisions without fear of political reprisal. This independence was intended to serve, and has served, as a powerful protection for the law from the politics of expediency. For this reason, federal judges are constitutionally protected by life tenure and non-diminution of salary. Although politicians and the electorate may not always agree with each particular decision, the critical need for the judiciary to interpret the law independently remains as important today as it was when our country was founded.

Unfortunately, in this age of the 24/7 news cycle and Internet “news” reporting, the judiciary is under attack like no other time in history. As an example, consider President Barack Obama’s comments during his January 2010 State of the Union address to a Joint Session of Congress. During the speech, President Obama directly criticized the Court’s decision in *Citizens United v. Federal Election Commission* that addressed campaign finance restrictions of the McCain-Feingold Act. The President chastised the Justices for the decision, and his comments were met with a standing ovation by the Democratic lawmakers. President Obama’s unprecedented comments during a nationally televised political forum exemplify the extent to which the independence of the judiciary is threatened in today’s world.
Despite the increasing frequency and severity of the attacks, the judiciary is expected to remain silent and avoid comment on judicial matters. As Chief Justice John Roberts noted following the State of the Union Address: “The image of having the members of one branch of government standing up, literally surrounding the Supreme Court, cheering and hollering while the Court — according the requirements of protocol — has to sit there expressionless, I think is very troubling.” The legal profession must stand in defense of the judiciary and stand ready to defend judges who are the subject of political or popular attack for decisions made during the judicial process.

As trial lawyers, the members of the IADC know first hand the importance of a fair, impartial and independent judiciary. The IADC and its members must be ready to take action to defend judges from political criticism or from scathing attacks by the media. The American Board of Trial Advocates, for example, has established and promoted “Protocols to Respond to the Unfair Criticism of Judges,” providing advocates with a standard set of tools to defend the judges from these unwarranted attacks. The American College of Trial Lawyers also has promoted judicial independence by presenting an award, appropriately named the Sandra Day O’Connor Jurist Award, to judges for courageous conduct in the face of public criticism. The inaugural recipient of this award was the Honorable George Greer, the probate court judge who presided over the Terri Schiavo case in Florida. Judge Greer never publicly commented on the case despite immense media attention and threats from members of the United States Congress and the Florida Legislature. Throughout the ordeal, Judge Greer sought to apply the rule of law as an independent judicial officer.

We must preserve the system that allows judges to apply the rule of law without outside political, religious, media, or other influences unduly or improperly affecting the process. It ultimately falls to us as advocates to protect the integrity of the judicial system on which we all rely.
The International Association of Defense Counsel is aware that applicable rules or codes of professional responsibility generally provide only minimum standards of acceptable conduct. Since we aspire to the highest ideals of professionalism, we hereby adopt these tenets and agree to abide by them in the performance of our professional services for clients.

1. We will conduct ourselves before the court in a manner which demonstrates respect for the law and preserves the decorum and integrity of the judicial process.

2. We recognize that professional courtesy is consistent with zealous advocacy. We will be civil and courteous to all with whom we come in contact and will endeavor to maintain a collegial relationship with our adversaries.

3. We will cooperate with opposing counsel when scheduling conflicts arise and calendar changes become necessary. We will also agree to opposing counsel's request for reasonable extensions of time when the legitimate interests of our clients will not be adversely affected.

4. We will keep our clients well-informed and involved in making the decisions that affect their interests, while, at the same time, avoiding emotional attachment to our clients and their activities which might impair our ability to render objective and independent advice.

5. We will counsel our clients, in appropriate cases, that initiating or engaging in settlement discussions is consistent with zealous and effective representation.

6. We will attempt to resolve matters as expeditiously and economically as possible.

7. We will honor all promises or commitments, whether oral or in writing, and strive to build a reputation for dignity, honesty and integrity.

8. We will not make groundless accusations of impropriety or attribute bad motives to other attorneys without good cause.

9. We will not engage in discovery practices or any other course of conduct designed to harass the opposing party or cause needless delay.

10. We will seek sanctions against another attorney only when fully justified by the circumstances and necessary to protect a client's lawful interests, and never for mere tactical advantage.

11. We will not permit business concerns to undermine or corrupt our professional obligations.

12. We will strive to expand our knowledge of the law and to achieve and maintain proficiency in our areas of practice.

13. We are aware of the need to preserve the image of the legal profession in the eyes of the public and will support programs and activities that educate the public about the law and the legal system.
Schedule and registration information is online.

www.iadclaw.org
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#### PAST PRESIDENTS

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Calendar of Meetings

Corporate Counsel College
April 22 - 23, 2010
The Ritz-Carlton
Chicago, Illinois USA

Professional Liability Roundtable
May 13, 2010
Gleacher Center, University of Chicago
Chicago, Illinois, USA

2010 Annual Meeting
July 10 - 15, 2010
Hotel Arts
Barcelona, Spain

38th Annual Trial Academy
July 31 - August 6, 2010
Stanford Law School
Palo Alto, California USA

International Corporate Counsel College
October 7-8, 2010
The InterContinental - Paris Le Grand
Paris, France

The full schedule for IADC Regional Meetings and Webinars is at www.iadclaw.org.
MAY 13, 2010
PROFESSIONAL LIABILITY ROUNDTABLE

Potential attorney liability and claims against other professionals under various federal statutes

The Gleacher Center at The University of Chicago
Booth School of Business
Chicago, Illinois USA

Schedule and registration information is online.

www.iadclaw.org
International Corporate Counsel College

7 - 8 October 2010
InterContinental Paris Le Grand
Paris, France
In the 1980s, courts addressed a wave of “garden-variety” fraud cases brought under the private civil action provision of the Racketeer Influenced and Corrupt Organizations ("RICO") Act. As these cases proceeded, a substantial body of case law developed limiting RICO’s potentially vast scope. For example, many claims were dismissed on standing grounds for failure to allege a direct injury proximately caused by the alleged racketeering activity. Others failed in the pleading stages for lack of the specificity required for allegations of fraud under Federal Rule of Civil Procedure 9(b). Many courts also held that RICO could not be used to circumvent already-existing law governing business or securities fraud.

More recently, plaintiffs have filed a new wave of civil RICO claims in class actions concerning pharmaceutical products. In this “Back to the Future” trend, pharmaceutical manufacturers now

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face suits brought by third-party payors and individuals. These plaintiffs generally claim that the defendant manufacturers engaged in off-label promotion and/or acts of deception and allege acts of mail or wire fraud as the RICO predicate acts. Frequently, the theory offered is that off-label promotion caused plaintiffs to pay or reimburse more for prescription drugs or to pay for prescriptions that they claim should not have been written. The plaintiffs generally claim that the off-label promotion caused economic injury to the payors, rather than claiming that the prescriptions were harmful or caused personal injury. To establish class-wide proof of causation and injury, plaintiffs often attempt to rely on statistical models and variations of the fraud-on-the-market theory advanced in securities litigation.

Plaintiffs invoke civil RICO in this context for several reasons. First, a successful civil RICO claim can produce an award of treble damages, costs and attorneys’ fees. Second, civil RICO plaintiffs potentially gain broad choices of venue because RICO claims generally may be brought against “any [liable] person” wherever “such person resides, is found, has an agent, or transacts his affairs” under 18 U.S.C. § 1965(c). Perhaps most importantly in the class-action context, civil RICO claims conceivably allow plaintiffs to sidestep the predominating choice-of-law issues that typically prevent nationwide class actions based on fraud or deceptive practice law after such decisions as *Castano v. American Tobacco Co.* and *Matter of Rhone-Poulenc Rorer, Inc.*

The Supreme Court’s 2008 ruling in *Bridge v. Phoenix Bond & Indemnity Co.*, eliminating the requirement that plaintiffs plead and prove first-party reliance in RICO mail fraud claims, also has encouraged potential plaintiffs to invoke RICO more frequently.

But like a new wax job on an old DeLorean, under the shiny new surface of such claims lie many of the same old problems. Most courts considering the issues in this context—including a wave of decisions following *Bridge*—have rejected class action claims for off-label marketing of prescription drugs under RICO. Several decisions have rejected complaints at the pleading stages by granting motions to dismiss. Other courts have disposed of these claims by denying motions for class certification. Only one reported opinion has granted class certification in this context; the presiding judge in that matter described the basis of the theory as “thin,” and that matter is

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5 84 F.3d 734, 740-44 (5th Cir. 1996).
6 51 F.3d 1293, 1300-04 (7th Cir. 1995).
8 Simply omitting state common law claims for fraud in favor of a federal RICO claim, however, may raise serious claim-splitting issues, which either could render the class representative inadequate or the action to be an inferior means of resolving the controversy. *In re Epogen & Aranesp Off-Label Mktg.*, No. 08-01934, 2009 WL 1703285, at *8 (C.D. Cal. June 17, 2009); *In re Actimmune Mktg.*, 614 F. Supp.2d 1037, 1056 (N.D. Cal. 2009); Ironworkers Local Union No. 68 v. AstraZeneca Pharm., LP, 585 F. Supp.2d 1339, 1344-45 (M.D. Fla. 2008); District 1199P Health & Welfare Plan v. Janssen, No. 06-3044, 2008 WL 5413105, at *1 (D.N.J. Dec. 23, 2008).
currently pending in the Court of Appeals.\textsuperscript{11}

Plaintiffs asserting these claims generally have encountered many of the same difficulties as plaintiffs who attempted to use civil RICO to bring traditional fraud claims in the 1980s. As a threshold matter, many courts have found that off-label promotion is not synonymous with fraud, and that civil RICO cannot be used to create a private right of action under the Federal Drug and Cosmetic Act (“FDCA”). When mere allegations of off-label promotion are stripped from the complaint, courts have rejected these claims for failure to plead fraud with sufficient particularity under Rule 9(b).

In addition, a number of courts also have rejected these claims on standing grounds for failure to plead or prove proximate cause or a cognizable direct injury. When considering causation, courts have largely rejected plaintiffs’ attempts to establish reliance and injury on a class-wide basis by using a fraud-on-the-market or price-inflation theory of liability. In cases such as \textit{Ironworkers Local Union No. 68 v. AstraZeneca Pharmaceuticals LP},\textsuperscript{12} courts also have concluded that the alternative to a fraud-on-the-market theory—determining why scores of physicians exercised their medical judgment to prescribe medicines for off-label uses for all of the prescriptions for which the payors seek reimbursement—asserts an injury too remote and speculative to sustain a RICO claim. This article will discuss these recent cases and analyze the legal principles which once again have limited attempted expansion of civil RICO.

I. Off-Label Promotion is Not the Same as Fraud

In most of these recently-filed cases, plaintiffs have principally based their claims on allegations that defendants engaged in off-label promotion of the medicines at issue. Civil RICO claims, however, must be based on violations of certain enumerated federal statutes. Alleged violations of federal regulatory laws concerning off-label promotion by pharmaceutical companies are not among the enumerated RICO predicate acts. Although acts of mail fraud or wire fraud can constitute RICO predicate sets, a number of courts properly have rejected plaintiffs’ attempts to equate “off-label promotion” and fraud. In \textit{In re Epogen & Aranesp Off-Label Marketing},\textsuperscript{13} for example, the plaintiffs alleged that Amgen committed mail and wire fraud based on a purported scheme to promote the prescription drugs at issue for off-label uses. The Court rejected the plaintiffs’ attempts to equate off-label promotion with wire fraud, concluding that “[p]romotion of off-label uses is not inherently misleading simply because the

\textsuperscript{12} 585 F. Supp.2d at 1344-45 (hereinafter “AstraZeneca”).
\textsuperscript{13} 590 F. Supp.2d 1282 (C.D. Cal. 2008).
use is off-label."\textsuperscript{14} Because the complaint lacked specificity regarding fraud, as opposed to alleged off-label promotion, the court dismissed the complaint without prejudice for failure to identify specific misrepresentations in the complaint.

After the plaintiffs filed an amended complaint, the court granted Amgen’s motion to dismiss with prejudice.\textsuperscript{15} The court found that the plaintiffs merely made cosmetic changes by adding the words “false” and “deceptive” throughout their complaint instead of providing specific allegations about allegedly false statements. Allegations that Amgen promoted the drug for unapproved uses could not satisfy plaintiffs’ responsibility to plead fraud with particularity under Rule 9(b). Instead, the court held that these allegations were “puffery” or non-actionable statements of fact, concluding that “[t]o merely assert that Amgen promoted EPO for ‘ineffective’ or ‘unapproved’ uses, without more, will not pass muster” under Rule 9(b).\textsuperscript{16} To state actual fraud, the Court held that plaintiffs “must show that Amgen’s actions went beyond presenting its drugs in the best light possible and crossed the line into actionable fraud.”\textsuperscript{17} For example, plaintiffs would need to allege that defendants falsely represented that the drugs were approved by the Federal Drug Administration for the off-label uses or that the defendants falsely reported the results of scientific studies. Although plaintiffs claimed that the defendant did not disclose certain information such as its sponsorship of several studies, the court found that the defendant had no duty to disclose this information, and thus the omission was not actionable. Without more, the plaintiffs’ allegations were too generalized to state a fraud claim.\textsuperscript{18}

EpoGen rejected the use of civil RICO as a vehicle to enforce existing federal law governing pharmaceuticals. The EpoGen court held that “[a]llowing Plaintiffs to proceed on a theory that Defendants . . . made false or misleading statements, would, in effect, permit Plaintiffs to use RICO as a vehicle to enforce the FDCA and the regulations promulgated thereunder.”\textsuperscript{19} The court stated that the FDCA does not contain a private right of action, and that RICO should not be used to create a private remedy indirectly. After plaintiffs submitted the amended complaint, the court found that this problem persisted. The court again criticized the use of RICO to supplement already-existing remedies, finding that “the Amended Complaint constitutes yet another attempt to shoehorn allegations that Amgen engaged in off-label promotion in violation of the FCDA into RICO and state consumer fraud causes of action.”\textsuperscript{20}

\textsuperscript{14} Id. at 1289 (internal quotations omitted) (citing United States v. Caronia, 576 F. Supp. 2d 385, 397 (E.D.N.Y. 2008)).
\textsuperscript{15} 2009 WL 1703285.
\textsuperscript{16} Id. at *6.
\textsuperscript{17} Id.
\textsuperscript{18} See also Central Reg’l Employees Benefit Fund v. Cephalon, Inc., No. 09-3418, 2009 WL 3245485, at *4 (D.N.J. Oct. 7, 2009) (“Merely alleging that Cephalon marketed the drugs at issue for off-label purposes does not state a claim for fraud. . . . In the absence of any specific allegations of fraud, as opposed to the mere fact of off-label marketing, the plaintiffs’ common law fraud claims must be dismissed.”).
\textsuperscript{19} 590 F. Supp.2d at 1289-90.
\textsuperscript{20} 2009 WL 1703285, at *5.
Similarly, in In re Actimmune Marketing Litigation, the court recognized that off-label promotion is not inherently fraudulent and that the complaint lacked specificity under Rule 9(b): “many of plaintiffs’ allegations conflate a false and misleading statement under the FDCA, i.e., one that occurs when the drug label does not match the promoted assertion about the drug, and a false and misleading statement about the drug itself that can give rise to a claim under RICO. The two types of statements are not the same.”21

The court noted that it is lawful for doctors to prescribe medications for off-label uses,22 and explained that “courts have routinely refused to find promotional marketing of off-label uses fraudulent when they are directed at sophisticated audiences, like physicians.”23 This is because doctors, as learned intermediaries, evaluate the qualities of a medicine based on their professional expertise. In addition, the “mere objective of a company or companies to maximize profits is not in and of itself evidence of fraud. It does not necessarily follow that off-label promotion plus resulting profits equals fraudulent conduct.”24 The court criticized the plaintiffs for making “tendentious leaps in concluding that defendant[s’] marketing efforts are false and misleading simply because defendants presented their drug product in the best light” and reasoned that “[t]here is a clear distinction in the law between puffery and fraud.”25 As in Epogen, the court refused to equate off-label promotion with fraud under RICO without pleading specific false representations.26


See also In re Schering-Plough Corp. Intron/Temodar Consumer Class Action, No. 2:06-cv-5774, 2009 WL 2043604, at *10 (D.N.J. July 10, 2009) (“[N]ot all off-label
Like many fraud claims brought under civil RICO in the 1980s, RICO class actions alleging off-label promotion have also failed due to a lack of particularity in pleading mail and wire fraud under Rule 9(b). In *District 1199P Health and Welfare Plan v. Janssen LP*, for example, the court rejected plaintiffs’ off-label marketing claims for this reason. The court found that the seventy-page complaint lacked information regarding the date, time and place of the alleged fraudulent acts. Although plaintiffs pointed to information in the complaint regarding the global sales of the drug and the estimated percentage sold for off-label use, these details did not supply particularity regarding fraud. The court also rejected plaintiffs’ RICO conspiracy claim for lack of specificity, finding that plaintiffs failed to plead the particulars of the conspiracy, such as the time or length of the conspiracy, the actions the defendants took to further it, and what knowledge the defendants possessed.

In *Janssen*, the plaintiffs argued for a relaxed pleading standard because “the internal corporate mechanisms and activities engaged in by the Defendants in furtherance of their fraudulent scheme are within the exclusive knowledge and understanding of the Defendants.” The court held that plaintiffs would fail to meet even relaxed pleading standards because the complaint did not allege the promotion involves misrepresentations or dishonesty. Rather, the off-label use of pharmaceutical products is both prevalent and is, often times, the best means for providing effective treatment for patients.”

II. Plaintiffs Fail to Satisfy RICO’s Direct Injury Requirements Due to the Intervening Medical Judgment of Physicians

Plaintiffs have failed in several recent decisions on proximate cause grounds. Under RICO, plaintiffs must prove a direct relationship between their injury and the defendant’s conduct. The Supreme Court held in *Holmes* that courts may evaluate the potential absence of such a direct relationship at the motion to dismiss stage by examining the directness of the injury, difficulties in apportioning damages, and whether the claim could be brought by a better, more appropriate enforcer. Although *Bridge* rejected the requirement of first-party reliance under RICO, the Court did confirm that its decision was not to be read as a departure from its prior precedent requiring a direct injury and further clarified that “none of this is to say that a RICO plaintiff who alleges injury ‘by reason of’ a pattern of mail fraud can prevail without showing that someone relied on the defendant’s misrepresentations.”

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27 2008 WL 5413105, at *1 (hereinafter “Janssen”).
28 *Id.* at *12 (internal quotations omitted).
29 *Holmes*, 503 U.S. at 268-270.
30 *Bridge*, 128 S. Ct. at 2144; see also *Bridge* at 2144 n.6 (“Of course, a misrepresentation can cause harm only if a recipient of the misrepresentation relies on it.”). The Supreme Court also recently addressed this issue in *Hemi Group, LLC v. City of New York*, No. 08-969, 2010 WL 246151 (Sup. Ct. Jan. 25, 2010), where the plurality of the court concluded that the plaintiff’s causal theory did not satisfy RICO’s direct relationship
In *AstraZeneca*, the company argued that all three *Holmes* factors supported dismissal: (1) plaintiffs’ claims included multiple links in causation, including the exercise of independent medical judgment by the prescribing doctor as well as a determination regarding reimbursement by the payor and its expert pharmaceutical benefits manager; (2) difficult questions of apportionment arise because payors may pass on their “increased costs” through rate increases; and (3) the FDA is the more appropriate enforcer. Chief Judge Anne Conway of the Middle District of Florida held that the third-party payor plaintiffs’ alleged injury was too remote from the defendant’s alleged misrepresentations to establish proximate causation. Focusing exclusively on the first *Holmes* criterion, Judge Conway reasoned that the “key independent factor” was that a consumer must obtain a prescription from a doctor to purchase the prescription medicines at issue. Physicians make independent medical judgments when prescribing medications, and those judgments may take into account a variety of sources of information. Determining whether a defendant’s representation caused a physician to write a prescription would thus require examining the specifics of each doctor-patient relationship for each prescription at issue. The many factors influencing the prescribing doctors’ decisions—including the doctors’ training, familiarity with the class of drugs, experience with the drug at issue and other factors—made such an analysis an “intricate, uncertain” inquiry. As a result, the court recognized the serious difficulties in proving whether alleged over payments were caused by the defendant’s conduct rather than other intervening factors. The court also noted that the named plaintiffs in the case continued to pay for the drug even after initiating the suit, making any causal connection even more tenuous.

In *Actimmune*, the Northern District of California took a similar approach. The court recognized that doctors prescribe drugs based on “personalized conditions,” while rejecting the plaintiffs’ claims on causation grounds.

 requirement because plaintiff’s theory of liability impermissibly “rest[ed] not just on separate actions, but separate actions carried out by separate parties” and on the “independent actions of third and even fourth parties.” *Id*. at *7, *9 (emphasis in original), Justice Ginsburg, concurring, agreed that the plaintiff failed to state a RICO claim. She wrote separately to express her “resist[ance] to reading RICO to allow the [plaintiff] to end-run its lack of authority . . . to reshape the quite limited remedies Congress has provided for violations of the Jenkins Act.” *Id*. at *11. Similarly, Congress has provided limited remedies under the FDCA, where there is no private right of action for the “off-label” promotion of prescription medications.

31 585 F. Supp. 2d at 1344-45.

32 *Id*. at 1344 (citing Anza v. Ideal Steel Supply Corp., 547 U.S. 451, 460 (2006)).

33 614 F. Supp.2d at 1054.

34 *Id*. See also *In re Schering-Plough Corp.*, 2009 WL 2043604, at *26 (“The TPP plaintiffs may not establish the requisite proximate cause through aggregate proof or generalized allegations of fraudulent conduct and resulting harm. Instead, a court or jury would have to determine whether each prescribing physician received fraudulent marketing information from the Defendants and whether each physician was influenced to prescribe the Subject Drugs on account of
The issue of intervening medical judgment is closely related to the learned intermediary doctrine. Under the learned intermediary doctrine, a prescription drug manufacturer fulfills its duty to warn of the potential risks associated with a drug by providing warnings to the prescribing physician, and has no duty to warn the patient directly.\textsuperscript{35} The learned intermediary doctrine is well established in virtually every United States jurisdiction, although it has been under attack in recent years.\textsuperscript{36} Both the \textit{AstraZeneca} and \textit{Actimmune} courts implicitly relied on the learned intermediary doctrine when considering the effect of doctors’ independent medical judgment on causation issues. Other courts considering civil RICO claims for off-label advertising have explicitly discussed the learned intermediary doctrine when rejecting plaintiffs’ claims, even in New Jersey where the learned intermediary doctrine has limited application to a product that has been mass-marketed.\textsuperscript{37}


\textsuperscript{36} See \textit{Perez v. Wyeth Labs.}, Inc., 734 A.2d 1245, 1262-1263 (N.J. 1999) (holding that when manufacturers engage in the direct marketing of drugs to consumers, they have a corresponding duty to warn of the risks associated with the drugs).

\textsuperscript{37} See \textit{In re Zyprexa}, 253 F.R.D. at 150-51 (discussing how the prescription drug context is unique and how doctors act as a learned intermediary when exercising independent medical judgment); \textit{In re Neurontin Mktg.}, 244 F.R.D. 89,113 (D. Mass. 2007) (noting the difficulty in identifying members of the

III. Courts Reject a Class-Wide Presumption of Reliance under a Fraud-on-the-Market Theory

In order to avoid the kinds of difficult problems described by the courts in \textit{AstraZeneca} and \textit{Actimmune} (and in an attempt to avoid substantial discovery concerning the prescriptions at issue), plaintiffs have attempted to argue that they do not need to establish that any doctor or any payor actually relied on any misrepresentation and that they can satisfy causation through “statistical proof” concerning either “purchasing trends” or “price inflation.” Courts generally have refused to accept these theories as a means to overcome individual causation issues in these cases. In \textit{Actimmune}, for example, Judge Patel of the Northern District of California rejected a presumption of reliance based on the fraud-on-the-market theory under plaintiff class because the patients purchased drugs only with the prescription of a doctor who is a “learned intermediary.”). At least one New Jersey court held that although the state rejected the learned intermediary doctrine in the context of direct-to-consumer advertising of prescription drugs, the intervening medical judgment of a physician still creates causation problems. \textit{N.J. Citizen Action v. Schering-Plough Corp.}, 842 A.2d 174, 178 (N.J. Super. Ct. App. Div. 2003). The court found that “[i]n this context, that is, within a highly regulated industry in which the ultimate consumer is not in fact free to act on claims made in advertising in any event, the relationship between words used in the advertising and purchase of the product is at best an attenuated one.” \textit{Id.} Although the case involved a state law fraud claim, it may provide guidance for other courts considering plaintiffs’ claims under RICO.
both RICO and state law claims. The court found that this theory does not apply in non-efficient markets and questioned whether prescription drugs have a “market” that is in any way equivalent to a securities matter. Judge Patel also found that this theory was inappropriate because the causal connection between the defendant’s alleged conduct and the plaintiffs’ alleged injuries was so attenuated that “it would effectively be non-existent.” Instead, to satisfy the causation requirements of RICO, plaintiffs would need to allege and establish what specific information individual plaintiffs and doctors had, the extent to which they relied on it, and what information was false, misleading, or otherwise fraudulent.

In In re Neurontin Marketing, Judge Saris of the District of Massachusetts held that plaintiffs could not use an expert’s statistical model based on a price inflation theory to establish causation, even if the model showed that nearly all the prescriptions written for the drug were for off-label uses. In doing so, the court relied on the growing body of law rejecting any presumption of reliance in the consumer fraud and prescription drug context. The court also noted the wide variety of factors influencing a doctor’s decision to prescribe medication and the differences among the formularies of the third-party payors. Without a class-wide presumption of reliance, the court held that individual issues predominated over common issues and thus denied the plaintiffs’ motion for class certification. In Janssen, Judge Wolfson of the District of New Jersey also noted that plaintiffs would likely have a proximate causation problem due to the individualized decision-making of physicians and could not proceed on a fraud-on-the-market or price-inflation theory. Most recently, the Superior Court of Pennsylvania upheld the decertification of a third-party payor class action, holding that “statistical probability does not substitute for actual inquiry, as a general showing of percentages does not tend to prove that the class members’ specific doctors relied upon Defendants’ statements or that Defendants’ statements were the proximate cause of an injury.”

IV. Plaintiffs Fail to Allege an Injury Cognizable Under RICO

Plaintiffs likewise have had difficulties in meeting RICO’s injury requirement. Pursuant to 18 U.S.C. § 1964(c), a plaintiff must suffer an “injury to business or property” to recover under RICO. In Janssen, the court held that the alleged “overpayment” for prescription

38 614 F. Supp. 2d at 1054.
39 Id.
40 257 F.R.D. 315.
42 2008 WL 5413105.
43 The court failed to address causation fully, however, because the claim failed on injury grounds. Id. at *9.
medicine was not a cognizable injury under RICO in the absence of allegations that the drug was inferior or injurious.\textsuperscript{45} In reaching this conclusion, the court relied on \textit{Maio v. Aetna, Inc.},\textsuperscript{46} in which the plaintiffs did not claim they received inadequate or harmful medical care as a result of the defendant’s health insurance, but merely that they “overpaid” for their insurance policies. The Third Circuit held that claims of overpayment in the absence of inadequate healthcare are not a “concrete financial loss” as required under RICO. Based on this precedent, the \textit{Janssen} court rejected plaintiffs’ claims.

V. \textit{In re Zyprexa Stands Alone As A Class Certification Victory For Plaintiffs}

A significant outlier among the recent wave of decisions rejecting purported civil RICO claims concerning the pharmaceutical market is \textit{In re Zyprexa Products Liability Litigation}.\textsuperscript{47} In \textit{Zyprexa}, private third-party payors sought damages for alleged overpayment for prescription drugs under civil RICO based on the defendant’s allegedly fraudulent off-label promotion. Eli Lilly argued on both a motion to dismiss and a motion for summary judgment that the plaintiffs failed to show proximate cause, lacked standing, and failed to suffer a direct injury as required under RICO. Lilly also challenged the plaintiffs’ experts, arguing that their calculation of injuries was analytically flawed and failed to take into account both other factors influencing pricing and the realities of the prescription drug “market.”

On class certification, Judge Weinstein allowed plaintiffs to introduce an expert using a statistical model to establish causation on a class-wide basis. Judge Weinstein held that a presumption of reliance was appropriate because “the total fraud resulted in an increased price as in securities cases, so the fact that some doctors, patients or others were unaware of the fraud is irrelevant.”\textsuperscript{48} Assuming plaintiffs proved that the fraud caused a difference in price, a jury could estimate damages based on the difference between what plaintiffs paid for the drug and its actual value. Thus, the court rejected the defendant’s arguments regarding causation and found sufficient proof of injury under a “price impact theory” to certify the class.

This ruling is based on the same theory that Judge Weinstein adopted two years earlier in \textit{Schwab v. Philip Morris USA, Inc.}\textsuperscript{49} In \textit{Schwab}, plaintiffs brought a RICO class action against a cigarette manufacturer claiming that the defendant’s fraudulent promotion caused plaintiffs to pay more for the cigarettes, resulting in economic injury. Judge Weinstein certified the class using a price-inflation theory of causation. The Second Circuit reversed, holding that “causation, much like the issue of reliance, cannot be resolved by way of generalized proof.”\textsuperscript{50} Instead, plaintiffs could not establish direct injury, because factors other than the defendant’s

\begin{footnotes}
\item[45] Id.
\item[46] 221 F.3d 472 (3d Cir. 2000).
\item[47] 253 F.R.D. at 75.
\item[48] Id. at 195.
\item[50] 522 F.3d at 226.
\end{footnotes}
misrepresentations contributed to the decision to purchase the cigarettes and several plaintiffs continued to purchase the cigarettes even after filing the suit. In overturning Schwab, the Second Circuit held that the “loss of value model is designed to award plaintiffs damages based on the benefit of their bargain. Such damages are generally unavailable in RICO suits ... [where the statute] compensates only for injury to business or property.”

In Zyprexa, Judge Weinstein attempted to distinguish the Second Circuit’s reversal of his light tobacco decision, asserting that the Circuit Court decision is no longer good law in light of the Supreme Court’s decision in Bridge. Although Judge Weinstein reasoned that Bridge held that a plaintiff need not prove reliance on the defendant’s misrepresentations, that rationale is hard to understand since Bridge took pains to reaffirm its prior decisions concerning the requirement of a direct injury under RICO and it expressly stated that plaintiffs usually have to show that “someone relied on the defendant’s misrepresentation.”

Even Judge Weinstein has publicly characterized this theory of liability as “thin,” and at least one subsequent opinion by Judge Weinstein clarified that his rationale extended only to “price inflation” claims and not to the other claims or theories in the case.

Other courts addressing purported civil RICO off-label marketing claims have declined to follow Zyprexa. For example, Judge Wolfson explicitly rejected Zyprexa in Janssen, noting that Judge Weinstein relied on the very theory of loss-causation from Schwab which had been explicitly rejected by the Second Circuit. Judge Wolfson also held that the alleged misrepresentations did not affect the value of the product, but merely could have encouraged the plaintiffs to purchase the product over others. Because the overall price of the drug was not affected, the court found that the plaintiffs’ reliance on Zyprexa was misguided.

Judge Saris in Neurontin found Zyprexa inapplicable, reasoning that the plaintiffs’ claims did not involve the same type of price inflation injury as alleged by the plaintiffs in Judge Weinstein’s opinion. Zyprexa is now on appeal to the Second Circuit and remains an outlier in the debate over the use of civil RICO to aggregate pharmaceutical product liability claims.

VI. Conclusion

The clear trend in this area has been to reject plaintiffs’ attempts to prosecute civilly pharmaceutical off-label promotion claims through civil RICO. These claims have failed in the pleading stages because plaintiffs did not allege (dismissing on summary judgment all similar claims brought by the State of Mississippi against Lilly except for price inflation because statistical evidence was legally inadequate to demonstrate causation).

51 Id. at 228 (internal citations omitted).
52 128 S. Ct. 2131.
53 Id. at 2144.
54 See Weinstein, supra note 11, at 17.
57 257 F.R.D. at 327, n. 7.
fraud with specificity as required under Rule 9(b) and instead alleged off-label promotion which is not inherently fraudulent. They also have failed on causation grounds due to the lack of a direct causal connection in light of the many intervening factors involved in a doctor’s professional decision to prescribe drugs and the valid unwillingness of courts to recognize a fraud-on-the-market theory of liability in this context. Finally, courts have rejected these claims for failure to state a cognizable injury to business or property under RICO. Zyprexa and AstraZeneca are on appeal to the Second and Eleventh Circuit Courts of Appeals. Although the outcomes of these cases remain to be seen, it appears unlikely that plaintiffs will succeed in future suits. Instead, plaintiffs will likely fail for many of the same reasons that courts rejected attempts to bring garden-variety fraud cases under civil RICO in the 1980s.

By Tamela J. White

In the United States, Medicare, along with other government-sponsored health benefit plans including Medicaid and SCHIP (State Children’s Health Insurance Program), is a stabilizing giant in public health intervention. The United States Department of Health and Human Services (DHHS) and its operating division, the Centers for Medicare and Medicaid Services (CMS) together operate one of the largest health care businesses in the world. Medicare, funded entirely by the United States government, provides benefits to persons over 65 years of age, persons with end stage renal disease, and persons receiving Social Security Disability for at least twenty four (24) months. Medicaid and SCHIP are needs-based programs funded through both state and federal resources.

2 Medicaid was established in 1965 as Title XIX of the Social Security Act. 42 U.S.C. §§ 1396, et. seq. (1965). Its beneficiaries do not necessarily contribute to/pay for its needs-based benefits, as vulnerable populations that lack resources to pay for health services. 42 U.S.C. § 1396d (1965). All states voluntarily participate in the program. SCHIP was established in 1997, and in 2009, was reauthorized until 2013. CHILDREN’S HEALTH INSURANCE PROGRAM REAUTHORIZATION ACT OF 2009 (CHIPRA), Pub. L. No. 111-3, 123 Stat. 8 (reauthorizing 42 U.S.C. §§ 1397aa, et seq.).
3 Department of Health and Human Resources (DHHR), Centers for Medicare and Medicaid

One in every four Americans receives benefits from these programs, and the populations served are those considered most vulnerable due to age, socioeconomic status, underlying health conditions, and other immutable factors.

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Medicare, Medicaid, and SCHIP spending exceeded that of the Department of Defense in 2009, despite the country being in two (2) wars and engaged in numerous other defense-related missions.\(^4\) Because of the programs’ suprainflationary cost increases, calls to action for health care expenditure cost containment and control have been made often since these programs were established.\(^5\) Fiscal responsibility is generally recognized as a necessity if these programs are to survive.

In 1980, Congress reversed twenty-five (25) years of uncontrolled payment of health care benefit claims through passage of the Medicare Secondary Payer Act (MSP).\(^6\) The MSP declares that Medicare is the secondary payer to other available payment sources for healthcare-related costs arising out of a particular triggering event (qualifying) event. The MSP provides that Medicare is not obligated to pay where there exists in place, for the benefit of the individual Medicare participant, another payment source. Medicare beneficiaries, beneficiaries’ attorneys, and alternative payment source plans (including, as discussed in greater detail below, liability insurers, self-insurance plans, employer-based group health plans, and workers’ compensation plans (private or state-funded\(^7\))) are all subject to the MSP’s mandates.

MSP recovery efforts by CMS have been robust. The DHHS estimates that in the first eleven (11) months of 2009, alone, MSP enforcement saved the Medicare trust approximately $6.24 billion dollars.\(^8\) However, $6.24 billion dollars is miniscule in comparison to the program, representing a mere 1.2% of

\(^4\) Id.

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\(^7\) Workers’ compensation is a “law or plan of the United States, or any state, that compensates employees who get sick or injured on the job . . . A workers’ compensation law or plan means a law or program administered by a State . . . or the United States to provide compensation to workers for work-related injuries and/or illnesses. The term includes a similar compensation plan established by an employer that is funded by such an employer directly or indirectly through an insurer to provide compensation to a worker of such employer for a work-related injury or illness.” CMS, *MMSEA Section 111 Medicare Secondary Payer Mandatory Reporting: Liability Insurance (Including Self-Insurance), No-Fault Insurance, and Workers’ Compensation USER GUIDE* (hereinafter “MMSEA User Guide”), Jul. 31, 2009, at 14, available at http://www.cms.hhs.gov/MandatoryInsRep/Downloads/NGHPUserGuide2ndRev082009.pdf. (last visited February 25, 2010).

Medicare’s 2009 total benefits payments.\(^9\)

From inception and until 2007, CMS’ MSP recovery efforts were through a framework designed around trailing indicators. CMS relied upon published mandates providing that notice and repayment obligations be satisfied by beneficiaries within sixty (60) days (the “60-day rule”) of receipt of a settlement or resolution payment. Beneficiaries and their attorneys regularly signed settlement releases affirming these repayment obligations had been or would be satisfied within the 60-day rule requirement. Insurers and payer sources had no separate obligation to report payments to CMS.

In 2007, Congress passed Section 111 of the Medicare, Medicaid, and SCHIP Extension Act (MMSEA), changing this paradigm by imposing an obligatory, leading indicator framework system upon primary payer sources.\(^10\) MMSEA mandatory reporting is anticipated to result in significant costs savings for the government, both in procurement (collection) and administrative (clerical) related expenses.\(^11\) The MMSEA accomplishes these savings by shifting the onerous burden to primary payers to timely report payments when made to beneficiaries and/or their counsel. Failure to timely report payments exposes primary payers to substantial non-compliance penalties ($1,000 a day) if there is a failure to report either single (lump sum) payments or ongoing (ongoing medical) payment agreements, as well as to MSP recovery action, which allows for double damages. The MMSEA makes primary payer sources the Orwellian “Big Brother” to beneficiaries and their counsel, forcing primary payers to administratively account for payments so that CMS may recover Medicare trust funds.

This article provides a resource for counsel and liability primary payer entities, discussing (a) the MSP, its historical judicial treatment and construction of its provisions, and (b) Section 111 of the Medicare, Medicaid, and SCHIP Extension Act (MMSEA), specifically in the context of the liability (and self-insurance) insurance, non-workers’ compensation, non-Group Health Plan (NGHP) context.\(^12\) Brief


treatment is also given to the Federal Medical Care Recovery Act (MCRA) applicable to service members and future issues such as Medicaid Set-Aside Agreements, as these will be an area to monitor as government enforcement turns to those arenas.

I. The Medicare Secondary Payer Act (MSP)

In its infancy, Congress made no provision in the 1965 Social Security Act\(^\text{13}\) for Medicare to be a secondary payment source for medically necessary care provided to beneficiaries. From 1965-1980, the United States experienced a significant, inflationary trend in healthcare costs and spending, which even in 2010 remains a political hot potato and public policy concern. To control health care costs and to recover moneys paid where alternative, primary payment sources exist,\(^\text{14}\) in 1980, the Medicare Secondary Payer Amendments to the Social Security Act\(^\text{15}\) (MSP) were passed.

MSP provides that if a beneficiary receives medically-necessary care for which payment has been or is reasonably expected to be paid by a primary payer source, Medicare does not have to pay at all.\(^\text{16}\) Because the existence of a primary payer may be unknown or ambiguous when care is provided, in order to protect the beneficiary, Medicare may issue payment conditionally to the provider. As a condition of program participation and for Medicare essentially to be willing to invest in the individual’s health, each beneficiary must agree that Medicare can recoup money that it has spent, prohibiting the beneficiary from profiting on an illness or injury. As an additional protection for individual Medicare beneficiaries, Medicare cannot deny conditional payment merely because a beneficiary has not completed a Medicare beneficiary application form.\(^\text{17}\)

Once conditional payments have been recovered from a primary payer source, Medicare may assert any future recovery rights directly against the beneficiary,\(^\text{18}\) a beneficiary’s attorney,\(^\text{19}\) or, alternatively,

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\(^\text{13}\) Medicare was created in 1965 as Title XVIII of the Social Security Act. 42 U.S.C. §§ 1395, et seq. (1965).

\(^\text{14}\) See Thompson v. Goetzmann, 337 F.3d 489, 495 (5th Cir. 2003) (noting the MSP was enacted to reduce Medicare costs); Zinman v. Shalala, 67 F.3d 841, 845 (9th Cir. 1995) (“The transformation of Medicare from the primary payer to the secondary payer with a right of reimbursement reflects the overarching statutory purpose of reducing Medicare costs”); Provident Life & Accident Ins. Co. v. United States, 740 F. Supp. 492, 498 (E.D. Tenn. 1990) (“The intent of Congress in shifting the burden of primary coverage from Medicare to private insurance carriers was to place the burden where it could best be absorbed”).


\(^\text{19}\) Id.
from the primary payer source. Medicare can only recover on its conditional payments. If a beneficiary receives other forms of economic (such as lost wages or household services) or non-economic recovery, Medicare cannot claim those sums under the MSP.

Often, primary payment source obligations ripen only after a beneficiary seeks necessary health care. Under those circumstances, Medicare makes conditional payments to health care providers where a known or identified primary plan has not or “reasonably cannot be expected to” pay for the item or service “promptly.”

20 42 U.S.C. §§ 1395y(b)(2)(B)(ii-iv) (2008); United States v. Baxter Int’l, Inc., 345 F.3d 866, 875 (11th Cir. 2003) (“Although the statute is structurally complex—a complexity that has produced considerable confusion among courts attempting to construe it—the MSP’s function is straightforward. . . . ‘[I]f payment for covered services has been or is reasonably expected to be made by someone else, Medicare does not have to pay. In order to accommodate its beneficiaries, however, Medicare does make conditional payments for covered services, even when another source may be obligated to pay, if that other source is not expected to pay promptly’”).

21 42 U.S.C. § 1395y(B)(i) (2008). Prompt payment has been defined in regulation to be payment of the health care provider’s bill in one hundred twenty (120) days. If a primary plan does pay for the subject-care within that four month time period, Medicare is obligated to pay any non-deductible or co-pay balance not otherwise paid for by a primary plan. The United States’ right to recover conditional payments made where a primary plan has not or is not reasonably anticipated to pay within 120 days of the health care provided, are superior to “any right . . . of an individual or any other entity to payment with respect to such item or service under a primary plan.”

A private settlement agreement between a responsible primary source and a beneficiary does not bind the United States and cannot circumvent government recovery rights. An attempted apportionment of economic and non-economic percentages by private agreement that favors the beneficiary such that the amount of prior, paid medical costs are not repaid in accordance with CMS requirements also will not be recognized by the government.


23 “Where payment for an item or service by a primary plan is less than the amount of the charge for such item or service and is not payment in full, payment may be made under this title. . . . for the remainder of such charge. . . .” 42 U.S.C. § 1395y(b)(4) (2008).


25 Zinman, 67 F.3d at 843 (9th Cir. 1995); Denekas v. Shalala, 943 F. Supp. 1073, 1078 (S.D. Iowa 1996).

Government cannot recover against non-beneficiaries that have legitimate derivative claims, provided that any resolution of derivative claims is not a sham intended to divert funds ultimately to the benefit of the Medicare beneficiary.\(^\text{27}\)

CMS recognizes and does not disturb in MSP recovery efforts any apportionment via final judgment and/or jury award.\(^\text{28}\) Nonetheless, MSP preempts state statutory apportionment provisions, the United States’ recovery rights in this regard being recognized as not merely rights of subrogation:

The [Medicare Secondary Payer] legislation does not confine the HHS’ right of reimbursement to its right of subrogation. The statute grants HHS an independent right of recovery against any entity that is responsible for payment of or that has received payment for Medicare related items or services, including the beneficiary herself... This independent right of recovery... is not limited by the equitable principle of apportionment stemming from the subrogation right... Nothing in the [language of the Act] limits Medicare's right of full reimbursement.\(^\text{29}\)

Hence, state laws designed to protect private interests in the event of liability insurance carrier insolvency are preempted by the MSP, as are any state laws that that otherwise interfere with federal recovery.\(^\text{30}\) For instance, a Texas law that sanctioned health care providers for not billing within eleven (11) months of service with beneficiary debt forgiveness (payment forfeiture)\(^\text{31}\) and an Indiana statute establishing a prioritized lien in favor of a hospital against any personal injury judgment award have been judicially challenged and found to be subject to conflict preemption principles.\(^\text{32}\)

Courts uniformly demur to CMS’ negotiation authority and discretionary decision-making as to compromise of any lien debt. Hardship waivers, discussed below, are not compromises. Hardship waivers constitute a relinquishment of the government’s right to collect a portion of

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\(^{27}\) Denekas, 943 F. Supp. at 1081.

\(^{28}\) Id. at 1079 (“Medicare will relent, however, and exercise its right of reimbursement only against damages found for medical expenses where the medical and nonmedical damages items are determined by judgment or an arbitration.” (citing Zinman v. Shalala, 835 F. Supp. 1163, 1167 (N.D. Cal. 1993), aff’d, 67 F.3d 841 (9th Cir. 1995))).


\(^{29}\) Energy Res. Conservation and Dev. Comm’n, 461 U.S. 190, 204 (1983); Cox v. Shalala, 112 F.3d 151 (4th Cir. 1997) (federal law preempts the North Carolina wrongful death act which placed a $1,500.00 cap on third party recovery of medical expenses; Medicare entitled to recover the $181,187.75 that it conditionally paid when the parties to the wrongful death action settled the matter (citing Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963))).

\(^{30}\) United States v. R.I. Insurer’s Insolvency Fund, 80 F.3d 616 (1st Cir. 1996).


its debt from the beneficiary.\textsuperscript{33} In negotiations, CMS can and will seek to recover 100\% of conditional payments (less procurement costs (reasonable attorney fees and expenses)).

MSP vests a cause of action to the United States “against any or all entities that are or were required or responsible (directly, as an insurer or self-insurer, as a third-party administrator, as an employer that sponsors or contributes to a group health plan, or large group health plan, or otherwise) to make payment with respect to the same item or service (or any portion thereof) under a primary plan.”\textsuperscript{34} The United States may bring a direct recovery action or may intervene in an existing lawsuit. Most commonly, it has flexed its recovery muscles through administrative processes by direct notice to a beneficiary and his/her representative counsel.\textsuperscript{35}


\textsuperscript{35} 42 U.S.C. §§ 1395y(b)(2)(B)(ii-iii) (2008); see also 42 U.S.C. § 1395y(b)(2)(B)(iv) (2008) (stating that the United States “shall be subrogated (to the extent of payment made ...) to any right under this subsection of an individual or any other entity to payment with respect to such item or service under a primary plan”). However, as explained supra, this subrogation right has been held to be exempt from equitable provisions of apportionment and counsel should not rely upon that concept in making decisions as to distribution of funds. Zinman, 67 F.3d at 843; Harris, 2009 WL 891931; Haro v. Sebelius, No. CV 09-134

The statute of limitations for MSP recovery is six (6) years, but that is tolled when “facts material to the right of action are not known and reasonably could not be known by an official of the United States . . . .”\textsuperscript{36} The new Section 111 MMSEA provisions will make documentation of this limitations period more precise with responsible applicable plans reporting resolutions by means of settlement, judgment, final order, or otherwise.

For private citizens with standing, the MSP also creates a cause of action “for damages (which shall be in an amount double the amount otherwise provided) in the case of a primary plan which fails to provide for primary payment (or appropriate reimbursement) . . . .”\textsuperscript{37} In other words, a private citizen may bring a suit against a primary plan and recover the underlying unpaid Medicare amount and 100\% of the same for himself/herself. This essentially would require a payer to settle the same medical expense claim three times.

There is an important difference between what this private action is and what it is not. It is a cause of action for specific beneficiaries where an obliged primary payer has failed to repay conditional Medicare payments upon which the primary payer had notice.\textsuperscript{38} The private cause of action is not a \textit{qui tam} action.\textsuperscript{39} Plaintiffs seeking to convert


\textsuperscript{38} Warth v. Seldin, 422 U.S. 490, 499 (1975).

\textsuperscript{39} \textit{In re} Guidant Corp. Implantable Defibrillators Prod. Liab. Litig., 484 F.
MSP repayment claims into mass-tort scenarios have been rejected for failing to meet the specific threshold standing requirements of injury in fact, causal connection, and injury redress. A given Medicare beneficiary lacks standing on behalf of a class of “all” Medicare beneficiaries, even if with common personal injuries. A generalized grievance that MSP payment was untimely is insufficient to state a claim for which relief may be granted. Injury in fact exists only with respect to a given beneficiary and conditional payments made on his/her behalf. Otherwise, dismissal for want of standing has been the uniform result in private action, double damages recovery challenges.

43 O’Connor v. Mayor and City Council of Baltimore, 494 F. Supp.2d 372 (D. Md. 2007) (upholding enforcement of city’s insurance plan to reimburse condition payments for firefighter with mesothelioma) (citing Manning v. Utils. Mut. Ins. Co., 254 F.3d 387, 394 (2d Cir. 2001) (“The MSP creates a private right of action for individuals whose medical bills are improperly denied by insurers and instead paid by Medicare . . . ”)).

44 See e.g., Woods v. Empire Health Choice, Inc., 574 F.3d 92 (2d Cir. 2009) (in the absence of injury-in-fact, there is no standing; pro se plaintiff that merely was resident of New York and federal taxpayer was insufficient basis for standing); Stalley ex rel. U.S. v. Orlando Regional Healthcare System, Inc., 524 F.3d 1229 (11th Cir. 2008) (plaintiff who alleges no injury to himself lacks standing to recover damages under the MSP); Stalley v. Catholic Health Initiatives, 509 F.3d 517 (8th Cir. 2007) (a volunteer plaintiff who lacks injury in fact lacks standing); Medalie v. Bayer Corp, 510 F.3d 828 (8th Cir. 2007); Stalley v. Catholic Health Initiatives, 458 F. Supp.2d 958 (E.D. Ark. 2006); Stalley v. Mountain States Health Alliance, et al., Nos. 2:06-CV-216, 2:06-CV-217, 2009 WL 37182 (E.D. Tenn. Jan. 5, 2009) (Plaintiff and Erin Brockovich sought MSP recovery as a private attorney general for reimbursement of Medicare expenses incurred dismissed for lack of standing); Brockovich v. Community Med. Ctrs., Inc., No. CV-F-06-1609 LJO DLB, 2007 WL 738691 (E.D. Cal. Mar. 7, 2007); Stalley v. Delta Health Group,
That which constitutes a responsible “primary plan” is central to MSP construction. Prior to 2003, courts were divided as to whether or not this included non-traditional forms of insurance such as funds created by entities that establish or carry their own risk in civil tort liability matters.\textsuperscript{45} Effective 2003, Congress changed the definition of “primary plan” to ensure the “Secretary’s authority to recover payment from any and all responsible entities.”\textsuperscript{46} For MSP (and MMSEA) mandates, primary plans include “certain group health plan[s] or


large group health plan[s]\textsuperscript{47} . . . workmen[s] compensation law[s], self-insured plan[s], or no fault insurance.”\textsuperscript{48} Self-insured plans include any “entity that engages in a business, trade, or profession shall be deemed to have a self-insured plan if it carries its own risk (whether by a failure to obtain insurance, or otherwise) in whole or in part.”\textsuperscript{49} No-

\textsuperscript{47} As stated in 42 U.S.C. § 1395y(b)(1)(A)(v) (2008), a “group health plan” is defined as set forth in 26 U.S.C. § 5000(b)(1) (1993): “[A] plan (including a self-insured plan) of, or contributed to by, an employer (including a self-employed person) or employee organization to provide health care (directly or otherwise) to the employees, former employees, the employer, others associated or formerly associated with the employer in a business relationship, or their families.” A “large group health plan” is: “[A] plan of, or contributed to by, an employer or employee organization (including a self-insured plan) to provide health care (directly or otherwise) to the employees, former employees, the employer, others associated or formerly associated with the employer in a business relationship, or their families, that covers employees of at least one employer that normally employed at least 100 employees on a typical business day during the previous calendar year.” 26 U.S.C. § 5000(b)(2) (1993).

\textsuperscript{48} 42 C.F.R. § 411.50 (2008) defines “liability insurance” as: “Insurance (including a self insured plan) that provides payment based on legal liability for injury or illness or damage to property. This includes, but is not limited to, automobile liability insurance, uninsured motorist insurance, under insured motorist insurance, malpractice insurance, product liability insurance and general casualty insurance.”

fault plans include automobile, commercial and homeowners plans.\textsuperscript{50}

There is an important difference between a “primary plan” and a “plan” for MSP purposes. A “plan” is essentially any form of resolution of a claim or dispute. The technical definition of a plan is “[any] arrangement, oral or written, by one or more entities, to provide health benefits or medical care or assume legal liability for injury or illness.”\textsuperscript{51} Any form of indemnity payment or compromised resolution is subject to MSP recovery. Primary plan payment examples given by CMS include settlements and claim payments, such as those arising out of automobile liability insurance, uninsured motorist insurance, under-insured motorist insurance, malpractice insurance, product liability insurance, and general casualty insurance.\textsuperscript{52} Self insured plans and trusts, including corporate mass-tort settlement funds, are liability insurance for purposes of MSP application.\textsuperscript{53}

Primary plan obligations and MSP non-compliance penalties are not relieved by the 2007 MMSEA. MMSEA penalties, including the assessment of interest charges, add to the consequences of MSP non-compliance.\textsuperscript{54} Interest has historically been assessed on beneficiaries given the 60-day rule. This time frame must be reconciled with primary plan MMSEA quarterly reporting windows which are operative beginning in 2010. To date, there are no reported opinions or decisions arising out of an attempted recovery or assessment of interest against a primary plan.

Stakeholders with specific obligations, sanction and liability exposure arising out of MSP obligations include beneficiaries, health care providers (participating providers), employers, group health plans (GHPs), attorneys, and insurers. Each has distinct obligations, which are outlined as follows with an accompanying discussion of major related judicial decisions.\textsuperscript{55}

A. Responsibilities of Beneficiaries

As a condition of participation, beneficiaries must disclose known actual or potential alternative payment sources. Any beneficiary who cannot comply due to physically or mentally incapacity is relieved of this duty.\textsuperscript{56} Otherwise, failure to properly disclose and cooperate with CMS may jeopardize a beneficiary’s plan participation.\textsuperscript{57}

Beneficiaries fulfill this responsibility when presenting for health care at the

\textsuperscript{50} 42 C.F.R. § 411.50(b) (2008); see also MMSEA User Guide, supra note 7, at 215.
\textsuperscript{51} 42 C.F.R. § 411.21 (2008) (emphasis added). By the disjunctive provision “or assume legal liability for injury or illness,” any “arrangement” to assume legal liability for injury or illness has been determined to be subject to these provisions. \textit{See Zinman}, 67 F.3d at 843; \textit{Denekas}, 943 F. Supp. 1073.
\textsuperscript{52} 42 C.F.R. § 411.50 (2008).
\textsuperscript{53} \textit{See Zinman}, 67 F.3d at 843; \textit{Denekas}, 943 F. Supp. 1073.
\textsuperscript{55} MMSEA User Guide, supra note 7; see also http://www.cms.hhs.gov/MEDICARESECON DPAYERANDYOU/ (last accessed February 25, 2010).
portal of entry into the health care system, if alternative payers are known. Beneficiaries are instructed to inform health care providers and the applicable regional Coordination of Benefits Contractor (COBC)\(^{58}\) about any health insurance or employment change; any legal action taken for a medical claim; involvement in an automobile accident that triggered the need for health care; and involvement in any workers’ compensation action.\(^{59}\)

If a beneficiary later receives a settlement, judgment, or other qualifying-event payment, even if the alternative payer has not been previously disclosed, the beneficiary still has the duty and obligation to report.\(^{60}\) The “60-day rule” applies: a beneficiary has the obligation to repay conditional payments within 60 days of receipt of payment by a primary payer source.\(^{61}\) Code of Federal Regulations, 42 Section 411.24(h) provides: “Reimbursement to Medicare. If the beneficiary or other party receives a primary payment, the beneficiary or other party must reimburse Medicare within 60 days.”\(^{62}\) The 60-day rule is designed to prevent these moneys from being spent before Medicare recovers. Receipt of funds by the beneficiary and his/her agent, which includes counsel or a negotiating surrogate/Power of Attorney (“or other party”), constitutes the triggering event for repayment.\(^{63}\)

Medicare is not a required payee on any settlement check because it is the beneficiary’s duty, not the primary source’s, to make the payment.\(^{64}\) Failure by a beneficiary to repay may result in a direct action by the government against his/her estate and may jeopardize a beneficiary’s Medicare eligibility status.\(^{65}\)

There have been few challenges in the courts to CMS’ beneficiary-oriented recovery efforts. Most conditional repayment claims are resolved through (and with) the beneficiary’s private attorney and that attorney’s negotiation efforts and established-relationship with the COBC. Other parties with interests in ensuring the repayment of any CMS lien, including those being released from liability and primary plan payers, have historically relied upon the beneficiary and his/her attorney to attest to satisfaction of any CMS repayment obligation. The MMSEA does not disturb a beneficiary’s obligations but it does, by operation, mandate a beneficiary to cooperate and provide a primary plan more than a promise or affirmation of

\(^{58}\) “The COBC consolidates the activities that support the collection, management, and reporting of other insurance or workers’ compensation coverage for Medicare beneficiaries. The COBC does not process claims or answer claims specific inquiries, nor does it handle MSP recoveries. Instead the COBC updates the CMS systems and databases used in the claims payment and recovery processes.” MMSEA User Guide, supra note 7, at 14.

\(^{59}\) MMSEA User Guide, supra note 7; see also http://www.cms.hhs.gov/MEDICARESECONDPAYERANDYOU/ (last accessed February 25, 2010).

\(^{60}\) 42 U.S.C. § 1395y(b); 42 C.F.R. § 411.24(h) (2008).

\(^{61}\) Contrast with primary payer obligations to timely report these payments, discussed infra.


\(^{64}\) Tomlinson, 2009 WL 1117399 at *5-6.

\(^{65}\) Harris, 2009 WL 891931.
MSP compliance. The MMSEA’s primary plan reporting obligations impose upon the beneficiary the obligation to cooperate with the primary plan in reporting payments and settlements. Failure to cooperate and provide necessary documentation will result in primary plans refusing to remit settlement payments, since the $1,000-dollar-a-day primary plan penalty calculation begins with payment date.

Courts have consistently found that disputes between CMS and a beneficiary are not ripe for federal court jurisdiction until there is an exhaustion of administrative remedies. Conditional payment recovery and any negotiated lien reduction are within CMS’ discretionary authorities, except that CMS is obligated to pay reasonable attorney procurement fees and costs. If a prior conditional payment is less than the amount of a settlement, attorney fees and procurement costs are calculated to be equal to the ratio of those fees and expenses to the total settlement (recovery). If the conditional payment owed to CMS equals or exceeds a settlement amount, CMS will recover the full amount of its prior conditional payments, less attorneys’ fees and expenses.

CMS may reduce or waive its lien if either the “the probability of recovery, or the amount involved, does not warrant pursuit of the claim.” CMS may also compromise a claim where the beneficiary is unable to “pay the full amount within a reasonable time”; where CMS is unable “to collect . . . in full within a reasonable time”; where “the cost of collecting . . . does not justify the collection of the full amount”; or where “there is significant doubt concerning the government’s ability to prove its case in court.” These scenarios are different from and should not be confused with hardship waivers (discussed below).

Pre-existing conditions do not diminish Medicare's claims. The divisibility of payments, if any, made by Medicare may be difficult and may require counsel to be prepared to make an evidentiary showing during any administrative or other process of the separate nature of the injuries for which litigation recovery is based. Medicare’s counsel may then be confronted with a tangible tension between the obligation to maximize litigation recovery for a beneficiary and the costs and expenses attendant with protracted litigation.

Hardship waivers may be granted, but are discretionary. Hardship waivers are granted where (1) a beneficiary was not at fault and (2) CMS recovery would defeat the purposes of the Medicare Act or be “against equity and good conscience.” The standard of proof requires a showing that Medicare's recovery would be against

67 The agency is obligated to reimburse (pay) a beneficiary/claimant’s attorney’s reasonable attorney fees and procurement costs. 42 C.F.R. § 411.37(a) (2008).
68 42 C.F.R. § 411.37(c) (2008).
70 42 C.F.R. § 411.28(a) (2008).
72 42 U.S.C. § 1395gg(c) (2006); 42 C.F.R. § 405.358 (2009); see also Fanning v. United States, 346 F.3d 386, 401 (3d Cir. 2003).
public policy and the goals of the Medicare legislation to provide health care to those in need. Hardship may be established by demonstrating that CMS recovery would deprive the beneficiary of income required for ordinary and necessary living expenses.\textsuperscript{73} Ordinary and necessary living expenses include fixed living expenses (food, clothing, rent, mortgage, utilities, maintenance, and insurance) as well as medical and hospitalization expenses, expenses for the support of others “for whom the individual is legally responsible” and “other miscellaneous expenses which may reasonably be considered as part of the individual’s standard of living.”\textsuperscript{74} For instance, if a child or individual is financially dependent upon the beneficiary, need and “equity and good conscience” may be shown.

Hardship waivers may be difficult to negotiate. Exhaustion and depletion of a settlement amount after payment of attorney fees and costs, for example, may be an insufficient basis for hardship waiver qualification without sufficient evidence of deprivation of ordinary and necessary living expenses for the beneficiary and bona fide, dependent household members. Courts generally defer to the agency’s discretionary authority in its negotiation and resolution efforts.\textsuperscript{75}

CMS’ current “guidance” for beneficiaries does not include the warning that failure to report recovery or payment from qualified primary payer sources and failure to re-pay prior conditional payments exposes beneficiaries to substantial penalties. In addition to consequences discussed previously, Medicare may also reject the beneficiary’s claim.\textsuperscript{76} CMS provides written notice of the consequences of failure to comply once it receives notice of an actual or potential recovery action/plan. These written notices are at the core of a case that is presently pending in Arizona: \textit{Haro v. Sebelius}.\textsuperscript{77}

Two plaintiffs are injured Medicare beneficiaries, each of whom received health care conditionally paid for by Medicare. Plaintiff Haro’s attorney, Balentine, is also a party-plaintiff. The plaintiffs all were placed on notice by the COBC of conditional payment repayment obligations. The Plaintiffs have sought declaratory and injunctive relief against the DHHR arising out of the agency’s assessment of interest against the Medicare beneficiaries, its declaration that attorney Balentine may not distribute settlement funds, and the absence of any obligation that the DHHR pay the plaintiffs interest on collected sums. The notice letter, a centerpiece in the litigation, is precise and aggressive, clearly communicating the authority exercised by the agency:

[Plaintiff Haro has/had] 60 days or until 3/12/2009 to pay the reimbursement claim of $1,682.72 in full. She was told: ‘[I]f you do not repay Medicare in full by 3/12/2009, you will be required to pay interest on any remaining balance, from the date

\textsuperscript{73} 20 C.F.R. § 404.508 (2005).
\textsuperscript{74} 20 C.F.R. § 404.508(a)(1-4) (2005).
\textsuperscript{75} \textit{E.g. Zinman}, 67 F.3d at 843; \textit{Denekas}, 943 F. Supp. at 1073.
\textsuperscript{76} MMSEA User Guide, \textit{supra} note 7, at 12-15.
\textsuperscript{77} No. CV 09-134 TUC DCB, 2009 WL 4497456 (D. Ariz. 2009).
of this letter, at a rate of 11.375% per year. If the debt is not fully resolved within 60 days of the date of this letter, interest is due and payable for each full 30-day period the debt remains unresolved. By law, all payments are applied to interest first, principal second. . . . To avoid having to pay interest, you should repay Medicare in full within sixty (60) days of the date of this letter, even if you decide to request a full or partial waiver of the amount you owe or decide to appeal our determination (see Part IV) of this letter). If you receive a waiver of recovery or if you are successful in appealing our decision, Medicare will refund amounts you have already paid.

You should also be aware that if you do not repay Medicare in full, it may decide to recover any amounts you owe (including accrued interest) from any Social Security or Railroad Retirement benefits to which you might otherwise be entitled, or from future Medicare payments. Your failure to respond as requested within sixty (60) days of the date of this letter may result in the initiation of additional recovery procedures without further notice, including referral to the Department of Justice for legal action and/or the Department of the Treasury for other collection actions. You should be aware that the Debt Collection Improvement Act of 1996 requires Federal Agencies to refer debts to the Department of the Treasury or its designated debt collection center for recovery actions including collection by offset against any monies otherwise payable to the debtor by any agency of the United States and through other collection methods. Under this and other authorities (31 U.S.C. 3720A), the Internal Revenue Service may collect this debt by offset against tax refunds owed to individuals or other entities.

Similarly, Plaintiff McNutt has been charged interest at the rate of approximately $251.00 a month on an unpaid $26,487.07 Medicare conditional payment claim. The fact that there is no federal authority obligating the United States to pay interest to beneficiaries for over-payments is undisputed as of the date of the November 30, 2009 Ruling denying the government’s Motion to Dismiss.

The District Court found that a due process violation argument, predicated upon the Secretary “demanding payment of a disputed MSP reimbursement claim without an ‘opportunity to be heard at a meaningful time and in a meaningful manner’” was plead by plaintiffs on the face of the Complaint. The District Court stated that due process balancing test threshold requirements have been

78 Id. at *2 (emphasis in original).
79 Since the November 30, 2009 Order denying the government’s Motion to Dismiss, plaintiffs have filed an Amended Complaint and the Government has filed an Answer to the Amended Complaint. Haro, 2009 WL 4497456 at *2, fn. 1
established by the plaintiffs as a vulnerable class (elderly, disabled, and statistically poor) at risk for erroneous deprivation of due process safeguards by CMS recovery and imposition of interest; that private interests are affected by CMS recovery efforts; and that there exists a government or public interest in the matter.\textsuperscript{81} The court waived administrative remedy exhaustion requirements as being futile and likely to result in irreparable harm.\textsuperscript{82} It also rejected CMS’ “strongest argument” that a compelling Government interest exists in the solvency of Medicare, as being inferior to individual due process guarantees as of this stage of the case.\textsuperscript{83} As of the date of publication of this article, the case remains pending with an Amended Complaint and Responsive Pleading having been filed. This case clearly is one to follow and monitor as MSP/MMSEA issues mature.

**B. Responsibilities of Providers**

Since they serve as the portal of entry for covered services, CMS encourages providers to obtain primary payer source information. CMS provides sample questionnaires to providers which include inquiries that are not foreign to providers, such as whether or not treatment occurred due to an automobile accident or work-related injury.\textsuperscript{84} CMS requests that providers disclose primary payment sources to it in order for it to begin payment tracking. When a provider is on notice that a Medicare beneficiary is pursuing legal action, CMS instructs it to submit an Explanation of Benefits (EOB) form with MSP information completed to the identified primary payer.\textsuperscript{85}

Participating providers have two options to recoup payment for health care services/costs rendered. Participating providers may either bill Medicare or wait and bill a primary payer if one is identified. If a provider elects to process a claim for payment that includes a claim to Medicare, it must accept the Medicare-approved payment as payment in full and may only charge up to applicable deductible and/or coinsurance amounts.\textsuperscript{86} Alternatively, a health care provider may wait and not issue a bill to Medicare and may maintain a claim or lien against a primary payer.\textsuperscript{87} If a provider elects to not bill Medicare, it may then bill for actual charges, “up to the amount of the

\textsuperscript{81} Id. at *8 (citing Kildare v. Saenz, 325 F.3d 1078, 1093 (9th Cir. 2003)); see also Ellender v. Schweiker, 550 F. Supp. 1348, 1378 (N.Y. 1982).

\textsuperscript{82} Id. (citing Cares, Inc. v. Leavitt (Wall), No. S-05-2553 FCD GGH, 2007 WL 2023543 (E.D. Calif. July 11, 2007)).

\textsuperscript{83} Id. (“Because the Ninth Circuit has not spoken on how the balance should tip in a case such as this, the Court finds the Plaintiffs state a claim under the Medicare statutes and the Due Process Clause to the United States Constitution”).


\textsuperscript{86} Speegle v. Harris Methodist Health Sys., No. 2-08-228-CV, 2009 WL 4878715 (Tex. App. Dec. 17, 2009) (hospital that did not bill Medicare, although the claimant was a Medicare beneficiary, was entitled to do so (citing CENTERS FOR MEDICARE AND MEDICAID SERVICES MANUAL (MMSP), Chapter 2, § 40.2 Billing in MSP Liability Insurance Situations)).

\textsuperscript{87} Id.
proceeds of the liability insurance less applicable procurement costs." This delay payment for some time and also interjects a substantial element of uncertainty into the accounting profile for a provider since liability insurance payment may never occur or may occur at a substantially reduced amount, potentially less even than Medicare contractual value.

Participating providers have a dual status, as they are also employers and may have separate MSP and MMSEA reporting obligations arising out of employment relationships.

C. Responsibilities of Employers Under the MSP

Employers are obligated to maintain a data base that identifies individuals to whom the MSP applies: those over 65 years of age, with End Stage Renal Disease (ESRD), and/or qualifying for and receiving Social Security Disability Benefits. When an employee qualifies for Medicare due to any triggering event, an employer must keep track of and fulfill MSP/MMSEA reporting obligations, if or when they ripen. Discrimination against an employee or employee’s spouse on the basis of Medicare eligibility status is forbidden. “Timely” reporting of a primary payment obligation is also required. Those employers with a Group Health Plan (GHP) must follow and comply with a complex series of GHP obligations and “cannot offer, subsidize or be involved in the arrangement of a Medicare supplement policy where the law makes Medicare secondary payer. Even if the employer does not contribute to the premium but merely collects it and forwards it to the appropriate individual’s insurance policy, the GHP policy is the primary payer to Medicare.”

Employers may also have liability and workers’ compensation insurance related obligations. In the event of a triggering event, such as an occupational injury or premises liability incident (e.g., slip and fall), employers may have independent reporting obligation depending upon the manner in which these events are handled and resolved with a claimant through and with a liability plan.

D. Responsibilities of Beneficiaries’ Attorneys Under the MSP

Receipt of a payment that includes a conditional payment recovery creates an obligation for a beneficiary’s counsel to meet the 60-day rule mandate. CMS’ web Overview declares “as an Attorney, you must: Immediately, upon taking a case, that involves a Medicare beneficiary, inform the COB Contractor about a potential liability lawsuit, and Contact the assigned lead contractor regarding Medicare’s interest in a liability, auto/no-fault, or workers’ compensation lawsuit.” Failure to ensure repayment in accordance with the 60-day Rule may result in penalties, including refusal to

88 Id. at *4.
90 Id.
91 Id.
92 Id.
negotiate a repayment with 100% attorney fee reimbursement.\textsuperscript{93} Counsel may also be targeted by a direct action suit by CMS, recovering attorney fees collected through a settlement or release that is not properly reported and negotiated.\textsuperscript{94} This sword is an important restraint and one that may be asserted by defense counsel when managing a reluctant claimant’s attorneys through this process.

E. Responsibilities of Non-GHP Primary Payers Under the MSP

Non-GHP (Liability Plan) Primary Payers’ MSP obligations ripen when there is an established obligation to pay by judgment, final order, compromise, release, and/or settlement of a claim that arises out of a triggering event for which Medicare paid medical costs.\textsuperscript{95} In order to be prepared for MMSEA reporting obligations, primary plans must obtain the necessary predicate information required by each necessary report.

If conditional payments are a portion of funds exchanged with a beneficiary or “other party” and the non-GHP fails to meet its MSP obligations, MSP entitles recovery of “double damages,” which is tantamount to settling conditional payments three times: once to the beneficiary and twice to Medicare.\textsuperscript{96} The standard of double damages recovery is a negligence standard; CMS may recover upon a showing that the primary plan "knew or should have known" of the outstanding conditional payment.\textsuperscript{97} The MMSEA compliments the MSP by penalizing failure to report with an additional $1,000 dollar a day fine upon non-GHPs.

II. Section 111 of the 2007 Social Security Act Amendment of the Medicare, Medicaid, and SCHIP Extension Act (MMSEA)

\textsuperscript{93} \textit{Harris}, 2009 WL 891931.
\textsuperscript{94} 42 U.S.C. § 1395y(b)(2)(B)(ii) (2008); 42 CFR § 411.24(g) (2008). HHS has an independent right of recovery against any entity that receives a third party payment, which includes attorney fees from any settlement proceed. Any party that receives a third party payment must reimburse the government within sixty (60) days of payment. 42 U.S.C. § 1395y(b)(2)(B)(ii) (2008); 42 CFR § 411.24(g) (2008); see also United States v. Sosnowski, 822 F. Supp. 570 (W.D. Wis. 1993) (plaintiff’s attorney fees are third party payments recoverable where plaintiff Medicare beneficiary and plaintiff’s counsel fail to reimburse the United States within 60 days of receipt of payment).
\textsuperscript{95} \textit{See} Mason v. Am. Tobacco Co., 346 F.3d 36, 43 (2d Cir. 2003) (“the trigger for a MSP claim is not the pendency of a disputed tort claim, but the established obligation to pay medical costs pursuant to a pre-existing arrangement to provide insurance benefits”); Glover v. Liggett Group, Inc., 459 F.3d 1304, 1309 (11th Cir. 2006) (alleged tort feasor's responsibility for Medicare conditional payment reimbursement must be demonstrated before an MSP private cause of action may be brought); United Seniors Ass’n, Inc. v. Phillip Morris USA, No. 05-11623-RGS, 2006 WL 2471977, at *3 (D. Mass. Aug. 28, 2006) (holding that responsibility and failure to reimburse Medicare within 120 days is required before a private cause of action may ripen), \textit{aff’d on other grounds}, 500 F.3d 19 (1st Cir. 2007).
\textsuperscript{97} \textit{Id.}
Security Act Amendment of the Medicare, Medicaid, and SCHIP Extension Act98 (MMSEA) imposes substantial new data-reporting obligations to identify, as soon as possible, where a Medicare beneficiary may have an alternative, primary payment source. Non-compliance penalties are $1,000 dollars per day, per claim,99 effectively creating a minimum penalty of $90,000 dollars since claims may only be reported during fixed, 7-day quarterly reporting periods. The MMSEA also adopts new definitions of “primary plans”, plans which are now called “applicable plans” for MMSEA purposes, and are also included as “Responsible Reporting Entities” (“RREs”) under its reporting requirements.

The MMSEA does not mitigate or alleviate existing MSP compliance mandates. The MMSEA creates separate, additional obligations which allow CMS to track and recover conditional payments. Additional reporting enables CMS to recover past conditional payments and to interject itself into discussions in addressing future health payments addressed by resolution of a disputed claim.100 Initially slated to take effect July 1, 2009, multiple extensions have been given and live reporting will not be required until January 1, 2011.101

MMSEA certainly will result in significant litigation and claims management and resolution challenges. CMS has already used confusing and contradictory language in its User Manual, for example providing that a Section 111 report is required from a primary plan (an MMSEA “applicable plan”) “where the injured party is a Medicare beneficiary and medicals are claimed and/or released or the settlement, judgment, award, or other payment has the effect of releasing medicals.”102 This statement expressly provides that notice is required at the time a claim is made and not merely when resolved by release, settlement, judgment or otherwise. This contradicts language in the paragraph immediately following which provides “Claim information is reported after ORM [ongoing responsibility for medical payment] has been assumed . . . or after a TPOC [total payment obligation to claimant] settlement, judgment, award or

101 See CMS, “CMS Alert February 16, 2010”, available at http://www.cms.hhs.gov/MandatoryInsRep/04_Whats_New.asp#TopOfPage: “CMS Advises NGHP RREs that the date for first production NGHP Input Files is changed from April 1, 2010 to January 1, 2011 effective immediately. NGHP file data exchange testing will continue. All NGHP RREs should now be registered with the COBC and either in or preparing for file testing status. NGHP file data exchange testing will continue during 2010, as needed. All NGHP file data exchange testing will be completed by December 31, 2010. NGHP RREs that have completed file data exchange testing at any time are encouraged to proceed to production file data exchange status.”
other payment has occurred." As operative compliance becomes required, conflicts in application and theory from will inevitably occur. In the face of such conflicts, there is no safe harbor provision in the MMSEA for relief from its onerous penalties.

The CMS Overview and other User Guide provisions attempt clarify this particular passage, suggesting that GHPs have “claims-made” reporting obligations, while NGHPs have “resolution-oriented” obligations. These sections clarify that, in the event of a settlement, judgment, award, or other payment, each NGHP “applicable plan” must submit a one-time report record provided that the payment constitutes a Total Payment Obligation to the Claimant (a “TOPC”). If the NGHP applicable plan assumes obligations for Ongoing Medical Expenses (“ORM”s), it must make an additional report when ORM payment responsibility is assumed and a second report when responsibility terminates.

Section 111 adds a new label to “primary plans”, requiring “applicable” plans, as RREs, report directly to CMS through a secure electronic system. The definition of applicable plans embraces the MSP definitions of both “primary plans” and “plans”: “[T]he term ‘applicable plan’ means the following laws, plans, or other arrangements, including the fiduciary or administrator for such law, plan, or arrangement: (i) Liability insurance (including self-insurance); (ii) No-fault insurance [and] (iii) Workers' compensation laws or plans.”

Applicable plans must report specific data concerning the identity of a Medicare beneficiary whose illness, injury, incident, or accident has triggered the claim in order to enable the Secretary to make “an appropriate determination regarding coordination of benefits, including any applicable recovery claim.” Form, manner, frequency, and reporting deadlines are all to be established by CMS. This framework is intended to encompass all potential primary sources.

An applicable plan may contract with a third party to serve as its RRE, or it may fulfill these obligations itself. However, even if the applicable plan contracts away its reporting function, it remains the responsible entity and does not shield itself from non-compliance sanctions and penalties by third-party contracting.

Section 111 is coordinated by CMS through its Coordination of Benefits Contractor (COBC), the same entity to which beneficiaries and their counsel are to report. The COBC is not an advisor to any RRE with respect to claims handling processes and is not the CMS’ agent for recovery negotiations and processes.

The COBC merely collects the information necessary to facilitate CMS’ MSP tracking and recovery processes and provides data input to other divisions.

103 Id. at 34.
104 Id. at 33-36.
105 42 U.S.C. § 1395y(b)(8)(F) (2008); see also Berdy and Nichols, supra note 100, at 399.
108 Id. at 22.
109 Id. at 14.
within CMS so that its payment and recovery efforts may be coordinated.

[See Figures 1 and 2].
An RRE is responsible for reporting “claims” at the “claim period” to CMS through its assigned COBC. A “claim” refers to “the overall claim for liability insurance (including self-insurance), no-fault insurance or workers' compensation rather than a single claim for a particular medical item or service. Claim information is to be submitted where the injured party is a Medicare beneficiary and medicals are claimed and/or released or the settlement, judgment, award, or other payment has the effect of releasing medicals.”110

Each RRE must register with its assigned COBC, maintaining both a responsible authorized representative and an authorized account manager. The authorized representative must have legal authority to bind the plan entity and has ultimate compliance accountability. The authorized representative must designate an account manager, approve the account profile setup, and also serve as the agent for service of non-compliance notifications.111

The account manager controls RRE account administration and the reporting process. The account manager is responsible for web-access registration and account setup. The account manager may also authorize reporting access for persons reporting to the account manager, known as “account designees”. The account manager oversees the logistics of information transfer to the COBC, monitoring RRE usage activities such as file transmission histories, processing status, and file statistics. The account manager cannot also serve as the authorized representative or as an account designee for the same RRE.112

Account designees are data processing personnel that input data into the electronic system. Account designees cannot serve as an account manager or authorized representative.113 There is no limit to the number of Account Designees associated with one RRE.

The same authorized representative may be assigned to multiple RRE IDs. This also applies to account managers.114 Before an RRE may go live and begin reporting, it must fully test the data submission process that is networked within CMS’ secure user electronic reporting data bank. Only authorized RRE agents may access this data bank, and a clear warning against unauthorized access is posted on its entry web page.115

Once registered, each RRE will be assigned a quarterly reporting schedule for Claim Input File Submission. Each quarter, the RRE has a 7-day filing period during which its quarterly report must be filed.116 Depending upon the manner in which a business elects to create its RRE IDs, it may have several quarterly claim input files.117 For example, a business with multiple locations is required to have a separate RRE ID for claim file submissions if the reports are made by

111 Id. at 24.
112 Id. at 25.
113 Id.
114 April 21, 2009 NGHPT (Town Hall Teleconference) Transcript, part 1, at 8; available at http://www.cms.hhs.gov/MandatoryInsRep/07_NGHP_Transcripts.asp.
115 See www.section111.cms.hhs.gov (last reviewed February 25, 2010).
117 Transcript, supra note 114, at 7-8.
different agents. A business may elect to have a separate RRE ID for different coverage lines such as no-fault, workers’ compensation and other.

Each RRE is responsible to develop its own protocols and processes to identify Medicare beneficiaries. The RRE is required to ascertain whether a claimant is a Medicare beneficiary or if not, if the claimant is entitled to, but not necessarily a participant in, Medicare. A person’s Medicare-participation status may change over time, and particularly for entities assuming ORM obligations, the capacity to track and trace participation status may become quite onerous.

To determine whether an individual is a Medicare beneficiary, an RRE may query the CMS database, provided that it has the Social Security Number (SSN) or the Health Insurance Claim Number (HICN), as well as the name, age, and gender, of the individual claimant. If the COBC determines that the claimant is a Medicare beneficiary, it will notify the RRE and require the RRE to provide additional mandatory information. The COBC will not release the date of Medicare eligibility, the type of Medicare coverage provided, or the reason that the beneficiary qualified for Medicare. If the COBC finds errors in the information submitted, it will return the file. The RRE has forty-five (45) days from file submission to correct the errors, but error correction must be done at latest at the time of the next quarterly file submission.

Significantly, the Date of Incident (DOI) used by CMS is not the same as commonly used by the insurance industry. CMS’ defines an incident involving multiple exposures from the date of first exposure, including all events exposure, ingestion or implantation. The generally referenced industry definition is: “. . . For claims involving exposure, ingestion, or implantation, the date of incident is the date of last exposure, ingestion, or implantation.” Each plan entity must carefully evaluate deductible, self-insurance, and multiple payer situations. Where multiple defendants are involved in a settlement, an agreement to have one defendant's insurers issue any payment in obligation of a settlement, judgment, award, or other does not shift RRE responsibility to the entity issuing payment. Each RRE involved in a settlement remains responsible for its own reporting. If there exists self-insurance for a deductible but the deductible is paid through an insurer, the insurer must include the deductible amount in its report of settlement, judgment, award, or payment. In the event of an uninsured motorist, state-based compensation fund, the State is the responsible RRE with reporting obligations.

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118 Id.
119 Id.; see also 42 U.S.C. § 1395y(b)(8)(A)(i) (2008) (stating that the applicable plan shall “determine whether a claimant (including an individual whose claim is unresolved) is entitled to benefits under the program under this title on any basis”).
120 MMSEA User Guide, supra note 7, at 17.
121 Id. at 35.
122 Id. at 112.
123 Id. at 112-13.
124 Id. at 20.
125 Id. at 44.
126 Id. at 21.
In the event of the existence and participation of re-insurance, stop loss insurance, excess coverage (umbrella or otherwise), guaranty funds, or patient compensation funds (excess exposure sources) in payment to or on behalf of a beneficiary, reporting may also be required. However, if an excess exposure source merely repays a self-insured plan for a payment by the self-insured plan to the beneficiary, the excess exposure source does not have a reporting obligation.127 A self-insurance pool may be responsible to report if three specific characteristics exist with respect to the pool. The self-insurance pool must be “(1) a separate legal entity (2) with full responsibility to resolve and pay claims using pool funds (3) without involvement of the participating entity.”128

The challenge of acquiring personal identifiers required by the reporting process requires special consideration. Personal identifiers, such as SSNs and HICNs, are necessary for CMS database queries and ultimate report submission. If Claimants and their counsel fail to supply this information before any plan indemnity or expense payment is made, an RRE will be unlikely to meet timely reporting obligations. Assertions by a beneficiary’s counsel or beneficiary of privacy interests, including the Health Insurance Portability and Accountability Act (“HIPAA”),129 are unfounded. Each beneficiary participates in the program conditionally, and CMS requires these identifiers to ascertain repayment obligations. MSP and MMSEA reporting requirements occur through secure portals, and each RRE certifies compliance with all privacy standards. Applicable plans are not permitted to misappropriate personal identifiers for any other use, and in the event of an unauthorized use, a beneficiary may have individual civil action rights and recovery interests alternative to MSP and MMSEA.

Because of the volume of reporting activities once the MMSEA becomes fully operational, CMS has established an initial threshold, interim reporting schedule. These thresholds are not safe harbors to exempt applicable plans from existing MSP obligations. These thresholds and applicable time schedules are:

**No-Fault Insurance: ORM and TPOC Amounts**
- There is NO de minimus dollar threshold for reporting the assumption/establishment of ORM or for reporting TPOC.

**Liability Insurance: ORM Amounts**
- There is NO de minimus dollar threshold for reporting the assumption/establishment of ORM.

**Liability Insurance: TPOC Amounts**
- RREs will be required to make TPOC reports. Prior to the February 16, 2010 reporting extension of January 1, 2011, the following threshold limits were published:130

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127 Id. at 20.
128 Id.
Figure 3 is a general reference tool reportable thresholds

**Figure 3:**

<table>
<thead>
<tr>
<th>Time Frame</th>
<th>TPOC Amounts Reportable</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1, 2010 thru December 31, 2011</td>
<td>TPOC Amounts Over $5,000.00</td>
</tr>
<tr>
<td>January 1, 2012</td>
<td>TPOC Amounts Over $2,000.00</td>
</tr>
<tr>
<td>January 1, 2013</td>
<td>TPOC Amounts Over $600.00</td>
</tr>
<tr>
<td>January 1, 2014</td>
<td>All TPOC amounts</td>
</tr>
</tbody>
</table>

As of the date of publication of this article, CMS has not published new thresholds or time frame schedules. Applicable plans must abide by the requirement that *payment* triggers the time-period for penalty assessment. Failure to timely notify CMS of payment, the definition of “timely” not being established to date, constitutes MMSEA violation. Settlements and claims resolutions may come to a stand-still until beneficiaries and their counsel not only provide Medicare self-identifiers for applicable plan query and data input but also, until proof of CMS/CBOC involvement in claim resolution and satisfaction of conditional payment obligations is given. Most claims will require proactive management of issues such as:

i. How interest is to be managed between the date of agreement pending CMS negotiation and final payment;

ii. Determining a date upon which CMS negotiations are to be or reasonably anticipated to be completion and specific criteria and documentation requirements by the primary plan to ensure CMS negotiation has been authorized, performed and an agreement reached;

iii. Addressing the administrative burden upon counsel for beneficiaries and for primary plans in securing CMS timely involvement in claims negotiations so that claims may be resolved;

iv. Anticipating beneficiary receipt of notices of claims and conducting discovery;

v. Securing necessary documentation needed from CMS with respect to lien release, satisfaction and negotiation and the provision of the same to the applicable, paying entities for file management purposes;

vi. Having a plan for the prioritization of payment(s) when a TPOC is paid by more than one entity;
vii. Determining whether or not an applicable plan desires to assume a duty and become a negotiator with CMS of any lien and if so, the consequences to the plan for assuming a duty for/of the beneficiary and the beneficiary’s private counsel;

viii. Confirming the identity of the Payees on a given payment check and account, inclusive of FEINs, SSNs, and HICNs and whether or not MEDICARE is or should be a proper payee on settlement checks;

ix. Confirming the timing of reporting obligations in the event of unique settlement arrangements such as “high-low” and Mary Carter agreements, which CMS has not addressed with specificity;

x. Securing of timely updates from beneficiaries and their counsel in the event of a Medicare status change (such as an individual qualifying for and beginning to receive Social Security Disability during the pendency of litigation);

xi. Managing reporting in mass-tort, class action situations in which the identity of beneficiaries that actually have standing to recover in the underlying litigation can be very difficult to ascertain.

It is self-evident and incumbent upon all counsel and any primary plan representative to engage one another early and to anticipate a means to navigate these processes.

III. Other Recovery Efforts to Follow: The Federal Medical Care Recovery Act

When a federal employee, including a member of the United States armed forces, is injured and under substantive state tort law recovers from a third party, the United States has certain superior rights to the monies recovered if the United States has been a health care provider/paid for health care services for the qualified person. The governing statute is the “Medical Care Recovery Act” (MCRA). As with the Medicare recovery provisions, the MCRA affords to the United States superior rights which cannot be extinguished or negotiated away between settling non-governmental parties. The MCRA's provisions apply equally to any injured party who has federal health care insurance. The MCRA’s provisions are substantially different from the MSP, and the MMSEA does not currently apply to it. The MCRA provision that allows recovery “under circumstances creating a tort liability” and the government's recovery rights of subrogation or direct action recovery certainly will be one to follow in the future.

If an injury inducing event does not give rise to a tort law cause of action under state law, the United States has no

131 42 U.S.C. § 2651 (a).
133 One important exception to this statute must be noted. The Medical Care Recovery Act does not apply to veterans receiving health care from the Department of Veterans' Affairs for a service related disability. 42 U.S.C. § 2651 (e).
basis for recovery.\textsuperscript{134} The MCRA does not preempt state law; rather, it is dependent upon state substantive tort law. The Act does not create a federal law of negligence. If there is no liability under state tort law, the government cannot recover.\textsuperscript{135} Likewise, and distinguishable from MSP, worker's compensation claims do not establish a basis for federal recovery under the Medical Care Recovery Act.\textsuperscript{136}

\textbf{IV. Medicaid Recovery and Set-Aside Agreements}

Medicaid is the joint federal and state medical assistance plan provided for those persons who do not qualify for Medicare and who are in need of assistance for the provision of health care services. State law establishes the government's right of subrogation, if any, in the event of settlement of a claim for which Medicaid paid, in whole or in part, medical services relating thereto. Given each state's sovereign authority, conflicting obligations for recovery of ORMs (future medical payment obligations) may arise unless a federal preemptive scheme is outlined. The MSP has required future medical expense payment obligations, and the MMSEA requires reporting for workers’ compensation and Group Health plans that may have ongoing, future payment obligations. Any attempted extension of the MMSEA into the Medicaid arena will be important area for future analysis and monitoring.

\begin{itemize}
\item \textsuperscript{134} See Heusle v. Nat. Mut. Ins. Co., 628 F.2d 833 (3d. Cir. 1980) (Pennsylvania No-Fault Motor Insurance Act precluded any recovery from insurer by plaintiff and further precluded any recovery by the United States under the applicable insurance policy).
\item \textsuperscript{135} Id.; see also United States v. Allstate Ins. Co., 754 F.2d 662 (6th Cir. 1985).
\end{itemize}
CONSTRUCTION contracts generally contain a “Changes” clause. This clause allows the owner the right to change the contract within the limits of the contemplated purpose under the agreement. In larger complex construction projects like stadiums, arenas, malls and hotel gambling complexes, there may be multiple changes on the project. When these multiple changes act in sequence or concurrently, there can be a synergistic effect upon the base work. This synergistic effect may be difficult to comprehend or anticipate. "Cumulative impact" is the disruption occurring between two or more change orders and basic work, but does not include local disruption directly attributable to a specific change order. The key notions with the cumulative impact claim are (1) the unforeseeability of the impact on productivity caused by a large number of changes and (2) whether the change order language constitutes a waiver or reservation of this claim.

A cumulative impact claim does not necessarily equate to a cardinal change to the contract. A “cardinal change,” “one that fundamentally alters the contractual undertaking of the contractor, [and] is not comprehended under the normal changes clause,” occurs when an owner’s individual change alters the contractor's terms of performance to such an extent that the scope of performance is beyond the original contemplated scope of work of the parties. In contradistinction, the cumulative impact claim is the aftermath of the inability of the contractor to

1 See, for example, Federal Government Standard Form 23A, 48 C.F.R. § 52.219 (1987); AIA Doc. A201, General Conditions of the Contract for Construction, §7.1.1.
accurately account for all impact costs resulting from the multiplicity of change orders, including costs not associated with any particular change. The multiple changes that produce the unforeseeable synergistic effect leading to a cumulative impact claim may or may not be changes that alter the fundamental nature of the contract.

In analyzing cumulative impact claims and cardinal change breaches, we examine similar issues, particularly the understanding or contemplation of the parties. When the contractor signed the multiple separate change orders, did the contractor contemplate all of the impacts that these changes would cause? It is understandable why some courts confuse the cardinal change notion with the cumulative impact claim presentation. In *L.K. Comstock & Company v. Becon Construction Company*, the United States District Court in extending a doctrine of federal government contract law to apply as state law in Kentucky noted that “under the contract doctrine of ‘cardinal’ change that where a party to a contract alters the terms of the other party’s performance to such an extent that the alterations could not have been within the realm of the parties’ contemplation as evidenced by the parties’ written agreement, the other party may elect not to perform and hold the other party liable for breach.”

The difference between the cumulative impact claim and the cardinal change breach is the injury/breach being examined. The focal point of inquiry in analyzing the cardinal change is whether

the change was or was not a logical extension of the base contract, i.e., whether the change was beyond what the parties had agreed was the scope of work. The focal point of the cumulative impact claim is not whether the changes fundamentally altered the contractor's contractual undertaking, but whether the sheer magnitude of the number of changes presented an unforeseeable impact upon the base work.

In order to establish a cumulative impact claim, the contractor must demonstrate that the change order procedure contemplated by the contract did not adequately take into consideration the cumulative impacts caused by the multiple change orders. The contractor must also establish that the impacts caused by the multiple changes were unforeseeable. The focal point on most cumulative impact claims will be whether the express language of the change order constitutes a waiver or reservation.

### I. Current and Historic Developments in Case Law

The “cumulative impact” claim was discussed over eighteen years ago in *Pittman Construction Company, Inc.* In *Pittman*, Pittman Construction Company, a federal government prime contractor, sought equitable adjustments on behalf of

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8 *Haas & Haynie Corp.*, GSBCA Nos. 5530, 6224, 6638, 6919, 6920, 84-2 at BCA ¶ 17,446.
9 *Id.*
11 *Pittman Construction Co. v. U. S.*, 2 Cl. Ct. 211 (Cl. Ct. 1983) (“*Pittman II*”).
electrical and plumbing subcontractors for delays and disruptions allegedly suffered in the construction of the Federal Office Building, Courthouse and Parking Facility in New Orleans, Louisiana. Pittman contended that as a result of 206 contract changes, its subcontractors sustained uncompensated impact costs.\(^\text{12}\)

The General Services Administration Board of Contract Appeals ("GSBCA") decision preceding Pittman\(^\text{13}\) provides a good framework to analyze what boards and courts perceive to be a "cumulative impact" claim. The GSBCA considered Pittman's claims in context of a "direct impact" claim and a "cumulative impact" claim.\(^\text{14}\) As to the "direct impact" claim, the board noted that, of the 206 changes on the job, 152 represented added work. Of these, only 11 of these exceeded $50,000. Only two were entirely related to electrical work and none were singularly related to mechanical work. Five resulted in time extensions for a total of 102 days.\(^\text{15}\) Pittman argued that the changes were excessive and caused delay and disruption, making the job more costly. The GSBCA described "direct impact" costs as the "change-related cost increases to unchanged work."\(^\text{16}\)

The contractor tried to reserve the right to assert impact claims caused by a change at the time of the change, differentiating between costs for immediate payment, which it referred to as "the usual cost elements such as labor, material and normal markups," and more remote expenses including "changes in the sequence of work, delays, disruptions, rescheduling, extended overhead, overtime acceleration and/or impact costs."\(^\text{17}\) The contract officer insisted that these additional remote items be priced at the onset of the change and not reserved. The board agreed and granted the government summary judgment, finding that the contract officer was willing to negotiate direct impact costs and that some change-order pricing allowed for extra labor resulting from out-of-sequence work. More importantly, the board concluded that Pittman's withdrawal of its reservation of rights letter constituted acquiescence by Pittman to the contracting officer's position that all direct impact costs would be priced at the beginning.\(^\text{18}\) In leading to the "cumulative impact" claim discussion, the board noted that the contractor had sent four subsequent letters claiming a "disability in its attempted pricing of delay costs" which the board considered sufficient only to preserve a claim for indirect impact costs. The board concluded that these letters did not constitute a reservation of rights to negotiate at a later time under the Changes clause, but only could be utilized in a judicial pronouncement through board action.\(^\text{19}\)

In attempting to define these "indirect impact" or "cumulative impact" costs, the board explained:

\[\text{"[C]osts . . . [which] addressed the inefficiencies and disruptions}\]

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\(^\text{12}\) \textit{Id.} at 212, 213.

\(^\text{13}\) \textit{Pittman Construction Co.}, GSBCA Nos. 4897, 4923, 81-1 BCA ¶ 14,847 ("Pittman I").

\(^\text{14}\) \textit{Pittman II} at 213 – 217.

\(^\text{15}\) \textit{Id.} at 213.

\(^\text{16}\) \textit{Id.}

\(^\text{17}\) \textit{Id.} at 214.

\(^\text{18}\) \textit{Id.} at 215.

\(^\text{19}\) \textit{Id.} at 216.
associated with changes which, when viewed cumulatively (i.e., retrospectively), were so large in number and/or magnitude as to give rise to a separately compensable impact claim. The term ‘ripple effect’ has also been used to describe such impact costs.”

In denying the contractor’s “cumulative impact” claim, the board differentiated its facts from *Ingalls Shipbuilding Division, Litton Systems, Inc.*,\(^\text{21}\) noting that although the present case had 206 changes, the number and dollar value of the changes were insufficient to support a cumulative impact claim. The board noted that in *Ingalls Shipbuilding*, there had been three contracts affected by several thousand change orders resulting in a 58% increase in contract price and a four-year delay. In the present case the contract price increased by only 12% and the term extended only 102 days on a 1000-day original performance schedule.\(^\text{22}\) Based on this comparison alone, the board noted that “no fundamental change in the character of the work had taken place and thus no costs had been experienced whose likelihood had not been foreseeable.”\(^\text{23}\)

The United States Claims Court sustained the board’s decision without amending on the board’s construction of and standards for a cumulative impact claim, finding that Pittman had itself deviated from the planned construction sequence and consequently where both parties contributed to the delay, neither could recover unless there was proof of clear apportionment.

Scholars cite *Pittman* frequently to establish a framework for defining “cumulative impact” claims.\(^\text{24}\) In *Pittman*, the GSBCA noted the diverging approaches taken in earlier decisions, concluding that a claim need not rise to the level of a cardinal change:

- Cumulative impact must rise to the level of a cardinal change or one that fundamentally changes the contemplated scope of work.
- Cumulative impact greater than the sum of the changes underlying it may occur without constituting a cardinal change.\(^\text{25}\)

Over the past two decades, boards and courts have not assisted the industry by clearly defining “cumulative impact” beyond the holding in *Pittman*, and parties, boards and courts continue to struggle with the necessity of proving a “cardinal change” as predicate to recovery. To derive the essence of this type of claim, it is instructive to review different definitions of cumulative impact. Some of the more notable case definitions are:

\(^{\text{20}}\) Id.
\(^{\text{22}}\) *Pittman II* at 216 n.3.
\(^{\text{23}}\) *Pittman II* at 217.

\(^{\text{25}}\) *Pittman I*, GSBCA Nos. 4897, 4923 at 73,297.
1. Cumulative impact costs are “costs associated with impact on distant work, and are not as readily foreseeable or, if foreseeable, as readily computable as direct impact costs. The source of such costs is the sheer number and scope of the changes to the contract.”

2. The source of cumulative impact loss is not simply “a series of mere isolated hardships, but rather the Gestalt principle of many problems occurring concurrently—with devastating impact on performance greater than the numerical sum of the parts.”

3. Using the term cumulative disruption and local disruption, instead of cumulative and direct impact, “‘[I]ocal [or direct] disruption’ refers to the direct impact that changed work has on other unchanged work going on around it . . . ‘[C]umulative disruption’ is the disruption which occurs between two or more change orders and basic work and is exclusive of that local disruption that can be ascribed to a specific change. It is the synergistic effect . . . of changes on the unchanged work and on other changes.”

4. “A critical condition precedent to the allowance of cumulative disruption costs . . . is a showing that they relate to excessive and frequent design or structural changes the impact of which were distant and unforeseeable during the pricing of proposals and negotiations for direct costs.”

5. Indicating numerosity of change orders or requests for proposals are not enough, one board noted that “the number of RFIs and changes alone is insufficient to establish the Government’s liability for a contractor’s inefficiency.”

6. “Cumulative impact need not be traced to specific causes of increased performance costs, but can arise from changes which, when viewed retrospectively, were so many and had such effect on performance that there

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26 Haas & Haynie Corp., GSBCA Nos. 5530, 6224, 6638, 6919, 6920, 84-2 at BCA ¶ 17,446.


is a separately compensable impact claim.”

7. “Cumulative impact is the unforeseeable disruption of productivity resulting from the ‘synergistic’ effect of an undifferentiated group of changes. Cumulative impact is referred to as the ‘ripple effect’ of changes on unchanged work that causes a decrease in productivity and is not analyzed in terms of spatial or temporal relationships. This phenomenon arises at the point the ripples caused by an indivisible body of two or more changes on the pond of a construction project sufficiently overlap and disturb the surface such that entitlement to recover additional costs resulting from the turbulence spontaneously erupts. This overlapping of the ripples is also described as the ‘synergistic effect’ of accumulated changes. This effect is unforeseeable and indirect.”

So where are we in 2010? This paper argues that requiring a cardinal change places an inappropriate limitation on any cumulative impact claim. Proof of a fundamental alteration of the contract may provide an alternative theory of recovery, but should not be a predicate for recovery under a cumulative impact claim. Certainly, if an owner has so fundamentally altered the contract that the contractor is entitled to claim a breach of contract, the contractor should be able to recover impact damages under a quantum meruit or modified total cost methodology. Once a cardinal change

Dennis R. Parces-Enriquez, Construction in Puerto Rico: Navigating the Legal Quagmire, 71 REV. JUR. U.P.R. 29 (2002). The authors cited Appeal of Godwin Equip, Inc., ASBCA 51,939, 01-1 BCA ¶ 31,221 (A.S.B.C.A., December 14, 2000) , in which the Armed Services Board of Contract Appeals relied on cases allowing contractors to recover for breach of contract when the government makes a cardinal change to the contract's scope of work. In Godwin, the contractor alleged that the government had significantly delayed the project, i.e., was responsible for a “cardinal delay,” and because of the material breach, the contractor should not be held to the contract's limited remedy for delay.

34 The Waiver or Reservation of Impact Costs, CONSTRUCTION CLAIMS MONTHLY, February 2001, at 3; see also Northrup Grumman Corp. v. United States, 47 Fed. Cl. 20, 63 – 70 (Cl. Ct. 2000) (Total cost method of calculating damages is based upon the difference between a contractor’s actual incurred costs and its proposed costs and is appropriate when (a) the nature of the losses makes it impossible or highly impracticable to determine the actual losses directly with a reasonable degree of accuracy, (b) the contractor’s bid was reasonable, (c) the contractor’s actual costs were reasonable, and (d) the contractor was not responsible for the added costs. “A modified total cost recovery is appropriate when a court can reasonably determine the difference between the cost of performance and the bid, subtracting from that subtotal an
has been demonstrated, this should “trump” any release in a specific change order.35 But in the event a claim where the fundamental contemplated scope of the base agreement has not been altered, the cumulative impact claim should require only “the issuance of an unreasonable number of change orders [that] creates a synergistic disruptive impact such that the total disruption caused by the changes exceeds the sum of the disruptive impacts caused by the individual change orders when looked at independently.”36 The “cumulative” impact claim is a separate and independent claim.37

II. Elements of a Cumulative Impact Claim

Like most contract and tort claims, the contractor claiming cumulative impact must prove (1) liability, (2) causation and (3) resultant injury.38 As stated in Centex Bateson: “In looking at [contractor's] cumulative impact claim, we must keep in mind the fundamental triad of proof necessary to sustain a contractor's recovery for a constructive change giving rise to cumulative impact costs: liability, causation, and resultant injury.”39

Elements of proof for a cumulative impact claim are: (a) a significantly large number of changes; (b) the changes impact on productivity (performance time and efficiency); (c) the impact flows from the synergy of the number and scope of changes; (d) the contractor was unable at time of pricing each change order or directive to foresee the ripple-type effect of the multiplicity of changes; and (e) the contractor did not knowingly waive the right to assert cumulative impact claims when negotiating changes.

When denying claims, courts and boards often focus on the issue of causation.40 Cumulative impact claims “are routinely denied because there were an insufficient number of changes, contractor-caused concurrent delays, disruptions and inefficiencies and/or a general absence of evidence of causation and impact.”41 One would naturally assume that causation is an extremely important element to be established in any construction-related claim. At least one decision, however, suggests that upon establishing a cardinal change, the only remaining issue is damages.42 Thus when the cardinal change is established, both liability and causation elements are satisfied.

35 Keating and Burke, supra note 24, at 31.
36 Finke, supra note 24, at 317.
37 See contra Ralph C. Nash and John Cibinic, Cardinal Change: A Correction, 6 NASH & CIBINIC REP. ¶ 27 (May 1992) (arguing that “there is no independent claim for cumulative impact”).
38 Keating and Burke, supra note 24, at 31.
39 99-1 BCA ¶ 30,153.
41 Id. (citing Appeal of Saudi Tarmac Co., ENG BCA No. 4841, 89-3 BCA ¶ 22,132; Appeal of McMillin Bros. Constructors, Inc., EBCA No. 328-10-84, 91-1 BCA ¶23,351, aff'd 949 F.2d 403 (Fed. Cir. 1991); Bechtel Nat'l, Inc., NASA BCA No. 1186-7, 90-1 BCA ¶22,549).
42 Id.
Practitioners should consider causation essential to prove a claim. In David J. Tierney, Jr., Inc., a matter involving 44 change orders that addressed some 133 separate items with multiple parts, the board permitted the contractor to recover under a cumulative impact claim, stating:

“we find on balance that the Government’s numerous changes to the contract impeded appellant’s completion of the job, substantially increasing its costs and eradicating its anticipated profit. Although we are not able to pinpoint, day by day, the effect of each change on each item of work, we do find that some of those changes had a cumulative impact on job progress as a whole, for which appellant is entitled to compensation.”

In this matter the award was not based upon any specific quantum associated with the contractor's individual claims, but rather, the award was in the nature of a jury verdict based upon a perceived balance of liability between the contractor and the government for overall delay in the completion of the construction project as a whole. Specific damages were not demonstrated to be causally related to the change orders. The GSBCA was unable to determine precisely when the compensable impact occurred, which portions of the work in fact were impacted, the severity of the impact, or which changes caused the impact. However, on the project as a whole, damages were awarded.

In Centex Bateson, the Veterans Administration Board of Contract Appeals explained that proving causation in the cumulative impact claim is difficult “because the concept of cumulative impact is, in itself, somewhat amorphous.” Yet, the VABCA indicated that the contractor presenting a cumulative impact claim must present the tribunal with a reasonable explanation of how the very large number of changes caused the claimed cost overruns. The VABCA also suggested an alternative method of proving causation: establishing that no other grounds or reasons exist for the loss of productivity. How a contractor could realistically be expected to prove that there were no contractor errors that led to cost overruns to be attributed to the multiple changes was not laid out in this VABCA decision.

A problem with the position established in Centex Bateson is that the VABCA treated the cumulative impact claim as a “total productivity loss” claim. One commentator has noted that the tendency of courts to place emphasis on liability and damages and not causation effectively equates the cumulative impact claim to a “total time,” “total cost,” or “total productivity loss” claim. Such a formulation is problematic because of the alternative elements of proof of these claims. For example, in a “total cost method” claim, the contractor may be

43 GSBCA Nos. 7107, 6198, 88-2 BCA ¶ 20,806, 105,121 (G.S.B.C.A, 1988).

44 Id.
45 99-1 BCA ¶ 30,153.
46 Id. at 149, 258.
47 Id. at 149, 259.
48 Id.
49 Finke, supra note 24, at 333.
required to establish: “(1) the impracticability of proving actual losses directly; (2) the reasonableness of its bid; (3) the reasonableness of its actual costs; and (4) lack of responsibility for the added costs . . . .”  

Another downside to this “total cost method” claims analysis is that the owner will likely be permitted to defeat the claim by proving the existence of disruptions caused by the contractor, without allowing any real ability to apportion between the Government/owner and the contractor. For example, in *Pittman* the court concluded that the contractor could not separate the impact costs caused by the Government and those caused by the contractor’s deviations from the sequence of work.

A review of state court decisions indicates that the cumulative impact claim approach has not been analyzed as an independent basis for recovery. In the California case of *Norman Peterson Company v. Container Corporation*, for example, where a guaranteed maximum price contract was under review and the drawings at the time for bidding lacked sufficient detail and required months of extended revision drawing, the eventual changes that resulted made it impossible for the contractor to keep accurate cost records for the hundreds of changes. The court noted that the numerous changes had a “dynamic impact” on construction productivity. However, the court further noted that the scope of work had been altered due to the excessive number of changes and invoked the cardinal change doctrine to allow a recovery to the contractor premised upon “the reasonable value of its services on a quantum meruit basis.”

In large casino/hotel complex projects and other projects in which large numbers of changes occur, the utilization of guaranteed maximum price (GMP) contracts is becoming prevalent. Accordingly, one can expect to see “cumulative impact” analysis employed more frequently in proceedings when numerous change orders come about due to scope changes that take place following significant fast track design changes from the early concept drawings on which the GMP contract was negotiated.

Reaction from commentators has been mixed, as at least two commentators believe that it should not be necessary for the contractor to establish a cardinal change, while another commentator believes that if the “synergistic” cumulative impact claim is to be presented by the contractor, a cardinal change should be demonstrated. As a matter of fact, the emphasis by courts should probably be focused on other issues, including the language of the change order itself and whether the

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50 *Southwest Marine*, ASBCA No. 36854, 95-1 BCA ¶ 27,601, at 137, 518. See also Appeal of Cocoa Elec. Co., Inc., ASBCA No. 33921, 91-1 BCA ¶ 23,442 (utilizing “total time” claim analysis).

51 *Southwest Marine*, Inc., ASBCA No. 36854, 95-1 BCA ¶ 27,601, at 137,520.

52 2 Cl. Ct. at 217.


54 Id. at 597.

55 Id. at 601.

56 Keating and Burke, *supra* note 24, at 35.

57 Finke, *supra* note 24, at 324.
contractor knowingly waived the right to assert a cumulative impact claim.\footnote{Construction Claims Monthly, “The Waiver or Reservation of Impact Costs,” Vol. 23, No. 2 (February 2001) at p. 7.}

In \textit{David J. Tierney},\footnote{88-2 BCA ¶ 20,806, at 105,121.} the government argued that a contractor's cumulative impact claim should fail due to language in the change orders and the doctrine of accord and satisfaction. The board specifically found that the parties had never intended the negotiated changes to encompass cumulative, or indirect, impact costs. In reviewing specific boilerplate language, the board noted as follows:

“All of the remaining thirty-nine change orders contained boilerplate language, immediately above the total, agreed upon price, denying any time extensions. Change Orders 31, 32, 37, and 38 each noted, ‘since this work will be performed after the Government's acceptance of the building for occupancy, it is not considered to be a basis for a time extension.’ . . . The other change orders contained the following boilerplate language, or a near equivalent:

It is considered that the performance of the work described can be accomplished concurrently with the work under the basic contract. Should you disagree, a detailed explanation of how the work will delay the overall project must be submitted with your quotation.

. . . Neither statement of boilerplate clearly indicates an intent by the parties to settle appellant's potential claims for cumulative impact costs, and therefore the change orders will not now bar those claims. In addition, despite the Government's argument concerning accord and satisfaction, Change Orders 10 and 42 at least demonstrate that the parties failed to view the latter piece of boilerplate as prohibiting claims even for direct impact. Although Change Order 10, which included changes to the hardware for front entrance doors, contained that boilerplate clause, the parties subsequently negotiated Change Order 42 as a ‘[s]ettlement of claim for time delay due ... to changing the hardware ... which in turn delayed the fabrication and installation of the entrance doors.’\footnote{Id.}

It is typical for the change order to include waiver or release language. The relevant question is whether this language is sufficient to block a cumulative impact claim. That is, did the parties fully and knowingly negotiate away the cumulative impact claim? Boards are willing to examine broad waiver and release language and conclude that the parties did not specifically address indirect impact costs in the change order negotiation process, thus allowing the cumulative impact claim.\footnote{See supra note 34; Saudi Tarmac Co., Ltd., ENG BCA No. 4841.}
III. Common Defenses Employed by Owner

A. Signed Change Orders Constitute “Accord and Satisfaction”

The chief defense articulated in most cases by the owner to a cumulative impact claim relies on the waiver language contained in the signed change order. They contend that the contractor by signing the change order included any possible costs that could be associated with the cumulative impact claim. The legal defense is essentially “accord and satisfaction.” The burden of proof on this affirmative defense is upon the owner.62

The contractor should show that the owner and contractor did not intend to negotiate and price the impacts derivative of the numerous changes on the job resulting in the cumulative impact claim.63 Although reservation language is not mandated,64 it is beneficial for the contractor to point to some reservation language in correspondence or otherwise, including in the change order itself, to the effect that impacts outside the specific change order were being reserved for future consideration and equitable adjustment.65

In Bell BCI Company v. United States,66 the Federal Circuit Court of Appeals held that a contractor had not effectively released the government from liability for the contractor’s delay and cumulative impact claims and that the accord and satisfaction defense had not been adequately proven. The relevant contractual language reviewed by the court stated that the modification “provides full compensation for the changed work” and that the contractor “hereby releases the Government from any and all liability under this Contract for further equitable adjustment attributable to the Modification.” To establish an accord and satisfaction defense, the court required proof of (1) proper subject matter, (2) competent parties, (3) meeting of the minds, and (4) consideration.67 Here, the court concluded that no money was paid for a release of specific cumulative impact claims and there was no meeting of the minds as to a release of such claims. The court indicated that express release language and consideration would have to be demonstrated. “Any and all” was not deemed sufficient language to release this specific type of claim. There were approximately 700 EWO’s and $21.4 million in change orders on a $63.6 million project. The 34% increase in contract price was considered of such magnitude to be unusual for construction projects.68

63 See supra note 34; Saudi Tarmac Co., Ltd., ENG BCA No. 4841.
64 David J. Tierney, Inc., 88-2 BCA ¶ 20,806, at 105,121.
66 570 F.3d 1337 (Fed. Cir. 2009).
67 Id. at 1341.
68 Bell BCI Co. v. United States, 81 Fed. Cl. 617, 630 (Fed. Cl. 2008).
In *Jackson Construction Company v. United States*, the following clause was upheld under the defense of accord and satisfaction:

The contract period of performance remains the same. It is further understood and agreed that this adjustment constitutes compensation in full on behalf of the contractor and his subcontractors and suppliers for all costs and markup directly or indirectly, including extended overhead, attributable to the change order, for all delays related thereto, and for performance of change within the time frame stated.

The court explained the difference between a release defense and an accord and satisfaction defense on cumulative impact claims. It noted that a “release constitutes no condition precedent to discharge by accord and satisfaction.” It further noted that the court with accord and satisfaction had to focus on the intention of the parties and whether there was a meeting of their minds. It explained that with a release, the court could “void or reform the release on several grounds, including lack of consideration, lack of performance, lack of authority, unilateral or mutual mistake, misrepresentation, duress, or under other circumstances in which the parties’ conduct evinces an intent to allow additional claims.”

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69 62 Fed.Cl. 84, 90 (Fed. Cl. 2004).
70 Id. at 93 (citation omitted).
71 Id.

**B. Contractor Should Have Been Able To Track Changes and Accurately Estimate Impact Changes**

Particularly, when the contractor has made prior claims for cumulative impact damages, the owner may reasonably contend that the contractor should have been able to track the changes and accurately estimate the impact changes within a large, complex project with foreseeable changes.

Few contractors keep adequate job-site records that would allow one to evaluate these types of impact costs. They simply fail to realize that they have incurred indirect costs until the project is near end and final construction cost accounting is underway.

Given constantly improving data management systems, courts and boards will expect experts and contractors to utilize technological analysis to establish a causal connection between changes and the impact costs claimed. The cumulative impact claim should require the following proof:

- Impact attributable to changes was unenforceable or was expressly excluded from change order settlements;
- The changes were the sole cause of disruption for which the claim is made;

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• The “cumulative impact” was excessive and unreasonable in relation to what the contractor might have expected;
• Impact costs cannot be segregated; and
• Cumulative impact costs can be reasonably proven as to amount.73

C. Lack of Causation

Because the costs associated with the cumulative impact claim may have resulted from the inefficiency of the contractor, owners often allege that the contractor has failed to prove causation.74 As discussed above, some boards or courts may not require “pinpoint” proof that certain damages were caused by a specific change order.75 However, some quantum of proof will likely be required to demonstrate that the multiplicity of changes caused a loss of productivity. Such proof should demonstrate must be a “real basis” for causation.76 For example, a contractor may prove that changes resulted in a change in working conditions, and the changed working conditions led to the loss of productivity.

The focus of causation disputes may be on the working conditions. Working conditions may be common to, or shared by, both the disrupting change orders and the disrupted work. The causal connection can be shown by proof that “the disrupting changes and disrupted work took place in the same area or used the same resources, or that performance of the changes was a prerequisite to performance of the unchanged work.”77

The difficulty in demonstrating causality may be fatal to an action. In an unpublished Nevada opinion, a district court granted summary judgment against a cumulative impact claim stating:

Cumulative impact claims are presented when contractors cannot allocate damages to specific breaches and therefore cannot establish actual and proximate cause. Cumulative impact claims are too speculative to meet the requirements for possible recovery in Nevada and are not recognized under Nevada law.78

While this unpublished opinion has no precedential value and provides no analysis of case law in other jurisdictions which have historically permitted such a claim, it demonstrates the concern for causation that may be expressed by the court.

D. Other Claims

When the contractor is responsible for a portion of disruptions to the work

74 AMEC Civil, LLC v. DMJM Harris, Inc., No. 06-64, 2009 WL 1883985 (D. N.J. June 30, 2009) (Contractor must demonstrate that its cost codes accurately represented costs attributable solely to owner’s actions).
75 David J. Tierney, 88-2 BCA ¶ 20,806, at 105,121.
76 Finke, supra note 24, at 328-329.
77 Id.
conditions, the owner will not be accountable for such working condition disruptions if the contractor can not apportion between his caused disruptions and the owner’s. The owner will contend that the contractor acted in a manner that impacted the project and there is no practical way to apportion between the two.

The owner may also contend that the contractor did not plan the project appropriately. If the contractor failed to provide the requisite manpower or equipment necessary for the changes, it will not be able at a later time to contend this was unforeseeable. This claim is the corollary to foreseeability as a defense. In a related fashion, the owner may even argue that is erroneous to assume that the contractor was otherwise efficient in its performance under the contract. This may be just another way of addressing the defense of unreasonable planning. However, it further connotes negligent in-the-field performance through supervision of crews and on-the-job performance.

IV. Improving the Contractor’s Position: Practical Pointers

A. Prove a Cumulative Impact Caused by the Excessive and Frequent Changes

The principal and most obvious proof of cumulative impact is the fact that the number of changes (and the dollar value of their impact) was indeed excessive. Numerosity is the prime consideration. In addition to this consideration, and juxtaposed with it, is the concept of the timing or frequency of the changes. The closer in time the changes came, the less opportunity for the contractor to thoroughly evaluate the change requests and foreseeably anticipate their indirect impact.

B. Prove that the Cumulative Impact Affected the Work and Increased the Cost of Performance

As an elemental proof of damages, the contractor must further demonstrate that the impact alleged to have been sustained by the excessive number of changes in fact directly increased the cost of job performance. In its defense, the owner will rely on two points: accord and satisfaction by contractual waiver, and the difficulty of proving causation. To defeat the owner’s causation defense, the contractor must establish by competent proof, in most instances relying on competent experts, that the cumulative impact of the excessive number of changes affected work conditions.

C. Prove that the Impact Was Not Foreseeable when the Change Orders Were Priced

Foreseeability is a critical factor that courts and boards focus upon in reviewing the cumulative impact claim. Therefore, the contractor should independently provide evidence that the impact sought to be established was not foreseeable at the time the change was requested or directed. This is a point-in-time proof issue, and the better the quality of records that exist contemporaneous to the time consideration, the better off the contractor’s claim will be. However, proving a negative is always difficult.
The contractor should strive to identify what information was available when pricing the change and remind the fact-finder that, at the time of pricing, there was no present indication of interruptions, re-sequencing or interference between trades due to the number of changes taking place.

D. Make a Decision Between Claiming Synergistic Cumulative Impact Damages or Unforeseeable Local Disruption Damages

When the contractor and counsel decide to pursue an impact claim in the presence of multiple changes on the job, they must recognize that the numerosity of changes alone does not dictate a compensable cumulative impact claim. Courts and boards often look to the concurrent, overlapping nature of the changes, as well as the frequency of the changes, in determining whether a contractor could reasonably foresee indirect costs.

When the contractor decides to assert a synergistic cumulative impact damages claim, the contractor needs to demonstrate that the release or settlement language contained in the change orders does not bar the claim. When the contractor decides to assert local-yet-unforeseeable impact associated with negotiated changes, the contractor needs to show that the changes were so numerous and/or overlapping that the contractor lost of productivity as a result. The issue and focus is the ability to recognize or foresee this impact when negotiating the individual change order.

E. Account for All Foreseeable Work and Working Conditions when Preparing Bids

At the bid stage, the contractor should analyze and account for all foreseeable work and working conditions. If the contractor’s accounting system cannot segregate change order costs and man-hours, the owner should be advised, and the contractor should reserve its rights to pursue its indirect costs. If the system is able to account for change order costs and man-hours associated with the change orders, it should be used in this fashion.

F. Establish a Productivity Baseline

When the project first commences, the contractor needs to put together a “productivity baseline” to document the anticipated productivity for the various trades as well as the types of work. If possible, this productivity baseline should establish one productivity rate, one quantity, and one crew for each activity.

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80 Space Age Engineering, 86-1 BCA ¶ 18,611 at 93,477.
81 Southwest Marine, 94-3 BCA ¶ 27,102.
82 Finke, supra note 24, at 324.
83 Id.
84 Id. at 336.
85 Id.
G. Document Changes in Working Conditions as they Occur

If working conditions change, the contractor is well advised to document not only changes in the working conditions, but the work that was being performed under changing conditions. Rates of productivity should be noted, and if the productivity rate has varied, this should be noted on a periodic basis.86

H. Price Change Orders Using Current Project Records

When pricing change orders, the contractor should price each individual change order utilizing current project records, noting the current status of the work and accounting for previously implemented change orders. Conducting this analysis when changes are made enables the contractor to more accurately price changes. The contractor should also qualify proposals related to changes as being subject to further correction or augmentation should other changes be ordered on the project.87

I. Use Limitation Language in Change Orders

Although Keating and Burke contend that a cardinal change “trumps a release,” the contractor should employ language in its change orders preserving the right for further negotiation.88 If an appropriate contingency cannot be added, the contractor should limit the scope of the change order settlement by defining the baseline against which the change order was priced, using language like that presented below:

“The time and cost adjustments hereby accepted for Change Order [insert the identifying number of the change order being settled] cover the direct cost of the change order and the impact of the change order on the scope of work as defined by the original base scope of work and those change orders formally implemented on or before [insert the date], but excluding Change Orders [insert the identifying numbers of those change orders meant to be excluded from the scope of the current settlement].”89

V. Using Experts and Studies

To establish the “cumulative” impact claim, the contractor will likely need an expert qualified and capable to prove the existence of the claim. One major issue contractors will face is how to increase the probability of the admissibility of expert opinion testimony on this type of claim.

Construction cases are voluminous paper cases. From the invitation to bid to the final payment, a large construction project generates thousands of documents, including contracts, blueprints, shop drawings, soil reports, change orders, and all of the

86 Id.
87 Id. at 336, 337.
88 Keating and Burke, supra note 24, at 32.
89 Finke, supra note 24, at 337.
correspondence flowing between the various subcontractors, contractors, architects, engineers, and the owner. Several of these documents are highly technical in nature, requiring the use of an expert to explain the relevance of a given document.

Because many cumulative impact claims arise when contractors have not maintained adequate job-site records to allow easy evaluation of impact costs, experts may attempt to extrapolate from studies on multiple change order projects to deduce an accurate pricing of the impact synergistically caused by the numerous changes. In *Kumho Tire v. Carmichael*,90 the United States Supreme Court extended *Daubert*91 to testimony provided by all experts in federal court. In the construction field, and specifically in regard to the cumulative impact claim, experts now must meet this level of scrutiny in delineating how a district court should peruse the proffered testimony of an expert offered under Federal Rules of Evidence Rule 702.

A. Expert Testimony

Courts and boards tend to rely justifiably on the expert to establishing various aspects of the cumulative impact claim. It is recommended that counsel for the contractor have the qualified construction expert focus on several factors. Where multiple changes in working conditions overlap, resulting in an established loss of productivity, the expert should determine how much of the loss was caused by or attributable to the changes. When the contractor confronts both compensable and non-compensable changes in working conditions which overlap an established loss of productivity, then the expert should focus upon determining what portion of the loss was caused by or attributable to the compensable changes versus the non-compensable ones. Finally, where there are compensable and non-compensable change orders overlapping an established change in working conditions, the expert should focus upon determining what portion of the changed working conditions was caused by or attributable to the compensable change orders versus the non-compensable ones.92

B. Expert Studies

The courts confronted with new federal evidentiary rules for admissibility of expert opinions in construction cases and boards desiring to follow the lead of federal courts on expert opinion admissibility standards are scrutinizing studies (and methodology) relied upon by experts more closely.93 Some commonly-cited studies that may be evaluated critically by state and federal courts and administrative bodies include:


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92 Finke, *supra* note 24, at 336.
93 *J. A. Jones Const. Co.*, ENG BCA No. 6348.
94 Thomas and Napolitan, *The Effects of Changes on Labor Productivity: Why and How Much*, SOURCE DOCUMENT 99,

CONSTRUCTION INDUSTRY INSTITUTE (Aug. 1994).
99 26 PUB. CONT. L.J. 311.


In Appeals of J. A. Jones Construction Company, 104 J. A. Jones Construction Company (“JAJ”) presented a cumulative impact claim arising out of the Matewan Local Protection Project and its contract with the U. S. Army Engineer District. In alleging a loss of efficiency on contract work resulting from the number of changes, JAJ’s expert, Mr. Paul DeMent, calculated the loss on the basis of the theory presented in Leonard’s “The Effect of Change Orders on Productivity.” 105 This study, written as a Master’s thesis at Concordia University, supported the proposition that there is a productivity loss if change order labor hours are greater than ten percent of the base contract work hours, and if this loss is compounded if other adverse impacts

104 ENG BCA No. 6348.
105 See supra note 95.
are also present on the job. The board’s perception of Mr. DeMent and his work product merit examination.\textsuperscript{106}

In its evaluation of JAJ’s expert, the board analyzed Mr. DeMent's education and professional standing, noting that he had obtained only a bachelor's degree in building construction, he had not received any formal training in the area of measuring labor productivity, he was not a member of any relevant professional associations, he had published no writings, he had not obtained an engineering or contractor's license, and he had only learned how to perform productivity measurements from on-the-job experience.\textsuperscript{107} The board then noted that Mr. DeMent's "measured mile" analysis was one-of-a-kind and noted that the opposing expert, who was much more experienced, had never heard of this methodology. The court then found that Mr. DeMent’s report was not based upon fact, and it did not contain any cause-and-effect analysis. The board could find no effort by Mr. DeMent to relate impacts on productivity to anything that might have caused them. The board noted that this expert had a shallow understanding of the factors affecting crew performance and had made several erroneous assumptions in carrying out his work assignment. He did not consider the nature of any specific changes, or what locations/areas and work activities they directly affected. His analysis did not consider the timing of changes and whether JAJ had adequate notice to implement the changes and sequence the work in an orderly fashion.\textsuperscript{108}

The board further scrutinized the Leonard Study and differentiated it from the facts of the dispute at issue. The board noted that the Leonard Study applied to projects experiencing greater than ten to fifteen percent change orders as measured by labor hours, not labor costs or overall construction costs, as applied by Mr. DeMent. The Leonard Study was observed to study fifty-seven relatively small building and facility projects, involving ninety-four contracts totaling $220 million. The board concluded that the present project was of different scope and involved different trades. Importantly, the board stated that no court had adopted the Leonard Study approach in measuring productivity loss or inefficiency.\textsuperscript{109} The specific formula used for the "Measured Mile" analysis conducted by JAJ’s expert had not been tested or peer-reviewed. In final analysis, the board concluded that this expert's opinion was highly questionable, unreliable and produced patently illogical results.\textsuperscript{110}

\section*{VI. Conclusion}

Cumulative impact is the disruption that happens between multiple change orders and basic work, but does not include local disruption directly attributable to a specific change order. A cumulative impact claim does not logically have to amount to a cardinal change in the contract, it is the aftermath

\textsuperscript{106} J.A. Jones, ENG BCA No. 6348.
\textsuperscript{107} \textit{Id.}
\textsuperscript{108} \textit{Id.}
\textsuperscript{109} \textit{Id.}
\textsuperscript{110} \textit{Id.}
of the inability of the contractor to accurately foresee or account for all impact costs resulting from the multiplicity of change orders, not the result of a change in the purpose of the project.

Nevertheless, courts have often confused cumulative impact claims with cardinal change claims. In evaluating cumulative impact, courts will be inclined to focus on waiver and reservation language in the change orders to resolve these disputes, and may be swayed by the arguments of owners that other factors (not cumulative impact) caused the reduction in productivity.

Practitioners bringing cumulative impact claims must be prepared to rebut arguments based on accord and satisfaction, as well as arguments on causation. To support their estimates of loss and causation, they should use experts that have the background and knowledge to support opinions that are testable and based upon methodologies that are generally accepted in the construction industry.
Reciprocal Indemnification Agreements in the Oil Industry: The Good, The Bad And The Ugly

By Christopher L. Evans and F. Lee Butler

RECIPROCAL or mutual indemnity agreements,¹ often referred to as “knock for knock” agreements, are frequently used in the oil industry to allocate risk by contract, rather than through the vagaries of the legal system. Under these agreements, “each party (as ‘indemnitor’) agrees to indemnify the other party (‘indemnitee’) and the indemnitee’s contractors for claims arising from injuries to the indemnitor’s employees, regardless of fault.”² In other words, each party agrees to take full responsibility for all bodily injury or property damage claims made by its own employees, regardless of which party may actually be responsible for the injury.

¹ A reciprocal indemnity obligation is an indemnity obligation in an agreement pertaining to a well for oil, gas, or water or to a mine for a mineral in which the parties agree to indemnify each other and each other's contractors and their employees against loss, liability, or damages arising in connection with bodily injury, death, and damage to property of the respective employees, contractors or their employees, and invitees of each party arising out of or resulting from the performance of the agreement. Edward Esping, Jr., “Reciprocal Indemnification Agreements,” 55A TEX. JUR. 3D Oil and Gas § 455 (2010).
² Energy Service Co. of Bowie, Inc. v. Superior Snubbing Services, Inc., 236 S.W.3d 190, 196 (Tex. 2007) (citing the amicus curiae brief of the Texas Oil & Gas Association).

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While a contractual allocation of risk based on who makes the claim, rather
Reciprocal indemnification agreements in the oil industry...than who is at fault, is contrary to the traditional risk allocation method under our legal system, such agreements can be very beneficial to both parties. The fact that mutual indemnity agreements have been and remain so popular in the oil industry attests to the beneficial aspects of such agreements. Unfortunately, as in the movies, good things often bring with them bad and sometimes ugly consequences. Accordingly, this article discusses some of the pros and cons of reciprocal indemnity agreements and finishes by briefly reviewing recent cases where courts in Texas have interpreted indemnity arrangements in interesting ways.

I. The Good – Benefits of Reciprocal Indemnity Agreements

Reciprocal indemnity agreements offer several significant benefits to contracting parties. The specific benefits enjoyed by contracting parties will often depend on the circumstances applicable to the object of the agreement. However, as a general rule, such agreements can reduce costs to both parties, help to strengthen the relationship between contracting parties and allow parties to work together against a common enemy, rather than against each other.

A. Reduced Costs

Even without complications, the search for oil and gas is expensive and always involves risk. Litigation inevitably increases the cost of the effort. Accordingly, one of the primary benefits of reciprocal indemnity agreements can be a reduction in cost to both parties.

When parties enter into a knock for knock agreement, potential liability is established at the time of contract for both parties through the contract. If an accident occurs causing an injury to the employee of either party to the agreement, the parties can avoid disputes between themselves regarding their relative responsibility for the accident. As between the two parties to the contract, the reciprocal agreement will have already established liability — Company A will be responsible for all claims made by its employees, and Company B will be responsible for all claims made by its employees — regardless of who is at fault. The parties can, therefore, avoid costs that might otherwise be incurred to establish their respective responsibility.

Furthermore, a reciprocal indemnity agreement allows one party to take over responsibility for both contracting parties and retain one lawyer to defend both parties. For instance, if an employee of a contractor for Company A is injured as a result of an accident caused by both Company A and Company B, the third party contractor employee would generally bring suit against both companies to determine liability. In maritime cases, where the employer is not protected by workers’ compensation laws, suit is often filed directly against both companies by their own employees. In either case, without a reciprocal agreement, both companies would have to hire their own attorneys and incur the cost of separate defenses. However, if the parties had in place a reciprocal indemnity agreement, one attorney would be able to defend both parties. Thus, mutual indemnity agreements not only...
diminish the need for litigation between the contracting parties, but can also reduce overall litigation costs, should suit arise.

B. Intangible Benefits

Along with reducing costs, there are a number of important intangible benefits that come with reciprocal indemnity agreements. Knock for knock agreements help decrease friction between the contracting parties, not only by establishing liability of both parties at the time of contract, but also by establishing a level of certainty to both parties with regard to their liability exposure.3 Furthermore, such agreements allow parties to work together to create a safer workplace for all employees.

When two parties enter into a reciprocal indemnity agreement, they promise to hold each other harmless for their own employees’ claims. In return, each party is freed from the burden of liability for claims by the other party’s employees. This practice of pre-setting liability reduces friction between parties by decreasing the likelihood of future litigation between the contracting parties. The parties are freed up to concentrate more on their business relationship without worrying about having a dispute if something goes wrong and an employee of either party is injured.

Moreover, a reciprocal indemnity agreement “provides a level of certainty to all of the parties regarding liability exposure” that is not otherwise available.4 An oil rig is often times a common workplace for employees of several different companies and, without a reciprocal indemnity agreement, each party is potentially liable for claims by any of the other companies’ employees. Accordingly, while each company can help protect itself from liability by properly training and managing its own workers, there is often little it can do with regard to the employees of other companies. Uncertainty about liability exposure can translate into higher costs for all involved.

By establishing in advance their relative exposure to liability for worksite accidents, the parties to a reciprocal indemnity agreement can better manage their costs. For example, each party can better determine the amount and cost of the insurance they will need for the job by simply knowing how many people will be at the work site that fall under the contracting party’s scope of liability. A contracting party with fewer workers at the site for whom the party is legally responsible will have a relatively smaller exposure than a company that has many workers at the site who might be injured if an accident occurs.

Finally, concerns about potential legal responsibility for safety issues are reduced when parties enter into a reciprocal indemnity agreement. When the liability of the parties involved is determined not by relative fault, but by the more random chance of who the person is that is injured, the parties are in a better position to work together on safety matters. Both parties have an equal incentive to make the work place safe for all, because either party can be responsible for an accident, even if it was not their fault. Further, the parties can

3 Bowie, 236 S.W.3d at 196.
4 Id.
work together to institute safety policies without concern that the party responsible for a particular safety policy will increase their relative responsibility for any potential liability that might arise if the safety policy they were responsible for is violated and someone is injured.

C. A United Front

When two parties contract with each other, they hope to form an amicable working relationship based on common interests and goals. Such a relationship facilitates all future agreements, meetings, and joint operations between the parties. However, when an accident occurs at a job site where the parties have not agreed in advance on their respective liability, an amicable working relationship can come undone in a hurry. Two parties that once worked side by side to accomplish the same goal will often be forced to point fingers at each other. Trying to establish another party’s responsibility for an accident is not at all conducive to a close working relationship, especially in situations where the parties still have a long way to go before the job is done. However, with a reciprocal indemnity agreement the contracting parties can work together to resolve a claim, rather than make matters worse for both of them by blaming each other.

Additionally, a suit brought by an employee of one of the contracting parties can generally be better defended if the contracting parties work together. In the typical case without a reciprocal agreement, the parties have divergent interests when a worksite accident occurs. Each party-defendant will often attack the other defendants in an effort to avoid liability, even if that means increasing the overall exposure for everyone. However, with the clarity of outcome produced by a reciprocal indemnity agreement, there is no longer any need for the parties to work against each other. The parties can focus on their mutual defense and the channels of communication between the contracting parties can remain open, making it easier for the defending party to obtain information regarding the accident from the other contracting party and to provide a better defense for both. By taking away the opposing party’s ability to divide and conquer, the contracting parties can enhance their ability to keep the overall exposure to a minimum.

II. The Bad and The Ugly – The Drawbacks Of Reciprocal Indemnity Agreements

Nothing comes without a price, and reciprocal indemnity agreements are no exception. While they do offer a number of benefits to contracting parties, they have their drawbacks as well.

A. The Bad: Reciprocal Indemnity Is No Guarantee of Resolution

One serious problem with reciprocal indemnity agreements is that courts will not always enforce them, regardless of whether the agreements were seen as beneficial by both parties at the time of contract. Whether a reciprocal indemnity agreement is enforceable generally depends on the law applicable to the claim brought. For example, the Louisiana legislature has declared certain
indemnity agreements in oil and gas contracts void as against public policy in an effort to protect contractors and their employees from large oil companies that require contractors to provide indemnification in their master service contracts, even when the oil company is at fault. Specifically, the Louisiana Oilfield Anti-Indemnity Act states:

> It is the intent of the legislature by this Section to declare null and void and against the public policy of the state of Louisiana any provision in any agreement which requires defense and/or indemnification, for death or bodily injury to persons, where there is negligence or fault (strict liability) on the part of the indemnitee, or an agent or employee of the indemnitee, or an independent contractor who is directly responsible to the indemnitee.5

In other words, under Louisiana law, reciprocal indemnity agreements which pertain to an oil or gas well are generally enforceable only against claims for property damage. If an attempt is made to enforce an indemnity agreement under Louisiana law regarding a claim involving death or bodily injury, the agreement will be held unenforceable. Accordingly, even where knock for knock agreements were considered beneficial by both parties at the time of contract, the parties may or may not receive the benefit of their bargain when the time comes to rely on the indemnity agreement.

Moreover, in offshore situations, determining the applicable law and, thus, the outcome of the mutual indemnity obligation, can often make matters more complicated than if no agreement was made at all.6 The reason for this confusion lies in the fact that several legal constructs exist in offshore situations, each with its own set of rules and outcomes. The law that applies generally depends on the circumstances giving rise to the incident causing the problem. Among the bodies of law which might apply are (1) maritime law, (2) the Outer Continental Shelf Lands Act (“OCSLA”)7, and (3) state law.

Determining whether maritime law applies to an offshore contract is often an arduous task that the courts have struggled with for years. Furthermore, even if a contract is determined to be governed by maritime law, the ultimate question of whether an indemnity agreement will be enforced may still be unsettled. Generally, express reciprocal indemnity agreements will be enforced under maritime law, even if they serve to protect a party from its own negligence. However, the existence of additional insured provisions and other complicating factors can undermine a reciprocal

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6 Even the courts have recognized the complexity and difficulty of determining the applicable law in this area. In Walsh v. Seagull Energy Corp., for instance, the court stated, “Since the oil industry went offshore, the legal system has struggled to produce a body of injury law that is rational, fair, internally consistent, and acceptably productive of safety incentives. The result has been chaos.” 836 F. Supp. 411, 412 (S.D. Tex. 1993).

indemnity agreement, even under maritime law.\(^8\)

When contracts involving offshore risks come under the OCSLA, a whole new set of rules comes into play. Determining whether the OCSLA applies to a given situation and what affect it will have on an indemnity agreement can be very difficult for the parties involved and the courts. Under OCSLA, the Outer Continental Shelf (OCS) refers to all submerged lands lying beyond three geographical miles in distance from the coastline of each state.\(^9\) When it governs, the OCSLA applies federal law to certain structures and devices on the OCS, incorporates state law into federal law on the OCS, and applies the Longshore and Harbor Workers’ Compensation Act (“LHWCA”)\(^10\) to certain injuries sustained by persons working on the OCS.\(^11\) Because of all the variables that can occur in an offshore case the applicable law and, therefore, the enforceability of a reciprocal indemnity agreement become less certain.

B. The Ugly: Paying For Another’s Mistakes

Perhaps the greatest drawback to reciprocal indemnity agreements is that inevitably a contracting party will eventually be required to pay damages for an event for which it has no responsibility. For example, suppose Company A and Company B enter into a reciprocal indemnity agreement for drilling a well. If an employee of Company A is later injured at the worksite, then Company A will be liable for all the employee’s damages, even if Company B was 100% at fault. That apparently unjust result is often difficult to swallow, but it is precisely the risk that Company A agreed to take by contracting for reciprocal indemnity with Company B.

By their very nature reciprocal indemnity agreements sometimes force parties to deal with claims they might otherwise not be involved with at all. In the example above, for instance, Company A might have been entirely free and clear of the lawsuit by its employee, but because it entered into a reciprocal indemnity agreement with Company B, Company A would have to handle the claim and defend the suit against Company B, which, of course, can be both time-consuming and costly.

One way that parties can avoid some of the worst consequences of this aspect of reciprocal indemnity agreements is to identify in advance specific circumstances where one party is in complete control of a particular aspect of the job and then carve out an exception to the reciprocal agreement that makes the party in control fully responsible for accidents that occur arising out of the area they control. For example, the standard IADC Daywork Drilling Contract form provides for the operator to be responsible for all liability arising out of

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\(^8\) See, e.g., Tullier v. Halliburton Geophysical Services, 81 F.3d 552, 553–555 (5th Cir. 1996).
the use of materials the operator supplies. To the extent the operator is in the best position to control the safety of the materials the operator brings to the site, the overall safety of the project is enhanced by leaving the responsibility for the safety of the materials with the operator. The drilling contractor is relieved from potential liability arising out of the use of materials that the drilling contractor has no say in providing for the job.

III. Reciprocal Indemnity Agreements in Texas

As a state with considerable oil and gas industry activity, several novel issues regarding indemnity agreements have been addressed by the Texas Supreme Court in recent years, bringing some clarity and some additional complication to the law in Texas on indemnity issues. Among those issues are (1) whether an employer subscribing to the state’s workers’ compensation system that enters into a written agreement to indemnify others against an employee’s personal injury claim may be enforced to indemnify a contractor of the indemnitee, even though the agreement was not executed by that contractor, and (2) the effect of limitations in an indemnity agreement on additional insured coverage provided to the indemnitee.

A. Energy Service Co. of Bowie v. Superior Snubbing Services, Inc.

From 1963 until 1989, the Texas Workers’ Compensation Act ("TWCA") held a subscribing employer’s agreement to indemnify others against an employee’s personal injury claim unenforceable. The Act had an exception, however, which permitted such indemnity agreements so long as they were “executed [in writing] by the subscriber” before the injury occurred.12

In 1989, however, the language of the TWCA was changed. The codification changed the wording to say that such indemnity agreements are only enforceable if they are “executed...with the third party.”13 Accordingly, the question before the Texas Supreme Court in Energy Service Company of Bowie v. Superior Snubbing Services, Inc. (hereinafter "Bowie"), was whether this change in language had any substantive effect on the law. More specifically, the question was whether a subscribing employer’s written agreement to indemnify a person and that person’s contractors was enforceable by one of those contractors, even though the agreement was not executed with a particular contractor.14

In Bowie, both Energy Service Co. (“ESC”) and Superior Snubbing Services, Inc. (“SSS”) provided oilfield services to Mitchell Energy (“Mitchell”). The Master Service Agreement between SSS and Mitchell contained reciprocal indemnity agreements, each agreeing to indemnify the other and each other’s contractors against any and all personal injury claims made by their own employees. Likewise, the Master Service Agreement between

12 Bowie, 236 S.W.3d at 190-91 (emphasis added).
13 Id. at 191 (emphasis added).
14 Id.
ESC and Mitchell contained an identical knock for knock agreement.15

ESC and SSS, on the other hand, did not enter into reciprocal indemnity agreements between themselves, nor was either a party to the other’s agreement with Mitchell. Nevertheless, because both were Mitchell’s contractors, each was covered by the terms of the other’s agreement with Mitchell. In other words, “[ESC] agreed to indemnify Mitchell and its contractors, one of which was [SSS], against claims by [ESC] employees, and [SSS] agreed to indemnify Mitchell and its contractors, one of which was [ESC], against claims by [SSS] employees.”16

As a result, when one of SSS’s employees sued Mitchell and ESC for personal injuries sustained while on the job, both Mitchell and ESC sued SSS for indemnity. Although the indemnity agreement between SSS and Mitchell made clear that SSS was responsible for indemnifying Mitchell, SSS claimed that it owed no duty to indemnify ESC, as the indemnity agreement under which ESC claimed coverage was not executed “with” ESC as a party, as required by the TWCA.17

In 2007, the Texas Supreme Court held in favor of ESC, stating that “when the Legislature required that a subscribing employer contract ‘with the third party’ seeking indemnity, it considered that an agreement intending to cover third party beneficiaries was an agreement with the beneficiaries.”18 In other words, the court followed the common law rule, allowing “parties to contract for the benefit of others – in effect, with others – if they do so explicitly,” and holding that “when they do, the beneficiary can enforce the promisor’s obligation in his favor as if he were himself a party.”19

Accordingly, before a party enters into a reciprocal indemnity agreement, it is wise to first determine how many contractors it will have in comparison to the number of contractors the other party will have to determine whether the bargain is fair. After all, if A and B contract for reciprocal indemnity agreements like the ones in Bowie, then A must indemnify B not only for its own employees, but for the employees of each of its contractors as well. Thus, if A has five contractors while B has none, a reciprocal indemnity agreement might not be in the best interest of A.

B. Evanston Insurance Co. v. Atofina Petrochemicals, Inc.

In many, if not most cases, a party entering into an indemnification agreement is required to procure insurance to cover its indemnity obligations under the agreement. In the oil and gas industry in Texas, insurance for the indemnity obligation is required to make a mutual agreement enforceable.20 Sometimes, parties to an indemnity agreement are also required to name the other party as an additional insured on their insurance policies. The addition of additional insured provisions to reciprocal indemnity agreements has caused a great deal of complication and difficulty in the

15 Id. at 191-92.
16 Id. at 192.
17 Id. at 192-93.
18 Id. at 195.
19 Id. at 194.
interpretation of indemnity contracts in Texas and elsewhere. In *Evanston Insurance Co. v. Atofina Petrochemicals, Inc.* ("Evanston") the Texas Supreme Court addressed one rather convoluted contractual scenario involving an additional insured provision.

In *Evanston*, Triple S Industrial Corp. ("Triple S") contracted to do construction work with Atofina Petrochemicals, Inc. ("Atofina"). As part of the contract, Atofina required Triple S to sign a service contract which contained an indemnity provision in favor of Atofina and a requirement that Triple S obtain insurance to cover its indemnity obligations. The contract also required Triple S to name Atofina as an additional insured under the policies.

Under the indemnity provision, Triple S agreed to indemnify Atofina from all personal injuries and property losses sustained, "except to the extent that any such loss is attributable to the concurrent or sole negligence, misconduct, or strict liability of [Atofina]." Further, Triple S obtained a $1 million comprehensive general liability insurance policy from Admiral Insurance Co., and a $9 million commercial umbrella policy *Evanston Insurance Co.* ("Evanston"). As required, Atofina was named as an additional insured under the policies.

Sometime thereafter, one of Triple S’ employees was injured at the job site and sued both Triple S and Atofina. Accordingly, an additional insured under the Evanston policy, Atofina demanded coverage from Evanston. Evanston refused to cover Atofina as an additional insured, however, pointing to the fact that the service contract and indemnity agreement specifically stated that Atofina was not entitled to indemnification from Triple S in circumstances where the losses were in any way attributable to Atofina’s negligence.

However, as the Court pointed out, Atofina was not seeking indemnity from Triple S. Rather, Atofina was seeking indemnification "from Evanston by virtue of its status as an additional insured" on the insurance policy issued to Triple S. Moreover, the Court noted that "where an additional insured provision is separate from and additional to an indemnity provision, the scope of the insurance requirement is not limited by the indemnity clause." Thus, the Court looked beyond the limiting language of the indemnity agreement, and to the language of the insurance policy itself to determine Atofina’s coverage under the Evanston policy. The Evanston policy stated that Atofina was an additional insured “only with respect to liability arising out of [Triple S’] ongoing operations performed for [Atofina], but in no event for [Atofina’s] sole negligence.” Based on that language, the Court then held that Atofina was covered under the policy as an additional insured, despite the fact that the insurance

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22 *Id.* at 662.
23 *Id.* at 663.
24 *Id.*
25 *Id.* at 663-64.
26 *Id.* at 664 n.5.
27 *Id.* at 663.
was originally purchased to cover Triple S’ indemnity obligation.\textsuperscript{28}

In reaching this conclusion, the court had to settle a difference of opinion between courts of appeals regarding the meaning of the “with respect to liability arising out of” language contained in additional insured provisions. In order to determine whether an additional insured was covered, some courts had “adopted a fault-based interpretation of ‘arising out of operations,’ recognizing coverage only if an insured’s wrongful act during the operation caused the injury.”\textsuperscript{29} In denying that test, the Texas Supreme Court interpreted the “with respect to operations” language under a broader theory of causation, stating that “an event ‘respects’ operations if there exists ‘a causal connection or relation’ between the event and the operation; we do not require proximate cause or legal causation. In cases in which the premises condition caused a personal injury, the injury respects an operation if the operation brings the person to the premises for purposes of that operation. The particular attribution of fault between insured and additional insured does not change the outcome.”\textsuperscript{30}

It is interesting to note that following the Texas Supreme Court’s decision in \textit{Evanston}, the Fifth Circuit examined the interplay of an additional insured provision and an insurance policy in \textit{Aubris Resources LP v. St. Paul Fire & Marine Insurance Co.}\textsuperscript{31} Based on the Texas Supreme Court’s ruling in \textit{Evanston}, the Fifth Circuit overturned the district court’s denial of additional insured coverage.

In \textit{Aubris}, United Oil and Minerals (“United”) entered into a service contract with J&R Valley Oil Service (“J&R”) in which J&R was required to carry a commercial general liability policy naming United as an additional insured.\textsuperscript{32} The contract contained a general indemnity provision providing that United would indemnify J&R for all claims and causes of action arising out of United’s own negligence.\textsuperscript{33} The contract also contained an additional insured provision requiring J&R to name United as an additional insured in its policy. However, the contract stated that “such extension of coverage shall not apply with respect to any obligations for which United has specifically agreed to indemnify [J&R].”\textsuperscript{34}

Pursuant to the contract, J&R secured a commercial general liability policy from St. Paul Fire & Marine Insurance Company (“St. Paul”). The policy contained an additional insured endorsement providing that any person or organization J&R agreed in writing to add as an additional insured was covered under the policy “if that written contract for insurance specifically [required] such coverage.”\textsuperscript{35}

One year into the contract, an explosion at United’s oilfield severely injured one, and killed another, J&R employee.\textsuperscript{36} Families of both workers filed suit against both J&R and United for

\textsuperscript{28} \textit{Id.} at 665.
\textsuperscript{29} \textit{Id.} at 664.
\textsuperscript{30} \textit{Id.} at 666.
\textsuperscript{31} \textit{Aubris Resources LP v. St. Paul Fire & Marine Ins. Co.,} 566 F.3d 483 (5th Cir. 2009).
\textsuperscript{32} \textit{Id.} at 485.
\textsuperscript{33} \textit{Id.} at 487.
\textsuperscript{34} \textit{Id.}
\textsuperscript{35} \textit{Id.}
\textsuperscript{36} \textit{Id.} at 485.
negligence. The claims against J&R were dismissed pursuant to the Texas Workers’ Compensation Act. The plaintiffs then pursued their claims against United for United’s negligence in causing the explosion. United sought coverage as an additional insured under the St. Paul policy. St. Paul denied coverage, arguing that United was not an additional insured for causes of action arising out of its own negligence, because United agreed to indemnify J&R for any liability resulting from United’s negligence. The district court agreed with St. Paul and granted St. Paul’s motion for summary judgment denying coverage.37

The Fifth Circuit began by emphasizing that Texas law favors a finding of coverage in insurance disputes — “if a provision has more than one reasonable interpretation, a court must interpret it in favor of the insured, provided that interpretation is not unreasonable, and even if the insurer’s interpretation is more reasonable.”38 With that understanding, the court started by looking at the insurance policy itself. St. Paul argued that because the policy only covered United for what the written contract specifically required and the contract stated that United was liable to J&R for its own negligence, United did not qualify as an additional insured for liability arising out of United’s own negligence.

However, in light of the Texas Supreme Court’s holding in Evanston, the Fifth Circuit held that, where an additional insured provision is separate from and additional to a general indemnity provision, the court could only look to the additional insured provision in the contract itself to determine coverage.39 Because United was not seeking indemnity from J&R, but coverage from St. Paul as J&R’s additional insured, the additional insured provision was separate and apart from the indemnity provision.

The court then addressed language in the policy itself which purported to limit the coverage by excluding coverage for any liability for which United owed indemnity to J&R under the contract. United argued that the language in the additional insured provision that coverage “shall not apply with respect to any obligations for which United has specifically agreed to indemnify [J&R]”40 excluded coverage only if United had, at some point, “separate and extra-contractually [agreed] to indemnify J&R.”41 In other words, the limiting language in the policy did not refer to the indemnity obligations in the underlying contract, but only to a specific indemnity agreement that the parties might enter into separate and apart from the contract.

Though United’s logic appeared to be somewhat strained, the Fifth Circuit stated that, as long as United’s interpretation was at least reasonable, the court had to rule in favor of United, as the insured. The court focused on the fact that the additional insured provision excluded obligations for which United had specifically agreed to indemnify J&R, as opposed to generally.42 The

37 Id.
38 Id. at 486 (emphasis added).
39 Id. at 488 – 89.
40 Id. at 487 (emphasis added).
41 Id. at 488.
42 Id. at 489.
court found that “specifically” could reasonably be read to mean that United was only forgoing additional insured coverage if it had made a separate agreement with J&R to indemnify J&R for some specific event. Therefore, the court vacated the summary judgment and rendered judgment for United.

Following the *Evanston* and *Aubris* holdings, courts are likely to find additional insured coverage if there is any reasonable argument to support the insured’s position, even when the parties probably intended for the additional insured coverage to dovetail with the indemnity agreement. Interestingly, one unreported federal case, decided before either *Evanston* or *Aubris*, attempted to deal with the issue of what language would be necessary in contract to ensure that the additional insured provision was not meant to undo the indemnity arrangement. The court in that case found the following language sufficient:

The naming of Mariner Group as an additional insured is not intended and shall not derogate from the division of risk and indemnity agreements set out under this Contract. The Mariner Group will not be entitled to assert a claim against Contractor’s insurance with respect to liabilities and losses assumed by Mariner or as to which Mariner has indemnified Contractor under this Contract.44

The court found that the above language was clear enough to indicate intent by the parties to limit the additional insured party’s coverage to losses and indemnity not assumed by the party claiming additional insured status.45

IV. Conclusion: Risk versus Reward

Before entering into an indemnity agreement, a company should always weigh the potential rewards against the obvious risk. It should consider the number of employees and contractors it will be responsible for under the agreement, both directly and indirectly. Furthermore, it must try and determine what law will apply should a dispute over the contract ever arise and how the indemnity arrangement might be affected by additional insured coverage. Ultimately, the decision to indemnify or not to indemnify will boil down to a case by case analysis of the good, the bad and the ugly of each particular circumstance.

43 *Id.* at 490.
45 *Id.* at *3.
Underage drinking in the United States remains an endemic problem. While every state has set a minimum drinking age of twenty-one, underage persons continue to drink. Alcohol is the most widely used substance of abuse among America’s youth, more than both tobacco and illicit drugs. While the notion of underage drinking is neither new nor novel, the statistics are nonetheless surprising. Underage drinkers are responsible for over sixteen percent of all alcohol consumed in the United States, and underage students consume nearly half of all of the alcohol consumed by students attending four-year colleges and universities. Furthermore, statistics show that underage drinking is often reckless and extremely dangerous. In a 2001 college survey, approximately forty-four percent of college students reported that they had engaged in binge drinking, which is usually defined as five or more drinks in a row for men and four or more drinks in a row for women. Each year, drinking by college students, ages eighteen to twenty-four, contributes to an estimated 1,700 student deaths, almost 600,000 injuries, nearly 700,000 assaults, and about 100,000 instances of alcohol related sexual assault or date rape.

5 Id. at 207.
rape. Looking at underage drinkers as a whole, the U.S. Surgeon General has estimated that approximately 5,000 persons under the age of twenty-one die each year from alcohol-related injuries involving underage drinking.

Minimum-age laws have not prevented those under the age of twenty-one from drinking, let alone from drinking in excess. In the face of national campaigns, resolutions by both houses of Congress, initiatives by the U.S. Surgeon General, and multimillion-dollar campaigns, the amount of underage drinking has been virtually unchanged.

As minimum-age laws fail to prevent underage drinking, more and more states have turned to imposing civil liability on those that provide alcohol to underage drinkers. In a report issued by the National Academies Institute of Medicine, states and localities are urged to enact a comprehensive set of strategies to reduce underage alcohol consumption, including strengthening social host liability laws.

Social host liability “imposes, by statute or court decision, a civil duty on social hosts across the relevant state that can be enforced through litigation brought by injured private parties seeking monetary damages against the host.” Social host liability is similar to, but not the same as dram shop acts, which allow third parties to recover from those that sell alcohol to an individual. Instead, social host liability allows anyone who furnishes alcohol to a guest to be held liable for the actions of that drinker. Unlike dram shop acts, which target commercial vendors such as bars and restaurants, a social host is an individual, and can be anyone who hosts a social gathering where alcohol is served, including private individuals, employers, and organizations.

This article evaluates social host liability, paying special attention to case law and statutory authority that specifically targets social hosts who furnish alcohol to individuals who are between the ages of eighteen and of twenty-one. This article argues that social host liability is not the proper way to address the problems associated with underage drinking, as it simply shifts blame without addressing underlying problems that lead to irresponsible behavior.

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See McMullen, supra note 1, at 1.

See Wechsler, et al., supra note 4, at 203.


See COMMITTEE ON DEVELOPING A STRATEGY TO REDUCE AND PREVENT UNDERAGE DRINKING, supra note 6, at 246.


drinking behaviors. In addition, this article provides alternative, more effective, strategies to combat irresponsible drinking behavior among college-age individuals.

I. Common Law Social Host Liability

Social host liability occurs in three forms. First, courts have extended the application of dram shop acts to social hosts. While dram shop acts, as explained above, impose liability on commercial ventures for the intoxication of their patrons, in some jurisdictions plaintiffs have successfully argued that dram shop acts not only create a cause of action against a bar owner but a social host as well. Social host liability has also been found based on a social host’s violation of a beverage control act setting the legal drinking age at twenty-one. Courts have ruled that in violating these types of laws, the social host is negligent per se for the actions of the guest. Social host liability has been found rooted within ordinary negligence, where the social host breaches a duty by continuing to serve either an already intoxicated guest or an underage guest. In doing this, the social host creates an unreasonable and foreseeable risk of harm to the public.

Social host liability in the college setting began in the 1980s when courts began to impose liability on fraternities for alcohol created risks. “These cases constituted a shift away from notions of exclusive student personal responsibility for high-risk drinking injuries.” A representative early case is Fassett v. Delta Kappa Epsilon. In Fassett, after attending a fraternity party, seventeen-year-old Anne Fassett, nineteen-year-old Monica Buckley, and eighteen-year-old Corbin Evans were involved in a car crash where Evans, the driver, collided with a pickup truck. As a result of the accident, Buckley was killed and Fassett was rendered quadriplegic. Buckley’s estate and Fassett brought negligence actions against the fraternity and various fraternity members. The United States Court of Appeals for the Third Circuit held that a rule extending social host liability only to individuals who physically served alcohol to minors was unduly restrictive and held that civil liability could be imposed on any individual who intentionally and substantially aided minors in consuming alcohol. The Fassett decision

16 Id.
17 Id.
18 Id.
19 Id.
21 See id. at 616-17.
22 807 F.2d 1150 (3d Cir. 1986).
23 See id. at 1152.
24 Id.
25 Id.
26 Id. at 1165. Courts generally have adhered to the idea that social host liability will only be imputed when the intoxicated person is
“enormously extended the range of host liability by defining an accomplice host as one who, in any way, cooperatively promotes or sponsors a party at which alcohol is consumed, even if he or she does not directly serve or furnish alcohol to guests.”

In *Jefferis v. Commonwealth,* Kurt Jefferis, an underage individual, was injured after he became intoxicated after attending a fraternity party. The Superior Court of Pennsylvania held that the defendant could be held liable as an entity for the injuries sustained by Jefferis, if it “intentionally rendered substantial assistance to [him] in his consumption of alcohol.” The court used the theory of accomplice liability, setting out the following three prong test to determine the fraternity’s liability:

1. the defendant must have intended to act in such a way so as to furnish, agree to furnish or promote the furnishing of alcohol to the minor, and
2. the defendant must have acted in a way which did furnish, agree to furnish, or promote the furnishing of alcohol to the minor, and
3. the defendant’s act must have been a substantial factor in the furnishing, under the age of 21. States that recognize social host liability have strictly adhered to this standard and ruled against imposition of liability for similar facts on the basis that the intoxicated person was under the age of 21. See *Estate of Vosnick v. RRJC, Inc.*, 225 F. Supp. 2d 737 (E.D. Ky. 2002).

However, neither the court’s test, which looked at three factors, all surrounding the fraternity’s act of furnishing the alcohol to Jefferis, nor its analysis of social host liability analyzed plaintiff’s decision to consume alcohol, focusing instead on the fact that fraternity provided him with alcohol that led to his intoxication and subsequent injury.

Since the 1980s, cases involving fraternities have continued to be the focal point in the realm of social host liability. In *Pawlowski v. Delta Sigma Phi,* for example, the underage plaintiff attended a fraternity party at Quinnipiac University, where he was served beer and punch containing alcohol. The plaintiff, after becoming intoxicated, left the party and was hit by a car while crossing the street, causing severe injuries that resulted in his death. Pawlowski’s estate brought a claim against the host and others, claiming both negligence and recklessness. The party host moved for summary judgment, arguing “that he took particular and appropriate steps to prevent the service of alcohol to minors such as [plaintiff].” The court denied defendant’s motion for summary judgment, reasoning that the host procured the keg that minors drank from and knew that underage drinkers were agreement to furnish, or the promotion of alcohol to the minor.

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27 See *Spring Walton, Social Host Liability: Risks for Fraternities and Student Hosts,* 34 NASPA J. 29, 30 (1996).
29 See *id.* at 358-59.
30 See *id.* at 358.
31 See *Walton, supra* note 27, at 30.
33 See *id.* at 1.
34 See *id.* at 2.
35 See *id.*
36 See *id.* at 4.
drinking at the party. The court held that it was therefore up to a jury to decide if Pawlowski was in fact served alcohol at the party and subsequently died as a result. The court made no mention of Pawlowski’s own voluntary decision to consume reckless amounts of alcohol.

While fraternities often find themselves involved in the most high profile of lawsuits involving social host liability, a great deal of underage drinking occurs absent the involvement of such organizations. In Herr v. Booten, for example, Benjamin Herr and his three college roommates began drinking early in the afternoon of January 16, 1984, the day before Herr was set to turn twenty-one, to celebrate Herr’s impending twenty-first birthday. That evening, Herr died from alcohol poisoning after consuming a nearly full bottle of Jack Daniel’s whiskey by himself. An autopsy revealed that his blood alcohol content was 0.64. Herr’s estate brought an action against Herr’s friends, alleging that they were negligent in causing Herr’s death. In finding Herr’s roommates negligent, the court reasoned:

Herr, could not have legally purchased or consumed alcohol on January 16, 1984; but he could have legally done so on the following day, the day of his birth, January 17. Thus, the furnishing of alcohol to Eric B. Herr on January 16, 198[4], amounted to negligence per se as a matter of law.

Because Herr’s death was a result of his consumption of alcohol hours before he was twenty-one, the defendants were unable to succeed on their summary judgment motion, as the per se finding of negligence made their claim of assumption of risk moot.

In Rust v. Reyer, the leading case on social host liability in New York, the New York Court of Appeals found the host of a “keg party” liable for injuries to a third party, even where the host did not purchase any of the alcohol, but only opened her house to those that brought the alcohol and allowed individuals under twenty-one to drink. The court held that “[defendant] was more than a passive participant who merely knew of the underage drinking and did nothing else to encourage it. . . . [Defendant] played an indispensable role in the scheme to make the alcohol available to the underage party guests.” Due to the indispensable role that she played in purveying alcohol to underage drinkers, the court reasoned that even where the social host does not purchase the alcohol, their role in providing it to underage drinkers amounts to “unlawfully furnishing” alcohol, the requirement for New York’s social host liability statute.

Courts have also entertained the idea of holding colleges and universities liable

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37 See id. at 19.
38 See id.
39 See id. at 19.
41 See id. at 1116.
42 See id. (This is eight times the legal limit for individuals operating vehicle in Pennsylvania.).
43 See id.
44 See id. at 1120.
45 See id. at 1121.
47 See id. at 361.
48 See id. at 360.
for dangerous drinking behavior of underage students. In *Seig v. Wilkes College*, Seig, an underage college student, attempted to slide down a handrail from a third floor to a second floor in a dormitory at Wilkes College while intoxicated and as a result lost his balance and fell two stories. While the court did not seek to answer the question of liability, it held that “the promotion of consumption by a college is and should be a basis for the assertion of liability. Certainly the person who promotes the consumption of alcohol is and should be held to the same degree of liability as the person who actually serves it.”

Similarly, in *Flynn v. Fairfield University*, Tracy Flynn was a passenger in a car driven by Joseph McInherney. McInherney crashed his car into a pole, leaving Flynn with serious injuries that left her in a coma for some time. Prior to the accident, McInherney, who was nineteen years old at the time, had been drinking in his dormitory at Fairfield University. Flynn brought suit against the university alleging negligence. The university subsequently moved for summary judgment, “claiming that the University can not [sic] be liable to the plaintiff, as a matter of law, because it did not supply alcoholic beverages to its minor students.” The court denied the University’s motion for summary judgment, reasoning that the University had a duty to Flynn and that the University’s negligence could be found to be the proximate cause of the underage drinking and the resulting accident.

II. Statutory Social Host Liability

While case law has played an important role in the development of social host liability, the most important source for social host liability is the states themselves. Generally speaking, there

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49 No. 3462-C, 1989 Pa. Dist. & Cnty. Dec. LEXIS 166 (Pa. C.P. Sept. 22, 1989); compare with Booker v. Lehigh Univ., 800 F. Supp. 234, 241 (E.D. Pa. 1992) (“[The University’s] position, and rightly so, was to assume that the adult students were responsible enough to make their own decisions. [The University], being detached from the events in question, is not responsible for the indiscretions and poor judgment of one of its underage adult students.”). Moreover, it appears that the outgrowth of social host liability to universities and national organization with little to no control over the drinking is limited to a few instances. See Anthony F. DiPadova, Jr., Comment, *Social Host Liability: Am I My Brother’s Keeper?*, 21 NEW ENG. L. REV. 351, 390 (1986).


51 See id.

are three models of statutes that statutorily impose social host liability. In Mississippi,\textsuperscript{59} and Wyoming,\textsuperscript{60} statutes explicitly disallow social host liability except for instances where the social host furnishes alcohol to an individual who is unable to legally or lawfully consume alcohol, and it is that individual who causes the injury.

The second model of statute, found in Colorado,\textsuperscript{61} Oregon,\textsuperscript{62} Montana,\textsuperscript{63} and Wisconsin,\textsuperscript{64} also disallows social host liability in instances where the host furnishes alcohol to an individual of legal drinking age. However, these statutes only hold a host liable when the host knowingly furnished alcohol to an individual under the age of twenty-one and that person causes another to be injured. These statutes include an element of proof, while the others explicitly hold any social host liable for the injuries caused by an underage guest, regardless of whether the host knew that individual was under age.

In the most common model of social host liability statute, found in Hawaii,\textsuperscript{65} Iowa,\textsuperscript{66} Minnesota,\textsuperscript{67} Nevada,\textsuperscript{68} New York,\textsuperscript{69} North Dakota,\textsuperscript{70} Utah,\textsuperscript{71} and Vermont,\textsuperscript{72} social host liability is not explicitly disallowed when the intoxicated person is of legal drinking age, and these statutes also use the age of twenty-one, rather than the term “legal” or “lawful” consumer, to determine liability. These statues all hold liable any social host who provides alcohol to someone less than twenty-one years of age liable for the injuries caused by that person.

III. Social Host Liability Fails to Fit the Idea of What Constitutes an Adult

The general reasoning behind imposing social host liability on hosts that serve guests under the age of twenty-one is that underage drinkers are irresponsible and unable to make the choice to drink or not to drink. While Tennessee does not have a statute that imposes social host liability, it has analyzed the age of twenty-one and its relationship to drinking by explaining that:

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\text{Persons under the age of twenty-one are incompetent to responsibly consume alcohol. There can be no doubt that the law attempts to protect minors, as well as the general public, from the consequences of their consuming alcohol by prohibiting the possession or purchase of alcohol by minors and the sale of alcohol to minors . . . These broad prohibitions are intended not only to protect minors from the folly of their own actions, but are for the protection of members of the general public as well. They are directed to minors as a class in recognition of their susceptibilities and the intensification}
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of dangers inherent in the consumption of alcoholic beverages, when consumed by a person lacking in maturity and responsibility. . . . Thus, the law recognizes both the dangers inherent in consumption of alcohol by minors and their weaknesses in judgment.  

The rationale that an individual under the age of twenty-one lacks the necessary judgment to drink responsibly fails to comport with the general view of what constitutes an adult. Imposing liability on social hosts in a manner that differentiates between a guest under twenty-one and a guest over twenty-one is inconsistent with other laws that dictate who is an adult. In 1971, the ratification of the Twenty-Sixth Amendment standardized the voting age at eighteen years old. At age eighteen one can purchase tobacco and serve in the armed services. The age of legal consent to sexual intercourse in every state is less than eighteen years old, with the majority allowing consent at either sixteen or seventeen. Similarly, every state except Nebraska has set the age one can marry at eighteen years or younger. Each of these decisions reflect the ability of an individual to make a choice on his own, similar to the ability to drink irresponsibly or in a manner that may otherwise cause injury to another. An individual aged eighteen to twenty-one is an adult and should be treated as one when it comes to application of tort law.

This argument has been used by the Supreme Court of Texas in *Smith v. Merritt* to rule against the imposition of social host liability. In *Smith*, nineteen-year-old Robert Barbee hosted a party at a lake house owned by his parents and his grandparents, where he provided alcohol to his guests. At the party were nineteen-year-old Robert Hale and eighteen-year-old Colin Smith. After drinking at the party, Hale left the party in his car with Smith as his passenger and soon thereafter collided head on with a truck, leaving Smith with permanent injuries. Smith sued Barbee and the owners of the home, alleging they were negligent in providing Hale, who was underage, with beer. The court held against imposing social host liability explaining that “Robert Hale was an adult at the time of the accident. The fact that he was defined as a minor solely for purposes of [Tex. Alco. Bev. Code § 106.01] is not significant in our negligence analysis.” The court further explained that the age of majority in Texas is eighteen, except for purposes of determining criminal liability under Tex. Alco. Bev. Code § 106 and that

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75 See http://www.ageofconsent.us/ (last visited March 2, 2010).
77 See *Smith v. Merritt*, 940 S.W.2d 602 (Tex. 1997).
78 See *id.* at 604.
79 Id.
80 Id.
81 Id. at 606.
82 TEX. ALCO. BEV. CODE § 106 defines anyone under the age of twenty-one as a minor.
therefore, “persons eighteen years of age or older are adults and have the right and corresponding responsibility to make their own choices.” The court further reasoned that “Hale was an adult for virtually all purposes at the time of this accident,” and “[a]s an adult subject to being sued in his own capacity, Hale’s tort duty should not be shifted to the social hosts in this case.”

In Robinson v. Matt Mary Moran, Inc., that Supreme Court of Virginia noted similarly that:

The responsibility of individuals for torts they commit does not change because they are 19 or 20 years of age, rather than 21 years of age. Moreover, the fact that they cannot legally purchase alcoholic beverages does not alter this responsibility, just as it does not alter the responsibility of intoxicated adults who cannot legally purchase such beverages because of their intoxication.

IV. Social Host Liability is a Misapplication of Tort Law

The imposition of social host liability also misapplies common law tort principles. A claim of negligence generally requires that (a) the defendant owed a duty to use due care; (b) the defendant breached that duty; (c) the defendant’s conduct caused harm to the plaintiff; and (d) the breach was the proximate cause of the resulting injury. Social host liability fails to follow this standard, imposing instead a legal duty onto the host and failing to consider alternative proximate causes.

A. The Host’s Duty

Generally, unless a defendant has assumed a duty to act, or stands in a special relationship to the injured party, the defendant is not liable in tort for the failure to act to the benefit of the plaintiff. This general principle is not changed even where the defendant foresees the harm to a particular individual stemming from his failure to act. However, the general no-duty rule has been ignored in cases of social host liability. In Kelley v. Gwinnell, the New Jersey Supreme Court imposed a duty on the social host after an adult guest injured a third party in a drunken driving accident. The court imposed a duty on a

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83 See Smith, 940 S.W.2d at 606.
84 Id.
85 Id.
87 See DiPadova, supra note 49, at 390.
89 See e.g., Marcum v. Bowden, 372 S.C. 452, 462 (S.C. 2007) (“Consonant with our duty to declare the common law, we hold that henceforth adult social hosts who knowingly and intentionally serve, or cause to be served, an alcoholic beverage to a person they know or should know is between the ages of 18 and 20 are liable to the person served, and to any other person, for damages proximately caused by the host’s service of alcohol.”).
90 See Dobbs, supra note 88, at 853.
91 Id.
93 Id. at 548.
social host on the basis of public policy.94 The court reasoned, that although imposition of such a duty would “interfere with accepted standards of social behavior . . . the added assurance of just compensation to the victims of drunken driving as well as the added deterrent effect of the rule on such driving outweigh the importance of those other values.”95 The court explained, “[t]he goal we seek to achieve here is the fair compensation of victims who are injured as a result of drunken driving. The imposition of the duty certainly will make such fair compensation more likely.”96

While the goal proposed by the majority in Gwinnell is noble, the extension of social host liability through statute or common law removes culpability from a real party at fault and shifts it to a third party.97

In contrast, the Supreme Court of Alaska in Chokwak v. Worley98 ruled against imposing social host liability even where the plaintiff argued that such a ruling would “shield, for example, illegal unlicensed vendors, fraternities which haze initiates, and hosts of high school drinking parties,”99 reasoning that “[a]s difficult as it is to defend a policy specifically immunizing those who unlawfully furnish liquor to minors from civil liability . . . a policy immunizing social hosts in general from liability for injuries caused by intoxicated persons to whom they have served liquor is not indefensible.”100

The public policy argument addressed in Gwinnell has many complications.101 As the dissent in Gwinnell noted, most host and guest relationships are often not one-to-one interactions, making it difficult for a host to monitor the activities of each guest at their party.102 Unlike commercial vendors of alcohol, a social host often lacks the means to regulate its guests.103 While it is reasonable to expect a social host to refuse to serve an intoxicated guest or to serve someone under the age of twenty-one, “due to a desire to avoid confrontation in a social environment, this may become a very difficult task.” Similarly, unlike a bar, where a patron is served each drink by a bartender, a guest in a social setting often serves himself or herself, making it difficult for the social host to monitor who is drinking, let alone how much each guest is drinking.104

B. Proximate Cause

94 Id.
95 Id.
96 Id. at 551.
97 See e.g., Estate of Ritchie v. Farrell, 213 Ill. App. 3d 846, 849 (Ill. App. Ct. 1991) (“The plaintiff was free to drink as little or as much as he chose. Tragically, the plaintiff chose to drink an inordinate amount of alcohol. Having placed himself in peril, he cannot now claim the defendant had a duty to come to his rescue.”).
99 Id. at 1254.
100 Id.
101 See generally, Harriman v. Smith, 697 S.W.2d 219, 221 (Mo. Ct. App. 1985) (“[T]he extension of liability to a social host opens the door to areas of the law yet unexplored having a substantial impact on a person's everyday social and family affairs.”).
102 See Gwinnell, 96 N.J. at 567 (Garibaldi, J., dissenting).
103 See id. (Garibaldi, J., dissenting).
104 See id. (Garibaldi, J., dissenting).
The imposition of social host liability lacks the direct causal connection required to create proximate cause between the conduct of the social host and the injury caused by or incurred by the guest. “The central goal of the proximate cause requirement is to limit the defendant’s liability to the kinds of harms he risked by his negligent conduct.”\textsuperscript{105} The most general test used to determine proximate cause centers around determining if the injuries were foreseeable to the defendant.\textsuperscript{106} The defendant is only liable for the injuries foreseeably risked by his conduct and is therefore, not liable for injuries that are unforeseeable.\textsuperscript{107} Prior to the expansion of social host liability, common law set forth barred a cause of action against social hosts because it was the drinking of the alcohol, not the furnishing of it, that was considered the proximate cause of the injury.\textsuperscript{108}

Courts and states, in the interest of public policy, have shifted this responsibility and attributed proximate cause to the furnishing of alcohol, rather than its consumption. Under this rationale, “the consumption, resulting intoxication, and injury-producing conduct are foreseeable intervening causes, or at least the injury-producing conduct is one of the hazards which make such furnishing negligent….”\textsuperscript{109} In the context of social host liability, by allowing the furnishing of alcohol to become the proximate cause of an injury, the social host is forced to take responsibility for another adult who may or may not choose to make irresponsible decisions.

The reasoning used to hold a social host liable for the torts committed by an intoxicated guest “is in derogation of the general rule of proximate cause.”\textsuperscript{110} Using the “but for” test to determine proximate cause, it cannot be said that “but for” the host providing a guest with alcohol that the accident would not have occurred,\textsuperscript{111} because “the guest might have just as easily obtained the intoxicant from another source.”\textsuperscript{112} This is especially true in the college setting, where alcohol is very easy for those underage to obtain.\textsuperscript{113} It cannot be assumed that underage drinkers are unable to obtain alcohol merely because it is illegal for them to obtain.\textsuperscript{114}

Moreover, in determining that furnishing alcohol to a guest is the proximate cause of an injury, social host liability fails to fall within the zone of foreseeability laid out in \textit{Palsgraf v. Long Island R.R. Co.}\textsuperscript{115} In \textit{Palsgraf}, Justice Cardozo found that under the foreseeability test, it was not reasonable to hold the railroad liable for its alleged negligence because it was the explosion that was the proximate cause of the plaintiff’s injuries, and the railroad could not have reasonably expected such a disaster.\textsuperscript{116}

\textsuperscript{105} See Dobbs, \textit{supra} note 88, at 443.
\textsuperscript{106} See \textit{id.} at 444.
\textsuperscript{107} See \textit{id.}
\textsuperscript{108} See Charles v. Seigfried, 165 Ill. 2d 482, 486 (Ill. 1995).
\textsuperscript{110} See DiPadova, \textit{supra} note 49, at 382.
\textsuperscript{111} See \textit{id.}
\textsuperscript{112} See \textit{id.}
\textsuperscript{113} See Miller, et al., \textit{supra} note 3, at 519-28.
\textsuperscript{114} See \textit{id.}
\textsuperscript{115} 248 N.Y. 339 (1928).
\textsuperscript{116} See \textit{id.} at 344.
is in fact the proximate cause, a social host must assume that each guest will become intoxicated and each guest will make poor decisions due to their intoxication. In making the furnishing of alcohol the proximate cause, “courts are eroding recognized negligence principle and requiring a purveyor of alcohol to have insight into consequences which extend far beyond Justice Cardozo’s ‘range of apprehension.’”117

V. Social Host Liability is Ineffective at Deterring Underage Drinking on College Campuses

Statistical studies have shown that social host liability, as a whole, is a successful tool in curbing dangerous behavior like drinking and driving.118 A study published in the Journal of Studies on Alcohol concluded that:

Persons living in states that recognize social host liability reported fewer heavy drinking episodes and drinking and driving behaviors among all drinkers. . . . Based on our results, it seems plausible to conclude that social host liability may encourage drinkers to be more responsible in naming a designated driver or finding other ways to get home after drinking in someone’s’ home. In addition, host may limit the serving of an excess amount of alcohol to those guests that are likely to drive home.119

After coming to this conclusion, the authors note that for these results to be true it must be assumed that those that reported fewer heavy drinking episodes and fewer instances of drinking and driving were aware of the social host liability policy in their respective state.120 On college campuses, ignorance of social host liability status and of the question of social host liability generally belies the assumptions provided by the authors.

Fraternity chapters, due to their structure and susceptibility to social host liability, provide a good example to determine how well social host liability laws are understood on college campuses.121 A 1992 survey of fraternities in Pennsylvania, a state where a great deal of social host liability cases have been litigated,122 attempted “to explore fraternity members’ attitudes and knowledge about social host liability” laws.123 The study concluded that the majority of fraternities that were at least aware of social host liability had received this information from their fraternity’s national foundation,124 but determined that “[a]lthough a majority of fraternities are aware of the dangers of social host liability, a substantial percentage remain unaware or are inadequately informed about the risks.125

119 See id.
120 See id.
121 See Walton, supra note 27, at 31.
122 See id.
123 Id.
124 See id. at 33.
125 See id.
Because most fraternity chapters surveyed who knew of social host liability received their information from affiliated national foundations, the majority of students, who do not have the benefit of a national organization, arguably remain much less informed on the risks associated with social host liability.\textsuperscript{126} Most college students remain unaware of the risks associated with social host liability, and accordingly, it is difficult to accept the \textit{Journal of Studies on Alcohol}'s conclusion that social host liability is a deterrent to dangerous drinking activities.\textsuperscript{127} Without more direct evidence of a deterrent effect associated with social host liability, it seems to be a very poor mechanism to fix the problems associated with underage drinking in the college setting.

VI. Alternative Strategies

Social host liability is largely an outgrowth out of the public's concern with underage drinking, alcoholism, and drunken driving accidents.\textsuperscript{128} However, this strategy unnecessarily stretches tort law principles and has failed to be an effective deterrent against underage drinking and binge drinking activities on college campuses. Because drinking is and will continue to be a problem that plagues America's youth, more effective strategies must be developed.

A. Stiffer Penalties on Drunk Drivers

As evidenced by many social host liability scenarios, drunken driving accidents often give rise to litigation resulting in social host liability. This is not surprising, considering the nearly 13,000 deaths each year attributed to drunk driving,\textsuperscript{129} and it is the estimated that thirty percent of all Americans will be involved in an alcohol related crash in their lifetime.\textsuperscript{130} Strengthening laws penalizing drinking and driving provides a more effective deterrent to individuals from carrying out an action that is at the center of so many social host liability cases. Such an action will both deter unsafe drinking and lower drunken driving accidents. Implementing administrative license revocation, the removal of a drunk driver's license at the time of an arrest due to the failure or refusal of a chemical test, would provide a more effective deterrent than social host liability.\textsuperscript{131} Nine states, including

\begin{itemize}
  \item \textsuperscript{126} See \textit{id.}
  \item \textsuperscript{127} See Stout, et al., \textit{supra} note 118, at 410.
  \item \textsuperscript{128} See Walton, \textit{supra} note 27, at 29.
  \item \textsuperscript{131} See Mothers Against Drunk Drivers, \textit{Administrative License Revocation}, http://www.madd.org/Drunk-Driving/Drunk-
Kentucky, Michigan, Montana, New Jersey, New York, Pennslyvania, Rhode Island, South Dakota, and Tennessee, have not enacted administrative license revocation laws. Studies have shown that these laws have a significant deterrent effect on drunk driving and they have reduced drunk driver fatalities.

States may also choose to enact legislation requiring alcohol ignition interlocks be installed in the vehicles of those convicted of drunken driving. Alcohol ignition interlocks are small devices that a driver must blow into prior to starting the vehicle. Currently, only a handful of states have enacted such a statute, though they are increasing in popularity. Alcohol ignition interlocks have been shown to be effective in preventing drunk driving among repeat offenders. Mothers Against Drunk Driving also asserts that there is broad public appeal for the use of these devices.

### B. Stiffer Underage Possession Laws

Social host liability laws punish social hosts who serve underage guests but fail to hold those between the age of eighteen and twenty-one accountable for their own choice to illegally consume alcohol. Stricter laws regarding underage alcohol possession could remediate this defect. For example, in New York, possession of alcohol by a person under the age of twenty-one is punishable by up to a fifty dollar fine and thirty hours of community service. Similarly, in Massachusetts a person under twenty-one years of age is subject to a fifty dollar fine for their first offense and one-hundred fifty dollars for the second offense. These laws clearly pose no deterrent threat to underage drinking, leaving those under the age of twenty-one with little to no reservation about accepting a drink from a social host. However, states have trouble passing stiffer penalties that would include jail time due to overcrowded jails. As former California State Assemblywoman Sharon Runner, who attempted but failed to pass stiffer penalties for underage drinking,
said, “[e]ighteen- to 20-year-olds are not quite getting the message.”

Real repercussions for underage possession or consumption of alcohol would reduce consumption by people under the age of twenty-one. Penalties like larger fines and suspension of the offender’s driver’s license have recently been imposed in Rhode Island. Rhode Island’s legislation provides that on the first offense one must pay a fine between one hundred-fifty and seven hundred fifty dollars, three hundred to seven hundred fifty dollars for the second offense, and four hundred fifty dollars to nine hundred fifty dollars for the third or subsequent offense. Under this statute, any individual who violates this statute must perform thirty hours of community service and is subject to a minimum sixty-day suspension of his or her driver’s license.

C. More Comprehensive Education

College-aged students often unknowingly open themselves up to liability under social host laws. Given the widespread use of alcohol by college students and the fact that students are likely misinformed or inadequately informed about the seriousness of the threat of social host liability, colleges have should educate students better about the risks associated with it.

Many schools offer programs for students that attempt to deter dangerous drinking and inform students of the dangers of drinking. One of the most popular is AlcoholEdu, which reaches over a half a million students each year. These types of programs are popular with colleges and have proven effective at curbing heavy drinking activity. Similarly, the U.S. Department of Education produced a report highlighting model programs on college and university campuses dealing with alcohol prevention. While AlcoholEdu and the programs outlined by the U.S. Department of Education focus on safe drinking, legal issues associated with drinking are rarely, if ever, mentioned.

For these programs to be effective in the college setting in relation to social host liability, the consequences of these laws must be discussed. Until states make a concerted effort to raise awareness of social host liability laws, such laws will have no deterrent effect. While this article argues against the imposition of social host liability for conduct of non-minors, it is unlikely that this type of liability will disappear. Therefore, the only fair response, absent elimination of these laws, is to educate those most affected by them.

141 See id.
142 See R.I. GEN. LAWS § 3-8-10 (2009).
143 See id.
144 See Walton, supra note 27, at 33-34.
148 See id.
VII. Conclusion

Drinking in excess is a problem that plagues young adults. There is a need to try to curb the activities associated with drinking in excess. However, social host liability laws, both statutory and judicially created, targeting social hosts who furnish alcohol to those between the ages of eighteen and twenty-one are not the right tool for this fight. Allowing an injured party to bring an action against a social host for an injury caused by a guest who is under the legal drinking age but is at least eighteen years old fails to fit the idea of what constitutes an adult. Allowing social host liability to shift the blame from the guest to the host shifts the responsibility away from the adults who have made the decision to drink too much and fails to follow long understood principles of duty and proximate cause. Social host liability creates a duty where there should not be one and makes furnishing, as opposed to consumption, the proximate cause of subsequent injuries. Finally, social host liability is an ineffective tool in curbing dangerous drinking activity, particularly on college campuses where drinking is the heaviest.

This article provides recommendations to fight dangerous drinking behavior, including stiffer penalties for drunk drivers, stiffer penalties for underage possession of alcohol, and a more comprehensive education on the dangers of drinking. These recommendations target the individuals who should be held accountable for their decisions, as opposed to the social host who makes alcohol available to their guests.
Conning the IADC Newsletters

International Association of Defense Counsel Committee members prepare newsletters on a monthly basis that contain a wide range of practical and helpful material. This section of the Defense Counsel Journal is dedicated to highlighting interesting topics covered in recent newsletters so that other readers can benefit from committee specific articles.

A LAWYER’S ROLE IN THE AFTERMATH OF THE MASSEY COAL DECISION

By: Michael D. Crim and Jeff Van Volkenburg

This article originally appeared in the February 2010 Professional Liability Committee Newsletter.

“YOU CAN’T HANDLE THE TRUTH . . .” This line was belted out in the film “A Few Good Men” by Col. Nathan R. Jessep (Jack Nicholson) in response to a line of questioning by Lt. Daniel Kaffee (Tom Cruise) related to whether Col. Nathan had ordered a “Code Red” resulting in the death of a Marine. The exchange between the two thespians has become the basis of movie lore...and comedy fodder. Irrespective of which side of the fence you find yourself related to the long-term evaluation of this movie

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scene, most lawyers can identify with Lt. Kaffee’s decision to challenge Col. Jessep at the risk of suffering a potential career ending disaster. Lt. Kaffee’s decision, while somewhat contrived and melodramatic, does epitomize what “zealous” representation is meant to encompass.

The act of moving to recuse a sitting trial judge has not historically been an issue that an attorney would likely consider when evaluating his or her obligation to “zealously” represent a client. In fact, recusal motions are sparingly used and have most often been utilized to remove a judge in situations where there is an outright and obvious conflict. An attorney would not likely consider his or her failure to seek recusal as a failure to “zealously” represent the client, nor would an attorney typically consider the possibility of being subjected to a malpractice claim as a result of the decision to move for recusal. All of that changed in June 2009 when the United States Supreme Court announced its decision in Caperton, et al v. A.T. Massey Coal Company.\(^1\)

In Caperton, the United States Supreme Court was called upon to decide whether there had been a constitutional violation of due process when Brent Benjamin, a West Virginia Supreme Court Justice, refused to disqualify himself from participating in an appeal brought by a corporate defendant, which had made substantial contributions to his judicial campaign. The United States Supreme Court ultimately found Benjamin’s refusal to disqualify himself to be a Due Process violation and sent the case back to the Supreme Court of Appeals of West Virginia for further consideration without Justice Benjamin participating.\(^2\)

As will be discussed briefly herein below, the Caperton decision created a new legal standard for determining whether a judge’s failure to recuse himself would constitute a federal Due Process violation, not based on actual bias, but based on the “probability” of bias. The Caperton standard has also arguably created a new legal malpractice cause of action predicated on an attorney’s failure to properly make use of the new recusal standard. Interestingly, this potential new cause of action could be asserted whether the attorney seeks recusal or decides that recusal is inappropriate. The remainder of this article will touch briefly on the history of the Caperton case and raise certain considerations that should be considered by practitioners on a going forward basis.

**The Facts Behind the Caperton Case**

In August 2002, a West Virginia jury found Massey Coal Company (“Massey”) liable for fraudulent misrepresentation, concealment and tortious interference with existing contractual relations and awarded the plaintiffs, Hugh Caperton, Harman Development Corp, Harman Mining Corp., and Sovereign Coal Sales

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\(^1\) 2009 U.S. LEXIS 4157 (2009).

\(^2\) Interestingly, and a point which often gets left out when discussed in the media, is the fact that when the Caperton case was again addressed by the West Virginia Supreme Court of Appeals without Benjamin participating, the trial court verdict was again overturned by the same 3 - 2 vote as had been the case on prior occasions.
(“Caperton”) damages in the amount of Fifty Million Dollars ($50,000,000.00). Thereafter, Massey began the appeal process. While Massey’s appeal was proceeding, West Virginia held its 2004 elections in which one of the seats on the state Supreme Court was being contested. Justice Warren McGraw was the incumbent and defense attorney Brent Benjamin was the challenger. During the judicial election process, Don Blankenship (Massey’s president and CEO) and a political action committee associated with him, contributed approximately three million dollars ($3,000,000.00) to Brent Benjamin’s judicial campaign. The contributions made by or on behalf of Mr. Blankenship exceeded the total contributions of all other contributors to the Benjamin campaign, including Benjamin’s own committee. As we all know, Brent Benjamin went on to win the judicial election and assumed his seat on the West Virginia Supreme Court of Appeals.

After being elected to the state Supreme Court, Caperton moved to disqualify Justice Benjamin prior to the appeal being heard, based on both the Due Process Clause and the West Virginia Code of Judicial Conduct. Justice Benjamin refused to disqualify himself and the West Virginia Supreme Court of Appeals, in a 3-2 vote, reversed the trial court and found in favor of Massey. As a result of this ruling, Caperton’s Fifty Million Dollar ($50,000,000.00) jury award was nullified. Thereafter, the West Virginia Supreme Court granted Caperton a rehearing. At the time of the rehearing, Benjamin had assumed the role of acting Chief Justice when both Spike Maynard and Larry Starcher voluntarily disqualified themselves from considering the case. Two state circuit court judges were assigned to sit in place of Justices Maynard and Starcher. Prior to the rehearing, Caperton again moved to have Justice Benjamin disqualified, asserting that Benjamin had failed to apply the correct legal standard for recusal under West Virginia law – i.e., whether “a reasonable and prudent person, knowing these objective facts, would harbor doubts about Justice Benjamin’s ability to be fair and impartial.”

Justice Benjamin again refused to disqualify himself. In April 2008, the West Virginia Supreme Court of Appeals, in another 3-2 vote, again found in Massey’s favor and overturned the trial court verdict. A dissent was filed which noted that there were “genuine due process implications arising under federal law” resulting from Justice Benjamin’s failure to recuse himself. A petition for a writ of certiorari was subsequently filed with the United States Supreme Court. After the filing of the writ, Justice Benjamin filed a concurring opinion, defending the merits of the majority opinion, as well as his decision not to disqualify himself. As is readily apparent, the Supreme Court granted certiorari and ultimately found a constitutional due process violation resulting from Justice Benjamin’s refusal to disqualify himself.

Don Blankenship’s personal contribution was $1,000.00. The remainder of the contributions came from the political action committee.
The United States Supreme Court Ruling

In its opinion, the Court analyzed the degree to which bias, whether actual or perceived should be addressed by a sitting judge. The Court recognized that “[n]ot every campaign contribution by a litigant or attorney creates the probability of bias that requires a judge’s recusal, but this is an exceptional case.” The Court concluded: “... there is a serious risk of actual bias – based on objective and reasonable perceptions – when a person with a personal stake in a particular case had a significant and disproportionate influence in placing the judge on the case by raising funds or directing the judge’s election campaign when the case was pending or imminent.

The Court’s inquiry focuses on the relative size of a campaign contribution in comparison to the total amount of money contributed to the campaign, the total amount spent in the election, and the apparent effect such contribution had on the outcome of the election. In response to Massey’s predictions of adverse consequences resulting from the finding of a constitutional violation, the Court attempted to limit the holding to the facts under consideration. The Court found that “[t]he facts before us are extreme by any measure. The parties point to no other instance involving judicial campaign contributions that presents a potential for bias comparable to the circumstances in this case.”

Despite the majority’s attempt to limit the impact of its opinion, the reality is that the new recusal standard is vague and limitless, is based on a mere “probability of bias”, and opens the door to an aggressive use of recusal motions, both for attorneys utilizing the new standard as a means of judge shopping and for legal malpractice claims. In fact, the dissent filed by Chief Justice Roberts recognizes the fact that the majority opinion creates a rather vague notion of when disqualification is appropriate. The dissent also argued concerning the lack of guidance as to what constituted too much money, warranting recusal. Additionally, there was no clarification as to “independent, non-coordinated expenditures.” The dissent listed a total of forty (40) issues related to the topic under consideration that were left unresolved by the majority opinion and open to further judicial interpretation and acknowledged that there were many more issues which could be added to the list. As a result of the lack of guidance in the majority opinion, the dissent also expressed concern with the potential explosion in what may become known as “Caperton” motions, i.e., motions alleging that a judge must be disqualified for one reason or another. In addition to Caperton motions, another factor worthy of consideration is the extent to which Caperton claims will be filed against attorneys based on alleged malpractice

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5 Caperton, at *29.
6 Id. at *33.
7 Id. at *34.
8 Id. at *39-*40.
9 Id. at *44 (Roberts, C.J., dissenting).
associated with the attorney’s decision as to whether to seek recusal.

**The Impact of Caperton**

The *Caperton* decision is significant for several important reasons. First, in reaching its conclusion, the Supreme Court found a judge’s refusal to disqualify himself to be a violation of the Due Process Clause for conduct which had never before recognized to create such a violation.10 Second, the *Caperton* decision sets forth a new legal standard for recusal of judges based on a “probability of bias”; thus, creating a potential cause of action for attorney malpractice predicated on the failure to seek a judge’s disqualification. Third, while the *Caperton* decision addresses cases involving campaign contributions, the holding is not so limited and could be applied to almost any factors which could call into question a judge’s potential bias, including, but by no means limited to other factors such as political affiliation, religious denomination, memberships, prior judicial opinions and scholarly writing. Fourth, the *Caperton* decision affords limited guidance on how this newly created legal standard is to be applied.

At this time, it is too early to accurately predict whether *Caperton* motions or *Caperton* claims will be frequently asserted or successfully prosecuted. However, it is clear that “zealous” representation now requires an attorney to at least consider a judge’s conduct, both on and off the bench, in an effort to determine whether there are subjective factors attributable to a judge which may be argued establishes a “probability of bias” sufficient to require recusal. This has the potential to become the norm as attorneys seek to limit their own potential exposure associated with a failure to seek a judge’s disqualification.

There are many uncertainties about the impact of the *Caperton* opinion on future litigation. However, there are a number of issues related to the decision that are certain. First, *Caperton* does establish a new legal standard regarding recusal of judges. Second, attorneys will be required to evaluate the judge assigned to their client’s case for the purpose of determining potential bias. Third, the Supreme Court has offered little guidance to attorneys or judges on what will satisfy the new “probability of bias” standard for judicial recusal. Fourth, the plaintiffs’ bar has a new legal malpractice cause of action at their disposal against attorneys who fail to conform their conduct to the appropriate standard of care in deciding whether to seek recusal. This new cause of action will be available whether the attorney moves for disqualification or chooses not to move for disqualification.

The purpose of this article has not been to fully address all of the potential ramifications of the *Caperton* decision, but simply to bring some of the issues to the forefront for consideration. The *Caperton* decision should be carefully considered by every trial lawyer, particularly those in states like West Virginia where judges are popularly elected and where there are no

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10Prior to *Caperton*, the Supreme Court had only recognized two distinct situations in which recusal was mandated by the Federal Due Process Clause; one, when a judge has a financial interest in the outcome of the lawsuit; and, two, certain contempt cases.
intermediate appellate courts. It will be interesting, in the years to come, to see how attorneys make use of this decision in an effort to zealously represent their clients. The potential for abuse is great, both by well-meaning attorneys trying to do right by their clients and by others who seek to use the opinion as a sword. In the future, it will be interesting to see how our courts address the unanswered issues raised by *Caperton*, as well as uses made of the decision by members of our noble profession.

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**HOW TO PROTECT YOUR CEO FROM BEING SUBJECT TO AN ARBITRATION AWARD, WHEN NOT A PARTY TO THE ARBITRATION AGREEMENT**

By: David W. Kash

This article originally appeared in the January 2010 Alternative Dispute Resolution Committee Newsletter.

While in your office, you receive a telephone referral from an out-of-state lawyer, whose corporate client wants to hire you to represent the corporation and its CEO, both have been named in an arbitration pending before a major arbitration organization in your city. You agree to take over as lead counsel.

As you review the file, you note that the CEO is not a signatory to the arbitration agreement, but is named in the arbitration. You conclude that the claimant is seeking an award personally against the head of the company. You determine that the CEO has not been served with any arbitration documentation. This paper deals with what you, as a practitioner, should do under these or similar circumstances.

**The Arbitration Agreement**

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1 Maggie L. Cox, a summer associate with Ryley, Carlock & Applewhite, assisted me in the research for this paper. She is a third year law student at the University of Nebraska, an Executive Editor for the *Nebraska Law Review* and a clerk for the U.S. Attorney’s Office in Omaha, Nebraska.
You would think that the following anti-joinder language in the arbitration agreement would be enough protection:

No arbitration arising out of or relating to this Agreement shall include, by consolidation, joinder or in any other matter, an additional person or entity not a party to this Agreement, except by written consent containing a specific reference to this Agreement signed by the Parties, and any other person or entity sought to be joined.2

2 Giller v. Cafeteria of S. Beach Ltd., L.L.P., 967 So.2d 240, 241 (Fla. App. 2007) (holding that an architect is entitled to arbitration of his malpractice claim even though he is not named in the arbitration agreement, because the agreement defines “Architect” as the “person” lawfully licensed to practice architecture and this unambiguously included the individual); LeNeve v. Via S. Fla., L.L.C., 908 So.2d 530, (Fla. App. 2005) (finding that individual having filed as a counter-petitioner, therefore waived its right to submit its claims in court); Holly & Smith Architects, Inc. v. St. Helena Congregate Facility, 872 So.2d 1147, 1151 (La. App. 2004) (holding that a nonparty to an arbitration agreement cannot be subject to award without evidence of written consent or rights establishing alter ego); Int’l Bullion & Metal Brokers, Inc. v. W. Pointe Land, L.L.C., 846 So.2d 1276, 1277 (Fla. App. 2003) (enforcing a nonjoinder provision); School Dist. of Philadelphia v. Livingston-Rosenwinkel, P.C., 690 A.2d 1321, 1322 (Pa. Cmwlth. 1997) (finding that a subcontractor could not compel arbitration when it was not a party to the contract to begin with and the contract contained a nonjoinder provision); Ex parte Stallings & Sons, Inc., 670 So.2d 861, 863 (Ala. 1995) (an architect could not compel arbitration based upon the owner contractor agreement to which it was not a party and which contained anti-joinder language); Curtis G. Testerman Co. v. Buck, 667 A.2d 649, 654 (Md. 1995) (a corporate officer is not subject to an arbitration agreement containing an anti-joinder clause without his consent simply because he signed the agreement which mistakenly misnamed the corporation); Donegal Mutual Ins. Co. v. Stern, 1984 WL 2421 at *1 (Pa.Com.Pl. 1984) (an architect which signed an arbitration agreement containing an anti-joinder provision with its client, the developer, is entitled to have claims against it arbitrated, therefore the state action was stayed).

Arbitrators can be influenced by claimants armed with some published case law, who want to assert personal liability of a respondent as a means to add leverage to their claims.

Theories Used to Bind Non-signatories to Arbitration Agreements

Despite the utilization of explicit language in an arbitration agreement, claimants have tried to bind non-signatories to arbitration agreements. A claimant may use ordinary notions of contract and agency law in order to bind a non-signatory to an arbitration award.3

3 Thomson-CSF, S.A. v. Am. Arbitration Ass’n, 64 F.3d 773, 776 (2d Cir. 1995) (“This Court has made clear that a non-signatory party may be bound to an arbitration agreement if so dictated by the ‘ordinary principles of contract and agency.’”) (citing McAllister Bros., Inc. v. A. & S. Transp. Co., 621 F.2d 519, 524 (2d Cir. 1980)); See Dwayne E. Williams, “Binding Non-signatories to Arbitration Agreements,” 25 FRANCHISE LAW JOURNAL 176–78 (2006) (discussing in detail the six theories used to bind non-signatories to arbitration agreements).
agreement to arbitrate, some federal courts have recognized that third parties may be bound through the following theories: 1) piercing the corporate veil or alter-ego; 2) assumption; 3) incorporation by reference; 3) agency; 4) estoppel; and 5) third-party beneficiary.4

Under a theory of veil piercing or alter-ego, the existence of a parent-subsidiary relationship is not enough to bind a non-signatory to an arbitration agreement.5 Courts will generally look to see if the parent corporation exercised total control over the subsidiary and if the parent committed fraud through this control.6 If such fraud injured the party seeking to bind the non-signatory parent to the arbitration agreement, the party has an argument to bind the non-signatory parent to the arbitration agreement.7 Piercing the corporate veil theory also can expose shareholders, directors and officers if they exercise such dominion and control over the corporation that they tout the entity as their own business and disregard corporate formalities.

Under the theory of assumption, a non-signatory may be bound to an arbitration agreement if one can infer from his or her conduct that the non-signatory is assuming the obligation to arbitrate.8 A party may also seek to bind a non-signatory to an arbitration agreement if the party has a separate agreement with the non-signatory which incorporates by reference the existing arbitration agreement.9 A claimant may seek to bind a non-signatory to an arbitration agreement through ordinary principles of agency law.10

If a non-signatory exploits an agreement which contains an arbitration agreement and directly benefits from that exploitation, the non-signatory may be bound through the theory of equitable estoppel.11 If a non-signatory is an intended third-party beneficiary to an agreement containing an arbitration agreement, the non-signatory may be compelled to arbitrate.12 All of these theories are highly fact-intensive issues.13 Most federal courts recognize these

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4 Comer v. Micor, Inc., 436 F.3d 1098, 1101 (9th Cir. 2006); Denney v. BDO Seidman L.L.P., 412 F.3d 58, 71 (2d Cir. 2005); Trippe Mfg. Co., v. Niles Audio Corp., 401 F.3d 529, 532 (3d Cir. 2005); Bridas S.A.P.I.C. v. Gov’t of Turkmenistan, 345 F.3d 347, 356 (5th Cir. 2003); Javitch v. First Union Securities, Inc., 315 F.3d 619, 628-29 (6th Cir. 2003); Zurich Am. Ins. Co. v. Watts Indus., Inc., 417 F.3d 682, 687 (7th Cir. 2005); Employers Ins. of Wausau v. Bright Metal Specialties, 251 F.3d 1316, 1322 (11th Cir. 2001); Williams, supra note 2.
5 Bridas S.A.P.I.C., 345 F.3d at 358–59.
6 Id.
7 Id.
8 Thomson-CSF, S.A., 64 F.3d at 777.
9 Id.
10 Id.
11 Id. at 778.
13 Comer v. Micor, Inc., 436 F.3d 1098, 1101 (9th Cir. 2006); Denney v. BDO Seidman L.L.P., 412 F.3d 58, 71 (2d Cir. 2005); Trippe Mfg. Co., v. Niles Audio Corp., 401 F.3d 529, 532 (3d Cir. 2005); Bridas S.A.P.I.C. v. Gov’t of Turkmenistan, 345 F.3d 347, 356 (5th Cir. 2003); Javitch v. First Union Securities, Inc., 315 F.3d 619, 628–29 (6th Cir. 2003); Zurich Am. Ins. Co. v. Watts Indus., Inc., 417 F.3d 682, 687 (7th Cir. 2005); Employers Ins. of Wausau v. Bright Metal Specialties, 251 F.3d 1316, 1322 (11th Cir. 2001); Williams, supra note 2.
theories, but vary in the way they analyze these theories. Even though federal courts recognize these theories, the results show that courts rarely bind a non-signatory to the arbitration agreement.

Contract Law Should Control the Issue

“Section 2 of the Federal Arbitration Act (‘FAA’) declares that any written agreement to arbitrate contained in ‘a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or equity for the revocation of any contract.’”

Section 2 of the Federal Arbitration Act provides:

A written provision in any maritime transaction or a contract evidencing a transaction involving interstate commerce

body of federal substantive law is enforceable in both the state and federal courts,” and both the state and federal courts have continually upheld this principle.

Arbitration is “consensual [and] a creature of contract. As such, only those who consent are bound. In the absence of any express agreement, no party may be compelled to submit to arbitration in contravention of its right to legal process.” Ultimately, “parties . . . are


entitled to the procedures for which they bargained.”19 Only the parties to an arbitration agreement may be bound to the agreement.20 The arbitration agreement is not applicable to nonparties or non-signatories.21 Especially in the context of an arbitration agreement, where parties specifically agree to exclude from arbitration persons and entities who are not parties to the agreement, a nonparty is not bound to arbitrate absent the requisite consent under the agreement. The example used above contains no exception to the prohibition, other than consent. In that sense, it should be absolute. Had a party desired to include potential non-signatory third parties, such language should have been included in the agreement.22

How Do You Keep a CEO from Being Bound to an Arbitration Agreement?

Who determines if a CEO, a non-signatory to an arbitration agreement, should be bound to the arbitration agreement or a party to an arbitration award? Is this a decision for the arbitrator or for the courts to decide? This question is known as the issue of arbitrability.23 This issue is “undeniably an issue for judicial determination.”24

The Supreme Court upheld this almost 50 years ago and has reaffirmed a court’s authority on this matter several times.25 “Arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.”26 The Supreme Court has held that “[a] corollary of that principle is that the arbitrator only derives his or her authority to resolve the dispute because the parties have so agreed in advance.”27 Thus, there is a distinction between the authority parties to an arbitration agreement grant to an arbitrator to decide the “merits” of the dispute and the jurisdictional question


24 Id. (citing AT & T Technologies Inc. v. Communications Workers of Am., 475 U.S. 643, 649 (1986)).


26 Carpenters 46 N. Cal. Counties Conference Bd., 96 F.3d at 414 (citing Warrior & Gulf, 363 U.S. at 582).

of who is subject to arbitration. “Unless the parties clearly and unmistakably provide otherwise,” the question of arbitrability is always reserved to the courts. An arbitrator should never be given the authority to decide who is subject to the provisions of an arbitration agreement, only the judiciary has the jurisdictional authority to decide this question.

However, the Eighth Circuit has “stated that a broad arbitration clause applicable to ‘any controversy arising out of the agreement’ will vest an arbitrator with the jurisdiction to determine whether a non-signatory is bound to arbitrate.” Thus, you should be aware that arbitrators could claim that the scope of their authority includes determining their own jurisdiction.

A Practitioner’s Guide to Challenging the Addition of a CEO in an Arbitration Proceeding

What steps should the lawyer take to challenge the addition of his CEO to the proceedings? Do not wait for the arbitration, or to challenge the arbitration award at confirmation. Take this issue away from the arbitrator, because unless defined in the arbitration agreement, arbitrators do not have to follow or conform to the law in deciding the case. File a motion with the court, asserting that the arbitrator has exceeded his or her jurisdictional authority. In this motion, the lawyer should define the distinction between the arbitrator’s authority to decide the merits of the dispute and the court’s jurisdictional authority to decide who is subject to arbitration. The lawyer should argue that this is a question of arbitrability and the authority to answer such question is reserved to the courts. The lawyer should address any principles of contract or agency law the party seeking to bind the CEO has asserted in compelling the CEO to the arbitration proceedings. If the CEO has not been served with a copy of the arbitration demand, the practitioner should add constitutional due process arguments to the motion. Surely, one has constitutional protections in an arbitration process.

Suggested Language to Include in Future Arbitration Agreements

What language should be employed to prevent your CEO from being forced into an arbitration proceeding or subject to an award? Here is a suggestion:

No arbitration arising out of or relating to this Agreement shall include, by consolidation, joinder or in any other matter, an additional person or entity not a party to this Agreement, except by written consent containing a specific reference to this Agreement signed by parties, and any other person or entity sought to be joined. The parties agree that no additional person or entity shall be bound to this Agreement or to an award through any legal or equitable

28 First Options, 514 U.S. at 944–45; Williams, supra note 2 at 182.
30 Lee v. Chica, 983 F.2d 883, 886 n.4 (8th Cir. 1993); Williams, supra note 2 at 186 n.110.
theories except by such written consent. The parties agree that if a disagreement should arise as to who is bound by this Agreement or subject to an award, the court has the sole jurisdictional authority to decide who is subject to this Arbitration Agreement.

Conclusion

Do not let the arbitrator decide the scope of his jurisdiction against nonparties to the arbitration agreement. If your CEO has already responded in the arbitration, you may be left with no alternative. If not, proceed to court, because there the rule of law should extricate your CEO from the arbitration proceeding.

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WHAT TO DO WHEN OPPOSING COUNSEL USES THE INTERNET AS A WEAPON: TOOLS TO COMBAT THE PUBLICATION OF DISCOVERY MATERIALS AND EXTRAJUDICIAL STATEMENTS ON THE INTERNET

By: Andrew Kopon, Jr. and Sarah E. Flotte

This article originally appeared in the March 2010 Trial Techniques and Tactics Committee Newsletter.

While the benefits of the internet to litigation are undeniable, the potential negative implications are equally clear. Indeed, the impartiality of the judicial system is lost where discovery materials are posted online, causing cases to be tried in the court of public opinion. A similar risk is posed where extrajudicial statements concerning ongoing litigation are splashed across the internet. When published online, discovery materials are often taken out of context and extrajudicial statements are almost always biased. The resulting slanted presentation of facts creates a significant risk of prejudicing the jury pool, causes unnecessary court battles, and implicates the right to a fair trial.

This predicament begs the question: what can attorneys do when opposing counsel publishes discovery materials and extrajudicial statements on the internet? The answer involves a careful balance between the right to free speech and the right to a fair trial. However, the United States Supreme Court is clear that attorneys and parties are not defenseless
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in such situations. Although the relevant decisions do not involve internet publications, the rationale behind those cases is nevertheless applicable to situations where opposing counsel uses the internet as a weapon in litigation.

UNITED STATES SUPREME COURT CASES

I. Supreme Court Cases Regarding the Publication of Discovery Materials

In Seattle Times Co. v. Rhinehart, the United States Supreme Court unanimously upheld restrictions on the release of information gained “only by virtue of the trial court’s discovery processes.” In Seattle, the Court addressed the issue of whether a litigant’s freedom comprehends the right to disseminate information that he has obtained pursuant to a court order that both granted him access to that information and placed restraints on the way in which the information might be used. The Court held that where “a protective order is entered on a showing of good cause as required by Rule 26(c), is limited to the context of pretrial civil discovery, and does not restrict the dissemination of the information if gained from other sources, it does not offend the First Amendment.” The Court reasoned that “in all civil litigation, petitioners gain the information they wish to disseminate only by virtue of the trial court’s discovery processes.”

2 467 U.S. at 32.
3 Id. at 37.
4 Id. at 32.
The Court further reasoned, because “[a] litigant has no First Amendment right of access to information made available only for purposes of trying his suit...continued court control over the discovered information does not raise the same specter of government censorship that such control might suggest in other situations.” Moreover, it noted that restraints placed on discovered, but not yet admitted, information are not a restriction on a traditionally public source of information. Pretrial depositions and interrogatories are not public components of a civil trial and, in general, they are conducted in private as a matter of modern practice. In reality, much of the information that surfaces during pretrial discovery may be unrelated, or only tangentially related, to the underlying cause of action.

Likewise, in United States v. Aguilar, the Supreme Court stated that protective orders may be imposed in connection with information acquired through civil discovery without violating the First Amendment.

II. Supreme Court Cases Regarding the Publication of Extrajudicial Statements

In Gentile v. State Bar of Nevada, the Supreme Court discussed the threat posed by extrajudicial statements made by attorneys regarding pending cases when it addressed the constitutionality of a ban which implicated the ability of counsel to speak freely about a pending case. The Court reasoned, “[b]ecause lawyers have special access to information through discovery and client communications, their extrajudicial statements pose a threat to the fairness of a pending proceeding since lawyers’ statements are likely to be received as especially authoritative.” The Court upheld a limitation on attorneys’ extrajudicial statements, which was directed at comments likely to influence a trial outcome and prejudice the jury pool. The Court noted, “[e]xtensive voir dire may not be able to filter out all of the effects of pretrial publicity.” “Extrajudicial comments on, or discussion of, evidence which might never be admitted at trial and ex parte statements by counsel giving their version of the facts obviously threaten to undermine [the] basic tenet of a fair trial.” In upholding the ban, the Court states “[f]ew, if any, interests under the Constitution are more fundamental than the right to a fair trial by ‘impartial’ jurors, and an outcome affected by extrajudicial statements would violate that fundamental right.”

The Supreme Court’s decision in Sheppard v. Maxwell, also indicates that the speech of lawyers representing clients in pending cases may be regulated under a less exacting standard. In Sheppard, the Supreme Court overturned a criminal conviction after the courtroom was taken over by the press and jurors turned into

5 Id.
6 Id. at 33.
7 Id.
8 Id.
11 501 U.S. at 1074.
12 Id. at 1075.
13 Id. at 1070.
14 Id. at 1075.
The prejudice to the plaintiff’s right to a fair trial was traced, in principal part, to the trial court’s failure to control the proceedings and the courthouse environment. In Sheppard, the Court noted:

[freedom of discussion should be given the widest range compatible with the essential requirement of the fair and orderly administration of justice. But it must not be allowed to divert the trial from the very purpose of a court system to adjudicate controversies, both criminal and civil, in the calmness and solemnity of the courtroom according to legal procedures. Among these legal procedures is the requirement that the jury’s verdict be based on evidence received in open court, not from outside sources.

Based on these principals, the Court held that the failure of trial judge to protect the defendant from inherently prejudicial publicity and to control disruptive influences in the courtroom deprived the defendant of a fair trial consistent with due process.

RELEVANT ETHICS RULES

The ABA Model Rules of Professional Responsibility also provide tools for combating prejudicial publications. These rules may be used to challenge such publications on the internet. Specifically, ABA Model Rule of Professional Responsibility 3.6(a) provides as follows:

[a] lawyer who is participating or has participated in the investigation or litigation of a matter shall not make an extrajudicial statement that the lawyer knows or reasonably should know will be disseminated by means of public communication and will have a substantial likelihood of materially prejudicing an adjudicative proceeding in the matter.

The limitations provided by the Model Rules are broad. Section (d) of the Model Rule 3.6 states that “[n]o lawyer associated in a firm or government agency with a lawyer subject to paragraph (a) shall make a statement prohibited by paragraph (a).”

States that have not adopted the ABA Model Rules typically employ their own ethical rules that can be used to constrain prejudicial attorney publications. For example, Illinois Rule of Professional Conduct 3.6, which is substantially similar to ABA Model Rule 3.6, provides as follows:

[a] lawyer who is participating or has participated in the investigation or litigation of a matter shall not make an extrajudicial statement that a reasonable person would expect to be disseminated by means of public communication if the lawyer knows or reasonably should

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16 384 U.S. at 335.
17 Id. at 359.
18 Id. at 350-51 (internal quotations omitted).

19 M.R.P.R. 3.6(a).
20 M.R.P.R. 3.6(d).
know that it would pose a serious and imminent threat to the fairness of an adjudicative proceeding.\textsuperscript{21}

Accordingly, attorneys should also refer to their respective ethics rules to determine whether they may use those rules to combat the publication of discovery materials and extrajudicial statements on the internet.

**FEDERAL CIRCUIT COURT CASES**

I. Circuit Court Cases Regarding the Publication of Discovery Materials

Similar to the United States Supreme Court, the federal circuit courts have upheld protective orders that restrict the publication of discovery materials based on the general holding that parties have no First Amendment right to publish materials obtained solely by virtue of the court system. The following cases are examples of those decisions, separated by circuit.

**First Circuit**

*In re Boston Herald, Inc.*, 321 F.3d 174 (1st Cir. 2003) (stating First Amendment does not grant the press or the public an automatic constitutional right of access to every document connected to judicial activity.)

*Public Citizen v. Liggett Group, Inc.*, 858 F.2d 775 (1st Cir. 1988) (noting public has no right to demand access to discovery materials which are solely in the hands of private party litigants.)

*Anderson v. Cryovac, Inc.*, 805 F.2d 1 (1st Cir. 1986) (upholding a protective order prohibiting parties from divulging information obtained through discovery, in light of specific instances of massive and potentially harmful publicity, and noting there is no presumptive First Amendment public right of access to documents submitted to the court in connection with discovery motions; instead, the same good-cause standard is to be applied that must be met for protective orders in general.)

**Second Circuit**

*U.S. v. Caparros*, 800 F.2d 23 (2d Cir. 1986) (holding that since appellant most recently obtained the documents solely by means of the judicial process, the district judge had “inherent equitable power” to prohibit him from abusing that process by disseminating them.)

*Bridge C.A.T. Scan Associates v. Technicare Corp.*, 710 F.2d 940 (2d Cir. 1983) (stating court has inherent equitable power to prohibit a party from abusing the judicial process by disseminating information or representations clothed in an official-looking document on file with the court; but, in light of First Amendment considerations, the court generally has no such power to prohibit dissemination of the information itself, stripped of its judicial garb, if that information has been gathered independently of judicial processes.)

**Third Circuit**

*Cipollone v. Liggett Group, Inc.*, 785 F.2d 1108 (3d Cir. 1986) (holding that where a protective order is entered on a

\textsuperscript{21} Ill. R.P.C. 3.6(a).
showing of good cause as required by Rule 26(c), is limited to the context of pretrial civil discovery, and does not restrict the dissemination of the information if gained from other sources, it does not offend the First Amendment.

*State of N.Y. v. U.S. Metals Refining Co.*, 771 F.2d 796 (3d Cir. 1985) (holding pretrial protective order temporarily prohibiting release to the public and requiring confidentiality in disclosing to government employees information discovered by means of the court’s processes did not constitute a violation of New York’s First Amendment rights.)

**Fourth Circuit**


**Fifth Circuit**

*Harris v. Amoco Production Co.*, 768 F.2d 669 (5th Cir. 1985) (noting that if the party from whom discovery is sought shows “good cause,” the presumption of free use dissipates, and the district court can exercise its sound discretion to restrict what materials are obtainable, how they can be obtained, and what use can be made of them once obtained.)

**Sixth Circuit**

*The Courier Journal v. Marshall*, 828 F.2d 361 (6th Cir. 1987) (finding district court’s protective orders were “limited to the context of pretrial civil discovery,” and they did not “restrict the dissemination of the information if gained from other sources.”)

*National Polymer Products, Inc. v. Borg-Warner Corp.*, 641 F.2d 418 (6th Cir. 1981) (stating an important purpose of a pretrial protective order is to preserve the confidentiality of materials which are revealed in discovery but not made public by trial.)

**Seventh Circuit**

*Bond v. Utreras*, --- F.3d ----, 2009 WL 3735802 (7th Cir. 2009) (noting that, generally speaking, the public has no constitutional, statutory, or common-law right of access to unfiled discovery.)

*Citizens First Nat. Bank of Princeton v. Cincinnati Ins. Co.*, 178 F.3d 943 (7th Cir. 1999) (public interest in observing judicial process can be overridden if the property and privacy interests of the litigants predominate in the particular case.)

*Jepson, Inc. v. Makita Elec. Works, Ltd.*, 30 F.3d 854 (7th Cir. 1994) (noting protective order may restrict the right to disseminate materials obtained during discovery.)

**Eighth Circuit**

*General Dynamics Corp. v. Selb Manufacturing Co.*, 481 F.2d 1204 (8th Cir.1973) (stating the Federal Rules of Civil Procedure require that “good cause” be shown for a protective order to be issued.)

**Ninth Circuit**

(noting that restraints placed on discovered, but not yet admitted, information are not a restriction on a traditionally public source of information.)

**Tenth Circuit**

*Oklahoma Hosp. Ass’n v. Oklahoma Pub. Co.*, 748 F.2d 1421 (10th Cir. 1984) (noting “it may be conceded that parties to litigation have a constitutionally protected right to disseminate information obtained by them through the discovery process absent a valid protective order.”)

**Eleventh Circuit**

*Chicago Tribune Co. v. Bridgestone/Firestone, Inc.*, 263 F.3d 1304 (11th Cir. 2001) (upholding protective order where all of the protected documents were produced during the discovery phase of the litigation, and the order did not restrict the dissemination of information gained from other sources.)

*McCarthy v. Barnett Bank of Polk County*, 876 F.2d 89 (11th Cir. 1989) (upholding protective order that prevented the parties from using any confidential information obtained during discovery except as part of the litigation, and did not affect the dissemination of information gathered by a party through sources other than discovery.)

**D.C. Circuit**

*In re Rafferty*, 864 F.2d 151 (D.C. Cir. 1988) (stating court did not question the power of the district court to regulate discovery or the manner in which materials may be used in a litigation pending before it, but denying district court’s order that had the effect of preventing petitioner from disclosing information that had been obtained before the litigation began.)

*In re Reporters Committee for Freedom of the Press*, 773 F.2d 1325 (D.C. Cir 1985) (finding district court did not violate the First Amendment right of public access to court records by postponing reporters’ access to discovery documents filed in civil suit and used in connection with summary judgment and trial proceedings until after trial, where claim of confidentiality had been raised by party who had produced the documents.)

*In re Halkin*, 598 F.2d 176 (D.C. Cir. 1979) (upholding a protective order that restricted civil litigants’ right to disseminate information gained through the pretrial discovery process, finding that the court properly found good cause.)

**II. Circuit Court Cases Regarding the Publication of Extrajudicial Statements**

The federal circuit courts have also upheld protective orders that restrict the publication of extrajudicial statements based on the general holding that those statements implicate the right to a fair trial. The following cases are examples of those decisions, separated by circuit.

**First Circuit**

*U.S. v. Coast of Maine Lobster Co., Inc.*, 538 F.2d 899 (1st Cir. 1976) (holding that where prosecutor made a public statement in the media while the trial was pending, where the statement
was given even further prominence in the newspaper during the trial and communicated to the majority of the jury, and where it singled out for tougher treatment the very species of criminal case that the jury was being called upon to decide, the integrity of the trial was needlessly impugned and the Court of Appeals would, in the exercise of its supervisory power, vacate the judgment of conviction and order a new trial.)

**Second Circuit**


*Application of Dow Jones & Co., Inc.*, 842 F.2d 603 (2d Cir. 1988) (upholding a restraining order upon a district court’s finding that the case was “widely publicized or sensational” within the meaning of Local Criminal Rule 7(c), which authorizes such an order when “extrajudicial statements by parties and witnesses” are likely to interfere with the right to a fair trial by an impartial jury.)

**Third Circuit**

*U.S. v. Wecht*, 484 F.3d 194 (3d Cir. 2007) (federal district court rule prohibiting an attorney’s public statements on subjects including defendant’s criminal record, existence of confession, and credibility of prospective witnesses constituted examples of subjects likely to be materially prejudicial, and thus unprotected by the First Amendment, if spoken about.)

*U.S. v. Scarfo*, 263 F.3d 80 (3d Cir. 2001) (in reviewing constitutionality of order barring disqualified defense counsel from making extrajudicial statements to press relating to pending criminal case, court was required to examine record to determine whether district court’s injunction prevented substantial likelihood of material prejudice to judicial proceeding.)

*Bailey v. Systems Innovation, Inc.*, 852 F.2d 93 (3d Cir. 1988) (stating that fairness in a jury trial, whether criminal or civil in nature, is a vital constitutional right.)

**Fourth Circuit**

*In re Morrissey*, 168 F.3d 134 (4th Cir. 1999) (local rule restricting lawyer speech in criminal litigation was narrowly tailored to impose no greater limitation than necessary to serve compelling government interest in protecting right to fair trial, and thus did not violate the First Amendment.)

*Hirschkop v. Snead*, 594 F.2d 356 (4th Cir. 1979) (subdivision of the rule of the Virginia Code of Professional Responsibility relating to lawyers’ comments about pending litigation, which prohibited statements “reasonably likely to affect the imposition of sentence”, furthered an important governmental interest unrelated to the suppression of expression and did not violate the First Amendment insofar as it applied to situations in which a jury would impose sentence.)

**Fifth Circuit**

*U.S. v. Brown*, 218 F.3d 415 (5th Cir. 2000) (“gag order” that generally prohibited attorneys, parties, and
witnesses from discussing criminal prosecution of a state official with any public communications media did not violate the First Amendment, as there was substantial likelihood that extrajudicial comments would prejudice the court’s ability to conduct fair trials in the instant prosecution and related cases, the order was sufficiently narrow to eliminate substantially only speech having meaningful likelihood of materially impairing the court’s ability to conduct fair trials, and, although the court did not explicitly discuss lesser alternatives, the record supported the finding that other measures would be inappropriate or insufficient to adequately address possible deleterious effects of pretrial publicity in cases at issue.)

**Bernard v. Gulf Oil Co.,** 619 F.2d 459 (5th Cir. 1980) (a lawyer’s First Amendment right to comment about pending or imminent criminal litigation can be limited only if his comments pose a serious and imminent threat of interference with the fair administration of justice.)

**Sixth Circuit**

*U.S. v. Ford,* 830 F.2d 596 (6th Cir. 1987) (‘‘gag’’ order issued by district court against a congressman undergoing criminal prosecution was overbroad and failed to meet the clear and present danger standard in context of restraint on defendant in criminal trial; no facts were found which would suggest a serious and imminent threat was posed if the congressman made certain statements regarding case, and the order was neither narrowly tailored nor directed to any specific situation, nor was there specific consideration of less burdensome alternatives of voir dire, sequestration or change of venue.)

**Seventh Circuit**

*Lemons v. Skidmore,* 985 F.2d 354 (7th Cir. 1993) (discussing the constitutional right to a fair trial in a civil matter.)

*Chicago Council of Lawyers v. Bauer,* 522 F.2d 242, (7th Cir. 1975) (provisions of local criminal rule of district court and disciplinary rule of American Bar Association proscribing lawyers’ extrajudicial comments with respect to a specific topic would not violate the First Amendment if limited to proper standard of serious and imminent threat to fair administration of justice.)

*In re Oliver,* 452 F.2d 111 (7th Cir. 1971) (holding that policy adopted by district which contained blanket prohibition against all extrajudicial comment by counsel in all pending cases whether tried before judge or jury, without regard to whether such comment is or even could be prejudicial to fair administration of justice, was violative of the First Amendment and was null and void.)

**Eighth Circuit**

*Orsini v. Wallace,* 913 F.2d 474 (8th Cir. 1990) (stating to determine whether pretrial publicity results in denial of constitutional right to fair trial, the court considers effect that publicity has on prospective jurors and not amount of publicity; court asks whether jurors can, despite publicity, lay aside impressions and opinions and render verdict in all
fairness based on evidence presented at trial.)

**Ninth Circuit**

_Levine v. U.S. Dist. Court for Cent. Dist. of California_, 764 F.2d 590 (9th Cir. 1985) (restraining order prohibiting attorneys involved in espionage trial from communicating with the media regarding merits of the case was an appropriate remedy for excessive trial publicity.)

**Tenth Circuit**

_U.S. v. Tijerina_, 412 F.2d 661 (10th Cir. 1969) (order prohibiting extrajudicial discussion of merits of pending criminal case by all attorneys and defendants did not violate defendants’ right to freedom of speech.)

**Eleventh Circuit**

_U.S. v. Campa_, 459 F.3d 1121 (11th Cir. 2006) (discussing appropriateness of gag order ordering parties and their attorneys to “refrain from releasing ‘information or opinion which a reasonable person would expect to be disseminated by means of public communication, in connection with pending or imminent criminal litigation’ where ‘such dissemination will interfere with a fair trial or otherwise prejudice the due administration of justice.’”)

**D.C. Circuit**

_U.S. v. Childress_, 58 F.3d 693 (D.C. Cir. 1995) (discussing the potential prejudice associated with pretrial publicity with respect to a motion for change of venue.)

**A RELATED NOTE: JURY INSTRUCTIONS**

While this article is geared toward addressing the use of the internet as a weapon by opposing counsel, attorneys must not ignore the potential implications of the internet on litigation by means of jurors. Indeed, reports of jurors using the internet to independently research pending cases are becoming more and more common. Likewise, the use of online social networks by jurors to communicate real-time developments in the courtroom is also becoming widespread.

To address this situation, the Judicial Conference Committee on Court Administration and Case Management has drafted Proposed Model Jury Instructions on the use of electronic technology to conduct research on or to communicate about a case. The proposed instructions provide as follows:

[D]uring the trial you must not conduct any independent research about this case, the matters in the case, and the individuals or corporations involved in the case. In other words, you should not consult dictionaries or reference materials, search the internet, websites, blogs, or use any other electronic tools to obtain information about this case or to help you decide the case.

You may not communicate with anyone about the case on your cell
phone, through e-mail, Blackberry, iPhone, text messaging, or on Twitter, through any blog or website, through any internet chat room, or by way of any other social networking websites, including Facebook, My Space, LinkedIn, and YouTube.

Conclusion

Because the interplay between the internet and litigation is still a relatively new phenomenon, the relevant case law regarding the publication of discovery materials and extrajudicial statements does not deal with internet publications specifically. However, the reasoning behind these cases is applicable to such a scenario. Whether the prejudicial publications are made on the internet or in the printed press, attorneys seeking to restrict the dissemination of prejudicial material must carefully weigh the right to free speech against the right to a fair trial. Most importantly, attorneys should understand that tools do exist to combat opposing counsel who use the internet as a weapon in litigation.
Law Review Highlights:

The world of social networking has expanded exponentially in the last two to three years. No longer the sole province of college students and middle-schoolers, sites like Facebook have opened up and now serve a population that includes teachers, grandmothers—and lawyers. While online social networking provides an easy way to keep up with family and old friends, it also opens up the possibility of new relationships, both personal and professional. Two articles look at some of the legal ramifications of this growing online environment.

In *The Ethics of Lawyer Social Networking*, Steven Bennett addresses some of the ethical considerations lawyers face as they venture into social networking.¹ The article gives a brief overview of social networking for those who have not yet tested the waters of reconnecting with people who avoided them in high school and then surveys how some of the ABA Model Rules of Professional Conduct might be interpreted when applied specifically to online social networking. Mr. Bennett concludes that in light of changing online environments, lawyers should keep current on new technology and stay alert for potential ethical concerns as they navigate how to use available tools and still serve their clients’ best interests.

A second article looks at social networks and blogs in the context of protecting the personae people create for themselves online.² For some, these online personae, distinct from the person’s real world existences, are commercially profitable entities and are, therefore, subject to exploitation or misappropriation, dangers the right of publicity has been fashioned to protect against. After providing an overview of the right of publicity, Daniel Nemet-Nejat explores how people create these online personae and discusses different sources from which a new legal protection could be fashioned. He concludes that a new right of publicity should be formulated to

protect the online persona while at the same time supporting the free exchange of information available on the Internet.

The following list is a selective bibliography of current law review literature thought to be of interest to civil defense counsel.

**U.S. and International**

**Damages**


**Evidence**


**Insurance**


**Products Liability**


**Professional Responsibility**


Selene E Mize, *Should the Lawyer’s Duty to Keep Confidences Override the Duty to Disclose Material Information to a Client?*, 12 LEGAL ETHICS 171 (2009).  
<http://www.hartjournals.co.uk/le/index.html>

<http://www.thefederation.org/process.cfm?PageID=2054&TopLevel=2054>

**Torts**

<http://www.cardozo.yu.edu/aelj/>

<http://www.albanylawreview.org/>

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<http://nclrev.unc.edu/cocoon/nclrev/current-issue.xsp>

<http://lawreview.law.wfu.edu/>

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<http://www.uakron.edu/law/aipj/>

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